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ANALYTICAL INSTITUTIONAL ECONOMICS AND RURAL DEVELOPMENT RESEARCH: OPPORTUNITIES FOR A NEW SYNERGISM*

Larry C. Morgan

Assistant Professor

Department of Agricultural Economics

Texas A&M University

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ANALYTICAL INSTITUTIONAL ECONOMICS AND RURAL DEVELOPMENT RESEARCH: OPPORTUNITIES FOR A NEW SYNERGISM*

During the past five years, the popularity of the rural development movement has waned considerably. The reasons for diminished RD support among both public officials and researchers are numerous and complex, but the failure to adequately incorporate institutional change into research on community resource allocation must be regarded as one of the movement's major disappointments.

The economist's traditional inclination to study community decision-making processes, given a particular institutional setting, has resulted in a wide variety of powerful, market-oriented economic tools being applied in RD research without much demonstratable evidence of success. Any researcher who has attended a public forum on RD research results understands local citizens' frustrations with applied economic analyses where few, if any, parameters can be manipulated in support of community objectives.

A reorientation of perspectives is needed to bridge the gap between the market-oriented approach to RD by most economists and the enphasis on the economic basis of collective action by analytical institutional economists. Both groups can make valuable contributions to RD by synergizing their respective compentencies in the development of a more precise theory of institutional change.

THE LEGACY OF OVERSIMPLIFICATION

Rural development research has suffered from the inertia of past approaches to RD problems. Many of the initial perceptions of problems, and analytical approaches to these problems, were oversimplifications that have too often become a part of the RD conventional wisdom.

The Problem of Rural Outmigration

Unfortunately, the publicity that influenced enactment of the Rural Development Act of 1972 portrayed outmigration and community decline as the major problems facing Rural America. Countless public officials insisted that outmigration would have to be stopped or reversed if the quality of life in rural areas was to be improved. Not only has the widsom of that assessment of problem priorities been questioned, but it detracted attention away from the more fundamental and obstinate problem of conflicts among private and collective actions in small-area economies.

While RD efforts were being organized to cope with rural decline, outmigration was apparently less severe than the popular impression. A new study of nonmetropolitan population patterns concludes that a majority of small towns and cities were not losing population during the 1950-1970 period (Fugitt and Beale). Since 1970, metropolitan population has grown at a slower rate than nonmetro population, leading to another popular, though oversimplified, impression of rural optimism and metropolitan pessimism.

The recent reversal of migration rates in many rural areas has been due almost entirely to factors other than RD efforts. If increased rural industrialization and energy resource exploitation had not occurred, a "stop outmigration" policy would have further impoverished rural areas. Instead, a simulation study of 17 popular RD strategies indicates that a desirable strategy should be multifaceted, including a combination of job creation, labor force expansion and improved resource productivity and capital utilization (Edwards and DePass). Such a strategy requires a major program to develop alternative institutional arrangements to assist where market processes have been unsuccessful.

The Importance of Self-Interest

The shortcomings of rural development efforts seem especially acute when compared with the contributions of economic research to commercial agriculture. But that comparison, however popular, is not an appropriate basis for evaluation.

Microeconomic theory holds a special reverence for the assumption that people will pursue their self-interest. In a market economy, self-interest is obviously a central feature of the resource allocation process. Beyond firm and household units, however, group action often supersedes the role of self-interest in community resource allocation processes. The allocation of public goods raises problems of freeriders and technical externalities that are beyond the firm or household's control. Even the voting process often obscures individuals' community preferences and permits or invites the intervention of political institutions that may discourage the individual pursuit of self-interest, to the detriment of community welfare.

Rural development research has been strongly influenced by the accomplishments in production economics. Studies dealing with the optimum size of cities, regional approximations of firm growth models, and the demand for public services are of limited value if market-oriented models are used with no provision for the influence of public goods effects. It is not much comfort to officials to learn that their town is either too small or too large in terms of per capita public service costs unless they have a method of comparing alternative schemes to achieve a size that meets the community's goals.

INSTITUTIONAL CHANGE AS AN ECONOMIC PROCESS

Criticism of the economist's failure to incorporate institutional change in the economic process is not entirely fair. The long-standing plea for a theory of institutional change remains essentially unanswered. I would expect sociologists to be leading the search for a concise theory, but recent writings by some of their leading scholars offer little encouragement (Blau). Among economists, the so-called "neo-institutionalists" are not much more advanced than the sociologists (Grunchy).

Davis and North have made a valuable contribution to institutional economics. The central role of self-interest in their theory of institutional change should help justify the study of institutional change as an economic process. Their theory is closely related to market activities and consequently may not attract much attention from non-economists. The challenge of research on institutional change is to develop a theory that applies to both market and non-market activity.

Economic Rationality and the Institutional Setting

Hirschman's treatment of exit and voice offers a unique approach to the study of institutional change. Exit from a firm or organization is viewed as a traditional economic process. Failure to correct the cause of exit ultimately threatens the firm with extinction. Voice consists of efforts to modify the firm or organization without resorting to anything so drastic as exit. Voice might be classified as a non-economic activity, but I regard it as activity to: reduce uncertainty; extend or modify property rights; reduce or shift transaction costs and liabilities; and acquire rents, windfall gains or other pecuniary or non-pecuniary benefits.

Voice falls within the scope of economic rationality since even random or non-maximizing behavior conforms to basic economic theroms in response to changes in production and consumption opportunity sets (Becker, 1962). Voice is thus a part of the institutionalizing process, an economic process where the "...sets of ordered relationships among people which define their rights, exposure to the rights of others, privileges, and responsibilities" are modified to permit new production and consumption opportunities (Schmid, p. 893). This view of institutionalization rejects Georgescu-Roegen's arguement that economics is not a theoretical science because the content of its fundamental principles is determined by the institutional setting (Georgescu-Roegen, p. 324).

The New Consumer Economics

The notion of "non-economic" activity has been revised by the works of Becker and Lancaster on the economics of time. Any activity requires an allocation of time, which has an opportunity cost in some other use. Such "non-economic" institutions as the family result from the allocation of time to maintain and enforce its working rules. The willingness of society to allocate time for such purposes ultimately reflects part of the social value of that institution.

The non-pecuniary nature of many activities does not justify classifying them as non-economic. The task of measuring time costs (value) is formidable, but it promises to explain, in economic terms, why actions are taken to create, modify, or abandon institutions.

Information

Members of institutions or social movements frequently have to influence some other institution or individual in order to successfully establish working rules (Breton and Breton; Goldberg). The creation of influence involves not only time, but the production and distribution of special types of information which is allocated according to its marginal value and marginal cost.

The cost of information is therefore an indirect measure of the value that members of an institution place upon either perserving it in its present state or modifying the working rules to enjoy new production or consumption opportunities. Lobbying efforts by the National Rifle Association against anti-firearm laws is an ample demonstration of the great value its members place on the right to own firearms.

The Bureaucratic Perspective

Organizations form to gain the benefits of collective action. The bureaucracy, contrary to its popular image of inefficiency, is highly efficient at protecting itself from budget cuts (Downs and Niskanen).

Government bureaucracies are particularly adept at lobbying to perserve their organizations' missions and their members' jobs. The bureaucrat's resistance to funding cuts is an economic action guided by self-interest, but it often results in political institutions being prolonged after they cease to serve a useful public purpose. The political institutions that have been created to support rural development are thus likely to drift into obsolescence as the bureaucracy's control and influence grows and emerge as impediments to further progress.

AN INSTITUTIONAL RESEARCH AGENDA FOR RURAL DEVELOPMENT

Among the many institutional problems that merit the attention of rural development researchers, I choose to emphasize those that pertain to political institutions created to support rural development. The premises that were cited to justify the creation of new laws need careful examination to determine whether they are still valid. The role of interest groups in lobbying for or against RD legislation should be examined to estimate the value of their efforts to change the working rules. The bureaucracies administering the new laws should be scrutinized for evidence of atrophy and obsolescence of mission.

Area Planning and Development Districts

Multicounty planning districts have been created under the provisions of the Office of Management and Budget's Circular A-95. The districts were created to coordinate the flow of federal funds and render technical economic planning assistance to each member city and county.

Serious doubts are now being raised about the organizational structure of the districts. Research is needed on the extent to which the district bureaucracies cooperate with other agencies to benefit their members. How effective are the members of their boards of directors in guiding the districts to accomplish community goals?

Health Service Areas

The National Health Planning and Resources Development Act of 1974 established multicounty health service planning areas to coordinate the flow of federal funds to improve health services and to coordinate the construction of all new health care facilities that are intended to serve patients enrolled in federal health insurance programs. The health service areas (HSA's) are designed to form functional health service areas. What methods were used to select the counties in each HSA? What interest groups attempt to influence the HSA's funding decisions and to what extent have they been successful?

The most fundamental research question on HSA's concerns their impact on the individual pursuit of self-interest to maintain adequate health care. How will voluntary associations and activities be affected by the HSA's decisions on whether new facilities can be constructed, even if a community raises the funds solely theough voluntary contributions?

Title V Research

Title V of the Rural Development Act of 1972 provides for federal funding of rural development research. At least two aspects of the law should be studied from an institutional perspective. First, the law requires evaluation of each Title V research project to determine its effectiveness. Since evaluation is normally conducted by the project's researchers, there is ample opportunity to repeat one of the mistakes that has sparked intense critizism of the agricultural research establishment, ie., producing trivial research results because trivial problems were proposed for investigation. The evaluation process should be studied to learn how rigorously and objectively it is conducted. The effect of evaluation on research performance should be analyzed to determine if new evaluation schemes are needed to stimulate more rigorous research and more challenging research problems.

Another feature of Title V that merits scrutiny is the role that state rural development boards play in setting research priorities and determining who does the research. Are projects approved in a manner that encourages low-risk research that has a correspondingly low value? Should competition for funding be opened to other research organizations outside the land grant-1890 school group, such as the newly formed National Rural Center?

CONCLUDING COMMENTS

Most of the RD research has had a strong empirical orientation. Until funding is available to provide incentives for more basic research on the economics of institutionalization, most of the applied research will have a limited payoff. The application of market models to community resource allocation problems often obscures the impact of collective action. More emphasis should be placed on developing a theory of institutional change that reconciles the market economist's perspective with that of the institutional economist. Unfortunately, far too many economists accept the rather obsequious notion that institutional change is an essence of the Invisible Hand's work and therefore inappropriate for further investigation.

Self-interest may not insure a Pareto-relevant solution, but it certainly should not be discouraged. The analytical institutional economist can make a valuable contribution to RD research efforts by studying the extent to which political institutions that were designed to support RD efforts are encouraging self-initiative and experimentation with new organizational arrangements. In this context, the accomplishments in environmental economics toward creating new institutions can make valuable contributions to other areas of RD research.

Finally, the institutional arrangements that have supported RD efforts need to be continuously evaluated for possible improvement. Agricultural economists have a rich tradition of offering alternative instituitional arrangements in commercial agricultural policy. The challenges of institutional research will hopefully stimulate that same tradition in rural development research.

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*Larry C. Morgan, Assistant Professor, Texas A&M University

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