Where the Law of the Invisible Hand fails: applying the perspectives of an Economic Tourist as he ventures into the heart of Antediluvian Economics

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Abstract

Value is subjective. Pricing structures are assumed to be an expression of value, but the problem is that they do not really express a universal value. While tourists may be armed with a bundle of local currency and a supply of sunscreen to protect themselves from the elements of nature, it's really the established institutions within the territory that pose the real threat to the sanity of the decision maker. This paper examines the role of ‘Information’ in an institutional framework with the aim of exploring the challenges that an economic tourist would be confronted with when attempting to determine the value of a commodity. This within a market which cannot be determined using typical market fundamentals. While an archetypal tourist would be capable of following a road map that may confirm his belief in the markets. However, his own interpretation of the information on that map will be challenged as he ventures further into the world of an antediluvian market where low levels of competition exist and the interaction between supply and demand would best be described as unstable. The problems that modern day economic tourists would face is greatly increased as they are confronted by new and unpredictable institutional information. This information has been developed over centuries within a culturally biased informational context regarding commodities and products in different markets. The real value of a product in an antediluvian economy is determined by the ‘value of Information’ held by the institution within that economy which would serve as a regulator of ‘value’. While value is subjective, the price set within the antediluvian economy may echo issues such as political, social and economic conditions, not reflected in the price, and thus create a flood of misperception to the aspiring tourists.

Key Words: ‘Value of Information’, Price Setting Behaviour, Economic Tourists, Antediluvian Economy, Institutions

Introduction

Every day thousands of tourists travel across international borders to explore new and unfamiliar territory. While the tourist may be well prepared to expect the unexpected, the greatest challenge will be to confront the workings of the institutions embedded inside societies. These institutions have evolved over centuries into the fabric of the cultures within the territories that the tourist may wish to explore. These institutions may be co-dependent on each other, while independently involved with establishing the value of commodities, the production and distribution of products, and the setting of prices.

The aim of this paper is to discuss price setting behaviour within an economy in which the laws of the ‘invisible hand’ as proposed by Adam Smith do not hold. While the writings of Adam Smith were leaning towards developing a case for the promotion of a free market economy, the reality underlying this supply and demand may have a very limited place within the field of price setting behaviour, especially within different market contexts. This does not suggest that the hypothesis used by Adam Smith should be ignored. For all intent and purpose, theories constructed on the principals of the invisible hand are quite important, in that, the argument created by Smith’ foreshadowed the institutional theory through much of the contemporary public policy debate on a number of issues such as the influence of unions.
or competition policy. His infamous philosophy captured within the ‘Wealth of Nations’ was more than just a critique of human exploitation and personal selfishness (Morgan, 2009).

The behavioural schools of economics and finance reason that there are many influences that need to be taken into consideration within the decision-making process of individuals. The most cited include rooted issues such as tastes, preferences, customs, cultures, social norms, the value placed on giffen goods (goods for which demand increases as price does) and most importantly, institutional behaviour and the willingness of institutions to both structure and exploit the market mechanism. This could be especially true in a non-homogenous market which abounds with high levels of asymmetric information underlying market inefficiency.

A large part of the inefficiency that occurs within a market is due to the role of these institutions broadly discussed (Gilson & Kraakman, 2015). Kauko (2004), suggests that while actors have a limited capability to perceive, elicit and actually respond to all the available information in the market, the information is contextualised through the role of the institution, thus shaping the interpretation of such information. Chong, Guillen and Raino (2010) mention that this ‘institutional contextualisation of information’ will result in a substantial impact on prices. While prices are then governed by the institutional context, the value of the goods are not clearly reflected in the market mechanism.

This political and institutional context of interpreting information within a market is noteworthy having a crucial bearing on the process within the market mechanism. For example, changes in political risk in general tend to have a strong effect on local stock market developments and can also induce volatile returns in emerging economies, suggesting that political risk is a market factor, interpreted by role players within an institutional context.

Yet, the market in itself is a complex interaction of institutions. Participants enter into the market with varying expectations linked to unique institutional characteristics, and as such, the role players within the broader economy can be contextualised into different forms of interaction, applying different roles to capital which may mimic the unique market elements. These elements, over time, have evolved independently and differ widely across the market institution (Kurien, 2015), and reflect different levels of market power through co-dependant pricing strategies salvaged through the individual institutional norms.

Antediluvian Economies

An underlying theme of studying ‘Antediluvian Economies’, is the dualism that exists between the role of institutions and the additional problem of uncertainty as experienced by market players. This would prove particularly true for the economic tourist entering an unfamiliar market whilst still believing in the institutional context of the market from which the tourist has originated. For example, an economic tourist exploring urban Ghana would notice that the accumulation of friends and the formation of social networks fabricated on reciprocity and trust are important properties that may reduce economic vulnerability and expand socioeconomic opportunities. Yet, contrary to modern expectations and democratic developments, the market philosophy in Ghana is built on increasing secularization, decreasing personalization of political power, the liberalization of the legal system encumbered by personal rule despite the solidification of its liberal democratic institutions. Local residents struggle for political power and economic resources (Paller, 2014).

Uncertainty plays a leading feature in virtually every type of market. Yet the more antediluvian principals are applied to a market, the more unstructured the economic principals appear, and the greater the likelihood of unpredictability of market outcomes to unexpected events. These events could be related to economic or natural shocks, political or regime changes, social destruction and regeneration.
The literature about the antediluvian world is bursting with speculations about how economic activity in antediluvian economies are organized. Much of the recent thought on the topic, focuses on the informal parts of the economic systems, including the role of friendship and patronage, as mentioned by Paller (2014). However, the literature on antediluvian economies increasingly acknowledges that these economies operate primarily on the basis of private markets within institutional frameworks (Kessler & Temin, 2007).

It is from this perspective that antediluvian economics is grounded, and it is held that prices do not reflect a universal value. Rather, price setting behaviour is a function of institutional power. In the words of Pascal and Pagliero (2012, 55), “exploiting market power increases profits”. However, institutions differ in their willingness to exploit market power. Pascal and Pagliero (2012) go further by making the assumption that the very different pricing styles are due to the different ‘willingness’ of institutions to exploit the market. Because of the difference in the ‘willingness to exploit market power’, it becomes possible to assign different correlations of value to similar products within different markets. This forms the foundation for explaining the different market pricing practices which exist within the market through differences of an institutions’ willingness to exploit its market power. This concept is echoed strongly by Kauko (2004), who suggest that economic outcomes are governed by changes in institutional structure and the developing power relations between institutions within the market.

For example, looking back in time, Murphy (2013) highlights that the ancient Chinese records describe lenders that required borrowers to offer small goods as collateral for loans. Also, it has been seen that the individual’s throughout Medieval Europe, deposited precious metals for safekeeping with gold or silversmiths. In some cases, some of these gold or silversmiths went further to offer loans to additional people, further having an impact on the economy at the time. Kessler and Temin (2007) suggest that that business institutions within ancient Rome, developed their own market tools, such as, warranties, brand names, legally enforcing contracts, and reputation. These all helped in reducing the problem or helping in managing asymmetric information. Therefore, these market institutions provided a means to reduce the problem of adverse selection by increasing the amount of available information to the market. Although merchants could not collectively concentrate their information in one place, private formal networks (along with legal institutions) were developed so as to share information.

One of the greatest challenges of understanding antediluvian economies, in the words of Smith (2004), is the tendency to “see the ‘past’ as the ‘same’, or to “see the ‘past’ as ‘other’”. Furthermore, this debate shares the ‘Same/Other’ dichotomy with the Formalist / Substantivés debate regarding antediluvian economies. The Formalists argued that the Antediluvian and non-Western economies differ from typical capitalist economies only in degree, not in kind, whereas the Substantivize school argues that non-Capitalist economies are fundamentally different from Modern Capitalism (Smith, 2004). Following Smith’s (2004) argument, the main reason behind such views was that the role of the institutions at the time could only be seen by many modern Anthropologists as states existing in an isolated context for a specific time, regional or geographic scenario. Three theoretical approaches to the issue of control of resources, production, or markets exist, namely, the Adaptations, the Commercial, and Political approach.

The adaptations approach focuses on the adaptation of human groups to their environment. Regional settlement patterns surveyed in many areas, their reconstructions of regional demography and agricultural practices remain fundamental contributions to the economic study of antediluvian states. By focusing on local adaptations, adaptationist scholars minimized the importance of long-distance exchanges and interactions. The commercial development model shows an economy structured on increasing specialization and exchange, which is seen as an integral part of the process of economic growth. Within the concept of the political model, local elites assume control of the economy as per the earlier
example of the Ghanaian economy. These elites set about strategically controlling aspects of the economy for their own economic and political ends, thus the ‘political’ model developed in two distinct directions. One, the role of the individual actor, elevating ‘agency’ and ‘practice’ to central concerns of archaeological research. The second approach, the ‘Archaeological Political Economy’, is one that recognises the existence of variability in the relationship between the political and economic institutions (Smith, 2004).

The ‘Archaeological Political Economy’ explores the relationships that existed between individual actions and the institutions, focusing more towards the concepts of property rights and transaction costs. There is much emphasis on the role of commercialisation, within specific political organisational (institutional) frameworks. This particular model recognises both external commercialisation (such as the role of trade) and internal commercialisation (such as the role of entrepreneurs), the function of money, structure of markets, development of credit, and banking systems (Smith, 2004).

Within the antediluvian framework, the Adaptations, the Commercial, and Political approach as highlighted above, agree on the problem of uncertainty (e.g. price shocks or other temporary conditions) and the role of information leading to the establishment of institutions. To the economic tourist, while these institutions create stability within their own cultural framework, they also create uncertainty outside of their framework. An economic tourist may recognise that the relative ease of entry or exit of businesses into and out of the market is in direct relationship to the institutions that exist within the market. The relationship between the business sector and the institution is what governs the market power that a firm may experience (Kurien, 2015). The more exogenous to a leading institutions the firm is, the lower the market power the firm will have, but the more endogenous a firm is to the leading institutions, the more power the firm has. For example, a monopolist of a perfectly homogenous good may have tremendous market power giving that the institutions allow complete autonomy of the firm over pricing strategies (Pascal & Pagliero, 2012). This type of organisational behaviour generates a level of market inefficiency, and in turn, institutions are responsible for granting firms additional power, and in so doing, making the market even more inefficient. However, the opposite may be true for the role of the institution. An endogenous institution is more efficient while an exogenous institution is less efficient.

**Endogeneity of institutions and market power**

In a study by Kessler and Termin (2007), it was suggested that an increase in the endogenous position of the institution (government), which established legal rules and other institutional aids for commerce, were designed to make the economy more efficient. This can be proven in that the bulk of the formal and informal rules and practices of the early Roman Empire were adapted to aid commerce, thus creating greater trade through market efficiency.

Another important theme of the antediluvian market synopsis is that the entry and participation in the markets is not totally free. All participants need some form of market power to be able to participate in the market. As most participants have different resource endowments, it would be true then to state that different participants in the market have different levels of market power (Kurien, 2015). Therefore, the role of determining ‘value’ is determined through the market institution, and not totally by individual participants acting within the market. This ‘value’ is established through the distribution of information from institution to market.

However, as mentioned earlier, the market itself is an ‘institution’, be it not completely independent. Therefore, ‘value’ is determined through a process of transmissions from institution to market, and then back to institution. The ‘value’ of this information reflected through a price range is in essence the power inherent within the information. Thus,
Institutions set prices as a derivative of the ‘value’ of that information. In other words, ‘Price’ is reflected as the amount of power that the information holds for an institution.

The role of the ‘Institution’ in the market

Institutions are not necessarily formal, and as suggested by Kauko (2004), some of the institutions are chiefly informal and function at the cognitive level of market behaviour. Furthermore, there are also ‘Institutional Variables’ which for the purpose of this paper can be defined as legal, political, cultural and administrative factors. These ‘Institutional Variables’ can be either informal or formal. In the case of informal, these would include socio-cultural behaviour or norms. Thus, in some cases, the informal ‘institutional variable’, representing the ‘non-rational’ behaviour of the economy. Formal ‘Institutional variables’ make up the rules and regulations of society.

For example, as a result of the geographical challenges when dealing with long distance trade, the problem of the distribution of information is of a greater scale than generally anticipated within generalised ‘free-market’ theory. Kessler and Temin (2007) explain how merchants in Ancient Rome organized trade by making use of a variety of mechanisms to deal with these types of informational problems, such as the formal use of contracts, companies, and invoices. This combination of social (informal) and economic (formal) institutions enabled the merchants to operate more efficiently and effectively across very vast areas and along distant trade routes.

The characteristics inherent in antediluvian economics may be defined as the perceptions, tastes, attitudes, diverse preferences, agency relationships, aspirations and other beliefs related to ‘human behaviour’. This would make up the individuals subjective experiences and the ‘socio-cultural’ factors being dependent on ‘shared meaning’. It is noted that institutions and agencies are not binary oppositions of each other, such as ‘Government’ and the ‘Informal Culture’, which are embedded into each other as suggested by (Kauko, 2004). Furthermore, the influence of antediluvian factors embedded within the institution, as suggested by Bai (2012), is mediated by the ability of an institutions to shape human behaviour.

When looking at modern Chinese businesses, there are cases where antediluvian tradition and superstition tend to intermingle with modern business practices, as discussed by Tsang (2004). Tsang (2004) mentions that, when looking at the role of the institution in the Chinese market, Feng Shui is probably the most popular superstition among Chinese managers. Feng Shui studies the influence of environment on human fortune. It should be noted that Feng Shui is usually constructed in the sense that the influence of the traditional belief of Feng Shui, they also provide other fortune-telling services. For example, calculating destinies, palmistry, and physiognomy. While superstition is often perceived as inconsistent with modern business management principles and despite the various schools of thought on decision-making, its most common portrayal interprets action as rational choice.

The view of shaping human behaviour is enforced by Chong, Guillen and Riano (2010) who illustrate that political and institutional variables interact with each other with increasing levels of electoral competition, greater levels of political cohesion, lower levels of electoral fraud, better governance and, in general, more democratic values.

Essentially, the effect on prices is being captured by the measures that reflect the political (institutional) process within the country rather than by the nominal political regime or even the broad political environment. The economic tourist would search through a list of potential destinations which would best suit his expectations and budget. Given alternatives, the economic tourist is seeking ‘value’. The institutional context clearly has a significant impact.
on determining ‘value’. For the economic tourist, this would mean that prices are not a determining factor of ‘value’, but an indication of social, cultural and political trends.

Developing and testing a model to support the concept of the endogeneity of institutions and market relationships

**Approach and methodology**

An economy which is endogenous to its institution should potentially have a greater tendency for growth, which could be either on a micro scale, such as in the case of a small tribal system, or on a national level such as in the case of a modern autonomous economy. If the institution is endogenous with the needs of its economy, it would be in a better position to grow based on the distribution of information between the institution and the market. Thus, as the institution becomes more exogenous, the potential for sustainable economic growth should weaken. In the case of an autocratic government, (extreme case), the potential for growth remains rather weak. In the case of market failure, monopolistic market structure may tend to dominate. The further either the formal institution or the market institution is from endogeneity, the greater the likelihood for market failure. The aim of this section is to test the relationship between the role of institutions and potential for growth of an economy, by meeting the needs of the economic tourist. To assess the validity of this theory, political risk (to simulate institutional endogeneity) and ease of doing business (to simulate market endogeneity) from a selection of 25 countries within Africa for the period from 2011 to 2014 will be analysed using a panel data methodology.

The panel data analysis was constructed from time series data derived from Quantec (2015) and NKC African Economics (2015) for the period between 2001 and 2014, for a range of 25 African Countries, including, Angola, Benin, Botswana, Cameroon, DRC, Egypt, Ethiopia, Gabon, Kenya, Lesotho, Malawi, Mauritius, Morocco, Mozambique, Namibia, Nigeria, Senegal, South Africa, Sudan, Swaziland, Tanzania, Tunisia, Uganda, Zambia and Zimbabwe.

**Data analysis**

Figure 1 graphically represents the relationship for a selection of African countries, using a Scatter Plot analysis by integrating Political Risk on the Y axis and the ease of Doing Business Ranking on the X Axis. As per earlier discussion, there is an endogenous or exogenous position taken by business or government respectively. If the role of the institutions (measured here as political risk), is endogenous to the market economy, then policy can be portrayed as being a benefit within the economy, by meeting the expectations of an economic tourist. If however, a country is exogenous, then this would reflect a heavy handed policy, in extreme cases reflecting an autocratic state, influencing the perceptions of the economic tourist. Endogenous business on the other hand would be typical of a free market economy, with higher levels of competition, ease of entry and exit into the market and a strong sense of economic endogeneity. An exogenous market structure would represent a market which shows lower levels of competitive behaviour, large inefficient market structures and negative business practices.
Examining figure 1, countries that would typically show signs of high stability would be found in the bottom left quadrant, in other words, these countries would be considered to have less restrictive markets by scoring favourably on the ease of doing business index. Similarly, due to favourable policies, these countries would also show lower levels of political risk making them more attractive to the economic tourist. Countries with lower levels of stability would typically be found in the upper right quadrant of this table. The quadrants of the upper left or lower right would reflect economies which may be experiencing faster economic growth or be moving through an economic transition, resulting in those sovereignties evolving into either a more stable economy or one which is completely unstable.

Table 1 shows the statistical relationship between the three elements that are captured in this model, namely, Change in real GDP, Political endogeneity and the endogeneity of doing Business. The panel data test was performed using Eviews version 8, analysing 25 African Economies, from the period 2011 to 2014. A total of 112 observations, using linear estimation and ‘White cross-section’ analysis. The findings are summarised in Table 1.
Table 1: Analysis of panel data from 2011 to 2014 from 28 African Countries

Dependent Variable: GDP
Method: Panel EGLS (Cross-section weights)
Date: 08/30/15   Time: 10:52
Sample: 2011 2014
Periods included: 4
Cross-sections included: 25
Total panel (balanced) observations: 100
Linear estimation after one-step weighting matrix
White cross-section standard errors & covariance (d.f. corrected)

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<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
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<td>1.095198</td>
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<td>POL</td>
<td>-0.135838</td>
<td>0.016088</td>
<td>-8.443195</td>
<td>0.0000</td>
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<td>BUS</td>
<td>0.024589</td>
<td>0.000909</td>
<td>27.05559</td>
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Weighted Statistics

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<td>Prob(F-statistic)</td>
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Unweighted Statistics

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(Source; Data derived from Quantec (IMF Africa Country Analysis) and NKC African Economics, (World Bank Group Doing Business), 2015)

The dependent variable ‘Change in real Gross Domestic Product’ (GDP) at constant prices, was analysed against the Political Risk Score and the Ranking of Doing Business (taken as a comparison against 189 countries). Change in real GDP at constant prices showed a strong negative correlation between Political Risk (POL) and a weak positive correlation between Business Ranking (BUS). In other words, the greater the perceived political risk the lower the Change in real GDP, and the easier it was to do business, the higher the change in real GDP.

In other words, GDP = 10.54399 - 0.135838*POL + 0.024589*BUS

As can be seen in table 1, the variables indicate a high level of statistical significance using the Students t-test, coupled with a relatively high Durban Watson Statistic of 0.98 using cross sectional weights. This value differs from unweighted cross sectional analysis which would produce a lower R-squared value. It must be noted that the greatest constraint to this model is the short time period in comparison to the large number of countries used in the analysis.

An important part of the analysis should involve the concept of economic size, (as per figure 2, namely the volume of GDP, US$ Billions). The relationship between the rate of growth, political and economic endogeneity is more subtle in that the development of economies (as per the rate of economic growth compared to overall size of the economy) is dynamic, and through the rate of change which is driven through economic and political endogeneity, may eventually result in far more stable economies in the future.
While the size of the economy (change in gross domestic product) is often interpreted as a leading indicator of economic success, it does not show strength of character of markets or institutions. The economic tourist may be impressed by rapid growth, but would most likely not be fooled by the deception. Rather than find solitude in rapidly expanding economies, the economic tourist would most likely prefer the economies that carry higher levels of endogeneity. This does not mean or imply that an economic tourist would not investigate or even enter into higher growth economies. Instead, economic tourists would see the endogeneity as an indication of potential ‘value’.

(Source: Data derived from Quantec 2015)

Figure 3: Scatter Plot comparing business political endogeneity of selected African Countries 2011

(Source: NKC African Economics, 2015)
Looking at figure 3 and figure 4, when examining the political and business relationship between the economies, it appears that there is much movement. While some countries seem to remain rather fixed in their positions, (South Africa, Botswana, Egypt, Namibia and Zimbabwe), others appear to show much larger movements across the graph. (Ethiopia, Kenya, Morocco, Sudan). Interestingly, the greatest movement within many of these economies is the vertical movement, namely, movements or changes in perceptions regarding endogeneity of institutions, namely, political risk. A horizontal shift would indicate views associated with perceptions and changes of market endogeneity. The positional shift of Tunisia versus Morocco could be of interest in this regard. Between 2011 and 2014, Tunisia saw a huge institutional shift, while Morocco saw a very large market shift, bringing them closer together in terms of endogeneity, Morocco clearly improved its position while Tunisia worsened its own position during that same time.

Figure 4: Scatter Plot comparing business political endogeneity of selected African Countries 2014

Clearly, while most analyst’s would implore economic growth within regions (in this case Sub-Saharan Africa), the economic tourist is most likely to relate to a model which is indicative of the institutional (Policy) shifts and market responsiveness, which appears to be a lot more sensitive to the growth of an economy (measured in real GDP). The role of institutions are clearly important factors in determining a growth trajectory even though the Adjusted R squared value of 0.526 for this model remains reasonably low. Despite the statistical significance of this data, there are unaccounted variables not captured in this model, which could possibly be explained in the perceptions and expectations of the economic tourist.

Findings and discussion

This model therefore highlights that there are clearly other factors which still need to be considered, despite the relevance of such a debate. It must be noted that the short time frame (2011-2014) is an important limitation to the model which may affect the robustness of
the overall findings. Further studies should include a longer time frame, and even a weighted index to represent the institutional and market factors which should be considered.

This model captures the relationship between the trade-off and the roles of the different institutions, given the levels of asymmetric information which are persistent within an antediluvian economy. The trade-off is shown as shifts either horizontally or vertically, given the institutional positions relative to each other. In economies where information is more symmetrically distributed, the positions of those economies would remain less volatile with a tendency to migrate towards the lower left quadrant of the scatter plot diagram. With economies having higher levels of information asymmetry, the tendency for the position to change is far greater.

This finding is supported in the works of Young (2000) who states because of the endogeneity of preference towards market and institutional factors, (a function of value to the economic tourist), there is a need for ‘competition policy’ to focus on the ‘power’ of firms and less on the effects of a change in market structure. Young (2000) goes further to show that the behavioural framework of the economic tourist is underpinned in ‘consumer preferences’, and needs to be in-line with governing policies and market structures present in antediluvian economies.

This idea represents a substantial exodus from mainstream theories of the efficient market hypothesis in the search to determine ‘value’ to an economic tourist. The overall model may be compatible with more radical views regarding the nature of institutions and the power relationships between the institutions, along with the central notions of Kaleckian-type (Kates, 2010) views of the competitive process within the markets. Economic tourists, in this context are able, by virtue of adopting particular strategies during one time period \((t)\), to influence the definition of a market in future time periods \((t+1)\). However, it must be stated, as per the findings in this analysis, that the role of the institutions are still more powerful in influencing future outcomes.

**Conclusion**

By investigating the type and nature of an antediluvian economy, exploring the role and trade-off of information in an asymmetric environment determines the sustainability and growth in an environment characterised by total uncertainty. It is this type of environment which undermines the value of supply and demand, thus bringing to the forefront the role of a market in order to overcome the problem for the economic tourist of uncertainty by creating a means of exchange and a strategy to hedge against risk.

The concept of antediluvian economics builds onto the role of determining ‘value’ through culture and traditions via the belief system of society, and how this then ultimately develops a power play between different institutions which leads towards conditions for either growth or failure of the market. This is tested using a panel data analysis of 25 African countries, exploring the level of an exogenous political and market structure. The findings of the model show that as long as the political institution is endogenous with the needs and nature of the market, there is a likelihood that the economy will grow. This remains similar to the level of endogeneity of business, but, unexpectedly, the level of political endogeneity is more important in determining the growth of an economy than that of a businesses.

By making use of the interaction of institutions and markets within many modern economies demonstrates that an antediluvian economy is depended on the co-existence of a strong institutional and market framework which would be of far more importance to the economic tourist who is on a search for ‘value’. As long as the political institution is in-line with that of its market fundamentals, there is space for economic growth, but as long as either the
political institution or the business structure became detached from each other’s ‘common’ objectives, economic growth becomes irrelevant, hampering economic development.

References


