Other institutionalism for development studies

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Prologue

In the early 1990s, the concept of development as a process of accumulation of capital led to a view which emphasized the strong link between institutions and economic performance. This view assumes that public policies and institutional frameworks are a fundamental part of the growth equation, and the most important explanation of the differences in income between countries (North, 1990; Olson, 1996). This shift from a "theory of development free of institutions" to a "New theory of growth" (Mantzavinos, 2003) generated a profusion of theoretical literature and a multitude of empirical studies on the institutional determinants of economic development. Ha-Joon Chang has been a prominent advocate of this approach but also a critic of some of its manifestations. For example, in a recent paper, "Institutions and economic development: theory, policy and history" in the *Journal of Institutional Economics* (Chang, 2011a), he demonstrates the presence of two distinct lines of research: ideological and political, which rely on very different theoretical legacies and establish distinct economic worldviews. This paper is a timely reminder of Chang's important contribution to institutional economics and development. With this in mind we present a comprehensive and analytical review of a recent significant publication, *Institutional Change and Economic Development* edited by Chang. This book is an essential source for researchers who study the relationship between development and institutions and constitutes one of the most ambitious attempts to study institutions. It offers an "explicitly institutionalist" approach - "Institutional Political Economics" (IPE). This is rooted in the intellectual legacy of Marx, Veblen, Schumpeter, Polanyi and Simon, and proposes a version of institutional change as a physical and cultural project (Chang, 2002).

Introduction

At the beginning of the nineties, a "counter-revolution" in development theory (Toye, 1994) was formalised in a new agenda: the Washington consensus. This was the "orthodox" economy's answer to the strategy followed by developmental states, which during the second half of the Twentieth Century consisted in interventionism and protectionism, and was considered an "historical anomaly" (Rodrik, 2006). Just five years later, doubts about the capacity of the "Consensus" to promote growth began to spread, and it was even argued that a stronger adherence to its postulates would have created a notable decline in economic performance (Easterly, 2001). Russia´s failure in its transit to a market economy, unsuccessful reforms in Latin America, and the Asian financial crisis, were proving that economic liberalization without a solid legal and political apparatus, and a complex safety net, would produce significant negative effects on economic growth (Evans, 1995; Jomo, 2003; Rodrik, 2004). The IMF began to talk about a "reform of the reform" or "second generation reforms". Williamson (2003) proposed to remove "Washington consensus" from all economic discourse, since it had provoked so many disappointments. In short, this so called "road to prosperity" for undeveloped countries had unfulfilled its promises. But, moreover, it had showed neoclassical economic theory's deficiencies and its inability to understand the specific problems of development (Stiglitz, 2006; Hoff et Stiglitz, 2002).

By that time, in the academic sphere, interest in Development Economy or "Post-consensus Development Economy" was emerging. Much of the literature began to research countries´ rate of development, emphasizing a strong connection between institutions and economic performance. Growth was related to the existence of a series of basic institutional preconditions, and in som cases it was proposed that underdevelopment be studied as an institutional failure (Bardham, 2002). From a comparative historical perspective, progress was linked with the existence of solid institutions that guarantee property rights and contractual liability. Prosperity would not be achieved where property rights were not secure and where elites´ economic and political power was unlimited (North, 1990; Acemoglu, 2003). Rodrik's account (2003) is conclusive: success in economic performance in the developed world is due to an appropriate institutional framework.

This new paradigm's influence has reached multilateral organizations, as the 1998 World Bank report makes clear, "Post-Washington consensus: Institutions matter". Econometric studies about the institutional causes of development and debates about its explanatory scope have proliferated in the academic world (Acemoglu, Johnson et Robinson, 2002, 2005). One of the most controversial aspects is the possibility for institutional transference, which has been questioned from a double perspective: (1) because it is an idealised projection of western institutional experience (Przeworski, 2004; Evans, 2004; Portes, 2007), and (2) because the effectiveness of formal institutions depends significantly on the support of informal institutions (norms, codes, cultural factors), which are of primary importance in traditional societies (Eggertsson, 2005). Despite all efforts that have been taken by New Institutional Economy theorisers, there is as yet no comprehensive theory of institutional change and economic development (North, 2005). Not even a "satisfactory theory of the economic effects of institutions", nor empirical studies that apply these theoretical concepts to other historical experiences (Chang y Evans, 2006). This state of things leaves open the debate about development's fundamental cause (Lavezzolo, 2008; Przeworski, 2004) and about causality in the institutions-development relationship (Chang y Evans, 2006).

Institutional Change and Economic Development, editor: Ha-Joon Chang, Tokyo: United Nations University Press, and London: Anthem Press, 2007.

As Deepak Nayyar states in its Foreword, *Institutional Change* constitutes the most ambitious attempt so far to study institutions in depth and to overcome the limits of any previous works on development. This great work is the result of research funded by the World Institute for Development Economics Research of the United Nations University (UNU-WIDER), begun in 2004, and has been carried out by a team of experts in development economy and, more specifically, institutional development. Its editor, Ha-Joon Chang, professor and researcher at Cambridge, is advisor of some international organizations, agencies and governments, and winner of the Myrdal Prize in 2003 and the Leontief Prize in 2005, which is awarded to some of the most recognised heterodox economists. In his research, he has demystified "orthodox economy" discourse, and questioned neoclassical methodology – based on abstraction and deduction – that upholds that orthodoxy. He has also followed some tenets of Developmentalism, in particular its critical response to modernization and the importance of institutional soundness (Coastworth, 2008). In this sense, drawing inspiration from Bairoch (1994) and especially from Reinert (2007, 1995), Chang has studied the relationship between prosperity and protectionism or free trade in a historical perspective, and obtained conclusions that contradict orthodox explanations: “good” policies recommended to developing countries by “bad Samaritans” (developed countries) and their executive branch, “the Impious Trinity” of multilateral organizations (IMF, WB, WTO), were concealing a plan which would kick away the ladder of progress. And, regarding “good” policies, he warned about the long and winding road that the evolution and consolidation of modern democratic States had followed (Chang, 2002; López Castellano, 2009; Labandeira, 2009). His works about Asian economies proved that state intervention was needed in order to attain economic development, because State actors applied “hidden” industrial and social policies (Chang, 2004b). More recently, Chang has expressed doubts about the World Bank’s and International Monetary Fund´s growing interest in social policies and institutions, which were completely forgotten in their “structural adjustment” programs during the nineties. In his opinion, the excessive emphasis and abundance of literature about the relationship between institutions and development is an orthodox economic attempt to disguise the failure of “good policies” and the theories that support them (Chang, 2006).

The book, which is divided in three parts with a clarifying prologue by the author himself, takes a multidisciplinary approach to research the institutions-development problem, through field studies focusing on different national and historical contexts. The first part (Chapters 2-4) analyses “superficial” institutional literature and deepens the study of the nature of institutions, its implications and relation with economic development. The second part (Chapters 5-9) considers the evolution of specific institutions – such as bureaucracy, central banks or tax systems – in particular countries. The third and final part expounds concrete experiences of institutional evolution across different nations.

Chang (Chapter 2 “Understanding the relationship between institutions and economic development: some key theoretical issues”) shows the main deficiencies of the “superficial” approach to institutions. This approach is limited for a number of reasons. It emphasizes institutions as restrictions; it lacks a commonly accepted definition of institution; it does not understand their complexity; and it confuses institutional form (democracy, independent judiciary, bureaucracy) with institutional functions (rule of law, respect for private property, enforceability of contracts). Those deficiencies imply the creation of very subjective indicators and a “Global Standard Institution”, ignoring the fact that equal institutions can perform different functions and forms according to their historical, political or social context. Moreover, many countries grew without an orthodox institutional framework and some others took different institutional forms to carry out the same functions. In short, to understand the configuration of an institutional structure, many elements should be considered: ideology, religion or culture and, also, history, colonizations or orography, which makes it essential to continue research in theory and field work. P. B. Evans (Chapter 3, “Extending the institutional turn: Property, politics and development categories”) confronts the problematic of measuring institutional quality and researchers´ attempts to overcome it by a “double-finesse model”, which lacks empirical validity, with some exceptions such as Acemoglu, Johnson and Robinson´s (2005) and North´s (2005). This first part concludes with a brief history of institutional economic thought, beginning with Bacon and ending with Veblen (E. Reinert, Chapter 4, “Institutionalism ancient, old and new: An historical perspective on institutions and uneven development).

These theoretical reflections give rise to some methodological considerations that serve as a framework for the study of specific institutions. Institutions cannot be transferred, as J. Toye (Chapter 5, “Modern bureaucracy”) argues. Bureaucracy can only be understood in a specific political scenario that will vary from one country to another. G. Epstein (Chapter 6 "Central banks as agents of economic development") concurs with Toye in his analysis of mono-function institutions applied to central banks as agents of economic development in the U. S., Japan and England. W. Lazonick (Chapter 7, "Corporate governance, innovative enterprise, and economic development") shares this view and shows that mono-function institutions can be easily misused for private interests. That is the case with financial politics, which is appropriated by share-holders and speculative investors, harming the rest of society, and so - Lazonick ends – gives rise to the need for regulations that favour social welfare.

The assumption that an institution is a whole, which comprises formal (laws, rules) and informal (culture, values, ideologies) aspects, fails to recognise the difficulty in apprehending the relation between institutions and human behaviour, for this is unpredictable and determined by informal institutions. This implies, firstly, that informal institutions should be studied, because they determine the functions, effectiveness and acceptance of formal institutions in a given context; secondly, that the complex nature of institutions and the possibility of hidden interests in its implementation hamper the chances of producing an accurate prediction of its effects; and, finally, that it is impossible to dissociate the political from the institutional. For M. J-E. Woo (Chapter 9: "The rule of law, legal traditions and economic growth: The East Asian example"), to assume the alleged superiority of Anglo-Saxon formal law system over informal traditional law implies the idea of the necessity of the former to condition the relation between state, economy and society. In his research (Chapter 11, "The role of federalism in developing the US during the nineteenth century globalization"), E. Rauchway maintains that federalism allowed the US to grasp enormous international flows of capital and labour, so that the country obtained local institutions that were best prepared for new situations to come. But, as state economic interests prevailed, a set of regional dysfunctions were created and are still maintained. In chapter 13 (L. Burlamaqui, J.A.P. de Souza, y N.H. Barbosa-Filho, "The rise and halt of economic development in Brazil, 1995-2004: Industrial catching-up, institutional innovation and financial fragility"), the role of state and bureaucracy as agents of institutional change is studied, focusing on the case of Brazil. J. di John (Chapter 8, "The political economy of taxation and tax reform in developing countries") argues that the level of taxation is not merely an economic issue, but a social and political one, for a given tax system implies a particular social contract legitimizing it, and presupposes a certain state capability of implementing it. The comparison between Latin-American and East Asian tax models, gives support to question any tax reforms that evade redistributive measures - such as the one proposed by international organisations in their structural adjustment programs - and to warn countries with inequalities to consolidate long term tax reforms based on direct and progressive taxation.

Case studies reach a clear conclusion: the greatest successes of institution-building were due to a combination of country-specific innovations and developed-countries' policies adapted to national contexts. In this sense, T. Zhu (Chapter 14, "Rethinking import-substituting industrialization: Development strategies and institutions in Taiwan and China") describes China's and Taiwan's economic performance as a state led process, combining import-substituting industrialization and export-oriented industrialization with an active participation of banking institutions, public companies and financial regulations. His recommendation to developing countries is to foster its industrial capacity and exportations by state policies to absorb national production. In turn, J. Kiiza (Chapter 15, "Developmental nationalism and economic performance in Africa: the case of three successful African economies") shows three successful experiences in the African continent: Mauritius, which accomplished a strong growth without any structural transformation, and Bostwana and

Uganda, each of which grew while transforming their industries. In these three cases, a Developmental state - with Weberian bureaucracy and other formal institutions - implemented mercantilist strategies, oriented toward protectionism in some cases or open to the market in others.

P. K. O´Brien (Chapter 10, "State formation and the construction of institutions for the first industrial nation") compares "laissez faire" policies imposed by Washington Consensus with the mercantilist policy of geopolitical expansion that the United Kingdom followed, to unmask the neoliberal myth which fails to correspond to real historical experience. Fiscal architecture, political decisions promoting industry, and technological investments on certain sectors, were part of a strategy that received support from the Royal Navy military conquests. In Chapter 12 ("Institutions and economic growth: the successful experience of Switzerland 1870-1950"), T. David and A. Mach explain how Switzerland used institutions that are now neglected by neoclassical economic theory (patents, central banks autonomy), and how Holland and Belgium followed a quite similar model of development, based on private-public cooperation and a combination of exportation policies with a selective control of their domestic markets.

It can be argued, from the theoretical reflections and case studies proposed, that the results back up those suggested by Chang throughout his career, namely, that historical experience contradicts the main neoclassical myth: that market and trade liberalization alone are the way to prosperity. Industrialized countries became rich through protectionism, aggressive industrial policies and interventionism in the financial sector. The economic success of the "Glorious Thirty" was due to wide intervention programs and strict controls on the flows of international capital, designed to boost economic growth and protect industry. Following "nationalist" policies, developing countries grew more when not merely following liberal policies (Chang, 2007; Sunkel, 2006). Therefore, only a kind of "historical amnesia" or overwriting of history, could explain the oblivion of such paradigmatic experiences as those of "the golden age of capitalism" (1950-1973), and the subsequent turn in macroeconomic programs of the eighties.

To sum up, this book is not only a great antidote to neoliberal determinism, but also suggests different political options depending on the specific conditions of developing countries. As Chang himself pointed out, the work of a development economist is "to find constant historic guidelines, to build theories that explain them and to apply those theories to contemporary problems". In short, this is a relevant text and a mandatory reference point to all those interested in international development and its potential obstacles. To economists, because they will doubt and reflect, to politicians, because they will find elements for analysis, and for citizens, because they will find arguments with which to conduct substantive debate.

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