

Institutional Approaches to Economic Development: The Current Status of the Debate

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Abstract: The recent publication of “Institutions and Economic Development: Theory, Policy and History” (Chang 2011a) has stimulated a thought-provoking debate, and has brought forth a wide-ranging demonstration of the theoretical arsenal of the new institutional economics. The debate proves that, as of yet, no satisfactory theory of institutions has been articulated, nor is there an agreement on the relationship between institutional change and the politics of development. It also demonstrates the presence of two distinct lines of research: ideological and political, both of which rely on different theoretical legacies, and embody distinct economic worldviews. This scenario allows a summary of the argument in the most recent literature to be made on the relationship between institutions and development, as well as to relate the debate to the concept of development as a process of expansion of capacities.

Keywords: deliberative development, economic development, institutional change, institutional political economy, new institutional economics

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The recent publication of “Institutions and Economic Development: Theory, Policy and History” (Chang 2011a) has brought forth a wide-ranging demonstration of the theoretical arsenal of the new institutionalism, while stimulating a thought-provoking debate.¹ The article, the critical responses to it, and the reply from Ha-Joon Chang himself (2011b) present an opportunity to discuss the status quo and to analyze the most recent literature on the relationship between institutions and development.² The debate brings forth disagreements about the nature of institutions, institutional change, and strategies of development. Moreover, it reflects on the presence of two lines of ideologically and politically distinct research: new institutional economics

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(NIE) and institutional political economy (IPE). To date, the current trajectories – which rely on very different theoretical legacies and establish distinct economic worldviews – run in parallel to one another and never intersect. Thus, in his review of literature on development, Mary M. Shirley (2008) ignores the heterodox movement (Chang, Evans, Hodgson, and Reinert), while Chang (2011b) admits that his vision on the matter has broadened and improved following the critical reaction to his article.

The objectives of this article are twofold. First, to describe the general terms of the debate concerning the idea of an institution, the role of the state, and the processes of institutional change and economic development. A brief description of the recent evolution in orthodox institutional literature linked to the NIE, and of the potential points of concurrence with the critical perspective associated with the IPE, is included here. Secondly, the article analyzes the development controversy in the recent literature and poses the following question: Must the institutional arrangements that facilitate good economic performance necessarily be homologous with those (deliberately designed) structures that promote economic development?

Institutions and Development: The General Terms of the Debate

In the early 1990s, the concept of growth as a process of accumulation of capital led to a view that emphasized the strong link between institutions and economic performance. It produced a shift from a “theory of development free of institutions” to a “new theory of growth.” It also assumed that public policies and the institutional frameworks were the most important factors accounting for differences in incomes between countries (North 1990; Olson 1996). This NIE-based interpretation became an orthodoxy. Its impact on the problem of development was twofold: In the academic world, it generated advances in theory and method, and in the development agencies, it reoriented the programs of market fundamentalism to the desideratum of “good governance” (Bates 2010). The critical literature deprecates the advances in the academic sphere, and emphasizes the negative influence this literature has wielded on development strategies. Regarding the academic world, the interest in institutions is attributed to the exhaustion of neoclassic economics (Nelson and Sampat 2001), or to the tendency of orthodox economics to downplay the failures of “good policies” and of the theories that sustain them (Chang 2007). As for strategy, the claim goes that the influence has been translated into the projection of “institutional monocropping” – that is, the universal adoption of an institutional architectural model in developed countries, as informed by the western experience (Evans 2005; Portes 2007; Przeworski 2004; Rodrik 2008).

Chang (2011a) questions the basic NIE position that the most efficacious institutions for development are those which safeguard property rights, guarantee the fulfillment of contracts, and minimize transaction costs. Chang attacks the NIE view that the failure of the “good” policies, recommended to the economies in development (and in transition), is equivalent to an absence of clearly defined and enforceable property rights.

Chang also casts doubt on the tenability of two leading approaches to institutional change in developing countries, which he identified as “voluntarism” and “fatalism.” The former approach proposes the implementation of a “global standard institution” which derives from the concept that the institutions are a product of the rational choice and, therefore, can be changed through political action. This idea, he suggests, ignores the historical, political, and social context of the receiver countries, disregards institutional diversity, and delivers institutional configurations advantageous to rich countries and financial capital, and disadvantageous to poor countries and industrial capital. The latter, “path-dependent” approach, attributable to Daron Acemoglu et al. (2001, 2003, 2005), is grounded in the time-and-place specific factors of culture, geography, and climate. Institutions tend, according to this view, to perpetuate certain norms of human interaction. The inertial forces of history and custom greatly limit the scope for political action. Chang argues that both voluntarism and fatalism err by linking economic growth to a structure of incentives tied to property rights. Expositors of both voluntarism and fatalism have, consequently, selected measures of institutional quality that are oriented to property rights. One other hand, he submits that the orthodox institutional literature, besides falling into isomorphism, does not consider the costs of institutional reforms, thereby resulting in costly reforms for old socialist economies and developing countries in recent decades. Chang further maintains that sophisticated econometrics, controlled experiments, and other “systematic tests” of orthodox methodology must be completed with other types of empirical methods, including time-series analysis, historical narrations, and comparative historical studies (Chang 2011b).

Chang criticizes the NIE distinction between the functions institutions must perform to promote growth and the institutional forms adopted by western countries in pursuit of economic development. He insists that the instrumentality of a particular institutional schema in achieving development is conditioned by historico-cultural context. These institutional forms, however variegated or context-specific, make development possible because they enable the coordination of development plans, encourage innovation, redistribute income, and promote social cohesion. Chang also insinuates that, should Amartya Sen’s concept of development be adopted, institutions and their functionalities would be different. That is, if development is understood as a process of expanding fundamental liberties – meaning, affording all persons the capability to enjoy liberty and live with dignity – institutions must serve to broaden the human capacities to achieve self-realization (Chang 2011a).

In his article, as well as in his response to the reviews it generated (Chang 2011a, 2011b), Chang synthesizes a theoretical and methodological line that he maintains throughout his work. He proposes a new research agenda based on a strategy of deconstructing the leading discourse on institutions and development. Chang reinterprets the orthodox vision on the basis of a multi-disciplinary approach supported by comparative analyses, and case studies drawing on diverse national and historical experiences. His provocative proposal has revitalized the debate and opened

the door to a productive future dialogue with heterodox theoreticians (Jameson 2011; Ros 2011; Ruccio 2011; Wallis 2011), and even with such orthodox authors as Mwangi S. Kimenyi (2011) and Robbert Maseland (2011).

However, Chang is very much at odds with another group of authors who condemn his argument and whose critical commentaries imply the presence of two irreconcilable methodological and theoretical positions. In general, they describe Chang's work as a compendium of ideological prejudices and contradictory ideas. More specifically, they accuse him of undervaluing institutions and downgrading the importance of property rights in the growth dynamic, as well as misrepresenting the public choice theory of the state (Boettke and Fink 2011; Brouwer 2011; Choi 2011). Chang has also been charged with failing to address the methodological problems of the NIE or of offering viable alternatives. Chang is further rebuked for making ostensibly outdated arguments without reference to new theoretical advances in institutions and development, and for lumping together a provocative minority vanguard under the rubric of "dominant discourse." This group of critics includes authors like Rafael La Porta et al. who question the idea of "institutional monocropping" and specifically accuse Chang of misinterpreting the "fatalism" current of change and of making unfounded criticism about the costs of institutional change on the part of the "volunteerist" course (Clague 2011; Nugent 2011; Shirley 2011). Critics further suggested that Chang's analysis centers on partial aspects of orthodox institutional literature and on the erroneous reading of policymakers (Clague 2011; John and Storr 2011; Wallis 2011). Finally, they charge Chang with a radical defense of central planning and a firm rejection of econometrics, a position he only sustains by weak methodology, unsystematic evidence, and a selective use of cases to suit his purpose (De Jong 2011; Keefer 2011).

NIE versus. IPE: Theory, History, and Politics

The debate confronts two institutional approaches to the problem of development. The first is what Chang calls the "superficial," economistic view and it is linked to the NIE. The second, or IPE, he classifies as "explicitly institutionalist" (Chang 2002b). The NIE is a research project that applies the tools of neoclassical economics to transaction costs, property rights, and public choice (North 1990). Institutions are, according to the NIE view, "rules of the game" or "restrictions which men impose on human interaction" that regulate the transaction costs and define the possibilities for economic development (North 1990, 2005). From this perspective, institutional change would entail a shift in the rules that constrain or encourage social behaviors (Levi 1988). The IPE, on the other hand, traces its roots to the intellectual legacy of Karl Marx, Thorstein Veblen, Joseph Schumpeter, Karl Polanyi, and Herbert Simon – that is, back to the tradition of the "old institutional economics," which emphasizes the importance of political realities in the selection of public policies and highlights the role of institutions in setting the terms of human interaction (Chang 2002b). The IPE project (advanced recently by Burlamaqui, Evans, Hodgson, Lazonick, Rutherford, and Toyé, amongst others) faces

a double challenge. On one side, it must overcome the conventional view of institutions as “restrictions.” On the other side, it must offer a more systematic and general explanation of institutional change.

In the following paragraphs the article will compare and contrast the discordant approaches with respect to the nature of institutions, the role of the state, the historical or path-dependent nature of development, and the relationship between institutional quality and economic performance.

The Nature of Institutions

The first noticeable difference between the two approaches concerns the nature of institutions. The NIE defines institutions as “the rules of the game” – formal and informal – in a society, which control human interaction and determine the structure of incentives on the political, social, and economic planes. The NIE starts from an institution-free “state of nature” and explains the origins of institutions as a rational, optimizing response of individuals agents. That is, institutions are reducible to individuals. In this construct, the individual is the basic unit of analysis, his/her motivations (preference functions) are taken as given, and causation runs unidirectionally from individuals to institutions. Consequently, while institutions sanction or reward individuals’ behavior, they do not alter their motivations or desires (North 1990).

The IPE, for its part, asserts that attempts to explain the origins of institutions are futile and highly misleading. Moreover, all societies, irrespective of time and place, achieve cooperation, cohesion, and order under the influence of a complex set of behavioral codes inherited from the past. Individuals are born into a preexisting institutional environment – that is, they are already institutional individuals in “the state of nature” (Hodgson 2006). Espousing an alternative concept of the human agency, which rejects the idea of individual maximization of utilities and posits habit as the driving force of human action and belief, Geoffrey Hodgson – following Thorstein Veblen – argues that institutions are durable entities that are integrated with customs and routines, and constitute a key element in the collective processes through which human agents perceive and understand their world (Veblen 1899). The key argument is that institutions are social structures implying a “descending restorative causality” – that is, bidirectional causation exists between individual motivation and social institutions. This is to say that institutions facilitate or restrict individual behavior and shape the individuals themselves by inculcating values and world views in them. (Chang 2002b). In short, the definition of H.J. Chang and Peter Evans (2005) suggests that institutions are systematic patterns consisting of shared expectations, unquestioned assumptions, and accepted norms and routines of interaction with profound influence on the motivations and behavior of groups of socially interrelated actors. These systematic patterns underpin “organizations” such as public agencies and firms which rely on formal norms to impose sanctions.

The Role of the State

The concept of the state and the state's role in the process of development is another relevant aspect differentiating NIE from IPE. Per the NIE, the basic functions of the state are to assure property rights, enforce compliance with contracts, reduce transaction costs, increase wealth, and encourage growth. That is, it embraces the schematic scenario of the "public choice" theory over the "predatory state" theory, the latter of which rejects all state redistributive policy and conceives of state governing as an extortionist activity (Bardhan 2001, 2005). In the NIE, the orthodox theory of the state is always latent. It holds that the state has a monopoly of violence, creates the rules, and has power to violate them (Weingast 1995). The solution to this problem lies in designing mechanisms for collective action to limit the state's predatory capacity. As an interested party in the economy the state has incentives to behave opportunistically in order to maximize the income of those with decision-making power (North 2005; Shirley 2008). Unrestrained opportunism accounts for the persistence of inefficient institutions by a "Leviathan" state (Brennan and Buchanan 1980) that seeks to maximize its income at the cost of undermining property rights and investment incentives (Levi 1988). In short, institutions that promote growth are seen as equivalent with those that facilitate the interaction of players in a market with low transaction costs (Nelson and Sampat 2001). In addition, institutions that create markets receive preference at the expense of those that regulate, stabilize, and legitimize the market (Rodrik et al. 2004).

For IPE advocates, the public choice theory presents a caricatured version of the state in developing countries – that is, central political control is weak and democratic institutions are half-formed at best (Toye 1987). This image of the state, according to the IPE, springs from egoism – as part of the theory of human motivation and behavior – and, as such, discounts the "public" nature of the motivations of politicians and state bureaucrats (Chang 2011a). Departing from the idea that individuals can be motivated by extreme egoism or pure altruism (Lewis and Steinmo 2011), the IPE draws attention to the existence of ethical values (such as justice and public spiritedness) and to the individuals who think and behave "institutionally." Moreover, individuals often have a sense of duty that transcends personal or organizational loyalty (Hecló 2008). Taking into account the constitutive character of institutions, the IPE professes that the behavior and motivations of public figures are subject to modification. That is, the behavior of public officials is, to a large degree, "instituted" and, as such, there is a predictable relationship between patterns of official conduct and the rules of the game (Chang 2007). For the IPE, the state is the foundational institution in the sense of acting as both agent of selection/codification and a third-party enforcer of the rules that stipulate rights, duties, capacities, and exposures in economic exchange. The market is an example of a capitalist institution formed by other informal institutions such as social conventions. The IPE insists that markets are socio-political constructs formed by clusters of formal and informal conventions that regulate participation, the means of exchange, as well as the rights

and obligations of the agents in the market (Chang 2002b, 2011b; Hodgson 2006; Lazonick 1991).

The IPE also calls into question the hypothesis of Geoffret Brennan and James Buchanan (1980) which holds that citizens perceive the fiscal capacity of the state as an index of its coercive power. The IPE maintains that the focus on finance ignores the role taxes play in the legitimacy of the state and its capacity to drive development (Di John 2009). The state's incapacity to implement a comprehensive, non-discriminatory, and enforceable taxation system was the principal brake on pre-modern economic growth. Insufficient collection of taxes in developing countries reflects the difficulty in obtaining political legitimacy when the state is too weak to manage taxation (Chang 2002a; Epstein 2000). As Stephan Epstein (2000), Patrick O'Brien (2003), and Karl Polanyi (1944) explained, the formation of national markets in the West (and especially the English mercantile state) coincided with the creation and expansion of state institutions. Similarly, the state played an active role in the successful episodes of development in Asia, above all with regards to industrial policy, but also through intervention and the channeling of credit towards industrial investment (Chang 1993; Evans 2007). On the other hand, the IPE posits that the existence of an effective government is a precondition for transition to a market economy, because voluntary exchange cannot occur in an institutional vacuum. Shaoguang Wang's study (2003) on China shows that market development requires an arduous process of "legitimization" sustained by coercion. Wang argues that a market economy cannot exist without legal, administrative, and tax-efficient institutions to define property rights, promulgate laws, enforce contracts, and collect taxes. For the IPE, in the end, the role of the state morphs into a "Schumpeterian" world built on competence and innovation (Burlamaqui 2000; Jessop 2003).

The Lessons of History

Following Douglass North's interpretation of the emergence and evolution of the western world and the attempts to project the European experience onto other societies (North et al. 2000), the NIE studied development from a historical perspective following two courses: the "new political economics of development" and the theories of institutional development based on colonial origins. The former course, linked to the theory of "rational choice," analyzes the political foundations of development and identifies violence as a source of prosperity. The thesis holds that violence fulfills a functional role in history and, in Western Europe, it contributed to the creation of the modern state. Linking the underdeveloped world and Hobbes' insecure society, the NIE argues that the development of European nations and the modernizing forces of developing countries have a common root: They use(d) violence to enforce collaboration (Bates 2001; López and Lizárraga 2006). More recently, researchers have observed a close relationship between development and the method of regulating violence affirming that the form of regulation is determined by existing institutions, organizations, and belief systems (North et al. 2007, 2009).

The latter – which Chang calls the “fatalism” – course of change is the more influential one. It has developed into two distinct lines which John H. Coatsworth (2008) terms the “political economics of conquest” and the “political economics of economic failure.” The “political economics of conquest” maintains that the forms of colonization shape the structure of emergent political, economic, and social institutions which then explain varied growth rates (Acemoglu et al. 2005). The “political economics of economic failure,” on the other hand, argues that the size of the indigenous population and resource endowments account for the emerging high levels of economic and political inequality in a society (Engerman and Sokoloff 2005). At the same time, both sides agree that the colonial institutions of law and order remain largely intact in post-colonial societies (Glaeser et al. 2004).

Supporters of the “new political economics of development” have been criticized for using a rational-choice model to explain the origin and evolution of the modern state, as well as the path followed by emancipated states in the middle of the twentieth century (Molteni 2006). Colonial theorists have also been questioned about their excessive historical generalizations and the limited empirical support for their conclusions (Przeworski and Curvale 2007).

In addition to the specific criticisms directed at each of these currents of thought, there is one they share: namely, they both make an inadequate historical review of the theories of development leading to the misconception that it is possible to fit a single model of growth to developing countries. From this criticism it follows that, historically, “good governance” came as a result of a long and turbulent journey toward institutional development, at least in the European case. As for “good policies,” the proposition is that all developed countries today actively apply industrial, commercial, and technological policies to strengthen nascent industries, at least in their infancy. (Chang 2002a, 2007). In the initial phases of their industrial development, the most successful economies of the world pursued a dynamic, imperfect competition through a regime of import and export prohibitions and tariffs. While rich countries specialized in the export of manufactured products, their colonial periphery remained technologically underdeveloped and devoted to the production of raw materials for the metropolis. At present, underdeveloped countries continue to be steered toward reliance on their natural resources and the export of raw materials, whereas advanced economies place emphasis on manufacturing and man-made products (Reinert 1995, 2007).

Empirical evidence shows that the negative relation between protectionist policies and the prosperity proposed by the leading institutional literature is seriously flawed and even erroneous. Chang argues that the strong growth both rich and developing countries experienced during the “the glorious thirties” came as a result of well-designed programs for control of the movement of international capital. In addition, he maintains that the abandonment of active economic policies in favor of institutional reforms of structural adjustment from the 1980s onward translated into an anemic growth (Chang 2002a). On the other hand, Chang posits that all countries with sustained economic growth applied public social policies to provide for infrastructure, technological innovation, and production investment, while

simultaneously protecting private property rights. Thus, the “developmentalist” Korean state exemplifies a policy that combines “orthodox elements with local heresies” (Rodrik 2006). On one hand, its impressive economic performance was due to a powerful bureaucracy which encouraged macro-economic stability and production efficiency. On the other hand, its growth was due to the special relationship that existed between the state and industry aimed at achieving a “national project of transformation” and at alleviating insecurity generated by rapid structural change and business cyclical fluctuations (Chang and Evans 2005). This triumph of the “idiosyncratic” Asian model was based on a formidable expenditure of political energy and economic resources, not on historical or cultural heritage. Like Sen, Chang maintains that culture can be changed through political messaging, educational policy, and institutional adjustment. (Chang 2007; Sen 2006). The argument thus far rejects Huntington’s thesis (Harrison and Huntington 2000) about culture as the dominant factor underlying the divergent performances of Ghana and South Korea, for example, in the period 1960–1990.

Institutional Quality and Development

As noted earlier, the NIE links development to two key institutions: those safeguarding the rights of ownership, on one hand, and those enforcing contract compliance, on the other. Shirley’s (2008) recommendations for developing countries are also of two kinds: namely, encouraging trade through reductions of transaction costs and increasing confidence and protecting private ownership from expropriation. Furthermore, Avinash Dixit’s (2009) notion of good governance can also be understood in terms of property-rights guarantees and contract enforcement. Similarly, Acemoglu and Robinson’s (2000) definition of “good social organization” identifies “good governance” with an array of political, economic, and social institutions that protect the property rights of citizens. These statements enable the construction of three indicators to measure institutional quality (Edison 2003) and to justify reforms in many countries. These include the quality of governance (Kaufman et al. 1999), the level of legal protection of private property (Acemoglu et al. 2001; La Porta et al. 1997; Rodrik et al. 2004), and the limitations imposed on political leaders (Acemoglu et al. 2003).

The IPE argument is that, despite its central position in the general discourse and its importance in the creation of quantitative indicators of institutional quality, the “system of property rights” concept is not clearly defined. Moreover, given the difficulty of combining in a single institutional matrix the complex institutional framework of property, the neo-institutionalist literature reconceptualizes it under the rubric of “risk of expropriation.” This measure of institutional quality has become the “New Testament” (Chang 2011b; Pzeworski 2004). The NIE establishes an antagonistic relationship between private property and state intervention and defends the superiority of private over public property to resolve the dilemma between self-interest and the collective good. The IPE objects that to assume the above involves disregarding the diversity of forms which property rights can take – as demonstrated

by the historical experience of countries like China, Singapore, and Finland (Chang 2004, 2011b) – as well as dismissing studies like Elinor Ostrom’s (1990, 2007) regarding the potential of actors to create their own institutional arrangements, to manage the natural resources, and to escape the tragedy of the commons.

Regarding the quality indices of Daniel Kaufmann et al. (1999a, 2002, 2003), Chang (2004) points out, variables that secure institutional forms (e.g., political democracy, independent judiciary, bureaucracy) coexist with others that define enforcement functions (e.g., authority of law, respect for private property, and enforcement of contracts). On the other hand, Chang attacks La Porta et al. (1997, 2008) for defending the superiority of “common law” systems over other types of legal institutions. He claims that, far from being a revolutionary idea, the position of La Porta et al. is a central tenet of orthodox institutional literature, already exerting a large influence on the recommendations of “good” policies for development (Chang 2011b). Indeed, this influence is reflected in the World Bank’s indicators of institutional assessment, particularly with regard to the “Governance Matters” series, a key criterion in the allocation of aid, and the “Doing Business” indicator, both or which are widely used by policymakers of developing countries (Michaels 2009). However, in her case study, Meredith Jung-En Woo (2007) questions the supposed superiority of the Anglo-American common-law system over the mechanisms of informal law (customary law) regarding development, and criticizes the misuse of the developed states’ history to justify reforms.

The IPE argues that the NIE emphasizes institutional forms because, in doing so, the NIE can propose a specific solution to an institutional problem, thus facilitating policy recommendations. Andrews (2010) warns of the danger of isomorphism with indicators, which move away from a deterministic concept of desirable development based on an idyllic image of government in developed countries. Moreover, adequate indicators for developed countries are of dubious application in developing countries because they concern formal institutions, whose effectiveness depends largely on the support of informal institutions (norms, codes of conduct, and cultural factors), entities of fundamental importance in traditional societies. More precisely, the interaction between slow-moving (informal) institutions and fast-moving (political) institutions explains the difficulty in transplanting cultural contexts and the existence of diverse institutions for development (Roland 2004). The Soviet Union did transplant the NIE idea of reform from “top down,” consequently establishing institutional change as a result of policy decisions and new laws. However, China’s case illustrates the more gradual and evolutionary view of institutional change from “bottom up,” beginning with changes in social norms that are subsequently formalized into written law (Easterly 2008).

Recent Advances of the NIE: Towards a More Pluralistic and Interdisciplinary Approach

One of the principal criticisms aimed at the NIE is that its advances are limited to the academic sphere. Thus, John Toye (1987) only attributes the NIE’s

incorporation of the “game theory” and the rational-choice approach in development studies to its defensive attitude to orthodox theory. Alejandro Portes (2007), for his part, emphasizes that the progress of neo-institutionalist analysis has abandoned only the most unrealistic assumptions of neoclassical economics.

Orthodox institutional literature confirms that there are grounds for optimism as its most recent developments move closer to the positions of “old” institutional economics. In light of this, the argument is that the profusion of theoretical and empirical works are stimulating researchers to create new conceptual structures to study institutions and their role in economic performance (Greif and Kingston 2011). The methodological proposals of Acemoglu et al. (2005) and the more recent works of North (2005) have given some strong impetus to economic studies, allowing correlations to be established between institutional variables, economics, and politics. Also, the growing number of case studies (North and Weingast 1989) and the use of experiments to deepen the knowledge of behavior (Ostrom 2007) are becoming denotive of progress. From the perspective of rational choice, extensions of the NIE have emerged that follow two approaches: one of the “institutional analytical narrative” (Bates et al. 1999) and another of the “historical and comparative analysis” (Greif 2006). The latter of the two assumes the importance of historical context and rests on the concepts of game theory and path-dependency (Caballero and Vázquez 2011).

As of late, the NIE has adopted a more interdisciplinary and pluralistic profile (Dixit 2009). But just a decade ago, as Oliver Williamson admits (2000), no unified theory of institutions existed. More recently, Robert Bates (2010) continued to argue that there was still no consensus on the nature and origins of institutions. However, Orion Lewis and Sven Steinmo (2011) have since registered an ontological change in the definition of institutions, which they attribute to the influence evolutionary theory has on the “new institutionalism.” This change, they believe, stems from the fact that institutions are not yet identified with the restrictions of behavior but, instead, with a set of norms, rules, and beliefs embedded in a wider social and political context (Greif 2006; Greif and Laitin 2004), or with “shared regularities of behavior or routines of a population” (Mantzavinos, North and Shariq 2004).

Now authors like North have acquired an evolutionist perspective on institutional formation and transformation showing “a certain degree of convergence” with the ideas of the old institutionalists, which allows channels of dialogue to be established with the followers of this tradition (Caballero, 2011; Nelson 2002; Rutherford 2001). North himself (2005) recognizes the influence of evolutionist literature and in his recent works one discerns bidirectional causality: The agents derive their beliefs from reality and transform them into institutions which, in turn, establish a structure of incentives influencing behavior; actions then modify reality to generate a process of feedback. The NIE has also modified its view of instrumental rationality and has replaced it with Herbert Simon’s “bounded rationality” (1986). As North (2005) maintains, what is usually understood as a rational choice is actually the incorporation of thought processes shaped in the more general social and institutional context, which does not respond to an individual cognitive process.

Moreover, in regard to method, there has been a shift away from methodological individualism and toward – what North describes as – “institutional individualism,” placing individual action and socio-institutional structures on the same analytical level (Toboso 2011).

Lewis and Steinmo (2011), very much in line with Hodgson (2002), confirm that there is an emerging agreement among scholars that institutions, ideas, and environment change in a co-evolutionary process. From an institution-as-a-balance standpoint, economists emphasize the theory of motivation and maintain that the key to institutional change does not lie in changing the rules, but in changing the motivations of the players and their patterns of behavior in an auto-reinforcing sense (Greif and Kingston 2011). Many neo-institutionalists have echoed the warning of Hodgson (2001) pertaining to the problem of specificity of economic phenomena and the necessity to rely on an economic theory that is more sensitive to the existing variety of historical and geographic situations. Avner Greif’s theory (2006) of endogenous institutional change incorporates this thesis and combines an agency approach with a structural one to show the importance of history in the current preferences of individuals.

Also, state-performed activities are integrated with the processes of development. North rejects the simplistic view of the state held by the traditional school of public choice, although he continues to argue that development requires the creation of political institutions which place limits on government power (North 2005). As for the state’s agenda, North maintains that efficient markets require a government that defines and enforces property rights, minimizes transaction costs, and upholds a sense of honesty and justice. He also recognizes that market freedom does not guarantee efficiency, because efficiency requires well-defined rights and the performance of corresponding duties. Greif (2001) notes that markets do not operate in vacuum, but rely on formal and informal institutions for the continuous, orderly resolution of conflicting interests among transacting parties. The studies referenced above evidence a distancing from the neoclassical model of growth as a basis for development policies. North himself (2005) recognized the lack of adequate dynamic theory to explain both the development of advanced societies and the transition from undeveloped to a developed society. Western institutions have emerged through a long process of adaptation, which prevents the model from being copied exactly in developing countries. Path dependency affects the degree of change while also obstructing the import of these institutions into other societies. Thus, the possibility of institutional transplant is effectively put into doubt (North 2005; Shirley 2008).

Summary and Proposal: From Institutional Transplant to Deliberative Development

The debate generated by Chang’s article and the responses to it have allowed the adoption of two approaches to studying the relationship between institutions and development. Although some closeness of the two approaches is appreciated, at least in the ambit of theoretic research, the points which separate them are manifold.

There is a general agreement that institutions restrict options and establish the very criteria by which agents show their preferences. Recently, the NIE has substituted the concept of instrumental rationality for that of “bounded rationality.” It has also overcome methodological individualism while emphasizing the theory of motivation. From here on, following an evolutionist perspective, the NIE maintains that institutional change implies a variation of the rules and motivations. It also rejects the more schematic conceptualizations of the state characteristic of public choice, but it continues to hold that development requires the creation of institutions which limit the power of the state. Finally, the NIE interpretation of the developed world history leads it to link economic success or failure to pro-market institutions and to build indicators of institutional quality attached to property rights. Most recent studies recognize the importance of context for development and accept the difficulty of transplanting institutional models.

Such extensions of the NIE herald optimism for a future dialogue with the current followers of the “old” institutionalist tradition. To date, however, scholars remain separated by differing views about the concept of the state, the interpretation of development in historic context, and the wisdom of projecting the western experience onto developing countries. The problem with the NIE concept of the state lies in the assumption of egoism as a theory of behavior, effectively negating the public nature of politicians and bureaucrats’ motivations. The IPE, on the other hand, defends the possibility of change in motivations, given the constitutive role of institutions in establishing a spirit of public service. The two schools are also separated by their different concepts on the role of finance in legitimizing the state and the state’s ability to drive development.

The IPE view puts into doubt the interpretation of the leading institutional literature about the development of “good governance” and “good policies.” The orthodox concept does not consider the significant contribution of social politics to development. Thus, redistributive policy is disregarded in the social, economic, and political dimensions included in the indicators of institutional quality. Equitable development requires the creation of credible institutions to represent and channel the interests of diverse social groups (Chang 2004; Mkandawire 2001). However, the external imposition of institutional patterns reduces the possibility of experimental, innovative institution-building by host countries (Chang 2007; Evans 2004; Rodrik 2000). From a Marxist point of view, David Ruccio (2011) proposes creating institutions that impede the appropriation of surplus value through capitalist forms of exploitation and promotes instead alternative forms for redistribution of surplus, non-exploitation, and for economic and social development.

In a key sense, the NIE reflects the economic production of countries achieving development in terms of output and income and links the idea of “good institutions” to the attainment of goals selected from the perspective of orthodox economic theory. Chang himself is in favor of manufacturing industries – a factor historically separating rich from poor countries, and (alongside Gerschenkron) he defends the financial-industrial orientation of policies in societies of belated industrialization. In general, the institutionalist approach to development continues to identify growth

with gross domestic product (GDP), industrialization, and technological advances (Dutt 2011).

But the NIE argues against such identification and proposed that the first step to rectifying this situation, as Joseph Stiglitz notes, is to do away with GDP fetishism as well as to conceive of development as the “transformation of society” (Stiglitz 2007, Stiglitz et al. 2010). In Amartya Sen’s concept of development as the process of expanding fundamental liberties, expansion of GDP is only a means to enhancing these liberties for all members of society. These fundamental freedoms then depend on the political (e.g., political participation) as well as social and economic institutions (e.g., health and education) for their development and enforcement. Thus, the importance of institutions is not measured by their contribution to the GDP or to industrialization, but by their capacity to enable people’s self-realization.

Such a concept of institutions requires the provision of healthcare, education, and incomes that allow the fulfillment of basic needs. Education becomes a key factor of development because it not only improves human productivity and increases personal income, but also contributes to the quality of political debate. Martha Nussbaum (2010) associates the current educational model with the economic development-growth paradigm which pursues profitability and creates “utilitarian machines.” Consequently, Nussbaum advocates another form of education that fosters human development, instills public spiritedness, and creates “good citizens.”

According to Sen, the public debate on distribution of collective wealth and strategy of development should be the cornerstone for institutional change (Chang 2007; Evans 2005). Therefore, it is becoming necessary for institutions to promote public debate and facilitate the collective decision-making on issues of development. Democracy is understood here as “government through debate” because it is immune to the market and generates social values (Sen 2006). In this deliberative democracy – as opposed to a mere liberal political system, basing participation on the secret ballot and on satisfying individuals’ preferences – the collective vote is a judgment about the most effective political options available to promote the common good (Fung and Wright 2003). As Rodrik highlights (2000), democracy reduces the temptation for expropriatory redistribution and decreases social conflict. Additionally, democracy has a constitutive character because it changes people, reinforcing their innate proclivities to altruism.

In short, this article calls for dispensing with metaphors linked to growth and its institutional projection. Adopting Sen’s perspective, this paper promotes appreciation for the importance of institutions, social values, and inherited customs in the process of development and considers the distribution of wealth a key social aspect to it. The challenge is to construct new institutional “imaginariums” with the aims of defining economic priorities, redistributing wealth, and promoting development through democratic processes.

Conclusions

The principal objective here was to outline the debate raised by Chang's publication and to demonstrate the existence of two institutional approaches to the problem of development. In his article, Chang questions the relationship between institutions and development as proposed by the NIE. He also challenges the NIE approaches to institutional change in developing countries, as well as its indicators of institutional quality and empirical work. Simultaneously, Chang proposes another set of institutions to promote development. The criticism to Chang's position by NIE-affiliated authors has been very forceful and focuses on his undervaluing the role of property rights in the growth dynamic, his disregard for the most recent studies on institutions and development; his misinterpretation of the approaches to institutional change; and on his rejection of methodology with unfounded arguments.

The debate has shown the existence of two institutionalist views on the problem of development: the NIE and the IPE. While the NIE connects to neoclassical economics, the IPE follows the tradition of the "old institutional economics." Both schools' intellectual legacies leads them to confrontation on such matters as the nature of institutions, the role of the state, the historical basis of development, and the relationship between institutional quality and economic performance.

But there has been a shift in the recent orthodox institutional literature toward more pluralistic, interdisciplinary, and IPE-friendly approaches to research, including the incorporation of "old institutionalist tradition." Yet, to date, the two schools remain separated by their distinct concepts of the state and historical interpretation of development. The NIE starts from an egoistic standpoint and does not contemplate the existence of altruistic, public-service proclivities in individuals. On the other hand, the concept of an extortionist state leads the NIE to overlook the importance of social politics in development. The NIE-outlined history of development brings it to propose a western model of institutional development for developing countries, which is not necessarily compatible with these countries' traditions and experiences

Overall, the Chang-generated discussion centers on the independent variables of the equation of development and does not consider development as a dependent variable. In general terms, it is identified with growth. This article highlights the necessity to overcome such identification and to adopt Amartya Sen's concept of development as a process of expanding fundamental liberties. The cornerstone of this model is the public debate on the distribution of collective wealth and on the strategy of development. This approach would entail shunning institutions linked to growth and constructing an institutional schema that encourages public debate and facilitates the collective decisions on development.

Notes

1. In this work the acronym NIE will be used, as well as other qualifiers such as Neo-institutionalism, orthodox institutional literature, dominant or conventional.

2. This polemic can be found in volume 7, issue 4 of the *Journal of Institutional Economics* (2011), encompassing a total of 18 critical responses to Chang's article (2001a) and to his subsequent response to the debate (2011b).

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