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Has Institutionalism Won the Development Debate?

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In his keynote to the IMF-sponsored "Conference on Second Generation Reforms," then-president of the World Bank James Wolfensohn said, "The second generation issues focus around the questions of the structure of the right institutions, of the improvement of the administrative, legal, and regulatory functions of the state, addressing the incentives and actions that are required to have private sector development and to develop the institutional capacity for reforms." His focus on institutions found resonance in the World Development Report, 2002, entitled "Building Institutions for Markets," and reflected Jeffrey Nugent's (1998, 8) calculation that the institutional content of the *Journal of Development Economics* increased from 15 percent to 27 percent after the 1970s, while that in the *Handbook of Development Economics* rose from 7.5 percent to 36 percent from the second to the third volume. This provides evidence that institutionalism has indeed won the development debate and Philip Klein's 1977 statement is again true: "[I]n the field of development economics the victory [of institutionalism] has been so complete that many economists fail to realize it" (785).

Klein was referring to "old" institutionalism, rooted in Veblen, Commons, and Ayres, in which the economy is a system that "embraces a body of knowledge and of skills and a stock of physical equipment; it also embraces a complex network of personal relations reinforced by custom, ritual, sentiment, and dogma" (1977, 789). This is certainly not the institutionalism of the World Bank, which privileges "institutions for markets" and explicitly states that "the recognition of the crucial role of institutions, organizations, and political economy restrictions is not tantamount to a rejection of the neoclassical model" (IBRD 1998, xi). One institution, the market, remains the focus of the international financial institutions such as the World Bank.

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Nonetheless, institutionalism has again become central to development thinking, accompanied by an appreciation of the variety and complexity of institutional evolution. The result is not the "old institutionalism" of Thorstein Veblen and Clarence Ayres or the "new institutionalism" of the early Douglass North. Rather it is a pragmatic combination of the constructs and approaches of the former with the epistemological and methodological advances of the latter, all brought to bear on the many issues of development. The challenges of the development process, and its resistance to reductionism, are the roots of modern institutionalism's contribution to understanding both development and the policies and processes that can guide development initiatives. I will term the current combination the "modern institutionalism of development."

The "New" New Institutional Economics (NNIE)

North (2000, 491) reflects the evolution quite well. While he still holds that "we know the economic and the institutional conditions that make for good economic performance," he no longer reduces that to the expansion of markets. Rather he calls for "a clear understanding of the new institutional economics," development of "a body of political-economic theory," and "a better understanding of the social norms and informal constraints" that affect performance. An "old" institutionalist could rightly suggest that that tradition provides a wealth of literature and methodological insights that should be part of this effort.

North (2005) has attempted to meet his own challenge by developing a comprehensive approach to economic change. In doing so, he discards the neoclassical model and substitutes institutionalist categories: beliefs and culture displace rationality, the imperative for understanding dominates maximization, and path dependence characterizes historical processes rather than an ahistoric continuity. This allows him to develop a set of constructs that he fruitfully applies to a variety of historical experiences, from the Spanish colonization process to the demise of the Soviet Union. His NNIE conclusion is that "[w]hile formal institutions can be changed by fiat, informal institutions evolve in ways that are still far from completely understood and therefore are not typically amenable to deliberate human manipulation" (50). This moves him far beyond the IFI belief in market institutions and commitment to implanting them into all societies under their sway.

Similar evolution is found in two other strains of NNIE. The "historical and comparative institutional analysis" (HCIA) school starts from the premise that there are multiple institutional equilibriums possible and therefore the historical outcome is path dependent. The actual institutions depend on historical conditions and cultural beliefs, and market institutions are only one possibility. Their case studies document many other institutional forms that have developed as societies confront economic issues (Greif 2000).

Finally, the "microfoundations of institutional arrangements" (Bardhan 2000) is based on imperfect or asymmetric information and the institutions that have evolved to deal with this reality. The early work of Joseph Stiglitz and Pranab Bardhan aimed to explain odd institutional arrangements such as share cropping and large inefficient landholdings. More recently it has been used to show that the popular property rights explanations of successful economic development are misleading and that other institutional mechanisms have been widely adopted, often with some success. Thus, once again the simple focus on creating the conditions for free markets to function is marginalized as a sufficient or even necessary condition for development. Much more important are the particular institutions that different societies have developed in the course of their history and the role they play in facilitating development.

The more recent Bardhan (2005) acts as a bridge between the NNIE and modern institutionalism of development (MID). His methodology is quite mainstream, with complex micro-based modeling of a variety of phenomena. On the other hand, his purview is far broader than the mainstream fixation on the market. He examines the interaction of the private sphere, the government, and the community, and he brings acute empirical scrutiny to experiences of collective action, distributive conflicts, accountability, and cooperative action. His rejection of "market primacy," combined with his methodology, make him an important figure in the emergence of a modern institutionalist understanding of many of the central elements in development.

While the NNIE has a different starting point from old institutionalism, it finally arrives at very similar positions: culture and beliefs matter; there are varieties of institutions that can be adopted; there is path dependence in institutional development; full understanding requires a theory of institutional change; and historical case studies are central to developing this understanding. New developments in the old institutionalist framework have converged with the NNIE, and to that we turn.

The "New" Old Institutional Economics (NOIE)

There are three institutionalist currents in development that emanate from old institutionalism rather than NIE. The first is a return to the old roots of institutionalism as a resource for understanding contemporary development and its failures. The *Journal of Economic Issues* is the most common outlet for this work. Several examples can illustrate. John Adams and Hans-Peter Brunner (2003) used Ayres' treatment of technology to examine the failure of a telecommunications project in Nepal and suggested that sensitivity to the ceremonial factors that can lead to resistance could have avoided many of its problems. P. Sai-Wing Ho and Geoffrey Schneider (2002) mobilized Gunnar Myrdal's concepts of backwash/spread effects and cumulative causation to analyze South Africa's path since the end of apartheid and to suggest alternative policies. Finally, Michael Stettler (2002) returned to John R. Commons' treatment of the emergence of rules and order to analyze disorder in the Maasai territory resulting from the implementation of private property rights. These and similar studies often update the analytical framework; however, they suggest that many of the issues faced in development have not changed fundamentally since the origins of old institutionalism. Their approach reasserts the value of OIE, and the novelty is in applying it to issues that other traditions ignore or cannot address.

The second strain in NOIE grows out of the institutionalist critique of mainstream economics, a critique that James Peach (2003, 131) sees as an institution in its own right and that "may contribute to reaching [beyond] the [mainstream's] threshold of resistance to change." Ha-Joon Chang (2003) best exemplifies the new critique. Elements of his position are familiar, namely, highlighting the importance of institutions beyond the market to the functioning of the economy and society. However, his historical treatments of the development of capitalism and his critique of the reigning neoliberal mainstream are clearly directed to the contemporary mainstream, including the NIE. He documents the "unholy alliance" of neoclassical economics' treatment of market failure with the Austrian-Libertarian belief that any intervention must be suppressed. He offers an institutionalist political economy that finds institutions and political decisions at the core of the economy; for example, the market is an institutional and political creation. His critique is buttressed by case studies of institutional evolution in the development process, for example, in South Korea (Chang and Evans 2005) and leads to suggestions for alternative development policies (Chang and Grabel 2004). All of these elements are necessary building blocks for an institutionalism that can begin to pass the mainstream's threshold of resistance, weakened as it is by development failures and the NIE wedge. One other new approach supports the effort.

Geoffrey Hodgson (2004, 2005) provides the final element that may ensure institutionalism's continued dominance in issues of development. He specifies the epistemological basis of a modern institutional program. He returns to the origins of institutionalism and highlights the approach to knowledge that existed at that time. In psychology, it was based in instinct theory. In addition, and especially with Veblen, it was evolutionary. And philosophically, its source was the pragmatism of John Dewey. In the attack on institutionalism that was so effective in the post-war, these were replaced by behaviorism, an ahistorical mechanical model, and logical positivism. Hodgson (2004) makes a strong case that psychology has moved back toward an instinct theory, that an evolutionary perspective and "emergentism" are becoming accepted as better explanations of complex social systems, and that logical positivism is being replaced by pragmatism. Each of these has taken on modern characteristics growing out of methodological and empirical advances in recent decades. Nonetheless, the core psychological and philosophical basis of old institutionalism has returned to prominence in social science. For Hodgson (2005, 95) there are two implications for development. First, the informal nature of institutions shows that their creation cannot be by government decree, and so development requires changes in individual mentalities as well as social relations. Second, for development to occur there must be a combination of spontaneous institutional formation and conscious institutional design. His conclusion is remarkably similar to North's (2005).

The contributions of NNIE and NOIE have provided a basis for the MID, to which I now turn.

Modern Institutionalism of Development

The sheer complexity of the development process lies at the root of the convergence of NNIE and NOIE to MID. Neither of the older traditions succeeded in solving the development challenge. This provides a needed caution to MID, lest its victory be pyrrhic. It must combine the new appreciation of the centrality of institutions in development with the most useful elements of the two institutional economics. What should guide MID as its practitioners engage the perennial issues of development?

- The urge to reductionism should be resisted, accompanied by acceptance of a wide range of possible definitions of development, institutional structures that can characterize a society, and historical processes that may move development ahead.
- The human dimensions to development must always be kept in the forefront, and policies that sacrifice the welfare of some for some future benefit, for example, the increase in inequality necessary to allow markets to function widely, should be resisted. These changes often become institutionalized.
- Efforts to create and foster responsive institutions that build upon participants' understanding and definitions should be encouraged and supported. For example, the creation of indigenous movements and structures in many Latin American countries has the potential to transform the historical development path in countries with large indigenous populations.
- "Local knowledge" should become part of any development process and should take precedence over the imposition of some blueprint for development (Rodrik 2001). For that is more likely to bring about the required combination of institutional development and change in mentality that can encourage development.
- Local, national, and international institutional factors all affect development, and institutional evolution must be congruent at these levels to be successful. When this is not the case, resistance to potentially beneficial changes causes disruption and loss of benefits. An example of incongruence comes from the indigenous mobilization across Latin America to oppose free trade agreements and extension of intellectual property right protections to multinational corporations. An example of congruence is the growth of micro-credit lending, supported by international willingness to subsidize credit to poor persons rather than discounting it based on "market performance criteria."

Conclusion

Institutionalism has won the development debate. However, this does not ensure that successful development will occur in coming decades. This is no surprise for institutionalist development economists who never succumbed to the naïve optimism of the "unholy alliance" of market fundamentalism.

In an article on historians' growing appreciation of the centrality of institutions in Latin American development, John Coatsworth's (2005, 144) description of contemporary Latin America captures this ambiguity well.

> Perhaps the region is witnessing not so much the collapse of the Washington Consensus as the slow-motion disintegration of the political economy that emerged at the end of the nineteenth century. . . . New systems of political and economic power seldom emerge from straight lines on a legible map, so scholars as well as policy makers and economic actors may find it convenient to not only follow developments with a healthy skepticism, but also to raise their tolerance for political, social, and even economic experimentation in coming years.

So the challenge will be to utilize creatively the insights of NNIE—a nascent theory of change, acceptance of the role of history and culture in institutional development, and careful micro analysis of the interaction of the private, government, and community spheres—in combination with those of NOIE—novel uses of the institutionalist tradition, policy development growing out of the critique of market fundamentalism, and firm grounding in contemporary psychology and philosophy. Winning the development debate will indeed be a pyrrhic victory unless MID contributes to improved development performance and to improvements in human welfare.

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