**SECOND INTERNATIONAL GROE WORKSHOP**

**Institutions and Economic Change**

20-21 September 2013 – Hitchin Priory, Hitchin, UK

Abstracts

**Masahiko Aoki** (Stanford University, USA)

"Between the Economy and the Polity: Causation or Correlation. Theory and a Historical Case from China"

A recent widely-read book, *Why Nations Fail*, by D. Acemoglu and J.A. Robinson argues that differences between extractive and inclusive political regimes generate different economic performance. In other words, political institutions are the cause of economic performance, although they admit a modicum of feedback from the latter to the former. Then how are political institutions selected? They argue that there are elements of serendipity. My paper attempts to challenge their view theoretically and with a case study of China. Theoretically, I base my argument on the following three points. First, in societal games of the economy, the polity and social relations, agents base their strategic choices on their beliefs. These are formed relying on linguistic public representations (such as organizations, constitutions, laws, norms, ideologies and so on) as external cognitive resources. However, for those public representations to appear credible, reliable, enforceable, legitimate and reasonable to agents, they must mediate salient features of recursive states of play and individual beliefs of the agents as substantive forms of institutional processes. Second, strategic play of the domains of the economy, the polity and social relations are linked and/or mutually complementary by the mediations of public representations of salient features of ways the games are recursively played and expected to be played. Finally, as stable states of play become failing to sustain themselves through the endogenous developments of economic performance, experimental, potential and/or sub-optimal choices of play become emergent. Corresponding to such situations, varied political programs and public discourses start to compete for saliency of public representations. This takes place in the public domain nested in the above-mentioned domains of societal games. There are feedbacks between the two. Thus institutional change in the sense of change in salient public representations is bound to be path-dependent and correlates (co-evolves) with economic and social progress. In the second part of the paper I illustrate the above arguments by analyzing institutional evolution in China from the time of stable state of the Qing Dynasty (18 century), to its demise (1850-1911) and the transitory period of violent competition for political hegemony (1911-1949), culminating in Mao's revolution. For this, I start with a stylized model of economic organizations in the Qing period (the so-called Malthusian stage) and discuss what kinds of political institution and social norm strategically complemented them. Then I go on to discuss why and how the Qing political state finally failed to sustain itself, yet how it left its legacies in subsequent state-building.

**Francesca Gagliardi** (University of Hertfordshire, UK)

"A Bibliometric Analysis of the Literature on Institutional Complementarities"

The notion of institutional complementarities (ICs) is mobilized in the explanation of persistently different institutional arrangements, both across and within socio-economic systems. In essence, ICs imply that the institutions that become established at various levels of a system, and their relative performance, are context dependent rather than being invariably conditioned by strict efficiency considerations. This undermines the idea of an optimal configuration towards which all socio-economic systems should converge, emphasizing that adjustment processes are to a large extent constrained by history and the structures inherited from the past. In a 2005 article published in the *Evolutionary and Institutional Economics Review*, Robert Boyer called for a paper surveying the available research on ICs, in order to clarify the nature of the mechanisms involved. In the absence of such a survey, he argued, one may fear that the concept of ICs may degenerate into a buzz word and a misleading fad. To fill this gap and advance our understanding of ICs, this paper provides a bibliometric analysis of the literature available on the topic. The aim is to get a sense of how research themes and methodologies have evolved over time in order not only to generate useful insights on the state of the art but also identify trajectories that future studies should explore.

**Geoff Hodgson** (University of Hertfordshire, UK)

"Legal Institutionalism: Capitalism and the Constitutive Role of Law"

(with Simon Deakin, David Gindis, Kainan Huang, and Katharina Pistor)

Social scientists have paid insufficient attention to the role of law in constituting the economic institutions of capitalism. Part of this neglect emanates from inadequate conceptions of the nature of law itself. Spontaneous conceptions of law and property rights that downplay the role of the state are criticized here, because they typically assume relatively small numbers of agents and underplay the complexity and uncertainty in developed capitalist systems. In developed capitalist economies, law is sustained through interaction between private agents, courts and the legislative apparatus. Law is also a key institution for overcoming contracting uncertainties. It is furthermore a constitutive part of the power structure, and a major means by which power is exercised. This argument is illustrated by considering institutions such as property and the firm. Complex systems of law have played a crucial role in capitalist development and are also vital for developing economies.

**Jack Knight** (Duke University, USA)

"Courts and Institutional Change"

A common claim in the literature on economic development is that the rule of law is a necessary element of the institutional foundation of economic growth. There are similar claims about the value of the rule of law for the development of other social goods like good governance and stable social order. Implicit in all of these accounts is the assumption that the rule of law has a positive effect on the types of institutional change that would be necessary to facilitate greater economic growth and more effective governance. But in most of these accounts the role of judges and courts, the central institutional component of the rule of law, remains underspecified and under investigated. In this paper I will focus on the role of judges in processes of institutional maintenance and change. In doing so I hope to identify the mechanisms by which courts may facilitate and/or hinder institutional change and thus to offer a more realistic and complete account of the relationship between the rule of law and social goods like economic growth and good government.

**Sue Konzelmann** (Birkbeck, University of London, UK)

"'Picking winners' in a Liberal Market Economy: Modern Day Heresy – or Essential Strategy for Competitive Success?"

(with Marc Fovargue-Davies)

This paper explores the current debate about industrial strategy and the UK's hesitant acceptance of a possible role for the state in addressing the challenges confronting British industry in the wake of the 2007/8 financial crisis. In this context – and following the 2012 London Summer Games – political leaders have been pointing to the strategy that succeeded in reversing the British Olympic team's fortunes following its nadir at the 1996 Atlanta Summer Games; and they are suggesting that there may be lessons for industry. However, the political rhetoric has yet to be translated into action. Analysis of the elite sport strategy, in the light of the evolving literature on industrial strategy and policy suggests that although there are details that are specific to sport, there are also aspects of the general strategic approach that can be used to inform the design and implementation of a strategy aimed at developing and improving the international competitive performance of UK industrial sectors and manufacturers. The significance of the UK elite sport strategy is that it was evolved and successfully implemented in the British social, political and economic context, building on and improving existing institutional capabilities.

**Ugo Pagano** (University of Siena, Italy)

"Synergy, Conflict and Institutional Complementarities"

In biology the evolution of species is influenced by two types of complementarities. One type is mostly related to the synergies among and within organisms while the other is the outcome of the conflicts among different species and among members of the same species. In both conflictual and synergetic complementarities, the traits selected in one domain affect the traits selected in the other domain and both complementarities involve the co-evolution of some traits. However synergies and conflicts involve different mechanisms and interact with each other generating complex dynamics. Social and economic systems are characterized by a similar range of interacting complementarities.

Whereas technology and property rights tend to have synergistic complementarities, workers' and capitalist organizations are mostly characterized by conflictual complementarities. The evolution of the different varieties of capitalism, as well as of different patterns of technological specialization across countries, can be better understood in terms of both typologies of complementarities and by their interactions. The comparative history of the American and the German economies is used to illustrate how models of capitalism can diverge, building over time different types of institutional complementarity.

**Richard Langlois** (University of Connecticut, USA)

"The Institutional Approach to Economic History: Connecting the Two Strands"

In recent years the economics of institutions has arguably taken center stage in economic history. What has been less well noted, however, is that economic historians have tended to practice their institutional economics in two seemingly quite different ways. As an illustration of this, consider two recent books about institutions that the economic historian Maxine Berg (2012) saw fit to profile in the same brief review in the *Times Literary Supplement*: *Why Nations Fail* by Daron Acemoglu and James Robinson (2012) and *The Institutional Revolution* by Douglas Allen (2011). "These two books raise the same question," says Berg: "why are some countries so rich, and others so poor? The answer, according to both, lies in understanding not just capital, technology and property rights, but the institutions designed to maximize wealth and the costs of establishing and maintaining them" (Berg 2012, p. 28). Berg traces the institutional approach from Coase through figures like North, Greif, and Ostrom, and, in the case of *Why Nations Fail*, connects it to the larger literature on the "great divergence" in economic history (Diamond 1997; Landes 1998; Pomeranz 2001). Although terse, this characterization does trace the outlines of the institutional approach to economic history. In my view, however, Berg misses an important point in lumping these two books together as representative of the institutional approach. I would argue that these books represent two characteristic – but two very different – ways in which the economics of institutions has manifested itself in economic history.

*Why Nations Fail* is indeed a contribution to the debate about the great divergence: why are some nations so rich and others so poor? The Holy Grail – or maybe the MacGuffin – of this otherwise complex and nuanced debate is the predominant causal factor of economic growth. Why did the countries of northwestern Europe enjoy sustained intensive economic growth much earlier and to a much greater extent than other parts of the world? Was it because of geography and climate? Relative prices and factor abundances? Culture and ideas? Or, as economists from North to Acemoglu and Robinson have increasingly wondered, is it that northwestern Europe somehow adopted earlier than other regions certain kinds of *institutions* that proved conducive to sustained intensive economic growth?

But *The Institutional Revolution* is a different animal entirely. Despite the word "revolution" in its title, and despite the occasional weak nod in the direction of economic growth, this work is representative of a quite different, and arguably far more typical, application of the economics of institutions to economic history. In this version of the economics of institutions, which I will want to associate with the so-called New Institutional Economics (NIE) in its narrowest sense, one observes a (perhaps puzzling) matrix of institutions in history and asks: what problem were these institutions solving? Rather than labeling puzzling behaviors as ignorant and inefficient (as historians once tended to do) or exclusively as mechanisms for oppressing the lower classes (as many still tend to do), the NIE attempts to explain such puzzles as responses to the costs, constraints, and scarcities the economic actors faced. This is the method of comparative-institutional analysis, inspired by Coase (1937, 1960), pioneered by Demsetz (1969), and championed by Williamson (1991). Rather than comparing actual (maybe puzzling) behavior against some imaginary frictionless standard, the NIE insists on comparing plausible institutional systems in real-world contexts rich in transaction (and other) costs. Explanation here consists in arguing that, and in detailing precisely how, the institutional system we observe is actually confronting some specified economic problem better than alternative candidates would have done. The hard part – the creative part – lies in discovering or imagining the right economic problem. What economic problem were they solving?

Some critics would immediately pounce on this characterization, seeing it not as the essence of good practice but as an example of all that is wrong with the NIE. By imagining alternative economic problems that observed institutions might be solving, these critics would say, one is creating a set of "just-so" stories: accounts that are sufficient but not necessary, that fit the facts but may not be the best, let alone the only, plausible story. The appropriate retort, I believe, is that good comparative-institutional analysis requires constant critical argument and analysis. One of the lessons of the philosophy of science, it seems to me, is that it is impossible to rule out theories on abstract methodological grounds. What defeats a weak theory is another, stronger theory. Comparative-institutional analysis depends and thrives on criticism and revision. Without criticism and revision, the "which problem?" approach would indeed be a slightly less fanciful version of Kipling. But *with* criticism and revision, including criticism from empirical evidence of various kinds, the "which problem?" approach is essentially what evolutionary biologists do. I will mention below a couple of cases in which, I believe, the process of criticism and revision has refined, modified, and enriched institutional explanations that began (among economists) with a conjectured just-so story.

At the same time, I have long argued that it is important to place any just-so story in its proper temporal or historical context: to pay attention to how institutions change, not just to how they solve a static snapshot of an allocation problem (Langlois 1986). From a methodological point of view, one wants to engage institutional change because change helps focus us on the nature of the selection problem that inevitably sits behind every institutional problem. In asking the "which problem?" question, we really also need to ask: "why did this institutional solution come to be and why does it persist?" At the broadest level, of course, the answer to the existence and persistence question is ultimately some kind of mechanism of variation, selection, and retention, even though conscious intention and design play a role in economic life that they do not have in Darwinian biology. At a finer level of detail, however, any explanation of specific institutional changes must take off from the initial conditions of some appropriate static "which problem?" conjecture. Institutional change in specific historical settings is about economic agents adapting to exogenous and endogenous changes in the economic problem they are confronting. Applying concepts like efficiency and optimality is no more appropriate here than it would be in assessing the "function" or adaptive properties of a relatively stable or static institutional system. But that doesn't mean that basic economic concepts like relative scarcities aren't essential to explaining the why and how of specific institutional changes. One goal of this paper is to argue in favor of one approach to bringing economic principles to bear on the phenomenon of institutional change – an approach I will call the good-old New Institutional Economics.

Notice also that an account of institutional change connects the two strands of institutionalism: it connects the "which problem?" question with the sources of economic growth. By identifying how the economic problems themselves change, we have some hope of talking about how resources might – sometimes – be channeled into increasingly more productive uses. That is to say, some hope of understanding the factors that are important for economic growth.

*References.*


Acemoglu, Daron and James A. Robinson. 2012. *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. New York: Random House.

Allen, Douglas W. 2011. *The Institutional Revolution*. Chicago: University of Chicago Press.

Berg, Maxine. 2012. Sink or Swim. *The Times Literary Supplement*. London: 28.

Coase, Ronald H. 1937. "The Nature of the Firm," *Economica* (N.S.) 4: 386-405.

Coase, Ronald H. 1960. "The Problem of Social Cost," *Journal of Law and Economics* 3: 1-44.

Demsetz, Harold. 1969. "Information and Efficiency: Another Viewpoint," *Journal of Law and Economics* 12(1): 1-22.

Diamond, Jared. 1997. *Guns, Germs, and Steel: The Fates of Human Societies*. New York: W. W. Norton.

Landes, David S. 1998. *The Wealth and Poverty of Nations: Why Some Are So Rich and Some So Poor*. New York: W. W. Norton.

Langlois, Richard N. 2013. "*The Institutional Revolution*: A Review Essay," University of Connecticut Working Paper 2013-11.

Pomeranz, Kenneth. 2001. *The Great Divergence: China, Europe, and the Making of the Modern World Economy*. Princeton: Princeton University Press.

Williamson, Oliver E. 1991. "Comparative Economic Organization: The Analysis of Discrete Structural Alternatives," *Administrative Science Quarterly* 36(2): 269-296.