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Development, institutions and class

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Abstract: Ha-Joon Chang effectively criticizes the mainstream approach to the institutions of development, on theoretical, empirical and historical grounds. He also creates an opening for a different kind of discussion about institutions and development, between heterodox institutional and Marxian economics. But he overlooks the opportunity to analyze the relationship between class and the institutions of development.

1. Introduction

This is not a particularly propitious time for the New Institutionalist Economics of development.

In January 2011, as I compose this commentary on Ha-Joon Chang's article, 'Institutions and Economic Development: Theory, Policy and History' (Chang, 2011), the institutions that are supposed to serve as the 'gold standard' for development in the Global South are widely recognized to have failed. We are now more than three years from the initial outbreak of the financial crisis and, around the globe, in the midst of the most severe crisis of capitalism since the Great Depression, hundreds of millions of workers are unemployed – with no relief in sight.

In the USA, the epicenter of the crisis, all of the leading indicators of development – unemployment, poverty, food insecurity, fiscal imbalances, the unequal distribution of income and wealth, and so forth – remain at or near record levels. And, again, there are only empty promises of improvement in the near future.

That is a real problem for the New Institutional Economics of development. Its two key premises are that 'institutions matter' and that the absence of the kind of institutions that characterize the USA and other developed nations – formal legal rules and informal social norms that promote and protect private property and free markets – explain underdevelopment in the rest of the world. The goal, therefore, is to theoretically and empirically identify the institutions that promote development and, in terms of policy, to encourage their creation elsewhere.

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The fact is, the same institutions that, according to the New Institutional Economics, are supposed to unlock the development potential of poor and middle-income nations are currently in disarray. They are responsible for creating the conditions for the global financial crisis that broke out in 2007 and, thus far, they have not been able to provide an effective solution to the crisis. Because of those institutions, we remain mired in the Second Great Depression.

In my view, what Chang accomplishes in his important article is to explain, in theory, the failure we have witnessed in practice. He also creates an opening for a different kind of discussion about institutions and development, between his own heterodox approach to institutional economics and Marxian theory.

2. Problems with the orthodox approach

The orthodox approach to institutions in relation to economic development is predicated on the idea that successful economic growth needs to be governed by the appropriate institutions. The approach represents both a break from and an extension of neoclassical economic theory. It breaks from standard neoclassical economics in the sense that, under the non-neoclassical assumptions of incomplete information and limited mental capacity, transactions are found to be both costly and uncertain. Therefore, markets need to be governed by formal rules, informal norms and conventions, and enforcement mechanisms. In short, institutions matter. One way of interpreting the orthodox approach, then, is that it serves to look inside and subject to economic analysis the various dimensions of the social context – firms, the state, culture, and so on – that are considered to be black boxes within the standard, textbook version of neoclassical theory.

But the orthodox institutionalists' break from neoclassical theory is only partial and incomplete. In many ways, what they have done is to refine and extend standard neoclassical economics. The starting point of analysis remains the essential human nature of preferences, technology and endowments. From there, they derive the various dimensions of what they consider to be the economic problem: scarcity, competition, individual choice under constraint, the definition of development as the accumulation of useful things, and the superiority of market exchange.

Like the standard neoclassical economists before them, orthodox institutionalists presume the existence of the basic units of capitalism – private property and free markets – as natural phenomena. What they add is that those units require an appropriate institutional environment to operate properly, in order to achieve economic growth.

A similar combination of break from and extension of neoclassical economics can be found in the orthodox approach to the institutions of economic development. To the usual neoclassical, Washington Consensus prescription of freeing-up markets and protecting private property, orthodox institutionalists suggest that due attention be paid to the way that markets and property rights are governed by the state and other institutions. In other words, to paraphrase the terms of debate within feminist economics, 'add institutions and stir'.

Chang regards this neo-neoclassical approach to institutions and development as the now-dominant paradigm within the World Bank, the International Monetary Fund and 'many other think-tanks and policy forums that are dominated by the rich countries' (Chang, 2011: 2). He hastens to add, quite correctly in my view, that the same institutions, which 'inherently favour the rich over the poor, capital over labour, and finance capital over industrial capital' (Ibid.: 3), are also demanded by ruling groups within developing countries.

In the remainder of his article, Chang challenges – on theoretical, empirical and historical grounds – the academic research that serves as the intellectual foundation for the new institutional development paradigm. Theoretically, orthodox institutionalists argue that institutions determine the pattern and pace of economic development. What they overlook, in Chang's view, is the reverse causality (that institutions themselves are at least partly determined by the form and level of economic development), the impossibility of objectively defining free markets (since such definitions depend on diverse and divergent political and ethical conceptions of freedom), and the complexity of the effects of institutions on economic development (that 'the relationship is not linear, differs across societies, and changes over time even in the same society'; Ibid.: 9).

Chang also criticizes the empirical work that serves as the basis of the conclusions of new institutionalists, arguing 'the evidence is a lot shakier than what the supporters of the dominant view want us to believe' (Ibid.: 11). As it turns out, the problem is a familiar one in development economics: the studies mostly consist of cross-section econometric estimations, not time-series analyses of individual country experiences, which might then be (carefully) generalized. In Chang's view, the problems inherent in cross-sectional studies are exacerbated with reference to the institutions of development in that measurement errors (whether introduced by political biases or conflating outcomes with institutions) increase the likelihood of heterogeneity in the sample.

Finally, Chang raises questions about the extent to which institutions can be easily changed. The orthodox institutionalists presume that, once they have identified the failure of existing institutions and the need for institutional reform, the appropriate development strategy is to create new institutions. He refers to this as voluntarism – as opposed to the fatalism of those who regard existing institutions as more or less immutable, given the effects of climate and cultural inheritance. Chang rejects both types of 'corner solutions' (Ibid.: 17). In his view, the orthodox institutionalists overlook or underestimate the effects of path-dependence (the idea that countries have different criteria, such as rationality, efficiency, and justice, for choosing particular institutions), the stability of existing institutions ('institutions are *meant* to be stable'; Ibid.: 18) as well as the costs associated with changing them (especially the costs of establishing and running new institutions), and the complementarities among institutions (in the sense that the beneficial effects of one institution depend on the existence of other institutions).

Still, Chang argues, institutional change *is* possible, for two reasons. First, social contexts are contradictory, and thus are constituted by battles over how to interpret their 'traditions'. Second, the interests of those individuals and groups struggling to maintain or change the existing institutions cannot be reduced to their 'objective' economic interests; instead, 'ideas, and institutions that embody them, influence how people perceive their interests' (Ibid.: 21). Chang's view is that economists need to recognize both structural constraints and real human agencies – and to relinquish the idea that there is single set of '"liberalized" institutions that provide maximum business freedom and strongest protection of private property rights' (Ibid.: 22) as the best way of promoting economic development.

3. Toward a new dialogue about institutions

Chang's critique calls into question orthodox approaches to institutional economics. It also creates openings for a new dialogue about institutions, between heterodox institutional and Marxist economists; and not just any version of Marxian theory but the approach that has come to be known as anti-essentialist or postmodern Marxism. Let me explain.

Many of the elements of Chang's critique of and alternative to the orthodox approach to institutions are echoed within the school of postmodern Marxism that has been developed over the course of the past 30 years or so at the University of Massachusetts Amherst and in the journal *Rethinking Marxism*.[1] These elements include the following: an emphasis on mutual determination (e.g., between development and institutions), a questioning of the naturalness of free markets (since it is impossible to define them objectively), a concern with the interplay between ideas and interests (which calls into question the notion of 'objective' interests), and a focus on the totality of institutional effects (in that the role of one institution depends on the existence of others).

These same issues have not only been central to the articulation of the postmodern interpretation of Marxian theory. They have been prominent in the existing dialogue between institutionalists and Marxists. One example is the symposium that was edited by George DeMartino and published in the December 1999 issue of the *Journal of Economic Issues*. It includes an introduction by DeMartino (1999) and essays by Stephen Cullenberg (1999), Robert J. Garnett, Jr. (1999) and William Waller (1999). What emerges from the exchange, as

1 I should explain that I received my doctorate in economics from the University of Massachusetts Amherst (working with Stephen Resnick and Richard Wolff, two of the pioneers of what later came to be called postmodern Marxism) and served as the editor of *Rethinking Marxism* from 1997 to 2009. I recount my own history with the group in chapter 1 of *Development and Globalization: A Marxian Class Analysis* (Ruccio, 2010).

DeMartino (1999: 800) makes clear, is a kind of Marxism that has strong affinities to institutionalism, since it is marked by an ontology that is anti-reductionist; a normative code that is radically egalitarian but pluralist; and an epistemology and methodology that are consequentialist and, in a word, institutionalist.

In my view, there are significant overlaps between such an interpretation of Marxian theory and the orientation that guides Chang's heterodox analysis of institutions.

A more recent contribution to the institutionalist–Marxian dialogue consists of Richard P. McIntyre's book, *Are Worker Rights Human Rights?* (2008), in which he seeks to draw insights from both institutionalist and Marxian traditions to make sense of how worker rights have been conceived and contested historically and need to be rearticulated today as collective rights. Similarly, in the symposium on McIntyre's book published in the October 2010 issue of *Rethinking Marxism*, Theodore Burczak (2010), George DeMartino (2010), Kenan Erçel (2010) and McIntyre (2010) demonstrate that elements of both traditions – especially the notions of convention and class – can be effectively utilized to analyze and reinvigorate the role of worker rights within contemporary globalization.

These two examples indicate that a rich dialogue between institutionalism and Marxism is already taking place. But significant differences remain. From a Marxian perspective, Chang and other heterodox institutionalists continue to overlook the significant role of class in relation to the institutions of development. In my view, three specific dimensions of class can be particularly useful for developing an alternative to the orthodox approach. First, existing institutions within developing countries often serve to initially create and, over time, to reproduce relations of capitalist exploitation. They constitute the legal rules and informal social norms whereby capitalists have the right to appropriate the surplus-value created by the direct producers.[2] Second, much of the surplus generated in and through those relations of exploitation is utilized to strengthen the institutions that make that exploitation possible. The surplus, once appropriated, is then distributed in an attempt to secure the institutional conditions whereby the surplus continues to be performed by one group and appropriated by another. And third, it is possible to imagine and to create alternative institutions that are both predicated on and which serve to strengthen non-exploitative forms of economic and social development. What I am referring

2 These include not only the 'gold standard' institutions advocated by mainstream institutional economists, but institutions that move in the opposite direction, in the sense that they lead to regulated markets and the protection of non-private (e.g., state) property. Thus, we can refer to various types of capitalist development. Other institutions, of course, condition the existence of forms of non-capitalist exploitation.

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to are rules and norms that make it possible for the direct producers themselves to appropriate and distribute the surplus they create.[3]

Chang has convincingly argued that institutions are too politically important to be left to those who remain confined within the 'simplistic and extremist' (Chang, 2011: 23) arguments of the orthodox framework. In addition, the real-world experiences of recent years have demonstrated that leaving class out of the discussion makes us less capable both of understanding the institutions that led to the current crises and of devising an alternative set of institutions.

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3 I discuss all three dimensions of class in detail, especially with reference to Latin American development, in Ruccio (2010).