

Institutions and development: generalizations that endanger progress

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Abstract: This article draws on several of the major breakthroughs in the institutions and development field to demonstrate that criticisms of work in this field as a whole based on its allegedly universal and unquestioning support for liberalizing institutions and the simplistic rationale and deficient empirical methods that have been used to buttress that support are outdated, inappropriate and misleading.

1. Introduction

There are few relationships in economics that are as complex and difficult to properly sort out and understand as those between institutions and development (I&D). Among the methodological difficulties are (1) that institutions are multi-layered, each with a multiplicity of different rules, and often slow to change (thereby making both their determinants and effects difficult to distinguish from those of the many other factors that change over time) and (2) that their appropriateness for development may well vary with the level of development and many other social and environmental conditions. Many of the same kinds of difficulties, moreover, arise with respect to development because of its multi-dimensionality, trade-offs between its various dimensions, and the quite different constraints (institutions, resources or adverse shocks) operating at different times. Although widely appreciated, these difficulties are sufficiently important that it is perfectly appropriate for Ha-Joon Chang (2011) to repeat them, explaining why ‘one size fits all’ policy or institutional prescriptions are unlikely to succeed.

Yet, by no means, does this justify Chang’s vastly exaggerated claims that the I&D literature as a whole is unaware of these problems and as a result consistently commits the following errors: that (a) liberalization reforms are always desirable regardless of country, level of development or other circumstances, (b) its rationale for the positive effects on development of institutions such as property rights and market liberalization is monolithic and simplistic, (c) the supporting empirical evidence is inadequate since it is based on international cross-section analysis, (d) institutions are unrealistically assumed

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to be either costless or impossible to change, and (e) causality is unrealistically entirely one-way, from institutions to development.

The purpose of this article is not to deny that in its infancy some individual studies suffered from one or another of these shortcomings. Rather, it is to show that, in making these excessively general claims, Chang (2011) has grossly overlooked a large part of what is being done in I&D. In fact, in recent years, I&D analysts have been doing much to enrich their theories, deal with reverse causation and endogeneity problems, and make use of better data and more advanced methods. I take each of Chang's claims (a)–(e) in the previous paragraph in turn, in each case identifying ways in which I&D contributors are overcoming these problems. While because of space limitations only a few of the many possible examples are cited, continuing advances in many of these areas fully justify the very considerable space that many leading journals including the *Journal of Institutional Economics* are devoting to them.

2. Analysis of the claims

(a) *Naive advocacy of liberalization reforms*

It may be true that some important multilateral donor organizations are sometimes overly zealous in advocating some Washington consensus-type reforms and overly powerful in pushing their adoption by developing countries as a result of their financial power and their large research staffs. But, there are other large and powerful international organizations that are often critical of such reforms. Moreover, more careful investigations of the writings of any single such agency is likely to reveal a more nuanced picture. For example, while their annual reports often cover a single theme on which they may make several general policy proposals, the same reports frequently contain special 'boxes' citing implementation problems encountered or alternative reforms introduced in certain circumstances. In any case, beyond the confines of international agencies but still within I&D, there is no dearth of alternative institutional reform proposals.

(b) *Overly simplistic rationale for such reforms*

Contrary to assertion (b), I&D analysts are quick to admit the complexities of the issues and the hazards of generalization. For example, in the case of *intellectual* property rights it is widely admitted that the usefulness of such rights will depend heavily on considerations such as the level of development, the ability of its citizens and firms to undertake research and development, the sector composition of output, and the legal system's ability to enforce such rights (Allred and Park, 2007). Even in the case of *land* rights, I&D contributors have long pointed out complexities, such as the need to distinguish between (1) common property rights and open access (recognizing that for some activities and some environments common property rights may be more suitable than

individual private property rights; Ostrom, 1990; Nugent and Sanchez, 1993), and (2) the many different dimensions of land rights, e.g., rights to use, to sell, to rent, to inherit and bequeath and their scope of application (e.g., to land itself, to the air space above ground or the mineral rights below it; de Janvry *et al.*, 2001). Political constraints on standard property rights reforms are also widely recognized (e.g., when a tribal chief opposes private property rights because this would imply the loss of his power to zone or allocate, which in some cases can be justified on efficiency grounds). Moreover, I&D analysts have identified important instances, such as when these rights are highly concentrated in the hands of a few large politically powerful landowners, where private land ownership can be disadvantageous, leading to the undersupply of important public goods (Galor *et al.*, 2009).

(c) Excessive reliance on cross-section evidence

While much of the early evidence used to support one side or another of debates on property rights and liberalizing reforms was based on international cross-section evidence, this was the natural result of the only recent development of comprehensive institutional indicators based on contemporary surveys. Yet, with time, increasingly panel datasets have been constructed allowing panel data techniques to be employed, thereby mitigating endogeneity and omitted variable biases and allowing for tests of structural breaks and sample heterogeneity.

Even more importantly, I&D studies have been making extensive use of micro-level data and quasi-experimental methods that help relax many of the simplifying assumptions that Chang criticized. For example, the revolutionary change in China's property rights in land from collective ownership to quasi-individual ownership known as the Household Responsibility System was the result of its experimental use in one particular district of one province in 1978 which, when successful, led to demands for its use all over the country (Lin and Nugent, 1995). Other examples arise from the use of detailed surveys of individual farmers to identify their perceptions of the strength and scope of the various different land rights. Indeed, Tim Besley (1995) constructed quantitative measures of the security of these perceived rights for Ghana and showed them (1) to vary across villages, land type, even fields in a particular village and (2) to have different effects on farm investments depending on many factors. Erica Field (2007) used a somewhat similar approach to show how varying perceptions of the security of land rights in Peruvian cities affected the extra-household labor supply in a somewhat more experimental setting. This kind of work has become quite standard and allows difficult selection issues to be treated.

While much of this work takes advantage of modern statistical and econometric techniques, contrary to Chang, appropriate case studies are much in use in I&D analysis. See, e.g., Platteau and Seki (2001), who explain why

fishermen in Japan's Toyoma Bay choose to fish cooperatively with full sharing of all costs and revenues in an otherwise rather capitalistic society, Nugent and Robinson (2010) who compare two countries in which coffee is produced almost entirely on large plantations with two others where coffee production is produced on smallholder farms and trace the consequences of these differences for institutional change, human capital and economic growth trajectories. For additional case studies applying a wide variety of institutional approaches to a wide variety of development issues, see Nabli and Nugent (1989).

(d) Ignorance and naiveté concerning the ability to change institutions

While early I&D studies focused on the effects of institutional changes, usually taking the latter as given, this was quite reasonable in view of the recognized costs of changing institutions. Only after determining which institutional changes matter and exert positive effects on development does it pay to investigate in detail the determinants of such changes. Nevertheless, especially for those institutional changes with demonstrated positive effects, very considerable efforts have been given to identifying and testing for the relative importance of a wide variety of determinants of these institutional/policy changes. Some of the factors affecting the likelihood of such institutional changes include pressures from donor agencies, large neighbors or trade partners, complementary institutions (which make for path dependence in institutions), and economic or political crises (Campos *et al.*, 2010). To explain reform efforts and to distinguish sustainable from unsustainable reforms, economists, sociologists and political scientists have made innovative use of such diverse methods as collective action theory, applied game theoretic approaches to coalition formation, and club theory. Virtually all these approaches recognize that institutional change is far from costless, and sometimes feasible only in rather special circumstances.

(e) Failure to examine the determinants of institutional change and reverse causality

Naturally, once I&D studies began to examine systematic differences in the effects of institutions or institutional changes from one level of development (or even from one village to another) as in (b) above, and the determinants of institutions as in (d) above, it was easy to see that the causality could in principle be two-way or even one-way from development to institutions. In the case of property rights the importance of reverse causation has long been recognized in that it would only pay to develop property rights in a certain kind of asset when that asset had become sufficiently scarce and potentially valuable as to outweigh the costs of establishing a system of property rights and legal systems capable of enforcing such rights, conditions that are more likely to be fulfilled in higher-income countries.

3. Conclusion

While it is easy to agree with Chang's plea 'that institutional economists need to pay more attention to the real world, both of the present and historical' (Chang, 2011: 22), let us hope that present and future researchers will not be deterred from continuing the impressive progress that is already being made by his excessive and inappropriate generalizations that I&D analysts are incapable of overcoming the methodological challenges that they face.

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