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THE POLITICAL ECONOMY OF DEVELOPMENT: THE ROLE OF INSTITUTIONS

Kenneth Jameson

Dr. Javier Iguíñiz's first book was entitled *Desde la crisis económica peruana: estrategia de desarrollo y política económica* (1981). His most recent book is *Desigualdad distributiva en el Perú: dimensiones* (León & Iguíñiz, 2011). His work between these two bookmarks has treated a variety of development topics, but always with the human and social dimensions in the forefront. Poverty, equity, social inclusion, and human development are not the result of some invisible hand, but are human creations and can and should be addressed directly.

In the Anglo-Saxon development world, these issues have been debated in terms of the relation between institutions and development. One school conflated market institutions and development. Their opponents claim that a variety of institutional structures can facilitate development, and those institutions should grow out of specific historical and cultural experiences.

This article will chronicle the debate and make some suggestions that could move the debate toward a resolution. Since I have played a small role in the debate, I will focus on my own perspectives and their evolution as a window into it. Suffice it to say that my own stance parallels Javier Iguíñiz's in claiming that any institutional structure will contribute to development only if it forefronts the human dimensions of development. In addition, not only are we able to create the appropriate institutions, the goal of development economists must be to contribute to this process.

This article provides me with an opportunity to review the evolution of the current debate on the role of institutions in development, relying mainly on several articles that I have written[1]. Latin America has played a central role in framing this debate, almost as the laboratory where the theories are tried out. This was most tangibly the case with the Chilean free market reforms of 1975, so I start there and then trace the debate's evolution, focusing first on my own treatment of the issue in several articles. I then turn to the debate around a recent article by Ha-Joon Chang (Chang, 2011a) that I participated in.

My own view prior to the Chang debate was that development economists had moved toward a general consensus on the role of institutions in development that had several main components:

- Institutions play a central role in the success of any development effort.
- There is no one institution or group of institutions that will facilitate development in all contexts; the challenge is to find the set of institutions appropriate for a given economic, cultural and historical situation.
- A variety of institutions can help achieve success and the key is a political process that responds to a given reality in a creative and positive fashion.
- Democracy is the best guarantor that institutions will adapt and take into account the key elements of the development process.

[1] In the interest of conciseness, most of my citations will be to my own articles, even if the occasional quote is from another author who was quoted in my earlier article.

The reaction to Chang's article contained in a special issue of *The Journal of Institutional Economics* (2011a) indicated that my assumed consensus does not exist. Most notably, the rancor that characterized the negative responses to Chang suggests the need for a reassessment and revision of the issues involved.

A recent article by López and García-Quero (2013) was a first attempt to find the common ground. I will summarize that effort. I will suggest that perhaps a different approach, melding institutionalism with post-Keynesian analysis, could be more successful in reaching toward a consensus in this area. This will comprise the last section of the article, along with my encouragement to Javier Iguíñiz and his collaborators to take up this task.

So let us begin with the Latin American experience that recast the debate: the triumph of free market ideology in Pinochet's Chile, along with its forcible imposition of free market institutions[2].

Development equals free market liberalization

The current story begins with the military dictatorships that ruled most of Latin America starting in the 1960s and extending in some countries to the 1990s. Political instability and a cold war fear of Communism were the main justifications for the coups that replaced civilian governments, though the promise of improved economic performance gave a somewhat broader base of support from a population whose economic status had suffered from the political strife. The actual economic policies of the dictatorships varied across countries, as I described in Jameson (1984). In general they adopted a policy package based on liberalization, i.e. removing market distortions

[2] The death of Margaret Thatcher recalled her role in using the electoral process to impose free market policies on Britain, and her use of the Chilean experience to garner credibility for her policies.

such as subsidies, tariffs, foreign investment restrictions, along with short run stabilization/austerity to lower rates of inflation. The results of the policy package were high rates of unemployment, significant deterioration in the standard of living of most of the population, and decimation of domestic production structures. This was seen as the price to be paid for long run growth and stability. As I noted, they promised what Alejo Carpentier would have described as a «chronicle of the marvelous in the real» (1984, p. 248).

Unfortunately the real was less than marvelous with inflation remaining high, unemployment quite resistant to market reallocation, balance of payments pressures continuing and becoming greater in many countries, and growth anything but stable. I noted (p. 254) that already in the most pure of the free market regimes, Chile, «the entire cabinet resigned in April 1982, and nationalist military officers took direct charge of economic policy from the hands of the civilian "Chicago Boys"». This was in the midst of what became known as «the lost decade» in Latin America.

For purposes of this paper, two elements of the experience should be noted. First, market relations were imposed on the society by the military; they did not grow organically. Thus market economics' failure to improve economic performance was not allowed to reverse the liberalization process. It provided the basis for an argument that the absence of supportive «institutions» was why liberalization's promise was not realized. Secondly, there was no meaningful political process that guided policy; after all they were military dictatorships, oftentimes quite brutal in their willingness to silence critics. I suggested that this was one of their main failures. However, but with some prescience, I saw a positive possibility in this. «Milton Friedman's dictum on the relation of political and economic freedom could be turned on its head: in the Southern Cone, only when the market (economic freedom) has failed is there the possibility of political freedom» (p. 256).

How can we account for the radical turn to a market based understanding of development? To understand this resurgence, we need a short treatment of how economic development theory and policy came to be understood after WWII.

Filling a vacuum: market = development

This market experiment in Latin America occurred at a time when development economics had lost much of its dynamism, along with its sense of purpose and a convincing rendition of the development process. Jameson used the construct of the «double helix» to describe the link of institutionalism and development, suggesting that at points there are strong links of the two strains, while at other points there is almost no relation. The links had been strong in Adam Smith, and in modern times they were quite strong after WWII. Postwar development economists were influenced by efforts to reduce the gap of Western and Eastern Europe by fostering investment, industrialization, and transformation of agriculture. Many of these development economists such as Paul Rosenstein-Rodan, Albert Hirschman, and Gunnar Myrdal had been raised in the neo-classical tradition, but had found it inadequate to confront these development challenges. So, as Rosenstein-Rodan put it: «an institutional framework different from the present one is clearly necessary for the successful carrying out of industrialization in international depressed areas» (Jameson, 2008, p. 165). The liberation of Asia from Japanese domination and the decolonization of Africa, India and other areas provided new venues for understanding and fostering the institutional structures that would lead to development. Institutionalism and development were inextricably bound, leading one economist to write «in the field of development economics, the victory of institutionalism has been so complete that many economists fail to realize it» (Klein, 1997, p. 789). Supporting this view was optimism about the likely success of development, a «bias for hope» as Hirschman termed it.

But development proved to be a complex and difficult process. While East Asia exhibited notable development success, the rest of the world seemed resistant to development policies and institutional development, leading Hirschman to write in 1981 of the «rise and decline of development economics». Latin America was a poster child for the loss of development momentum. The notable initial successes of Latin American structuralism in the postwar were overshadowed by unaddressed imbalances and by increased political, and military, turmoil occasioned by the Cuban revolution. The imposition of the market in Chile filled the vacuum that had resulted and signaled a return to the neo-classical understanding of the economy. The institutionalist approach to development had focused on the state, on technology, and on habits of individuals and groups, while highlighting the cumulative nature of change and downplaying equilibrium approaches. It was ultimately data based and inductive. This was cast aside in favor of market fundamentalism, based on an epistemology of behaviorism, an ahistorical mechanical model —the market— and on a logical positivist methodology (Jameson, 2008, p. 172). Deduction and equilibrium guided this approach to development. The link of development and institutions, as traditionally understood in institutionalist economics, was broken. Development and markets became synonymous.

North and Williamson did create a «new institutionalist» strain within orthodoxy. But its assertion was that rational action of maximizing individuals would actually generate market institutions because of markets' unique capacity to minimize transaction costs (Jameson, 2008, p. 169). Williamson went so far as to assert «in the beginning there were markets». So the imposition of market relations on foundering economies received added support. The expectation that economic performance would improve dramatically under a market regime seemed a logical conclusion from new institutionalist economics.

Saving the market: *deus ex* institutions

As noted above, the imposition of liberalization and subjection of major elements of society to market relations across much of Latin America had mediocre results, at best. The best mainstream source documenting the failed promise was Birdsall and de la Torre (2001). This should have occasioned a healthy skepticism about «market fundamentalism». Instead, orthodoxy pointed the finger at the absence of the institutional basis for successful market operation, i.e. the natural evolution toward an efficient market-based society must have been truncated by misguided statist policies under the rubric of structuralism. So rather than turning away from market oriented reforms, the process needed to be broadened to develop or impose a wide range of institutions that were required to allow markets to do their magical work.

Jameson (2006) traced this trajectory and its incorporation into the program of «second generation reforms» spearheaded by the IMF and the World Bank. Their documents make their fallback position quite clear. For example, James Wolfsensohn, President of the World Bank, 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». In other places the Bank moved the centrality of the market even more to the fore: «the recognition of the crucial role of institutions, organizations, political economy restrictions is not tantamount to a rejection of the neoclassical model» (Jameson, 2008, p. 369). The prime exemplar of the second generation reforms was 1989's «Washington Consensus», which sketched the ten main market based reforms that had been implemented across most of Latin America to varying degrees. Its appearance just at the end of the «lost decade» of Latin American development is quite ironic, in retrospect.

The result was once again a juncture in which the double helix strands had become one, with the market and its associated institutions, subsuming all of development. However, the reductionism of market fundamentalism and its failure to live up to its promise had unintended side effects. It actually stimulated a revitalization of work on broader understandings of institutions that more closely resembled the early years of development economics.

Jameson (2006) describes the intellectual activity of this period, coming from both old and new institutionalism. One indicator of the renewed dynamism of institutionalism was an increase in institutional content of the Journal of Development Economics from 15 to 27 percent between the 1970s and 1990s. Each strain, both old and new institutionalism, saw novel approaches. In each case we can find three different kinds of additions to the existing analytical framework.

Let's start with the new institutional economics program (Jameson, 2006, pp. 370-371). First, the new historical and comparative institutional analysis approach examined how institutions actually evolved over many historical experiences, and its main finding was that the market was only one of many possible outcomes. Historical conditions and cultural beliefs made the result highly path dependent. Second, examination of the micro-foundations of institutional evolution, growing out of the asymmetric information program, showed that property rights explanations of development are inadequate. Other institutional mechanisms have often been successfully adopted. Finally, North himself developed a much richer explanation of institutional evolution, with new concepts displacing the earlier set that had inexorably generated free market institutions. Beliefs and culture displaced rationality; the imperative of understanding dominated his earlier emphasis on maximization; and path dependence across history trumped historic continuity.

Three new approaches growing out of old institutionalism were also stimulated. One went back to the roots of old institutionalism and applied the original constructs to modern issues of development, underlining that many of the development problems have been with us throughout the modern period. A second approach critiqued the epistemological basis of the market fundamentalist program and updated the old institutionalist epistemology. Hodgson and others claimed that this reclaimed epistemology is actually more consistent with modern psychology, historiography, and scientific methodology. Finally, empirical investigations of market fundamentalism's development failure and of alternative development successes, such as documented by Chang in East Asia, reiterated the importance of traditional understandings of institutions and development. They once again suggested humility in reducing development to simple formulae.

Based on this reading, I saw the emergence of a «modern institutionalism of development» that would draw upon both of these strains and would have five characteristics: resistance to reductionism, foregrounding of the human dimension to development, support for institutional evolution based on participants' understanding and definitions (really democratic processes), institutional development based on local knowledge, and congruence of local, national, and international development processes (Jameson, 2006, p. 373).

My vision was that development and institutionalism were once again coming together, and that this conjuncture would restore the optimism and bias for hope that had been characteristic of the postwar. Thus when I was asked by Geoff Hodgson to participate in a special issue of The Journal of Institutional Economics, based on a lead article by Ha-Joon Chang, a representative of the third old institutionalist economics strain, I was enthused. The issue contained Chang's article, 16 responses to it, and his response to those 16 articles.

Trying out the consensus on development and institutions

Chang's article (2011a) was a critique of efforts to implant «global standard institutions» in countries as part of the development process. He isolated seven GSI elements: i) a common law legal system, which, by allowing all transactions unless explicitly prohibited, promotes free contracts; ii) an industrial system based on private ownership, which requires significant privatization in many countries; iii) a financial system based on a developed stock market with easy M&A (mergers and acquisitions), which will ensure that the best management team available runs each enterprise; iv) a regime of financial regulation that encourages «prudence» and «stability», including a politically-independent central bank and the strict observance of the Bank for International Settlements (BIS) capital adequacy ratio; v) a shareholder-oriented corporate governance system, which will ensure that the corporations are run for their owners; vi) a flexible labour market that allows quick re-allocation of labour in response to price changes; and vii) a political system that restricts arbitrary actions of political rulers and their agents (i.e. bureaucrats) through decentralization of power and the minimization of discretion for public sector agents. This is quite close to the institutional underpinnings of the Washington Consensus. Chang's article reiterated many of the points he had made in his early writings that had centered on Korean development policy since the 1960s, and in which he made theoretical and empirical critiques of the effort to impose these GSI's. My own reaction to the Chang article was that it broke very little new ground and did not move us beyond Chang's earlier contributions to the old institutionalist approach to development.

Thus in my response (Jameson, 2011), I tried to show that Latin America had moved far beyond the naïve institutional imposition that went by the description of the Washington Consensus. Since the restoration of democracy across the area, the rejection of the GSI-type policies that had led to the lost decade was widespread. More importantly, many successful institutional innovations to confront the underlying problems that had beset Latin America had been undertaken across Latin America. In other words, this was «modern institutionalism of development» in action. The result, well known in Latin America, is that recent economic performance has been a major improvement over the Consensus period. Among the improvements I highlighted were improved growth and inflation performance, even during the great recession in Europe and the US after 2007; changes in social safety net policies that confronted extreme poverty and the unequal income distribution; and the rise of a significant middle class in most countries. In addition there has been a reorientation of infrastructure investments to provide more local benefit, renegotiation of many natural resource concessions to insure greater benefit to the host countries, and formation of a number of regional institutions to allow greater engagement with regional issues. Underpinning these efforts has been a generally robust democratic stability, with widespread acceptance of the processes of electoral democracy.

To be sure, the success has rested heavily on the booming commodity market and there have been cases of non-democratic regime change, both of which provide a cautionary note. Nonetheless, the steps taken and their notable success seem to me to validate the Modern Institutionalism of Development, which has moved us far beyond the old New Institutionalism with its GSI's.

Thus I was quite surprised when 10 of the 16 responses to Chang were quite critical, and in some cases even vitriolic. Chang's response (2011b, pp. 1-2) highlighted some of the surprising claims against him. He grouped them into three.

First, they argue that I make extreme and one-sided theoretical claims against the dominant discourse on institutions and development.

Second, they point out that even those criticisms of mine that are not so extreme are irrelevant because I am not attacking the «real thing» but some distorted and/or partial version of the orthodox institutional literature. Third, they say that my arguments are based on an unscientific empirical methodology, which invalidates my evidence-based (as opposed to theoretical) criticisms. Having defined me as an extremist deploying a «straw man» argument and using dubious empirical methodologies, most of these commentators seem to feel justified not to engage with my substantive criticisms… I can only surmise that, seeing me criticize their own school of thought, some of the commentators decided that I am their enemy and therefore must be in denial of all the main conclusions of their school.

It appears that my assertion that we have now moved to a Modern Institutionalism of Development was overly optimistic. Chang addressed each of the critiques. Unfortunately, it appears to me that the debates do not move Chang beyond his lead article. Nonetheless, let us see how he proposes to move beyond these fundamental misunderstandings. He suggests that there are three substantive areas of criticism of his stance: the definition of a «free market», the definition of «property rights», and the costs of institutional change. In the first two cases, he returns to underlying disputes within new institutional economics. The third calls into question the effort to implement «second generation reforms», i.e. imposing institutional structures that can allow markets to function. While I agree with Chang's critique and with the inadequacy of the analysis and policy in this area, work in these areas will not bridge the gaps between old institutionalists and new institutionalists and move us toward a consensus modern institutionalism of development. How can this movement be initiated?

One recent bridging attempt

López Castellano and García-Quero's (2012) article is a recent attempt to move the debate beyond polemics toward a consensus. Much of the article summarizes the JOIE debate that we have outlined. Their treatment in many ways parallels my own (2006), though they divide the positions into «institutional political economy (IPE)» and «new institutional economics (NIE)». They provide a four-part categorization of the differences, many elements of which are familiar from the debates: the nature of institutions, the role of the state, the lessons of history, and institutional quality and development. This categorization is not novel, but coming as it does after the polemics around Chang's article, it provides an appealing effort to at least delineate the battlefield.

The article then makes two efforts to move beyond the differences. In the first they highlight changes in the NIE «towards a more pluralistic and interdisciplinary approach». This in many ways parallels my own treatment of the «new new institutional economics» (Jameson, 2006, pp. 370-371). At least at a theoretical level, North has admitted evolution of institutions and reciprocity between development and institutions. Greif and others have broadened the empirical investigation of institutional development beyond naive market fundamentalism. I drew upon these positive changes and changes in old institutional economics to make my case for a «modern institutionalism of development». The reactions to Chang indicate that North and the others are far ahead of many of their old new institutionalist economics colleagues.

López Castellano and García-Quero make a second move. They suggest a change from «institutional transplant to deliberative development» (2012, pp. 932-934). This is an interesting suggestion.

They correctly point out that both theoretical approaches use growth of GDP as the dependent variable, i.e. that development is reduced to this dimension. It is not clear how they motivate their suggestion to rethink the definition of development, e.g. they claim that they find NIE proposing a move away from GDP fetishism, though they do not provide any citations for this claim. Nonetheless, they suggest that the role of institutions in development should be seen in their «capacity to enable people's self-realization» (p. 934). Drawing on Sen they suggest that there are two keys to this reorientation: first, democracy as government through debate; and second, serious engagement with the redistribution of wealth. I think they move in the correct direction; however my own view is that this is not a bridge between the two approaches to the question, but is an assertion of the superiority of what I have termed the new old institutionalism of development or the modern institutionalism of development. For there is very little of new institutional economics that would remain if our understanding of development moved toward that which the authors suggest.

In addition, I see my own article in the Chang volume (Jameson, 2011) providing an empirical basis for the kinds of claims these two authors make. For it documents the innovations and steps in Latin America toward a more equitable development, all predicated on and supported by the restored democratic political systems in the hemisphere. Such an empirically based understanding of successful development seems to me to be the most viable means of moving toward the type of resolution I suggested at the outset of this article. Rather than resulting in a consensus, my claim is that the perspective of the vitriolic anti-Chang authors will become progressively more irrelevant over time, as a result of the development of the «modern institutionalism of development».

A more comprehensive resolution

I would like to leave this debate by suggesting that an alternative theoretical structure might bring more economists to a common understanding of the link of institutions and development. In this I wish to draw upon the construct of «Post-Keynesian Institutionalism» that was first suggested by Charles Wilber and me in our 1983 book (Wilber & Jameson, 1983) and then reiterated in a revised version (1990). The construct has most recently been elaborated on and revised by Charles Whalen and a series of authors in a book (2013a).

The focus of our books, and of Whalen's, was the United States economy. So its application to issues of development would require significant elaboration and modification. However, the general approach and underlying claims may provide a foundation for resolving the tensions around the institutions and development conundrum. Let us examine that structure of the argument.

Wilber and I attempted to «provide the basis for a new social consensus to control capitalism's uneven development» (1990, p. 16). Our starting point was quite similar to López Castellano and García-Quero's (2012) final point, a redefinition of the goals of the economy, i.e. development. We suggested that a successful economy will contribute to human welfare in three dimensions: life sustenance, self-esteem/fellowship, and freedom. In each of these cases we specify three elements. For example, freedom means consumer sovereignty, worker sovereignty, and citizen sovereignty.

Taking this as a starting point had two implications. First it allowed a critique of the two dominant theoretical systems, market fundamentalism or in our terms «Conservative Economic Individualism», and «(bastard) Keynesianism». By positing a wider set of goals for the economy than growth in GDP, we were able to take the two orthodoxies as special cases of the broader understanding of the economy. In terms of the current debate, the die-hard new institutionalists end up relevant to a very small segment of the much more important and wider debate about economic processes. Their points may be well-taken in that context, but they are minor. The methodological and ethical dimensions of the question dominate. So this step is consistent with that suggested by López Castellano and García-Quero (2012).

To that we added another dimension, an empirical critique of the dominant approaches. In this, we took a stance similar to Chang (2011) in his critique of the GSI, and in this we built an institutionalist case. In our first volume we focused on the institutionalist structures surrounding the stagflation of the 1970s. In the second, we examined economic performance under Reaganomics/Thatcherism.

Whalen (2013b) faulted us for focusing on stagflation in our first empirical critique, correctly. However, our critique of Reaganomics has stood up much better. Indeed, the recent death of Margaret Thatcher has renewed evaluations of Thatcherism, many of which are quite compatible with our points, documenting how her policies moved Britain far away from an economy that fostered life sustenance, self-esteem/fellowship, and freedom (Hudson, 2013).

While the approach to this point is compatible with both Chang and with López Castellano/García-Quero, the «post-Keynesian» element differentiates it and could offer another dimension helpful in reaching a resolution to the debate. For it suggests that to the broader definition of development and to the empirical critique of orthodoxy, we must add a theoretical understanding of the economy and of development. That can provide the final element for a coherent and persuasive understanding of development and of the institutional basis for development.

Again, our concern was primarily the U.S. economy, and it would not apply directly to development. However, understanding the approach can give some indication of how it might be adopted in the development arena. We specified five central elements of a Post-Keynesian approach. It is holistic, systemic, evolutionary, its agents' behavior is «non-rational» and power is central. The PKI understanding of development will have these same characteristics. Let me note for completeness the PKI frameworks that we and Whalen used.

We took our definition of post-Keynesianism from Eichner (1978), who provided a general definition, e.g. «the study of how an economic system is able to expand its output by producing and distributing the social surplus» (Wilber & Jameson, 1990, p. 191). We attempted to provide more specificity by enlisting Karl Polanyi and his seminal work, The Great Transformation (1944). He traced the emergence of the «self-regulating economy» in the 19th century, its self-destruction in the Great Depression, and the restoration of intervention in the economy as an antidote to the failure of the «free market». Intervention must certainly be an element of a PKI understanding, but Polanyi's focus on the U.S. and Europe and on the Depression limits its usefulness as a guide to understanding modern development. Nonetheless, his work and Eichner's indicate how the issue can be joined.

In the new Whalen volume case, the version of post-Keynesianism that guides its analysis is Hyman Minsky's financial fragility hypothesis (1986). Minsky is quite successful in helping understand the financial crisis in Europe and in the U.S. that led to the great recession of 2007+. And the implication of his analysis, that intervention and regulation of financial markets is essential to stable growth and development, is certainly a lesson that has been learned in Latin American development. So it supports the institutionalist dimension, but once again could not serve as the post-Keynesian underpinning of a PKI resolution of the development and institution debate.

The challenge for Iguíñiz

So that search must continue. I leave it to Javier Iguíñiz and others who are working on issues of development and who are closer to the contemporary challenges of development. In the context of Latin America, one can see the outlines of the challenge clearly. The success of the last decade has to a large extent run its course, and the institutions that have supported it must adapt and change. The boom in commodities and in their prices has come to an end; growth in GDP is slowing measurably; gains in dealing with poverty are becoming harder to find; income inequality continues to be stubbornly resistant to policy and institutional change; and one must wonder when the U.S. acquiescence in questionable governmental change in Honduras and Paraguay and the strong questioning of the recent Venezuelan election will embolden non-democratic forces to remove governments not to their liking.

Iguíñiz's 2009 book on economic development and well-being (Gonzales and Iguíñiz) and the 2011 book on Peru's inequality (León and Iguíñiz) can certainly shed light on these issues. And perhaps most importantly, his efforts as the Executive Secretary of the «National Accord» could be interpreted as an effort to get agreement on the institutions that will foster development in Peru. In its outlines it seems to incorporate all of the PKI elements that Wilber and I espoused: the effort is holistic, systemic, evolutionary, it sees agents' behavior as «non-rational», and power is central.

So my hope is that his efforts and the efforts of those inspired by his work and commitment can move us to a resolution, and that we can find that combination of institutions and development theory that will build on recent progress and embed it in the core of Latin American economies. Thus will the modern institutionalism of development come to describe and guide the Latin American economies.

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