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**MOVING BEYOND 'INSTITUTIONS MATTER':  
SOME REFLECTIONS ON HOW THE 'RULES  
OF THE GAME' EVOLVE AND CHANGE**

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DISCUSSION PAPERS

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## Crisis States Development Research Centre

### Moving Beyond ‘Institutions Matter’ Some reflections on how the ‘Rules of the Game’ evolve and change

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#### Introduction: ‘Institutions Matter’

Scientific inquiry leads to incremental discoveries anticipated from the existing body of knowledge, but sometimes it also results in a paradigm change if unexpected ‘anomalies’ are confronted.<sup>2</sup> But in each instance, as past knowledge is worked upon and improved, either cumulatively or through changing it fundamentally, scientific knowledge advances to a higher plane.

However, knowledge building in the social sciences, despite claims to their scientific nature, often runs in *cycles*, burying old wisdom for some time, and reinventing it later. Take, for example, what Adam Smith, considered to be the chief protagonist of free market theory, had to say in his classics treatise on the *Wealth of Nations* about the embedded nature of market<sup>3</sup>:

Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice.... Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government.

Almost an axiom,<sup>4</sup> if you will, this insight was largely buried during the heydays of the Washington Consensus in the 1970s and 1980s (perhaps in the zeal of establishing the supremacy of Smith’s ideas concerning the ‘invisible hand’ of the market, ignoring that he also spoke of its nexus with more ‘visible arms’ of government). Instead, the idea, or more aptly the illusion, of a minimalist state was aggressively promoted as the key to ensuring a free market based path to prosperity in the developing countries.<sup>5</sup> Its extreme emphasis on “rolling back the state” consequently paid “very little attention to institutions and the complementarity between the private and public spheres of the economy”.<sup>6</sup>

However, over the next twenty years, with the growing realisation that such an a-institutional thinking on reform would not work in the divergent social-cultural and political contexts of

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<sup>2</sup> Thomas S. Kuhn, ‘Historical Structure of Scientific Discovery’, *Science* 136:3518 (1962), pp.760-764.

<sup>3</sup> Cited in Dani Rodrik, Arvind Subramanian & Francesco Trebbi, ‘Institutions Rule: The Primacy Of Institutions Over Geography And Integration In Economic Development’, *CID Working Paper* No. 97, Harvard University, 2002, p.1.

<sup>4</sup> Dani Rodrik points out that even the sophisticated Arrow-Debreu mathematical model, with a full set of complete and contingent markets extending indefinitely into the future, assumes that property rights are protected and contracts enforced. So in the background there exists institutions that establish these; there has to be a system of laws and courts to make even ‘perfect’ markets function (‘Development Strategies for the Next Century’, paper given at the conference on *Developing Economics in the 21<sup>st</sup> Century*, Institute for Developing Economics, Japan. UNU/WIDER, 2000, pp.11-12).

<sup>5</sup> John Gray, ‘The Illusion of a Minimum State’, *LSE Public Service Seminar Series*, 1997, pp.1-15.

<sup>6</sup> Rodrik (2000), p.2.

developing and transition countries, the peculiar cyclic process of knowledge building seems to have taken almost a full turn.<sup>7</sup> Resultantly, the primacy of the role of institutions in shaping developmental trajectories of such nations is now being reinvented and robustly reargued. This has not only resulted in calls such as ‘bringing the state back in,’ or ‘reinvigorating state capability’, but has also motivated organizations such as the World Bank to think in terms of moving beyond the Washington Consensus.<sup>8</sup> The impact of informal socio-cultural institutions, such as social networks and participatory institutions, on development has also drawn considerable attention.<sup>9</sup>

So institutions matter. And if one prefers to go with Rodrik’s findings, the role of institutions may appear to triumph over those of geography and integration into the world economy (through open trade) in influencing the developmental outcomes of a nation.<sup>10</sup> But the real complication starts when one begins to ask questions such as: how much of institutions matter? Which institutions, among the many operating in society, have primacy over the others in influencing the developmental outcomes under question? What structures or quality should they have to be able to effectively promote shared progress in a society? How can we know about their causal linkages? How can such quality institutions be acquired, if they are absent? Moreover, if acquiring them implies transformation of the historically-given, unsupportive, prevailing institutions that are resistant to change, how can that be overcome?

Bringing institutions back into developmental discourse, notwithstanding their undisputed importance and desirability, has not necessarily resulted in clarity around these complex issues. The challenge appears to be well recognized by a number of scholars. Reviewing the literature on both old and new institutionalism, Nelson and Sampat observe that “there is a difficult road ahead before institutions can be weaved into a coherent theory of the determinants of economic performance”.<sup>11</sup> Having established that institutions are the key to economic development through an exhaustive cross-national study of how geography, trade and institutions influence economic development, Rodrik *et al.* point out, rather ironically, that “the operational guidance (for the policymakers who want to improve the performance of their economies) that our central result on the primacy of institutional quality yields is extremely meagre”.<sup>12</sup> In some of the extreme views on the New Institutional Economy (NIE),

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<sup>7</sup> Richard R. Nelson & Bhaven N. Sampat also point out that that the surge of new interest in exploring institutions’ role in affecting economic performance is a revival of the central concern of Adam Smith and his great classical followers (‘Making sense of institutions as a factor shaping economic performance’, *Journal of Economic Behaviour & Organization*, 44 (2001), pp.31-32). Contrast this with those times, as Douglass North interestingly reminds us of, when similar assertions on the importance of institutions, coming from the old institutionalists, were fast losing ground to the ascendancy of the neoclassical mainstream economics, and the picture of the cyclic turn will be vivid: “But even while the new breed was destroying one traditional explanation after another, the traditional historian even in retreat kept muttering over and over, ‘But you are destroying the existing myths without replacing them. Soon there will be no explanation - no economic history - just an immense heap of numbers’. And sometimes, plaintively from the left flank of the retreating historians, there would come the cry, ‘But institutions ARE important!’” (Douglass North, ‘Institutional Change and Economic Development’, *The Journal of Economic History*, 31:1 (1971), p.118).

<sup>8</sup> Shahid Javed Burki & Guillermo E. Perry, *Beyond The Washington Consensus: Institutions Matter*, Washington, DC: The World Bank, 1998.

<sup>9</sup> David Dunham, ‘States, Reforms and Institutional Change: On the Dynamics of Failure’, paper given at Annual Bank Conference on Development Economics, Oslo, 24-26 June 2002, p.2.

<sup>10</sup> Rodrik, *et al.* (2002); Dani Rodrik, ‘Institutions, Integration, and Geography: In Search of the Deep Determinants of Economic Growth’, *CID Working Paper*, Harvard University, 2002.

<sup>11</sup> Nelson & Sampat (2001), p.32.

<sup>12</sup> See Rodrik, *et al.* (2002), pp.21-22, who forthrightly observe that their “findings indicate that when investors believe their property rights are protected, the economy ends up richer,” but *what the “actual form that property*

it is seen as “more a persuasion or an emphasis”,<sup>13</sup> whose “various branches are united by little but common scepticism toward atomistic accounts of social processes and a common conviction that institutional arrangements and social processes matter”.<sup>14</sup>

This paper is a modest attempt to engage with the theories and debates on institutions, (especially on institutional change) offered by the different traditions working within the institutionalist perspective, to assess how helpful they are in unravelling the complex set of issues and questions raised above. I discuss four particularly relevant dimensions of an institutionalist perspective, in order to unbundle the concept of institutions and institutional change, as expressed through the abstract ideas of the structure and the dynamics of ‘rules of the game’. In the first section, I briefly discuss the first three issues, which are: (a) multiplicity and multi-layering of institutions; (b) institutional arrangement; and (c) institutional appropriateness. In the following section, the issue of institutional change is examined in some detail. Three broad traditions or strands of the institutionalist perspective, namely, (i) Rational Choice Institutionalism, (ii) Historical Institutionalism, and (c) Sociological Institutionalism, are explored here, to understand how *strategic actions*, *conflicts around asymmetrical power structure* in polity and society, and *engagements with the cultural systems of meaning* that pervade all aspects of life and society – respectively the key themes or the conceptual constructs of these traditions – help us to understand better why ‘rules of the game’ evolve and change. The reflections draw attention to the fact that, though offering a few useful ideas on institutional development in their own ways, none of them pays adequate attention to the role of ideas and agency, and the multi-directional causal relationships between them and institutions, which I argue are critical to enriching the explanatory scope and depth of an institutionalist mode of inquiry. In the concluding section, I offer brief comments to further highlight this problem and offer a few thoughts on some possible alternative conceptual constructs that may help to resolve the dilemmas in which these traditions are engulfed, and highlight the need of developing and testing them through empirical research into cases of institutional change.

### Unpacking ‘Institutions Matter’: Complexities and Challenges

The most commonly quoted definition of ‘institution’ within the tradition of NIE comes from the writings of Douglass North:

Institutions consist of a set of *constraints* on behaviour in the form of rules and regulations; a set of procedures to detect deviations from the rules and regulations; and, finally, a set of moral, ethical behavioural norms which define the contours that *constrain* the way in which the rules and regulations are specified and enforcement is carried out.<sup>15</sup>

Scholars such as Chang and Evans, Harriss, and Putzel, pick up on the emphasis this view places on the constraining role of institutions, and argue that institutions should also be seen as providing incentives and playing enabling roles.<sup>16</sup> First, it is not clear whether North misses

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*rights should take,” is neither clear, nor can it be deduced that “private property-rights regime would produce superior results compared to alternative forms of property rights.” (emphasis added).*

<sup>13</sup> David Brian Robertson, ‘The Return to History and the New Institutionalism in American Political Science’, *Social Science History*, 17:1 (1993), p.2.

<sup>14</sup> Gunnar Grendstad & Per Selle, ‘Cultural Theory and the New Institutionalism’, *Journal of Theoretical Politics*, 7:1 (1995), p.6.

<sup>15</sup> D. North, ‘Transaction Costs, Institutions, and Economic History’, *Journal of Institutional and Theoretical Economics*, 140 (1984), p.8 – emphasis added.

<sup>16</sup> Ha-Joon Chang & Peter Evans, ‘The Role of Institutions in Economic Change’, Paper prepared for the meeting of the Other Canon group, Venice, Italy (13 – 14 January 2000), pp. 1-67, at

this dimension of institutions, important as it is. His later writing explicitly mentions that “[i]nstitutions ...and their enforcement characteristics ...together define the *incentive* structure of societies and specifically economies”.<sup>17</sup> Second, both constraining and enabling roles are intertwined, as constraining some actions appears to be inextricably linked to producing incentives for shaping and choosing others. Hence, despite making a serious criticism of NIE for continuing the rhetoric that “the unconstrained market ...is the natural order”, by emphasizing the constraining role of institutions, Chang and Evans are quick in noting that:

[T]his is, of course, *not* to say that institutions do not impose constraints. Just about all “enabling” institutions involve constraints on some types of behaviour by some people.<sup>18</sup>

Examples abound: rules that prohibit commuters from driving wrongly in a one-way lane, or crossing roads when a stop light is on, also provide incentives to choose more orderly traffic systems. The rules of targeted poverty-reduction programmes provide people living below the poverty line with certain welfare-enhancing entitlements, but constrain others from availing of them. The institution of caste in India has been viewed as almost entirely constraining in nature (prohibiting: occupational mobility, inclusive social interactions, and so on). Nonetheless, its political use in mobilising large-scale lower caste-based identity politics enabled the balance of power to tilt in favour of the depressed castes – something that had remained almost impossible in the previous thousand years of the nation’s history – within a short span of fifty years after independence. However, it also constrained the state from following universalist approaches in developmental arenas. Thus, not only enabling and constraining roles are intertwined, they can untangle differently over time and in relation to different issues in a society.

We must, therefore, move beyond this to bring to the centre the essence of an institutionalist perspective. As Hall and Taylor rightly point out, the issues that are fundamental to any institutional analysis are “how to construe the relationship between institutions and behaviour and how to explain the process whereby institutions originate or change”.<sup>19</sup> In exploring these, one can keep both the constraining and enabling roles of institutions in mind, but which of them is more relevant for the analysis at hand can only be inquired empirically, and cannot be settled *a priori*. These fundamental issues, however, when viewed through abstract and generic concepts of formal and informal rules that contextualize and influence human behaviour in shaping societal outcomes, do not help to visualize a range of complexities associated with an institutionalist perspective. In order to deepen our understanding of the fundamental issues, broadly speaking four analytical components require close examination: (a) multiplicity and multi-layering of institutions; (b) a dynamic hierarchical relationship of influence between them, or institutional arrangements; (c) institutional appropriateness, i.e., what type of institution or institutional hierarchy is appropriate for the welfare-enhancing societal outcomes under question; and (d) institutional change. A brief discussion on the first

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<http://www.econ.cam.ac.uk/faculty/chang/c&e-pdf.pdf>; John Harriss, ‘Institutions, Politics and Culture: A Case for “Old” Institutionalism in the Study of Historical Change’, *DESTIN Working Paper Series* No.02-34, 2002, p.1 f.n.2; James Putzel, ‘Accounting for the dark side of social capital’, *Journal of International Development*, 9:7 (1997), pp.939-949, cited in Crisis States Programme, ‘Concepts and Research Agenda’, *Crisis States Working Paper* No.1, London: Development Research Centre, LSE, 2001, p.3, f.n.3.

<sup>17</sup> Douglass C. North, ‘Economic Performance Through Time’, *American Economic Review*, 84:3 (1994), pp.359-60 – emphasis added.

<sup>18</sup> Chang & Evans (2000), p.8.

<sup>19</sup> Peter A. Hall & Rosemary C. R. Taylor, ‘Political Science and the Three New Institutionalisms’, *Discussion Paper* 96/6, Max-Planck-Institut für Gesellschaftsforschung, 1996, p.6.

three issues follows in the next subsection, and the last issue, the most vexed of all, is discussed in some detail in the following sub-section.

### *The issue of layers, hierarchy and appropriateness*

#### **1. Multiplicity and multi-layering of institutions**

A wide range of rules operate in a society, i.e., multiple institutions (economic, political, socio-cultural, and so on) exist. They also operate at different layers of state and society. For example, rules that govern political interactions – political institutions – operate at macro, meso, and micro levels of a society. The constitution of a country sets out the rules that define the macro framework of political interactions (democratic or authoritarian; parliamentary or presidential; separation of executive, legislative and judicial functions, etc.). The detailed rules (including informal) – for example, the ways elections are conducted, political parties recruit their members and compete with each other, and political executives work in different state organizations – demonstrate the workings of the political institutions at the meso level. And the rules that guide the interactions of voters with the political parties and their candidates – for example, patron-clientalism, the caste system (in India), and religious symbolisms – reveal the micro layer of political institutions operative at the deeper level of a society. The outcomes under question, such as political participation of the low caste poor in India, can be varyingly influenced by rules operative at these different layers. The macro rules may be well designed, but their effective translation into reality may be seriously hindered if the micro layer rules are such that they debilitate the poor from participating in elections and other political processes. But depending upon how the rules at the meso-level work, this outcome can vary again.

#### **2. Institutional arrangements**

At the same time, a certain interrelatedness between, or a hierarchical structure of, different institutions (with their internal layered structures and their hierarchy of influence as well), also matters in shaping the influence of a particular institution on certain outcomes of concern in a society. To return to the example discussed above: the issue of the exclusion of the low caste poor from political participation in India can be viewed as resulting from the socio-cultural institutions such as the caste system. But economic institutions such as the regressive agrarian structure (highly skewed land ownership; semi-feudal mode of production with practices of attached and bonded labour) appear to matter too, in so far as they structure a subservient relationship between the low caste poor and landed forward castes that privileges the latter in controlling the political processes in their areas. Absence or presence of institutionalised left-of-centre, or even ‘ultra left’, political parties, driven by their respective rules of the game for political mobilisation of the poor, appear influential as well. Robust and impartial government institutions and organisations (election commissions; rule bound and ‘well-capacitated’ bureaucracy, especially the lower bureaucracy) can mediate by providing protection to the poor in times of voting at the booths and affect the outcomes. Which of the set of formal and informal rules pertaining to socio-cultural (caste system), economic (agrarian structure), political (party structure), and governmental institutions matters more in producing the nature of (non)participation of the poor in politics, for example, in voting?

Deciphering the chain of causality between different types and layers of institutions to trace their impact on outcomes has not been easy.<sup>20</sup>

This issue is made more complicated when reverse causality is recognized to be at work that leads to a dynamic (changing) nature of such a hierarchy over time. Much “cross-national empirical work on institution[s] has been plagued by the endogeneity of institutional variables”. Questions such as, “are rich countries rich because they have high-quality institutions, or the other way around?” easily illustrate the dilemma in the inquiry.<sup>21</sup> Hirschman demonstrates this insightfully too, when he points out the “on-and-off” connection, or a coupling and decoupling, between economic and political institutions in advancing democracy and economic progress.<sup>22</sup>

### 3. Institutional appropriateness

The proposition that institutions matter is of concern for the following two subsets of propositions, especially from a policy perspective: (a) there are certain institutional arrangements that help to achieve welfare-enhancing ends in a society; and (b) certain other institutional arrangements not only hinder processes of achieving such desirable ends, but also resist introduction of, or transformation by, welfare-enhancing institutions.

However, there is no theory to let us deduce *ex-ante* what would be an appropriate design of an institutional arrangement in a society that can promote societal welfare. On the other hand, defining the appropriateness *ex-post* runs the danger of being tautological,<sup>23</sup> besides posing the challenge for its generalization beyond the specific context within which it worked.

Take, for example, the case of institutional arrangements that provide protection of property rights. What is widely believed is that entrepreneurs’ sense of security about the returns they get from their ventures through the protection of the property rights they enjoy, *inter alia*, is a

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<sup>20</sup> See Johannes Jütting, ‘Institutions and Development: A Critical Review’, *OECD Technical Papers*, No. 210, 2003, that reviews a large number of cross-national statistical and case study-based researches on institutional issues and highlights this as a major challenge in the institutional analysis.

<sup>21</sup> Rodrik (2002), p.8. See also, in the same article, Fig 3 on p. 27 that depicts the multidirectional causality, and the problem of endogeneity, between trade, institutions, and other growth variables. However, a recent and much cited work by Daron Acemoglu, Simon Johnson and James A. Robinson (‘The Colonial Origins of Comparative Development: An Empirical Investigation’, *American Economic Review*, 91:5 (2001), pp.1369-1401) claimed to isolate a truly exogenous institutional variable that can robustly account for the growth differentials among different countries. The central argument in this article is interesting: settler mortality rate due to the varying levels of prevalence of disease in colonies where Europeans migrated to induced patterns in their settlement and institutional quality of states formed. Where they settled in large numbers such as in ‘Neo-Europes’ (prime examples: Australia, New Zealand, Canada, and the United States), they replicated European institutions with strong emphasis on private property and checks against government power. But, in places where the disease environment was not favorable, ‘extractive states’ (such as Congo), lacking in these features, were set up primarily to transfer maximum possible resources of the colony to the colonizer. These differences in the institutional qualities of the states have persisted since the colonial times and explain well the growth differentials between them in the present. See also Rodrik, *et al.* (2002), who refute this argument (taking a much larger sample of 163 countries, which included 60 such countries that were never colonized), on grounds of: (a) model’s incapacity to explain similar growth differentials in non-colonized countries; and (b) not directly resting the impact of colonial policies and institutions on income, and thus loading a larger than merited causal story on an otherwise plausible statistical instrument such as settler mortality to identify the causal relationship between institutional quality and income levels.

<sup>22</sup> Albert Hirschman, ‘The On-and-Off connection between Political and Economic Progress’, *American Economic Review*, 84:2 (1994), pp.343-348.

<sup>23</sup> See Jütting (2003). Harriss (2002), p.2, also draws attention to this issue while discussing Nugent’s ideas on NIE.

must for the development of markets.<sup>24</sup> But there is no fixed design of institutional arrangements that can provide this function effectively. The classic case is of China, where Township and Village Enterprises (TVE), which represented an intermediate form of ownership between private and state ownership (i.e., local community ownership) not in conformity with the blueprint of the ‘best practice’ institutions usually modelled on those prevalent in the US and other advanced industrial nations,<sup>25</sup> is said to have spurred entrepreneurial activity.<sup>26</sup> Contrast this with the case of India, where private property rights were far more secure in colonial times, and after independence as well, through legislative enactments, and were well protected by the judiciary in both periods. But, as Clark and Westcott revealingly demonstrate, the Indian case represents a paradox as, notwithstanding this favourable institutional underpinning of the economy, India not only remained one of the poorer countries in the world, but also experienced falling per capita income relative to both Britain and the USA between 1873 and 1987.<sup>27</sup>

<sup>24</sup> Douglass C. North & Robert Paul Thomas, ‘An Economic Theory of the Growth of the Western World’, *The Economic History Review*, 23:1 (1970), pp.1-17; Rodrik, *et al* (2002); Acemoglu, *et al.* (2001) – see f.n.21 above; and many others categorically endorse this proposition, especially in the context of the rise of the West (in terms of modern economic growth), the essence of which is that: “an entrepreneur does not have the incentive to accumulate and innovate unless s/he has adequate control over the return to the assets that are thereby produced or improved” (Rodrik 2000, p.5). And, of course, the ‘final’ argument comes from De Soto (*The Other Path*, New York: Harper, 1989), who, as Boettke describes, “points out that in his youth while it was common for everyone to assert that property was held in common, when he and his friends would wander near a home the dog on that land would growl and bark to keep them away. The dog knew, de Soto points out, that the home belonged to his owner. The punch-line to de Soto’s story is that he predicts that the countries that will succeed in the 21st century will be those that formally recognize what the dogs already knew” (Peter J. Boettke, ‘The New Comparative Political Economy’, *Forum Series on the Role of Institutions in Promoting Economic Growth*, Directed by the Mercatus Center at George Mason University and the IRIS Center Sponsored by USAID, 2003, p.28).

<sup>25</sup> Usually viewed as comprising of: secure private property rights protected by the rule of law; impartial enforcement of contracts through an independent judiciary; appropriate government regulations to foster market competition; effective corporate governance; and transparent financial systems.

<sup>26</sup> Yingyi Quian observes: “The most important segment of local government firms are Township-Village Enterprises (TVEs) in rural areas, which numbered 1.5 million with employment of 52 million in 1993. The TVE shares of output and employment in rural industry were 72 percent and 58 percent respectively, the rest being private shares” (‘How Reform Worked in China’, *Working Paper*, Department of Economics, University of California, Berkeley, 2002, pp.19-20). See also Yingyi Qian, ‘The Process of China’s Market Transition (1978-98): The Evolutionary, Historical, and Comparative Perspectives’, *Journal of Institutional and Theoretical Economics*, 156:1 (2000), pp.151-171.

<sup>27</sup> See Gregory Clark & Susan Wolcott, ‘Why Nations Fail: Managerial Decisions and Performance in Indian Cotton Textiles 1890-1938’, *Journal of Economic History*, 59:2 (1999), pp.97-123; and Gregory Clark & Susan Wolcott, ‘One Polity, Many Countries: Economic Growth in India, 1873-2000’, in Dani Rodrik (ed.), *In Search of Prosperity: Analytic Narratives on Economic Growth*, Princeton: Princeton University Press, 2003. In the latter article, they demonstrate that that Indian per capita income continued to fall relative to USA and Great Britain for a long period from 1873 till 1987. The erosion in income during the colonial period was, authors observe, a great 20<sup>th</sup> century paradox since “from an economist’s perspective the institutional environment in the colonialist years from 1873-1947 – secure property rights, free trade, fixed exchange rates, and open capital markets – was close to ideal.” Even later, the institutional structure viewed central to promoting growth (secure property rights) did not vary. Based on an intensive study of textile industries of India, they speculate a provocative answer to this paradox. The problem, they suggest, lay not in a deficit of institutional arrangements or policies, but in the peculiar employer-employee relationship that debilitated the Indian industries from employing technology more profitably. Elaborating on this, they observe that in productive economies, workers exert more effort in the workplace than can be justified purely by monitoring or by direct financial incentives because they expect everyone else to act in that manner, thus, a condition of *mutual gift-giving equilibrium*. In the Indian (textile) industries, on the contrary, everybody shirks, as they expect nobody to exert more, thus, a condition of *mutual-shirking equilibrium*.

However, with the Indian economy growing between 5 and 6% annually since economic reforms were initiated in 1991, the view has been advanced that the nature of the state also matters. The Indian state lacked developmental features that the East Asian countries possessed, which had secured them shared progress. But when institutional features of the well-known developmental states are examined, more questions than answers arise. The influential study of the Ministry of International Trade and Industry's (MITI) role in Japan's development presented to the world the idea of the developmental state as:

a weberian ideal type of an interventionist state that was neither socialist (a plan-irrational state ..... ) nor free-market..... but something different: the plan-rational capitalist developmental state, conjoining private ownership with state guidance.<sup>28</sup>

A number of important studies on East Asian developmental states (especially South Korea and Taiwan) furthered this concept.<sup>29</sup> Following Chang and Evans, who have in their recent papers revisited this concept in the case of South Korea (in the context of the recent Asian financial crisis), the institutional elements of the Korean developmental state appear to be: meritocratic bureaucracy; powerful ministry with planning and budgetary functions; close coordination with business conglomerates (*chaebols*); start of five-year plans; nationalization of the banks; and semi-public agencies to help business, such as the state trading agency.<sup>30</sup>

Almost all of these elements were present in significantly comparable ways, and possibly more robustly, in the Indian State, especially in the pre-liberalization period: a strong meritocratic bureaucracy bequeathed by the British that was nurtured and further strengthened after independence;<sup>31</sup> a vibrant Planning Commission, building up five year plans early on with top economists in command additionally strengthened by the aura and the authority of the Prime Minister being its Chairman;<sup>32</sup> nationalized banks; different formal (FICCI, CII)<sup>33</sup>

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<sup>28</sup> M. Woo-Cumings, 'Introduction: Chalmers Johnson and the Politics of Nationalism and Development', in M. Woo-Cumings (ed.), *The Developmental State*, Ithaca, NY: Cornell University Press, 1999, p.1.

<sup>29</sup> See among others A. Amsden, *Asia's Next Giant: South Korea and Late Industrialization*, New York: Oxford University Press, 1989; P. Evans, *Embedded Autonomy: States and Industrial Transformation*, Princeton, NJ: Princeton University Press, 1995; and R. Wade, *Governing the Market: Economic Theory and the Role of Government in Taiwan's Industrialization*, Princeton, NJ: Princeton University Press, 1990.

<sup>30</sup> Chang and Evans (2000), pp.22-24. See also Ha-Joon Chang, 'An Institutional Perspective on the Role of the State: Towards an Institutional Political Economy', in L. Burlamaqui, A. Castro & H-J. Chang (eds), *Institutions and the Role of the State*, Cheltenham: Edward Elgar, 2000, pp.3-26; and Ha-Joon Chang, 'Industrial Policy and East Asia: The Miracle, the Crisis, and the Future', a revised version of the paper presented at the World Bank workshop on *Re-thinking East Asian Miracle*, San Francisco, 16-17 February 1999.

<sup>31</sup> For an insightful account of how the British colonizers formed a robust bureaucratic institution in India during colonial times, and how the basic structure and culture survived even after independence, see Potter (1996). From what Chang and Evans (2000) describe of the bureaucracy of South Korea, it may appear that the Indian bureaucracy had a much longer history of meritocracy and also greater competence. Quoting T. Cheng, S. Haggard & D. Kang, 'Institutions and Growth in Korea and Taiwan: The Bureaucracy', *Journal of Development Studies*, 34:6 (1998), p.105, they observe that: "The bureaucracy was nominally organized along a meritocratic line, but the practice was such that between 1949 and 1961, only 336 passed the High Civil Service Examination, compared to the 8,263 who got government jobs through 'special appointments'. The quality of the bureaucracy was such that, until the late 1960s, several years after the civil service reform by the new military government was started, Korean bureaucrats were being sent to countries like Pakistan and the Philippines for extra training." Note that Pakistan had exactly the same legacy of the institution that India had, and as it was training the Korean bureaucrats till late 1960s, *it will not be unfair to imagine that the Indian bureaucratic institution was superior to that of S. Korea.*

<sup>32</sup> Note that only after the coup by General Park Chung Hee in 1961, the Economic Planning Board, with both planning and budgetary authorities, came into existence in S. Korea, and began to formulate the five-year plans thereafter. India, on the other hand had set up the Planning Commission almost 11 years before, and by the 1960s, the country was well entrenched with the planned development process.

and informal groups of powerful industrialists with close linkages to the Finance and Industry Ministries; a tradition of laying out comprehensive Industrial Policies, framed in close collaboration with the big private players, offering directions and incentives for private investments; and a plethora of semi-public agencies, such as Export Promotion Councils and Trading Corporations, to help business.

Yet the Indian economy is said to have improved only after, if you may, the ‘Indian developmental state’ had been made less interventionist and regulatory. On the other hand, comparable features of the East Asian states have been viewed as the driving force behind the famed developmental miracles that they achieved. One may go into the finer details to argue that perhaps the comparison is not accurate (I will return to this in the following section). But when one learns that the much acclaimed developmental state of South Korea and its industrial policies were, after all, not so good, as they eventually created conditions that led to the recent financial crisis experienced by this and other states in East Asia, and subsequently confront the counter analysis that the crisis occurred not because of, but by the abandonment of, this very developmental state, the puzzle returns.<sup>34</sup>

The list can be long. There are raging debates, with unceasingly shifting positions discovering and rediscovering values of one institution over another, on just about any finding on what the appropriate institutions or institutional arrangements are that can kick the developing countries out of the low-equilibrium trap, and enable them to catch up with the advanced nations. Unsurprisingly, therefore, in the midst of this some provocative and engaging arguments are also advanced that the prescriptions of good institutions emanating from the advanced nations for the developing countries, in fact amount to ‘kicking away the ladder’ by the former, that had helped them reach where they now are:

In terms of institutional development, until they were quite developed (say, until the early 20th century), the developed countries had very few of the institutions deemed essential for developing countries today, democratic political institutions, a professional bureaucracy, and the central bank. Indeed, when they were developing countries themselves, the developed countries had much lower-quality institutions than today’s developing countries at comparable levels of development.<sup>35</sup>

And when an eminent Nobel Laureate such as Stiglitz also alerts us, echoing heresy and unorthodoxy as we have noted above, to “think twice before dismissing the deputies’ doubts as populist rants” (as against “technocratic proposals”), since “perhaps the populists are popular because they know something that the technocrats don’t,”<sup>36</sup> scepticism abounds. What, then, should be the reference points against which institutions in the developing countries need to be understood in terms of their appropriateness or disfunctionality for facilitating welfare-enhancing societal outcomes? How to construe them *ex-ante* and endogenously, if exogenously drawn templates do not hold or should be avoided? And how, without establishing the end point before beginning the journey of institutional reform (however short or piecemeal), we can even chart out a trajectory of a forward movement?

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<sup>33</sup> FICCI: The Federation of the Indian Chambers of Commerce and Industry. CII: Confederation of Indian Industries.

<sup>34</sup> See this debate in Chang & Evans (2000), Chang (1999), and a detailed critical treatment in Chang (2000).

<sup>35</sup> Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective*, London: Anthem Press, 2002, p.1.

<sup>36</sup> Joseph E. Stiglitz, ‘Populists Are Sometimes Right’, *Project Syndicate* (June 2003), at [http://www.project-syndicate.cz/commentaries/commentary\\_text.php?id=1234&lang=1&m=contributor](http://www.project-syndicate.cz/commentaries/commentary_text.php?id=1234&lang=1&m=contributor), p.1.

There may be an emerging sober consensus in this regard that argues in favour of “experimentation (and) willingness to depart from orthodoxy”, and asserts that:

‘good’ institutions ...must often have elements that are highly specific to a country's circumstances.... institutional reform that ignores the role of local variation and institutional innovation is at best inadequate, and at worse harmful.<sup>37</sup>

Nevertheless, we still need to tackle the questions raised above. After all, even a trial-and-error approach (perhaps simpler than experimentation, innovation, and engineering) needs some mental maps about a few, if not all, of the steps ahead. It may sound blind, but it is never so in reality. Or are we stuck with the idea of ‘changing the rules of the game’, when the trick lies in ‘playing the rules of the game differently’?

### ***What do the Institutionalists know about Institutional Change?***

We are already beginning to get some clues about the even greater complexity involved in unbundling the concept of institutional change, to which in this section I now turn. I propose to briefly and critically reflect upon the arguments of Chang and Evans, Grindle, Hall and Taylor, Pierson, and Pierson and Skocpol on institutional change, as these are based on an extensive critical survey of a large amount of literature relating to institutionalism of different shades.<sup>38</sup> These authors offer varying classifications of work within the institutionalist tradition. However, it appears that they broadly comprise three themes of emphasis, which I briefly discuss: efficiency in exchange, therefore choice matters; conflict around power, therefore history matters; and culture, therefore worldview matters.

#### **1. Efficiency in exchange, therefore choice matters**

Ronald Coase, whose famous work on “The Nature of the Firm” is said to have initiated the school of New Institutional Economics by introducing the notion of transaction costs in economic analysis, in a scathing attack on the mainstream economists comments:

[E]conomists think of themselves as having a box of tools but no subject matter. It reminds me of two lines from a modern poet...: *I see the bridle and the bit all right. But where's the bloody horse.*<sup>39</sup>

The “bloody horse”, the subject matter of economics, according to Coase, is the flow of goods and services in the real world and how they can be made more productive for the benefit of mankind. This in turn depends on exchange relationships involving transaction costs, i.e.,

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<sup>37</sup> Rodrik (2002), pp.13 & 15.

<sup>38</sup> Chang & Evans (2000), pp.2-18; Hall & Taylor (1996); Mirilee S. Grindle, ‘In Quest of the Political: The Political Economy of Development Policy Making’, *CID Working Paper* No. 17, Harvard University, 1999; Paul Pierson, ‘Explaining Institutional Origins and Change’, 2001, draft chapter from *Politics in Time: History, Institutions and Social Analysis*, manuscript in progress, at <http://www.people.fas.harvard.edu/~pierson/ch4.pdf>; and Paul Pierson & Theda Skocpol, ‘Historical Institutionalism in Contemporary Political Science’, in Ira Katznelson and Helen Milner (eds), *Political Science: The State of the Discipline*, New York & London: Norton, 2002, pp.1-32. They present their assessments of different institutionalist schools. I primarily draw upon the synthesized accounts as presented by the authors mentioned above, and do not separately discuss the contents of the source materials they rely upon.

<sup>39</sup> Though Ronald Coase is himself modest about it and gives credit to Williamson for coining this term in order to differentiate from, what he describes, anti-theoretical works of old institutionalists (‘The New Institutional Economics’, *The American Economic Review*, 88:2 (1998), pp.72-74).

costs involved in acquiring information, enforcing exchange rules, and managing risks.<sup>40</sup> The lower these costs, the more efficient the exchange, and the greater the productivity of the system.

This underlying fundamental thought under NIE views institutional creation and change as driven by rational actors' ongoing pursuits of optimization of efficiency that are aimed at lowering transaction costs in their (market) exchange relationships for maximizing their wealth. But what if potentially efficiency-enhancing institutions are not found in existence? The classic rationalist explanation to account for this anomaly suggests reducing "transactions costs (thus bringing up more efficient institutions), that tend to be subject to economies of scale," becoming feasible only when a "larger potential market makes it worth while to acquire information which would have been unprofitable in a very small market". For example, policing of piracy or brigandage for improving information and reducing externalities were secured only after market growth made such institution-building a profitable venture.<sup>41</sup>

However, in political spheres, the "rational choice institutionalism", as Hall and Taylor demonstrate, views emergence, persistence and change of institutions as the means to solve *collective action dilemmas* (such as, the 'prisoner's dilemma' and the 'tragedy of the commons'). In this, a more generic view of transaction costs in exchanges is taken to cover a ubiquitous large domain of non-market interactions in a society:

Institutions structure such interactions by affecting the range and sequence of alternatives on the choice-agenda or by providing information and enforcement mechanisms that reduce uncertainty about the corresponding behaviour of others and allow 'gains from exchange,' thereby leading actors toward particular calculations and potentially better social outcomes.<sup>42</sup>

Self-evidently, a highly functionalist view such as this predictably comes under sharp attack by many scholars. Empirically it is challenged by pointing out an abundance of existing and persisting inefficient institutions in the real world (even when replacing them with potential efficient alternatives is considered to be profitable or capable of better solving collective action dilemmas). But theoretically the view is seen as flawed as well, since it assumes rational actors' incredible capacity to indulge in "'meta-optimization' exercises involving both resource costs and decision-making costs (or transaction costs)", when they "are not even capable of doing the standard optimization exercise involving only resource costs",<sup>43</sup> due to their 'bounded rationality'.<sup>44</sup> These apart, attention is brought to problems of "self-reinforcing mechanisms of socially suboptimal institutions" leading to what is known as path dependence,<sup>45</sup> and of unintended consequences for institutions (the latter long recognised,<sup>46</sup>

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<sup>40</sup> Following North & Thomas (1970), pp.5-6, who define it as "costs of externalities, of information, and of risk".

<sup>41</sup> North & Thomas (1970), pp.5-.8.

<sup>42</sup> Hall & Taylor (1996), p.12.

<sup>43</sup> Chang & Evans (1999), pp.11-12.

<sup>44</sup> The concept comes from Herbert A. Simon, *Models of bounded rationality*, Cambridge, Mass.: MIT Press, 1982.

<sup>45</sup> See, among others, Pranab Bardhan, 'Understanding Underdevelopment: Challenges for Institutional Economics from the Poor Country Perspective', Villa Borsig Workshop Series 2000 - The Institutional Foundations of a Market Economy, 2000, pp.6-7; Harriss (2002), pp.3-4; Grindle (1999); and Chang & Evans (2000), pp.12-13.

<sup>46</sup> See Bardhan (2000), who draws attention to Menger's insightful work (*Problems of Economics and Sociology*, translated by F. J. Nock, Urbana, IL: University of Illinois Press, 1963 [1883]) that distinguished between: "'pragmatic' institutions – the direct outcome of conscious contractual design, as in the institutional models in

but rather naively ignored by rational choice institutionalists), to demonstrate the inefficacy of this view.

In line with these, but with some valuable additional insights, a recent work by Pierson also brings up the issues of: multiplicity of effects (other than those institutions were designed for); non-instrumentality (actors may be motivated more by conceptions of what they *believe* to be appropriate than by conceptions of what would be effective); short-time horizon; rapid environmental change (altering the parameters on which institutions were shaped); actor discontinuity (actors inheriting institutions may have different interests and motivations than those who founded them); and, of course, the unanticipated consequences, that seriously challenge the functionalist (or actor-centred functionalist) view discussed above. Pierson also takes issue with the idea of institutional learning and competition, modelled on what Williamson has argued for the economic sphere,<sup>47</sup> as inadequate to remedy these by providing for a cumulative process of institutional enhancement. The greater complexity of political interactions and difficulties posed by institutional resilience (the latter arising most significantly from asset specificity constraints),<sup>48</sup> are said to limit the possibilities of institutional corrections and enhancements through learning processes and feedback mechanisms in the socio-political spheres of life.

So what should we make of all this? The reliance on the ‘calculus of rationality’ of actors (*a la* Peter and Hall) suggested by this school undermines an understanding of the complex dynamics of change in society, much of which is the story of institutional change. For some scholars, this weakness is of an extreme kind. They therefore suggest that NIE, and by extension rational choice institutionalism, is vacuous as a theory of institutional change.<sup>49</sup> Others point towards the need of bringing an inter-temporal perspective in studying politics,<sup>50</sup> and enriching the thin rationality assumption.<sup>51</sup> Let me therefore turn to the historical institutionalist tradition, which claims to deal with the question of change through an historical perspective much better.

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the theory of imperfect information or transaction cost – and “organic” institutions – comparatively undesigned and evolving gradually as the unintended and unforeseeable result of the pursuit of individual interests” (Bardhan, 2000, p.6).

<sup>47</sup> Oliver E. Williamson makes the classic rational choice argument in favour of institutional enhancement by suggesting that “the ‘far-sighted propensity’ or ‘rational spirit’ would work on the feedback and fold them into the organisational design in ways to improve overall efficiency” (‘Transaction Cost Economics and Organization Theory’, *Industrial and Corporate Change*, 2 (1993), pp.116-117; cited in Pierson (2001), p.25).

<sup>48</sup> The key point about asset specificity concept (this note primarily draws upon Pierson, 2001), that is due to Williamson, is that investments are made over historical periods in certain physical, intellectual, and relational ‘specific assets’ assuming the presence of particular institutions. This in turn engenders strong interest in the holders of these assets to preserve them, and thus causes institutional resilience, as those assets could make the institutions serve the interests of the holders more efficiently *vis-à-vis* alternative institutions. Gourevitch insightfully brings out the importance of this concept in politics: “Political actors develop investments, ‘specific assets,’ in a particular arrangement – relationships, expectations, privileges, knowledge of procedures, all tied to the institution at work. Where investments in the specific assets of an institution are high actors will find the cost of any institutional change that endangers these assets to be quite high; indeed, actors in this situation may be reluctant to run risks of any change at all” (Peter Alexis Gourevitch, ‘The Governance Problem in International Relations’, in David Lake and Robert Powell (eds.), *Strategic Choice and International Relations*, Princeton: Princeton University Press, 2000, pp.144-145, cited in Pierson, 2001, p.42). This is a very useful concept, and can relate well to the real world cases.

<sup>49</sup> Harriss (2002), p.5.

<sup>50</sup> Pierson (2001), p.52.

<sup>51</sup> Hall & Taylor (1996), p.18.

## 2. Conflict around power, therefore, history matters

Rather than taking a snapshot view of political processes when the ‘dust has settled’ (as the rational intuitionists do), Historical Institutionalism claims to offer, “substantive enlightenment... about the social structures in which we are enmeshed and which largely condition the course of our lives”,<sup>52</sup> through exploring how the dust goes about settling.<sup>53</sup> How do the historical institutionalists go about doing this? It is difficult to pinpoint a core set of generic analytical constructs that this school of thought employs in their investigations due to their strongly held belief that specificity and context matters; thus theories can at best, and should, be of “middle range generalisations,” at the level of the “eclectic messy centre”,<sup>54</sup> rather than grand and all encompassing.

However, substantive agendas, temporal arguments, and attention to contexts and configurations are the key themes that distinguish it from the other schools of thought working on understanding institutions.<sup>55</sup> Because of this, multiple macro-historical structures (in the sense of large and complex institutions), their interactions over an extended time period and their sequence, and conjunctures that join even those structures and processes that may be evolving historically separately, rather than individuals, are at the centrestage of the analysis. And often these macro-structures and their processes are viewed “as developing products of struggle among unequal actors” around “uneasy balances of power and resources” that they embody.<sup>56</sup> Hence, scholars working in this tradition view that institutions mirror asymmetries of power in a society between different groups and collectivities, and persist for all the wrong reasons already discussed,<sup>57</sup> due to this very asymmetry; but also ultimately change due to conditions of challenge, contestation and conflict surrounding the skewed control of resources and decision-making processes that this asymmetry gives rise to. But even when the struggle for altering the power balance is ‘settled in one round’, the dust does not, as:

new sources of conflict, new claims for resources, new spaces for contestation, or efforts by various collectivities to undo the impact of the new institutions on their claims to power and influence (arise)... Political actors would reorganize, recombine, or reassert themselves to take advantage of new resources or reclaim lost ones; they would re-connect in conflict, coalition building, and bargaining over the distributional consequences of change, probably with reconfigured access to political, economic, and leadership resources.<sup>58</sup>

There is no doubt that paying close attention to the historical narratives of power, conflicts around control of resources and decision-making for their uses, and socio-political mobilizations and movements; and deciphering their underlying processes and patterns, provide a thick account of institutional development. Thus, unravelling large historical events such as revolutions in certain historical epochs, regime transformations across the world, the

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<sup>52</sup> Lewis Coser had viewed this as the “supreme test of social science” (‘Presidential Address: Two Methods in Search of a Substance’, *American Sociological Review*, 40 (1975), p.698, cited in Pierson & Skocpol (2002), p.4).

<sup>53</sup> H. Peyton Young, *Individual Strategy and Social Structure: An Evolutionary Theory of Institutions*, Princeton: Princeton University Press, 1998, cited in Pierson (2001), p.1.

<sup>54</sup> See a persuasive discussion by Evans of why this is preferable in theory building in Kohli *et al.*, ‘The Role Theory in Comparative Politics: A Symposium’, *World Politics*, 48:1 (1996), pp.2-6.

<sup>55</sup> Pierson & Skocpol (2002), p.3.

<sup>56</sup> These are based on Pierson & Skocpol (2002), p.12.

<sup>57</sup> See the discussions on rational choice institutionalism in the text.

<sup>58</sup> Grindle (1999), p.11.

rise of backward castes and classes, long term conflicts between groups or nations, and the like, require analysis of multiple institutions and their interactive processes that evolve over decades, or even centuries. But this thickened account, often undertaken to challenge and replace the thin rationality assumptions, generally *removes* the actor or the agents from the scene as well, as if they do not matter to the dynamics of these historical constructs that shape deeper institutional changes in a society.

Individuals do enter into the equation and make a difference, by producing and seizing upon ideas; changing world views; and redefining and symbolizing what is just and not just, what is honourable and what is not, what are desirable collective goods and what are not. They equate their definitions of personal attainment and striving in life with these social visions and causes. They take enormous risks in their lives when they choose to follow new ideas, redefinitions of the 'just order', and new meanings of dignity and honour amidst the darkest uncertainties about their outcomes. They may perish in the process, but if they succeed that can trigger chain reactions among their fellow beings that, through a complex process of aggregation over time and space, engender the very dynamics of large historical constructs that are dear to the historical institutionalists.

These interventions are far different from those conceived in the rationalist school, where either maximizing wealth (economic actors), or rents (bureaucrats), or personal political power (politicians) are the only generic forms of contributions that are assigned to actors. Historical institutionalists who challenge this should have all the more reason to look not only for thicker accounts of macro-structures and processes, but also for alternative and richer accounts of generic individuals preferences. In fine combing the historical details for discovering their deep layers of sequences, patterns, and causalities, they need also to look for how such a broader set of generic preferences gets culturally and historically shaped, and expressed over time; most importantly, how, despite those structurations, they enable continual reflections on, and reinterpretations of, contexts, institutions, culture, and their histories to eventually lead to – or, following Kuhn, make quantum jumps to – changes in the world views and institutions of a society. This, I submit, can only be possible if individuals with thin rationality are replaced, and not removed, in the analytical schema of historical institutionalism by conceptions of individuals working with a larger set of preferences, generic in form, cultural in content, and deliberative in dynamics.

In certain types of analysis, where relatively more abstract historical constructs, such as revolution that by definition are products of a long term and a complex historical process,<sup>59</sup> are the subject matter of explanation this problem may not be acute (although it does not vanish). But, when one peeps into what is happening when the dust has settled, even temporarily (as in how revolutionary regimes are delivering the promised dream of development or justice to their citizens), the absence of agents from the analysis creates serious difficulties. These difficulties, *inter alia*, concern two sets of issues: causality issues in linking macro and micro; and mistaken conflation of layers and types of institutions.

I return to my discussion of the developmental state in the context of South Korea and India to illustrate this. The apparent puzzle of divergent economic performance in these two countries, notwithstanding the similarities in the structural features of their developmental states, can be understood in terms of differentials in their institutional underpinnings.<sup>60</sup>

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<sup>59</sup> Theda Skocpol, *States and Social Revolutions: A Comparative Analysis of France, Russia, and China*, Cambridge and New York: Cambridge University Press, 1979.

<sup>60</sup> I am thankful to Dr. James Putzel for drawing my attention to this aspect by his comments on an earlier and a partial version of this paper.

Scholars argue that large-scale land reforms, expansion in health and education, and support to agriculture in South Korea helped to substantially mitigate asymmetries in the rural power structure (and consequently the distributional conflicts), and thus provided a supportive institutional foundation to the developmental state to blatantly focus on promoting growth-promoting policies.<sup>61</sup> But why were these foundations and the shaping of a developmental state pushed, when the state power structure continued to be dominated by the wealthy elites, who could have, as in other developing countries, enjoyed rents from the existing national pie rather than labouring hard to increase its size?<sup>62</sup> Scholars provide interesting insights to unravel this issue. They argue that there was a credible and robust threat to the survival of the ruling elite in power from internal (threat of rural populace embracing communism) and external sources, and that this was the determining factor that drove the ruling elites to follow a path of shared progress seriously.<sup>63</sup>

This is an important insight. It does help to show why a ruling elite might be *oriented* towards establishing and activating a developmental state. But such historical causation does not explain the subsequent *activities*, the nuts-and-bolts that the developmental state employs to achieve the desired ends, such as: how choices from among a set of alternatives are made to define ‘a path’ to shared progress (policies, strategies of implementation, and the like);<sup>64</sup> and how within the overall institutional underpinnings to the state’s functioning, new meso-level rules are constructed and enforced to support the transition of the state and society to the chosen path.<sup>65</sup> The final outcomes for the society depend on the nature of both the *orientation*

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<sup>61</sup> Irma Adelman, ‘Social Development in Korea, 1953-1993’, at <http://are.berkeley.edu/~adelman/KOREA.html>; James Putzel, ‘Developmental States and Crony Capitalists’, in P. Massina (ed.), *Rethinking Development in East Asia: From Illusory Miracle to Economic Crisis*, Richmond: Curzon Press, 2002, pp.189-222.

<sup>62</sup> See Robinson’s theory of predatory states (*Theories of ‘Bad Policy’* Los Angeles: University of Southern California, 1995), which, as Bardhan describes, demonstrates that “it may not be rational for a dictator, for example, to carry out institutional changes that safeguard property rights, law enforcement, and other economically beneficial structures, even though they may fatten the cow the dictator has the power to milk, if such change can damage or weaken his pre-existing rent-extraction machinery. The dictator may not risk upsetting the current arrangement for the uncertain prospect of a share in a larger pie” (Bardhan, 2000, p.8). Robinson’s arguments are quite similar to the asset specificity issue earlier discussed (see f.n.48).

<sup>63</sup> Putzel (2002), p.11. E. Campos & H. L. Root observe that: “In contrast with Latin America and Africa, East Asian regimes established their legitimacy by promising shared growth so that demands of narrowly conceived groups for regulations that would have long-term deleterious consequences for growth were resisted. In particular, broad-based social support allowed their governments to avoid having to make concessions to radical demands of organized labor” (*The Key to the East Asian Miracle: Making Shared Growth Credible*, Washington, D.C.: The Brookings Institution, 1996, cited in Bardhan 2000, fn.15). Bardhan also points out that “[w]here wealth distribution is relatively egalitarian because of land reform and widespread expansion of education and health services, as in large parts of East Asia, it has been somewhat easier to enlist the support of most social groups – and to isolate the extreme political wings of the labor movement – in making short-run sacrifices at times of macroeconomic crisis and coordinating stabilization and growth-promoting policies” (Bardhan, 2000, p.10).

<sup>64</sup> See an interesting study by Daron Acemoglu (‘Why not a Political Coase Theorem? Social Conflict, Commitment and Politics’, *National Bureau of Economic Research Working Paper* 9377, 2002, pp.1-48) that tries to explain why different developmental paths were chosen by South and North Korea. While Acemoglu wanted to demonstrate that the difference was rooted in the difference of the structure of interest of politicians – the main argument of his paper – held in these two parts of the once single country, he finally fumbled and recognized it might have had to do with their differing world views and beliefs.

<sup>65</sup> North had long back insightfully alerted us to possibilities of different dynamics of institutional change in the context of institutional layering that I have already discussed: “There are the fundamental institutions that specify the basic ‘ground rules’ ...and then there are the secondary institutional arrangements which may be created without altering the basic institutions. The innovation of secondary institutional arrangements may sometimes take place without any political or legal change, but others require political implementation. Historically, many secondary institutional developments have been entirely consistent with existing basic institutions; but the implications of others have been in conflict with the status quo” (North, 1970, p.9).

and *activities* of the state. This, I submit, requires bringing back agents without sacrificing the useful insights from historical analysis, a combination of a diachronic with a synchronic analysis, to bridge the divide between macro and micro. A few examples of what the agents were doing to operationalize the developmental state in South Korea may help illustrate this.

In an interesting account of how the developmental state functioned within a deep rooted culture of patron-clientalism in Korea, that had a long history in the Yi dynasty (1392-1910) in the form of *yangban* (patron-aristocrats) providing protection to the client-peasants for securing rents and tributes in return, Yoo discusses an amazing episode about how strategies were formulated to move onto a high growth path:<sup>66</sup>

In 1973, Park announced a quixotic plan. By targeting six areas of industrialization – steel, chemical, metal, machine-building, ship-building, and electronics – Park demanded that the *chaebols* produce \$10 billion in exports.... Park realized there was going to be a large demand for oil tankers ...and summoned Chong-Chu Yong (of Hyundai), ordering him to start building ships:

Chong flew off to Greece and landed two contracts for 260,000-ton oil tankers, by promising cheaper and quicker delivery than any other company. He didn't bother to mention that he had no shipyard to build them. He then put the two orders in front of Barclay's Bank, and it lent him enough capital to build shipyards. No Korean knew how to do this; so Chong sent sixty engineers to Scotland to learn how. Two years later the tankers were finished, before the deadline.

The truly surprising part of the story is not that Chong built his ships against all odds, but that *Park was able to convince Chong to build ships in a shipyard yet to be built by engineers who did not know how to build ships* ...Park was telling Chong that he would do everything within his power to support the success of Chong's enterprise, and *Chong took him at his word*.<sup>67</sup>

This episode, Yoo suggests, is a robust indicator that such a personalised approach to defining highly unconventional strategies was only possible in a context of the deep-rooted institution of patron-clientalism in South Korea. Thus, the key argument of his persuasive paper, based on an impressive range of evidence, is that it was not the Weberian, but the patron-clientalist character of the Korean State that was behind formulating and enforcing the peculiar strategies that pushed Korea on a high growth path.

Taken together, the preceding discussion demonstrates that historically evolved institutional foundations, that structure the power relations more symmetrically, and credible threats to the political survival of the elite in power, can cause the *orientation* of the state to follow a path of shared progress. But, unless one examines what was actually done and why so as to concretely define and get on to that path effectively, the dynamics of the societal and political power structure on its own cannot explain the final outcomes, as they depend upon the role of 'institutional play' as well – how the rules of the game were actually played out – that can even be contradictory to their formal structure.<sup>68</sup> In the case of the shipbuilding project, the

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<sup>66</sup> Hyung-Gon Paul Yoo, 'Corruption, Rule of Law, and Civil Society: Why Patronage Politics Is Good for Developing Markets and Democracies', *International Affairs Review*, 12:1 (2003), pp.32-33.

<sup>67</sup> Bruce Cumings, *Korea's Place in the Sun*, New York: W.W. Norton, 1997, p.324, cited in Yoo (2003), p.34 - emphasis added.

<sup>68</sup> My hunch is that the avowed patron-clientalism displayed in the actual implementation of developmental policies would not only have been absent in the formal structures of the policy rules, say the Industrial Policy of S. Korea, but even appeared contradictory to their universalistic design.

way General Park could motivate and push the business leaders to make such decisions, almost inconceivable if they were to decide on their own, following usual economic rationality in making business decisions, illustrates the need for investigating the role of institutional play, and, as a corollary, *inter alia*, of agency and ideas in making the casual story of change complete.

It is here that historical institutionalism usually commits the fallacy of making a flawed causal jump to link micro and macro, and in the process also erroneously mixes up different layers and arenas of institutions. Changes in power structures may best explain the changes in the orientation of the state, but cannot fully account for differentials in the final outcomes, constant orientations. Also, while they can explain many alterations in the deep micro layers of certain, especially the political, institutions, but may be inadequate to understand the workings of meso-layers of, for example, different governmental institutions.

Do institutionalists recognise facets such as these, and are they bringing them under the ambit of their investigations, especially to offer a more nuanced understanding of the macro-micro linkage? For answers, we must turn to the third shade of institutionalist inquiry, the sociological institutionalism, which seems to offer some promise.

### **3. Culture, therefore, world view matters**

To begin with, let me share a few thoughts:

What do we mean by reality? How do beliefs get formed? How do they change? What is the relationship between beliefs and institutions? ...But whose perceptions matter? Obviously not everyone's; we need to delve into the structure of rule making in the society to answer that question ...For the most part economists, with a few very important exceptions like Hayek, have ignored the role of ideas in making choices ...The way we perceive the world and construct explanations about the world requires that we delve into how the mind and brain work, the subject of cognitive science.

Reading these, it may be hard to imagine they are coming from the scholar who is viewed as the leading mind of NIE. It is North again, writing on 24 June 2003.<sup>69</sup> North is raising here some fundamental questions, extremely challenging in nature, hence, predictably, remaining unanswered.

But the sociological institutionalists are delving into these complex issues. Developed as a reaction to formalism and the salience of the means-end rationality of organization theories of the 1970s, this school has redrawn attention to what Harriss calls "one of the most awkward

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<sup>69</sup> Douglass North, 'Understanding the Process of Economic Change', *Forum 7 Institutional Barriers to Economic Change: Cases Considered*, Forum Series on the Role of Institutions in Promoting Economic Growth, Mercatus Center, George Mason University and the IRIS Center, sponsored by USAID, 2003, pp.1-21. The quotations are arranged in a different sequence than in the text. I don't know whether this can finally persuade scholars to consider that North has travelled far away from the initial conceptions of NIE and resolved the "constant tension between his commitment to the framework of choice-theoretic economics and his awareness of the limitations which it imposes when it comes to the analysis of change" (Harris, 2002, p.6). I, for one, think some fundamental shifts in North's intellectual journey are demonstrated by, among others, his observations quoted above. See also Klaus Nielsen ('Review of Institutional Approaches in the Social Sciences: Typology, Dialogue and Future Prospects', *Network Institutional Theory Research Paper* no.7/01, Roskilde University, 2001, p.14), who goes to the extent of suggesting that North has initiated a new Cognitive-Institutional Approach (CIA).

words in the English language”, i.e., ‘culture’.<sup>70</sup> Sociological institutionalists argue that the boundaries between institutions and culture are blurred. In fact, institutions shade into culture. Ideas, values and symbols ultimately embed the formal rules of the game. This is important, but also not unknown.<sup>71</sup> The question is what new insights do these provide for understanding the workings of institutions? The researchers in this field answer this by claiming that their findings are helping to go beyond a general though strong, but arguably theoretically quite weak, reaction to the thin rationality assumption by demonstrating that individual preferences are culturally shaped and thus not exogenous to institutions. Individuals are not always engaged in maximising self-interest, whether for profit, rent or power, but also strive to attain identity and gain legitimacy in ways that are culturally constructed, and valued. Rules of the game are “not just formal rules, procedures or norms” that are devised by the strategic calculations of individuals, but are “the symbol systems, cognitive scripts, and moral templates that provide the ‘frames of meaning’ guiding human action,” that even “constitute the self-images and identities of social actors”.<sup>72</sup>

These thoughts enrich our perspective on what institutions are about, but ironically they make comprehension of institutional change more difficult. In the other schools, wealth-maximisation or conflicts to gain a more inclusive and a more just order in society – the basic drives, though highly questioned – are regarded as the exogenous impetus for change. But, if these turn into culturally shaped constructs, thus dependent variables, then questions such as why and how preferences change (for example, from collectively-oriented social preferences to that of individualistic wealth-maximising self-interest), or why institutions transform in ways that escape from cultural influence, demand plausible answers. And if the answer is that they change because cultures change, then we run into circularity with the question: why do cultures change?

However, sociologists alert us to the fact that this oversocialized view of individuals, and treating of culture as a latent-variable, held in the past, are now yielding to ones that treat:

culture as fragmented across groups and inconsistent across its manifestations. The view of culture as values that suffuse other aspects of belief, intention, and collective life has succumbed to one of culture as complex rule-like structures that constitute *resources that can be put to strategic use* (emphasis added).

In other words, culture is viewed as a “grab-bag of odds and ends: a pastiche of mediated representations, a repertoire of techniques, or a toolkit of strategies”.<sup>73</sup>

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<sup>70</sup> Harriss (2002), p.8.

<sup>71</sup> One of the major though provocative attempts to read off policy distortions in cultural terms was advanced by Myron Weiner, a highly respected scholar on India, who argued that the problem of child labour and lack of commitment to universalizing primary education both by the state and the societal actors and organizations in India was due to the deep roots of the values of the caste system, that denigrated the lower class in the society and did not consider them fit for education (Myron Weiner, *The Child and the State in India: Child Labor and Education Policy in Comparative Perspective*, Princeton, N.J.: Princeton University Press, 1991). More recently, see Svetozar Pejovich (‘Understanding the Transaction Costs of Transition: It’s the Culture, Stupid’, *Forum Series on the Role of Institutions in Promoting Economic Growth*, Mercatus Center at George Mason University and the IRIS Center, sponsored by USAID, 2003, pp.1-37) for arguments that also place great emphasis on the role of cultural factors in creating resistance to introducing market economy in the transition countries.

<sup>72</sup> Hall & Taylor (1996), pp.14 & 18.

<sup>73</sup> P. J. DiMaggio, ‘Culture and cognition’, *American Review of Sociology*, 23 (1997), pp.263-87. However, not everybody agrees. Interestingly, even DiMaggio’s own findings (see P. J. DiMaggio, ‘The New Institutionalisms: Avenues of Collaboration’, *Journal of Institutional and Theoretical Economics*, 154:4 (1998), pp.696-705) are questioned on this issue by Nielsen, who observes that his presentation of the key themes of

But, this is begging the question. If culture is not entirely constitutive, and if people can use culture strategically, then questions such as what those strategies are, what are the sources of their availability, for what uses they are employed, and why these are preferred – which were thought to have been resolved by bringing culture back in – bounce back to life. No amount of reinforcing findings such as “all cultures, though by definition they involve enduring habits, are both contested within the field of power, and they are all the time being reflexively reworked or reinvented”;<sup>74</sup> actors are “cultural puppets but like Pinocchio they can break away from the strings”;<sup>75</sup> or, individuals are “culturally formed but not totally socialized”,<sup>76</sup> can prove helpful, as they too do not answer the questions such positions necessarily give rise to (e.g., what configures the contests around, and what are the referrals to reflexive reworking of, culturally shaped values, thoughts and habits?).

Even the ideas of institutional logics advanced by Friedland and Alford, describing them as sets “of material practices and symbolic constructions” that constitute an institutional order’s “organizing principles” and are “available to organizations and individuals to elaborate”<sup>77</sup> (a kind of ‘practical reasoning,’ whereby the individual works with and reworks the available institutional templates to devise a course of action),<sup>78</sup> do not help much, as the drivers and directions of the hinted elaborations of the ‘material practices and symbolic constructions’ themselves remain unelaborated.

These problematics also limit the strength of ideas on institutional change this school advances. Change is viewed as resulting from a “logic of social appropriateness” in contrast to a “logic of instrumentality”.<sup>79</sup> That is, enhancing culturally valued social legitimacy rather than efficiency in transactions as driving institutions to change. This is because, as a direct corollary of such a view, questions such as what constitutes the authority behind the legitimacy of one type of institution vis-à-vis other;<sup>80</sup> is it culturally shaped (in which case, the problem of infinite regression: what is the authority behind the authority?); or, does it have an outside referral (in which case, the problem of exogeneity and the related vexed questions as to why such an exogenous construct is viewed as an authority to define or confer legitimacy upon certain institutions?), can seriously challenge this perspective.

Can we meet, or obviate, these awkward questions if we take the interpretative view on culture more seriously, as the institutional logics perspective does, and consider changes as “simultaneously material and symbolic transformations of the world”, which involve “not

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Sociological Cultural Institutionalism perpetuate this social-constructionist view point, in so far as those themes argue that “all elements of rational-action models – actors, interests and preferences – are ‘socially constructed’ and therefore endogenous. Research is focused on informal institutions such as schemata, roles, scripts, or ‘taken-for-grantedness’. Institutional change is seen as a process of isomorphism or diffusion through mechanisms such as pressures to appear legitimate and normative schemes embedded in training and practice” (Nielsen, 2001, p.4). My reading is different, and I think DiMaggio is advancing the ideas of a deliberative view of culture.

<sup>74</sup> Harriss (2002), p.10.

<sup>75</sup> A. Mayhew, ‘Contrasting origins of the two institutionalisms: the social sciences context’, *Review of Political Economy*, 1:3 (1989), pp.319-334, cited in Nielsen (2001), p.12.

<sup>76</sup> G. M. Hodgson, ‘Institutional economic theory: the old versus the new’, *Review of Political Economy*, 1:3 (1988), pp.249-269, cited in Nielsen (2001), p.12.

<sup>77</sup> R. Friedland & R. Alford, ‘Bringing Society back in: Symbols, Practices, and Institutional Contradictions’, in W. W. Powell and P. DiMaggio (eds), *The New Institutionalism in Organizational Analysis*, Chicago: University of Chicago Press, 1991, pp.248-249, cited in DiMaggio (1997) – emphasis added.

<sup>78</sup> Hall & Taylor (1996), p.16.

<sup>79</sup> John L. Campbell, ‘Institutional Analysis and the Role of Ideas in Political Economy’, Paper presented to the Seminar on *The State and Capitalism since 1800*, Harvard University, 1995, cited in Hall & Taylor (1996), p.16.

<sup>80</sup> Hall & Taylor (1996), p.18.

only shifts in the structure of power and interests, *but in the definition of power and interests*".<sup>81</sup> Some scholars think we can:

[T]he proponents of this view see the project of institutional changes not simply as a 'material project' but also as a 'cultural project' in the sense that changes in institutions require (or at least are helped by) changes in the 'worldview' of the agents involved. And once we allow the possibility of 'cultural manipulation', the role of human agency becomes a lot more important than in any other version of the theories of institutional change that we have talked about, as it is necessarily the human agents who actively interpret the world (albeit under the influences of existing institutions) and develop discourses that justify the particular worldview that they hold. Indeed, we should not forget, to paraphrase Marx, that it is human beings who make history, although they may not make it in contexts of their own choosing.<sup>82</sup>

I am absolutely in agreement with this view as far as it places importance on the role of agency, a point that has been a constant theme of my reflections in this paper. But, even by correctly bringing agency back in, we still may not be doing much better analytically in unravelling the questions raised above due to the choice of the route of 'world view', or 'mental model' (schemata, epistemic), for doing so. The questions trail us, albeit in altered forms. I will return to this later. But, for now, it is apt to observe that our journey to search for an understanding of institutional change seems to have reached an interesting turn: from exploring how helpful (or not) are the issues of politics and power (macro level), transaction costs (meso level), and culture (micro or deep structure level) in unravelling how formal and informal rules change; to entering into the realms of the human mind. We had not even visualised that this level would also be required in our explorations, hence had not thought of a term for it. Shall we call it the 'fundamental level'? We may, if we recall how almost 45 years ago the issue of 'mind' was viewed by a highly perceptive scholar. Examining the puzzles of development in Latin America, Hirschman had "place[d] the difficulties of development back where all difficulties of human action begin and belong: in the mind".<sup>83</sup>

Mental models and their connections with institutional change is an emerging field of inquiry, bringing cognitive psychologists, sociologists, and even political scientists somewhat closer, though a lot of ground remains to be covered. DiMaggio draws out a few lessons from the recent advancements made in this field that are worth noting. For example, he points out that recent research on human cognition supports the latent-variable view on culture. A large set of indiscriminately assembled and relatively unorganized, and even conflicting symbols, thoughts, beliefs, and values are stored in memory as a collection of odds and ends. These explain an individual's capacity to deal with multiple traditions, even comprising of inconsistent elements; maintain distinctive and inconsistent action frames in response to varying contextual cues; and hold contradictory expressions of attitude over time.

However, this tool-kit view of culture implies a more pronounced need for organization of the disparate elements in cognition to render the world intelligible, than did the earlier oversocialized view of cognition. This involves a partial selection from the 'grab bag of odds

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<sup>81</sup> Friedland & Alford (1991), p.246, cited by Chang & Evans (2000), p.17 – emphasis added.

<sup>82</sup> Chang & Evans (2000), p.18.

<sup>83</sup> A. O. Hirschman, *A Strategy of Economic Development*, New Haven: Yale University Press, 1958, p.11, cited in Paulo Seri, 'Losing areas and shared mental models: towards a definition of the cognitive obstacles to local development', paper prepared for presentation at the DRUID Winter Conference, 2001, p.4.

and ends' for constructing schemata, or mental models, to bring some coherence or intelligibility in perceiving and negotiating with the outside world. How is this achieved? "Automatic cognition", or everyday cognition, that is made of "typification, of the habitus, of the cognitive shortcuts that promote efficiency at the expense of synoptic accuracy", is one source of this ordering. It has parallels in sociological understandings of how "institutionalized structures and behaviours are taken for granted, reproduced in everyday action and treated as legitimate." But more significant are the findings on "deliberative learning," which, though not easily activated, when achieved under certain conditions (problem situation; dissatisfaction with status quo; and failure of existing mental model to account for new stimuli) can enable overriding of "programmed modes of thoughts to think critically and reflectively".<sup>84</sup> Interestingly, even the political scientists, working in the tradition of rational choice and using game theoretic approaches, are seriously employing the concept of mental model and are looking into how histories shape them to make more nuanced analysis of political behaviour.<sup>85</sup> At the same time, development researchers are using this idea to understand problems of local development even in the developed western world.<sup>86</sup>

In the light of this brief discussion, one may return to the questions to see if the findings on how mental models are constructed and change answer them. I think the difficulties do not go away. The following illustration will help. The mental model concept may suggest, as evident from the preceding discussion, an inherent role of agency in interpretative and creative interactions with cultural resources in constructing and changing a worldview (especially through deliberative cognition). But what remains unclear are issues such as: what parameters agency employs in making selections of, and reflections on, cultural resources to impose an order on the grab bag of odds and ends, and also change it under certain conditions; what is the basis of their selection in the first place; and how do those parameters remain unconstrained by culture to allow overriding of programmed modes of thinking, while also simultaneously remaining under its influence? If mental models allow intelligibility to the outside world, it implies a congruence with its status quo position. How, then, does a dissatisfaction with the status quo arise, and in reference to what, so as to lead to a revaluation of the model and effect its change? Similarly, perception and evaluation of the failure of existing schemata to account for external cues raise the issue of what benchmarks an agency employs and why such a conclusion should be reached.

Surely we need more research to develop these ideas more robustly and usefully for understanding institutional change. But, to my mind, insights emerging from sociological institutionalists oriented towards developing more nuanced understandings of how culture plays a role in structuring a broader preference set for actors to strive for, providing broader meanings to the issues of power and conflict, and especially in drawing attention to agency's reflective and deliberative involvement in social change, unresolved dilemmas about these notwithstanding, are helpful. They need to be tested and refined through rigorous inter- and intra-nation comparative case studies.

To close, perhaps we would do well to reinforce the observations made in the preceding paragraph with those of Denzau and North, which, indeed, are striking:

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<sup>84</sup> These are from DiMaggio (1997).

<sup>85</sup> John W. Schliemann, 'History and Emotions, Beliefs and Mental Models: Toward a Hermeneutics of Rational Choice', 2002, at <http://alpha.fdu.edu/~schieman/research/mental-models.pdf>.

<sup>86</sup> Seri (2001).

The mental models that the mind creates and the institutions that individuals create are both an essential part of the way human beings structure their environment in their interactions with it. An understanding of how they evolve and the relationship between them is the single most important step that research in the social sciences can make to replace the black box of the 'rationality' assumption used in economics and rational choice models.<sup>87</sup>

### Concluding observations

A few general observations, illustratively made in the context of rational choice institutionalism, that apply to the institutionalist perspective as a whole, are in order here. The thin rationality issue has been repeatedly discussed. There is absolutely no doubt that it is the weakest spot in the rational choice frame of analysis. But a mere dismissal will not do.

First, the multiplicity of institutions, and people's capacity to employ multiple rationality assumptions or preferences while working with them, require closer attention. Self-interest expressed in terms of wealth maximisation may play a prominent role within the economic institutions in life, though there too, as I argue below, it is unlikely that it works in solitude. However, this should not lead us to think that this, or some other equally thin equivalent, guides individual behaviour in other spheres of life too. Individuals may take their own brothers' lives in conflict over family property disputes, but may also give their lives for matters of honour and dignity.

Second, even though the self-interest of wealth maximisation in market transactions may be easily observable and quantifiable, there may still exist other preferences, even if not at its root (though I suspect they are), working in conjunction with it to guide institutional development in the economic realm. Much of the story of the evolution of complex economic institutions (banking, etcetera) in the West, when viewed only from a transaction cost perspective, naturally focuses on the efficiency criteria. But the urge to establish conditions for a just and fair exchange relationship has driven the story too. Bardhan's discussion on how reducing opportunism in transactions among people largely unknown to one another,<sup>88</sup> and North's discussion of externality, point to the fact that a serious concern of the traders was to ensure they were not cheated.

Why do people want to avoid being cheated? It is not because it means loss of wealth, though that too remains a factor. This is because, at least in part, people feel a sense of injustice or unfairness in such an exchange situation. It is not uncommon to find wealthy western tourists in a rage after realising they were cheated by the auto drivers in India, or haggling with them to avoid such an eventuality, for a few rupees, when those may be equivalent to a few cents, which they rarely carry back when returned by restaurants to avoid the hassle of juggling with small coins. This behaviour pattern expresses a deep-seated urge to resist being subjected to unjust, thus unacceptable, exchange relationship in a society. If this is correct, then it will be quite unjust to conclude that wealth-maximisation preference drove the evolution of the institution of pre-paid taxi counters at the Indian airports, the undisputed gains to the taxi drivers (the counters are run by their associations) and the government (more foreign exchange) from the greater inflow of tourists notwithstanding.

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<sup>87</sup> Denzau & D. C. North, 'Shared mental models: Ideologies and Institutions', *Journal of Institutional and Theoretical Economics* (1994).

<sup>88</sup> Bardhan (2000), pp.2-4.

Take another case. I have a strong suspicion that a firm such as Infosys in India,<sup>89</sup> and the actors working within, may not exhibit any signs of departure in their wealth maximisation preferences in their usual inter-firm and firm-client transactions. Yet creativity, setting worldwide standards of professional excellence, visions of changing society through the knowledge revolution have also driven the actors involved in building this institution in ways that make Infosys be what it is like today.

Similar is the case in other non-economic phenomenon, where institutional developments, or impediments to it, arise from a play of multiple sets of preferences juggled by individuals. Institutionalists employing rational choice methods will also do well here to identify the preferences as a spectrum-like structure and conditions that allow preference switching. The problem is that maximising power, once again more amenable to observation and reduction into model building, remains the focus of research, disallowing more nuanced findings, and even restricting the researchers from raising the right questions. It is therefore not uncommon to find researchers getting into the trap of the fallacy of inverted causality. Studying a policy and finding its failure in implementing its intent, though resulting in political benefits (for example, an effect on expanding the vote banks of the politicians in power), lead to an easy causal inference that the policies were pursued to maximise power. This backward causal linkage (judging an action by its outcome) must be double examined by the forward flow of causality (under what understanding of the more certain political costs in the present, and the distant and more hazy future political benefits, were those policies formulated? If costs were perceived to be higher, then why was such a risky path was chosen?) to uncover the reasons for pursuing such a policy, notwithstanding its ex-post political payoffs.

Third, once we take seriously the concept that preferences exist as a spectrum, and preference switching is possible, the role of ideas, highly neglected in the institutionalist inquiry as admitted by North himself,<sup>90</sup> can assume their much-needed salience. Novel ideas, their presentation style, and deliberations and persuasion can have a vast impact on altering the internal hierarchy of the preferences to socially more beneficial forms. I am not arguing this is easy. It is very challenging. But, studies must document and analyse how ideas have played successful roles in altering the preference structure, whenever they have, to let us know how challenges have been met in those cases.

Finally, leadership occupying institutionally powerful positions is another variable that works on its own, as well as adds robustness to the role of ideas, in positively impacting on the preference switching processes, and solving such collective action problems which may have remained unresolved despite a labyrinth of rules and regulations. The definition of institution comprises both rules and their enforcement structures. We often focus on the former and generate puzzles of existence of inefficient institutions despite having efficient rules, but ignore that the problem may lie elsewhere at the enforcement level. Leadership, in so far as it enhances the efficacy of this latter element of institution, *inter alia*, makes a difference. In the abstract notion of actor and agency, the distinctiveness of leadership, despite being played out by one or the other actor, remains poorly explored. In academic research, there is now an increasing, though extremely slow, recognition of this factor. Yet, it is seen more as a unique or an idiosyncratic variable, and, thus, is employed to explain deviant (positive) cases as a composite category, as a black box.

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<sup>89</sup> A software development company, that started with a handful of Indian Institute of Technology (IIT) graduates with about Rs. 10,000 (\$200) initial investment, that has risen in a short span of last about 15 years to become a multi-billion dollar software giant in India, and has been internationally acclaimed for its innovative business practices.

<sup>90</sup> North (2003).

There is a need is to deconstruct it and look for what strategies leaders employ, how they differently use institutional resources (authority and the rule structure embedded in the position they hold), and how they synthesize inside knowledge of the institution and external ideas to generate different perceptions about a problem and innovative solutions that sometimes lead to ‘gestalt shifts’ in preference structures of other institutional actors to unlock the institutions’ welfare-enhancing potentials. Once such a deconstructed analysis of leadership is undertaken, what might come to attention is the concept of institutional play that I have already briefly discussed. This can highlight that possibilities for innovatively playing the rules of the game may exist to unleash their enabling potentials, without necessarily altering their basic, or even the broad framework of the meso-level structure, which for historical reasons might have assumed constraining characteristics. In other words, what may come to light is that history matters, indeed, in structuring the rules in ways that make their play inefficient and also path dependent. But, it still leaves spaces for conceiving alternate games that can be played out within the same structure to both change the outcomes in the present, and also trigger contradictory pressures on the structure that can cumulate in the future to alter the very structure as well.

Some of these thoughts equally apply to the other schools discussed in the paper, besides other reflections made on their strength and limitations at appropriate places in the text. And these ideas will be developed further, subjecting them to scrutiny in relation to the ethnographic details and findings of the case studies on reforms in Madhya Pradesh, that I intend to discuss in a companion paper. I must, therefore, end this more abstract discussion, lest it transcend to the fourth or fifth order of abstraction, that Scott is so concerned of<sup>91</sup> – and I am in absolute agreement with him – which may disconnect us from the reality the abstractions are intended to capture.

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<sup>91</sup> James Scott makes this interesting observation in Kohli *et al* (1996), p.20: “I personally have never been able to think my way through a fourth-order extractions or simplification without embedding it in a concrete case. I just cannot understand fourth – order extractions; once there are four or five or them simultaneously in the air, I am essentially lost because I have no empirical reference”.

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- DP1 James Putzel, 'The Politics of 'Participation': Civil Society, the State and Development Assistance' (January 2004)
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These can be downloaded from the Crisis States website ([www.crisisstates.com](http://www.crisisstates.com)), where an up-to-date list of all our publications and events can be found.

The aim of the Crisis States Programme (CSP) at DESTIN's Development Research Centre is to provide new understanding of the causes of crisis and breakdown in the developing world and the processes of avoiding or overcoming them. We want to know why some political systems and communities, in what can be called the "fragile states" found in many of the poor and middle income countries, have broken down even to the point of violent conflict while others have not. Our work asks whether processes of globalisation have precipitated or helped to avoid crisis and social breakdown.

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### Research Objectives

- 1 We will assess how constellations of power at local, national and global levels drive processes of institutional change, collapse and reconstruction and in doing so will challenge simplistic paradigms about the beneficial effects of economic and political liberalisation.
- 2 We will examine the effects of international interventions promoting democratic reform, human rights and market competition on the 'conflict management capacity' and production and distributional systems of existing polities.
- 3 We will analyse how communities have responded to crisis, and the incentives and moral frameworks that have led either toward violent or non-violent outcomes.
- 4 We will examine what kinds of formal and informal institutional arrangements poor communities have constructed to deal with economic survival and local order.



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