Forum Series on the Role of Institutions in Promoting Economic Growth

Comments on Peter Boettke's "The New Comparative Political Economy"

Prepared by John Simon
United States Agency for International Development
Oral comments transcribed from USAID Forum 6

Forum 6

The Interaction Thesis: Alternative NIE Perspectives on Development Economics and the Dilemmas of Foreign Aid Policy

4 April, 2003

Washington D.C.

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's EGAT EG SEGIR/LIR PCE-I-00-97-00042-00, TO 07

About the Series

The objectives of the Forum Series are to help USAID make its donor assistance more effective and sustainable by incorporating insights from the New Institutional Economics into USAID's programming and delivery of development assistance. Services for Forums 6,7, and 8 are provided by the Mercatus Center at George Mason University and its consultants and the Center for Institutional Reform and the Informal Sector (IRIS). Editor for Forums 6, 7, and 8 is Peter Boettke, the project director for this portion of the Series with support from the overall project director, Clifford Zinnes, and the Forums Steering Committee (Ed Connerley, Jim Elliott, Jonathan Sleeper, and Mark Gellerson), chaired by the activity's COTR, Fred Witthans. Funding for the Series is provided by USAID's Bureau for Economic Growth, Agriculture, and Trade, Office of Economic Growth through SEGIR/LIR contract PCE-00-97-00042-00, Task Order 07.

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Thank you and thank you Peter. I thought your paper was very thought provoking and fairly accurate. I don't have too many issues with it so I will focus my talk on areas I would like to see explored further and made potentially more practical for those of us who are actually trying to not only study development but also to make it happen.

The first point I want to make, and there are basically three points, is this focus you point out on the great mistake of the last hundred years in economics.

The classic mistake of economists of: "If you have a problem assume a hammer, or a light bulb, or whatever you need to fix it." In this case economists assumes nothing so great as an omnipresent, omnipotent, all-knowing force that could plan an economy, assuming away the fallibility of humans.

I think Peter, you did a very good job of showing how in practical terms that was an incredible intellectual error that has led to 100 years of traveling down something of a blind alley. But I wanted to focus a little bit on this concept: that in the real world people are fallible, and what that means for economic attempts to foster markets. It's often said and we who now recognize the fallibility of assuming an omnipotent planner shouldn't make the same mistake of assuming an omnipotent, all-knowing market. People are fallible but so are markets.

Anyone who's had money in the stock markets over the last 5 years has learned that lesson potentially to their detriment. Though if you're really smart you may have learned it to your benefit. What fallible markets and fallible people do have though, and their great strength, is they learn from their mistakes and they adapt.

In the planned economy, the mill in Washington [State] that sends a truckload of lumber to Germantown, Pennsylvania instead of Germantown, Maryland sees their lumber rot and society loses a truckload of lumber.

In a market economy, the price of lumber goes up in Germantown, Maryland and goes down in Germantown, Pennsylvania. Potentially someone notices the discrepancy, puts it on a truck, ships it to the right place and that lumber eventually builds the houses in Germantown, Maryland that probably provide shelter for some of the people in this room and basically accomplished the goal the economy wanted to accomplish to begin with. The loser is still the miller in Washington State who had to sell lumber at a lower price, the winner is the entrepreneur who figured out the discrepancies and made a quick buck, and people get their houses built just the same.

I think it is that strength of markets, to be able to be fallible but learn from their mistakes and capitalize on them that allows that institution to be one of the key institutions in development, and one of the key reasons why the socially planned model was so mistaken in the past. I also think it's important to recognize that within the mistakes of markets are opportunities.

As Peter mentioned, I worked for the Commonwealth of Massachusetts, and in Massachusetts during the 1980's the market made a big, bad bet. They made a large bet on large mainframe computers. Anyone remember Wang? Big, fat boxes that basically, by and large, are all rusting today if they still exist. But if you go to Lowell and see the Wang headquarters, it is bustling. Many of the people who used to work for Wang, many of those same engineers are now in companies whose combined market value, if you were to add up all the companies that are in that building, dwarfs anything that Wang ever achieved in its hay day.

The market was able to turn that big mistake into a fantastic success. Now we've probably made another mistake in terms of what has happened with the Internet bubble. But in a planned economy, that's water under the bridge, a wasted resource. In a market economy we're able to take those mistakes, learn from them, take the capital that was invested in the technology, in the capacity, and turn it to something that is valuable, something that will move growth forward, something that will create production in the long term. That is a critical strength of market economies that we cannot forget. It is the fallibility of markets that in some ways create the opportunities of tomorrow.

The second issue of concern or issue for further exploration with Peter's paper is this discussion of the word "institutions." From my perspective this is a bit of a general term. What institutions? It's not just general it makes it sound just a little too easy. Well, we've figured out the problem, [now] we fix the institutions. It's almost like assuming the role of that omnipotent planner; we assume omnipotent institutions. We need to be fairly specific about what institutions we are talking about.

In Peter's paper he actually gets down to it a bit; he talks about private property, the ability to enforce contracts through third party means, and the ability to transfer property. These are obviously critical institutions and clearly the basis for capitalism. But I think it's important to recognize the gestation period it took for these institutions to come into existence.

I started what little academic career I had as a medievalist. John Nye worked in the bright lights of rocket science and I worked in the dark shadows of medieval history. For medievalists, if you do your primary research you have letters from kings to their nobleman, you have manuscripts of journals of what was happening in the current period, but primarily what you have if you go down and try and get the documentation of medieval times, is records of property transfers, and records of deeds and quitclaims and gifts of one sort or another.

I'll just read one little passage from a brilliant thesis on the War of the Roses, that for some reason never really saw much light of day. Basically, this is about two gentlemen in Berkshire [and a Nobleman named John Norris]

> who in July of 1449 with the help of two other Berkshire gentlemen, Edmund Bradennell and Thomas Lavington, John Norris took possession from Robert Innkeep of the manors of Wyle and Buckcult and all lands, reservations, rents and services of Wyle, Buckcult, Hampstead, Crewast, Basselton, Assumstead and Southcoat.

Anyone from Berkshire in England might know those places, I unfortunately don't.

> That November, Norris and Lavington received from Edward Warner of Reading a gift of all goods, chattels and debts in Reading and elsewhere within the realm and overseas. Andrew Ties, citizen of beloved London gave a similar gift to John Norris and associates in May of 1452. That year John Norris joined with fellow member of Parliament and Justice of the Peace, Thomas Delmar and Robert Harrowcourt to buy Thomas Bruns' manor of full scope. The next year the group had Thomas Bruns' son, Robert, issue a quitclaim of full scope to secure the manor to the heir and the sons of John Norris.

Now, that was over 600 years ago during a time of a civil war and those records could be found by an undergraduate student at a university 3,000 miles away. The ability to record and to maintain the records of property transfers over that period of time, which survived through the type of turmoil that occurred in England in the 15th and 16th centuries, is just astounding. And it is that institution that we are putting so much stock in. So we have to think a little bit, how can we possibly take that 500 years of institution building that created the bulwark of our capitalism and transfer that to countries where that history just does not exist. And I think if you look at other areas of the world where you have seen the rapid economic growth—like East Asia for instance—there is a history there of private property and private property transfers and of keeping those records. You can read *The Good Earth* by Pearl Buck about the effort that was put into documenting claims to land, but where that does not exist how can we [establish property rights], and I don't say this to dispute the fact that private property is necessary, there's no capitalism without capital and otherwise you have just an "ism", which can go with all the other "isms" into the dust heap of history. It's necessary, and capitalism is the mechanism by which we achieve economic growth, the only one we know, but how do you do that? I'm asking as someone who is charged in some ways to figure out how, how do you do that without compressing, given the effort and the history that has gone into developing those institutions where we know they are?

And the other point that needs to be made and this is why I think Peter makes a very valid point when he talks about the need to work though indigenous institutions: it is not as if those places where these institutions do not exist haven't found other mechanisms of adapting. There's a story in *The Economist* about how Mongolian herdsman use a system of common land to basically adjust to different weather patterns to keep their herds more vibrant. When in fact, at the advice of development specialists they began to privatize much of the land, that disrupted this system and as a result there was a decline in the herd population. Since Mongolia is made up primarily of herders, there was a decline in economic growth. That's not to say again that privatization was wrong; it is to say it needs to be done in a way that doesn't disrupt the adaptive systems that already exist. In Africa, many of the communities where there is no private property use a system of communal lands where different people rotate caring for different parts of the communal lands. This ensures that the good farmers get the parts of the land that have become less productive so they can use their techniques to ensure that its productivity is enhanced, and so that the bad farmers are moved around so they don't degrade one piece of property and thereby degrade the assets of the community. These are systems that exist and somehow we need to figure out how to work with these systems, not against them. But at the same time not assume that because a system exists and because a clumsily imported system, the constitution that's "emailed**"** from the west, fails that that's an excuse to let the old system lie and for underdevelopment to persist. There needs to be a method to take those old systems and convert them into systems that create the savings and the capitol that is necessary for economic growth.

The last point I want to make is to question a point Peter makes in his paper, that if we get the prices, and the institutions and the culture right, that is what we in terms of development specialists need to focus on to get economic growth moving. And to question whether there is not a missing piece. Those of you in AID know we've spent a lot of time talking about competitiveness in the Michael Porter context. What can you do to create the sophistication of management, to create the culture of entrepreneurship; and again, maybe this is semantics, maybe this is all about culture, but it seems to me it's more than just a laissez-faire approach. It is something that needs to be done to allow, to create an environment that allows, a type of clustering that you see in places like Silicon Valley, in places like the French wine county, and in places like the California wine country. To get the innovation, and the expertise, and the entrepreneurship and the support systems that support those things that support innovation which I believe is the generator, somewhat different than technology, that is the generator of increased productivity which is the generator of increases in wealth.

What can we do proactively to support those systems that create economic growth? And is there something we can learn from Michael Porter, and again when he came to us and talked, he talked about this being more of an art than a science. We have a lot to learn in this area but we do know that there are some areas: Bangelor, Silicon Valley and other areas where the ingredients have come together to create a dynamic, entrepreneurial, growing engine for the people in those areas and the people around them and that we need to find ways to develop those types of environments more and more in countries in the developing world if we expect them to move beyond simply the subsistence level where many of them currently are. And again, I present that more as a question for discussion then as an answer and I propose that potentially within this context of competitiveness there are some answers, some solutions to these issues.

To close, I just want to focus on my great concern, which is theoretically I think we've created a fairly sound paradigm here: the concept that you need prices, you need institutions, you need culture. What does that really translate into [for] policies of governments, how does that translate into policies for development agencies? What can we do to tackle these great issues when as we think about it, culture is a product of 501,500 years of history and I don't think we have 501,500 years to wait to address these development issues. If the South remains at a level under development that it stays in then the political problems that it creates for the globe as a whole are just untenable. So, that's a negative note but on a positive note, I appreciate Peter's contribution. I think it is right on. I think really though it is more of a call to more work as opposed to a simple solution. Thank you, Peter.