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Institutions and Economic Change

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There is now widespread consensus among scholars and policy makers that institutions are a crucial determinant of economic performance, and that the mechanisms involved in the processes of institutional emergence and change can generate solutions to socio-economics problems that enhance economic growth (Acemoglu et al., 2005; North, 2005). Both the conceptual frameworks focusing on the study of institutions and the large body of existing empirical literature on the topic show that a country's long-term economic performance critically depends not just on its institutional environment but also on complementarities between different kinds of institutions (Gagliardi, 2015).

Historical evidence also suggests that the causality from economic development to institutions may be even stronger than the one running from institutions to economic development. Economic development changes institutions through a number of channels. While increased wealth due to

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growth may create greater demands for higher-quality institutions, and may make better institutions more affordable, economic development creates also new agents of change, demanding new institutions (Chang, 2011).

From a theoretical point of view, two broad approaches have been proposed in economics to study institutional issues. The first, pioneered by Douglass North (1990) and other new institutional economists, and referred to here as the “historical approach”, conceptualizes institutions as the rules of the game, and integrates economic theory and economic history. The emphasis placed on the historical context comes from the observation that much of the developmental trajectory of societies is conditioned by their past in a path dependent way, with the implication that institutions are historically specific. It follows that historical contexts must always be taken into account, especially when dealing with the issue of institutional change (Alston, 1996).

The historical approach furthermore combines a theory of human behavior with a theory of transaction costs. Its central result is that institutions determine the structure for exchange that influences the level of transaction costs, thereby affecting the feasibility and profitability of engaging in economic activity. It is through this mechanism that institutions are the underlying determinant of long-run economic performance. In other words, by defining and constraining the opportunity sets available to economic agents, institutions structure incentives in human exchange, provide a stable structure to human interaction, and reduce uncertainty by fostering convergent expectations (Gagliardi, 2008).

The second analytical framework is the “comparative institutional analysis approach” associated with Masahiko Aoki (1996) that also draws on historical information while at the same time making extensive use of game theory. Institutions are here conceptualized as the endogenously emerging equilibrium outcome of a game and the focus is on the interdependencies existing across economic, political, social and organizational domains. In addition attention is given to interdependencies arising across institutions linking different domains.

The core issue is how the rules of the game are generated and become self-enforcing through the strategic interaction of the agents, whose behavior is influenced by the self-enforcing constraints determined within the existing set of rules (Aoki, 2001). The study of institutions through equilibrium analysis provides the basis for examining questions related to the emergence and change of institutions as reflecting the interrelations among society's decision-makers, their past institutions and the evolving environment in which they interact (Greif, 1998).

Despite the significant advances made by institutional analysis using both the above perspectives, we are still a long way from a satisfying theory of institutions and their economic effects. This symposium, dedicated to the memory of the late Masahiko Aoki, whose contributions to institutional analysis cannot be understated, aims to shed light on some of the issues involved in attempts to further this research agenda. The three papers included in the symposium were presented at a September 2013 workshop on "Institutions and Economic Change", organized by the Group for Research in Organizational Evolution of the University of Hertfordshire Business School in England.

The first paper, by Masahiko Aoki, proposes a conceptual and analytical framework for institutional analysis that aims to reconcile differences in the main approaches to institutions by showing that they are mutually supplementary. Aoki argues that on its own the game-theoretic approach to institutions (i.e. the comparative institutional analysis framework) is incomplete as a theoretical tool for institutional studies. Given that the comparison of various institutional arrangements and the exploration of institutional change involve multiple equilibria, the role of societal devices in aligning the strategic choices of agents also needs to be considered. Put differently, Aoki argues, strategic and linguistic presentational considerations are mutually complementary for institutional studies.

Aoki applies this combined framework to conduct a historical comparative institutional analysis of Qing China and Tokugawa Japan, revealing similar institutional complementarities. The productivity of the peasant-based economy provided the basis for the fiscal capability of the Qing rule, while the political stability of the military and administrative apparatuses of the Qing rule provided a relatively secure environment for the peasant-based economy. Likewise, the village undertaking system established by the Tokugawa and Han governments made the peasants owners of their cultivated lands, which provided collective incentives for farmers to make productivity gains and, at the same time, enlarged the fiscal capability of the governments. Aoki argues that these two stable patterns of strategic play were publicly represented by, respectively, the deontological values of Confucian principles and the polysemic notion of *kō-ghi*. The paper then shows that, facilitated by specific salient public propositions, agents' strategic play led to the demise of these stable patterns with the Xinhai Revolution and the Meiji Restoration respectively.

The second paper is by Richard Langlois and sheds light on the uses of institutional economics in economic history. It does so by examining the historiography of two major puzzles in European economic history: the scattering of plots in the open fields in the Middle Ages, and the transition to the factory system in the Industrial Revolution. The analysis falls within what Langlois calls the "good old" new institutional economics, i.e. the methodological approach previously referred to as the "historical approach". The core argument is that both puzzles must be examined in light of the role they played in the larger institutional system. In both cases the very success of institutions in solving the economic problem with which they were confronted eventually created a new economic problem to which the original institutions were no longer adapted, leading to their replacement with new institutions.

A feature of the open-field system, namely the scattering of plots held by villagers, has given rise to multiple interpretations in the literature. In Langlois' view, the open-field system was a set of rules *à la* Ostrom to manage a complex semicommons, and scattering operated as a protection of the entire set of adapted rules. It did so by providing flexibility and diversification against a variety of contingencies, many of which were essential elements of the collective management system of the open fields. The institutional change from the open field-system to enclosures produced significant rural unemployment, and this led capitalists to put out spinning and weaving to the countryside. Langlois contends that when the expansion of the market for British textiles drove the putting-out system beyond the point of diminishing marginal returns, technological and institutional change occurred, leading to the development of mechanization and the factory system.

In the final paper, Simon Deakin, David Gindis, Geoffrey Hodgson, Kainan Huang and Katharina Pistor claim that institutional analysis needs to take into account legal rules and the constitutive role of law, and that this is not only essential for scholars but also for the formulation of sound policies and regulations. The proposed approach of "legal institutionalism" focuses on the idea that law is a constitutive part of the institutionalized power structure, and a major means through which power is exercised. Law, from this perspective, is primarily constituted by the public ordering of the state, while customary law dominates only in the parts of the economy beyond the state's reach. At the same time, spontaneous order explanations of law are found wanting, particularly in any developed economy of a certain size and complexity.

Besides making these general points concerning the role of law, the paper argues that the removal of legal considerations from the economic concepts of property rights, exchange, contract and the firm has impaired the understanding of their nature and function in modern capitalism. For instance, legal institutionalism clarifies that the essence of the right of ownership of a resource is its acknowledgement of that right by others through mechanisms of legal accreditation and legitimation. Similar claims are made about the key notions of exchange and contact. Importantly, the paper also demonstrates that the recognition of the firm as a legal entity contributes to solve some of the enduring problems in the theory of the firm literature.

It is not suggested here that the above three papers fill completely the current lacunae in institutional analysis as discussed in earlier parts of this essay. However, the diversity of approaches that the three papers exhibit can enlarge the possibility of further conceptual innovation, while the significant overlaps in terms of core theory provide scope for the research program to make headway.

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