The Pakistan Development Review
31: No. 4 Part I (Winter 1992) pp. 581–605

Distinguished Lecture

Institutional Economics, Development Economics and Labour Economics

GERRY RODGERS

I. INTRODUCTION

It seems to be quite fashionable for economists to be interested in institutions nowadays. At least, there is a growing interest among economists in the economic effects of institutions (reflected most obviously in the award of the 1991 Nobel Prize to Ronald Coase). And quite a few books on the economics of institutions have been coming out recently.[1] Sociologists are not impressed, of course. Institutions are and always have been central to much sociological theory. But for economists, an interest in institutions has in the past been off the mainstream. One reason may be that it is difficult to reach agreement on what institutions really represent, because there are so many ways and levels at which one can consider them. One definition is that "institutions are the humanly devised constraints that structure political, economic and social interaction" [North (1991)]. "Humanly devised" might seem too purposive for some tastes. Others refer to "rules of a society or of organisations that facilitate co-ordination among people by helping them form expectations which each person can reasonably hold in dealing with others" (Ruttan and Hayami); or "complexes of norms of behaviour that persist over time, by serving collectively valued purposes" (Uphoff) [both cited in Nabli and Nugent (1989a), p. 7]. But there are two quite distinct classes of institution, or two distinct meanings given to the word [van Arkadie (1990)]: the first is in the sense of organisations; the second refers to persistent rules, norms and constraints governing behaviour. These rules may be formal and written, or they may be informal and implicit. Both organisations and rules are relevant, since both form part of the set of social relationships underlying any set of economic relationships; moreover they

Gerry Rodgers is Head, Labour Market Programme at the International Institute for Labour Studies, Geneva, Switzerland.

Author's Note: This paper is part of a continuing research project on labour institutions and economic development. I am grateful for comments, contributions and suggestions to Andres Marinakis and other colleagues at IILS, and to participants in several seminars during 1991 where work in this area was discussed. Views expressed here are personal and imply no responsibility on the part of the IILS.

[1]For example Eggertsson (1990); North (1990); Nabli and Nugent (1989a); Bardhan (1989).

interact, in that there will be a set of rules which govern the behaviour of social organisations.

An example of the importance for economic processes of both formal and informal institutions lies in the rules governing the ownership, use and exchange of property. There is a formal (legislative) component – in this case the rights to property, and the boundaries to those rights (e.g. ceilings on land ownership, conditions under which the State may purchase compulsorily, restrictions on foreign ownership), and an informal component (usage, social convention, and the contribution of property to status and hierarchy). Both elements will in general place constraints or conditions on the use and exchange of property, and they may of course be in conflict. For instance, there may well be formal restrictions on the renting out of land or housing, but these formal conditions may be overridden or modified by the power of usage, or by the direct use of force by property owners. The rules may operate generally throughout society, and be internalised (only marginal groups reject the rules), or they may require the direct application of force or sanction.

Most economists recognise that their discipline is surrounded by conventions, values, norms, laws, organisations, agreements and the like. But the majority of mainstream economists have been happy to ignore these messy, social phenomena, and consider that one can fruitfully analyse economic behaviour holding institutions constant. Institutional explanations are regarded as "soft", as descriptions with little predictive value. Often they are merely used to explain, with hindsight, the difference between the predictions of the researcher's model and what he or she observes in the real world (and so institutions become rigidities and imperfections, preventing the world from functioning as it should).

If economists are changing their views about institutions, it is surely partly because the sterility of mainstream neo-classical economics is becoming increasingly obvious. Not long ago, Wassily Leontief looked at several years worth of articles published in the American Economic Review, and found that two thirds of them contained no data, a quite extraordinary situation.[2] In practice, the high status work of the profession has been centred around the mathematical representation of mechanisms based on efficient exchange between rational, utility maximising individuals, with only a secondary interest in whether this has much to do with the real world. There is an increasing credibility gap between this literature and the real world problems of unemployment, poverty, economic dynamism, entrepreneurship, of motivation and participation.

There has always been a fringe of economists concerned with institutions, recognising that it is difficult to explain differences in economic performance in

[2]See Morgan (1988) who notes that this makes economics unique among the natural and social sciences!

purely economic terms. They have remained on the fringes mainly because of a perception that institutional theory was weak and certainly inelegant, so that much of this work was basically description, and difficult to generalise. Does the recent resurgence of interest in institutions mean that this concern is at last moving to centre stage?

II. A BRIEF HISTORY OF INSTITUTIONAL ECONOMICS

Various schools of institutionalist economists have attacked these issues from one angle or another. One school emerged in the United States at the beginning of this century, its principal contributors being Veblen, Ayres and Commons. Their theory was characterised by a holistic approach to economics, relating the nature of the economic system and the nature of human behaviour. Under the influence of Marx's vision of history, Veblen explained the process of social change as the result of the conflict between new forms of production and social institutions representing the existing power relationship. Similar ideas were developed by Ayres who, reviewing the history of western civilisation, pointed out the importance of the strength or weakness of the existing institutions in blocking or promoting technological progress. Contrary to the established economists who described the economy as tending toward an ideal "stationary state" (following J. S. Mill), Veblen introduced the idea of an evolutionary economic process without a predetermined result. Commons shared this evolutionary vision, but his major contribution was in the domain of social legislation, as he saw the legal system as the institution which could canalise conflicting social interests [Street (1987)].

Another school developed around the institutions of the labour market in the early post-war period. The "Post-Institutionalist School", including Dunlop, Ross and Myers among others, was closer to market analysis but paid considerable attention to the growth of unionisation and of collective bargaining. Their approach was influenced by the experience of unemployment in the 1930s, which showed that labour markets did not necessarily clear and so demonstrated the limits of competitive theories. These authors provided the first analytic treatment of unions as economic institutions, playing an important role in the wage determination process. Their model assumed that workers behave rationally but under imperfect information. The resulting behaviour, combined with relatively low labour mobility, explained the persistence of wage differentials on similar jobs [Segal (1986); Gazier (1991)]. Like their predecessors, they had a strong empirical orientation, a historical approach, and a belief in indeterminacy which left room for the exercise of discretion, power and social norms in the labour market [Jacoby (1990)].

Theories of dualism and of labour market segmentation shifted the emphasis towards enterprise strategy. While both mainstream and radical versions of segmentation theory can be identified, many authors in the US literature at least stressed institutional arrangements within firms, and in particular the development of internal labour markets insulated from competitive pressures, providing security and job progression in return for an internalisation by workers of firm objectives [Doeringer and Piore (1971); Osterman (1984); Rosenberg (1989)]. At the same time, irregular, poorly paid and unskilled jobs continued to exist on a competitive market alongside protected forms of employment. While such structures could be explained as the result of rational behaviour by firms aimed at overall efficiency or cost minimisation, the institutional forms which developed varied, and appeared to reflect social forces as much as economic ones.

The growth of development economics in the 1950s and 1960s provided fertile ground for institutionalists. The classic development literature – Arthur Lewis or Gunnar Myrdal, for instance – is rich in institutional detail. Development was seen as a process of institutional change, as "traditional" institutions were supplanted by modern, each with their own complement of economic and social mechanisms. The co-existence of differing systems of economic and social organisation, each with its own rules for the creation and distribution of value, gave rise to models of dualistic development long before they appeared in the industrialised country literature. The diversity of systems of social organisation highlighted that which was obvious to the anthropologist, that exchange could occur within a variety of alternative institutional frameworks. The question was which system was likely to provide incentives for economic development, and a considerable literature developed, much of it sceptical about the appropriateness of Western models of property and of market exchange. This literature seems to have become less influential in the 1980s, perhaps because of the economic failures of many alternative development models, and the identity of development economics within the broader discipline has become less distinct. Nevertheless, a concern with the dynamics of institutions continues to mark work in this field.

The recent resurgence of interest in institutions has come not from practitioners of development economics, but from two schools which have emerged from mainstream neo-classical and post-Marxian economics.

Many practitioners of mainstream economics have become dissatisfied with the poor treatment of economic institutions, but believe that the primary mechanisms of neo-classical economics (essentially rational, utility maximising behaviour) could explain the development of particular institutional frameworks. The result has been the development of the "new institutional economics" (NIE) or "neoinstitutionalist" school.[3] This school is generally taken to originate with Ronald

[3]Eggertsson (1990) distinguishes between "neoinstitutionalist" economics, based on utility maximisation, and the "new institutional economics" which may incorporate non-maximising behavioural assumptions such as satisficing. In practice, however, both schools are concerned with similar issues and I refer to them both under the neoinstitutionalist heading.

Coase's classic (1960) article on "The problem of social cost". Coase was concerned to demonstrate the importance of transactions costs in economic exchange. Transactions costs include the costs of information and of enforcement of contracts. If information is perfect and all exchange is free of cost, under the assumptions of neo-classical economics economic systems would move rapidly to optimal equilibrium. But as soon as knowledge is incomplete and asymmetrical, agreements have to be arranged, monitored and enforced. To enter into agreements, agents have to have rights over economic resources, and these rights also have to be agreed and enforced. These mechanisms give rise to a range of formal and informal institutions. It is important to realise that while alternative institutional arrangements are possible, no economic exchange is institution-free; as a result, one should not compare outcomes under particular institutional conditions with the theoretical cost-free equilibrium (the Nirvana fallacy), but only with alternative institutional conditions. The primary logic of neoinstitutionalist economics is that there will be a tendency for more efficient institutions, in the sense of institutions which reduce transactions costs, to drive out less efficient institutions, through the effects of competition – economic agents will seek new contractual forms which reduce transactions costs.

This basic idea gives rise to a rich set of theoretical propositions. In particular, it suggests a variety of ways in which institutions may interact with economic development. In societies where transactions take place at a personal level, the possibilities for cheating are limited so transactions costs are low, but production costs are high because of the small scale of operations. In contrast, under impersonal exchange production costs are reduced as a result of specialisation, but transactions costs may be important [North (1989)]. In order to reduce such costs, third party enforcement becomes important, and this is used as a starting point for a theory of the state [Eggertsson (1990)]. Institutions which constrain participants to a determined pattern of behaviour may reduce transactions and information costs, as the need to seek information and monitor one's counterpart's behaviour is substantially reduced. This is true, for instance, of property rights, and of legal restrictions on contracts. But it is equally true of norms, values, ideology and custom which may generate solidarity, trust and co-operation. Thus the informal institutions may be as important as the formal [North (1990)]. These relationships are seen as fundamental in development: "Third world countries are poor because the institutional constraints define a set of payoffs to political/economic activity that do not encourage productive activity" [North (1990), p. 110].

An important strand of this literature is concerned with collective action. The fundamental problem is the "free rider": the gains from group action will be obtained by individuals whether or not they participate in the costs of the action. This may refer both to the provision of and access to public goods, and to joint organisation in pursuit of a common goal (e.g. higher wages). It is also important in the definition and application of non-exclusive property rights. This is in the end another aspect of the problem of ensuring co-operation, and so of monitoring agreements, hence its relationship to the rest of the neoinstitutionalist literature. Again, the interaction with the theory of the state is important, since a third party may be required to control free riding. Game theory, bandwagon models and public choice theory have all been applied to such situation.

Several points can be made about this school of institutional economics, which is giving rise to a substantial research programme. Firstly, the neoinstitutionalist school has been concerned with *explaining* the determinants of institutions and their evolution over time, in terms of economic factors; secondly, in contrast to the earlier Institutionalist school, the new institutional economics, although critical of mainstream neo-classical economics, attempts to complement rather than replace it. "The NIE attempts to modify or broaden the mainstream toolkit and then to use this broadened analytical framework to explain phenomena that had previously seemed impenetrable" [Nabli and Nugent (1989a), p. 10]; thirdly, despite the interest in collective action and the theory of the state, this is clearly a development of micro-economics, based upon the behaviour of individual economic agents; fourthly, like mainstream neo-classical micro-economics, it has no theory of distribution, and no real interest in distributional questions. This latter is a rather dangerous weakness, for the measure of efficiency of institutions is in terms of conventional measures of costs and values, which, as Eggertsson points out, are themselves dependent on the distribution of income in the economy. What is more, institutions are seen as responding to the actions of interest groups, and the success of these groups in modifying institutions reflects the prevailing pattern of economic and social power. The pattern of institutional change is therefore likely to be such as to reinforce the positions of those in power. In view of the likelihood of path dependence [North (1990)] in economic development patterns, expectations of a tendency for more efficient institutions to drive out less efficient seem optimistic if this is inconsistent with the interests of those in power.[4]

A quite different institutionalist vision of development is represented by the "Regulation" school, which also considers the interplay of multiple institutions in regulating the economic system. Here institutions are not only concerned with efficiency but also with control. Growth paths are necessarily based on particular forms of social control, notably in terms of the incorporation of labour in production, and particular patterns of accumulation, which again requires a framework for social action and co-ordination. Glyn *et al.* (1990), in their analysis of growth in industri-

[4]North now seems to believe that this tendency now occurs through competition between societies at the global level – e.g. Latin America versus the United States.

alised countries, identify four dimensions to this framework: the macro-economic structure; the system of production, notably the wage relation and the mechanism for control of work practices; the rules of co-ordination, including the social and economic policies of the state and the legislative framework; and the international order, including dominance in international markets and the role of international capital. This is institutionalist in the Veblen sense, in that development is open-ended; at any point of time, alternative sets of institutions can be envisaged, which may stabilise economic systems at different levels of economic activity, with different growth rates and with different patterns of distribution; see for instance typologies developed by Boyer (1986, 1989). Thus the breakdown of the Fordist model of regulation, dominant until the early 1970s in most industrialised countries, may give way to alternative systems based on different relationships between capital and labour, depending on policy choices or on the power of different social forces.[5] There is a strong historical strand in this approach – institutional frameworks and their effects need to be studied in historical context, and outcomes are path-dependent, in the sense that history limits the range of alternative futures. For instance, Dore's comparison of industrial relations systems in Japan, Sri Lanka, Mexico and Senegal Dore (1979) shows how the choice of institutions was conditioned by the models which dominated at the international level at the time the systems were crystallising at the national level.

The "Regulation" school might be classified as macro-institutionalist, and the neoinstitutionalist school as micro-institutionalist, since the starting point of the regulationists is societal and that of the neoinstitutionalists the individual. The difference is fundamental, but in practice it is difficult to maintain a clear distinction in these terms, for the macro-institutional picture depends on micro-level workplace relationships, while the micro-institutionalists require a theory of the state and North at least applies the model to broad historical patterns. Perhaps the crucial institution for both lies rather uncomfortably between the micro and the macro: the market. In a neoinstitutionalist perspective, the market can be understood as a device to minimise transactions costs, and the institutional framework of the market – the rules, formal and informal, which govern its operation – are ultimately determined by efficiency in these terms. In a regulationist perspective, the function of the market in distributing power and in controlling economic processes is equally crucial. Bowles (1991) distinguishes several types of markets: those in which the agents are endogenous (i.e. affected by the exchange), such as labour markets, as against the more classic case of exogenous agents; and those in which claim enforcement is endogenous (because the market contract is incomplete – again the labour market is a good example) against those in which the contract is complete

[5]See the special issue of *Economie et Société*, No. 11, 1989, devoted to regulation theory.

and uncontested. In both cases, market outcomes depend on the distribution of power, but when market processes "shape the capacities, values and desires of the exchanging parties", as they do when agents or claim enforcement are endogenous, and when they influence the definition and distribution of property rights, they modify the rules of the game in ways which need a macro-social framework for their analysis. Efficiency in a neoinstitutionalist sense will not do because the very meaning of efficiency depends on the way the market operates within society.

Despite their differences, these alternative approaches have some elements in common. Probably the most significant is the recognition of the need for a historical view – the evolution of institutions depends on historical circumstance. Partly a result, there is a common acceptance of the view that progress is likely to be achieved by iterating between theory and evidence, between observation and verification. There is as yet no acceptable overall body of theory, and it is important to build up such a body in iteration with empirical observation.

III. LABOUR INSTITUTIONS

The way labour is used and remunerated is a crucial aspect of institutional economics, and institutions of many sorts are correspondingly important in the labour market. The purchase of labour time is usually part of a much more complex system of relationships, involving not just the payment of a wage in return for a number of hours worked, but also levels of commitment and motivation, work intensity, a continuing relation over time (since most work occurs in continuing jobs), control over the pace and content of work, a working environment, a social position, an income level and a set of consumption standards, etc. These relationships depend on a set of what I am calling labour institutions, i.e. the social institutions which affect or derive from the incorporation of labour in production, the remuneration and working conditions of labour, and associated social and income guarantees. Labour institutions are those which affect the structure and functioning of the labour market, from within or without, which determine who supplies what sort of labour where, who has access to what sort of employment and income opportunities, what sorts of jobs are on offer and the conditions under which they are carried out, how labour is represented and organised.

These labour institutions can be conveniently visualised in five categories: (1) organisations, (2) formal labour market institutions, (3) informal labour market institutions, (4) underlying formal social rules, and (5) underlying informal social rules.

1. Organisations

Examples: Trade unions and other organisations of labour, likewise of employers; firms, training organisations, State enforcement systems (e.g. labour inspectorate) and other state bodies, tribunals.

2. Formal Labour Market Institutions

Examples: Employment contracts as they define the nature of jobs, the conditions under which they are done and the rights and obligations attached to them; The formal mechanisms for controlling these contracts, including labour legislation, bargaining procedures, wage fixing rules; Rules for job access (e.g. educational qualifications); The hierarchy of jobs within firms (might also be informal).

3. Informal Labour Market Institutions

Examples: Aspects of employment contracts based upon social deference or control, procedures and patterns of behaviour in the workplace; Informal mechanisms controlling access to jobs and income opportunities, discrimination against women, the methods of transmission of skills and their recognition by employers; Indirect forms of control over self-employment (sharecroppers, sub-contractors, homeworkers).

4. Underlying Formal Social Rules

Examples: Property rights and the rules for the ownership and operation of firms; State-defined rights of individuals to income, to public goods, to subsistence; Rights of expression, of political activity; The recognition of authority.

5. Underlying Informal Social Rules

Examples: Values and norms, culture and ideology, as they affect roles and perceptions of particular social groups in the labour market (women; ethnic groups), affect the "work ethic" and the social valuation of leisure, affect perceived needs for consumption. Kinship and community systems (particularly as they affect patterns of sharing of obligations and benefits).

These different types of labour institution – a more systematic list is given in an annex – interact with economic processes in different ways and at different levels. Several points should be made. First, the concept is broad; but this is essential, for we may not be able to understand the operation of formal labour market institutions if we do not understand the underlying informal social rules. Formal and informal institutions may co-exist and either complement or compete with each other. Assaad's (1991) investigation of formal and informal institutions in the Egyptian labour market shows written employment contracts alongside casual labour relationships, formal training alongside traditional apprenticeship, and trade unions alongside coffee houses; in each case the informal institution was in practice more important. Including the underlying social rules is equally important; these are the means by which patterns of behaviour are internalised, hierarchical relationships legitimised, social divisions of labour determined – all crucial if the labour market institutions and organisations are to function effectively.

Second, these institutions do not vary independently of each other. Various combinations and sets of institutions emerge, underpinning particular economic structures or particular patterns of development. Thus the Fordist model of development in industrialised countries can be described as a combination of elements from each of these headings (involving particular types of employment contracts, particular ways of regulating them, particular forms of social guarantee and of training, particular consumption norms, etc.) and not just in terms of the characteristics of the production line. "Modern" sector production in many developing countries is co-ordinated by a similar set of interlinked institutions. Various forms of corporatism likewise involve particular combinations of state regulation, worker organisations, negotiations over employment contracts and social guarantees. So it may not be very fruitful to analyse individual institutions without first exploring their interdependence.

Third, labour institutions vary in strength or nature across different parts of the production system and of the labour force, and this is a critical determinant of labour market segmentation or other forms of inequality. The resulting structures (e.g. a particular stratification of the labour market in terms of contractual status) may themselves in turn be regarded as derived labour institutions. Segmentation may also make it possible to cheapen labour overall, by rewarding and co-opting those with market or political power, but discouraging solidarity between this group and the mass of workers. The point is particularly obvious in many developing countries, where forms of regulation and the associated institutions vary greatly from one part of the economy to another. State regulation of labour conditions and institutionalised labour relations may apply to only a fraction of jobs [Portes (1990)]; labour markets may be fragmented, with very different sets of institutions governing jobs of different types [Harriss, Kannan and Rodgers (1990)].

Fourth, the analysis of labour market phenomena may require investigation at several different institutional levels. Take for example the role of training and educational systems.[6] At one level these are *organisations* – schools, or the school system as a whole, or training bodies – which, because they directly affect employment and labour productivity, belong as such in the list of labour institutions (train-

[6]The example was suggested by P. Gopinath.

ing organisations are included as examples of "organisations" in the list). At a second level, the qualifications which educational systems provide (or at least the interpretation of those qualifications) are important *formal labour market institutions,* because they determine who has access to what sort of job according to well defined and often written rules. As the average educational level of the population rises, the educational qualification required for entry to each job also rises, a form of rationing linked to the ways jobs are hierarchised. This is quite distinct from the human capital approach to the link between training/education and productivity, which assumes that there is a direct effect of the former on the latter, and so neglects the institutional issues. Because education also affects attitudes and perceptions, it also modifies the structure of labour supply through other institutional mechanisms (e.g. the widespread tendency for high levels of female education to be associated with high levels of female labour force participation). So education plays a role through its effects on the *underlying informal social rules* as well.

IV. LABOUR INSTITUTIONS AND DEVELOPMENT ECONOMICS

The traditional analysis of economic development is primarily concerned with the macro-economics of output growth. The centre of interest is increasing production, and the main determinants are factors such as physical investment; technological level and change; labour and its qualifications; natural resources; the costs of factors of production and the efficiency with which they are combined; aggregate savings; and the growth of effective demand. A variety of models depict the interaction of these basic variables. But the contribution of such models to explaining differences in development performance between countries remains unsatisfactory. Large differences in productivity levels, in capital-output ratios and in rates of technical change between countries are difficult to explain in conventional macro-economic terms. "The disparity in the performance of economies and the persistence of disparate economies through time have not been satisfactorily explained by development economists, despite forty years of immense effort. The simple fact is that the theory employed is not up to the task". [North (1990), p.11.]

At least part of the answer lies in conceptualising development as a process of institutional change, and as I noted above there has traditionally been a school of development economists which favours institutional approaches. The growth of institutional concerns in mainstream economics seems likely to reinforce this view of development, and the current fashion for a more market-oriented vision of development is therefore unlikely to survive. But the ways in which development economics will change to accommodate new approaches to institutions is not yet clear. I would like to consider this question, focusing in particular on the labour institutions discussed above.

1. Aggregate Patterns of Growth and Development

The approach of the regulation school suggests that to link labour institu-tions to patterns of growth and distributions requires an analysis of how each institutional mechanism, or the system of institutions as a whole, interacts with the macro-economic structure. What sorts of patterns of distribution between labour and capital arise at the aggregate level, or between different groups of workers? How does this in turn generate particular patterns of demand, for what types of goods? In which sectors does investment occur as a result? What sorts of systems of industrial organisation are implied? What are the implications for profits, for savings, for accumulation? The idea underlying this approach is that the components of the institutional structure are interdependent; their interpretation requires an assessment of the whole as well as of the parts. If this is to be done in a comparative perspective, it would be desirable to work towards a typology of growth patterns and labour institutions, investigating regularities and sets of relationships which recur in different environments. This involves classifying countries or production systems in terms of major macro-economic variables – production, wage and profit shares, economic structure – as well as in terms of the dominant labour institutions, and no doubt also bringing in other major institutions which interact strongly with labour institutions, notably political. The work of Boyer (1989), for instance for Europe suggests how one can distill a manageable typology from a mass of detailed institutional information. Banuri (1990) suggests a classification of labour institutions as decentralised (E. and S.-E. Asia), pluralist (S. Asia, US), polarised (Latin America, Philippines, UK) and social corporatist (Scandinavia), implying that each is associated with particular political arrangements and development patterns. Typologies need not be developed only at the level of countries; they might be based on comparisons between regions within countries (Calcutta against Bombay, Northeast against Southeast Brazil), between agrarian systems, or between time periods. Societies may show a range of alternative clusters of institutions, dominating in different parts of the economy or among different groups of the population.

The endogeneity of institutions is a crucial point: the basic argument must be that economic and institutional factors interact, and they both change in consequence. An important aspect of this endogeneity, of course, is the inertia of institutions in comparison with economic variables – Banuri refers to this as hysteresis, by analogy with the literature on persistent high unemployment. Part of the reason for inertia, no doubt, lies in the mutual reinforcement of institutions of different types. North (1991) argues that informal institutions are more resistant to change than formal ones. Nevertheless, institutions clearly do respond to economic forces, as when precarious forms of employment relationship develop in response to competitive pressures, or unionisation is influenced by firms' hiring and pay policies, or the internal labour markets of firms depend on their product market position see also

Bowles (1985), or indeed if the State responds to economic hardship by creating institutions to protect vulnerable labour market groups.

It may not be easy to construct a comprehensive typology of development paths in relation to labour institutions, but such an approach would provide a basis around which country experiences can be differentiated and a comparative analysis built up. Clearly an historical approach is appropriate; many institutions can be interpreted only in a specific historical and social context, and a broad historical view permits an overall dynamic picture to be built up. Much could be learnt by studying thresholds and crisis points, periods during which rapid institutional change occurs. A common situation, for instance, is that of an authoritarian regime which promotes rapid, inegalitarian development, while building part of its support around a relatively protected fraction of the urban working class – but neglecting poverty elsewhere, which ultimately generates irresistible pressure for change. A related pattern is one in which informal institutions dominate much urban and the bulk of rural production, and only a small, externally oriented sector is subject to formal institutions patterned on those in industrialised countries – but the latter is crucially vulnerable to shifts in international markets and in international capital flows. Another widespread pattern is one in which the organisation of labour and collective bargaining is discouraged through economic or extra-economic means, in order to maintain wage costs low, and hence promote accumulation and export-oriented growth – a system which may break down if rising real incomes eventually generate pressures for democratisation at the level of the enterprise or the society. Such broad relationships between economic and institutional change may in the long term dominate the many more specific relationships between labour institutions and development.

2. The Economic Functions of Institutions

There is a fairly substantial literature on the economic effects of institutions, though much of it is weakened by *ceteris paribus* assumptions. Take for example the analysis of labour market regulation on employment [e.g., Fallon and Lucas (1991), on India and Zimbabwe]. The comparison between regulation and its absence is a false one, because labour markets are always regulated by a cluster of formal and informal institutions; removing one may generate a variety of compensating behavioural effects, and a new institutional equilibrium, rather than the apparently straightforward partial equilibrium results. This is the problem of treating institutions as exogenous – they are not. The transactions costs approach of neoinstitutionalist economics avoids this problem by considering that particular institutional patterns emerge because they reduce costs, or because of other economic forces, often as a result of deliberate choices by economic agents, or because of the effects of "natural" selection through competition. These costs concern non-economic variables such as distrust, the availability of information, risks of opportunistic behaviour and the like. The creation of non-economic institutions (e.g. legally enforceable contracts) which can reduce such risks is therefore cost reducing overall, and will be favoured by competitive forces [Matthews (1986); Nabli and Nugent (1989)]. The literature is not always clear just how the institutions come to be created, but in a Thévenot-type cognitive model of end-seeking actors who are involved in political as well as economic processes, the link is not too hard to visualise.

There are a variety of applications to development. Take for example the labour market structures observed in rural India. In relatively stagnant, backward situations there is a frequent use of jajmani systems of specialised labour in which payment is related to a social position rather than to work actually done, the prevalence of payment in kind, the tying of labour to landowners, tenancy systems related to labour obligations, and other linkages between land, credit and labour markets. Many of these institutions can be interpreted in transactions costs terms – means for the control and enforcement of contracts, ways of generating increased labour intensity, mechanisms for assuring landowners of guaranteed labour supply at peak agricultural periods, and the like, and hence as institutions designed to maximise or at least increase the rental incomes of landowners. Most, but not all of these institutions are informal in nature, and reinforced by norms and conceptions of status. Such institutions, though, tend to discourage mobility and innovation, and support hierarchies unrelated to productivity, so that they are unlikely to be consistent with rapid agricultural output growth; more dynamic rural production systems seem to generate different forms of labour contract, often less personalised as far as casual labour is concerned, with a decline in tenancy, cash wages and – where the political institutions permit – more effective labour organisations.

Among other economic interpretations of specific labour institutions, one important one is the mobilisation of the labour force. This applies to institutions promoting say the use of female labour, or the absorption of migrants (or the prevention of out-migration). An interesting case concerns intermediaries in the labour market – labour contractors, temporary work agencies and the like – which may be important in mobilising specific sorts of labour and thereby promoting the development of particular labour market structures. The economic interpretation of systems of skill development and recognition is also interesting. Productivity growth is closely linked to human capital, so that the latter may be one of the most important links between labour institutions and economic development. Dore *et al.* (1989) show how the institutional framework within Japanese firms, for instance, creates an on-the-job learning environment, making the firms "learning organisms". But skill is at least in part a social category, and the institutions for the "creation" of skill and its channelling to particular jobs play an important part in ordering hierarchies and in explaining differentiation and exclusion; institutions concerned with education, training, skill and the validation of qualifications therefore play an important role both in the process of economic growth and in determining the distribution of the gains from growth.

Neoinstitutionalist economics tends to be heavily biased towards the issue of efficiency in production, whereas a cursory overview of the list of labour institutions suggests that most of them are concerned with distribution – institutions respond to the power of particular groups to control the end use of production, rather than responding to competitive pressure to increase efficiency. For instance internal labour markets might be visualised, not as a cost-minimising system which is determined by considerations of efficiency, but as a system of distribution and social control, both within the firm and between the firm and the outside world, which generates labour force commitment and stability. In so doing it also creates exclusion and deprivation, but among groups which do not have the political or economic power to undermine the system. In a more general sense, this may explain institutional structures in many unbalanced low income economies, where the institutional framework favours those in the relatively privileged parts of the system. Although economic growth might well be promoted by more egalitarian institutions, there is no automatic mechanism for institutional change in the direction of such institutions, indeed a stability of inegalitarian systems because those who benefit are likely to be in a position to obstruct institutional change. In short, the political economy of labour institutions may well provide us with better models of their emergence and persistence than the cost-minimising approach; while labour institutions which are promoted by both efficiency considerations and the reinforcement of privilege are likely to be particularly stable.

3. The Behaviour of the Actors

Interpreting the way labour institutions function involves considering the behaviour of the actors – workers, households, firms, the state – which are affected by the rules or the social structures concerned. The interaction between actors and institutions occurs at several levels. First, institutions reflect the aims and behaviour of individuals, though they are more than the aggregation of individual behaviour. One view of institutions is as "negotiated compromises", a mechanism for channelling the diversity of attitudes and objectives. Secondly, actors create and manipulate institutions. Thirdly, institutions constrain and mould individuals.[7] The outcomes of these interactions reflect the locus of power in any given society, and all three levels may be valid simultaneously for specific institutions. Thus, while

[7]Cf. Bowles' (1991) distinction of endogenous and exogenous agents in market transactions, noted above.

individuals and groups may compete for influence through the creation of organisations and the imposition of rules, these same institutions may simultaneously be conventions which regulate and stabilise the interaction between actors (and are intended to do so by the actors concerned), rendering their assumptions more transparent and their reactions more predictable [Thévenot (1985)]. This view (of institutions as consciously built and shaped by those concerned) may be contrasted with a non-cognitive vision of institutions as external to social actors, and limiting their possibilities for action for a discussion of the contrast see Paradeise (1988). Institutions may also operate to exclude actors from economic or social participation.

Insofar as development is seen as a process of institutional change, the key actors also change over time. Traditionally, of course, it is the actors of the industrial relations system – essentially organisations of workers and of employers – which have attracted the most attention in the literature on labour institutions. The industrial relations literature is voluminous, but relatively little of it is directly concerned with growth and development. Nevertheless, the stress on wage determination and on labour allocation in this literature provides a framework for exploring the consistency between the specific interests of the actors concerned and broader economic development objectives. A neoinstitutionalist view would perhaps start by treating much industrial relations in terms of game theory. A simple negotiation between employer and worker may be represented as a prisoner's dilemma game, in which both employer and worker are better off with a consensual, high wage-high work input solution, but in which the incentive structure generates a low wage-low work input outcome. Starting from a conflictual situation, if workers take a more consensual approach employers may take advantage of this to reduce wages; if employers become more accommodating, workers may reduce work input. The problem is then one of the institutions which may permit workers and employers to reach the high equilibrium, since the economic incentives trap the system in a low level equilibrium. Such institutions may include legal instruments, independent arbitration bodies, or less formal factors such as social norms, ideology or personal interdependence through kin or community networks which help to generate trust and co-operation.

This model is oversimplified. In practice there may be multiple equilibria, and control over the institutional framework by one of the parties to the negotiation, so biasing its effect. More to the point in the present context, the developmental linkages are dynamic, and this analysis is static. And collective organisations respond to a complex set of concerns and incentives. The linkage between industrial relations and development, for instance, depends crucially on how organisations of workers and employers respond to macro-economic considerations. It is, for example, commonly argued that by successfully defending the real income levels of their members unions indirectly help to create unemployment (because by raising wage costs they encourage capital-labour substitution or reduce competitivity), but among groups not represented in the union. Insider-outsider issues are therefore important here – under what circumstances do unions represent the interests of workers as a whole and when they do not, does the interplay of trade union and employer strategies tend to lead to inequality and exclusion? These are issues on which strong views are encountered distinctly more frequently than hard evidence.

4. The Theory of the State

In most countries the most important single actor in the field of labour institutions is the state. The state plays an active role in structuring labour use, most obviously under centralised planning, but to a varying extent also in countries which subscribe to a free market model; this can be clearly seen in rapidly growing market economies such as Singapore or the Republic of Korea, where there has been extensive State intervention in wage fixing and in controlling trade union activity. There is a close relationship between the political institutions underlying the state and labour institutions: democratic institutions render the suppression of trade unions difficult, for instance, which in turn affects the way the labour market functions and hence also the economy. In some countries the whole process of labour market functioning and organisation is highly regulated, through a complex system of rules and regulations, enforced either through the state or through a system of control over the organisation or labour or of production. These rules may largely serve to protect subgroups of workers or industrial sectors, they may serve to maintain the work force fragmented and to keep wage costs low, or they may reflect broader social goals of the state, and provide a legitimation for its development strategy.[8] Elsewhere state legislative intervention may be mainly symbolic because the means of enforcement are absent. But even when the rules are effectively enforced, such systems of regulation are rarely global, and alongside them there usually exists a substantial unregulated sector – unregulated, that is, by the state, for less visible forms of regulation may substitute for legal and administrative structures. The relative importance of these explicit and implicit forms of regulation is often poorly understood, simply because formal regulation is visible to the outside observer and so dominates perception.

The political economy of the state is important for understanding the functioning of labour institutions, in terms of the nature of its class support and the way this support is rewarded. The state as producer also plays a considerable role in

[8] It is also argued [e.g. by Deyo (1987) for East Asian countries] that state intervention may have aimed at the "economic inclusion" of an increasing proportion of workers, but at the cost of their political exclusion.

structuring labour institutions, and in so doing usually reinforces the power of particular groups with which it becomes allied both politically and economically. These of course will often include parts of the labour movement, where privilege may accumulate in favoured segments, groups who themselves develop and interest in stability, in smoothing out conflicts and preventing alternative power centres from developing. State intervention may then have interesting undeclared objectives, for example if intervention to provide temporary jobs, income support or subsidised food is designed to undercut support for radical labour movements. The links between these patterns of state intervention in labour, the nature of the political processes with which they are connected, and the pace and character of development, is an area of both controversy and importance. It underlies, for instance, much of the current debate about the desirability of privatisation of state enterprises.

The neoinstitutionalist vision of the state is rather more restrictive see in particular Eggertsson (1990), but it plays no less important a role in development – as an umpire, an enforcer of the rules, a guarantor of property rights, an institution which by providing social services reduces the costs of private transactions. But the state has also to be interpreted as an instrument of collective action, a means for not only enforcing the rules but also changing them in one's favour. The presence of the state changes incentive structures, including among its own agents; indeed, the state would have a built-in tendency to appropriate quasirents (for the ruler or the agents of the state), so that there is a permanent tension between the predatory and the benign state. The links with labour institutions are clear, since the interests that dominate the state are likely to be associated with particular labour institutions and groups, and so are likely to affect the direction of development even if they do not affect its pace.

V. CONCLUSIONS

There are fundamental institutional issues involved in economic development; the pace and nature of development depends on sets of institutions which permit exchange, determine who has rights to what sorts of entitlements (and property) and the values attached to them, control the terms of agreements and provide for their enforcement. The institutions underlying growth are closely bound up with the institutions underlying distribution – particularly through labour institutions, which are crucial for both production and distribution. Both formal and informal institutions are involved; the formal institutions, on which attention is usually focussed because they are more visible, can only be understood when placed in a broader social context. These institutions are to a large degree endogenous – their evolution interacts with the development path, and economic forces determine which institutions survive – but through processes which are complex, historically specific and involve social and political as well as economic factors.

At the heart of the link between labour institutions and development lie the economic and social forces inducing workers to undertake productive work on their own account or for others. Workers may be induced to work in many ways: through financial and other economic incentives, positive or negative; through the promise of advancement; through the rewarding nature of the work itself; through socially reinforced motivation; through the threat of dismissal or of reduced levels of employment; through direct coercion. Each of these elements may be associated with specific institutions. These institutions will tend to form coherent patterns of institutions of different types, in turn linked to patterns of control over work and patterns of distribution in the economy as a whole. Trying to understand the economic consequences of such constellations of institutions is bound to be speculative, but is of particular importance for an overall understanding of the process of economic development.

Annex 1

LABOUR INSTITUTIONS

1. The nature of employment contracts – the rules, both formal and informal, which govern hiring of workers, firing, working conditions, the length of the working day; the duration of such contracts, the nature of control over work which they imply; the extent of protection and of security. More generally, this fundamental labour institution refers to the nature of jobs, as socially defined entities involving rights, obligations, and social position.

2. The mechanisms for controlling and regulating employment contracts – state regulation (administrative or legal) or collective negotiation, or sets of values or norms held by the parties concerned. The nature of the machinery for enforcement and adjudication (such as the labour inspectorate, labour tribunals). This may also include social forms of control, e.g. through indebtedness or the threat of force.

3. The organisation and representation of labour: trades unions, trade or craft associations, etc., and the areas over which they have control or influence, the ways they are organised and function. This may include whether they are unitary or fragmented, their linkage with other (e.g. political) institutions, the range of their activities.

4. The organisation and representation of employers: employers' associations, business or enterprise associations and the areas over which they have control or influence, the ways they are organised and function.

5. The institutions of the labour market itself – the dominant procedures for job search and rules for access to jobs of different types, the systems for informa-

tion – hiring halls, employment exchanges, newspaper advertisements, or alternatively particularistic networks of contacts and intermediaries. Discrimination, screening and selection procedures and institutional constraints on mobility may come in here.

6. The methods by which wages are paid (in cash and in kind, directly or as fringe benefits, piece or time rate, the frequency and reliability of payment, regulated by contract or discretionary).

7. The process of wage fixing: regulatory bodies, procedures, rules to be followed; negotiation and conciliation procedures; reference points and minima, their levels and the processes by which they are determined.

8. Training and skill institutions – the mechanisms for the acquisition of skills and credentials for labour market access; thus the formal and informal education and apprenticeship systems. The recognition of skills and qualifications – their acceptability as credentials for job access; and the systems for learning on the job.

9. The organisation of jobs within the firm – the nature of occupational hierarchies and job progression within internal labour markets, criteria for promotion or for dismissal, the operation of work groups and the division of labour; systems for motivation and the operation of "corporate culture"; the ways different types of firm organise labour use (small and large, formal and informal,...).

10. The structure of ownership and control over production, and in particular the rules governing the spheres of influence of workers and owners of capital or land: joint decision-making procedures, co-operative or worker-managed organisations, tenancy and the rules governing its functioning.

11. The social and state regulation of self-employment – the rules governing conditions of work, access to the means of production and to markets; the prevalence of indirect or hidden wage relationships in self-employment, e.g. in homeworking and other forms of subcontracting (to which the elements of item 1 above may apply). Property institutions are important here, particularly (but not exclusively) in agriculture.

12. Social security and income guarantee systems, the institutions for social insurance (health, unemployment...), the "social wage" – provided by the state, by the enterprise, through institutionalised private systems, through informal private community or semi-feudal networks; the conditions imposed for access to benefits. The nature of family or community obligations to support the sick or unemployed.

13. The conventional standard of life: norms and values which determine consumption standards and targets, and the social valuation of leisure, of saving and of work. Such values underlie work inputs both directly – through an internalised work ethic – and indirectly, through the pressure they put on individuals to conform to socially valued living standards.

14. The organisation of labour supply: (a) within the household: the relative

social and economic obligations and constraints on different family members and the way they affect labour market activity (e.g. sexual and age divisions of labour); (b) outside the household: labour gangs, labour pools...

REFERENCES

Assaad, Ragui (1991) Formal and Informal Institutions in the Labour Market: The Case of the Construction Sector in Egypt. Minneapolis: Humphrey Institute of Public Affairs. (Mimeographed.)

Banuri, Tariq (1990) Comments on Fields. In Herzenberg and Perez-Lopez (1990).

Bardhan, Pranab (1989) *The Economic Theory of Agrarian Institutions.* Oxford: Clarendon Press.

Boyer, Robert (1986) *La flexibilité du travail en Europe.* Paris: Editions la Découverte.

Boyer, Robert (1989) *L'impact du marché unique sur le travail et l'emploi: Une comparaison des approches macroéconomiques et des recherches en économie du travail.* Paper presented at the first meeting of the European Association of Labour Economists, Turin, September.

Bowles, Samuel (1985) The Production Process in a Competitive Economy: Walrasian, neo-Hobbesian and Marxian Models. *American Economic Review* 75: 1.

Bowles, Samuel (1991) What Markets Can- and Cannot-Do. *Challenge* July-August.

Coase, Ronald (1960) The Problem of Social Cost. *Journal of Law and Economics* 3: 1 – 44.

Deyo, Frederic C. (1987) State and Labor: Modes of Political Exclusion in East Asian Development. In Frederic C. Deyo (ed) *The Political Economy of the New Asian Industrialism.* Ithaca: Cornell University Press.

Doeringer, Peter, and Piore, Michael (1971) *Internal Labour Markets and Manpower Analysis.* Lexington, MA: D. C. Heath.

Dore, Ronald P. (1979) Industrial Relations in Japan and Elsewhere. In A. M. Craig (ed) *Japan: A Comparative Review.* Princeton, New Jersey: Princeton University Press.

Dore, Ronald P., Jean Bounine-Cabalé and Kari, Tapiola (1989) *Japan at Work: Markets, Management and Flexibility.* Paris: OECD.

Eggertsson, Thrainn (1990) *Economic Behavior and Institutions.* Cambridge: Cambridge University Press.

Fallon, Peter, and Robert Lucas (1991) The Impact of Changes in Job Security Regulations in India and Zimbabwe. *World Bank Economic Review* 5: 3.

Gazier, Bernard (1991) *Economie du travail et de l'emploi.* Paris: Dalloz.

Glyn, Andrew *et al.* (1990) The Rise and Fall of the Golden Age. In Marglin and

Schor. (1990).

Harriss, John, K. P. Kannan and Garry Rodgers (1990) Urban Labor Market Structure and Job Access in India: A Study of Coimbatore. Geneva: International Institute for Labour Studies. (Research Series 92.)

Herzenberg, Stephen, and Jorge F. Perez-Lopez (eds) (1990) *Labor Standards and Development in the Global Economy.* Washington: U. S. Department of Labor.

Jacoby, Sanford M. (1990) The New Institutionalism: What can it Learn from the Old? In D. Mitchell and M. Zaidi (eds) *The Economics of Human Resource Management*. Oxford: Basil Blackwell.

Marglin, Stephen, and Juliet Schor (eds) (1990) *The Golden Age of Capitalism.* Oxford: Clarendon Press.

Matthews, R. C. O. (1986) The Economics of Institutions and the Sources of Growth. *Economic Journal* 96: Dec.

Morgan, T. (1988) Theory versus Empiricism in Academic Economics. *Journal of Economic Perspectives* II: Fall.

Nabli, Mustapha K., and Jeffrey B. Nugent (1989) The New Institutional Economics and its Applicability to Development. *World Development* 17: 9 1333 – 1347.

Nabli, Mustapha K., and Jeffrey B. Nugent (1989a) *The New Institutional Economics and Development.* Amsterdam: North-Holland.

North, D. C. (1989) Institutions and Economic Growth: An Historical Introduction. *World Development* 17: 9 Sep.

North, Douglass C. (1990) *Institutions, Institutional Change and Economic Performance.* Cambridge: Cambridge University Press.

North, D. C. (1991) Institutions. *Journal of Economic Perspectives* 5: 1 Winter.

Osterman, Paul (ed) (1984) *Internal Labor Markets.* Cambridge, Mass.: The MIT Press.

Paradeise, Catherine (1988) Acteurs et institutions. La dynamique des marchés du travail. *Sociologie du Travail* xxx: 1 janvier-mars.

Portes, Alejandro (1990) When More Can be Less: Labour Standards, Development and the Informal Economy. In Herzenberg and Perez-Lopez.

Rodgers, Gerry (1986) Labour Markets, Labour Processes and Economic Development. *Labour and Society* 11: 2 May.

Rodgers, Gerry (1991) Labour Institutions and Economic Development. Geneva: International Institute for Labour Studies. (Discussion Paper 41.)

Rosenberg, Sam (1989) From Segmentation to Flexibility. *Labour and Society* 14: 4 October.

Segal, M. (1986) Post-institutionalism in Labour Economics: The Forties and Fifties Revisited. *Industrial and Labour Review* 39: 3.

Solow, Robert (1990) The Labour Market as a Social Institutions. London:

Blackwell.

Street, J. (1987) The Institutionalist Theory of Economic Development. *Journal of Economic Issues* 21: 4.

Thévenot, Laurent (1985) Les investissements de forme. Dans Centre d'Etudes de l'Emploi, *Conventions économiques*. Paris: Presses Universitaires de France.

van Arkadie, Brian (1990) The Role of Institutions in Development. *Proceedings of the World Bank Annual Conference on Development Economics 1989*. Washington, D. C.: The World Bank.

Comments on "Institutional Economics, Development Economics and Labour Economics"

The Paper highlights the role of institutions in the process of economic development which has been almost completely neglected in the current economic literature. Professor Rodgers points out that the discipline of development economics essentially has focussed on the relationship between the evolution of institutions and economic development, with the passage of time it was transformed into a discipline which took institutions as given. It has been argued that the neglect of the role of institutions in the growth and economic development process in the economic literature has been the main failure in explaining real world economic phenomena.

Professor Rodgers distinguishes two types of institutions, viz. the orgnisations and the set of rules, norms and constraints governing the behaviour of the constituents of the economic system. It has been argued that poverty in the third world may be attributed largely to institutional constraints which define a set of pay-offs to political/economic activity that do not encourage productive capacity. It has also been argued that the institutions established on the basis of equity may not be adjudged on the basis of efficiency and as such the whole debate on privatisation should be seen in the proper perspective.

The interaction of economic and institutional factors, brings about rather significant changes in the economic development process. Since the existing institutions generally reinforce each other to maintain the *status quo,* they obstruct the development process. The paper fails to mention as to how existing institutions can be modified or new institutions established to promote the process of economic development.

In economic literature, institutions are generally taken as being exogenous and, at best, only the implications of different types of institutions are drawn for the working of the economy. Professor Rodgers argues that institutions should be endogenised in economic models. The endogeneity of institutions would, no doubt, provide for an interactive mechanism between the institutions and the development process thereby enriching the analysis. However, its implications for the axiomatic approach of neo-classical economics are not very clear.

Some institutions may be conducive to the development process while others may obstruct the development process. Institutional economics would have an operative value only if the institutions can be classified on the basis of their efficiency in promoting development. What criteria may be used to determine the adequacy or the efficiency of an institution is, therefore, basic to the analysis. Many a criteria has been suggested in the paper including survivability of the institution over time and an inter-temporal, inter-regional or international analysis of various institutions with reference to their contribution towards economic development. Survival as a criterion of an efficient institution may lead to various problems. In particular, the most oppressive system may survive. Alternatively, inter-temporal, inter-country and/or inter-regional analysis of the institutions may tell us as to which institutions have contributed to economic development and which have obstructed the process. However, such an analysis assumes that all other things remain the same. Since institutions are expected to modify the behaviour of individuals, it would be rather difficult, if not impossible, to hold other things constant.

All in all, the paper makes interesting reading. No doubt implications of endogenising institutions in economic models, and the need to develop criteria for selecting an appropriate institutional framework calls for more work in the area, yet the paper makes a useful contribution towards highlighting the issues.

A. R. Kemal

Pakistan Institute of
Development Economics,
Islamabad.