The Institutions of Economic Development: Two Views
A Setup and Come On

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Institutions generally, and those that encourage or obstruct economic development in particular, have no meaning except in relation to the contexts—the domains of activity—that they regulate. In recent decades debate about economic development have been centered on an exceptional class of institutions—those that are supposed to create the very market contexts they govern.

The disarmingly simple core of this Washington Consensus view of institutions is that an economy grows if, and only if, it is endowed with those features that dispose economic actors to engage in market exchange, not least by protecting their interests when they do. Among these protections are clearly defined property rights and the availability of courts and regulatory bodies capable of adjusting property and other rules to encourage investment when circumstances demand. Such particulars this view assumes that the features that favor or obstruct development are part of a society's fundamental constitution—its definitive endowments—and as such all but inaccessible to deliberate revision. Thus a society that has not spontaneously generated the growth-promoting institutional endowments, or acquired them as a historical legacy (for instance, through colonization by a society that is so endowed) is likely to come into possession of them only when continuing stagnation renders it unable to resist the conforming pressure of more successful competitors.

But in recent years failures of Consensus-based reform programs, the success of countries—China above all—which largely ignored the Consensus, and the findings of detailed empirical evaluations of the orthodox institutional view are prompting articulation of an alternative view of the institutions of development. Where the Consensus view sees market-favoring institutions as an all-or-nothing proposition, with still-to-develop economies typically endowed with nothing, the emergent process or bootstrapping view of growth sees developing economies as often, perhaps nearly always, disposing of (part of) many of the institutions and capacities needed for growth: Many developing countries experience sustained—though not self-perpetuating—growth spurts. Many have highly differentiated economic geographies, with some regions or clusters of firms in a particular industry growing steadily, while other areas do not. Many have institutions in which well functioning subunits border badly broken ones, and so on. The elements of this internal heterogeneity of the economy and economic institutions of many developing economies might be called the new stylized facts of growth.

Assuming these facts the process view takes the obstacles to growth in a particular, currently stagnating economy to be some combination of two kinds of constraints. The first are direct barriers to market exchange (predatory officials, confiscatory taxes--though these tend to be, in light of the new stylized facts, less frequent and daunting than the Consensus holds). The second and often more important type of constraint is the absence of a wide variety of public goods: support institutions that help potential exporters determine where they should direct their efforts, and then provide the training, quality certification, physical infrastructure, and various stages of venture capital that new entrants to the export sector are unlikely to be able to provide themselves. Removal of the most pressing bundle of constraints, the argument continues, raises growth rates by several percentage points a year. Continued growth, and the gradual transformation of an economy into a reliably growing "tiger," depends on relaxing successive (and successively different) bundles.

The focus on relaxing successive constraints corresponds to a re-interpretation of the kinds of institutions that favor growth; and this re-interpretation in turn undermines the claim that growth depends on institutional endowments in the familiar sense of a single, well defined set of mutually supportive institutions. As a reform program, the goal of the Consensus view is to create institutions that shape economic activity—directing it towards market transactions—yet are not shaped by it, except as may be required by (and limited through) the rule of law. The process or bootstrapping view, in contrast, assumes that even in the absence of market distortions, growth requires continuing social learning. The goal therefore is to create institutions that can learn to identify and mitigate different, successive constraints on growth, including of course such constraints as arise from defects in the current organization of the learning institutions themselves. Insofar as these institutional interventions go beyond rescission of the market-obstructing rules and aim to shape entrepreneurial behavior (if only by helping potential entrepreneurs clarify what their choices might be) they resemble the traditional industrial policies—the state picking winners—which the Consensus vehemently rejects.

But that is as far as the similarity between industrial policy in the traditional sense and the process view goes. Traditional industrial policy assumes that the state has a panoramic view of the economy, enabling it reliably to provide incentives, information and services that less knowledgeable private actors cannot. There are no actors in the process or bootstrapping view with this kind of overarching vision. All vantage points are partial. So just as private actors typically need public help in overcoming information limits and coordination problems, the public actors who provide that help themselves routinely need assistance from other actors, private and public, in overcoming limitations of their own. Instead of trying to build inviolate public institutions whose perfection guarantees, once and for all, an equally inviolate, but wholly private, market order, the process view aims for corrigibility: institutions which, acknowledging the vanity of perfectibility

from the beginning on can be rebuilt, again and again, by changing combinations of public and private actors, in light of the changing social constraints on market activity that their activity helps bring to notice.

The problem of development, given this much, is literally to institutionalize these results: to build institutions that can identify and relax the constraints on growth. What is needed, in still other words, are institutions that do not supplant their context, but rather use the growth-promoting strengths of the latter to overcome its growth-retarding weaknesses.

To get from a general understanding of the relevant institutional innovations to their application to the problem of development I will proceed in the presentation to the meeting in three steps. The first is to define the class of especially context-sensitive and context-modifying organizations that improve outcomes by routinely identifying and overcoming limits posed by current operating procedures or routines. Because of their origins I will call these Toyoda-model institutions. If they exist at all the growth-promoting institutions have to be a member of this class, and the distinguishing features of their operation are most conspicuous at this highest level of generality. The next step is to illustrate the operation of this class in the domain of new public services, whose novelty consists precisely in their ability to provide customized or contextualized bundles of educational and other services to heterogeneous groups: just the kind of contextual adjustment of means to complex and changing ends, in other words, required for the new institutions of development. The last step is to suggest, by illustrations from Chile and Argentina, how similar principles are indeed already informing economic policy making in developing economies, and to indicate how they are addressing the distinctive governance issues that arises from the forms of collaboration on which they depend.

I look forward to the discussion.