INSTITUTIONS, POLITICS AND CULTURE: A CASE FOR 'OLD' INSTITUTIONALISM IN THE STUDY OF HISTORICAL CHANGE

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INSTITUTIONS, POLITICS AND CULTURE: A CASE FOR ‘OLD’ INSTITUTIONALISM IN THE STUDY OF HISTORICAL CHANGE

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*Such terms as ‘values’ and ‘culture’ are not popular with economists, who prefer to deal with quantifiable (more precisely definable) factors. Still, life being what it is, one must talk about these things ...*

David Landes¹

Institutions are, as Jeffrey Nugent explains (in his paper in this volume), humanly devised rules that affect behaviour, constraining certain actions, providing incentives for others, and thereby making social life more or less predictable². They are, Geoffrey Hodgson puts it, “the stuff of socio-economic reality”³. It is in a way rather curious that so fundamental an aspect of social life should not have been a more important focus of study in the social sciences (outside anthropology) until relatively recently. This reflects the facts that, as Nugent says, mainstream, choice-theoretic economics has not previously problematised institutions, such even as those that are necessary for markets to function - and the expansionary pre-eminence of this kind of economics amongst the social sciences. Hodgson, however, reminds us that the dominance of this particular style of economics, with its pretensions to universality, has overlain and led to the forgetting of a rich tradition of thought about institutions, associated both with the German historical school and with American scholars such as Veblen and John Commons⁴. I shall pick up some of his arguments in this short essay.

Nugent distinguishes between the ‘demand’ for institutions and their ‘supply’, pointing out that the former involves in particular problems due to informational asymmetries, and

² Note that one of the leading figures of new institutional economics, Douglass North, emphasises constraints on behaviour. With Nugent I believe it is important also to recognise the incentive effects of institutions.
⁴ Hodgson (2001), see footnote 1
the latter problems of collective action. He then shows us how it is possible to explain, parsimoniously, within the framework of neo-classical economics, why particular institutions are the way they are and why they differ from each other, and how they influence productivity, taking great care as he does so to point out the dangers of making tautological, functionalist assumptions: (on the lines of the following: these are the institutions that exist; they must therefore reduce transactions costs; therefore they exist - and they must be efficient).

Institutional theorists recognise that it is perfectly possible for a society to get ‘locked in’ to an inefficient set of institutions because of the interests of power-holders in their reproduction. An example from some of my own work would be the existence of socially inefficient agrarian institutions, such as those that obtained in Eastern India, and which made usurious money-lending and speculative trading in foodgrains privately profitable for a small class of landowners to the extent that, for a long time, there was little or no incentive for them to make productive investments in agriculture, and certainly not those that required collective action, as in the organisation of irrigation. I think it can be shown that the institutional arrangements that under-pinned this kind of rural economy were socially inefficient; but they supported and were supported by the power of the landowning oligarchy which thus had a strong interest in their reproduction. This is one way, at least, whereby ‘historical path dependence’ may arise.

How good is the kind of institutional theory that Nugent describes when it comes to explaining change in institutions? How valuable or effective is it, therefore, in theorising

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5 Compare Douglass North: “…unproductive paths (can) persist. The increasing returns characteristic of an initial set of institutions that provide disincentives to productive activity will create organizations and interest groups with a stake in the existing constraints”. *Institutions, Institutional Change and Economic Performance*. Cambridge etc: Cambridge University Press, 1990, p.99. And see also Ha-Joon Chang’s historical review of ‘Institutions and Economic Development’ from which he concludes that “in many cases institutions were not accepted … because of the resistance from those who would (at least in the short run), lose out from the introduction of such institutions”. *Kicking Away the Ladder: development strategy in historical perspective*. London: Anthem Press, 2002, p.117

6 My own work on this is ‘Making out on Limited Resources; or, What Happened to Semi-Feudalism in a Bengal District’, published in the *CRESSIDA Transactions* II: 16-76 (1982). The paper refers in part to Amit Bhaduri’s classic ‘A Study in Agricultural Backwardness under Semi-Feudalism’, *Economic Journal*, 83 (1973), 120-37. An authoritative study which substantiates my argument is James Boyce’s *Agrarian
change in human societies? Nugent is explicit about the limitations of the NIE: most of it is rather static, he says, and “because of the interdependencies among different institutional arrangements within a given institutional structure, it is often difficult to isolate the most relevant institutional change for hypothesis testing”. The examples that he gives of NIE Explanations of Important Institutional Changes are all interesting, but each of them confirms the modesty of his claims for the NIE as a way of explaining historical change. NIE explanations provide an interesting gloss on current understandings of the emergence of the factory system of production during the Industrial Revolution: the factor of the danger of asset misuse helps to explain why capital owners hired workers in, rather than hiring machines out; the demand for skilled labour probably made the tying of workers into relatively long-term contracts advantageous; there were probably advantages in terms of knowledge and information sharing and the building of trust and cooperation, when workers were brought together in factories. But Nugent says that he would not argue “that evidence exists to suggest that the traditional economies of scale argument for the rise of the factory system is entirely dominated by these transaction cost and NIE considerations”. The second of his cases, about the emergence and distribution of private property rights involves an interesting study of property rights and coffee production in Central America and the contrasts between Guatemala and El Salvador on the one hand, and Costa Rica and Colombia on the other. The argument is that the latter pair of countries “developed coffee quite early thanks to the rapid development of private property rights for mostly smallholders”, and the reason for this is said to be ‘elite schism’ or in other words the fragmentation and consequent development of competition amongst the elites of the two countries – whereas Guatemala on the other hand “was dominated by a conservative alliance of church and monopolistic merchants that did not fission”. The argument is an interesting one. The application of the NIE in this case, however, does not in itself explain change. It serves to highlight the importance of power considerations and of politics, but it does not in itself explain them at all. Rather it raises interesting questions about the political context which have to be answered through some other, historical [and political] analysis. Thinking of E H Carr’s

metaphor of fishing, in his classic study of the nature of history, the NIE is a useful net that directs our attention to particular facts that then need to be explained historically. It is not in itself a theory of historical change. I believe that John Toye’s judgement that the NIE has no theory of history (“The main weakness of the NIE as a grand theory of socio-economic development is that it is empty”) is substantially correct.

I refer back to my East Indian example again. As I said, I think it can be shown that an inefficient set of agrarian institutions persisted over a long period; and it can be shown that this in turn explains the long run stagnation in the agriculture of Bengal. This stagnation came to an end in the early mid-1980s, and since that time the rate of growth of agricultural output in West Bengal has been amongst the highest, perhaps the highest, in the country. The explanation of this historic change is of course, complex, and exactly as Nugent says “it is difficult to isolate the most relevant institutional change for hypothesis testing”. The precise role of the modest agrarian reforms implemented by the Marxist-led government of the state remains controversial; but they were certainly instrumental in changing the socially inefficient institutions that I have referred to. Institutional change here followed from the rise to state power of a (moderate) left wing political party. It is not too long a jump, then, to argue that the relationships between social classes, and the nature of power structures, which themselves have to be analysed historically, are of particular significance in explaining change or alternatively the lack of it over long periods of time. If we wish to explain the different historical trajectories of Guatemala and Costa Rica, for example, amongst the cases referred to by Nugent, we will also have to take account of the specifics of class relationships, for it is these which

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8 John Toye ‘The New Institutional Economics and its implications for development theory’, in, J Harriss, J Hunter and C Lewis (editors) (1995) *The New Institutional Economics and Third World Development*. London: Routledge, p. 64. Douglass North (one of the leading exponents of the NIE) and Lance Davis conceded in their work on American economic growth that their “model is not dynamic, and we know very little about the path from one comparative static equilibrium to another”. L Davis and D North (1971) *Institutional Change and American Economic Growth*. Cambridge: Cambridge University Press, p.263. It is a moot point as to whether North has been able to develop a dynamic theory in his subsequent work, as I explain later in the main text.
appear to underlie the institutional differences that are his focus. As Pranab Bardhan has said “The history of evolution of institutional arrangements and of the structure of property rights often reflects the changing relative bargaining power of different social groups”; and he points out that “North [who won the Nobel Prize for Economics in 1993, for his contributions to institutional economics], unlike some other transaction cost theorists, comes close to the viewpoint traditionally associated with Marxist historians”. North’s work, indeed, can be seen as reflecting a constant tension between his commitment to the framework of choice-theoretic economics and his awareness of the limitations which it imposes when it comes to the analysis of change. This is reflected in his admission that there is “much to learn” from “the ‘old economic historian’, the institutionalists of Veblen and C.E.Ayres’ persuasion, or the Marxist”, and in his concern, as Lazonick has pointed out, to graft onto “mainstream economics a theory of political change”.

If I may extend my point. I have long been interested in the differences between the historical trajectories of the major Indian states, in terms of rates of economic growth and of levels of development. Contrary to the theoretical presuppositions of many economists, in regard to both growth and human development, the Indian states have continued to diverge rather than to converge. A large number of different indices show that in many respects the states of the Hindi Heartland in the North, notably Bihar and Uttar Pradesh, lag far behind those of the South and the West. It is a much longer story than I can conceivably do justice to here: but there is a lot of evidence to suggest that a major part of the explanation has to do with the persistence of hierarchical social relationships, and of the fairly extreme social fragmentation associated with them, in the

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12 Lazonick (1991), loc cit, footnote 11
Hindi Heartland, while these have been more or less successfully challenged by the political mobilisations for over more than a century of lower caste and class people in the South and the West. I can offer an institutional explanation for different patterns of change, if you will, but one which focuses on the persistence or not of what I have referred to as ‘hierarchy’, or what Francine Frankel and M S A Rao call the (traditional) ‘dominance’ of upper caste/class people who exercise authority that is sanctioned by religious beliefs. With a group of co-authors these writers have shown how the particular political histories of the major states reflect the workings out of the persistence or not of this upper caste dominance, which is of course linked with the history of lower caste/class mobilisations. Now, in terms of this framework, it becomes difficult to explain how and why two of the states of the Hindi Heartland, Rajasthan and Madhya Pradesh, should have started to grow much more vigorously and to improve levels of human development, clearly distancing themselves from UP and Bihar. The answer, I think, still lies in political factors, in this case having to do with the nature of party political competition in the these two states, by comparison with Bihar and Uttar Pradesh, and with political leadership. In Madhya Pradesh, in particular, a reforming Chief Minister, with a definite vision of development for the state, has created a kind of a local version of the ‘developmental state’.

The question is whether new institutional economists, and notably North, have succeeded in ‘grafting a theory of political change onto mainstream economics’. For North, “a dynamic model of economic change entails as an integral part of that model analysis of the polity”. But it is not at all clear that the NIE actually has a theory of how and why polities differ. It offers no explanation of the fact that the same economic institutions can


have very different consequences in distinct contexts. As Robert Bates has argued this shows “the necessity of embedding the new institutionalism within the study of politics”, for the reasons for the differences observed – for example between the outcomes of the establishment of coffee marketing boards in Kenya and Tanzania – have to do with the political context. Ultimately this means studying institutions historically and so integrating theory building and the study of reality.

I have described my analysis of different patterns of change across the various major Indian states as positing an ‘institutional’ explanation – but, pace North’s attempts at grafting together an analysis of political change with choice-theoretic economics, I do not think that it is one that fits within the frame of the ‘new institutional economics’ outlined by Jeffrey Nugent. This is described as ‘new’ because, unlike the older traditions of thought about institutions in the German historical school and in early American institutionalism, it operates with the same basic assumptions, about scarcity and individual choice, as mainstream neo-classical economics. The institutions to which my analysis of political regimes across Indian states refers are those of caste, and they involve ideas about authority rooted in religious belief. They have to do, then, with what is commonly referred to as ‘culture’. This is one of the most awkward words in the English language, not least because it is polysemic. Here I am referring to culture in the sense of ‘the (historically specific) habits of thought and behaviour of a particular group of people’, or of ‘the ideas, values and symbols – more generally, “meanings” – in terms of which a particular group of people act’. ‘Culture’, in this sense, is quite often used as a kind of a residual in explanations for social change, or the lack of it, to account for what appears to be ‘irrational’, or in other words what is not readily explained in terms of the

16 Quotations here are from the Introduction to the collection edited by Harriss, Hunter and Lewis(1995) loc cit, footnote 8, which includes essays by Douglass North and Robert Bates.
18 I am not implying that these two definitions of culture have absolutely the same meaning (see Hodgson loc cit, footnote 2, pps 292-94), but both assert the historical specificity of cultural patterns. As Platteau has argued “Ultimately, the cultural endowment of a society plays a determining role in shaping its specific growth trajectory, and history therefore matters”. ‘Behind the Market Stage Where Real Societies Exist’, Journal of Development Studies, 30, 3, April 1994, p.534
basic model of utility maximisation. The NIE engages with the problem of culture, as it does with politics, but with difficulty. Douglass North argues that “culture defines the way individuals process and utilise information and hence may affect the way informal constraints get specified”\(^\text{19}\), which at least adds to the factors involved in explaining the nature of institutions in any particular case but leaves culture as exogenous to explanation. It remains a residual.

Taking serious account of those aspects of social life and experience that are labelled in English as ‘culture’ (in the particular sense just described) starts to expose the limitations of the universalising pretensions of neo-classical economics, which depend in part upon quite simplistic assumptions about the preferences that individuals are supposed to be maximising, and upon a simplified notion of human rationality. Even rather cursory empirical examination of human behaviour shows that people very often act habitually – that is, in ways which are characteristic of their ‘culture’ - and that preferences too are culturally specific. Of course these preferences and actions may be subjected to rational thought by the social actors themselves\(^\text{20}\), but they are very often not. The strength of the ‘old’ institutionalism is that it does not treat culture as an awkward (though sometimes convenient) residual, but rather makes it central in analysis. My own analysis of variation in the patterns of change between the Indian states is, it follows, much more in line with the ‘old’ institutionalism than it is with the NIE.

The ‘old’ institutionalism has been criticised as being ‘descriptive’ and lacking in the formal rigour of mainstream economics and its off-shoot in the NIE\(^\text{21}\), but as Hodgson has argued there was more to it than this for scholars from the German historical school, and the Americans like Veblen and Commons, at least sought to tackle the problem of historical specificity, and the serious limitations of attempts at producing universal theory in the face of the sheer complexity of society and the historical variation between different ‘societies’. In doing so they did not retreat into empiricism, but aimed rather to


\(^{20}\) Amartya Sen shows this in his commentary on identity politics in *Reason Before Identity*. Delhi: Oxford University Press, 1999
develop ‘middle range’ theory, or a particular historiography, based – in Hodgson’s own exploration of the tradition of the ‘old’ institutionalism – on certain general propositions concerning the importance for understanding of socio-economic systems of “the laws … that dominate the production and distribution of vital goods and services. Such laws would concern property rights, contracts, markets, corporations, employment and taxation”. These legal rules and contracts, it is held, are always and necessarily “embedded in deep, informal social strata, often involving such factors as trust, duty and obligation (so that) a formal contract always takes on the particular hue of the informal social culture in which it is embedded”. Further, it is clear that “The emergence of law, including property rights, is never purely and simply a matter of spontaneous development from individual interactions (but rather) is an outcome of a power struggle between citizens and the state”. Politics and power, as I argued earlier, thus become of central significance in this approach.\textsuperscript{22}

Let me illustrate the argument further, referring again to India.\textsuperscript{23} We may recognise that ‘shared habits of thought and behaviour’ (i.e a particular culture) associated with caste are central to what it means to be Indian - though we should also recognise both that caste is an important aspect of a dominant ideology (that of orthodox Brahminical Hinduism, resisted by subordinated groups over more than two millennia), and that it is an historical phenomenon. Notably, caste underwent significant restructuring under colonial rule. It is not true that caste is a colonial creation, but there is no doubt that the meaning of caste was changed by the ways in which the colonial rulers used it to classify the population. All cultures, though by definition they involve enduring habits, are both contested within the field of power, and they are all the time being reflexively reworked or reinvented.

\textsuperscript{21} See, for example the comments of Harriss, Hunter and Lewis (1995), \textit{loc cit}, footnote 12, p. 4-5
\textsuperscript{22} Hodgson (2001) \textit{loc cit}, footnote 2, p.301, p.304 and p.312. Hodgson notes the continuities with Marx’s approach, but argues that “the analysis goes further than Marx, by grounding property relations in shared habits and by also emphasising the concept of culture” (p.309).
\textsuperscript{23} The following discussion draws on my forthcoming paper ‘On Trust, and Trust in Indian Business’ (see the Working Paper series of the Development Studies Institute, London School of Economics).
\textsuperscript{24} See A K Ramanujan’s introduction to his translations of Veerasaivite poems, many of which expressly ridicule and repudiate caste, in \textit{Speaking of Siva} (1973) Harmonsworth: Penguin Books
The values and practices of caste have tended to create relatively tight, closed social networks, so that Indian society, it has been said, is pronouncedly segmented or ‘cellular’. This in turn has important implications for economic action. As we know, from some of the new institutional economists indeed, most transactions involve uncertainty, arising from any one actor’s incomplete knowledge about the future actions of others with whom s/he is transacting. Trust is one way of coping with this uncertainty – uncertainty that is occasioned by the freedom of others - that is never entirely removed, as Hodgson has argued (see above), even in the presence of legal rules and contracts. But where does trust come from? One important source of or basis for trust is the sharing of key characteristics with others, or from knowledge of them in particular social networks (predictability comes with familiarity). Caste relations, involving both shared characteristics and particular social networks, are an important source of trust in Indian society - and it may be said of certain caste communities that they constitute an economic organization. A South Indian caste community, for instance, the Nattukottai Chettiars, has functioned very much like a bank, and Nattukottai Chettiars have transacted vast sums of money across long distances relying on the specific trust to which their caste relationships have given rise. But there is a significant difference between such specific trust based on particular shared characteristics or social networks, or that which depends upon personalised transactions, and generalised trust running through society as a whole (beyond such networks/relations as caste). Generalised trust can be shown to be desirable for an effectively and efficiently functioning market economy. As David Landes has put it “(The) ideal society would …be honest [or, in other words, ‘generalised trust’ would prevail]. Such honesty would be enforced by law, but ideally the law would not be needed. People would believe that honesty is right (also that it pays) and would live and act accordingly.” I think that it can also be shown that the very strength of the specific

26 This idea appears in some of Marx’s writings on India; in Barrington Moore’s great classic (1966) The Social Origins of Dictatorship and Democracy, New York: Beacon Press; and most expressly in Satish Saberwal’s (1996) The Crisis of India, Delhi: Oxford University Press
28 See Platteau ‘Behind the Market Stage’, loc cit, footnote 13
29 Landes, loc cit, footnote 1, p.218
trust that is generated in caste relationships stands counterposed to such generalised trust or morality, and that this has constrained India’s economic development.

For example, the private sector of the Indian economy has been dominated for a long time by a small number of powerful family business groups, which have been secretive and non-transparent, and have relied heavily on personalised, family and kinship networks – on ‘specific trust’, therefore – resisting the professionalization of management. Now, in the context of India’s increased integration into the global economy these great family firms are finding themselves disadvantaged, and they are having to open themselves up more to scrutiny, in order to attract investors. New institutions of corporate governance are being introduced, or are sought to be introduced, substantially because of pressures from one fraction of the business elite. In a sense the contest is now on, with different champions on either side from within the business world, between ‘traditional’, informal institutions, linked to family, caste and kinship, and formal institutions of corporate governance involving laws and codes of practice.

The case shows up key points which together help to support the argument that I am making for an approach deriving from the ‘old’ institutionalism in the analysis of social change, as against the static nature of the NIE. First it shows up the inter-relations of formal institutions with the ‘deep informal social strata’ in which they are embedded, and hence the importance of those historically specific ‘shared habits of thought and behaviour’ (or culture). These are not at all easily or satisfactorily explained in the would-be universal theory of mainstream economics - and they remain exogenous in the NIE. Yet they may be central to understanding what is happening! David Landes, after all, concludes his magisterial history of economic development over the last millennium by saying that “If we learn anything from the history of economic development, it is that culture makes all the difference” (though he also points out that “culture does not stand alone …monocausal explanations will not work”)\(^\text{30}\). Second – though I have only been

\(^{30}\) Landes, *loc cit*, footnote 1, p.516. The point about culture ‘not standing alone’ is an extremely important one, in the light of the current vitality of cultural determinism – reflected, for example in Francis Fukuyama’s book on *Trust: the social virtues and the creation of prosperity*. New York: The Free Press,
able to suggest the argument here, and in my earlier examples – explaining institutional change, and hence social change, requires that we take account of power, as Hodgson implies and as Pranab Bardhan explicitly stated in the commentary that I cited earlier. Power is missing from the NIE. Whether or not the rules of corporate governance in India will be changed in such a way as to be effective will depend upon the outcome of a power struggle between different fractions of Indian business and their political supporters, and on ‘deeper’ changes in habits of thought and behaviour. The two are inter-related and the outcomes cannot be predicted. Change in human societies can only be satisfactorily explained when these historically specific factors are taken into consideration, as they are in an approach based on the ‘old’ institutionalism - while they are not in the NIE.

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1995. On this point, as in other ways, Landes follows Max Weber, who of course also argued that culture does not stand alone in his classic *The Protestant Ethic and the Spirit of Capitalism*. 