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The Veblenian Roots of Institutional Political Economy

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Abstract

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From Veblen to Chang in Institutional Economics

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The term "Institutional Economics" has been applied to some of capitalism's strongest critics as well as its most ardent apologists. This paradox in terms has bred contradictory literature in development economics, some declaring the death of this line of thought while others herald its resurgence. In examining the roots of Institutional economics, this paper attempts to disentangle the ambiguity surrounding this label. The Institutional Political Economy of Ha-Joon Chang will then be examined as a return to Institutionalism's radical roots in development economics. Concluding remarks suggest that this approach is capable of encompassing gender as an analytical category, an extension that would improve the ability of policy makers to assess the impacts of macroeconomic policy.

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Introduction

A quick glance at development literature can leave the reader with no thought other than "institutions matter." However, such a thought should not be taken for granted. What once was precluded from economic lines of inquiry as a consequence of the stale, lifeless notion of isolated economic man, has traversed the distance from Classical Political Economy, to the center of policy making with the likes of J. R. Commons and others, relegated to the underbelly of heterodoxy, and more recently, has basked in the limelight of mainstream economics. Indeed, Philip A. Klein pronounced that in spite of Paul Samuelson's declaration of the death of Institutionalism, "in the field of development Economics the victory has been so complete that many economists fail to realize it or to credit Institutionalists with contributing any part of the current analytical framework of development economics." (Klein 1977, 785) However, a review of Institutional literature reveals a remarkable difference in the way in which institutions are viewed, the function of private property, and policy implications that result. This is the consequence of a bifurcation in Institutional economics, resulting in the categories of Old Institutional Economics and New Institutional economics, or OIE and NIE, respectively. This paper examines what distinguishes the "old" from the "new," concluding that only the former is capable of challenging the existing power relations at all levels of inequalities.

The remainder of this paper will be divided into four sections. The first section will survey Veblen's Institutional economics, considered to be the foundation of the radical line of Institutional economics. The next section considers the work of Douglass North and Oliver Williamson, as the originators of NIE. Having so established the distinguishing features of the two schools of thought, Ha-Joon Chang's Institutional Political Economy will be explored as a return to Veblenian Institutionalism in the field of development economics. Concluding remarks will suggest an extension of this method to encompass gender as an analytical category.

The Economics of Thorstein Veblen

Veblen's Institutionalism is rooted within a Darwinian framework, hence he considered himself pioneering an "Evolutionary Economics." (Veblen 1898) Such an endeavor was in direct response to Marginal Utility Theory, or, in his chosen vernacular, "hedonist" economics. Therefore, in order to understand what Veblen wished to construct, it is useful to first understand what he meant to tear down.

Veblen brandished the term "neo-classical" ostentatiously at marginalist economics – what he considered to be the maladroit child of the "classical" economics of the nineteenth century. While he dismisses both lines of economics as teleological and inconsistent in moving from cause to effect within their own theoretical underpinnings, he is more critical of the neoclassical school, which "is confined within narrower limits and sticks more consistently to its teleological premises." (Veblen 1909, 621) As is typical of Veblenian sardonicism, his insult swung too high, and marginalist economists embraced and adopted the term. (Chavance 2008, 8)

His critique was complete, arguing that it is ahistorical, "of a wholly statical character," and unable to comprehend the world in which it exists. (Veblen 1919, 232) This, he argues, is a necessary outcome of an analysis that takes what *is*, as *given*. Such a starting point renders neoclassical economics non-scientific, shutting off lines of inquiry where they should begin. Limited to the narrow range in which values adjust to a given situation, it is incapable of grasping origin or human historical movement, perceiving only constraints posed by the bounded economic circumstance so assumed. A theory of price emerges, but "as to the causes of change or the unfolding sequence of the phenomena of economic life they have had nothing to say hitherto; nor can they, since their theory is not drawn in causal terms but in terms of teleology." (Veblen 1909, 621)

In proceeding from a reductionist methodology, neoclassical economics is at once thwarted from analyzing the foundation of habitual action from the perspective of the system as a whole, precluding true understanding of sensuous human activity. “Hedonistic man” moves through space and time without pulse or consciousness. He is:

> “a lightning calculator of pleasures and pains, who oscillates like a homogenous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. . . He is an isolated, definitive human datum, in stable equilibrium except for the buffets of the impinging forces that displace him in one direction or another. . . When the force of the impact is spent, he comes to rest, a self-contained globule of desire as before.” (Veblen 1919,73)

Thus, humans are not a living process. They are but matter, with exogenously given preferences and void of the human relations of which the social fabric is spun. Institutions are “taken for granted, denied, or explained away.” (Veblen 1909, 622) Such an abstraction yields a theory lacking correspondence to reality, defeating the purpose of theoretical modeling. From this perspective, Ludwig Feuerbach’s critique of the “speculative” Hegelian philosophers who “pluck out their eyes that they may see better” may just as well have been written by Veblen in view of utilitarianism. (Feuerbach 1989, xiv) In economic theory the stakes of such abstraction are high, above all when a school enjoys the status of the dominant paradigm and so persuades policy.

For Veblen, human and economic development can only be understood in terms of growth and change, therefore a true understanding of economic phenomena requires that nothing be taken as given. (Veblen 1898) What *is*, is not eternal, existent from time immemorial. The web of relations, material conditions, and institutional structure within which we carry on the life process has origin, sculpted in time and culture, constituting its present form. Questions of the life-history of human activity are questions of cultural growth, which for Veblen, in true Darwinian fashion, is a process of non-teleological cumulative causal sequence.

From this perspective, an inquiry into institutions and their role in cultural growth is central. For Veblen, institutions are the customs and "settled habits of thought common to the generality of man." (Veblen 1919, 239) As such, these evolutionary elements are rooted in culture and explain the historical movement of social structures. These social norms and customs become solidified into institutions, which in turn come back and shape our customs and habits of thought. In stark contrast to hedonistic man with exogenously given preferences, these customs and habits of thought are changing endogenously over time. This complex causal relation between individuals and institutions underlies Veblen's notion of cumulative causation, which emphasizes sequential change and the cumulative nature of these changes, a "theory of a process of cultural growth as determined by the economic interest. . . of a cumulative sequence of economic institutions stated in terms of the process itself." (Veblen 1898, 398)

Following Bernard Chavance, Veblenian causation can be understood as a type of "recursive causation." (Chavance 2008) While a "linear" notion of causation follows cause to effect and considers its work complete, recursive causation continues, bringing to light the influence effect has on cause. Veblen tells us that human life "is a struggle for existence, and therefore it is a process of selective adaptation. The evolution of social structure has been a process of natural selection of institutions." (Veblen 1994, 188) In understanding his complex causality we can see that institutions are both object *and* factors of selection in this process of selection. "Institutions are not only themselves the result of a selective and adaptive process which shapes the prevailing or dominant types of spiritual attitude and aptitudes; they are at the same time special methods of life and of human relations, and are therefore in their turn efficient factors of selection." (1994, 188) Thus, preferences become "endogenized" in this evolutionary process. (Chavance 2008)

Once this cumulative causation is understood, it becomes clear that Veblen's rejection of methodological individualism in no way implies that the study of human beings is outside the scope of understanding economic phenomena. Indeed, it is variation in cultural customs and habit that gives motion and change to social structures. "Changes in the material facts breed further change only through the human factor. It is in the human material that the continuity of development is to be looked for; and it is here, therefore, that the motor forces of the process of economic development must be studied if they are to be studied in action at all." (Veblen 1898, 388) Once this is understood we can see that Veblen was neither purely holistic, nor purely reductionist, but moved between the social whole and the individual with methodological consistency. (Hodgeson 2004)

In order to fully understand Veblen's approach to economics and growth, it is important to grasp his theory of human nature, which he emphatically rejected as static. The way in which Veblen accounts for human *active* nature is in his theory of instincts. (Hessian and Sardy 1969) According to Veblen, humans have certain innate instincts that embody both potential and propensities. These instincts are genetically and culturally inherited and conditioned, and are more or less manifest depending on the particular historical and material conditions individuals reside in, which is to say, human nature adapts to the demands of the situation.

These instincts fall into two general categories: those which are advantageous to the social whole and those which are injurious. Among the former are the instincts of parental bent, idle curiosity, and workmanship. The latter set of instincts include predatory behavior, arrogance, and emulation. One of the main drivers behind human behavior is status, and the instinct of arrogance compels individuals to put this into evidence by making invidious distinctions. However, that which bestows status, and the form that invidious distinction takes, is dependent on historical circumstance. For example, in primitive communal societies the instinct of workmanship (a taste for effective work and distaste for "futile effort") was a point for invidious distinction. An individual demonstrated efficiency by doing work that promoted survival of the group. With the dawning of economic surplus cultures became warlike societies, bringing the predatory instinct into dominance. Aggression, seizure, and plunder became the "accredited form of action," and a conspicuous display of ill-gotten gains became the way to put status into evidence. As a result, an invidious distinction between exploit and industrial employment was created, and engagement in industrious behavior became socially inferior and "irksome." (Veblen 1994)

For Veblen, economic growth in capitalism is threatened by the dominance of the predatory instinct, as it breeds inefficiency and waste. His notion of growth rests in his evolutionary system and cumulative causation. Therefore, his concern was not with short run fluctuations in output, but rather one of long run structural change and the *composition* of output. Thus, increased output is not a sufficient condition for economic development. For sustained growth to occur, output must be of the type that smoothes the progress of technological advancement. (Hessian and Sardy 1969) This is critical for Veblen because in the very process of growth, the institutional fabric of the economy is transformed. Technology is itself an institution, as both object and factor of selection, shaping capitalist institutions and the social mind-set. As Veblen elucidated, "the mechanical equipment and the standardized processes in which the mechanical equipment is engaged. . . embodies not the manual skill, dexterity, and judgment of an individual workman but rather the accumulated technological wisdom of the community." (Gruchy 1958, 161) From this view, technological progress has an evolutionary function, challenging existing institutions and the power relations embedded in them.

However, Veblen did not maintain that the mere appearance of some new technology would directly bring about the new institutions that would allow for the full effect of technological progress. He recognized an institutional stubbornness, making economic growth a strained and often broken process. The difficulty lies in what he termed institutional lag. This is the observation that there is ever a gap between today's institutions and the current needs of society. "Institutions are products of the past process, are adapted to past circumstances, and are therefore never in full accord with the requirements of the present." (Veblen 1994, 191) Given that each step in institutional evolution is shaped by what was before, cumulative causation necessarily entails institutional inertia. This is exacerbated by an inherently antievolutionary element that tenaciously resists progressive tendencies. Social inertia, or "past-bound drag of cultural habit wedded to privilege" is solidified in the present in what Veblen called "imbecile institutions." (Jennings and Waller 1994, 110) Those in power are capable of impeding new social interpretations that would allow society to address the needs of today, and their imbecile institutions rationalize their power position, spilling over into the attitudes of those lower in the social strata. Veblen recognized that neoclassical economics in all ways fits this bill, hence his scathing critique of its method. "They are principles of action which underlie the current, business-like scheme of economic life, and as such, as practical grounds of conduct, they are not to be called in question without questioning the existing law and order." (Veblen 1909, 626) In other words, the neoclassical paradigm functions as an apologia for the existing state of affairs. To question its validity is to question nothing short of the whole of society, and the power relations therein.

Veblen illustrates the way this power elite acts as an antievolutionary element to social progress in his *Theory of the Leisure Class*, which demonstrates the role and extent to which the leisure class, a refined version of yesterday's predatory class, affects the social structure. Put simply, there occurs a "selective elimination" of individuals that dare challenge the status quo. That is not to say that those who recognize institutional lag and the "imbecile institutions" that perpetuate unhappy social relations are entirely eliminated – this would remove the variation required for an evolutionary system. But it does highlight a significant source of rigidity in terms of institutional adaptation.

When the invidious distinction of a society is attached to non industrious occupations, as is the case in capitalist enterprise where the predatory instinct dominates "captains of industry," economic growth is threatened. The upper tier of the social strata gain prestige by putting their lack of engagement in productive work on conspicuous display, engaging in conspicuous consumption (a conspicuous waste of goods) and conspicuous leisure (a conspicuous waste of time). This lifestyle establishes a standard of living for all of society, changing general habits of thought and disseminating an ideology of inefficiency and waste throughout the culture. In this regard Veblen astutely recognized the antirevolutionary nature of society *in general*. From this perspective the lower social strata, engaged in productive efforts, not only face obstacles to bringing about social change with the barrier of imbecile institutions, they simply do not wish to revolt against those who hold the power. Rather, they aim to become one of them. Should this effort fail, which it most certainly will, they will at least attempt to look and act like them through pecuniary emulation of conspicuous waste and leisure.

Returning to his notion of economic growth, Veblen saw the *potential* in new technology to eventually corrode imbecile institutions and restructure society in conformity to its needs. This is a potential because Veblen saw no reason that it had to unfold this way. As a result of complex and cumulative causality, Veblen saw human history evolving in a "blind drift," or in the manner of path dependence. (Jennings and Walker 1994) That part of the population which is immediately in contact with the technological process would have the instinct of workmanship more strongly expressed in their nature, and consequently would develop a matter-of-fact way of viewing their world. This class would necessarily recognize the inefficiency of the captains of industry, and would ultimately take over the productive process to ensure efficiency in production. (Veblen 1990) Veblen did not conceive of this as a swift or seamless process, and lamented the considerable waste that society would incur in this evolutionary unfolding. He saw only two paths the United States could pass over: a road to socialism, or a road to complete fascism. (Gruchy 1958) This latter road would be the consequence of assiduous exploitation of the working masses by the vested interests.

Those who followed the Veblenian tradition, termed OIE, carried on many of his themes; placing institutions at the center of analysis, recognizing the role of technology in growth and the non-automatic nature of its dissemination, and the centrality of cumulative causation in economic development. However, from this they extracted an optimism rather than pessimism. For these Institutionalists a third road appeared on the horizon, one in which the human element in the recursive causation between individuals and institutions plays an active role in eroding imbecile institutions. Economists such as Clarence Ayres, J.R. Commons, and Wesley Mitchell saw the Veblenian insight as one in which policy could be the tool to fashion capitalist institutions in a way that would promote efficiency and limit its tendency to reproduce and deepen economic inequality.

As Paul M. Sweezy points out, "Veblen treated the United States as the prototype of an advanced capitalist society, just as Marx, writing earlier, had assigned that role to Great Britain." (Sweezy 1958, 177) He may well as have said this of Veblen's earliest disciples, who "used the U.S. economy almost exclusively as their geographic unit of analysis." (Peach 2003, 128) However, over time Institutionalism did begin to gain a global perspective as economists like John Kenneth Galbraith and Wendell Gordon began to apply the institutional paradigm into their studies of development and international economics, and economists outside the U.S., notably Nobel Laureate Gunnar Myrdal, also made use of the institutional framework to discuss international economic issues. (Peach 2003) From basking in the limelight of U.S. economic policy in the early part of the twentieth century, to marginally existing on the fringes of heterodox economics by the latter half, this "Old Institutionalism" has nonetheless survived to inform modern economists who are attuned to its basic tenets. As will be discussed below, it has made a particularly useful reemergence in the field of development economics.

However, not all Institutional economics are created equal. By the mid 1970s a development in economic thought bearing the name "Institutional" emerged from a paradoxical source: Veblen's so-called "neo-classical" economics. Appropriately, it was a qualified institutionalism, lest it be dismissed as a return to a radical Veblenian school, and thus New Institutional Economics, or NIE, was born.

New Institutional Economics

The names Douglass North and Oliver Williamson have become synonymous with this branch of economics. Broadly speaking, the assumptions underlying this deductive school of thought are the existence of certain institutions because they have the lowest transaction costs, and the notion that institutions should be envisaged as the interactions of individuals from which institutions emerge. Although at times there may be some recognition of endogenized preferences through the influence of institutions, this typically enters in ad hoc and fails to be fully wed to theory. For methodological legitimacy to be maintained, analysis begins with Homoeconomicus, justifiable as an "Ideal Type" in the vein of Max Weber. According to Malcolm Rutherford the fundamental distinction in outlook "shows up in the tendency of new Institutionalists to see the development and functioning of institutions largely in efficiency and economizing terms. . . as opposed to the old Institutionalist who tends to see many other social and political factors (status, group identity, ideology, and economic and political power) as also involved." (Rutherford 1995, 444)

For Williamson, emphasis is placed on transaction costs, adapted from Coase's theory of the firm. This necessarily entails a study of individual action and rationality. As will be seen with North as well, one of the first tasks Williamson sets for himself is a reevaluation of the notion of strict rationality of methodological individualism. This is achieved with a "bounded rationality," such that the individual agent, in pursuing his own self-interest, is limited by his own incapacity to perfectly predict the risks and uncertainties implicit in contract agreements. In his own words, this rationality "refers to rate and storage limits on the capacities of the individuals to receive, store, retrieve and process information without error." (Williamson 1973, 317) In contrast to Simon Herbert's bounded rationality, which results in satisficing behavior in the individual, Williamson's usage of this concept is terminal in transaction costs. Additionally, the individual is thoroughly infused with "opportunism," which is "an effort to realize individual gains through a lack of candor or honesty in transactions." (Williamson 1973, 317) Though coercion is not within this individual's given motivation set, he is "farsighted" in terms of his outcomes and will conceal or bend information to the other party in pursuit of his best outcome, thus yielding high costs in transaction.

The institution of interest to Williamson is the "governance structure," which is where transactions and negotiations occur. (Williamson 1998) When specific investments must be made by either buyer or seller in a transaction, a problem of "asset specificity" arises. It becomes more cost efficient for these two parties to merge than remain separate and incur rising transaction costs. This "mutual dependence" therefore occasions the need for a governance structure capable of organizing their activities. Changes in these structures change the comparative costs, such that the "institutional environment is a 'shift parameter' – a datum for the actors." (Groenwegen et al. 1995, 470) Although he recognizes agents as they may try to influence legal institutions, this is not decisive to his analysis. In the end, this leads him to praise the "institutional reforms" of the Washington Consensus, which place private property and contract enforcement at the heart of the policy agenda. (Herrera 2006)

Similar to Williamson, Douglass North wishes not to replace neoclassical theory, but rather to "build on, modify, and extend" it in order to incorporate a theory of institutions into economics. (North 1993) He maintains the assumptions underpinning microeconomics of competition for scarce resources, and therefore sees the study of economics as a theory of choice subject to constraints. For North, institutions should be central to any economic theory as they are the critical constraints individual agents face in achieving their objectives. Drawing upon Coase, he sees institutions formed by economic agents in order to decrease uncertainty in exchange, and he emphasizes the connection between neoclassical theory, institutions, and transaction costs:

> "The neoclassical result of efficient markets only obtains when it is costless to transact. When it is costly to transact, institutions matter. And because a large part of our national income is devoted to transacting, institutions and specifically property rights are crucial determinants of the efficiency of markets. [Coase's] insight is the key to unraveling the tangled skein of the performance of economics over time, which is my primary concern." (1993, 2)

What we see from this statement is that the assumptions underlying neoclassical economics are not incorrect *per se*, but rather that we live in a world of asymmetric information and therefore market imperfections. If this could somehow be rectified, institutions would cease to be of economic relevance. This stands in stark contrast to a Veblenian understanding of the nature of institutions. As fundamentally social beings who must organize in order that production takes place, institutions are the very substance of human life. Thus, from a Veblenian perspective the phrase "institutions matter" goes without saying, and necessitates no qualification. (Veblen 1898a)

However, working from a framework that places individuals as the proper starting point for analysis, North accomplishes his task of incorporating institutions into the neoclassical paradigm by modifying "instrumental rationality," as this is the element he pinpoints as the source which causes institutions to vanish from neoclassical analysis. Under its strict assumptions, individuals operating on the basis of instrumental rationality necessarily act on the basis of optimization, with the choice of ends as given. In such a scenario there is no need to discuss the role of institutions, they simply do not enter analysis. But as has already been established, in our lamentably imperfect world (lamentable on the grounds that we have not achieved perfect competition), "institutions matter." North looks for his modification to the strict rationality of methodological individualism in the way in which human beings process information.

According to cognitive science, humans possess mental modes that allow them to understand their world. These are bestowed upon us through culture, which articulates values, norms, and custom, as well as through our experiences within our "local" environment. In this way variation in mental modes and world perception can be accounted for. Individual action stems from these mental modes, and can be altered if presented with an experience that contradicts what would have been expected on the basis of these modes. This results in "multiple equlibria." As a result, world perceptions are limited and vary widely from one individual to the next, creating an environment riddled with asymmetrically held information and an inability to process all the necessary information required for transparent and harmonious exchange. Returning once again to Coase, information bears a high price in this environment, and it is this in combination with contract enforcement costs that the costs of transaction are determined. The upshot of this line of reasoning is that institutions, in order to reduce the uncertainty inherent in exchange, are born of transaction costs.

What has emerged is a linear causality: from individuals to institutions. Not surprisingly then, North has a different conception of institutions. They are, "the rules of the game of a society, or more formally, the humanly-devised constraints that structure human interaction," which entail both formal, and informal institutions, as well as the "enforcement characteristics of both." (1993, 5) These he distinguishes from organizations, which are the "players," grouped together by function and purpose. For example, firms, labor unions, churches, political parties, all fall under organizations. Institutional change, or "modification," then takes place based upon individual maximizing behavior. If individuals believe they can improve their outcomes by reorganizing the terms of exchange, they will do so, and incremental, path dependent institutional change transpires. In a notion that reminisces of Veblen's imbecile institutions, North argues that the individuals and organizations with bargaining power in a society are also the agents that have a stake in maintaining the system. The consequence he sees to this is that an economy on an "inefficient" path will persist on this as a result of the institutional inertia the privileged are able to sustain.

For North, the primary driver of institutional change and economic growth is not the engineer that Veblen saw such revolutionary potential in, but the entrepreneur within an organization. Entrepreneurial "learning" dictates both the rate and direction of economic change. While North does grant Veblen an element of "idle curiosity," he does not factor it into his motivations for invention and innovation. His purpose is to give an "institutional/cognitive story" of economic change in the long run. The true source is to be found in the neoclassical assumptions that stand at the base of the New Institutional Economics. The more competitive is a market, the higher the rate of learning and the faster will economic change occur. The type of learning that takes place governs the direction in which economic change moves, and is a reflection of the mental modes of the individuals involved and the incentive structure as determined by the institutional framework. The primary incentive structure is, of course, strong property rights.

What North gives us then is a radically conventional story of the entrepreneurial spirit motivated by pecuniary gain, nurtured and made stronger with the institution of private property. David Landes perhaps captures the essence of this perspective when in looking at weak property rights in history he remarks, "Today of course we recognize that such contingency of ownership stifles enterprise and stunts development, for why should anyone invest capital or labor in the creation or acquisition of wealth that he may not be allowed to keep?" (Landes 1999, 32) This argument from authority apparently requires no justification, it is just something that we "of course" all know. Kenneth L. Sokoloff and Stanley L. Engerman, also New Institutionalists, make the same argument under the name of "good" institutions. Even when taking one step back from institutions to include colonization patterns and factor endowments, this is still a means to the end, which is to argue that property rights in the form of patents were critical in creating incentives for innovation and investment, and therefore lie at the heart of modern successful capitalist countries. (Sokoloff and Engerman 2000)

North, as promised, brings his thesis to the State, as the institution that enforces the so-called "rules of the game." This, he argues, is an improvement upon neoclassical economics which typically views the state as exogenous or irrelevant to economic development. Here the emphasis is on "getting prices right" by removing State action that would inhibit the natural movement of prices toward equilibrium. Adhering to the principle of perfect competition in theory, North argues that this holds true only if property rights are such that the conditions for competitive markets are created and sustained. "It is polities that shape economic performance because they define and enforce the economic rules of the game. Therefore the heart of development policy must be the creation of polities that will create and enforce efficient property rights." (1993, 7) In this way he has brought institutions into light not just as constraints, but also as entities that can enable economic agents, specifically, by improving efficiency.

Although North has indeed brought institutions to the center of analysis, NIE is still theoretically bound to a notion that holds the competitive marketplace as the natural ordering of economic life. The State has a place insofar as it supports the objective of maintaining it where it is existent, and cultivating this environment where it is deficient. As Malcolm Rutherford again points out, "Despite his references to the limited computational power of individuals, to cognitive psychology, and to the influence of social norms – all of which lead us to rule-guided behavior, North persists in describing the activities of individuals and entrepreneurs predominantly in terms of self-interested maximization." (Rutherford 1995, 447) Groenewegen et al. conclude similarly, "the [NIE] is of an individualistic, deductive nature. After having characterized the transaction, different potential governance structures are discussed in terms of their transaction cost minimization. Then hypotheses are confirmed using historical examples." (Groenewegen et al. 1995, 471) While North makes mention of the Veblenian elements of power, ideology, and myth, they are not effectively integrated into his theoretical assumptions, and therefore fail to play a decisive role in the policy prescription that follows. When causality runs from the self-interested individual to institutions, and institutions are deemed the “rules of the game,” institutional policy is one of either constraining or channeling individual behavior in a way that yields optimum efficiency.

The appeal of such reasoning is not difficult to see. What has emerged is straightforward guide to economic development that tends to justify the existing state of affairs in capitalist developed countries, and is backed with all the legitimacy of the dominant paradigm in economics. Indeed, the World Bank adopted the philosophical underpinnings of this NIE by the early 1990s, as the phrase “institutions matter” became increasingly ubiquitous. A quick survey of this literature reveals institutions as “rules of the game,” with emphasis placed on contract agreements and strong property rights. (See for example Javed and Perry 1998, and Poverty Reduction and Economic Management Network 2000.) Establishment of robust property rights, alongside other “good” institutions that would foster “good governance,” became the strategy for promoting economic growth worldwide.

It is in this context that Ha-Joon Chang can be understood, as he offers up a direct response to this development in the Washington Consensus. His critiques of this policy and the methodological foundations that guide it bear striking resemblance to Veblen’s critique of neoclassical economics. This is of no accident, given that NIE is firmly rooted in neoclassical economics and Chang is a methodological return to OIE. Taking a historical approach to the study of economics, critiquing the dominant paradigm for taking what *is*, specifically institutions, *as given*, recognizing institutional lag and the recursive nature of causation, Chang brings Veblenian insight to the field of development economics.

Ha-Joon Chang’s Institutional Political Economy

One of the fundamental critiques Chang has of the “so-called New Institutional Economics” is that an emphasis on institutions is not enough, and finds fault in its failure to break from neoclassical economics in authentic and essential way. (Chang 2003a) Insofar as it views institutions as constraints that can generate inefficiencies, it is entirely consistent with mainstream economics and demonstrates a linear causality. Where it adds dimension to the understanding of institutions is in the recognition that they can also play an "enabling" function. However, as was seen in North, "they still maintain the myth that the unconstrained market is the natural order, while institutions are man-made substitutes that should be (and will be) deployed only when that natural order breaks down." (Chang and Evans 2005, 102) Bringing institutions to light, Chang argues, is a necessary, but not a sufficient condition in understanding the nature of economic development. Institutions *do* matter, but the way in which they are understood is of grave importance. As Chang points out, even good intentions, if misinformed, can mean utter devastation to a nation. Institutions deemed "good" and "natural" in capitalist developed countries are transplanted onto developing capitalist countries, often with great consequence. Thus the definition and understanding of institutions is far more than an exercise in semantics, "people are hurt because social scientists and policy makers misunderstand institutions." (Chang and Evans 2005, 100)

To remedy this misconception of the nature of development in general, and institutions in particular, he develops a theoretical framework of Institutional Political economy, or IPE. From this perspective institutions are defined as "systematic patterns of shared expectations, taken-for-granted assumptions, accepted norms and routines of interaction that have robust effects on shaping the motivations and behavior sets of interconnected social actors." (Chang and Evans 2005, 99) Thus, institutions are not axiomatically taken as the maxims of a game, but run much deeper, indeed into Veblen's customs and habits of thought, highlighting human nature as one of social being. From this vantage point a view of human life as it interacts with institutions recursively once again emerges.

Chang refers to this interaction as the "constitutive" nature of institutions, which highlights an endogenous process of preference formation. In starting at the cognitive level before theoretically erecting institutions built of individual maximizing rituals, NEI maintains exogenous preferences and thus fails to recognize the profound nature of their basic unit of analysis. For Chang, institutions are such a part of the social fabric that they transform the very substance that motivates us. IPE then does not take human motivations as given,

> "but as being fundamentally shaped by the institutions surrounding the individuals. This is because institutions embody certain 'values' and, by operating under these institutions, individuals inevitably internalize some of these values, thereby altering themselves. This [constitutive role of institutions] is a central hallmark of a truly 'Institutionalist' approach. . ." (Chang 2003a, 54-55)

There are three "mechanisms" by which this constitutive aspect operates. First, institutions have the capacity to shape what human beings perceive to be in their interest. Secondly, they are of the nature that they can imbue the common view of *which* issues are valid for political action, and, finally, institutions shape what is perceived to be the legitimate *forms* of such political action. (Chang 2002) Institutions are constraints, to be sure, while also having the capacity to enable in the sense that North discussed above, but must also be understood as one element of a two-way street of causation. From the perspective of NIE it is a narrow one-way path, with direction running from individual (cause) to institution (effect.) Although more "sophisticated" approaches have emerged from the simple dimensions of NIE, Chang argues that the challenge of developing a strong theory of culture remains. (Chang and Evans 2005)

Much of Chang's historical analysis reveals a Veblenian institutional lag. Indeed, this is the main thrust of his book *Kicking Away the Ladder: Development Strategy in Historical Perspective.* Looking at institutions such as universal suffrage, central banking, protection of property rights, and child labor regulation in the now developed capitalist countries, or NDCs, he demonstrates temporal delay from when the need for these institutions surfaced and when they finally became institutionalized. For example, universal suffrage in the U.S. was not achieved until a full 95 years after the vote was given universally to men. But even this is misleading, as this universal male suffrage was reversed only twenty years later as African

American males were disenfranchised, and did not witness their voting rights restored until 1965. In the case of Switzerland and France it took nearly 100 years. (Chang 2003) Furthermore, a comparative look at GDP per capita reveals that the NDCs were much wealthier at the time they erected these "good" institutions than has perhaps been perceived. "In the early days of their economic development, the NDCs were operating with far less developed institutional structures than those which exist in today's developing countries that are at comparable levels of development." (Chang 2003b, 515) Even once these institutions were erected in the NDCs it was not a seamless process. As shown above in the case of male suffrage in the U.S., reversals often took place. Thus, arguments which claim that "good governance" preceded and fostered growth are simply inaccurate. When put in historical perspective, precisely the reverse thesis emerges.

Although Chang makes clear that reasons for institutional lag vary country by country, there are broadly two explanations underpinning this gap. Put simply, institutions are expensive, and it was untenable to adopt social welfare programs when resources were lacking. But there is also an element of "social inertia" that takes place. Once again, a historical view reveals that the wealthy elite actively block progressive change. Although he does not use the term "imbecile institutions," Chang is capturing the essence of the way in which Veblen's privileged class was able to hinder social change. Child labor laws and voting rights were not in the interest of the upper tier, and through their control over institutions were able to hinder such developments for decades in the U.S. However, Chang is not entirely pessimistic. The constitutive nature of institutions has the consequence that when an institution is put into place what once was unthinkable, such as banning child labor, overtime changes human motivations. Child labor is now universally accepted as inappropriate and exploitative in the NDCs. Furthermore, this recognition of privilege wedded to power does not mean policy cannot be actively altered, it merely highlights the challenges that will be faced. As Chang and

Ilene Grabel argue "it is both fatalistic and incorrect to act as if their [IMF, World Bank, and WTO] power and influence are absolute and immutable." (Chang and Grabel 2004, 203)

Chang also stresses the significance of institutional inheritance in the formation of new institutions, the result of which is institutional path dependency. Chang points out that new institutions are adaptations of old institutions, and are erected of the same material. "The strong element of legacy, inertia, and path dependence in the determination of institutional forms" must be recognized by those who would ask capitalist developing countries to implement a "global standard" of "good" institutions in as short a time span as five to ten years. (Chang and Evans 2005, 104) Again, it must be remembered that it often took the NDCs generations to develop their current institutions. It must also be recognized that not all institutions packaged as "good governance" are necessary. The imposition of an unneeded institution may come at the cost of other, necessary institutions.

Having outlined Chang's approach to development economics, it is worth returning to what is perhaps the most fundamental critique waged at the NIE: the tendency to take institutions as given. For Veblen this was what rendered neoclassical economics ineffective, shutting off the "inquiry at the point where modern scientific interest sets in." (Veblen 1919, 240) What Veblen was pointing to was the tendency to observe current institutions, generalize them, and then view all times and all places in history through this lens. With such an approach to history it is no surprise that verifications abound. This method presupposes that what is, must be right. But the notion of institutional lag would suggest just the opposite. As Veblen is quoted as saying, "What is, is wrong." (Lekachman 1994, viii) Chang continually refutes ahistorical theory and policy that assumes, in essence, that regarding institutions in the NDCs – particularly the U.S. – what is, is right. "History is written by the victors, and it is human nature to reinterpret the past from the point of view of the present." (Chang 2003, 64)

Among the most critical institutions to have been presumed "natural," with perhaps the greatest consequence, is that of private property. According to E.K. Hunt, one of the defining characteristics of OIE "has always been its concern with the organization and control of the economy. This has inevitably involved an analysis of the structure of power – a topic systematically avoided by the mainstream economists. For most Institutionalist economists an analysis of power necessarily involves a study of the complex institution of property. . ." (Hunt 1994, 54) Indeed, one of Veblen's major tasks was to move beyond the "Natural Rights" view on the origin of private property to uncover the genesis of modern ownership. (Veblen 1898a)

For Veblen, ownership is a cultural fact which must be learned, not a fact of nature to be presupposed. According to the natural-rights theory, the "natural" owner of some object is the individual that either produced it, or somehow improved upon it. The basis of ownership in this view then is rooted in a self-sufficing individual, an individual Veblen denies has ever existed.

> "Within the human period of the race development, it is safe to say, no individual has fallen into industrial isolation, so as to produce any one useful article by his own independent effort alone. . . The only possible exceptions to this rule are those instances of lost or cast-off children nourished by wild beasts. . . But the anomalous, half-hypothetical life of these waifs can scarcely have affected social development to the extent of originating the institution of ownership." (Veblen 1898a, 33-34)

Not only is the self-sufficing individual a mythical creature, but a glimpse into our own history reveals that being engaged in the production of some article does not entitle one to that which they produce. As Veblen sagaciously observes, serfdom and slavery are clear demonstrations that "those who work cannot own, and those who own cannot work." (Veblen 1898a, 42) He includes women's productive efforts in the patriarchal home as another example of this aphorism, ultimately rooting the "beginnings of ownership" to the seizure of women and the products of their labor once apprehended. Ownership of a "trophy wife" becomes the preferred way of putting ones physical prowess into evidence and demonstration of invidious distinction. Passed from one generation to the next, this becomes solidified into the institutions of ownership-marriage and private property.

NIE, in contrast, views the function of private property quite differently. From this perspective the modern form of ownership is not a conflictory element in society, but is the foundation upon which successful capitalist countries were built. Bestowed upon this institution is the power to unleash the entrepreneurial spirit, so it is not surprising that the origin of private property is rooted special cultural characteristics. Although not the first to emphasize culture as the source of capitalist development, David Landes is representative of this line of thought. He argues that the origin of private property is to be found in medieval Europe, specifically, the Judaic-Christian tradition. (Landes 1999) While not all New Institutionalists who argue that private property is the key to capitalist development see the genesis of modern ownership in culture, the story and policy converge with the conventional story once the institution of private property is historically reached. For example, authors like Daron Acemoglu see existing wealth and labor exploitative opportunity of colonizers as the basis for this institutional development. (Acemoglu, Johnson and Robinson 2002) Sokoloff and Engerman place emphasis on geography and factor endowments as the route to private property. (Sokoloff and Engerman 2000) Once this stage is reached, entrepreneurial energy, from which economic growth and development springs, is allowed to flourish. As Landes says, "why should anyone invest capital or labor in the creation or acquisition of wealth that he may not be allowed to keep?" (Landes 1999, 32)

Chang points out that it is this myth of the sanctitude of private property and the promotion of privatization through the Washington Consensus that is the cause for so much hardship in capitalist developing countries. The New Institutionalist neoliberal view sees patents, copyrights, and trademarks as critical in the development of the NDCs and argue that monetary incentives for invention and innovation are the only appropriate incentives. Although arguing that at times privatization is the appropriate policy, Chang and Grabel point out that this process is both expensive and complex. It results in a great burden on the State, even as the private sector profits. (Chang and Grabel 2004) In terms of patents and copyrights, historical canvassing does not support the claim that economic growth follows from strict property rights. In fact, it supports just the opposite. Much growth in NDCs took place *before* patents and copyrights were existent, or when they were particularly weak. (Chang 2003, Chang 2003a, Chang and Grabel 2004) Furthermore, not all motivations underpinning invention and innovation are of a pecuniary nature. History, Chang points out, is full of examples of innovation driven by a motivation for the public good. Yet the Washington Consensus enforces strict intellectual property rights, privatization, and enforcement of private property in the name of economic growth. In looking at such policy as dictated by the NDCs via the WTO, World Bank, and the IMF on the developing world, Chang concludes that once the advanced capitalist countries secured core status in the world economy, they "kicked away the ladder" to ensure other countries could not follow. (Chang 2003)

Concluding Remarks

The distinction between NDCs and developing capitalist countries is then one of power, wed together by imbecile institutions, and fortified by the institution of private property. It is a return to the powerful Veblenian understanding of institutions and the role of private property as a power relation. In making such a return, Chang's IPE opens a powerful door for policy that includes gender as an analytical category, as it allows emphasis to be placed on individuals, households, and institutions, while enriching and understanding of the way in which these shape one another. Indeed, Veblen wrote much on the subjugation of women both in the household and in society at large. Due to the constitutive nature of institutions, the inclusion of gender is not only compatible with IPE, as it brings equal emphasis to individuals in their cultures and institutions, but would enrich and strengthen it in terms of developmental policy that would otherwise be invisible. In 1970 Ester Boserup demonstrated the significance of the omission of women in the study of international and development economics, ushering in a wave of literature that has attempted to rectify gender blind analysis.

(Boserup 1970) More recently, feminist literature has called for an approach to economics that allows its practitioners to see into the "black box" of the household. Numerous authors have cataloged male-biased development policy and its consequences, including the inability to accurately assess the true impact of macroeconomic policies aimed at increasing efficiency as long as the unpaid portion of the labor force is invisible. (See for example Elson, Grown and Cağatay 2007.) Though this paper does not attempt to develop an IPE that encompasses gender as an analytical category, having established the connection of Chang to Veblen, this can be seen a useful undertaking for future research. As James T. Peach argued, Institutional economics is itself an institution. (Peach 2001) As such it is critical that power relations at all levels of analysis are challenged.

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