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***Comparative Economic Systems and the New
Comparative Economics:
Foes, Competitors, or Complementary?***

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Comparative Economic Systems and the New Comparative Economics: Foes, Competitors, or Complementary?

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Abstract

The field of comparative economic systems has been recently enriched by the arrival of the new comparative economics. This approach is in the line of the law and finance tradition and presents an important contribution under different perspectives. In the paper I present the most important propositions of this new approach and I evaluate them in the light of the problems that the comparative study of economic systems traditionally considers. The conclusion is that this new approach can give important contributions to the development of the discipline in particular fields, but falls short of its pretended general validity.

1. Introduction

The changes that took place since late Eighties, particularly internationalisation and transition, have had profound consequences for economics. These consequences were particularly dramatic for fields that have traditionally dealt with economic systems that have disappeared or have been deeply changed. Comparative economic systems is certainly among the first in the list of affected fields.

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This situation has prompted many, particularly in the academic world, to raise the crucial question: “is comparative economic systems (comparative economics) dead?”² The most recent answer given to this question has been advanced by a group of well-known Authors, mostly based in Harvard and at the World Bank,³ who are usually in the line of the rapidly growing field of law and finance. These Authors have applied their peculiar approach to analysing an extensive database having mostly to do with such important institutions as ownership, finance, law, government, regulation “around the world”.

The answer that these Authors give to the above question is a straightforward one: NO. This simple answer in itself makes this line of research particularly interesting and important for the scholars in the more traditional field of comparative economic systems (CES). The motivation that the above Authors give to their answer is presented as follows:

“Traditional comparative economics has evolved into a new field. This field shares with its predecessor the notion that by comparing alternative economic systems, we can understand better what makes each of them work. But it sees the key comparisons as being those of alternative capitalist models that prevail in different countries. Each capitalist economy has many public and private institutions. These institutions function to choose political leaders, to secure property rights, to redistribute wealth, to resolve disputes, to govern firms, to allocate credit, and so on. Political economy over the last two centuries, as well as recent empirical research, demonstrate that these institutions differ tremendously and systematically among countries, with significant consequences for economic performance. The analysis of these differences is the subject of the new comparative economics.” (Djankov et al. 2003a., p. 1)

This quotation offers some food to think about. That CES has to evolve further, and possibly restructure its focus, few in the field would doubt. Is the new comparative economics (NCE) the good and correct answer? Are the topics it enquires, the methods it use and the analysis it performs really contributing new ideas and new solutions to the field? And if so, in which sense? Which are these ideas, methods and solutions? In which sense do they differ from more traditional ones? Are they compatible or are they antagonistic with those more deeply established in the discipline?

There are at least three other reasons beyond its novelty and aim why careful attention should be paid to this contribution. First, law and economics is part of the broad field of institutional economics and therefore comparative economists should devote particular attention to it, since institutional economics is akin CES both methodologically and in the field of study. The second reason for devoting particular attention to the NCE is the name of the Authors. Third, the important approach of relative efficiency, that the NCE places at the heart of its

² Although there are some important differences between the two, in the present work I consider comparative economic systems and comparative economics as synonyma.

³ The most active participants to the project discussed here are Simeon Djankov, Edward L. Glaeser, Simon Johnson, Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer, and Robert W. Vishny

explanation, is a serious candidate for fruitful analysis of intersystemic differences and an important contribution to reform drawing, planning and implementation.

In the above quotation, the proponents of the NCE make three important statements, that is worth enquiring in some depth. First, they write that the NCE shares with its predecessor the notion that by comparing alternative economic systems, we can understand better what makes each of them work.⁴ Since we are all convinced that this is so, there is no need to investigate further this issue.

Second, the NCE sees the key comparisons as being those of alternative capitalist models that prevail in different countries. This is presented in a supposed contradiction with CES, which is considered to be concerned only or at least in large part with non capitalistic systems. Although there is much truth in the statement that CES scholars have been dealing extensively with the socialist system first, and with the transition issues later, the statement is at least imprecise. Therefore, there is a need to devote some effort in clarifying this issue. This will be done in section 2.

Third, there is a stress on the fact that institutions differ tremendously and systematically among countries, with significant consequences for economic performance. The NCE states that the analysis of these differences is its subject of research. This implies that the correct benchmark of comparison is (institutional) efficiency.⁵ This is, in my view, the most interesting and important contribution of the NCE to the field. Much of this paper will be devoted to discuss this issue since the apparent outcome of the exercise is an appealing theoretical explanation which hides the risk of excessive analytical simplification and may produce a justificationist and rationalising interpretation of the data.

The rest of this paper illustrates and examines critically the NCE contribution to this third issue. In section three I introduce the “New” New Comparative Economics and highlight its main features. Each of the following sections focus on a particular aspect of the NCE and presents my analysis of its strengths and weaknesses. Section four presents the basic NCE idea of comparative institutional efficiency and the following section five outlines the premises of the comparative institutional efficiency analysis. In section six the institutional possibility frontier (IPF) is introduced as the basic NCE instrument to represent and analyse comparative institutional efficiency. Civic capital as the basis of the IPF is discussed in section seven,

⁴ “... the comparative perspective, which identifies both the possibilities and the limitations of individual societies, can serve as a useful framework for future progress.” (Djankov et al. 2003a, p. 39). See also (Shleifer 2002, p. 12).

⁵ However, the authors go beyond the efficiency issue to admit that there may be other ways of choosing institutions. In particular, they deal with the important issue of the transplantation of institutions through conquest and colonisation.

together with the role of the legal system. Section eight looks at the consequences of this approach for institutional reform and section nine discusses the role of legal origin. Section ten concludes by considering the relation of the NCE with CES.

2. *The “Old” New Comparative Economics*

The term New Comparative Economics is not new. It was first used in a 1989 article by Irwin-L. Collier, Jr. that was published in one of the journals of the American Association for Comparative Economic Studies.⁶ This Author supports an interesting point of view which is of relevance for the topic discussed here. After maintaining that “myriad programs of economic research belong into CES, he groups these programs into two broad, yet distinct areas: analysis of economic systems and the methodology of comparative economic analysis. He uses the definition of “new comparative economics” just to indicate “...the current duplex of the *analysis of economic systems* and *comparative economic analysis*.” (emphasis in the original, p. 24) This is meant as “...a branch from the mainstream of analytical economics.” (Ibid., p. 27) This latter, strong statement imposes Collier not to include in the field such an author as János Kornai, a statement that few, at least in Europe, would accept.

This change in the discipline took place starting in the early 1970s, when the NCE became increasingly analytic and as such a part of modern economics, and took substance through the publication of the *Journal of Comparative Economics*. The NCE replaced progressively the previous primary task of correct labelling and classification of economic systems and the documentation of the great variety of systems existing. However, the discipline kept its distinctiveness, thanks to its “...overriding concern for the effect on economic behaviour and performance of ‘unconventional’ institutional constraints, “unconventional” objective functions and “unconventional” mechanisms for the coordination of economic activity.” (p. 25)

It is this latter statement that makes the “old” NCE distinct from the “new” NCE. What distinguishes them is not so much the broad theoretical reference, namely mainstream economics, but the object of study: “unconventional” economies in the former, “conventional” capitalist economies in the latter. However, as this will become clear later on, this difference in the object of study has important implications for the particular method of the discipline and the particular aspects that are studied and compared. As to the broader method, there are no radical differences in view, since the “old” NCE – similarly to the “new” one - stressed that that method must comprise both “careful institutional and historical description and the patient

⁶ Cf. Collier, Irwin-L. Jr. (1989).

sifting and collating of statistical data” together with the application of quantitative methods, and the use of mathematics and modelling.

If Collier is correct, and I am convinced he is, a major shift in the discipline took place more than three decades ago. The most important evidence of this change was possibly the publication in 1971 of a proceeding volume that included some landmark papers.⁷ This was a shift primarily in the approach, that became more analytical, and in the methods, that shifted towards quantitative and mathematical without reneging descriptive and interdisciplinary methods.

However, between that shift and the supposed new one there was a watershed: transition in Central and Eastern Europe and the booming internationalisation (“globalisation”). There also was a remarkable evolution and change in economic thought, with revival and rapid development of institutional and evolutionary economics, among other things. These are certainly sufficient reasons to justify a new shift in the object of study. Since a change in the object may require the use of different methods and also the enquire of new problems, these should also be sufficient reasons for a major shift in analytical methods. Is the “new” NCE representing this second major shift? And if so, in which sense?

To try to answer this latter question in a very rough way, a short enquire in the Econlit database may be useful. EconLit includes coverage of over 400 major journals as well as articles in collective volumes, books, book reviews, dissertations, and working papers licensed from the Cambridge University Press Abstracts of Working Papers in Economics. Over 99% of the articles are in English or include English summaries. This database is somehow biased, since it excludes the large part of publications in languages other than English and in journals of smaller countries. Econlit classification is also somewhat inconsistent, since many publications that belong in CES are actually classified not in group P (Economic systems), but in group O (Economic Development, Technological Change, and Growth), which has a subgroup O5 (Economywide Country Studies) that includes studies on the world countries and also the subgroup O57 (Comparative Studies of Countries). However, there are sufficient reasons to rely on this database as a broad approximation, since it is a standard in the profession, and in any case it is the most easily accessible.

The electronic database is defined as including publications since 1991 and up to September 2003. It actually includes publications since 1969, although prior to 1991 the classification was different and not easily comparable. For this reason I limit my brief examination to 1991 and the following years up to 2002, because 2003 is clearly incomplete (also 2002 is apparently in

⁷ Cf. Eckstein (1971).

process of being completed). Keeping these limitations in mind, the twelve years considered witnessed the publication of more than 1000 works that Econlit considers belonging in the CES field (group P).

According to Econlit classification, most of the publications (54%) are on comparative economic systems and more than 9% are not classified to a special group, but are attributed to CES in general. This makes the remarkable share of 64% (including the few publications on economic systems in general). Out of the remaining nearly 37%, the majority is in the field of socialist systems and transitional economies (more than 20%) and socialist institutions and transition (5.3%). Only 7.2% of the considered publications deal with capitalist systems and publications on “Other Economic Systems” (basically developing economies) are barely present. The tentative conclusion, then, would be that if there is dominance in the field, it is of studies on the economic system and comparisons, while the supposed dominance of studies on “unconventional” economic systems is a secondary feature (see table 1).

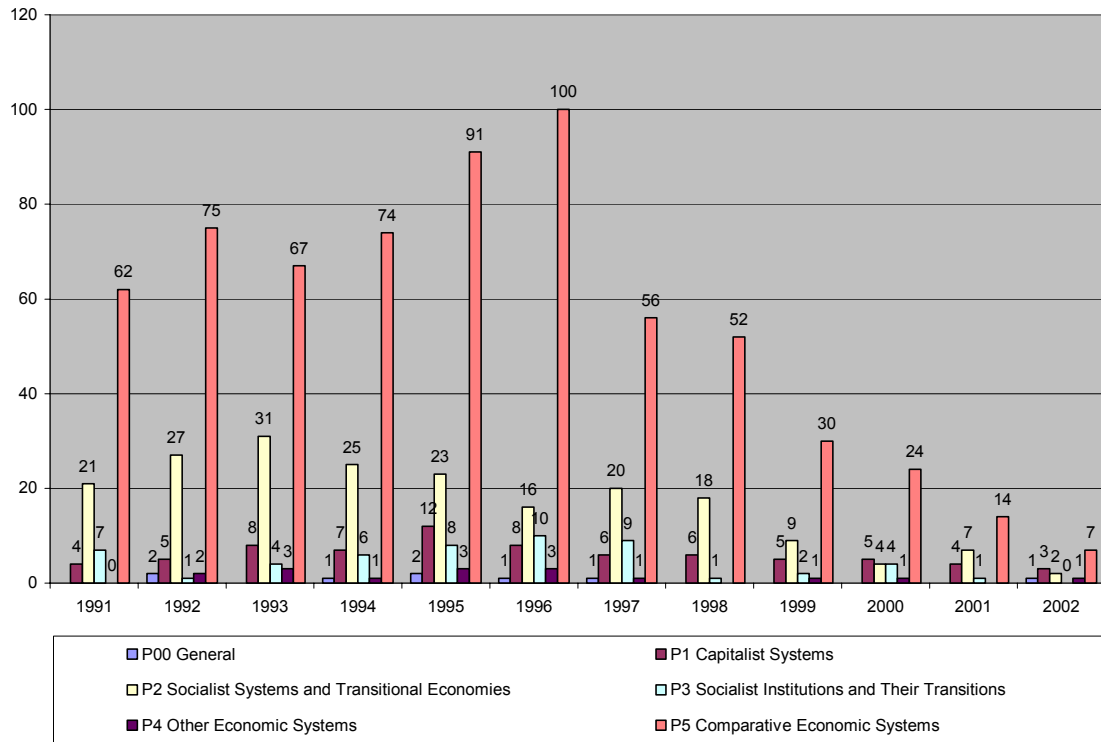
Table 1. Classification of publications in the field of comparative economic systems according to Econlit (1991-2002)

	No.	%
P00 General	8	0.8%
P1 Capitalist Systems	73	7.2%
P2 Socialist Systems and Transitional Economies	203	20.1%
P3 Socialist Institutions and Their Transitions	53	5.3%
P4 Other Economic Systems	18	1.8%
P5 Comparative Economic Systems	654	64.8%
P6 Total	1009	100.0%

It is true, however, that the dominant part of studies on comparative economic systems (more than 26% of the total of the studies classified by Econlit), consist of comparative studies of particular economies. Most of these (nearly 45%) are indeed on economies in transition (including China). However, their concentration is particularly high in the first half of the Nineties and is decreasing progressively in later years. At the same time, inter-systemic comparisons, including comparisons among capitalist, socialist or transition, and developing economies, make up nearly one quarter of the group. Studies on capitalist economies represent more than 22% and become relatively more frequent in later years. A minor part of studies is devoted to developing countries. However, these trends take place along with a marked decline in the number of publication that Econlit recognises as belonging in CES (see chart 1). This

may be incorrect, as explained above, still it is an important external perception of this field of study.

Chart 1. Yearly number of publications in the field of comparative economic systems according to Econlit (1991-2002)

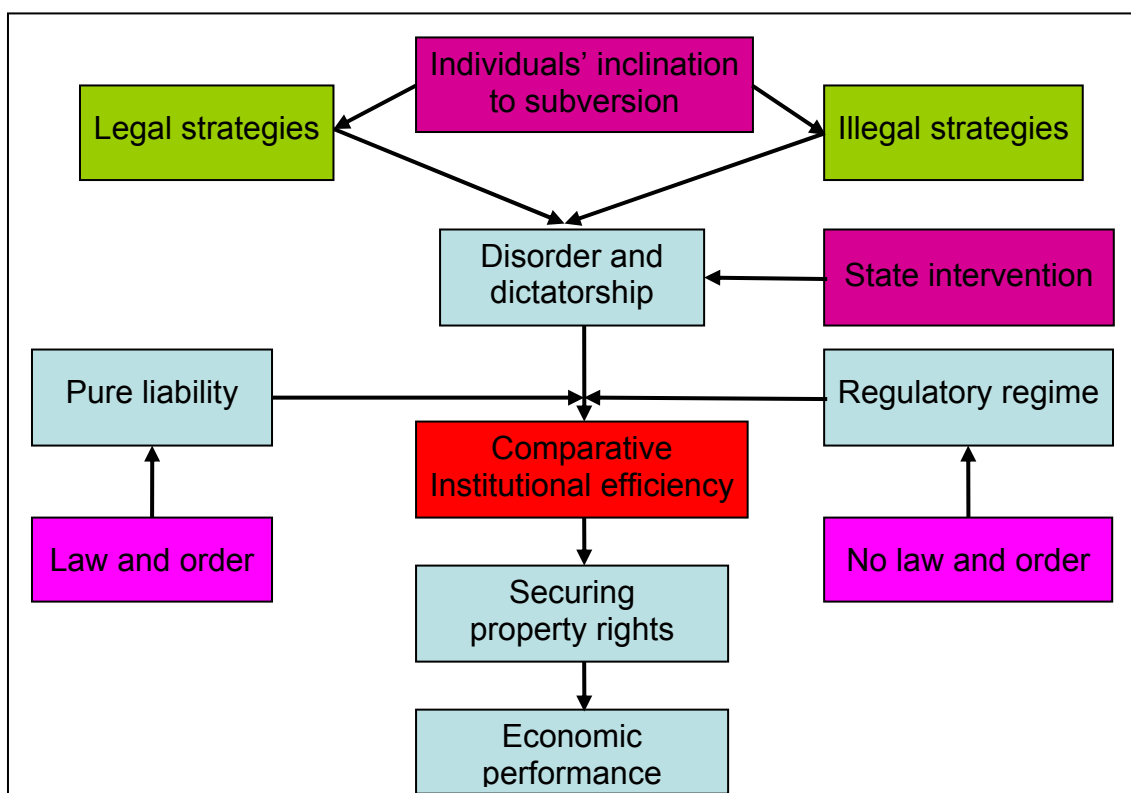


Now we have sufficient, although tentative elements to give an answer to the accusation that the “New” NCE (in the following NCE) raises against CES. First, it is not true that CES dealt primarily with socialist and transition economies, even less so that it did practically only so. In the field there is a clear dominance of truly comparative studies, often involving inter-systemic comparisons. Second, there is a true problem with CES that the NCE overlooks, namely the rapid decrease since 1997 in the number of publications that Econlit – hence an important part of the economic profession – recognises as belonging in CES. This may be due to a rapid decrease in the number of publications by scholars in the field, to their publishing in different fields, or to a lower profile of the discipline so that the authors themselves or Econlit managers directly allocate to the field a lower number of studies, or to a combination of these factors. In any case the problem is clear and serious. In this perspective, a forceful contribution to the field by an important group of scholars can only be welcome.

3. The “New” New Comparative Economics

We can explain the basic message of the NCE into two steps. In the first step the NCE organises what one could define as the core variables of the explanation. Since these are insufficient to clarify all the issues that the NCE intends to explain, in a second step the complementary variable of civic capital is introduced. The first step of the explanation is summarised in the following Chart 2.

Chart 2. The core variables of the NCE explanation



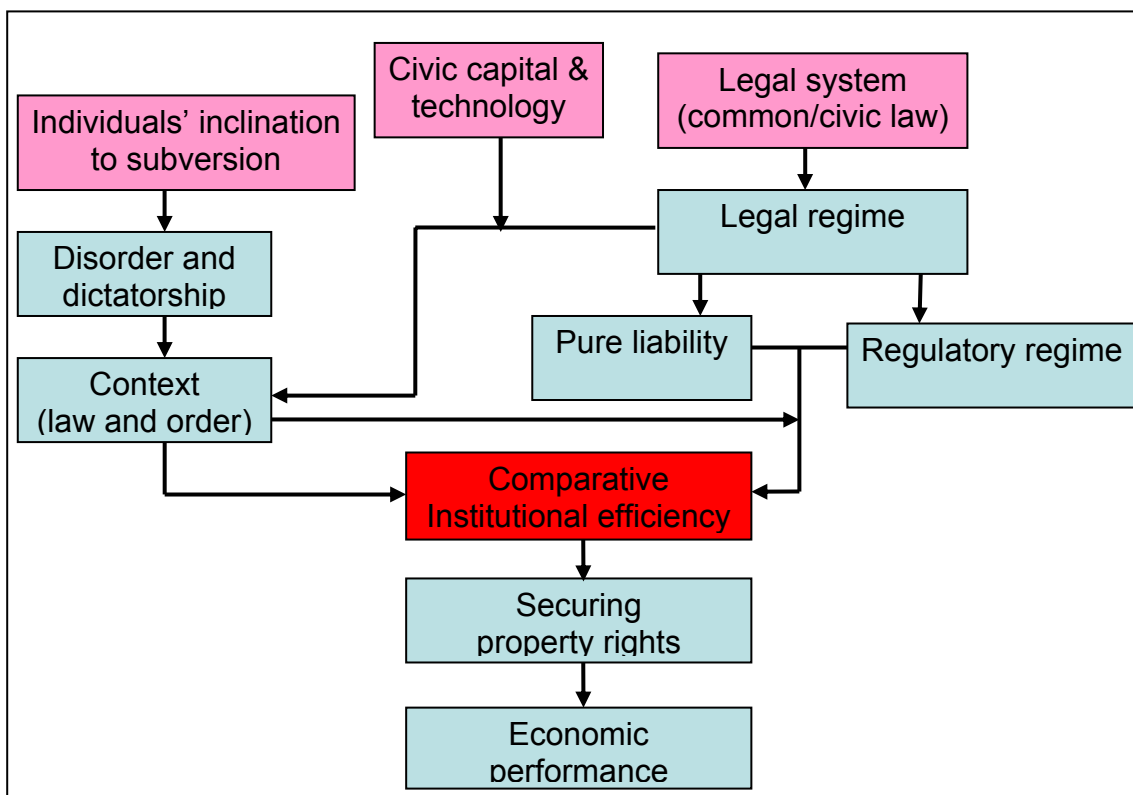
The starting point is human nature, i.e. the individuals' inclination to subversion. This inclination leads individuals to pursue their own advantage by making use of both legal and illegal strategies. Since this threatens to create disorder, which would jeopardise economic activity, state intervention is necessary. However, the latter creates the danger of dictatorship.

The trade-off between disorder and dictatorship is under the influence of the legal system, although it is also true that the “law and order” endowment of a particular economy determines which legal regime is efficient. In particular, a pure liability regime is efficient in conditions of law and order. When the latter does not hold, a regulatory regime is the only possibility. The trade-off between disorder and regulation, under the influence of the legal system, determines institutional efficiency, i.e. those institutions that are most efficient in securing property rights. These in turn determine economic performance.

However, this description is insufficient to explain why institutional efficiency is different in diverse economies. To do so another element is necessary, i.e. civic capital. Civic capital explains what the possibilities of a particular economy are in terms of the absolute value and mix of disorder and dictatorship that exist and is tolerable. This element is actually corroborated by the role of technology, that further refines the issue of disorder and dictatorship.

Considering all these elements and simplifying somewhat the explanation depicted in Chart 2, the overall explanation advanced by the NCE is outlined in the following Chart 3.

Chart 2. The NCE explanation of comparative institutional efficiency



4. Comparative institutional efficiency

The core of the NCE lies in the concept of institutional efficiency. This was a central problem in Coase's (1960) analysis who considered the efficiency of alternative strategies of law enforcement in securing private property. The crucial issue, then, is to identify which institutional arrangements are more efficient in securing property rights, which remain the actual core issue of the explanation. Glaeser and Shleifer (2003) consider three plus one alternative institutional arrangements: private litigation, government regulation, a combination

of the two, and doing nothing. In a following work, intended to establish the NCE (Djankov et al. 2003a), socialism is added to the previous three arrangements.⁸

The importance of the law enforcement strategy the society chooses comes from the fact that private individuals are considered naturally self-interested with guilt. They will seek to subvert the law workings to benefit themselves. This creates a threat of disorder that jeopardizes property rights and consequently business and economic life.⁹ Disorder must be put under control in some way, either privately or by the state or in any intermediate mixed way. However, the intervention of the state opens the way to dictatorship, of which socialism is the extreme form.

Institutions are seen in a narrow functional perspective and their role is to control the twin dangers of dictatorship and disorder. Institutions are considered in formal terms and no mention is made of the role of informal institutions except in the case of transplantation, but then only in an implicit way. However, the power of institutions is not unlimited and institutions are vulnerable to the subversion by the potential violator. Subversion includes a number of both legal and illegal strategies. “The legal ones include acquiring favorable legislation and regulation (even after an accident), lobbying for an appointment of friendly law enforcers (including both judges and regulators), hiring top lawyers, or using delay tactics in case of a suit. Illegal subversion strategies include intimidating and bribing judges, regulators, or juries. By expending sufficient resources on subversion of justice, the potential violator can avoid regulatory fines and liability payments.” (Glaeser and Shleifer, 2003, p. 402) However, as far as institutions work properly, “[t]he theory leads to predictions as to what institutions are appropriate under what circumstances.” (Glaeser and Shleifer, 2003, p. 401). This is clearly an ambitious research program, which has the goal of replacing the entire traditional CES framework with a new paradigm. In this new perspective, comparative economics becomes a

⁸ The NCE apparently uses the term socialism in different ways. In the IPF socialism is implicitly defined as the highest level of dictatorship, but along the continuum identified by the IPF curve. Elsewhere, when discussing transition countries, socialism is defined as a system alternative to capitalism (which as such should not be located on the IPF curve together with the other arrangements), more precisely as “the system that concentrates all political power and economic decision making in the hands of a small elite” (Djankov et al., 2003a, p. 36).

⁹ “The two central dangers that any society faces are disorder and dictatorship. By disorder we mean the risk to individuals and their property of private expropriation in the form of murder, theft, violation of agreements, torts, monopoly pricing, and so on. Disorder, in this framework, is also reflected in private subversion of public institutions, such as courts, through bribes and threats, which allows private violators to escape penalties. By dictatorship we mean the risk to individuals and their property of expropriation by the state and its agents in the form of murder, taxation, violation of property, and so on. Dictatorship, in this framework, is also reflected in expropriation through – rather than just by – the state, as with the use of regulators to eliminate entry by competitors. Some phenomena, such as corruption, are reflections of both disorder and dictatorship: in so far as individuals pay bribes to avoid penalties for harmful conduct, corruption is a reflection of disorder, but in so far as officials create

simple, although important, chapter of (a particular brand of) the property rights interpretation of the world.

After this summary description and in order to evaluate the NCE program of re-founding CES, two questions should be put and answered. First, in which sense and in which ways are different legal regimes vulnerable to subversion? That is, in which sense can we speak of comparative (in)efficiency of alternative legal regimes? Second, how can efficient institutions evolve?

In answering the first question we find an important similarity with the CES approach, since the NCE bases its answer on the features of the context in which the legal regime is embedded. However, this NCE context is rather thin since it is reduced to the issue of law and order, however important this may be. To understand this point, we can follow the proponents by considering the two opposite legal regimes:¹⁰ a pure liability regime and a regulatory regime.

According to the NCE, pure liability regimes entail the risk of having to make large payments with a small probability. Particularly in environments lacking law and order, such regimes are more vulnerable to ex post subversion than regulatory regimes. Therefore, when law and order hold, pure liability regimes are efficient. However, when law and order are missing, a regulatory regime is more efficient than a pure liability regime. In intermediate cases intermediate solutions prevail. This explanation is complemented with other variables that the literature has shown to be important, such as the stronger incentives and greater specialization of regulators compared to judges (for a contribution on this point by the same group of authors see Glaeser et al. 2001)

In a later contribution (Djankov et al. 2003a) a framework is presented that describes the tradeoff between dictatorship and disorder and also introduces the extreme case of socialism (the purest case of dictatorship with very low level of disorder). This framework is then applied to the problem of social control of business. It is worth noting that the authors do not support the view that efficient institutions eliminate the dangers of disorder and dictatorship. These are simply reduced to the minimum possible level, given the features of the society – to be discussed later on. This is, I believe, one of the most important statements of the NCE, which identifies an interesting point of possible cooperation with CES.¹¹

harmful rules to collect bribes from individuals seeking to get around them, corruption is a cost of dictatorship.” (Djankov et al. 2003a, pp. 6-7)

¹⁰ We leave socialism out of consideration for the moment, since it is considered incompatible with private property – although this initial disregard is a serious heuristic flaw in the way towards generalization of the new approach.

¹¹ “...looking at efficient institutional choices does not mean that, in equilibrium, the society eliminates the problems of dictatorship and disorder. It does not. Consistent with Coase (1960), even the most

The answer to the second question introduces an interesting evolutionary element, that is however restricted and remains undeveloped: “Efficient institutions could evolve from democratic pressures (...), from the influence of growth-seeking interest groups such as merchants (...), from a Coasian negotiation among the members of the elite, such as the Magna Carta or the American Constitutional bargain (...), or from a long term evolutionary process described by Hayek (...).” (Djankov et al. 2003a, p. 9)

This quotation is the boldest dynamic perspective of the NCE, that CES can easily share. However, it fails short of explaining why, under which conditions, and how efficient institutions evolve. It does not answer the basic evolutionary theory statement that the selection process does not give necessarily origin to efficient solutions. The same evolutionary ways quoted above could generate also inefficient institutions (Nelson 1995). The only answer NCE gives under this perspective is that inefficient institutions can be the outcome of transplantation. The NCE is simply uninterested in the dynamic evolutionary perspective. The Authors also criticize the special interest group theory and do not support it as a convincing explanation of comparative institutional efficiency, although they do not see this theory as incompatible with their theory of institutional subversion (Glaeser and Shleifer 2003, pp. 417-419)

5. The premises of the comparative institutional efficiency analysis

In the Law and finance perspective property rights have primary importance and so is the same in the NCE. Protection of property rights is so fundamental for economic activity, that basic differences among economic systems derive primarily, if not exclusively from differences in the degree of protection, along with differences in the modes of protection.

In general, security of property rights is an important, although incomplete foundation to systemic differences, since it may be the basis of different types of behaviour and decision making of actors, not necessarily all in line with performance maximisation (including rent-seeking attitudes and wealth hoarding). Moreover, it has been shown that – at least under certain circumstances – weak definition and enforcement of property rights may also provide powerful incentives to economic activity (Li, 1996). The proponents of the NCE are not aware of the latter problem, and do not consider the former in their explanation. Indeed, they stress only the double threat of expropriation of investment in case of unprotected propriety rights. They maintain that property rights must be secured, typically by the state, against the threat of private

efficient institutional structure retains residual levels of both dictatorship and disorder.” (Djankov et al. 2003a, p. 9)

expropriation of investment by other private actors. But a state which is sufficiently powerful to do this is also strong enough to threaten to expropriate private economic actors.¹²

However, to the merit of NCE we should ascribe that NCE does not assume *a priori* the superiority of private property over any other kind of property and the suboptimality of regulation. These become – second best – alternatives to the free market or pure private ordering.

It is from the necessity of an economy to navigate safely between the Scylla and Cariddi of the twin goals of controlling disorder and dictatorship that descends the idea of comparative institutional efficiency. The analysis of the tradeoff between the need to control disorder, that pushes toward greater state intervention, and the goal of controlling dictatorship, that pushes against state power is applied to the problem of social control of business. At the basis of this approach is the idea that, provided that agents have freedom of negotiation concerning institutional choices, spontaneous processes among the relevant actors (including the state) will find the proper efficient solution, including by means of regulation. The only serious impediment that could block this virtuous mechanism that is explicitly considered in the NCE presentation is institutional transplantation, which obviously contradicts contractual freedom. No endogenous reason or mechanism leading to institutional inefficiency is considered.

Although this NCE approach looks at different states of the society in terms of disorder and dictatorship and at different solutions that apparently differ also in quality (from private litigation to regulation and socialism), it really overlooks the qualitative aspects of the issue, in particular concerning the consistently different nature, organisation and roles of the state and also the judiciary in different contexts. However analytically powerful NCE is and however important it may be in explaining particular aspects of the real world, its approach is too narrow to serve as the foundation to CES. To do so we must account also for consistent (systemic) qualitative differences in the nature of the state and the actors operating within it. After all, this is a major difference that distinguishes societies and economies and, more importantly, a difference that has important consequences not only on economic performance, but also on the nature and behaviour of private actors.¹³ The same holds obviously for the private sector.

Given this unidimensional approach to the economic system, also the concept of institutional efficiency is one-sided. The only dimension under which different economic systems are compared, and consequently the only kind of predicting power of the theory, is one in which

¹² “But there are two sides to the security of property rights. On the one hand, investment must be secured – typically by the government – from the expropriation by one’s neighbors: thieves, competitors, or tortfeasors. ... On the other hand, a government capable of protecting property against private infringement can itself become the violator and thief.” (Djankov et al. 2003a, p. 2)

¹³ On the role of the quality of bureaucracy and government in policies of reform cf. Rodrik (1996).

economies differ as to the degree of protection they provide to property rights and how this protection is enforced. It is this simplification that allows the NCE to depict the entire issue in a bidimensional chart, whose core is the Institutional Possibility Frontier (IPF). We will return to this important issue in the next section.

It is on this rather narrow analytic approach that the NCE takes a general view of comparisons: the public and private institutions that characterize every capitalist economy "...differ tremendously and systematically among countries, and ... these differences have significant consequences for economic and political performance. The comparison of these institutions and of their effectiveness, with a focus on understanding which ones are appropriate in what circumstances, is the subject of the New Comparative Economics." (Shleifer 2002, p. 12)

Along with the clear relation with CES, at least concerning the comparative method and the goal of confronting different economies, the NCE also has a rather strict relation with institutional economics and with public choice. With the former it shares the criticism of the neoclassical model of a pure free market economy and obviously the view that economic institutions have a fundamental role in determining performance. Along with this, it also shares a certain view of relative (comparative) institutional efficiency, although it overlooks the important TCE idea of (organisational) governance.¹⁴ It is true, though, that the NCE is definitely more explicit than the traditional institutional economics in recognising and analysing institutional diversity. On this point, the NCE is definitely more in line with CES.¹⁵

The NCE has also an important point in common with the field of public choice theory (but also again with CES) in emphasising the role of politics. This interest for politics derives from the conviction that "[m]ost crucial institutional differences among countries - whether regulating markets or regulating policies - are governmental." (Shleifer 2002, p. 12) Again, this is a simplistic assumption, that overlooks the role of crucial differences that exist in other economic institutions in explaining the features of economic systems, such as the mobility of resources, the features of capital and financial markets, the nature and working of labour markets, and the nature of corporate governance systems. Disregarding these issues really weakens the generalising power of the NCE, at least in its present form.

¹⁴ See, e.g. Williamson (1991).

¹⁵ "The New Comparative Economics shares with institutional economics the recognition that the pure competitive model is not a useful way to think about capitalist economies, and that political and economic institutions crucially shape performance. Unlike institutional economics, however, which stresses the common achievements of capitalist economies, such as protection of private property, the New Comparative Economics focuses on institutional diversity." (Shleifer 2002, p. 12)

6. *The representation of comparative institutional efficiency: the IPC curve*

The idea of comparative institutional efficiency is quite appealing and potentially powerful in supporting the CES agenda. One earlier, important attempt in this direction – although based on transaction cost economics – has been due to Dieltz (1998). The NCE approach is simpler than that and possibly more general, and therefore quite appealing, although it is also less precise. Simple approaches and explanations are always welcome in any science, because they can simplify the analysis and allow greater depth into the topic. However, simplicity should not come at the expense of explanatory power. This is the crucial question that we should address in this section.

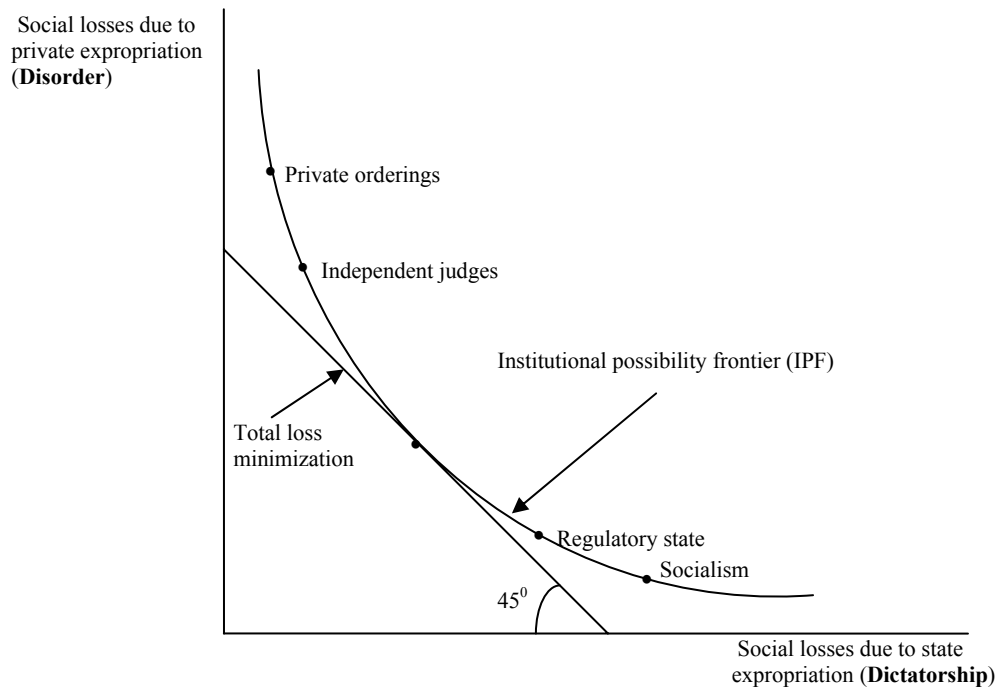
The reductive functional concept of institutions, compared to the richness of outcomes of institutional literature, is functional to the NCE analysis. In this framework, an institution (e.g. a legal or regulatory system) is a point on the IPF. The latter “...reflects the institutional possibilities of the society: how much disorder can be reduced with an incremental increase in the power of the state.” (Djankov et al. 2003a, p. 7) This definition has a certain strength, since it reflects – albeit only indirectly – a greater variety of institutional variables, such as culture, which influence the behavior of society and economic and social actors under the particular angle of disorder and dictatorship.

As mentioned above, the NCE explanation is based on the role of law, given human nature and, as we will see in the next section, given social features and activities in the form of social or “civic” capital. Diagrammatic presentation is a powerful instrument to represent a complex problem in simple, ready visible terms. The basic diagram of the NCE is represented in fig. 1, which outlines the issue of institutional possibilities of a given country and identifies the efficient institutional solution.

The two basic threats to social economic life: disorder and dictatorship, cause costs to the society. The costs are represented on the axes of a bi-dimensional diagram. Disorder is defined as social losses due to private expropriation and dictatorship is defined as social losses due to state expropriation. In both cases, social losses are measured relative to a world with perfectly defined and enforced property rights. These are not further defined, but we can easily infer from property rights analysis that these are rights that offer the best possible protection (although not perfect in the NCE view) to private rights. Graphically, these should be represented by the IPF which is the closest possible to the origin. With this representation the richness of economic life in general and the economic system in particular is lost to the advantage of simplification and comparability. Basing the analysis on efficiency considerations is certainly an important strength of the NCE which allows for predictions on which solutions are better (more efficient) in given situations. However, it says nothing on the factors that may

enter this calculation except property rights protection and even less on how we can get from here (a suboptimal institutional situation) to there (optimal institutions).

Figure 1: Institutional possibilities



Source: Djankov et al. (2003a), p. 10

As in any standard chart of this type, there is a convex isoquant, which is the institutional possibility frontier (IPF) and a constraint, which identifies the total loss minimization which is theoretically possible in a given society. The latter has a 45° inclination to represent the symmetric cost deriving to society from social losses due to private expropriation (disorder) and social losses due to state expropriation (dictatorship). Economies can move along the curve and the curve can translate and rotate. The point of tangency of the line of total loss minimization with the IPF is the efficient institutional choice for a given society or a sector within a society. Although the NCE does not clarify this point, we can suppose that different social (dis)preferences for disorder and dictatorship can be represented by the total loss minimisation line having a different inclination. This would generate a different mix of disorder and dictatorship in equilibrium.

Given the IPF, that is distinct for any society, the society will try to stay on the curve, since this is the highest level of institutional efficiency that can be reached. Obviously, the society cannot reach a point below the curve, while it would be inefficient staying above it. One can

suppose that this would create potential rents that would give (political) entrepreneurs an incentive to capture, thus moving the society back to the curve.

Politics has an important influence over the choice of institutions. Although politics may prevent the choice of efficient institutions, there are at least four significant ways in which the political process moves institutions toward efficiency: spontaneous evolution, the activity of interest groups favoring efficiency, Coasian bargaining, and democratic voting. However, in general the success of politics in choosing efficient institutions depends on a society's ability to cooperate (to negotiate constructively), i.e. on its civic capital: "Countries with higher civic capital, and the more attractive IPFs, are more likely to have successful political negotiations and to choose an efficient point on the IPF. In this very important way, the location of the IPF, and the political choice of a point on it, are not independent." (Djankov et al. 2003a, pp. 37-38) I will return to this important issue in the next section.

The next step is to identify the four strategies of control of disorder: private orderings, private litigation, regulation, and socialism, which is identified with (nearly) full state regulation. While the former three strategies are represented in a rather realistic and theoretically sound way, the description of socialism is somewhat blurred. The contradiction noticed above on the different nature of the term apart, the question goes beyond terminology, since the Authors use this concept to analyze the process of transition. For them there is no distinction, at least theoretically, between full state regulation and socialism, let alone among the different types of "socialism" that have been described, sketched out and implemented in various countries. This simplistic view is obviously a blow on the explanatory power of the theory, in particular when applied to those countries where state regulation or some form of socialism are or were an important issue.

The four strategies are illustrated as points on the institutional possibility frontier, ranked in terms of increasing powers of the state. When we move downward along the IPF and the role of the state increases, each point representing a distinct strategy is associated with progressively diminishing social costs of disorder, and progressively rising social costs of dictatorship. The NCE uses this framework to analyze efficient institutional choice and to provide empirical predictions and guidance for reform. (Djankov et al. 2003a, pp. 5-6)

Such an ambitious goal for a simple diagrammatic interpretation requires that no crucial factor is left out of the diagram and that qualitative variables – such as the capacity of the state bureaucracy or the social control over firms – play no role. Needless to say, any true dynamic perspective is also missing. However, this interpretation is interesting and raises several questions if we think of comparing it to CES.

Three questions are of particular importance here. First: can the IPF be interpreted as the economic system? Apparently, this is the farther we can go in crediting the NCE with some idea of an economic system, beyond the generic recognition of "...the amazing consistency with which a given country regulates different activities..." (Djankov et al. 2003a, p. 6) This point is also stressed in the discussion of institutional transplantation: "...there is systematic variation among these institutions in origin countries, shaped by their political economy over the last millennium. ... These channels of both voluntary and colonial transplantation suggest that there might be systematic variation in legal systems among countries." (Djankov et al. 2003a, p. 27 and p. 28).

These aspects are considered also in the important case of the protection of investors, on which there is by now a substantial comparative literature that the same group of scholars proposing the NCE have been producing during the years.¹⁶ According to this literature there are clearly distinct styles of social control of business in the areas of entry, courts, and labor in different countries. These differences are strictly related to the legal origin of their laws: those countries that regulate one (socialist and French legal origin countries) also regulate the other two. Similar observations hold, according to the NCE, also for state ownership of enterprises and banks. The authors find here evidence of the great role of transplantation, rather than local conditions, in deeply affecting national modes of social control of business. However, the internal logic of each legal model is not examined further.

Second, is the choice between different institutions continuous along the IPF or is it discrete? Looking at the chart and considering various statements in the paper, one should think that according to the authors the choice is continuous. This actually blurs further the weak systemic concept, since one does not understand where the "amazing consistency" can be if the choice is continuous. Possibly even more problematic is the fact that the costs of change from one point on the IPF curve to another are completely disregarded. How costly can be going from one point to the other? How does the existence of these transition costs enter the decision making calculation of economic agents? And even more so their implementation efforts? How can this influence their behaviour?¹⁷ Since NCE's agents are clearly opportunists, free-riding in institutional change should be at least one of the options considered. NCE lacks a theory of collective action to predict success or failure of institutional change.

Third, are the dimensions generating the IPF sufficient to interpret the complexity of an economy (and a society)? Social losses due to disorder or dictatorship are determined, in the

¹⁶ See, e.g., Djankov et al. (2003b), Djankov et al. (2002), La Porta et al. (1997), La Porta et al. (1999), La Porta et al. (2000), La Porta et al. (2002). See also Djankov et al. (2003a), pp. 28-30.

¹⁷ On the importance of the costs of transition cf. Dallago (1996).

NCE perspective, by the legal and the political systems. These are certainly very important dimensions of social and economic life. However, one is also puzzled by the lack of qualification of those systems and the disregard for other, including economic variables. As to the former, are only the formal features of the legal and political systems that matter?¹⁸ What is the role of the quality, e.g. of bureaucracy, or social control over politicians, the role of religion or trade unions, or of ideology?¹⁹

As to the latter, do structural and organizational economic variables play no role? Let suppose that two countries at the same level of development and sharing similar legal and political systems present different organizations of industry. For instance, in one mainly small and medium size firms exist, while in the other mainly large firms exist. What kind of consequences does this have for the analysis and its predictive power? Or is the overwhelming power of the legal system ruling out this possibility, because the above difference could not exist in countries sharing similar legal systems but only in countries having different legal systems? Given the tradeoff between disorder and dictatorship such variables should be important for the nature and working of markets (think about the differences in labour markets in the two cases) and consequently should offer different perspectives for private interaction and conflict resolution and should require a different role of the state. Elsewhere, two of the authors (Glaeser and Shleifer, 2003) present an interesting analysis applied to the United States, along the same NCE lines. However, there the two systems are seen as successive stages of development and no real synchronic comparison is made. One should also add that limiting the role of the state to regulation of economic activity and disregarding other important functions (e.g. in demand management, pursue of equity, support to development) means impoverishing and distorting reality and weakening theoretical analysis.

7. *Civic capital and the legal system*

One important statement for comparative analysis and potentially also for systemic analysis is that, according to NCE, “[t]he shape and the location of the IPF -- and hence the efficient choice -- varies across activities within a society, as well as across societies.” (Djankov et al. 2003a, p. 9). Although this statement is largely acceptable, its explanation reveals some contradiction. In fact, it is stated that activities that involve repeated interactions among participants of roughly similar resources and that imply little technological change, such as

¹⁸ This problem is simply avoided by stating in a footnote (p. 9) that variables that define the institutional quality of a country, such as law and order, risk of government expropriation, rule of law, corruption, efficiency of the judiciary, or some combination of these variables “...are highly correlated with each other, and have proven to be strong predictors of per capita income, economic growth, and many other “good” outcomes, but it is not entirely clear what they measure conceptually.”

diamond trading, can achieve order with little dictatorship. Quite different is the case of activities such as security issuance that involve players with few repeated interactions and massive inequalities of power. These activities are vulnerable to much more disorder for a given level of police. This implies also (as is stated later in the same paper) that countries having stationary and traditional economies should be able to go along with little dictatorship, since they have a low level of disorder. Opposite should be the situation of the most economically developed and dynamic countries.

The above reasoning seems to introduce technology as an important force shaping institutions, but falls short of deriving important implications. Indeed technology, in the examples given, apparently suggests the existence of lock-ins, although the Authors do not admit this. If we admit that technology limits institutional choice and that there is international division of labour, in the sense that different countries specialise in different productions that are implemented by means of different technologies, then different economies would be consistently limited in a particular area of the IPF. Consequently, not only the shape and the location of the IPF— and hence the efficient choice — would vary across societies; also the portion of the IPF that is relevant for particular societies would be different. If so, institutional choice would not be (completely) free and the movement along the IPF would neither be continuous nor smooth.

Along with this, and perhaps at the basis of all analytical difficulties is the fact that the NCE apparently oversimplifies and forgets fundamental explanatory factors, as noted above. Added to that, maybe that institutions do not arise simply to control the twin dangers of dictatorship and disorder. They may also serve to many other aims such as (to remain within the economic domain) recover from heavy crises (which is not controlling disorder as the NCE intends it), impose or defend the power of some (group of) powerful agents, create or defend opportunities for rents, the coordination of common defence against natural or external threats, better exploitation of the natural environment, the conquer of external markets, and many others. Very often the control of dictatorship and disorder is an indirect outcome or a step in a longer process of institutional development that pursues other goals. Most often than not institutional development — as the NCE admits but does not develop consistently — is the outcome of spontaneous processes or of forced processes, in the sense that actors have no choice, under the pressure of powerful external threats or compelling force.

But analytic realism comes back soon. Indeed, according to the NCE: “Looking across societies, the differences loom even larger. The institutional possibilities of modern Sweden, or even China, are far superior to those of Albania or Congo. Sweden can pursue either extreme

¹⁹ On the economic role of ideology cf. Denzau and North (1994).

laissez-faire policies or toy with socialism and still achieve decent outcomes, Albania can choose a perfect balance of dictatorship and disorder for its IPF, but property rights would remain insecure.” (Djankov et al., 2003, pp. 9-10) All this is rather obvious, how does the NCE explain it?

To explain this apparent contradiction within the micro-level, the NCE has to introduce another concept well-known in sociological and economic analysis, that of social capital. The Authors term this form of capital as “civic capital”²⁰ and use it to explain the location of the IPF.²¹ Their idea is that societies with more such capital are better capable of achieving cooperation among their members. In the NCE parlance, a high level of civic capital corresponds to an IPF closer to the origin.

The use of this concept is apparently at odds with the basic premises of the NCE analysis. In fact, it is not clear how much this concept can be based on methodological individualism²² that is the fundament to the rest of the explanation. Indeed the Authors quote various determinants of civic capital, including culture, ethnic homogeneity, factor endowments and the physical environment, demographic conditions, long run history of cooperation, technology of production and of government repression, and the level of human capital. Although all this appears to be realistic, these determinants have mostly collective nature and it is not clear why and how this explanation should be a logical continuation (or premise?) of the explanation of the IPF curve and the rational choice of institutions.

The need to use such an exogenous device as civic capital theoretically weakens the analysis, but makes it more reasonable. Yet we are told that in some countries (e.g. Sweden or “even” China) social capital is much higher than in others (e.g. Albania or Congo). Does this mean that the determinants of civic capital or, better, investment in these determinants are all or most of them higher (better) in the former group than in the latter? Here again, the NCE forgets the crucial quality of variables. After all, also criminal organizations and Mafias require a great deal of social or civic capital. What determines the allocation of those variables to constructive uses? (Baumol 1993). This is a task ahead for the NCE.

Obviously, it is the conception of economic actors as selfish and opportunistic and only ready to subvert the law workings to benefit themselves that is at odds with the concept of civic

²⁰ The Authors justify – but do not further explain or define - their use of a somewhat different term compared to the current literature “because we have something similar but broader in mind. We stick with the idea of capital because investments in civic capital pay off in the medium run.” (Djankov et al. 2003a, p. 9)

²¹ Consistently, the location of the IPF is often fixed in the short run. In those cases, civic capital is a constraint rather than a choice.

²² The basic reference for the explanation of social capital based on methodological individualism is Coleman (1990). Cf. also Lin (2001). I thank Antonio Chiesi (University of Trento) for this information.

capital. It is difficult to accept that such actors go well beyond the standard solution of cooperation in repeated interaction (Axelrod, 1984) and invest in social capital in order to overcome the well known suboptimal outcome that would derive from the lack of cooperation. In any case, since civic capital is clearly a public good, selfish and opportunistic actors should free ride. To avoid this danger, we need a *Deus ex machina*: institutions, that constraint such actors to cooperate in the protection of property rights. In reality it may work, but why is this process successful only in a minority of societies, while in the rest the process has been a failure? And why should opportunistic actors invest in institutions? Or is some third party imposing these institutions?

The NCE hardly offers a convincing explanation of the existence of institutions, let alone of different economic systems. In fact, in this way institutions became in a sense alien to the intimate nature of individual actors, a product of pure rationalisation. One can certainly suppose that this is so in theory. However, when pretending to use a model to interpret the reality – and even more so when pretending to use it to change the reality – one should be careful in confronting the analytic premises with what the observation of reality shows.

The reasoning is subtle: since economic actors have property rights, it is in their interest to invest in civic capital and hence determine the choice of efficient institutions, i.e. those institutions that protect those rights in the best way and give the strongest incentives to the economic utilization of those rights. Supposedly each individual gains more from those rights than he has to pay in the form of investment in civic capital and has no other way to give up the payment while keeping the advantages. Since institutions are a public good, why doesn't a selfish rational actor abstain from the investment, while still enjoying the return from the investment that others would do? I can see only two answers, looking at the NCE: one is that there is an external enforcer (the state). But why did actors set up a state? Even the state is, after all, an institution. So even this first answer boils down to the second one: selfish actors do not free ride because institutions constrain them. We returned in our explanation to the point where we started from and we are left without a theory of institutions in the NCE.

The NCE offers a convincing but partial explanation of institutions in the case of countries other than the most developed ones. Transplantation of institutions is the cause of their lower development. In fact, efficient choice of institutions does not explain all. "One dramatic deviation from the assumption of indigenous formation of institutions is transplantation." (Djankov 2003, p. 27) Transplantation can take place through conquest and colonization, but it may also go through voluntary channels. One prominent example of the latter is the voluntary

adoption of the German legal system in Switzerland, Austria-Hungary, and later Japan. One can think also of much of the transition in Central-Eastern Europe and the former Soviet Union.²³

This is a reasonable answer, again, which misses a crucial factor. If transplantation is the cause, one must admit that there are asymmetries among countries at least as far as power and freedom of choice is concerned. More than true. If this is so for countries, why shouldn't it be true also within individual economies and societies, among individuals and possibly complex agents, such as firms? Why is this problem solved here by institutions and in the socially best possible way supposing that actors are perfectly equal? Having expelled from – or not even considered in – the analysis social relations, giving an answer to this question becomes impossible. Indeed, the NCE ignores it.

8. *Institutional efficiency and reform*

The NCE sees its effort as an important device for implementing better reform policies. This operational aim requires that the NCE analysis and policy recipes are soundly based in a correct interpretation of real economies. The first question to consider is: why should reforms be implemented according to the NCE? Clearly because the existing institutional setting is suboptimal (inefficient). It burdens economic actors with too many and high costs due to excessive disorder or excessive dictatorship. In short, the society does not maximise institutional efficiency, probably because it is located externally to its IPF and/or generates modest or negative outcomes. This is the easy part, since the hypothesis of rationality is sufficient to understand the motivation for reform.

But reforms are a complex social and political undertaking, that require the cooperation of many individuals and that are costly. Who, then, should take the decision of implementing a reform? This cannot be by definition an individual undertaking, since reforms have a public good character. The answer is generic: “the society” (Djankov, 2003a, p. 11) “...through its institutions” (ibid, p. 12). But what is a “society”? How can a social and economic entity made of selfish individuals create and nurture a society? No answer. The best part of the issue, the one that can highlight the distinction among different systems, is missing. And how can institutions – that are after all interpersonal and interorganisational relations – act? Only individuals (and organizations) can act. Why and in which way?

This silence actually means that the concept of institutions and the institutional analysis in the NCE is at least incomplete, possibly wrong. It leaves unexplained what should most be

²³ The NCE considers transplantation, and particularly understanding its diverse consequences, “a crucial challenge for the new comparative economics” (Djankov et al. 2003a, p. 33).

explained – being this the essence of the comparative approach, let alone the comparative analysis of economic systems.

The Authors discuss the important example of the social control of securities issues. This concerns the particular features of the four possible choices along the IPF, and their relative merits and disadvantages (inefficiencies). Even here it is unclear who should start reforms or decide which choice should be made. Stating that the society is the decision maker is clearly unsatisfactory, since it avoids solving any of the obscure aspects stressed above.

Even if we suppose that “the society” acts, two crucial aspects remain unanswered. First, do the four possible choices the society confronts afford the same (absolute level and structure of) costs of choice and implementation? Are these costs the same (in both level and structure) in any society? Clearly this has much to do with the probability that one particular option is chosen. Choice does not only depend on the preference (or dispreference) for a particular degree of public control. Rational actors should pay particular attention to costs in their choices. Apparently not in the NCE, though, in spite of the recognition of “...Coase’s (1960) realization that the costs of enforcement shape the optimal institutional choice.” (Djankov, 2003, p. 15) And also in spite of the fact that different societies are distinguished on the basis of the mix of social losses due to disorder and dictatorship in the IPF analysis.

Second, how is demand for institutional reform organized? Although it is clear that it arises from the unsatisfactory performance of old institutions, a reform requires that social actors organize their demand for reform, by possibly delegating some individual or organ (the government?) to do so. But which type of reform is delegated? If there is perfect symmetry of information and bargaining power among individual agents and if these share the same ideological (dis)preferences for the different choices, some kind of voting will base the choice on efficiency considerations. Apparently this is the choice process that the NCE implies, which is put in motion by the actual (inefficient) mix of social costs of disorder and dictatorship compared to the optimal solution for that particular society. However, the simplicity and elegance of this solution does not explain why consistently and permanently different economic systems exist.

To clarify the true novelty and importance of the NCE for CES, let us consider in some detail one of the three cases that the Authors consider. I choose the one that is the closest to our times: post-communist transition. This is indeed the most difficult test for the NCE approach, also because the institutional and systemic dispersion (variety) of the countries involved is the greatest. The two other cases are the divergence between France and England in the 12th and 13th centuries in their choices of legal systems and the rise of the regulatory state in the

progressive era in the United States. In all three instances, the Authors focus on efficient institutional choice, given each country's IPF.

Although the Authors caution that they do not pretend to explain all the aspects of transition, nevertheless they afford a wide-ranging explanation based on the NCE framework. All the complexity of transition is reduced to a tradeoff between dictatorship and disorder. The collapse of communism, i.e. the old system, and the following dramatic decline in dictatorship led to a rise of disorder. Although the latter has had some obvious benefits in terms of freedom, the growth of entrepreneurship, openness to the rest of the world, it has also had great costs, particularly in the form of extreme economic disorganization. The latter included booming unofficial economy, subversion of institutions by the powerful through crime, corruption and political influence and obviously the disintegration of the USSR and various severe problems of localism within Russia itself.

Since the grip of dictatorship was strongest in the Soviet Union, Russia has experienced a much more dramatic decline in dictatorship and rise in disorder than other countries. These processes have also been much stronger than in the non-reforming post-Soviet states, such as Belarus and Uzbekistan. So Russia moved swiftly along her IPF curve from dictatorship in the direction of disorder. Russia in 1990 and the non-reforming post-Soviet states through the decade remained in the low part of the curve, with much dictatorship and little disorder. Apparently no movement of the IPF curve took place in this case, although the Authors consider that such shift took place in the other two cases they examine.

However, the transition processes in Russia and in (Central-)Eastern Europe were not identical. The Authors explain this fact by supposing that "...Russia's IPF is probably less attractive than that of the East European countries and, at the same time, its shift along the IPF was probably greater." (Djankov 2003, p. 24) The reasons for this relative advantage of Central-Eastern Europe compared to Russia are the shorter time spent in the communist system, the rebellions in some countries against the Soviet occupiers and local dictators, the existence of many more independent organizations and, in the case of Poland, an independent Church, greater integration into Western Europe, and the perspective of joining the European community, which imposed rules of cooperation restricting dictatorship and disorder. These countries also faced less severe problems of decentralization and localism compared to Russia, which may explain why they did not move as far up along their IPFs.

All this is apparently correct if we accept the IPF approach. But then we do not explain much. Why did Russia move so fast upward its IPF? Why did this not happen – not at least in such a great way – in Central-Eastern Europe? Why did the IPF curves remain in their previous place? Shouldn't have transition moved them towards the origin, if the market economy – the new

freely chosen set of institutions - is more efficient than the Soviet-type one? Didn't the efficiency approach work out in Eastern Europe and if so, why?

A tentative and partial answer to some of these questions is given as follows:

“A plausible case can be made that Russia in the 1990s stayed on its institutional possibility frontier. It has moved away from the communist dictatorship, but arguably overshot initially in its institutional change toward too much disorder. Under the Putin presidency, Russia has moved down along its IPF toward reducing disorder, even at the cost of some growth in dictatorship.” (Djankov 2003, p. 26)

This explanation is weak indeed. Although it describes correctly what actually happened, it gives no explanation of why things occurred in that way and in particular why Russia failed to choose more efficient institutions.²⁴ What apparently comes out from this description is that transition did not change the economic system – at least it is so if one thinks that systemic change means shifting the IPF. One point is important in this description, though: the recognition that there is no absolute, but only relative efficiency criterion:

“The more general point suggested by this reasoning is that economic and social change in each country should be considered in light of its own institutional possibilities, rather than some idealized view of perfect law and order.” (Djankov 2003, p. 26)

And again:

“The fact that colonial transplantation is such a significant determinant of institutional design suggests that the observed institutional choices may well be inefficient. A legal and regulatory system perfectly suitable for France might yield inefficiently high levels of regulation and state ownership when transplanted to countries with lower civic capital.” (Djankov et al. 2003a, p. 30)

This quotation is important because it makes clear that only spontaneous institutional developments, based on domestic endowments, are efficient and consequently stable. This is standard mainstream economics, still it has important practical relevance. However, the NCE fails short of extending this approach further. Why should inter-country transplantation be (often) inefficient and domestic institutional choice efficient? Put in another way: why are domestic actors in developed economies capable of negotiating freely the establishment of more efficient institutions, while actors in other countries are prevented from doing so? Why do asymmetries exist among countries and not within countries?

Let us suppose that a powerful social group (a social class, an interest group, a political party, a group of army officers or a criminal organisation) takes overwhelming power in institution making. Is this a guarantee of efficient institutional choice? If imposition is used upon other

²⁴ In a more recent paper (Shleifer and Treisman, 2003) the Authors state that, after a decade of extraordinary transformation, by the late 1990s Russia had become a typical middle-income capitalist democracy. This statement is apparently in contrast with the other statements quoted above. We can interpret jointly this apparent contradiction by supposing that, in the NCE view, correct policies are finally chosen and are effective, but their costs are the higher, the farther away the IPF is from the origin. This is somehow fatalist, since even systemic change is unable to move the IPF inward.

social groups, is this not comparable to the case of transplantation? A quotation reported above makes clear that efficient institutions could evolve also from the not-so-democratic influence of growth-seeking interest groups and from a Coasean negotiation among the members of the elite. These are examples of growth promoting devices (however socially costly they may be), but growth promotion is not the only possible motivation of social activity.

If the society moved outward the IPF because of rising disorder (a clear sign of institutional dissatisfaction), trading off less disorder for more dictatorship does not move further the society outward and can even move it inward back to the curve. Or so is the justification of the promoters of the “extraordinary” means of institutional choice. However, it is not clear why those who are disadvantaged or even suffer for such institutional choice should be willing to accept the outcome, threat and repression in the real world apart. They will certainly try to subvert the outcome as soon as possible, collective action failures notwithstanding. So it is not clear why we should not consider the possibility of domestic institutional “transplantation” (or, better, imposition) as a source of institutional inefficiency. After all, interest groups and negotiations among the members of the elite are not cases of pure competitive market mechanism working. Evolutionary economics has a clear advantage here, when it shows that evolutionary change may be inefficient.

But again the explanation of institutional possibilities – and the position of the society on the IPF chart - remains rather vague and excessively general (see above). For instance, the fact that change in each country should be considered in light of its own institutional possibilities seems to suggest the existence of a path-dependent process of change. However, it is not explicitly stated whether it is so and even less explained why and through which processes this takes place and what are the consequences for change itself. Is Russia a case of perverse path dependence and Central-Eastern Europe one of positive path dependence? It is apparently so, but again no explanation. Nor is it clear how this perspective can be included into the main body of analysis.

In this way, the NCE promises much but implements rather little as a general theory for comparative economics. It seems more interested in rationalizing what has been happening (and that we already know) than in explaining why it was so and through which processes this took place. Clearly its predictive power is jeopardised. The NCE may use the wrong analytical instruments or it is unable to give the proper theoretical framework to those instruments. Apparently both problems are relevant.

9. The tricky role of legal origin

Legal origin is, in the analytic approach of the law and finance economics and hence also the NCE, the most important exogenous device that explains inter-country differences in the social

control of business and consequently also in the economic system. Since legal origin is a type of market imperfection and is consequently the source of comparative inefficiency, it determines the actual location of a particular country on its IPF, which does not coincide with the optimal position.²⁵ This is true both in the case of developed economies and in that of developing economies, the difference being that the latter's IPF is external to the former's due to transplantation of institutions.

Legal origin also explains why the existing institutions fall short of their potential and suggest some possible directions for reform. In the NCE approach, the legal system limits dictatorship and disorder in fixed proportions. Any legal system can be represented as a ray emanating from the origin and defining the proportions of disorder and dictatorship. The equilibrium position of any particular country is identified by the intersect of this ray with the country's own IPF. Based on the findings of a substantial research program in which this group of Authors has been involved over the years, they maintain that of the two broad legal paradigms, the common law ray has a higher proportion of disorder to dictatorship than the civil law ray.

This representation has important policy implications. Since transplantation makes the IPF shift outward, the Authors conclude that the marginal amount of dictatorship required to reduce disorder rises. This amounts to say that the marginal productivity of dictatorship decreases, because in developing countries the judiciary is particularly inefficient and corrupt. It is for this reason that, in their view and contrary to the findings of other authors (cf. Stiglitz 1994), less developed countries need relatively less dictatorship in equilibrium, i.e., less regulation, than developed countries. Under these circumstances, "[d]eregulation is likely to diminish the problems of dictatorship without a significant increase in disorder." (Djankov et al. 2003a, p. 32) This is so particularly in those areas where market competition and discipline are most effective to control disorder.

In my view, the issue of legal origin may be at odds with civic capital, which determines the position of the IPF. The idea of institutional transplantation suggests that transplanting institutions is like forcing an extraneous organism (the transplanted institutions) upon a body used to function according to different institutions with which they are (up to a certain extent, at least) incompatible. If an institutional organism (the receiver) is diverse compared to another organism (the transplanter), also individual features, capabilities, and cognitive processes and

²⁵ Legal origin affects growth only indirectly through the specific mechanisms of social control. These affect markets for capital, labor, and entrepreneurs, thereby influence factor accumulation and productivity growth. Any direct influence on growth (e.g. by human capital of the people operating the institutions) must go, in the NCE view, through the influence over civic capital, which is represented as the location of the IPF.

organizational competences in the former are different from those existing in the latter and that the transplanted institutions require. Therefore, even if the judiciary would be perfectly uncorrupted and hard working in the former country, the transplanted institutions would impose upon that organism exceptional adaptation and learning costs and also resistance costs (resistance to and rebuttal of the transplanted institutions). Inefficiency is the most obvious consequence. The IPF would shift outward even without recalling “less attractive” civic capital. It is the working of transplanted institutions that is costlier (perhaps this can be identified with higher transaction costs) or, alternatively, investment in the transplanted institutions generates lower returns than comparable investment in original (non transplanted) institutions.

All this, however, the NCE disregards, to concentrate simply on regulation and deregulation as policy alternatives. The only mention to this kind of problems is when it is said that how institutions are transplanted may also matter and when the NCE Authors recall authors who stress the importance of “receptivity” for the success of transplantation of legal systems, perhaps forgetting other authors who, in a possibly more convincing way, have reached similar conclusions well before (e.g. Sylos-Labini 1983)

10. Conclusions: The “new” comparative economics and comparative economic systems

I have considered here the new comparative economics, comparing its approach and findings with those of the more traditional field of comparative economic studies and contrasting its appearance with the situation of CES. It appears that the NCE incoming is a welcome event enriching the discipline. However, due to its intrinsic features and limitations it cannot pretend to replace CES.

The “new” New Comparative Economics (NCE) is an important project having both strength and weakness. I consider first its general aspects. On the strength side I put the idea of innovating the discipline while keeping the powerful comparative approach. This may foster further the innovation of CES by embedding in its set of instruments and the approach and results of an important line of comparative research. I also put here the NCE stress for the need of a microeconomic approach, whereby the centre of analysis becomes the institutions that form the economic system, and the stress over the need to analyse the consequences deriving from the inter-country differences among particular institutions.

However, these same strengths hide methodological and analytical weakness and danger. The stress that this approach puts upon individual, albeit complex institutions (legal systems) is one of the basic reasons why NCE loses the complexity of the whole economic system and the basic network of mutual interaction that links all the constituent institutions. This may have important consequences not only for analytical soundness, but particularly for policy

implications. The strength of the “traditional” CES approach to comparing different economic systems is the awareness that individual institutions are embedded in the broader network of links that connects all these institutions and that may generate complementarity, externalities, path dependence and lock-ins, and ordering. Since these features create multiple equilibria, the important issue of institutional efficiency becomes much more complex and possibly less straightforward than the NCE depicts.

There also are, as often happens, aspects that cannot be precisely defined a priori. The NCE actually restricts its method to what the law and finance perspective offers, namely the economic consequences of legal systems, enriched with the economic role of civic capital which jointly determine the form and position of the IPF. By restricting the method, much greater consistency is reached, at the price of some methodological unilateralism. Which one prevails, analytical strength and deepness or disregard for complexity and interactions among the variables, depends much on the particular topic that is analysed. Certainly this approach restricts methodological variety, which means in itself narrowing the spectrum of problems that can be fruitfully analysed and the possibility to offer competing confutable interpretations and explanations.

Finally, there are mistaken statements, as often is the case with “new” approaches that want to find their place and possibly dominance in an established field. Major among these is the actual identification of “the traditional field of comparative economics” with the comparison of socialism and capitalism. However, this statement is actually contradicted in a footnote that states that “[t]his field has its own category in the *Journal of Economic Literature*, called Economic Systems.” (Djankov et al. 2003a, p. 1) The traditional discipline, then, is much wider and varied than the proponents of NCE are ready to admit and their statement is not supported by even a superficial look at Econolit classification, as we saw above. In supposed contrast with the supposed unilateralism of CES, the NCE privileges comparisons of alternative capitalist models that prevail in different countries.

It is now time to summarise the main points of our examination of the issue and try to answer the questions advanced in the introduction.

First, the NCE is clearly comparative. Less clear is its standing on the economic system. The idea and the evidence that there is something that strongly keeps together and coordinates institutions of the same stock is embedded in the NCE. Unfortunately, the NCE does not go further than the barely recognition of this fact. We are left without an explanation why this is so and, perhaps more important, what are the analytic consequences of this fact. Although according to the NCE it is not apparently possible – or is inefficient – to go from one “style” or system to the other, we have no explanation why this would be so. The same ignorance remains in the case of

transition: is the sole transition between different legal systems inefficient or is it any kind of transition to be such? We only know that such attempts to change take place, but we do not know which are the conditions that govern the change and its outcomes. As a consequence, the NCE really lacks any serious role for the economic system. In this perspective, the NCE considers a thin context (law and order) and an even thinner economic system (legal regimes).

Second, the NCE is innovative only in part, at least in the sense that it does not innovate the subject. The subject to which it proposes to restrict its analytical effort was always there, although perhaps not in a dominant position. It is more innovative in the method, because it brings in the discipline a method – particularly in the law and finance perspective - that has not been used often in CES and that has shown its strength elsewhere. Although important it has shown to be, though, this approach does not appear sufficient to provide satisfactory answers to the many and varied problems that CES deal with. However, it can certainly give – and already gave – an important contribution to discover new problems and provide new explanations. It is only to be hoped that also other disciplines will want to contribute directly to CES by applying their method to typically CES problems.²⁶

Third, and most importantly, I see many problems in seeing the NCE replace CES. They share the comparative approach, but on the method side integration is not easy. The NCE has a very well defined and distinct method, that allows it to reach important results in well defined and limited cases. On the other side, CES does not have a distinct method, but is more an eclectic field of research in which researchers belonging to different schools of economic thought and following different theories work on problems of more or less common interest. In a sense, CES is a competitive arena, while the NCE aspires to be a monopoly. Due to this rather loose methodological nature of CES, the NCE can easily integrate in the field and enrich it. It is hard to imagine that it will replace all the extremely rich spectrum of methods that are present in CES. It can offer additional opportunities and challenge the results reached by means of different methods. In this sense it can play a fundamental role in enriching CES and stimulating its evolution.

In short, chances are that the NCE will complement CES in offering new method and studying new problems or presenting new solutions to known problems, thus challenging other approaches and competing with them. This can be very healthy to the discipline. I think that the most important NCE statement in this sense is the following: “... now economics can move further, and recognize that different institutions are appropriate in different circumstances. This, we believe, is the goal of the new comparative economics. ...reforms in any country should be evaluated relative to its own institutional opportunities, rather than some idealized benchmark

free of dictatorship and disorder.” (Djankov et al. 2003a p. 38) This statement is important because it stresses a vital component of the NCE program: look for the country and system specific conditions that constrain the pursue of efficiency and devise reforms that are compatible with the existing structural features of each system. This is an important program for the evolution of economic systems, as against their convergence.

To do this, CES does not have to share the NCE belief that “...institutional diversity can in part be understood in terms of the fundamental tradeoff between controlling dictatorship and disorder.” (Djankov et al. 2003a p. 38) Although the use of the tradeoff is somewhat problematic, as I tried to show above, and without disregarding the central role of the economic system in the discipline, I think we can completely agree with this last conclusion: “...the comparative perspective, which identifies both the possibilities and the limitations of individual societies, can serve as a useful framework for future progress.” (Djankov et al. 2003a p. 38) Putting the CES agenda in this perspective would mean simply to accelerate the implementation of the “old” NCE. In this sense, the “new” NCE is more a component of this process, than the whole process.

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²⁶ I have particularly in mind transaction cost economics and evolutionary economics.

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