School of Oriental and African Studies University of London

DEPARTMENT OF ECONOMICS WORKING PAPERS

No.137

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June 2004

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GLOBALISATION AND COMPARATIVE ECONOMICS: OF EFFICIENCY, EFFICIENT INSTITUTIONS, AND LATE DEVELOPMENT

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June 2004

ABSTRACT

Does globalisation entail a demand for uniformity, or diversity, of the (political) economic institutions of nation-states? What is the theoretical underpinning of the demand? And what are the implications of the demand for economic development? The conventional literature known as comparative economic systems has been unable to answer these question, because there is an intrinsic tension between its methodology (the neoclassical framework of individualistic rational choices and their equilibrium) and the subject matter (the multiplicity of economic institutions and development experiences in the real world). The new comparative economics has consisted of a variety of attempts to cope with this tension: some aimed at preserving the neoclassical framework at a more fundamental level, while some others aimed at transcending the framework to arrive at a new theory of economic systems and development. This paper argues that attempts that adhere to the neoclassical tradition is likely to lead to dead ends, while attempts that encompass collective as well as individualistic rationality represent more promising directions. Fuller developments of the literature, however, require incorporating objectified institutions and paradigmised technology into its sphere of inquiry. It is submitted that there are important lessons to learn from classical political economy and their modern presentations, particularly Marxian theories of the social forces of production, in this regard.

JEL Classification: B3, B4, F02, F10.
Keywords: Globalisation, comparative economics, late development.

1. Introduction: Comparative Economics in the Era of Globalisation

The new comparative economics, as some protagonists have pointed out, arises from the recognition that 'capitalist economies differ in important ways in how they regulate economic activities' (Djankov *et al.*, 2002). This recognition, trivial as it might appear to be, reflects important developments in the real world. While the protagonists cite a range of specific events – 'the transition from socialism, the Asian financial crisis, and the European political and economic integration' – as main motivations for the recognition, it is the general process of capitalist globalisation that is the ultimate motivation. This motivation could be coined in the form of the following question: does globalisation entail a demand for uniformity, or diversity, of the (political) economic institutions of nation-states? This question has loomed large in the policy debate over the different approaches to the transformation of the Soviet-type economic system. It has also been central to the discussion over how far the prevailing Anglo-Saxon economic model is representative of capitalism, particularly when compared with the 'continental European model' as well as the 'East Asian model'.

Intellectually, the central question that has confronted the new comparative economics could be coined as the following: what is the theoretical underpinning of the demand imposed by globalisation on the political-economic institutions of nation-states? For, the new comparative economics is supposedly different from its predecessor, the literature known as comparative economic systems. This older literature has been in a state of crisis since the collapse of the Soviet-type system, and the crisis is paradigmatic because central to the literature is the presumption that capitalism in the real world is and can only be represented by the ahistorical, monolithic model of the free market economy. There is thus an intrinsic tension between the methodology of the literature (the neoclassical framework of individualistic rational choices and their equilibrium) and its subject matter (the multiplicity of institutions and development experiences in the real world). What follows logically from the neoclassical framework is the claim that there exists an uniquely optimal set of institutions and thereby uniquely optimal development paths. Yet, this claim has appeared to be delusive with respect to the reality of capitalist globalisation. It is precisely in the attempts to cope with the indicated tension between methodology and subject matter that the new comparative economics has emerged. Understandably, this new literature has been subject to diverse convictions – some aimed at preserving the neoclassical framework at a more fundamental level, while some others aimed at transcending the framework to arrive at a new theory of institutions and development.

The objective of this paper is two-fold. First, it offers a critical review of both the old literature and the new comparative economics, with an emphasis on highlighting the relative strength and weakness of the various theoretical attempts indicated above. Specifically, it is intended to show that attempts that adhere to the neoclassical tradition is likely to lead to dead ends, while those encompassing collective as well as individualistic rationality – such as the 'comparative institutional analysis' approach – represent more promising directions. Second, the paper makes its own attempt to explore the indicated theoretical issues about institutional uniformity versus diversity. On the basis of the preceding literature review, it is submitted that fuller developments of the literature require incorporating objectified institutions and paradigmised technology into its sphere of enquiry. It is further submitted that there are important lessons to learn from classical political economy and their modern presentations, particularly Marxian theories of the social forces of production, in this regard.

This paper is organised in five sections, of which the present introductory section is the first. The second section seeks to clarify the nature of the paradigmatic crisis of the old literature of comparative economic systems, and, on this basis, to examine the innovations and limitations of the variety of theoretical attempts in the new comparative economics. It is argued that, for addressing issues of institutional uniformity versus diversity under globalisation, ultimately, both collective and individualistic rationality as determinants of institutional change have to be incorporated into theoretical explorations. Section three draws on a range of prominent theses in classical political economy to further argue that rationality cannot solely determine institutional change but must rather interact with objectified institutions and paradigmised technology. And some modern presentations of Marxian theories have offered good insights for unravelling such interaction. Section four then provides a further exposition of the themes of the preceding section at a more concrete level and in connection with some prominent stylised facts of globalisation. Section five gives some concluding remarks.

2. Rationality and Efficient Institutions in Comparative Economics

2-1. The Paradigmatic Crisis of Comparative Economic Systems

The term 'economics', in daily usages, is most likely to refer to 'the study of the economy'. Yet, mainstream textbooks in the standard neoclassical tradition typically begin with a different definition: that 'economics is the study of how people use their limited resources to try to satisfy unlimited wants.' In other words, in the fundamental sense, the neoclassical tradition of modern economics defines the nature and boundary of the discipline in terms of its distinctive methodology – that is, individualistic rational choices and their equilibrium – rather than its subject matter. A notable exception, however, is the branch of neoclassical economics known as comparative economic systems. It defines itself in terms of its subject matter. And it takes the existence of the subject matter as given. Precisely because of such a peculiarity the literature has been plunged into a state of crisis since the late 1980s, following the world-wide collapse of the Soviet-type economic system.

In first sight, the crisis of the literature of comparative economic systems seems to have arisen from the sudden disappearance of its subject matter or ‘anchor’. That is why a prominent protagonist (quoted in Bonin 1998, p.2), in a cynical tune, voices out the following: ‘we are all economic historians now.’ Yet, the crisis is much more deep-going than that. The claim that the literature has come to a close implies ignoring the multiplicity of institutions and development experiences within the reality of capitalism itself. More precisely, it implies that, insofar as different institutions embody different developmental attributes, the attributes are all reducible to a somehow unified model of capitalism. And the model, the free market model, is constructed on the basis of individualistic rational choices and their equilibrium. Conversely, the central character of the literature is that it has ostensibly (even ostentatiously) striven to use the free market model both as a summary representation of capitalism, and as a welfare standard to judge any alternative. The price of following such a theoretical approach is that the literature has thus been unable to offer any insight to the following analytical issues: the endogeneity and exogeneity of institutional formation, the interaction between social and technological factors in the process of institutional change, and the impact of the interaction between different economic systems on development. Yet, it is conceivable that the inquiry into these issues are of paradigmatic importance for answering the policy and intellectual questions of globalisation as indicated in the beginning of this paper.

The new comparative economics offers to dwell on the above issues. There are discernibly three main theoretical approaches in this newer literature: namely, the application of ‘new institutional economics’, the extension of ‘new political economy’, and the development of ‘comparative institutional analysis’. The first two approaches, because of their adherence to the framework of individualistic rational choices, are within the neoclassical tradition broadly defined. The main difference between them is that, in line with the distinction made by Douglas North and associated scholars, the first approach focuses on issues of institutional arrangements while the second approach focuses on the institutional environment (see Smyth [1998] for a review of the theoretical implication of North’s taxonomy). Meanwhile, the third approach has attempted to incorporate both individualistic and collective rationality in the analysis of the formation, evolution and developmental attributes of institutions and economic systems as a whole. It has also sought to derive the economic properties of institutions from accumulated empirical case studies, rather than taking as starting point the presumption of an universally applicable, uniquely optimal (or most efficient) model of institutions. This third approach is thus not at ease with neoclassical economics.

2-2. Faring with Globalisation: The New Institutional Economics

With respect to the first theoretical approach, the best exemplar is Gregory and Stuart (1999). This is perhaps the most popular textbook for decades in comparative economic systems, and is also, not by coincidence, the first to use the term ‘new comparative economics’. Starting from its sixth edition, published in 1999, the book has abandoned the traditional ‘black box’ approach to the study of economic systems – that is, treating an economic system as no more than a variable, which together with policies and environmental factors jointly determine economic outcomes such as growth performance. Instead, it seeks to apply theories of new institutional economics to the comparative analysis of conceptual models of capitalism and socialism. These include theories of property rights, transaction cost, and principal-agent relations. The general character of the application is to conceptualise the overarching task confronting any economic institution or system as one of facilitating voluntary exchange and thereby achieving efficient economic outcomes. Hence, an economic institution or system is understood as consisting of a range of information-incentive arrangements to facilitate the exchange between rational individuals with the objective of minimising the cost of problems such as shirking, opportunism, adverse selection, and moral hazard.

It is noted that the principle of voluntary exchange between rational individuals is of central importance to the above theories. The theories are all connected to the famous Coase theorem, which states that when property rights are well defined and transaction costs are zero, rational individuals will organise their transactions in ways that achieve efficient outcomes. And the concept of efficiency thereof need not always confine to allocative efficiency. In the Alchian and Demsetz (1972) model, the best known of the property rights perspective, there is the concept of the residual which is the outcome of production rather than pure allocation. In Williamson (1985), the representative work of transaction cost economics, there is the explicit recognition of the importance of tacit knowledge learnt from the production process and from cooperation. Overall, therefore, these theories do offer insights to the formation and evolution of efficient institutions, and, by extension, of efficient economic systems.

But, are efficient institutions really reducible to individualistic rationality? Theoretically, there are two fundamental problems with new institutional economics. First, it is logically flawed to analyse institutional formation and change solely in terms of the principle of the market. Even if it is true that individualistic rationality forms the basis of efficient institutions, it is still necessary to clarify the precise mechanisms through which the exchange between individuals can be brought into equilibrium. The market as an entity (e.g., the market for corporate control), rather than as an institution-free principle, then must be proved to be able to work in a way that is faithful to individualistic rationality. This is unlikely to be possible, given the existence of information asymmetry/incompleteness, transaction cost, etc. Hence, whilst extremists like Alchian and Demsetz (1972) claim that market-produced institutions are optimal, more eclectic scholars such as Williamson (1993, 1995) and North (1994, 1997) tend to argue that they are at most 'comparatively efficient'.

Meanwhile, the second problem with new institutional economics concerns the very concept of efficiency itself. The claimed causality between individualistic rationality and efficiency hinges on the assumption that the sources of efficiency are at least potentially exchangeable. Put another way, it assumes a specific technological paradigm, where the determination of the level of and change in efficiency is either exogenous to the working of institutions or confined to individualistic learning. This is a very restrictive assumption, although whether or not it is valid is ultimately an empirical question. The point to note is that so long as the validity of the assumption is not proven, economic institutions – and, by extension, economic systems as a whole – that are faithful to the theories of new institutional economics cannot have prior claim to comparative efficiency, let alone optimality (for elaborate expositions on institutions and sources of efficiency, see Lo and Smyth [2004] and Smyth and Lo [2000]).

2-3. Faring with Globalisation: The New Political Economy

The second approach to answering the questions of globalisation concerns the extension of theories of new political economy. The focus of this approach is on comparing the politico-legal arrangements of nation-states in the regulation of economic activities, on the assumption that these arrangements are fundamental determinants of institutional formation and change and thus economic development. Moreover, in line with a prominent thesis of neo-liberal political economy, this approach considers the government (taken to be synonymous with the state) as in nature no more than a collection of self-interested bureaucrats, which interact with the 'political market' (the existence or otherwise of election and its precise forms) to produce politico-legal arrangements. In this way, these works offer to construct a theory, confined to individualistic rational choices and their equilibrium, of endogenously-determined economic institutions as well as politico-legal arrangements (Beck *et al.*, 2003; Djankov *et al.*, 2002, 2003; Glaeser *et al.*, 2001).

To answer the question of institutional uniformity versus diversity, the above theory devises an analytical framework that involves the trade-off between market failures and government failures. The analysis of two particular issues are illustrative of this approach. The first concerns the relative efficiency of two arrangements, the court vis-à-vis regulatory agents, in the enforcement of laws or contracts. It is argued that, compared with judges, regulators are typically faced with stronger but more biased incentives to enforcement. Hence, in the context where the costs of verifying the circumstances of specific cases and interpreting statutes are high, enforcement by regulators, which have more lopsided but powerful incentives, may be a more efficient arrangement. The opposite conclusion can be reached, however, in the event where factors such as government transparency, press freedom, and bureaucratic efficiency are lacking – that is, where the likelihood of government failures is high. Meanwhile, the second issue being analysed concerns the relative efficiency of governance by common law vis-à-vis civil law. In the final analysis, this, again, involves the trade-off between market failures and government failures. It is argued that common law provides better protection to private property rights, while civil law offers a greater scope for government intervention in economic activity. Hence, in the circumstances where the potential of market (government) failures is greater, civil (common) law may be a more efficient system.

It appears that the above theory does allow for institutional diversity, but only within a tight limit. To see the point, note that the trade-off as illustrated above has been reconstructed by Djankov *et al.* (2003) to form a general theory of efficient institutions. In this theory, market failures have been generalised to what the writers call 'private disorder' (infringement of private property rights by private agents), while government failures has been generalised to so-called 'dictatorship' (infringement of private property rights by the government). And the four common strategies of social control over business – private orderings, private litigation, regulation, and state ownership – are viewed as points on the institutional possibility frontier (IPF) of a particular nation-state. These four strategies, ranked in terms of increasing state power, are considered to be associated with progressively diminishing social costs of disorder and progressively rising social costs of dictatorship. Now, as Figure 1 illustrates, for a given IPF, precisely which of the four strategies (and thus the associated institutional arrangements) is the most efficient depends on the slope of the IFP, that is, the level of development of the market relative to that of the government. This delineates the scope allowed for institutional diversity. But, note that, in the figure, both the vertical and horizontal axes are defined in a negative way, as distances from a state that is free of 'social losses'. And this state refers to a world with perfect property rights, which defines institutional uniformity.

[Figure 1]

The two afore-mentioned problems with new institutional economics, regarding the claimed optimality of institutions that are faithful to the principle of individualistic rational choices and their equilibrium, also apply to new political economy. Insofar as the claim is only over comparative efficiency, rather than optimality, the problem concerning the market as an entity will be less serious. But, the theory would then need to prove that its conceptualisation of the state – as no more than a collection of self-interested bureaucrats – is well-established. This is very doubtful, because its treatment of the state-society relationship is simplistic and it says nothing about the importance of inter-state relations. In this theory, the relationship between the society and the state is viewed as no more than a principal-agent relationship constructed via a formalistic ‘political market’, while important issues such as ideology, legitimacy and the functioning to ensure the reproduction of the existing social relations are simply ignored. Needless to say, alternative concepts such as ‘the state as a committee for managing the common affairs of the dominant social class’ or ‘the developmental state’ are not considered to be worthy of contemplation in this theory (for a review of the vast literature on the political economy of the state, see Sawyer [1989], ch.10).

The problem regarding the flawed concept of efficiency is even more serious in new political economy than in new institutional economics. For, in the former strand, the concept is strictly referred to allocative efficiency. This is most clearly illustrated by Beck *et al.* (2003), who, in effect, argue that efficient politico-legal systems are arrangements that embody maximum flexibility to accommodate ‘financial needs’ and therefore to foster ‘financial development’. This is the extreme form of the argument that perfect property rights are the optimal state, because ‘by encouraging people to invest in themselves and in physical capital, such security [of private property rights] fosters economic growth’ (Djankov *et al.*, 2003, p.596). The claimed equality between financial development and overall economic development hinges on the assumption that the sources of efficiency are marketable, which is even more stringent than that held by new institutional economics. Yet, given alternative technological paradigms, institutional arrangements that offer maximum flexibility to the financial interests could be imparted with short-termism, resulting in a state where the logic of speculation prevails over that of creation in the economy. Such arrangements could cause insufficient effective demand at the macro level, as Keynesian economics has posited, and could hinder the improvement in productive efficiency at the micro level. The claim over optimality by new political economy would then turn out to be no more than delusion.

2-4. Faring with Globalisation: Comparative Institutional Analysis

The third approach to answering the questions of globalisation concerns the development of comparative institutional analysis. The ambition of this theoretical strand is to incorporate both individualistic and collective rationality in analysing institutional formation and change. Crucial to the theory is the recognition that, for individualistic rational choices to be brought into equilibrium, it requires a process of interaction characterised by evolutionary games. And the games are evolutionary because, taking place in real time, the players learn: individuals are not endowed with complete information about the objective structure of the games. At any time, game players have only incomplete cognitive views regarding the structure of the games, that is, they only have ‘subjective game models’. It is only when actions taken by the players, based on their own subjective game models, are mutually consistent that their views ‘can be confirmed by the observed reality jointly created by their action choices and reproduced as a guide for their further action choices’ (Aoki 2001, p.3).

An institution, then, can be conceptualised as a system of self-sustaining shared beliefs of the players about the structure of the game that they actually play. It is the joint product of individualistic and collective learning, or, the equilibrium of the co-evolution of the traits of individuals and the convention of behaviour. In this way, an institution is both endogenously created and existing objectively. And an efficient institution corresponds not to individualistic rationality per se, but rather to some particular combination of individualistic rational choices – that is, collective rationality. The same reasoning applies to economic systems as a whole, because each system is understood as ‘a coherent set of institutional arrangements’ formed on the basis of the co-evolution of shared beliefs and individual traits (Aoki 1996).

The summary above clarifies an important feature of comparative institutional analysis: that, concerning institutional formation, the equilibrium of individualistic rational choices can be brought about by a wide variety of mechanisms, of which the market is one but not the only one. This enables the theoretical strand to avoid the problem of market failures, which, as indicated earlier, poses a serious challenge to the theories of both new institutional economics and new political economy. But, having a broader set of possible mechanisms for achieving equilibrium also implies a more difficult task for constructing a theory of efficient institutions. At stake is the question as to what are the parameters upon which the co-evolution of shared beliefs and individual traits is based. Put another way, what factors would guide the co-evolution towards the kind of equilibrium where efficient institutions are created? It appears that the comparative institutional analysis approach offers no explicit, well-developed answer to the question. At one level, this lacking indicates a reservation over the notion of uniquely optimal institutions – that is, a recognition of the multiplicity of development experiences in the real world and an anticipation for constructing a theory of efficient institutions through accumulated case-studies of the experiences. Yet, at another level, it also reflects an intrinsic weakness of the theoretical strand. Whilst recognising that the parameters upon which the co-evolution is based are the paradigmised technological conditions and the globalised social conditions (Aoki 2001, ch.15), it stops short of explicitly exploring these conditions. The theorisation, in the main, focuses its attention on the sphere of exchange. This makes itself impossible to construct a general theory of efficiency, and therefore of efficient institutions.

3. Inspirations from Classical Political Economy

The inquiry into objectified institutions and paradigmised technology lies at the heart of classical political economy. This stands in contrast to neoclassical economics, which seeks to derive its theories of institutions and development from the construct of ahistorical, universal rational individuals. This contrast has important ramifications in the field of comparative studies of economic systems. As a matter of fact, in the relevant literature, neoclassical economics, while being predominant, has never been the solely existing approach. There are discernibly two alternatives that are in the classical tradition.

One approach, drawing on David Ricardo, concerns mainly issues of objectified institutions. It focuses on the analysis of the social conditions that determine the pace and direction of the reproduction of the economy. More concretely, a central thesis of modern neo-Ricardian or Sraffian economics posits that the scramble for the surplus product of the economy between different social classes determines the relative prices system, the path of economic growth, as well as the sustainability of the economy and the existing social relations (Dutt 1990, ch.2-3; Sawyer 1989, ch.8-9). Meanwhile, a second approach, drawing on Adman Smith and Karl Marx, concerns mainly issues of paradigmised technology. It conceptualises an economic institution, and the economic system as a whole, as an arrangement to re-integrate the division of labour in the society. And because the division of labour is not only the commonest characteristic of all modern societies but also the most fundamental cause of productivity improvement, the developmental attributes of economic institutions can thus be assessed in this light (Putterman 1990; Sayer 1995).

It would be useful to go a step further to clarify the relationship between the above two approaches, in terms of theories of efficient institutions. The starting point is the concept of efficiency, which is defined as productivity improvement and thereby economic development. In the literature of growth theory broadly defined, productivity improvement over the long term is often considered to be emanating from three sources: allocative efficiency, economies of scale, and economies of scope, which give rise to different forms of technological progress. Theoretically, it could be argued that these different sources of productivity improvement could ultimately be traced to two different principles of the division of labour. Economies of scale stem from the deepening of the detailed division of labour à la Smith (the separation of conception and execution). Technological progress thereof is equivalent to producing new information, which is made possible by the deepening of the division of labour within a given cognitive framework. Economies of scope, in contrast, stem from the deepening of the social division of labour à la Marx (the integration of conception and execution to produce a complete commodity). Technological progress thereof is the production of knowledge, which is generated by individual as well as collective learning, i.e., the process of exploration between deepening the given cognitive framework and selecting a new cognitive framework. Finally, allocative efficiency, while involving the production of a complete commodity and is thus being based on the social division of labour, hinges on the peculiar assumption that what is produced is exchangeable, i.e., information rather than knowledge (Lo and Smyth 2004; Smyth and Lo 2000). Thus, the theoretical approach that focuses on the division of labour and its re-integration can be interpreted as a theory of efficient institutions at the micro level and in the sphere of production. The theoretical approach that focuses on the reproduction of the economy, meanwhile, can be interpreted as a theory of efficient institutions at the macro level and in the sphere of income distribution and exchange.

Now, recall from the previous section that common to all the neoclassical approaches in comparative economics is the conceptualisation of an institution as an information-incentive arrangement governing the exchange between individuals. And because the equilibrium of the exchange between individualistic choices is considered to be the necessary cum sufficient condition for optimal (or at least comparatively efficient) outcomes, the efficiency attributes of institutions can thus be assessed accordingly. It is clear that, compared to theoretical approaches that are in the classical tradition, neoclassical theories of efficient institutions are seriously wanting because they reduce production into exchange at the micro level – that is, they must assume, in a very restrictive way, that sources of productivity improvement are marketable, or at least potentially exchangeable between individuals. This assumption is clearly of much less intellectual value than the explicit theoretical expositions of the classical approaches. Nevertheless, it is of note from the review above that the classical approaches, while making the sources of productivity improvement endogenously-determined, have also had to leave institutional formation and change exogenously-determined. This is reasonable, given the recognition of the multiplicity of collective rationality and that collective rationality must be history specific in nature. Yet, such recognition need not preclude the inquiry into the possibility that, within the confinement of historical conjunctures, objectified institutions and (individualistic as well as collective) rationality could follow a path of co-evolution towards comparatively efficient outcomes. The synthesis between the classical approaches and the comparative institutional analysis approach, in other words, might offer scope for developing theories of history-specific efficient institutions.

One possible direction for developing theories of history-specific efficient institutions is to resort to the notion of ‘the social force of production’ in Marxian economics. There is a well-known thesis in historical materialism, which states that, at the most general level (i.e., in an anthropological sense), the development of the force of production is the fundamental cause of social change (Zhang 2002). Yet, within the confinement of historical conjunctures (i.e., in the sense of political economy), the force of production must be social in nature. With reference to capitalism, Harvey (1982, p.100) puts it this way: ‘in the same way that use value becomes re-integrated into political economy as *social* use value, so the purely physical idea of productive force is re-integrated into political economy as the power to create surplus value for capital through material commodity production.’ The power to produce surplus value must be qualitatively different from the power to produce for human needs. Thus, the reproduction of labour power, which is a core component of the productive force, must involve a complex social process embodying the specificities of income distribution, the pattern of consumption, etc. Similarly, the invention of new scientific understandings, and their application to the labour process, must necessarily be integrated into the dynamics of the prevailing social relations (Lin *et al.* 2002).

The importance of employing the notion of the social force of production is not just that it entails an explicit exposition on production and productive efficiency, which is conspicuously lacking in neoclassical economics. By viewing the social and technical aspects of the labour process as integrals of a unified whole, the notion also marks a distinctive feature of Marxian economics vis-à-vis Sraffian economics. This, namely, is the thesis that the surplus product of the society is the outcome of a joint social and technical process, rather than that of a purely technical process. And, in the Marxian view, the functioning of socio-economic institutions is to govern both the production and distribution of this social surplus product. This thesis has formed the underpinning of a range of theoretical approaches in modern radical economics: theories of techno-economic paradigms, the theory of the social structure of accumulation, and the concept of the regime of accumulation in the work of the French Regulation School. It is particularly of note a notion commonly used by these theoretical approaches to characterise twentieth-century capitalism: namely, Fordism. This notion is a good example illustrating the integrated treatment of the social and technical aspects of the force of production. For the social aspect, Fordism is consisted of ‘big business, big unions, and big government’. For the technical aspect, it is consisted of the application of Taylorist techniques and scientific management, together with the combination of dedicated machinery and standardised parts for mass production. The integration of the two aspects gives rise to a pattern of economic development that is based on a particular technological paradigm and the corresponding demand condition (Harvey 1989, part two; Kotz 1994; Nell 1998, parts I and V).

It should be noted that the above are not meant to be general theories of efficient institutions. Insofar as Fordism is/was comparatively efficient, it is/was so only within the confinement of some particular historical conjunctures. As a tradition in Marxian theory, and as all strands of modern radical economics have stressed, in the process of institutional formation and change, the interaction between the social (class relations) and the technical (paradigmatic change) is no more than conjunctural. It is one thing to say that the expansion of the force of production requires, in a functional sense, certain social condition; it is another thing to say that the condition would be actually available. Considering experiences of more efficient alternatives to Fordism – the case of the stylised Japanese firm, the case of the 'Third Italy', etc. – Best (1990, ch.5-7) and Sable (1982, ch.4) both note that they are products of specific historical processes. Referring to the emergence of capitalism in general, Harvey (1982, p.27) notes: 'how and why did it ever come about that the owner of money finds a labourer freely selling the commodity labour power in the market place? The relation between capital and labour has no "natural" basis – it arises as the result of a specific historical process.' This stands in sharp contrast to neoclassical approaches, which typically seek to construct general theories of efficient institutions on the basis of some universal characteristics of the human nature.

4. Globalisation in the Lens of Theories of Techno-Economic Paradigms

In the scholarly literature, there are two extreme views on the developmental impact of capitalist globalisation. Neo-liberalism considers globalisation as promoter of development, and this is based on the neoclassical theory of economic growth (the thesis of convergence) and international trade (the thesis of factor price equalisation), and, ultimately, on theories of efficient capitalist institutions. The dependency view, in contrast, considers globalisation as promoter of underdevelopment (meaning negative development). This is based on theories of unequal exchange and forced specialisation, and, ultimately, on theories of the exploitative and crisis-prone nature of the capitalist system.

Each of the two extreme views has its difficulty in faring with experience. Whilst neo-liberal protagonists have boldly claimed that 'capitalism typically produced growth and wealth' (Djankov et al. 2003, p.596), this claim must be qualified by an extremely selective reading of history. It is almost a consensus in the literature of empirical studies that, over the last century, there is no evidence of a levelling convergence of growth rates and thus levels of per capita income (Weeks 2001). More up to the point, the last two decades of the twentieth century were commonly known as the era of globalisation, yet these were precisely what have come to be known as 'the lost decades of development'. As Easterly (2001) has observed, development was lost in this period despite the fact that the vast majority of developing countries (and countries of the former Soviet bloc) actually implemented policy reforms in the direction of transition towards the free market economy. Meanwhile, along with the general stagnation of economic growth in the developing world, in the era of globalisation, there has been a trend of growing disparity among major regions – a trend of uneven development. East Asia, which among developing economies is certainly not the least integrated into the world market, is perhaps the only region that has closed its income gap with advanced capitalist economies. And China, which has undergone a process of progressive marketisation in the 1980s and 1990s, has achieved a magnitude of poverty reduction that outweighs the developing world as a whole (implying that the developing world excluding China has indeed undergone an underdevelopment process in the absolute sense). The experience of uneven development appears to contradict the dependency view.

What explains the trend of general underdevelopment, as well as that of uneven development? An influential answer from neo-liberalism, known as the thesis of 'conditional convergence', is to ascribe the observed stagnation of growth in the developing world to 'bad policies', i.e., policies that obstruct the functioning of the market. The conclusion that follows, then, is that it is not capitalism that has caused the underdevelopment; it is the insufficient development of capitalism that has caused it. In contrast, an alternative explanation, exemplified by Weeks (2001), focuses on the competition between capitalist and semi-capitalist economies. It is contended that the nature of the competition is such that it tends to produce divergence rather than convergence, because capitalist innovations and hence growth require the existence of capitalist social relations. This phenomenon, called 'primary uneven development', is posited to be qualitatively different from the competition between predominantly capitalist economies, i.e., 'secondary uneven development', which exhibits fluctuations between convergence and divergence dancing to the tune of the general process of system-wide capital accumulation. Week's arguments are in the same spirit as Krugman's (1981) formal, two-stage model of imperialism and uneven development. In the model, it is argued that, in the stage of international trade capitalistic industries kill off less-capitalistic industries, while in the stage of international capital flows industries are re-built in less-capitalist economies. A logical conclusion from both Weeks and Krugman is that divergence will cease to be the dominant tendency when capitalist globalisation is completed, although it will be the dominant tendency before then.

The exposition above hinges on the question as to whether capitalist globalisation can ever be completed. A prominent thesis in radical economics posits that capitalism as a history-specific system would not necessarily reproduce the same social relations everywhere across the globe, and that, once being integrated into the world market, non-capitalist (or semi-capitalist) social relations would become part and parcel of the capitalist system. In other words, non-capitalist institutions would then be perpetuated by the dynamics of the general process of system-wide capital accumulation. This thesis is shared by some strands of dependency theory (the notion of lumpen development), of structuralist Marxism (theories of the articulation of modes of production), and of the Chinese theory of the semi-feudal, semi-colonial social formation. The general thrust of the thesis is that it is in the spirit of the conjunctural view on institutional formation and change. Yet, to validate the thesis requires a corresponding, explicit theory of the dynamics of the general process of system-wide capital accumulation. Two further theses in radical political economy, concerning capitalism in general and especially in the present era, are of relevance in this regard.

The first is the thesis of the new international division of labour (NIDL), first raised by Fröbel *et al.* (1980). The thesis identifies three factors as main determinants of the consequence of spatial expansion of capitalism in the second half of the twentieth century. First, there is the expansion of the reservoir of wage labour, following the incorporation of increasingly wider part of the globe into the capitalist system. Second, there is the development of the Taylorist production system, and this development, by de-skilling work, ensures labour productivity in 'world factories' of the late developing world being equal to or in excess of that in advanced capitalist economies. Third, there is the development of the means of transportation and communication, which makes it possible for industry to be untied to specific locations. The combination of these three factors, according to the NIDL thesis, creates a development trap where developing economies are forced to specialise in low skill/technology industrial activities and receive low compensation for workers. The main mechanism through which the development trap is created is the transfer of surplus from developing economies to capital-exporting developed economies – in line with the famous Lewis model of the consequence of unlimited supply of labour. Subsequent developments along the line of the NIDL thesis, such as in the work of the French Regulation School (e.g., Lipietz 1987), emphasise the unlimited supply of labour and lacking of domestic mass-consumption markets as both cause and consequence of the development trap. The message remains that the development trap is antithetical to the perceived pattern of economic growth in advanced capitalist economies, where productivity growth via capital deepening plus demand expansion due to increased compensation for workers form a virtuous circle (for a review of radical as well as orthodox theories of late industrialisation, see Lo [1995]).

The second thesis on the dynamics of system-wide capital accumulation comes out from the literature of historical capitalism: the thesis of the long-period, systemic cycle of capitalism. Referring to the second half of the twentieth century, it is submitted that there is a transition from the phase of expansion in production activities to one of financial expansion (Arrighi 1994). *Prima facie*, this transition follows the secular trend of decline in aggregate industrial profitability, although the explanation of the profitability decline can vary – it could be result of the paradigmatic shift in technology (the neo-Schumpeterian explanation of the Kondratieff long wave), the intrinsic tendency of capitalism (the Marxian explanation of long wave à la Ernest Mandel), the tension between the paradigmatic shift in technology and existing socio-economic institutions (the social structure of accumulation explanation of long wave à la David Gordon as well as the general thesis of the profit squeeze), or some syntheses of them. Characteristic of the transition is a tendency progressively to incorporate productive resources across the world into the capitalist system, a process which is essential to the international movement of capital in the pursuit of high profitability. And high mobility of capital requires high flexibility on the part of the productive system, i.e., the minimisation of fixed investment and the maximisation of surplus-value production. Yet, in line with the literature on techno-economic paradigms, the behavioural flexibility of the productive system could arise from two types of institutional arrangements. One consists of flexible institutions constructed on the basis of the detailed division of labour to minimise labour cost, and this is characteristic of the 'low skill/technology, low income' model. Another consists of rigid, or long-term oriented, institutions constructed on the basis of the social division of labour, where behavioural flexibility arises from collective learning and horizontal co-ordination. This is characteristic of the 'high skill/technology, high income' model.

The exposition above can be represented by Figure 2, where the theoretical reasoning is from Lo and Smyth (2004) and Smyth and Lo (2000) and the formalisation is based on Bowles and Edwards (1993). The central message that arises from Figure 2 is that, in the context of integrating themselves into the world market, latecomer economies could have some scope of choice between two different paths of development. The constraint imposed by the world market is represented by given levels of the unit labour cost, which industries of latecomer economies must strive to attend in order to survive the pressure of competition. And the unit labour cost (*ulc*) is, by definition, equal to the wage rate (*w*) divided by the product of output per unit work done (*e*) and work done per labour time (*d*), that is, $ulc = w/(ed)$. One way to achieve a particular given level of the *ulc* is by means of utilising the unlimited supply of labour, that is, by keeping down the wage rate *w* or by raising the work intensity *d*, or both. This corresponds to the 'low skill/technology, low income' model. And, as indicated above, this is made possible by flexible institutions that follow the principle of the detailed division of labour. In contrast, an alternative way to achieve a given level of the *ulc* is by means of raising the labour productivity *e*. This is made possible by rigid, long-term oriented institutions that follow the principle of the social division of labour. This corresponds to the 'high skill/technology, high income' model. In addition to protecting workers from the welfare lost due to deskilling and increased work intensity, this second model, by promoting the growth of labour compensation and hence the formation of domestic mass-consumption, also helps to alleviate the problem of demand deficiency that is characteristic of world development in the era of globalisation.

[Figure 2]

Theoretically, there does not appear to exist an overwhelming logic of capital accumulation on the world scale to determine which of the above two models must be the prevailing outcome. From the standpoint of individual capitalists, cost minimisation is the overwhelming logic and hence the temptation of the (creation and exploitation of) unlimited supply of labour is irresistible. From the standpoint of total capital, though, demand consideration is of equal importance and this could act as a restraint on the international and national attempts to push for adopting the ‘low skill/technology, low income’ model. Now, empirically, in view of the application throughout the developing world of policies pertaining to the ‘Washington consensus’ – particularly, policies to privatise the ownership of productive assets and land, to liberalise the labour market, to deregulate financial activities up to the point of opening up the capital account and floating the exchange rate, etc. – it appears that the ruling establishment of international political economy has been working in a way to serve short-term sectional interests, rather than the interests of total capital. The establishment might have been, to a significant extent captured by speculative financial interests, and this might be a significant factor accounting for the observable world-wide crisis of late development (Wade 1998; Wade and Veneroso 1998).

There remains the phenomena of uneven development that need explanation. Specifically, the explanation of the development experiences of East Asia and China, the exceptional cases of world-wide underdevelopment, requires identifying the main factors based on which the two entities have escaped the indicated development trap. In the case of East Asia, an explanation that is in line with the exposition above contends that the developmental success has been based on a range of long-term oriented institutional arrangements which exhibit behavioural flexibility, and thus foster productivity improvement and income growth. And the formation of these institutions owes much to specific historical circumstances, including the ideological orientations of the states, particular forms of domestic social mobilisation in relation to the Cold War, and the favouritism provided by the United States for Cold War considerations (see Lo [1999] and the references thereof for elaborate expositions on this literature). Turning to the case of China, a similar thesis concerning the development pattern has been developed in the literature (see Lo [2004] and the references thereof). The main factors that have shaped institutional formation and change, though, are significantly different from East Asia. Instead of US favouritism, it is the ability of Chinese state to resist the demands of the international political-economic establishment that has enabled it to escape the indicated development trap as well as the type of financial and economic crisis that engulfed East Asia in the closing years of the century. And it is the legacy of a revolutionary society that has underpinned the long-term oriented institutions and the corresponding domestic demand condition, which are the ultimate driving forces of the sustained rapid growth. On the whole, in both of these two exceptional cases, neither the development patterns nor the underpinning institutions are reducible to the universal, ahistorical construct of individualistic rationality.

5. Summaries and Conclusions

In addressing the directions for the development of the 'economics of transition', Douglas North (1997, p.2) states: 'A set of political and economic institutions that provides low-cost transacting and credible commitment makes possible the efficient factor and product markets underlying economic growth.' This statement, whatever qualification it might have, is typical of neoclassical economics because of its focus on exchange between the choices of rational, optimising individuals, and on the success of the market as an entity in bringing the exchange into equilibrium. The same spirit runs through all the neoclassical approaches to comparative economics, despite the varied degrees of allowance for possible failures of the equilibrating function of the market. And it applies to local markets as well as the global market, thus underpinning the claim that globalisation is producer of efficient institutions and is thus promoter of development.

This paper offers a critique of the neoclassical approaches, as well as an attempt of its own to explore into the impact of capitalist globalisation on institutional formation and change in late development. Its starting point is the theoretical argument, advanced by the comparative institutional analysis approach, that efficient institutions are product of collective rationality, instead of being reducible to individualistic rationality. Further exploration into the nature and determinants of collective rationality draws on a range of theses in radical economics about objectified institutions and paradigmised technology. The substantive argument that emerges from this exploration is that, capitalist globalisation – if it strictly follows the principle of the market (i.e., the logic of financial interests) – is more likely to result in underdevelopment than development. A range of institutions that contradict the prevailing logic of globalisation will be needed for avoiding the development trap.

In this context, it seems possible to submit a more concrete argument concerning the political economy of institutional formation and change in the context of late development. In relation to the notion of behavioural flexibility generated by rigid institutions, which is considered to be underpinning of the sustainable model of development (i.e., ‘high skill/technology, high income’), a conceptualisation of state power in the spirit of Marxian theory appears to be of more value than the formalistic, neo-liberal concepts of ‘disorder’ and ‘dictatorship’. For, as is argued in Lo and Smyth (2004), rigid yet efficient institutions constructed on the basis of the social division of labour require mass participation, together with appropriate state power for ensuring collective rationality. Within the confinement of capitalism, and as exemplified by the East Asian experience, it takes the form of certain degree of mass mobilisation mainly at the firm level, together with the state serving as ‘a committee for managing the common affairs of the capitalist class’. In the case of China, meanwhile, a higher degree of mass participation in economic and social affairs has coupled with a similar ‘developmental state’ to largely account for the record of sustained rapid growth. The existence of these ‘anti-systemic conditions’ (to paraphrase the literature on historical capitalism), then, while being interpreted as producing no more than undesirable disorder and dictatorship, are arguably necessary for late development in the context of capitalist globalisation.

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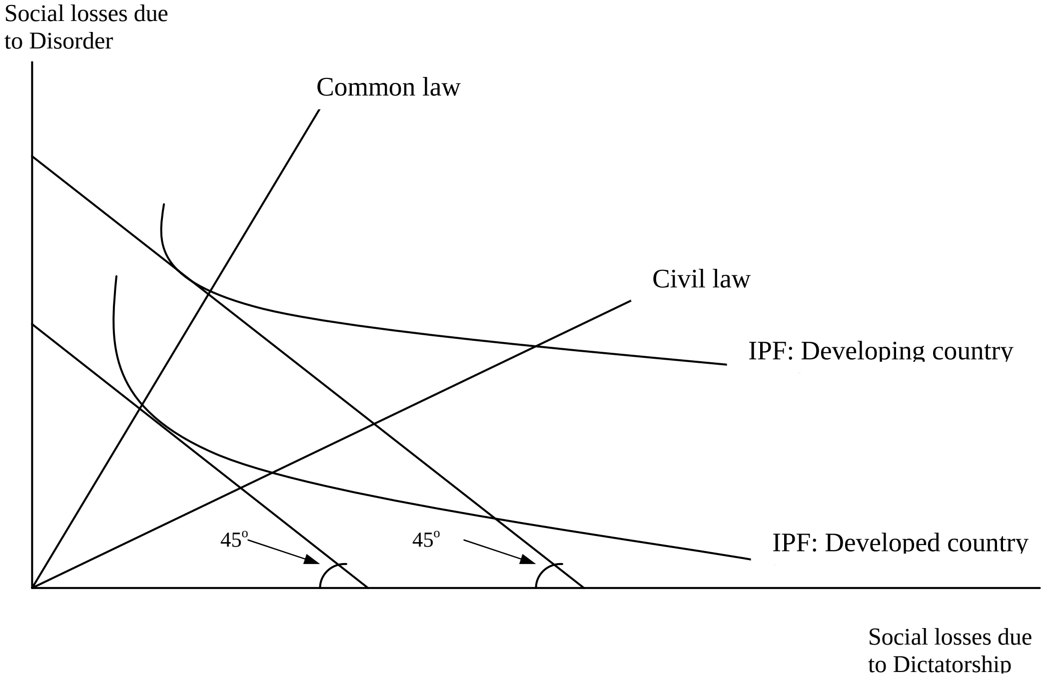
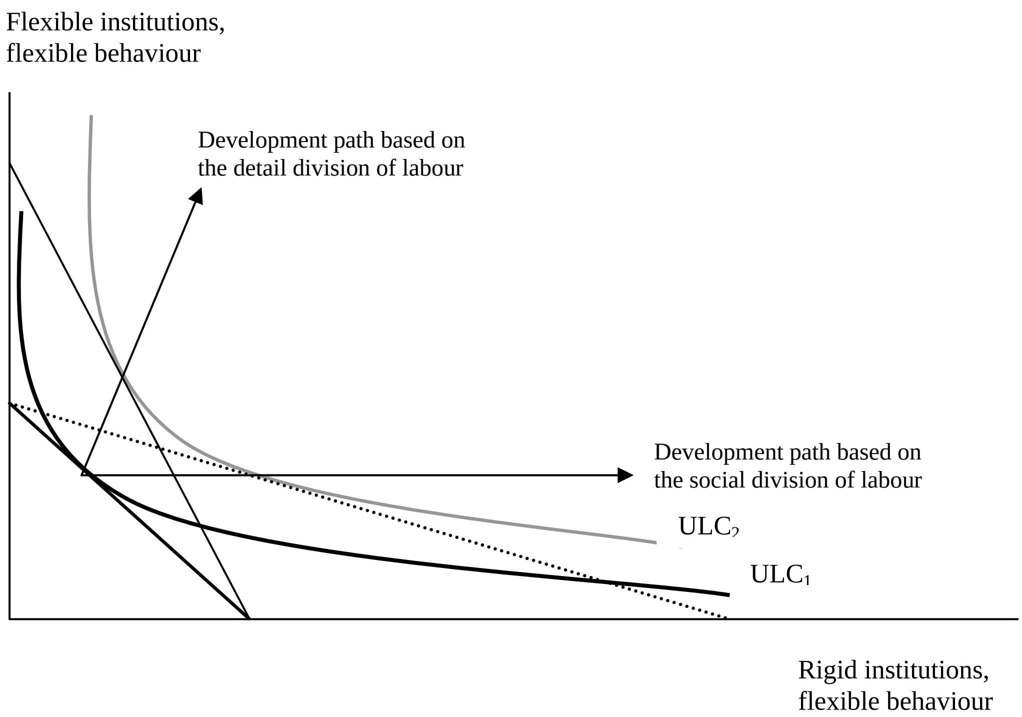
Figure 1. The Comparative (In)efficiency of Market Failures and Government Failures



Source: Djankov et al. (2003).

Note: IPF = institutional possibility frontier. The 45° line indicates total loss minimisation. The origin position of the graph represents a state with perfect property rights.

Figure 2. Two Development Paths: Detailed versus Social Division of Labour



Note: ULC = unit labour cost = *w//Q* = *w/(ed)*, where *w* = wage rate, *Q* = output, *e* = *Q* per unit work done (i.e., labour productivity), *d* = work done per labour time (i.e., work intensity). The tangent lines of the graph represent the social cost of different combinations of "flexible institutions, flexible behaviour" and "rigid institutions, flexible behaviour", which, in turn, are determined by the interaction between technological change and social relations.