



Comparative Economic Systems and the New Comparative Economics

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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.

JEL Classification: P10, P50 , P51

Keywords: Comparative Economic Systems, Comparative Economics, New Comparative Economics

1. Introduction

The changes that took place since late Eighties, particularly globalisation 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.

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, and regulation “around the world”.

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

³ Among 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.

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 for thought. That CES has to evolve, and possibly refocus, few in the field would doubt. Is the new comparative economics (NCE) the good and correct answer? Are the topics it examines, the methods it uses 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 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 are worth examining 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 this issue any further.

Second, the NCE sees the key comparisons as being those of alternative capitalist models that prevail in different countries. This is presented in an ostensible 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 at first given priority to socialist systems and later to transition issues, the statement is at least imprecise. There is therefore a need to devote some effort to clarifying this issue. Since this issue is not central in the NCE analysis, I will postpone its discussion to section 9.

Third, there is a stress on the fact that institutions differ tremendously and systematically among countries, with significant consequences for economic

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).

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 a discussion of 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. In doing so, I will make reference primarily to the two papers that present directly the authors' effort at establishing the NCE (Djankov et al. 2003a, Shleifer 2002). However, since these papers are in a sense the summary of a broad and long lasting research program, due attention will also be paid to other contributions by this group of authors.

Most of this paper illustrates and examines critically the NCE contribution to this third issue. In section 2 I introduce the New Comparative Economics and highlight its main features. Each of the following sections focuses on a particular aspect of the NCE and presents my analysis of its strengths and weaknesses. Section 3 presents the basic NCE idea of comparative institutional efficiency and the following section 4 outlines the premises of the comparative institutional efficiency analysis. In section 5 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 6, together with the role of the legal system. Section 7 looks at the consequences of this approach for institutional reform and section 8 discusses the role of legal origin. Section 9 considers earlier contributions to the idea of a "new" comparative economics and discusses the overall situation of CES to assess whether the NCE criticism of CES is well taken. Section ten concludes by considering the relation of the NCE with CES.

2. The New Comparative Economics

The basic message of the NCE can be divided into two steps. In the first step the NCE organises what one could define as the core variables. 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 starting point is human nature, i.e. the individuals' inclination to subvert social institutions to their personal gain. 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 affected by 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. which institutions are the most efficient in securing property rights. These in turn determine economic performance.

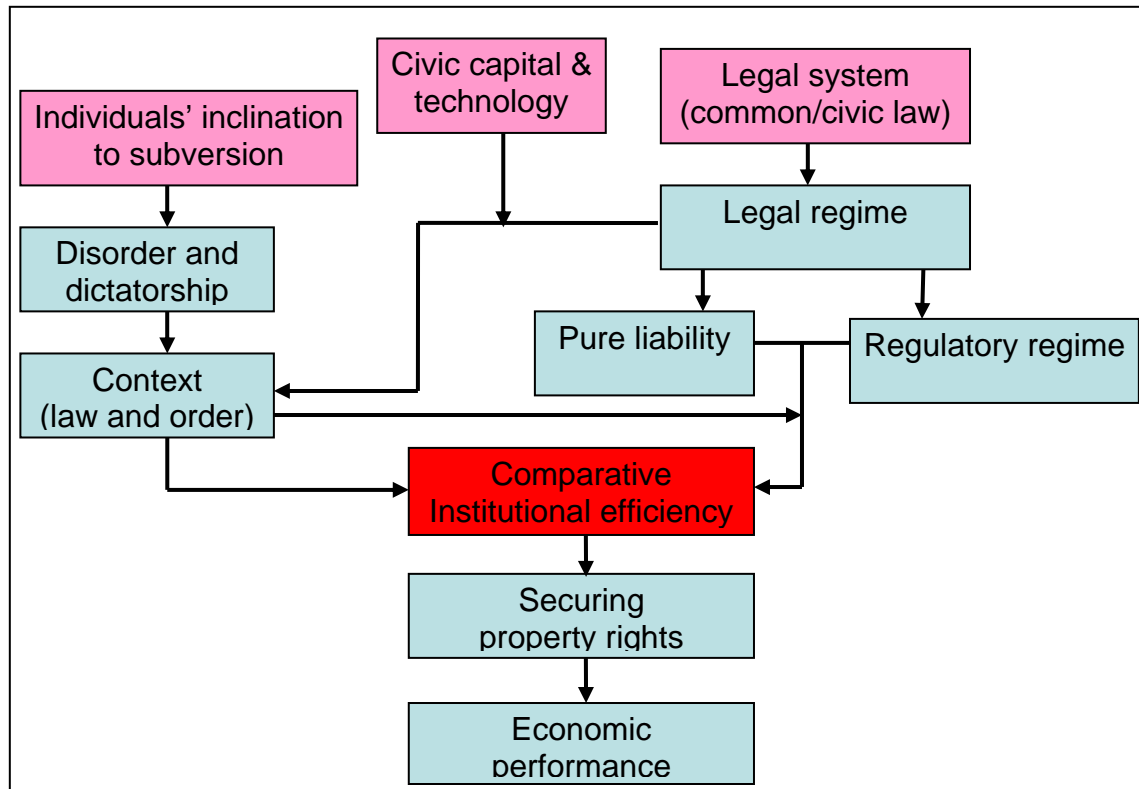
This description is insufficient to explain why institutional efficiency is different in diverse economies. This depends on the absolute level and mix of disorder and

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.

dictatorship that exists and is tolerable in a given society, which in turn depends on civic capital. Civic capital, then, explains the actual possibilities of a particular economy. This element is corroborated by the role of technology, which further refines the issue of disorder and dictatorship.

Considering all these elements and with some simplification, the overall explanation advanced by the NCE is outlined in the following Chart 1.

Chart 1. The NCE explanation of comparative institutional efficiency



3. Comparative institutional efficiency

The core of the NCE lies in the concept of institutional efficiency. Similarly to Coase (1960), the NCE intends to identify which institutional arrangements are more efficient in securing property rights. 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.

The importance of the law enforcement strategy that society chooses comes from the fact that private individuals are considered naturally self-interested. 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.⁶ Disorder

⁶ “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

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.

The NCE sees (formal) institutions in a narrow functional perspective, whereby their role is to control the twin dangers of dictatorship and disorder. Moreover, no mention is made of the role of informal institutions except in the case of transplantation, but then only in an implicit way. A dynamic element is introduced by considering that institutions are vulnerable to subversion by the potential violator making use of a number of both legal and illegal strategies.⁷ However, as long 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 explicit goal of replacing the traditional CES framework with a new paradigm. In this new perspective, comparative economics would become a simple, although important, chapter of (a particular brand of) the property rights interpretation of the world.

After this summary description, in order to evaluate this program of re-founding CES it is useful to assess how the NCE answers two crucial questions. 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, particularly so if we consider the role of subversion?

The NCE answer to the first question reveals an important similarity with the CES approach. In fact, the NCE answer is based 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:⁸ 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, in the absence of law and order a regulatory regime is more efficient than a pure liability regime. In intermediate cases mixed solutions prevail. This explanation is complemented with other variables that the literature has shown to be important, such as stronger

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 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)

⁷ “The legal ones include acquiring favourable 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)

⁸ We leave socialism out of consideration for the moment, since socialism is considered incompatible with private property. This initial disregard is a serious heuristic flaw in the way towards generalization of the new approach.

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 in section 6. This is, I believe, one of the most important statements of the NCE, which identifies an interesting point of possible cooperation with CES.⁹

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) 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).

This quotation is the boldest dynamic perspective of the NCE, which CES can easily share. However, it falls 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 necessarily generate efficient solutions. Those same evolutionary processes could also generate inefficient institutions (Nelson 1995). The only clear answer NCE gives on this point is that inefficient institutions can be the outcome of transplantation. The NCE is simply uninterested in the dynamic evolutionary perspective.

4. The premises of the comparative institutional efficiency analysis

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, for whom property rights have central importance in explaining differences among economic systems, are not aware of the latter problem, and do not consider the former. 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 expropriation of investment by other private actors. But a state sufficiently

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

powerful to do this is also strong enough to threaten to expropriate private economic actors.¹⁰

However, to its analytic merit, 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.

The idea of comparative institutional efficiency stems from the necessity of an economy to navigate safely between the Scylla and Charybdis of the twin goals of controlling disorder and dictatorship. The analysis of the tradeoff between the need to control disorder that asks for greater state intervention, and the goal of controlling dictatorship that requires curbing 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 will find the proper efficient solution. 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 institutional solutions (from private litigation to regulation and socialism), it really overlooks the qualitative aspects of the issue. These concern in particular 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 for 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 to economic performance, but also to the nature and behaviour of private actors.¹¹ The same holds obviously for qualitative differences of and within the private sector.

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

On this rather narrow analytic approach 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

¹⁰ "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 tort-feasors. ... 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)

¹¹ For a vivid picture of the crucial importance of the quality of bureaucracy and government in reform policies cf. Rodrik (1996).

understanding which ones are appropriate in what circumstances, is the subject of the New Comparative Economics." (Shleifer 2002, p. 12)

Along with the relation with CES, the NCE has a rather strict relation with institutional economics and with public choice economics. 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. It also shares the concept of comparative institutional efficiency, although it overlooks the important transaction cost economics idea of (organisational) governance.¹² It is true, though, that the NCE is definitely more explicit than the traditional institutional economics in recognising and analysing institutional diversity.¹³

The NCE has also an important point in common with the field of public choice theory (but again also with CES) in emphasising the role of politics. This interest in 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. Although governmental intervention is often present, in many cases it is more the consequence of pre-existing institutional differences than its direct cause. CES has a definitely stronger tradition also under this perspective.¹⁴

5. The representation of comparative institutional efficiency: the IPF curve

The idea of comparative institutional efficiency is quite simple, and therefore 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 Dietl (1998). 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 behaviour of society and economic and social actors under the particular angle of disorder and dictatorship.

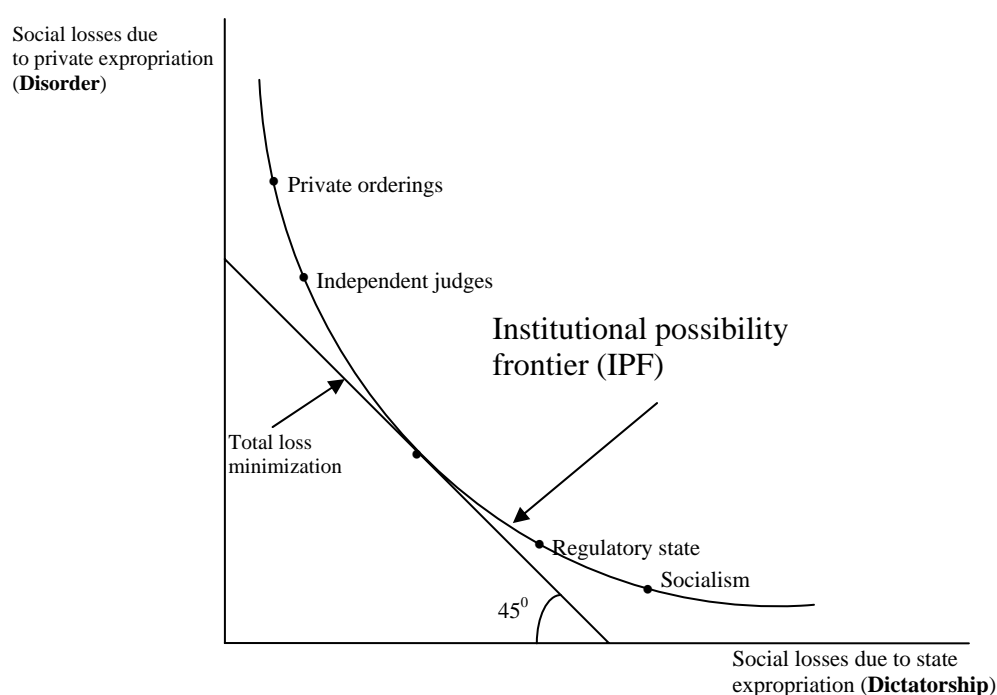
¹² See, e.g. Williamson (1991).

¹³ "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)

¹⁴ For an early truly comparative approach to different economic institutions cf. Wiles (1977). For a recent innovative view cf. Aoki (2001).

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 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.

Figure 1: Institutional possibilities frontier (ipf)



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

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 they 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).

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. In the NCE representation the latter has a 45° slope to represent the symmetric cost deriving to

society from social losses due to private expropriation (disorder) and social losses due to state expropriation (dictatorship). Although the NCE does not clarify this point, we can suppose that societies having different preferences or aversion to disorder and dictatorship can be represented by total loss minimisation lines with different slopes. This would generate a different mix of disorder and dictatorship in equilibrium. 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.

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 favouring efficiency, Coasean 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 to control disorder: private orderings, private litigation, regulation, and socialism. While the former three strategies are represented in a rather realistic and theoretically sound way, the description of socialism is somewhat blurred.

The NCE's concept of socialism is quite vague and apparently at odds not only with the two basic variables of dictatorship and disorder, but also with the other three regimes. In the IPF socialism is implicitly defined as the highest level of dictatorship, which however belongs to 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). Either the concept of socialism is redundant and, as an extreme case of pure regulatory regime, meaningless, or it is at odds with the two basic variables defining the IPF. This ambiguity of the concept of socialism is apparently the outcome of a deeper lack of clarity in defining economic systems and in distinguishing macroeconomic from microeconomic levels and processes.

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 to 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)

In the NCE perspective, then, the IPF is not only a theoretical device: it is also an analytical representation of all the (relevant) states of different economies and a one which can supply scholars and policy makers with fundamental insights and suggestions for reform and policy making. Given this general perspective, such an ambitious goal for a simple diagrammatic interpretation requires that a) all the points represented on the IPF should be on the same dimension, b) no crucial factor is left out of the diagram, and c) qualitative variables – such as the capacity of the state bureaucracy or the social control over firms – play no role.

The NCE proposal is weak under each of these three points. First, and as noticed above, the consideration of socialism as a point on the IPF curve is either redundant or belongs in a dimension that is different from the rest of the curve. In this latter case, convexity would not hold and optimality would not follow. Second, as noticed above many crucial variables enter the diagram only indirectly.¹⁵ However, the authors do not explain why these variables act indirectly or why they are less important than those directly considered. Third, we have already seen that quality variables cannot be easily discarded, in particular if one wants to explain, interpret and change reality. Added to these, any true dynamic perspective is also missing. However, this interpretation is interesting and raises several questions when compared to CES.

Three questions are of particular importance here. First: can the IPF be interpreted as the economic system? Apparently, this is the farthest 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). These aspects are considered also in the important case of the protection of investors, on which there is by now a substantial comparative literature, also thanks to the contribution of the same group of scholars proposing the NCE.¹⁶ According to this literature there are clearly distinct styles of social control of business in the areas of entry, courts, and labour in different countries. These differences are explained as 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, 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 any further.

¹⁵ Among the variables that enter the picture in the best case only indirectly are sanctions and incentives, without which it is not clear why and how the impersonal “society” could impose its wishes upon decision makers. I thank Michael Keren for having drawn my attention to this point.

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.

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 or other obstacles from one point on the IPF curve to another are completely disregarded. How costly can it be to go 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 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 variables, including economic ones. As to qualifications, do only the formal features of the legal and political systems matter?¹⁸ What is the role of the quality, e.g. of bureaucracy, or social control over politicians, the role of ideology,¹⁹ religion or trade unions, of education and human capital?

As to the disregard, do structural and organizational economic variables play no role? Let us suppose that two countries at the same level of development share similar legal and political systems, but have different types of organization of industry (e.g. in terms of the relative weight and role of large and small firms). What kind of consequences does this have for the analysis and its predictive power? Or does the overwhelming power of the legal system rule out this possibility, because the above difference could not exist in countries sharing similar legal systems, but only in countries having different legal systems? Could differences in the organisation of industry not explain (in part) differences in legal systems?

Given the tradeoff between disorder and dictatorship, such variables should be important for the nature and working of markets and consequently should offer different perspectives for private interaction and conflict resolution. They should therefore require a different role for the state. The authors may perhaps have this problem in mind when they take shelter under the concept of civic capital (see the next section). 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, pursuit of equity, supply of public services, support of

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

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.”

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

development) leads to the impoverishment and distortion of reality and the weakening of theoretical analysis.

6. 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 by and large 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 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 get along with little dictatorship, since they have a low level of disorder. The situation of the most economically developed and dynamic countries should be the opposite.

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 constrained to 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 be neither continuous nor smooth.

Along with this, and perhaps at the basis of all analytical difficulties is the fact that the NCE apparently oversimplifies and disregards fundamental explanatory factors, as noted above. These include the fact that perhaps institutions do not arise simply to control the twin dangers of dictatorship and disorder, however broad is the meaning that these two concepts receive. They may also serve to many other aims, such as (to remain within the economic domain) to benefit from cooperation, to recover from heavy crises (which is not quite the same as controlling disorder as the NCE defines it), to impose or defend the power of some (group of) powerful agents, to create or defend opportunities for rents, the coordination of common defence against natural or external threats, to improve the exploitation of the natural environment, to conquer 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. More often than not institutional development – as the NCE admits but does not develop consistently – is the outcome of spontaneous processes, or of the lack of alternative choices.

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 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., 2003a, 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 fundamental 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, many of these determinants have a 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 higher (better) in the former group than in the latter? Here again, the NCE forgets the crucial quality of variables. After all, criminal organizations and

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 Civic capital is given at any point of time and the location of the IPF is fixed in the short run. In the short run, then, civic capital is a constraint rather than a choice variable. Under normal conditions it evolves over time, as a function of investment in it. However, the authors disregard the important issue of the *use* of civic capital, that can change rapidly during exceptional circumstances, such as political or economic crises. In general, similar amounts of civic capital can foster economically productive (e.g. diffuse entrepreneurship) or destructive (e.g. Mafia-type) activities depending on the ruling system or institutions (Baumol 1993). When the system changes, incentives too change and social actors may put the same amount of civic capital to different uses. Thus when transition from a Soviet-type system to a market system takes place the same amount of civic capital can support competition and entrepreneurial activities instead of bureaucracy (and therefore breed entrepreneurial inclination instead of bureaucratic attitudes, corruption, and the like). In the case of collective goods, this is the case, e.g., of civic networks fostering ethnic division and conflict or of national pride and cohesion being transformed into aggressive nationalism. This transformation may take place in fairly short time, depending on the strength of incentives. When transformation is from destructive to productive activities, and since the IPF position measures the potential of a country in terms of the production or destruction of social losses, transition should correspond to a fairly rapid inward translation of the IPF, perhaps similarly to the case of transplantation that the authors consider. In fact, the same amount of civic capital used in a different and more productive manner should correspond to a lower mix of disorder and dictatorship. This was after all what motivated transition.

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.

Mafias also 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 workings of the law to benefit themselves that is at odds with the concept of civic 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 constrain 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 explanation that NCE offers for the existence of institutions, let alone of different economic systems, is hardly convincing. In fact, in this way institutions become 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 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 investing, while still enjoying the return from the investment that others would do? Looking at the NCE I can see only two answers. One is that there is an external enforcer (the state). But then why did the actors set up a state? Even the state is, after all, a costly institution. So even this first answer boils down to the second one: selfish actors do not free ride because institutions constrain them. We have returned in our explanation to the starting point, and we are left in the NCE without a theory of institutions.

The NCE offers a more 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: "One dramatic deviation from the assumption of indigenous formation of institutions is transplantation." (Djankov et al., 2003a, 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

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

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 also be true within individual economies and societies, among individuals and possibly complex agents, such as firms? Why is this problem solved in developed countries 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 by means of what looks like a tautology.

7. 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 on a correct interpretation of real economies. Reforms are needed because the existing institutional setting is suboptimal. Inefficient institutions burden economic actors with too many and high costs due to excessive disorder or excessive dictatorship. The hypothesis of rationality is sufficient to understand the motivation for reform in the NCE context.

But reforms are complex and costly social and political undertakings and require the cooperation of many individuals. Who, then, should take the decision of implementing a reform when interpersonal and intertemporal variables matter? The answer is generic: “the society” (Djankov et al., 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? 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?

The NCE supplies no answer to these crucial questions. This silence actually means that the NCE concept of institutions and the institutional analysis is at least incomplete, possibly wrong. It leaves unexplained what should most be 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, which 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 for (or aversion to) a particular degree of public control. In their choices rational actors should pay particular attention to costs. 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 et al., 2003a, 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 the demand for reforms arises from the unsatisfactory performance of old institutions, a reform requires that social actors express their demand, perhaps by delegating some individual or organ (the government?) to do so by means of some kind of voting mechanism. However, the NCE does not explain why this individual or organisation should implement what is delegated to him. Control, incentives or sanctions are not considered. It is not clear either which type of reform is delegated. It is true that the efficient solution is unique, if there is perfect symmetry of resource endowment, knowledge, information and bargaining power among individual agents and if these share the same ideological (dis)preferences. However, the simplicity and elegance of this solution does not explain why in reality consistently and permanently different economic systems exist even in competitive contexts.

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, *inter alia* 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 offer a wide-ranging explanation based on the NCE framework. 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, and openness to the rest of the world, it has also had great costs, particularly in the form of extreme economic disorganization. The latter includes 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 the 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 throughout 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 shifts 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 et al., 2003a, p. 24) The reasons for this relative advantage of Central-Eastern Europe compared to Russia are 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 impose rules of cooperation that restrict dictatorship and disorder. Most of the quoted facts suggest that the authors suppose that no investment in civic capital took place during Soviet times, and that pre-existing civic capital was depleted. Central and Eastern European countries also face 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 – at least not in such a sweeping manner – in Central-Eastern Europe? Why did the IPF curves remain in their previous location (see footnote 21)? Shouldn't transition have 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 et al., 2003a, 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 if one thinks that systemic change means shifting the IPF as explained above. 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 et al 2003a, 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 falls short of extending this approach further. Why should inter-country transplantation be (often) inefficient and domestic institutional choice always efficient? Put in another way: why are domestic actors in

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. Again, the meaning of systemic change remains blurred.

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) gains overwhelming power in institution making. Is this a guarantee of efficient institutional choice? If imposition is exerted upon other 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 (which, by the way, are economic costs). They will certainly try to subvert the outcome as soon as possible, thus raising further the costs of change. It is therefore not clear why we should not consider the possibility of domestic institutional “transplantation” (or, better, imposition) as a source of institutional inefficiency. The only such case the authors envisage, albeit only implicitly, is the Soviet system. 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 is it 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 thereby limited. 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. Or perhaps the main mistake is to claim to reestablish an entire discipline on a consistent, but rather one-sided approach.

8. 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 the common law ray has a higher ratio of disorder to dictatorship than the civil law ray.

This representation has important policy implications. Since in their view transplantation makes the IPF shift outwards, the authors conclude that the marginal amount of dictatorship required to reduce disorder rises. This amounts to saying 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 in controlling disorder.

In my view, the issue of legal origin may be at odds with civic capital. 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. If an institutional organism (the receiver) is diverse compared to another organism (the transplanter), individual features too in the former (including capabilities, cognitive processes and organizational competences) are different from those that the transplanted institutions require. Therefore, even if the judiciary would be perfectly incorrupt and hard working in the former country, the transplanted institutions would impose upon that organism exceptional adaptation and learning and resistance costs (resistance to and rejection of the transplanted institutions). Inefficiency is the most obvious consequence. The IPF would shift outwards even without considering “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 indigenous institutions.

²⁵ Legal origin affects growth only indirectly through the specific mechanisms of social control. These affect markets for capital, labour, and entrepreneurs, thereby influencing factor accumulation and productivity growth. Any direct influence on growth (e.g. by human capital of the people operating the institutions) must work, in the NCE view, through its influence on civic capital, which is represented as the location of the IPF. In principle and as M. Keren notes, it should also determine the IPF slope. However, the Authors disregard this aspect in discussing the IPF.

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

9. The “Old” New Comparative Economics and Comparative Economic Systems

The NCE also meets a terminology problem. 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.²⁶ Collier supports an interesting point of view, which is of relevance for the topic discussed here. After maintaining that a myriad of programs of economic research belonged to 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” 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 leads Collier not to include an author like János Kornai in the field, a conclusion that few, at least in Europe, would accept.

According to Collier this change in the discipline took place starting in the early 1970s, when the old NCE became increasingly analytic and as such a part of modern economics, and accelerated with the founding 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 existing systems. 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. As to the broad 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 sifting and collating of statistical data” together with the application of quantitative methods, and the use of mathematics and modelling.

I share Collier’s view that a major shift in the discipline took place more than three decades ago. The most important evidence for this change was possibly the publication in 1971 of a proceeding volume that included some landmark papers.²⁷ This was a shift primarily in the approach, that became more analytical, and in the method,

²⁶ Cf. Collier (1989).

²⁷ Cf. Eckstein (1971).

that shifted towards quantitative research and mathematical modelling without deserting descriptive and interdisciplinary approaches.

However, between that shift and the supposed new one there was a watershed: transition in Central and Eastern Europe and globalisation. There also was a remarkable evolution and change in economic thought, with revival and rapid development, among others, of institutional and evolutionary economics. 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 novel methods and also enquiry into new problems, these could 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?

In order to answer this latter question in a very rough way, a short examination of 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 largest part of publications in languages other than English and in journals of smaller countries. Econlit classification is also somewhat inconsistent from our point of view, since many publications that belong in CES are not classified 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 of the economic system of various 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.

At the time of writing, 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 (2002 too seems to be in process of being completed). Keeping these limitations in mind, the twelve years considered, that coincide with the period of transition in Central and Eastern Europe, witnessed the publication of more than 1000 works that the authors themselves or Econlit consider to belong to the CES field (group P).

According to Econlit classification, most publications (54%) are on comparative economic systems and more than 9% are not classified in any subgroup, but are attributed to CES in general. This makes the remarkable share of close to 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 transition 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 in Econlit (1991-2002)

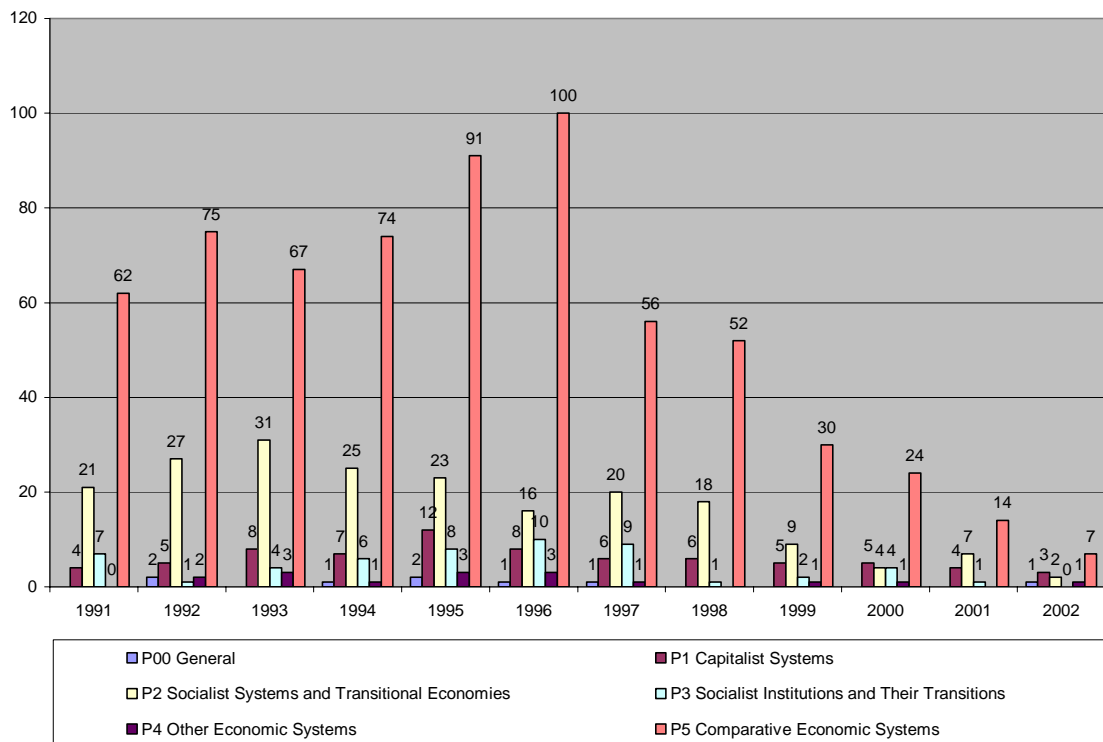
	No.	%
P00 General	8	0.8%
P1 Capitalist Systems	73	7.2%
P2 Socialist Systems and Transitional Economies	203	20.1%
P3 Socialist Institutions and Their Transitions	53	5.3%
P4 Other Economic Systems	18	1.8%
P5 Comparative Economic Systems	654	64.8%
P6 Total	1009	100.0%

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. The majority 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 their share has been progressively decreasing 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 became 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 publications belonging in CES (see chart 2).

Now we have sufficient, although tentative elements to answer the accusation that the “New” 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 nothing else, at least since the Nineties. 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 authors or Econlit recognise as belonging to CES. This may be due to rapid decrease in the number of publications by scholars in the field, to their publishing in different fields, to the placement of articles in different groups, or to a combination of these factors.²⁸ In any case the problem is clear and serious. In this perspective, a contribution to the field by an important group of scholars can only be welcome.

²⁸ During the Nineties most journals started to ask authors to personally attribute Econlit codes to their articles, but not their books. The decline of CES publications may reflect therefore the desire of Authors to place their articles into more “prestigious” groups.

Chart 2. Yearly number of publications in the field of comparative economic systems according to Econlit (1991-2002)



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 arrival of NCE is a welcome event that enriches the discipline. However, due to its intrinsic features and limitations, its pretension to replace CES is misplaced.

The “new” New Comparative Economics (NCE), taken in its entirety is an important project having both strengths and weaknesses. I consider first its general aspects. Among the strengths 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 it a set of instruments and approaches that are the results of an important line of comparative research. I also put here the NCE stress on the need for 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 weaknesses and dangers. 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 of 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 among different institutions, externalities and path dependence. 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, greater consistency may be reached, at the price of some methodological unilateralism. Which one prevails, analytical strength and depth or disregard for complexity and the interactions among the variables, depends to a large extent on the particular topic that is analysed. Certainly this approach restricts methodological variety, thereby narrowing the spectrum of problems that can be fruitfully analysed and the possibility of offering competing confutable interpretations and explanations.

Finally, there are mistaken statements, as often is the case with “new” approaches that aim at finding their place in, and possibly dominating, an established field. Major among these is the actual identification of “the traditional field of comparative economics” with the study of socialism and 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 even by a superficial look at EconLit classification, as we saw above (section 9). In supposed contrast with the presumed unilateralism of CES, the NCE privileges comparisons of alternative capitalist models.

It is now time to summarise the main points of our examination 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 kind is embedded in the NCE. Unfortunately, the NCE goes no further and barely recognises 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 it only the transition between different legal systems that is inefficient, or is any kind of transition inefficient? We are told that such attempts at change take place, but we are not provided with an explanation regarding 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 restricts itself to 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 introduces to the discipline a method – particularly in the law and

finance perspective – that has not often been used in CES and that has shown its strength elsewhere. Although it has been shown to be important, this approach does not appear sufficient to provide satisfactory answers to the many varied problems that CES deal with. However, it can certainly contribute – and has already contributed – to the discovery of new problems and to the provision of new explanations. It is only to be hoped that CES will also take advantage of other disciplines by applying their methods to typical CES problems.²⁹

Third, and most importantly, I see many problems in the NCE pretension of replacing CES. They share the comparative approach, but from the perspective of methodology 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 by offering new methods and studying new problems or presenting new solutions to known problems, thus challenging other approaches and competing with them. This can add to the health of 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 pursuit 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 problematic, as I tried to show above, I think we can 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. Also in this sense, the “new” NCE is a *component* of this process, not its *whole*.

²⁹ I have particularly in mind transaction cost economics and evolutionary economics.

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