
The New Comparative Economics versus the Old: Less Is More but Is It Enough?¹

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Abstract

The seeming demise of the field of comparative economics as it evolved in the 20th century is often seen as the result of the collapse of the communist economy, which left us with only one economic system, capitalism. Moreover, the old comparative economics has been replaced by the new comparative economics, which focuses on varieties of capitalism and ascribes an almost exclusive explanatory role to institutions. I argue that the demise of the old comparative economics has more to do with the fact that it was fatally flawed in terms of the criteria it used for comparing economic systems rather than with the demise of communism or the fact that it failed to understand the causes of inter-system differences in outcomes. The great advantage of the new comparative economics is in its choice of a single criterion for judging the performance of an economic system. I illustrate these advantages of such a single criterion by examining the contributions of the new comparative economics to the cross country analysis income levels, and, on the basis of this analysis, I then suggest that there is still value in the approach of the old comparative economics to the analysis of economic outcomes.

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1. Introduction

It is commonly believed that the field of comparative economics entered something of a terminal crisis with the collapse of communism and the socialist economy in the late 1980s. For example, Djankov *et al.* (2003) write:

The traditional field of comparative economics dealt mostly with the comparison of socialism and capitalism.... Traditional comparative economics ...studied under what

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circumstances either the plan or the market delivers greater economic efficiency....By the time socialism collapsed in Eastern Europe and the Soviet Union, this question had lost much of its appeal....If capitalism is triumphant, is comparative economics dead? [pp. 595-6].³

Djankov *et al.* answer their rhetorical question somewhat ambiguously. The old comparative economics, as they define it is, indeed dead, they believe, but a new comparative economics, one that involves comparisons among capitalist systems and that places primary emphasis on the role of institutions is being born. They provide a brief manifesto for this new comparative economics:

...the key comparisons are those of alternative capitalist models prevailing in different countries. Each capitalist country has many public and private institutions.... These differences (in institutions) and their consequences for economic performance are the subject of the new comparative economics. [p. 596]

It can hardly be argued that the communist economy has largely disappeared as a subject of economic research, with the notable exception of China, which the advocates of the new comparative economics seem to view as a capitalist economy with a somewhat above-average level of state ownership of firms.⁴ But, as I shall argue in this paper, the verdict that the old comparative economics is dead confuses what was the major preoccupation of the field, the detailed study and comparison of capitalist and socialist economies, with its methodology or its broader and more general objectives. This confusion of the old comparative economics with the comparisons of capitalist and socialist economies should not come as a surprise, nor should it be attributed to the unfamiliarity of “outsiders” with our field. Indeed, as Frederic Pryor (2008) very aptly notes,

The comparative study of economic systems should ask three basic questions: What is an economic system? How have economic systems evolved and where are they heading? And what impact does an economic system have on economic performance?....

Given its present trajectory, the comparative study of economic systems has no future. If you peruse the current journals devoted to comparative economics, you mostly find either country studies or comparative studies of particular institutions, policies, or performance results between countries, but not analyses *of economic systems* focusing on *the three basic questions*.

3 Some readers may find this triumphalist claim for capitalism to ring a bit hollow as China appears on track to become the world’s biggest economy in a decade or so despite the fact that a large share of its GDP is produced by state-owned firms, agricultural land continues to be socially owned, and the Communist Party remains in charge, etc., and as many capitalist economies are contemplating nationalizing their banking system, the “commanding heights” of the capitalist economy.

4 For an excellent overview of how China relates to the characteristics of a capitalist economy and to the lessons of the new comparative economics, see Jefferson (2008).

This paper presents five theses, not all of which I develop to the same extent. The first thesis is that comparative economics was, and continues to be, a broader intellectual enterprise than the comparison of capitalist and socialist economic systems. Indeed, I argue that comparative economics as traditionally constituted is fundamental to the discipline of economics *in toto*. My second thesis is that the old comparative economics was based on concepts and methodologies that both *a priori* reasoning and experience show to be useful for the description of economic systems. However, and this is a critical *caveat*, the old comparative economics paradigm burdened itself with a fundamental flaw that prevented it, and prevents it to this day, from fulfilling the potential that is inherent in its descriptive and analytical apparatus. The third thesis is that the appeal of the new comparative economics has less to do with the disappearance of socialist economies or with the explanatory power of the concept of “institutions” that lie at the core of the new comparative economics and much more to do with the fact that the new comparative economics has, perhaps unconsciously, managed to overcome the fatal weakness that plagued the old comparative economics. In this sense, the new comparative economics appears to be able to explain more of the questions economists ask than does the old comparative economics. To illustrate this greater explanatory power, I will review some of the recent literature on inter-country differences in *per capita* incomes and their growth that are based on the concepts of the new comparative economics. From this analysis, I will argue, as my fourth thesis, that, whatever its advantages, the new comparative economics, in comparison with the old comparative economics, leads to a significant limit on questions that comparative economics can ask and excessively constrains the explanations for differences in economic performance that fall within the realm of acceptable discourse. This then leads to the fifth and final thesis that there remains considerable value in the methodological framework of the old comparative economics if its criteria for judging the performance of systems can be aligned with the criterion used by the new.

2. Thesis One: The Centrality of Comparative Economics

A central question asked by philosophers is: what is the good life? Correspondingly, the central question asked by economists has been: what makes for a good economic system?⁵ Framed this broadly, comparative economics then seeks to answer this fundamental question of our discipline, one that every great, and not so great, economist has sought to answer in one way or another. Moreover, in answering this question, economists have generally accepted that their inquiry should include the evaluation of differences in systems going well beyond the variants of capitalism to which the advocates of the new comparative economics now wish to limit its scope.

The emergence of socialism and central planning, both as a theoretical possibility in the Lerner-Lange debates and as a reality in the USSR, East Europe, China and elsewhere had both positive and negative effects on the development of comparative economics. On the positive side of the ledger, it led to the creation of a value-free and scientific way of describing economic systems most notably by Koopmans and Montias (1971) and Montias (1976). On the negative side, the stark

⁵ At least this was the question asked by early philosophers before philosophy became an “academic” subject and also the question asked by economists at least through Adam Smith.

differences between the capitalist and socialist economic systems clearly did focus research on a set of stark, though not unimportant, system differences such as the plan *versus* the market, centralized *versus* decentralized decision making, social *versus* private ownership, etc.⁶ However, to identify these specific research themes with the entirety of the field of comparative economics is to confuse the past research preoccupations of the practitioners of comparative economics with the field's fundamental concepts and objectives.

3. Thesis Two: The Paradigm of Old Comparative Economics Is Sound but It Has a Fatal Flaw

A. The Strengths of the Old Paradigm

Koopmans and Montias (1971) and extensions by Montias (1976) and Montias *et al.* (1994) proposed a conceptual framework for the value-free description of economic systems. While this effort clearly contained a number of original insights and concepts, in many ways it was also a systematization of the concepts and approaches that were commonly accepted by comparative economists as witnessed, for example, by the textbooks on comparative economics of that era.⁷

The economic outcomes of a country, or whatever the unit of analysis may be, were seen as influenced by three factors, the environment, the economic system, and the policies followed by the country. In turn, the *environment* consisted of the country's starting conditions, the preferences of the economic agents who made up the system, resources and technology available to the country, the existing organizations and institutions and the country's location. The *system* consisted of rules, both formal and informal; institutions, generally construed more narrowly than they are by the new comparative economics; and mechanisms. These *mechanisms*, packaged by Neuberger and Duffy (1976) under the rather unfortunate acronym "DIM", consisted of *decision-making authority*, meaning who in the economy had the power to make decisions about the allocation of which resources; *information*, which described the information generated by the system and its distribution among agents; and *motivation*, which characterized the means available to induce agents to make decisions and supply effort and other productive resources under their control. Finally, *policies* were seen as a special set of rules that were valid for relatively short periods of time and whose alteration would not change the essential nature of the system.⁸

⁶ It is perhaps superfluous to add that such a judgment on the research undertaken in the 1950s and 1960s, when the socialist model looked rather formidable in its ability to marshal resources for manifestly higher rates of growth than were evident in market economics and to avoid the cyclical fluctuations that were feared for the post-WWII period as a result of the experiences of the Great Depression, can only be made with the benefit of hindsight.

⁷ See for, example, Gregory and Stuart (1985, Ch. 2) and subsequent editions or Neuberger and Duffy (1976).

⁸ The common sense of this was that a change in the VAT rate from 15% to 12% would not involve a fundamental change in an economic system and would fall into the policy category; the abolition of a VAT tax and its replacement by an income tax would be seen as a change in a formal rule, and thus a change in the system itself. Such a distinction between policy changes and system change is actually

This framework, I would submit, is based on a useful and comprehensive set of concepts and principles that should be able to describe and classify economic systems and to facilitate comparisons between, and analyses of, different economies and the outcomes they generate. Moreover, unless the new comparative economics chooses a definition of “institutions” that is so broad as to make the term useless as an analytic concept, it is obvious that the old comparative economics offers a richer and more realistic link between economic outcomes and their causes: environment, system, which we may provisionally equate with institutions, and policies.

B. And the Fatal Flaw of the Old Paradigm

The fatal flaw of the old comparative economics as an intellectual enterprise and the seeming success of new comparative economics thus were not due to the former’s inability to set out the fundamental links between system and outcomes but in its choice of criteria for evaluating systems, which were descriptive rather than prescriptive. Thus, Koopmans and Montias (1971), for example, proposed to judge economic systems on the basis of at least six criteria, including high *per capita* consumption, its growth, equity in its distribution, the stability of employment and income, etc.⁹ These, in some cases obviously conflicting, criteria are not ranked lexicographically nor are weights assigned to them. One option for operationalizing comparisons would be to have the researcher choose the appropriate weights to be assigned to various outcome indicators, but in that case, as Hewett (1978, p. 104) points out, “who cares which system wins the sweepstakes?” Alternatively, each system’s outcomes can be weighted by its rulers’ or citizens’ preferences, in which case comparisons become irrelevant due both to the tradeoffs between various outcome measures and to differences between systems in tastes over outcomes.

Thus, while the criteria of the old comparative economics help explain why a system produces the outcomes that it does, it makes any effort to compare systems in a normative sense, that is, to say which system is “better”, virtually impossible. The strength and the appeal of the new comparative economics is precisely that it is unicausal, emphasizing institutions as the main drivers of differences in economic outcomes, and it has only one criterion, *per capita* income (or in some cases its growth) by which to judge economic performance.¹⁰ Thus by offering “less” in the way of conceptualizing economic systems and the link between systems and outcomes than did the old comparative economics, the new comparative economics is able to offer “more” in the way of concrete results on which economic system is better according to a single generally acceptable criterion.¹¹

quite problematic for both the old and the new comparative economics, as Hewett (1978, p. 103) points out in his review of Montias (1976). I return to this problem later in this essay.

9 The Koopmans-Montias criteria reflect the work of Balassa (1959, Ch 4) who proposed a more limited list such as static efficiency, dynamic efficiency, actual growth of output, etc. as the criteria by which to evaluate economic systems. Re-reading Balassa’s analysis of the Hungarian economy on the basis of his criteria reveals that it remains a compelling case for the use of these multiple criteria for descriptive purposes.

10 I am happy to accept the point that the better empirical work spawned by the new comparative economics tries to control for the effects of environment (though generally being some what hostile to, say, geographic effects), but I believe that, taken more broadly, my statement holds.

11 If one had applied the new comparative economics to compare the Soviet and Chinese economic systems to those of the United States and Europe in the 1960s, the higher per capita incomes of the

4. Thesis Three: Less Is More: Contributions of the New Comparative Economics to Our Understanding of Economic Growth

A. Some Valuable Results

One of the most visible contributions of the new comparative economics is to our understanding of what Kuznets (1966) termed modern economic growth. In this section, I will briefly sketch the concept of modern economic growth and highlight several noteworthy contributions that the new comparative economics has made to our understanding of the sources of this growth. The seminal empirical contribution that defined the study of modern economic growth was that of Solow (1957) who estimated that of the entire change in output per worker in the US economy in the first half of the 20th century, about 13 percent was due to increases in capital per worker and the remaining 87 percent was due to an increase in total factor productivity (TFP). Thus, understanding the sources of TFP growth was critical to the understanding of modern economic growth and of differences in *per capita* income between countries or economic systems.

To put the contributions of new comparative economics into perspective, I briefly review the stylized facts about economic growth, drawing on Prescott (1998). Before about 1800, *per capita* incomes were roughly the same in major civilizations around the world, and they grew only slowly. After 1800, in Europe, *per capita* income growth increased by twenty-fold per century. Since the end of World War II, there has been an acceleration of *per capita* income growth elsewhere, principally in Asia. Because the main source of this growth is TFP improvements, any understanding of the link between economic systems and TFP growth would constitute an important component of the field of comparative economics. Moreover, as both Prescott (1998) and Hall and Jones (1999) forcefully demonstrate, TFP not only explains cross-country differences in the growth of *per capita* income, it largely determines the international differences in the levels of *per capita* income as well. For example, Hall and Jones show that, of the 35-fold difference in *per capita* incomes between Niger and the United States, 12 percent is accounted for by differences in *per capita* endowments of capital, 25 percent is accounted for by differences in human capital and the remaining 63 percent is accounted for by differences in TFP. Thus, if we could discover the sources of TFP differences, we would make a signal contribution to comparative economics, and the new comparative economists have clearly been in the forefront of the effort to do this.

Very briefly, the literature suggests that environmental factors such as natural resources are not important, nor are starting conditions, because all countries started from more or less the same level. Location appears to play a mixed role; somewhat controversially, location near the equator may not be a source of low TFP or its growth, while having a coast line appears to have a positive effect on TFP. Policy, with the exception of Prescott (1998), does not appear much in this work, and thus the major

latter would have easily “shown” the superiority of capitalism. Such a conclusion would not have helped our understanding of socialism or of what was happening in these economies very much, and in this sense the multi-faceted Balassa-Koopmans-Montias criteria were helpful in the short term, although obviously not in the long term, to the development of comparative economics.

explanatory factor has been institutions, as Djankov *et al.* (2003) state in their manifesto for the new comparative economics cited at the beginning of this essay.¹²

The value of an approach that takes TFP differences as the key determinant of the only criterion for judging economic systems, *per capita* income, and attempts to link TFP to institutions is evident in the work of Hall and Jones (1999) cited above. They take a sample of a large number of countries and show that the differences in *per capita* income are largely the result of differences in TFP. They posit that differences in TFP are the outcome of what they call differences in social infrastructure, by which they mean institutions that provide protection from predation by government and by other individuals. They consider measures of the risk of expropriation, bureaucratic quality, provision of law and order, corruption, and government repudiation of contracts as important indicators of protection against domestic predation, and openness to trade, low tariffs, etc., as protection against external predation.¹³

The authors of the study recognize that causality is not unidirectional and that countries with higher *per capita* incomes are likely to also have better institutions. Thus, in their empirical work they use two-stage least squares estimation, and, as instruments for their index of institutional quality, they use a number of variables such as “European influence”, measured by the country’s distance from the equator and if a European language is spoken, and predicted trade flows drawn from a gravity equation.¹⁴ The results are clear: differences in institutions explain differences in TFP, and differences in TFP explain (most of) the differences in *per capita* incomes.

At about the same time the Hall and Jones paper was published, Frankel and Roemer (1999) published a paper entitled “Does Trade Cause Growth?” that examined the effect of trade, or, more correctly, the trade to GDP ratio, on *per capita* output and its growth. They, too, recognize the endogeneity problem, and they construct an instrument for the trade share also using a gravity equation. Their argument is that:

...countries’ geographic characteristics are not affected by their incomes, or by government policies and other factors that influence income....[t]hus countries’ geographic characteristics can be used as instrumental variables to obtain estimates of trade’s impact on income. [p. 380]

Frankel and Roemer’s results show that trade has a positive effect on both the level and growth of *per capita* output and that most of this effect operates through the impact of trade on TFP. Again, given the link found by Hall and Jones between institutions and TFP, Frankel and Roemer’s results can be seen as providing a further connection between openness and the quality of institutions and thus of TFP levels and their growth.

12 This emphasis on the centrality of institutions owes much to the work of North. See, for example, North (1990, 1998).

13 One might question whether low tariffs are a policy or an “institution”.

14 The gravity equation posits that trade between any two countries depends on the economic characteristics such as income and population as well as geographic characteristics such as the distance between them, whether they have a coast line, etc. See Andersen (1979) or Bergstrand (1985). For obvious reasons neither of the studies described here uses the full gravity equation specification.

B. But How Should We Interpret Them?

The proponents of the new comparative economics would clearly interpret the Hall and Jones results as powerful evidence that institutions are a major determinant of TFP levels in individual countries.¹⁵ However, when viewed in combination with the results and methodology of the Frankel and Roemer study, the claims for the key role of institutions become problematic along the following dimensions:

Accounting for changes in per capita income over time. If institutions can be well proxied by geographic factors that do not change much, if at all, over time, this would imply that institutions themselves also do not change much if the relationship between the instruments and actual institutions is to be stable over time. Because institutions determine TFP, we would then expect that a country's TFP, or, more important, its TFP relative to other countries, would not change over time either, and convergence or "catch-up" by some countries would be impossible. The only way the theory can account for changes in the level of country's TFP relative to other countries from year to year would be to posit that each year there is a new relationship that is established between the (mostly) time-invariant instruments and the institutions being instrumented as well as between these instrumented measures of "institutions" and TFP. The stylized facts presented by Prescott (1989) clearly indicate that TFP growth, and thus relative TFP levels, vary considerably among countries and over time. Casual empirics show that institutions at times do change quite quickly and extensively.¹⁶ Thus, proponents of the new comparative economics appear to be trying to use a relationship between invariant instruments, varying institutions and varying relative TFP levels to demonstrate the long-term validity of the relationship between fundamental institutions and economic performance. But the only way that this relationship can hold and yet be consistent with the facts is if the relationship between invariant instruments, institutions and TFP levels itself is fluid, that is that the regression parameters linking instruments to institutions and institutions to TFP varies over time in ways we neither know nor understand. However, such a shifting relationship implied by a realistic interpretation of the empirical work is at odds with the theoretical connection between institutions and economic performance claimed by the new comparative economics and with the policy prescriptions of the new comparative economics that call for the adoption of the same "good" institutions by all countries that seek to raise their TFP.

Can the same set of instruments explain everything? It is somewhat unsettling to see that roughly the same set of instruments is used to estimate quite different economic variables and then to see these estimates of causal variables linked to TFP levels or levels of *per capita* income. Thus Hall and Jones use gravity-equation estimated measures of trade to estimate "institutions" in the first stage of their 2SLS estimates, and these estimates of the institutions to explain TFP levels. Frankel and Roemer use more or less the same "estimated" trade flows to instrument openness and then estimate the effect of this instrumented openness on TFP levels. In the end, to the cynical observer it would

15 This approach itself carries some implicit assumptions and limitations on the research agenda for the new comparative economics that are generally unappreciated but that are potentially limiting as well. See Paldam and Gundlach (2007).

16 The transition in Eastern Europe and the former Soviet Union is perhaps the most obvious example of this, but by no means the only one.

appear that whatever “explanation” for, or theory of, TFP levels one proposes, so long as the explanatory variable is proxied in a 2SLS procedure by trade flows derived from the (partial) gravity equation, then it is likely that the “theory” will in the end be verified.

A second problem is that the same explanatory variable, institutions, is used in different studies to explain both cross-country differences in TFP *levels* and cross-country differences in TFP *growth*, and that these institutions are instrumented by the same gravity-equation-calculated instruments. But, the stylized facts are that there are important differences between the cross-country distribution of TFP levels and TFP growth. Given this, what conclusions one should draw about the role of institutions in influencing the level and growth of per capital income around the world is not as clear as needs to be.

5. Theses Four and Five: New Comparative Economics Is Limiting Because It Leaves Out Policy and Policy Is Important

The studies conducted in the framework of the new comparative economics described above take no account of policy differences. Outcomes are largely explained by institutional differences, themselves the products of relatively immutable forces such as colonial past, location, etc., an approach that seems to leave little or no room for policy as a determinant of economic outcomes. Such a stance might be acceptable either if institutions are defined so broadly as to include policies under the rubric of institutions or if policies were largely determined by the institutional environment in which they are framed. The latter point of view has some validity; institutions do influence policies in explicit ways. For example, there is an extensive literature demonstrating that institutionalizing central bank independence does improve the quality of monetary policy and results in lower inflation rates. As another example, consider von Hagen (1992) and von Hagen and Harden (1995) who show quite persuasively that budgetary institutions do influence the quality of fiscal policy. Nevertheless, the proposition that all economic policy is endogenous and determined by economic and political institutions has yet to be put forward much less verified by empirical research..

Part of the problem of discussing the relative role of institutions and policy is that the boundary between the two is not always clear, as Footnote 11 suggests. Montias (1976) attempts to do so, by defining “rules”, which in his framework are analogous to institutions, as “stipulating or constraining the actions of a set of participants for an indefinite period and under specified states of these individuals’ environment” (p. 18). Such a definition is quite consistent with the definition of institutions used by the new comparative economics. Montias also defines policy as “a class of contingent decisions, frequently announced ... with a view to creating stable expectations about the future decisions of the policy maker” (p. 18). It is true that policies are generally contingent and that policy announcements are intended to convey information about future contingent acts. But, the economic purpose of policy is missing from this definition, because, after all, we view policies as ways of obtaining certain economic outcomes. Montias’ definition may thus not be entirely in tune with the common use of the term policy, which in every day usage applies to the parameterization of institutional characteristics. Thus, openness to trade is seen as an institution, while tariff levels for

individual goods are a matter of policy; low predation by the state is an institution, while income tax rates are policies.

At an intuitive level, institutions are viewed as system characteristics that are broader in their reach and more immutable in nature than policies. Changes in institutions almost always result in changes in systems; policy changes do not necessarily lead to system changes. Moreover, institutions map into economic outcomes relatively uniquely, so that property rights, rule of law, etc. generally map into good economic outcomes and lack of these institutions maps into bad economic performance. In contrast, the mapping from institutions to policies to outcomes is less rigid. To quote Rodrik (2003):

...first-order economic principles—protection of property rights, contract enforcement, market-based competition, appropriate incentives, sound money, debt sustainability—do not map into unique policy packages.

Rodrik's reference to first-order economic principles, which we may view as institutions, suggests one potential distinction between institutions and policies: the former deal with fundamental system characteristics and the latter with the "details" of implementation. Rodrik himself cautions against this interpretation, arguing that "the empirical research on national institutions has generally focused on the protection of property rights and the rule of law. But one should think of institutions along a much wider spectrum." Thus tipping, giving children an allowance, etc., although seemingly trivial in nature, are also institutions consistent with Montias' definition.

To show the key importance of policies in determining economic outcomes, we turn to an example also drawn from the literature on TFP. Prescott (1998) stresses that TFP growth and levels are inversely related to the ability of incumbent workers to prevent the adoption of new work rules and ways of organizing production that would fully exploit the productive potential of newly available technologies in order to protect the rents that the workers are able to earn using older technologies or ways of organizing their work. This posits a central role for labor market policies and firm-level investment and human-resources policies in determining TFP. Here, the old comparative economics, with its more balanced view of the determinants of economic outcomes offers some useful lessons.

The USSR and the countries of East Europe saw gains in TFP come to a virtual halt in the early 1980s, if not even before then, an event unprecedented among countries at such a level of development.¹⁷ This collapse of TFP growth can be understood in terms of David Granick's (1989) description of the Soviet economy as a "job-rights economy". What Granick meant was that not only were Soviet, and East European, workers protected against unemployment by an explicit policy of maintaining excess aggregate demand for labor, but that, as a matter of policy, these workers also had a more or less explicit right to a particular job at a particular location. At the start of the Soviet experiment, this was not a problem for productivity growth as millions of new,

¹⁷ The first to note the slowdown in TFP growth in the USSR was Kaplan (1968) who showed that, for any plausible parameter values of a Cobb-Douglas production function, Soviet TFP growth was falling toward zero.

unskilled, workers were brought into factories from agriculture; they had no rents to preserve and no understanding of their job rights. However, as the system evolved, and workers gained tenure at their places of work, they became increasingly aware of their rights, and, through skills acquired on the job, they were also increasingly able to earn rents from operating the existing technology. Such workers thus had both the ability and the incentives to block the efficient introduction of new technologies and ways of working. As a result, increasingly, new technology and ways of fully exploiting its productivity-enhancing characteristics could only be introduced into newly-built and staffed factories but not into existing ones, thereby sharply reducing TFP growth, especially when the growth of the labor force slowed, limiting the possibilities for opening new factories.¹⁸

In the course of the transition, these job rights disappeared both because the joblessness created by the transition recession reduced workers' bargaining power and because socialist-era laws providing these job rights were swept away. Moreover, given the collapse of many of the key communist-era industries, the rents earned by the entrenched industrial elite of the work force disappeared. The transition also created new owners, whether domestic or foreign, who were less willing to accept, and more able to overcome, worker resistance to new technologies or work rules, and, given the environment of the early transition, they were able to enforce their will. Thus, in the Prescott-Granick view, the post-1989 increase in TFP growth in the transition countries is thus the result of policy changes, not of institutional change.

Moreover, policies that influence such work-place inflexibilities are seen by many observers as the cause of slow TFP and economic growth in the European Union relative to the United States, whose labor market and income tax policies are seen as being more flexible and work-friendly. Proponents of the new comparative economics may seek to label many of these labor market impediments as "institutions", but, as we have already noted, this seems to suggest that there are no policies and everything is subsumed under the label of "institution" or there is a strong and unique causal relationship running from institutions to policies, thus completely endogenizing policies.

Both of the above approaches are inconsistent with the facts in that people view labor market impediments as well as many other determinants of economic performance as policies, and policies that are subject to change. The truth of this proposition is to be found in the fact that most of the economic debates about government actions have to do with the shaping of economic policies: tax rates, fiscal stimuli, subsidies, labor market policies, etc. and not with changes in institutions. The old comparative economics may have neglected institutions in favor of policy and system differences, but we should be careful not to have the pendulum swing too far the other way. Doubtless, institutions are an important driver of long-term economic progress, but policies matter as well, and it behooves us to attempt to learn where policies come from and what effects they have in the long run.

18 This problem was partially understood by the Soviets. Gorbachev's policy of "acceleration" was based on the massive introduction of new, western, machinery into existing factories, but, as Granick would have predicted, this was much easier said than done.

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