Preface

In the last few years, several technical books and many journal articles have been written about institutional economics and political economy. The purpose of this book is less to present original research contributions to this literature, more to provide an integrative and somewhat reflective account of where we stand today, particularly on some of the major issues of that literature as they relate to problems in developing countries. The treatment in most of the chapters here is more discursive than in technical journal articles, although I'd like to think that the arguments are not loose, they instead provide a coherent logical structure and an "analytical narrative".

Since my intended readership goes beyond the research community in economics to include most social scientists and policy thinkers in general, I have tried to avoid formal models. In two chapters, however (chapters 7 and 10), I briefly outline new models to formalize some ideas, partly because of a dearth of formalization in areas that are underresearched at present. In some other chapters (for example, chapter 4), I review the existing models without elaborating on their formal details, focusing instead on their essential ideas. In economics the prevailing culture does not take researchers seriously if they come unarmed with (or should I say, unescorted by) a model. I find models particularly useful in helping me to puzzle out the various assumptions that are often needed to derive what seem like intuitively obvious conclusions and to decipher unifying principles that connect seemingly unrelated case studies. But the world of institutional and political economy is full of ambiguities, contextual nuances, and multi-dimensional complexities, which—given the current state of empirical knowledge—are extremely difficult to capture with necessarily oversimplified quantitative exercises in model building or hypothesis testing. Research, of course, progresses with abstractions, but at these early stages of inquiry into this rather murky territory, undue preoccupation with precision may often mislead us about the larger picture, and we may never find the missing keys if we confine our search only to the lighted area. Some, of course, go to the other extreme of echoing what Ansel Adams once said about photography: "There is nothing worse than a sharp image of a fuzzy concept".

Institutional failures, weak accountability mechanisms, and missed opportunities for cooperative problem solving constitute the running themes of our story of economic underdevelopment. The institutional framework of an economy defines and constrains the opportunities for individuals, determines the business climate, shapes the incentives and organizations for collective action by local communities in resolving their common problems, and encompasses the structures of commitment and accountability that the political authority in society provides. In all these respects the institutional framework is weak in many poor countries, and that is the main concern in most of the chapters in this book. Chapter 1 introduces the recent literature on institutions and development, examining the current emphasis on quantifying the macroeconomic effects of institutional quality (taken largely in the limited sense of secure property rights). Apart from pointing to the usual econometric problems in identifying the impact of property rights institutions on the basis of crude cross-country data, it is arguable that other institutional variables play as important a role as secure property rights. For example, we show the significance of the regime of political rights in determining particularly outcome variables measured in the standard human development indicators. Also, particular social and political institutions that coordinate individual actions are of critical importance in economic performance, but their effects are usually hard to quantify. So here we move on to a comparative-historical analysis of the various imperfect coordination mechanisms of society (state, market, business groups, local community networks, and so on) that attempt to correct the pervasive coordination failures that beset the early stages of industrial transformation.

Chapter 2, after exploring the various processes through which dysfunctional institutions seem to persist in poor countries, emphasizes (contrary to much of the literature) the role of distributive conflicts to show why few self-correcting forces work to change these institutions. It is often claimed that certain cultures (such as Japan or Sweden) seem to find it easy to orchestrate improvements in institutional arrangements through coordination or collective action. I have no doubt that these cultural factors are important in determining a country's institutional history. But one common thread running through some of the chapters here (chapters 2, 3, 5, 6, 9, 10, and 11) is how these institutional differences may be related to underlying social or ethnic heterogeneity and initial inequalities in asset distribution.

Since much of the political economy of institutional change involves distribution of power, we analyze the structural basis of the concept of power in chapter 3, after looking at various social battlefields where power is exercised and linking power to inequalities in resource endowments. As is now widely recognized in the political economy literature, processes to work out better institutions are often blocked by different kinds of commitment problems. In interactions between the state and private economic agents (and among the agents themselves), various commitment devices can play a crucial role, particularly in decisions involving long-term investment, which is discussed in chapter 4, along with the issue of tradeoffs between commitment and accountability. Issues of accountability bring to mind the various democratic rules of ensuring accountability, which are discussed in chapter 5 in the context of examining the complex relationship between democracy and poverty in a large poor democracy, India, and this democratic country's rather slow grappling with its mass poverty. We illustrate with concrete examples how the welcome expansion of democratic rights for the hitherto subordinate groups in a poor country can sometimes overwhelm the usual commitment procedures that are indispensable for both governance and long-term investment. One way to mitigate the conflict between the procedural and participatory aspects of democracy is to bring accountability and responsibility face to face at the local level. A lot of attention has been paid in this context in recent years to the accountability mechanism that works through decentralization and devolution of power, which is the theme of chapters 6 and 7. In spite of the informational and other advantages of decentralization in situations of weak political accountability, it has some special problems not discussed in the standard literature on fiscal federalism. One problem relates to the frequent cases of elite capture of local governments in cases of a high degree of social and economic inequality. One question then arises about how prone government is to capture at its different levels. Chapter 7 works out in a theoretical model the conditions under which the capture of governments by elite interests is stronger or weaker at the local level compared to the central level. Weak accountability is also behind the common institutional failure called *corruption*; its effects, reasons for persistence, and policy issues that it raises are discussed in chapter 8. Institutional failures, rather than cultural antagonism, is also the focus in chapter 9, which looks at the raging ethnic conflicts in different parts of the world, the difficulties of containing them, and the policy lessons that can be drawn from them.

Bringing about institutional changes requires collective action, and chapters 10 and 11 analyze the impediments to attempts at collective action—particularly those posed by distributive conflicts in heterogeneous groups and unequal societies (a problem that links up with the role that is played by distributive conflicts in the persistence of dysfunctional institutions, which is discussed in chapter 2). Chapter 10 investigates theoretical issues, both at the macro and the micro levels, and chapter 11 illustrates with an empirical study of collective management of irrigation water in rural south India, which quantifies the social and economic determinants of conflict or cooperation by local communities of farmers in water management, with a particular emphasis on the role of initial wealth inequalities.

Finally, in chapter 12 the discussion goes beyond national boundaries and explores the effects of global rules, institutions, and market processes from the point of view of the world's poorest people. The focus here is on domestic institutional quality, which often determines how much a poor country can both participate in the opportunities opened up by globalization and at the same time minimize the concomitant hardships.

In chapters 7 and 10 where we have explicitly introduced formal models, we have confined the models in starred sections, so that readers who are not interested in the technical details may skip those sections; there are some pointers and summaries of the main arguments in the other sections of the chapters. Chapter 4 reviews an array of theoretical models, focusing on some of their essential ideas without elaborating on the technical details. But those nonspecialist readers who find the chain of analytical arguments rather heavy going can look for the summaries of the main arguments at the beginning and also in various sections of the chapter.

Some of the chapters draw on and revise materials that have been published in the *American Economic Review*, the *Journal of Economic Literature*, the *Journal of Economic Perspectives*, *Economic Development and Cultural Change*, *World Development*, and *Economics and Politics*. I worked with Dilip Mookherjee in developing the model in chapter 7

and with Tsung-Tao Yang on chapter 10. Tsung-Tao also assisted me in researching the materials in some other chapters. I have also benefited from comments from Samuel Bowles, Maitreesh Ghatak, Karla Hoff, and Gerard Roland on parts of the manuscript and from three anonymous referees who read the complete manuscript. While working on this book I received financial assistance from the Network on Inequality and Economic Performance, which is funded by the MacArthur Foundation. I am grateful to all of these people and organizations.