

The New Institutionalism

Whether in the guise of formal theory (e.g. Persson and Tabellini 2000) or empirical research (e.g. Acemoglu, Robsinson et al. 2001), in the study of political economy, “institutions rule” (Rodrik, Subramanian et al. 2002).

If anyone can lay claim to the being a founder of the new institutionalism, it would be Douglass North. In this paper, I attempt to account for the reception accorded North’s work. While doing so, I probe the origins and foundations of the field, which lie in both formal theory and applied economics. I then appraise it. On the one side, I see confusion: a multiplicity of notions as to what is an institution what is not remain at play. On the other, I see unrealized promise. Those who work in this field, I contend, have yet to extract the full implications of its deepest insight: that power, if properly deployed, can create value. I then engage in remediation by, on the one hand, proposing a way of introducing greater clarity in the field and, on the other, by outlining a productive form of political analysis. The first response reminds us of the field’s deep preoccupation with time, while the second shifts its focus from the economics of institutions to the politics that shapes their behavior.

Three major themes emerge from this discussion. As already intimated, one is the importance of time and a second is that coercion can be a source of value. The third is that people expend political effort to create institutions not only to privilege particular claims but also to increase the likelihood and magnitude of future outcomes. To create an

institution is to invest; to destroy one is to extinguish future possibilities. Institutions, we learn, are a form of capital.

1. The Reception

I begin by analyzing the reception accorded North's work, thereby complementing the contributions of Wallis and Ménard and Shirley which survey both the development of North's ideas and of the field he helped to found. As they note, the new institutionalism was rapidly incorporated into the academy and quickly gained influence in the policy world. One reason for this, I argue, is that advances in theory and methods attuned academic audiences to North's arguments. And in the policy making community, his work served the pragmatic needs of the development agencies: it provided a means for bridging professional differences within them and for reorienting their programs from the promotion of "market fundamentalism" to the promotion of "good governance".

1.A. *The Academy*

Traditionally, in economics, markets, not institutions, rule. People do not starve, Smith famously argued, because of the benevolence of the butcher, the brewer, or the baker; rather, the latter sustain the former because in so doing, they could reap profits in markets for food (Smith 1976). It was because of the market, Smith argued, that the pursuit of individual self-interest could be aligned with the interests of society.

Market Failure: The fundamental theorems of welfare economics established the conditions under which Smith's conjecture was valid. In doing so, they also prepared the

ground for the study of *non-market* institutions, and in two ways. Firstly, the proofs highlighted an embarrassing inconsistency: notable by their absence were the rational, maximizing individuals that stood at the core of neo-classical theory. On the supply side stood firms and on the demand side families. An opening therefore beckoned and ambitious scholars surged into it, with some, like Williamson (1985), asking why profit maximizing individuals would move transactions out of markets and imbed them in firms and others, like Becker (1981), applying economic reasoning to the behavior of households. The theory of the firm and the theory of the family represent two of the earliest contributions to the new institutionalism.

Secondly, by establishing the conditions under which markets align self-interest with the social welfare, the theorems highlighted as well the conditions under which they would fail to do so. In imperfect markets, individuals, behaving rationally, might choose strategies that yield equilibria; but an equilibrium can be inefficient. And when markets fail, there will therefore be alternatives that some would prefer and no one oppose; incentives will then exist, it was argued, to inspire a search for alternative ways of generating collective outcomes. For example, when information is costly, people might find it useful to signal, as by offering collateral when seeking a loan or by passing an exam to exhibit their skill. The very conditions that lead to the failure of markets thus lead to the creation of remedies, some in the form of institutions.

To be noted is the functionalist nature of this reasoning: by such arguments, the origins of an institutions lie in its consequences (Stinchcombe 1958, Elster 1979). To provide a

causal account, in a section that follows, I will therefore distinguish between the demand and supply of institutions and call for closer attention to politics – as do, for example, by Pincus and Robinson and Puga and Tefler in their chapters. Those who emphasize the implications of market failures address demand for institutions. To account for their supply, we need to explain why politicians might chose to insert power into economic life and why they would do so in ways that secure the creation rather than the mere redistribution of wealth. I return to this theme toward the end of this chapter.

From Normative Debate to Positive Theory: The proof of Smith's conjecture thus led to the recognition that institutions rather than individuals dominate markets and that incentives are often such as to drive people to devise them. James Buchanan and Gordon Tullock (Buchanan and Tullock, 1962) were among the first to build on these insights; under their influence, the new institutionalism took the form of public choice theory. Public choice theorists divided the world into two spheres: the sphere of choice, where markets ruled, and the sphere of coercion, where the powerful governed. In the one, exchanges were voluntary and generated welfare gains. In the other, the powerful extracted involuntary transfers; while one person might gain, it could be at the expense of another. Liberty thrived in the one realm; tyranny threatened in the other.

Initially compelling, public choice soon became sterile. Stasis in the field can be attributed, at least in part, to its technical foundations. While Buchanan and Tullock (1962) made use of cooperative game theory, they lacked the tools of non-cooperative game theory and thus had largely to ignore matters of sequence and timing. Almost of

necessity, their arguments therefore portrayed economic activity as if it consisted of simultaneous exchanges. Within that framework, transactions would of necessity be consensual, which implied in turn that they generated improvements in welfare. It was the study of non-cooperative games in extensive form that made possible a less obvious insight: that coercion could be socially productive. In these games, as in the real world, agents would encounter opportunities to profit from duplicitous behavior. At one moment, they might receive goods and promise subsequent payment; later, they would be tempted to renege. But because of the passage of time, one agent could condition his choices on the actions taken by others; she could therefore threaten to respond by punishing those who behave opportunistically. And when the conditions are such that their threats were credible, then mutually beneficial transactions could take place, even in environments suffused with temptation (Kreps 1990). When cast in extensive form, non-cooperative games thus suggested that, *contra* public choice theory, the insertion of power into economic life makes possible the creation of value.

Employing non-cooperative game theory, researchers began to explore the properties of non-market institutions. In particular, they probed the manner in which, by imposing sanctions, such institutions could alter the behavior of those responding to the perverse incentives that prevail in private markets..

To illustrate, consider a market for labor. Specifically, consider what would occur were information costly and an employer, ignorant of the individual abilities of those applying for a job, were to offer a wage based on his assessment of the average ability of the

applicants. As each job candidate knows her own ability, those with above average skills would then find the wage offered too low while those with low abilities will find it attractive. The result is then a downward shift in the average quality of the applicant pool. And should the employer revise downward her assessment of the average quality of the job applicants and adjust her wage offer accordingly, the market would begin to unravel. Workers of high quality would withdraw their services, even though employers desire them and would be willing to reward them with higher wages. The market would fail (Akerloff 1970).

The remedy to this failure lies in costly signaling, i.e. in acts that demonstrate one's willingness to be penalized, as by being dismissed from one's job. Workers confident of their abilities might voluntarily incur such a risk; they might agree to let themselves be fired should they fail to perform. They could do so by acceding to a contract under which they would serve an initial period of probation, while their work is monitored, followed either by selection for permanent employment (if judged to be of high quality) or dismissal (if judged to be inept). As only those sure of their success would agree to such an offer, the provisions of the contract enable the skilled to "reveal their type" and a market to function.

Note the role of sequence and coercion. By choosing at time t to agree to being punished at time $t+2$, should she not perform at time $t+1$, a job candidate can signal her ability. The existence of punishments and the possibility of coercion make it possible for her to reveal previously hidden information in a credible manner. By allowing the market to

form, they also allow welfare enhancing bargains to be made, and higher levels of welfare to be attained.

North argued that by modifying the environments within which agents make choices, institutions ameliorate market failures, thus aligning the pursuit of private interest with the social welfare, and enhancing the performance of economies. In advancing these arguments, he was laboring on grounds that had been well prepared by advances in economic theory, and, in particular, the theory of non-cooperative games. North's work was well received in part because he mobilized data at the macro-level that appeared to confirm the implications of the reasoning that others were developing at the micro-level. Had these advances in micro-theory not taken place, contemporary political economy might well have remained the provenance of public choice theory; instead, "institutions rule"¹

1.B. *The Policy Community*

As did those in academia, economists in development agencies quickly recognized the cogency of North's arguments and the manner in which they resonated with intellectual trends in their field. Other practitioners came from the ranks of sociology, anthropology, and political science, however. They too were certain of the value of their insights into the development process and, in particular, into the economic significance of institutions other than markets. When, under the influence of North's work, development economists too converted to the new institutionalism, these non-economists found their arguments

¹ See also the chapter of Ménard and Shirley.

validated. By championing the new institutionalism, they forged common ground with economists in the development community.

The political realities confronting this community further contributed to the favorable reception accorded North's arguments. During the Reagan-Thatcher years, governments were commonly viewed as part of the problem rather than part of the solution to underdevelopment. In the 1970s and 1980s, the World Bank and the International Monetary Fund, fortified in their bargaining position by the magnitude of the debts owed them, insisted that governments lay off employees, sell off public-sector firms, free up markets, and reduce public spending. By allowing private markets, rather than public programs, to determine the allocation of resources, they contended, resources would be allocated efficiently and the developing world once again grow. But despite strenuous efforts at structural adjustment and policy reform, economies in the poorest regions of the world continued to stagnate. Attitudes toward government therefore began to alter. And a consensus formed that for economic incentives to promote productive behavior, markets had to be imbedded within institutions: legal systems that defined and enforced property rights, bureaucracies that provided public goods, and regulatory structures that enabled capital markets to form. Rather than inferior substitutes for private markets, it was realized, public institutions might better be viewed as productive complements. North's work then provided a neo-classically based justification for the rehabilitation of the public sector, aimed at strengthening rather than undermining institutions.

2. The Current Disarray

Thus the favorable reception accorded North's work and the rapid rise of the new institutionalism in the academic and policy communities. In the next two sections, I address two shortcomings in the field. The first is the conceptual disarray arising from the various and divergent notions of what constitutes an institution. The second is what I regard as the unwarranted reluctance of those who subscribe to the new institutionalism to pursue the implications of the basic insight of the field: that coercion can be socially productive. Both of these critiques lead to positive insights, the first regarding the importance of time and the second the importance of politics.

2.A. *Institutions?*

Just what counts as an institution? As noted by Ménard and Shirley and by Wallis, in *The Economic Origins of the Western World*, North makes little effort to define the term; his discussion suggests, however, that the word “institution” refers to whatever brings the “private rate of return close to the social rate of return.” (North and Thomas 1973, p. 1) and so ensures the efficient use of resources. In *Institutions, Institutional Change, and Economic Performance*, North instead emphasizes the element of constraint. Institutions, he states

include any form of constraint that human beings devise to shape human interaction. Are institutions formal or informal? They can be either, and I am interested in both formal constraints – such as rules ...-- and informal constraints – such as conventions codes of behavior (North 1990, p. 4).

As stressed by Shepsle in his chapter in this volume, North thus tends to caste institutions as if they were external forces, capable of limiting choices made by human beings.

While others in the field concur in emphasizing the element of constraint, they appear less ready to reify; rather than casting institutions as external sanctions, they view them as internalized restraints. Some, such as sociologists, speak of “norms”, while others, appealing to game theory, refer to “self-enforcing” patterns of behavior. Viewed either way, institutions are seen as patterns of conduct from which people are reluctant to deviate (Shepsle 1979; Schotter 1981; Weingast 1995; Medina 2007).

And where do institutions come from? In responding to this question, practitioners of new institutionalism again diverge, some viewing them as chosen and others as bequeathed.² In one of his most famous papers, North joins Weingast in analyzing the origins of Parliamentary sovereignty and the Bank of England (North and Weingast 1989), which they treat as the product of design. In doing so, their paper echoes others, such as Riker’s study of the constitutional convention (Riker 1984); Shepsle and Weingast’s (1987) and Gilligan and Krehbiel’s (1997) studies of legislative rules; and McCubbins, Noll, and Weingast’s papers on the design of bureaucracies (e.g. McCubbins and Schwartz 1987). Others – most notably Greif (2006), perhaps -- treat institutions as inherited rather than chosen; i.e. they treat them as the product of long term historical processes and deeply embedded cultural practices.

² See once again the chapter by Shepsle.

Those who champion the new institutionalism thus hold divergent conceptions of the nature and origin of institutions. If, as some proclaim, “institutions rule” (Rodrik, Subramanian et al. 2002), one would think it better that it not be because they can be anything.

Upon reflection, it is possible to discern order midst this disarray. It is not an order that derives from a narrowly bound consensus, however; rather, it is an array. The order highlights that the new institutionalism is not a single approach but rather several and that what distinguishes them is the temporal scale they presume. To make this point, I make use of Marshall’s (1890) distinction between the short and the long term and then shift to *la longue durée*, a time scale more frequently employed by historians than by economists (Braudel 1992).

2.B. Marshallian Time and La Longue Duree

In differentiating between the short term and the long, Marshall made reference to factors of production. While producers can change their use of labor in the short run, he noted, to alter their use of capital, they have to allocate resources inter-temporally; the change requires the passage of time. In the short term, some factors are thus fixed and others variable; but in the long term, factors that were once treated as fixed can be altered. In seeking to bring greater clarity to the analysis of institutions, I appropriate Marshall’s distinction.

The Short Term: When speaking of the *constraining role* of institutions, scholars, I argue, are viewing them within a short term time perspective. In the short term,

institutions are fixed; they therefore constrain, allowing only actions that influence outcomes at the margin. In the short run, they themselves are not subject to alteration.

The Long Term: When analyzing the *creation* of an institution, then, scholars shift to Marshall's second period: one in which actors are not seeking to influence current outcomes but rather to generate future benefits. In this time frame, maximizing decisions are not single period; rather, they are inter-temporal. Institutional design is thus an investment decision, in which people seek to increase the magnitude of future payoffs as well as the certainty with which they will occur.

Marshall's second period is that in which capital is formed and investment occurs. Viewed in this light, it is intriguing that both investors and politicians speak of "policies" and that in both settings the word signifies flows of future payoffs. They also speak of "portfolios:" bundles of financial instruments in the economic realm; the distribution of power in the political; and, in both, an assemblage of value-yielding assets. The very language employed thus suggests that we view institutions as a form of capital – as indeed we should, now that we inhabit Marshall's second period.

La Longue Durée: For historians, institutions are best viewed within yet another temporal scale, *la longue durée*. Within this setting, we treat institutions as structures (Braudel 1967). Structures map variables into the set of choices and the set of constraints; they determine what can be decided and what must be taken as fixed. They also embody the technology that determines the interactions that can take place and the

consequences that follow from them; the ramifications of, say, a given financial decision will vary, depending on the era in which one lives and the kind of economy – agrarian, commercial, or industrial – that prevails. Structural variables are very slow moving; they include the demographic composition of a population (Ladurie 1976), its productive technology, and its *mentalité* (Braudel 1967; Mokyr in this volume), or the beliefs and assumptions that govern the way in which people perceive each other and the world about them. It is in this setting that the term institution – as Shepsle notes – refers to the game form.

The “new institutionalists” thus come in several varieties. Some, such as (Greif 2006), focus on issues that arise in *la longue durée*; the fine grained features of institutions little preoccupy him. Others as Shepsle and Weingast (Shepsle and Weingast 1981), take institutions as fixed and demonstrates how their structures and rules constrain the strategies that people can chose and the outcomes that can prevail in equilibrium. Still others, such as (Riker 1996), explore their “founding”. This diversity of approaches, I argue, results not from disagreements among these scholars as to what is, or is not, an institution, but rather from differences in time scale that they inhabit.

2.C. Persistence

Focusing on the temporal nature of institutions thus enables us to discern order in a field that might at first glance appear in disarray. It also leads us to recognize that institutions persist over time. Indeed, as is widely recognized, they are longer lived than their members. In this section, I turn to the different explanations advanced for the longevity of institutions.

Internal and External Defenses: Institutions possess defenses. One set is internal:

Those who create an institution often recruit its top officials as well; when doing so, they recruit persons who share their goals, confer upon them legal mandates and the resources with which to implement them. Thus chosen and thus empowered, the staff is equipped to defend the institution and its mission. Those who serve in the lower ranks of an institution also defend it, but for a different reason. While working their way up its ranks, they acquire site-specific skills. Because these skills are not portable, the private prospects of the staff depend upon the health and durability of the institution in which they serve. In the words of (Huntington 1968), the institution then itself acquires value.³

Institutions acquire external lines of defense as well; they generate constituencies whose fortunes depend upon the policies that the institution propounds and its ability to implement them. By way of illustration, consider those that generate projects, the returns to which depend upon the maintenance in place of their policies. Encouraged by the Department of Commerce, for example, manufacturers may import costly equipment and install production lines behind a panoply of protective tariffs; should the Ministry of Finance, say, then seek to promote free trade, the Department of Commerce will be well positioned to rally defenders for its protective policies. The institution thus creates rents which it shares with those who return a portion in the form of costly effort in defense of the institution and its programs. Protected by external defenders, the institution endures.

Relevant is David Sills' classic study of the March of Dimes, an organization dedicated to the eradication of polio. The creation of an effective vaccine marked both a triumph and a disaster for the organization; while it had achieved its mission, it had also lost its reason for being. Its members responded by redefining its mission, Sills reports, thus keeping the organization alive. See Sills, D. L. (1957). The Volunteers: Means and Ends in a National Organization. New York, Free Press.

Overlapping generations:

In part as a result, institutions outlive those who create them. Being longer lived than those who staff them, they are manned by overlapping generations. Writing in 1992, Soskice, Bates and Epstein apply the logic of overlapping generation games (Kandori 1992) to Max Weber's (1985) characterization of an institution and thereby derive this ability to endure. Among the properties of an institution, Weber (1985) lists:

1. A division of labor.
2. Hierarchy, i.e. the division of labor by rank.
3. Rule governance.
4. That the organization is longer lives than its members.

Soskice, Bates and Epstein (1992) argue that given the fourth, the other three imply that policies will be stable, rules will persist and the institution will replicate itself over time.

Returning to Soskice, Bates and Epstein (1992), we can trace their argument, which begins with a society that has been endowed with a valuable asset. The senior members of this society would like to consume the asset; the juniors would prefer that it be preserved so that they could consume it later. But if governed by an institution bearing Weberian attributes, the authors contend, the society will be able to resist pressures to consume the resource. If the initial state in this society is defined by the existence of the asset, future states will be as well. The features that characterize institutions, the authors argue, promote permanence and stability. Note that these properties distinguish institutions from organizations, which are often less hierarchical, less rule governed, and less internally differentiated. As a corollary, organizations are also less long lived;

founded to advance a particular cause, they are likely to atrophy after attaining their objective (but see Sills 1957).

By condition (4), Soskice, Bates and Epstein (1992) note, institutions contain overlapping generations. When seniors command and juniors implement (Conditions 1 and 2), then juniors can restrain their elders; they can undermine the efforts of seniors to use power to despoil. But what would prevent seniors from bribing juniors, as by sharing with them a portion of the resource? The answer lies in the desire for high office and in the rules (Condition 3) which deem expropriation a delict of sufficient gravity to disqualify someone from holding it. Given the desire for high office, then, countering efforts to suborn becomes a sub-game perfect strategy. If there is ambition to advance in the ranks of the institution, then, given the characteristics above, its rules will be observed.

The attributes enumerated by Weber (1985) characterize most institutions. By the logic advanced by Soskice, Bates and Epstein (1992), “institutionalized” orders will persist over time.

Institutions as Predetermined Variables: A third approach adopts the language of time series and casts an institution as a predetermined variable. Viewed in this manner, the properties of an institution are initially determined “in the model”: the institution is created in response social or economic forces. While at first endogenous, a predetermined variable subsequently becomes exogenous; it acquires causal power. So

too an institution: once created, is able to influence the very forces that lead to its creation.

Proceeding a step further, the analogy offers a theory of change—one whose properties share elements in common with those stressed by Wallis in his chapter. Over *la longue durée*, slow moving forces alter. The institution continues to shape outcomes and to determine behavior; it continues to be a causal variable. But because societies and economies change – be that change ever so slow moving -- a gap opens up between the welfare maximizing choice of policies and policies actually chosen. Rather than promoting desirable outcomes, the institution begins to impede their selection; as a result, it is increasingly viewed as imposing costs rather than promoting welfare. Slow moving forces that operate over *la longue durée* can thus lead to demands for reform (Greif and Laitin 2004).⁴ Returning to the analogy with structural equation models, it is as if the model reverts to the initial period; economic and social variables that have been being shaped by the institution now shape it instead.

Institutions, such as monarchies or “central planning,” that once may have been viewed as providing valuable solutions to society’s needs, are now viewed as imposing barriers to the attainment of what is desirable. This “contradiction” between the nature of the polity and forces shaping their social and economic environment provides points of entry for reformers and revolutionaries. In much the same way as Pincus and Robinson discuss

⁴ Among the approaches discussed by Shepsle in his chapter, this argument thus adheres to the assumptions that underlie the approach of Calvert and Schotter, rather than those that characterize the thought of Riker – or Shepsle himself.

the origins of the glorious revolution (see also Jha 2010), the tensions between the polity and the society it governs prepare the ground for institutional change.

There are of course other interpretations. Most prominent among them, perhaps, is the theory of path dependence (Arthur 1994); Pierson 2007). While presented as a dynamic theory, however, path dependence is better at accounting for persistence than for change. Institutions limit the range of choice, its proponents note, and political changes will therefore be incremental and cumulative rather than discontinuous and revolutionary. Because institutions vest power in those who benefit from their policies, those proposing changes find themselves powerfully opposed. And if institutions propound and defend broadly held values, then it is easier to coordinate in support of them than to rally in opposition. Once created, institutions are therefore likely to endure or, if they do change, to do so incrementally. Where they start therefore determines where they end up.

3. From Clarification to Critique

This paper began by exploring the diverse forms of the neo-institutionalism and by seeking to account for its reception. It then attempted to impart order to what had become a disorderly field. As noted at the outset, to my mind, at least, the approach remains incomplete, and in two ways. Having emerged from the analysis of market failures, it provides a theory of the demand for but not the supply of institutions. For related reasons, it therefore too often fails to realize the implications of its basic insight: that coercion can be productive. Taken together, I argue, these criticisms suggest that for its completion the new institutionalism must re-center on the study of politics.

To motivate this argument, consider the institution of property rights. Where the legal system defends property rights, then the fear of punishment provides an incentive to refrain from trespass, thereby strengthening incentives to expend productive labor and to invest. Now, however, consider Weingast's (1995) pithy rejoinder: that someone powerful enough to create a system of property rights is powerful enough to violate them. If one acknowledges the validity of the point – as I believe we all must – then we must also look beyond institutions themselves when seeking to account for their existence their and their impact on economic life.

Will an institution employ its powers so as to promote the creation of wealth or will it use them to seize and distribute it? Given that one of the goals of the new institutionalism is to account for economic growth and development, no question could be more fundamental. And yet, when we look for an answer, the new institutionalism appears to have little to offer. To remedy that deficiency, I would argue, we need to turn to the study of politics. It is politicians who create institutions; it is they who determine how that power is employed and how, therefore, institutions will behave. Put simply: the new institutionalism need to focus on *politics*.

To advance this argument, I turn to some of my own work and explore the impact of political institutions on the agricultural economies of Africa. In doing so, I add more material to that provided by Jakiela, Gehlbach and Malesky, and Galiani and Schargrodsy, and, and, even more directly, Pincus and Robinson, who stress the importance of partisan politics to the creation of British institutions.

3.A. Lessons from Kenya

Agriculture constitutes the single largest sector of the economies of most nations in Africa. In the 1970s, growth rates in Africa declined and, in some instances, turned negative. My research (Bates 1981) led me to believe – and others to concur – that government policies toward agriculture constituted a major reason. Governments intervened in agricultural markets, enabling bureaucrats and politicians to extract wealth from the rural economy. Public institutions failed to furnish protection to farmers; rather, they engaged in predation, thereby discouraging farmers from committing their resources to the expansion of production. The resultant decline of the rural sector was both a symptom and contributor to the decline of Africa's economies.

For many, the remedy appeared obvious: governments should withdraw from the industry and let market forces prevail. In defense of this position, they cited Kenya, whose government cheerfully endorsed the private pursuit of wealth and proclaimed itself “capitalist” and whose economy continued to grow while others’ declined.

When I turned to the study of Kenya (Bates 1989), I was therefore surprised to find its rural sector was marked not by the prevalence of free markets but rather by high levels of government intervention. Most farmers faced but one licensed buyer; less than 40% of total agricultural production was freely marketed. Farmers were compelled to join government-sponsored cooperatives that processed, stored and marketed their crops; furnished seasonal loans; and sold farm inputs – seeds, fertilizers, and pesticides. Crop

authorities – for cotton, sugar, coffee, or tea, for example – prescribed and enforced farming practices and imposed conservation measures. The government may have proclaimed itself capitalist and a friend of the market, but it maintained a powerful presence in Kenya’s rural economy.

In contrast to what I had found elsewhere in Africa, in Kenya, many farmers tolerated high levels of regulation by non-market institutions and indeed opposed proposals to introduce market competition. For in Kenya, not only did the agencies offer prices that approximated those in global markets; they also provided additional benefits, the most prized being seasonal credit. And the farmers acknowledged that it was precisely because the agencies were given sole right to purchase the crop that were they willing to advance loans: where land rights remained unclear, they recognized, it was the crop that best served as collateral.

In Kenya, institutions not only corrected for market failures in credit markets, but also helped to promote the formation of public goods and the amelioration of externalities (Bates 1989). By deducting fees from their payments to farmers, cooperatives funded laboratories, which developed crop varieties that produced more fruit and succumbed to fewer diseases. They also imposed fines on those who failed to employ proper cultivation methods. If farmers planted their coffee or tea bushes too closely, rendering them difficult to inspect for pests or plant diseases; or if they continued to harvest from infected trees, then diseases would infect their farms and spread to neighboring *shambas*.

By penalizing individuals who engaged in such practices, government agencies altered private incentives in ways that enhanced the welfare of the industry.

Institutions, I have argued, introduce power into economic life. As stressed by the public choice school, and as confirmed by my earlier research, that power can be employed to predate. Alternatively, as argued here, it can also be employed to instill incentives and to constrain choices and thereby counter the perverse incentives that prevail when markets fail. The contrasting manner in which institutions operate in Africa highlights a major weakness in the new institutionalism: As presently constituted, the approach offers little insight into the conditions under which the power of government institutions would promote or forestall the creation of wealth.

3.B. *The Turn Toward Politics*

To remedy this defect, I argue, the new institutionalism needs to focus on politics. In support of this argument, I return to East Africa, focusing first on the divergent fate of coffee growers in Uganda and Kenya and then on changes within Kenya itself.

Uganda and Kenya in the 1970s: As in Kenya, the coffee industry in Uganda was governed by a marketing board; indeed, the enabling statutes of the two boards are virtually identical, empowering them both to serve as sole purchaser of the crop, to provide research and agricultural services, and to promote, in these and other ways, the prosperity of the coffee sector. Despite possessing similar institutions, in the 1970s, the boards behaved in a strikingly different manner. In Uganda, the coffee board imposed prices that enabled it to extract over 60% of the revenues generated from coffee exports;

by contrast, Kenya's board extracted less than 10%, and it converted a major portion of the revenues it seized into public goods and productive services for the industry.

The origin of this contrast lay not in the institutions themselves, which closely resembled each other, but in the political environment within which they operated. In Uganda, political power lay in the hands of politicians from the North, which was arid and poor; capturing power at the national level, these politicians used the coffee board to extract resources from the South, which they then spent on Northern "development projects." In Kenya, by contrast, power lay in the hands of politicians from the coffee-growing regions: Jomo Kenyatta, Kenya's president, and his colleagues from Central Province. In exchange for the votes that kept them in office, they used their power to enhance the wealth of their constituents and to defend the wealth of the industry from efforts by other regions to lay claim to its resources.

In both Uganda and Kenya, institutions inserted power into economic life. The manner in which power was employed was not determined by the institutions themselves, however, but rather by politicians.

Kenya Over Time: Explanations based on institutions are thus not complete; they need to be grounded on an understanding of the incentives that shape the choices of the politicians who oversee them. Changes that took place in Kenya after the death of Jomo Kenyatta help to drive this point home⁵

⁵ Note that this within-country variation helps to identify my causal claim. For an elaboration, see the chapter by Gehlbach and Malesky.

Upon the death of Kenyatta, power passed out of the hands of the Central Province and into the hands of Daniel Arap Moi, a politician from Western Kenya. Western Kenya grows much grain and little coffee; by comparison with Central Province, its people are therefore disadvantaged. In the months following his rise to power, Moi unleashed teams of auditors and public prosecutors upon the coffee board and the cooperatives in Central Province. Filing charges of corruption and mismanagement, he shifted their funds to institutions that financed the planting, purchasing, and storage of grain in the West.

With the shift from Kenyatta to Moi, new interests animated the use of power by the institutions that governed farming. When the political order changed, so too did the performance of institutions. Rather than using the institutions of the coffee industry to safeguard its interests, politicians employed them to seize and redistribute its revenues.

4. The Productive Margin

Data from the field thus underscores that institutionalist arguments are wanting and require political analysis for their completion. As adumbrated in our discussion of the public choice school, institutions are Janus faced: instilling power into economic life, they can redistribute or destroy value or they can facilitate its creation. The key question, then, is: when will politicians find it politically rewarding to mobilize power for the one purpose or the other? Under what conditions will they fashion and employ institutions to promote the creation of wealth, thereby promoting development? Such questions, I argue, mark the productive margin of this field.

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