FAST-MOVING AND SLOW-MOVING INSTITUTIONS

GÉRARD ROLAND*

Understanding the conditions for successful economic growth and development is becoming an increasingly central question in economics. Why has the growth performance of Russia been so dismal in its first decade of transition, whereas China has been growing at over eight percent per year throughout its two decades of transition? Why has the Argentine economy, one of the richest in the world in the early twentieth century, more or less collapsed? Why have the "Asian tigers" experienced a successful economic takeoff, whereas the economies of most African countries have been decimated by misery, war and disease? The same question is also central in economic history and transition economics. Why the early success of Britain? Why the failure of Spain to take off when Britain was industrializing? How can one explain the success of some of the latecomers to industrialization (Gerschenkron 1962) and the "modernization failures" in Egypt and large parts of the former Ottoman empire?

The mainstream view now is that differences in institutions are the main explanatory variable following the institutionalist school in economics (North 1990; Williamson 1975, 1985; and others). A recent very influential paper by Acemoglu, Johnson and Robinson (2002) has provided econometric evidence of the causal link between institutions and growth.

However, the word "institutions" tends to be used like a mantra these days. What are the relevant institutions for successful development? Is there one "first-best" set of institutions or is the optimality of institutional systems country-specific? How can a country improve its institutions? All of these questions are fundamental, and few have yet received convincing answers.

In the following I propose a classification of institutions to provide a basis for understanding the interaction between institutions and institutional change. This classification is based on the capacity of institutions to change rapidly or slowly, and whether or not that change is continuous.

Fast-moving and slow-moving institutions

I distinguish between *slow-moving* and *fast-moving* institutions. The former generally change slowly, incrementally and continuously, whereas the latter are more given to rapid, discontinuous change in large steps. Political institutions, for example, have the potential for centralized decisional changes in large steps. In this sense, they can be fast-moving institutions, which change almost overnight when there are revolutionary moments. In contrast, social norms are more often an example of slow-moving institutions. While some social norms and values can change very rapidly in historical terms (e.g., a society's tolerance for cigarettes), in general, social norms and values change slowly. Even individual social norms, such as attitudes toward the death penalty or acceptance of corruption, tend to change rather slowly, possibly because many norms are rooted in religions whose basic precepts have changed remarkably little for centuries and even millennia. The major world religions have shaped and continue to shape the basic values and preferences of individuals, what they consider important in life, and how they expect other people to behave toward them. One can always find examples to the contrary, but values and social norms, seen as a whole, tend to change slowly. An important reason why social norms or values change slowly is that they cannot change by authoritative decision. Legal systems tend to for that reason be faster-moving institutions than social norms but slower-moving than political institutions. A given

* Gérard Roland is Professor of Economics at the University of California, Berkeley.

law can be changed overnight, but legal systems are rarely changed as rapidly as political institutions, such as electoral rules. On the other hand, the effectiveness of the legal system and the enforcement of laws depend on their acceptance and legitimacy in society and on the expectations of many actors. The legal system is in that sense closer to social norms.

Slow-moving institutions are by definition good candidates to influence fast-moving institutions, since the former may change little at a time when the latter is changing dramatically. On the other hand, for this perspective to make any sense, slow-moving institutions must also change continuously, so as to produce inconsistencies with fast-moving institutions and thereby create pressures for change. An appropriate analogy is an earthquake: pressures along fault lines build up continuously but slowly, then suddenly provoke an earthquake that abruptly changes the topography of a given area. Slow-moving institutions are the equivalent of these tectonic pressures; fast-moving institutions are the equivalent of the topography.

Culture, understood in terms of social norms and underlying values – as basic slow-moving institutions influencing human behavior generally but also as affecting fast-moving institutions in the longer run – is thus hypothesized to affect long run economic growth. Just as we are familiar with analyzing technological innovation and its role in economic growth, we should also look at cultural innovations and analyze their broad social and economic effects. Different societies have throughout history exhibited different attitudes toward manual labor and work in general, toward thrift and usury (and even toward the use of interest rates), toward respect of private property and of creativity, and toward the participation of women in different economic activities. Obviously, these cultural differences have had a profound impact on economic development and growth.

It is in a way strange that most economists have shied away from incorporating cultural differences and cultural innovations in economic analysis. The process of economic growth tends currently to be seen by economists as a combination of technology and institutions. I propose to view institutional change as the interaction between slow-moving institutions, culture in particular, and fast-moving institutions such as political and legal institutions. It is this interaction that drives institutional change, and it is the interaction between institutional change and technology that drives economic growth.

While it would be wrong to exclude the role of economic interests from discussions of institutional change, interests are not sufficient either to explain why institutional change takes place or to elucidate the direction of change. The institutional changes that took place in Western Europe in the eighteenth and nineteenth centuries would be difficult to imagine without the intellectual turmoil created by the Renaissance and the ideas of the Enlightenment, which were spread by communication technology such as the printing press. Ideas of equality and human rights led to enormous changes in forms of government and to the long transition from absolutism to democracy. This contrasts sharply with China, where Confucianism and related ideas were miles away from the Renaissance and Enlightenment ideas. China has experienced time and again large rebellions of peasants (larger than in ancient Rome or feudal Europe), some of which even managed to overthrow the empire. However, given the ideological background of these revolts, most only led to a change of emperor or of dynasty, because the purpose of the rebellion was to replace the emperor with a "more just" one. The October Revolution in Russian is probably a good example of the powerful role of our broad notion of culture: organized elites with a certain world-view managed to seize power in a situation of semi-anarchy after a military defeat. There is thus an important role for culture, worldviews and ideological commitment in explaining institutional change.

It is necessary to understand how the interaction of slow- and fast-moving institutions creates pressures for institutional configurations that may be growth-enhancing or growth-inhibiting. This interaction is not one-sided: slow-moving institutions exercise causal pressures on fast-moving institutions, and, by the same token, the latter have a life their own and can influence the path of slow-moving institutions. Moreover, different slow- and fast-moving institutions may have different effects on economic growth in their own right, while the form of existing fast-moving institutions may promote or, alternatively, may inhibit further institutional change, with positive or negative implications for economic growth.

These issues demand major research. Some hypotheses nevertheless follow quite directly from the framework I sketched.

The failure of institutional transplantation

A first hypothesis is that transplanting institutions is likely to be unsuccessful. Support for this hypothesis is provided by the fact that the transplantation of European institutions did not work well outside the settler colonies. Colonial settlers transplanted European institutions, fast-moving by definition, into a setting to which they brought their stock of knowledge, technology and culture. The countries that grew from these settler colonies are now counted among the rich, advanced economies of the world. Contrast this economic outcome with post-colonial India, where British institutions were transplanted into a different cultural context, including a deeply rooted caste system. An even stronger contrast is Africa, where conscious attempts to introduce the Western-style institutions of the democratic, modern European nation-states pathetically failed to produce economic growth. Transplantation often does not work well precisely because institutions are characterized by the complex interaction between slow-moving and fast-moving institutions, and the former change slowly and are largely autonomous. Trying to impose Western fast-moving institutions adapted to the West's own slow-moving institutions in countries with a very different history and culture is not likely to meet the same economic success.

The interaction between slow-moving and fast-moving institutions thus provides an explanation for why the transplantation of "best-practice" institutions does not work. It provides content to the idea that different countries have different "local conditions", which arise from each country's slow-moving institutions. It also provides a rationale for why reforms in a given country must build on these local conditions. In other words, countries with different cultural and historical paths must find within their existing slow-moving institutions the roots for changes in their fast-moving institutions.

The European "head start"

Another hypothesis stems from a "Jared Diamond" (1998) vision of the world, which proposes to explain the unequal development of civilization by the differences in the initial conditions facing early humans. Focusing on domesticable plants and animals and the (latitudinal or longitudinal) shapes of the continents, Diamond argues that the best conditions for developing civilizations were met in Eurasia, and within Eurasia, mostly in the Middle East and the Mediterranean. Favorable initial conditions led to population growth, which led in turn to higher production of surplus via division of labor. The latter led in turn to a higher production of knowledge, both scientific and cultural.

Let us take as a starting point the stock of knowledge dating from antiquity in the Mediterranean. This higher stock of knowledge does not refer only to scientific knowledge; the study of mathematics in Ancient Greece was more developed than anywhere else in the world, but the region's cultural diversity was also quite impressive, as evidenced by the number of competing religions in the Mediterranean at that time. Institutional innovation was also thriving: the variety of political systems in the region was much greater than elsewhere. Most of the forms of government known throughout history were invented in the Mediterranean and in the Old World (Finer 2001).

The evolution of knowledge and culture may be linked to political institutions; the vigorous development of technologies suggests the parallel development of ideas concerning political innovations. Indeed, it is reasonable to think that innovation should apply not only to technology but also to the political and social sphere. Since knowledge and culture accumulate slowly, geographic areas with environmental conditions that promoted the interaction of diverse cultures, and hence large stocks of accumulated knowledge may have had greater potential for fast-moving institutional change. It may, therefore, be no coincidence that Europe, historically diverse and geographically favorable to interaction between cultures, was the location of most of the political innovations throughout history. How can we explain Western Europe's economic dominance over much of the rest of the world in the last several centuries? One hypothesis is that the initial conditions proposed by Diamond favored a cross-cultural exchange of ideas and that this exchange permitted an accumulation of knowledge that gave Europe an institutional "head start" that still continues to have powerful effects in today's world.

Long term stocks of knowledge

Europe, of course, did not experience an uninterrupted accumulation of knowledge but also went through centuries of dark ages after the collapse of the Roman empire. Countries with accumulated knowledge may witness historical setbacks for prolonged periods due to war or internal institutional failures. However, to the extent that stocks of knowledge and cultural capital remain preserved, countries with an accumulated stock of knowledge may be positioned for a more solid growth path once they are on a favorable track as far as their fast-moving institutions are concerned. Flanders, for example, experienced a cultural flowering during the Middle Ages and early Renaissance, when it was one of the richest areas in the world, and even recovered (albeit centuries later) from the massive losses inflicted by the Spanish Inquisition.

Consider also the case of China: the twentieth century was certainly one of the worst in all of Chinese history, but until the seventeenth or eighteenth century, China had the most advanced economy in the world. While Europe, despite its earlier superiority in terms of the development of knowledge, was mired for centuries in bloody wars, China developed its economy through centuries of relative peace and remarkable institutional stability equaled only by ancient Egypt. Since then, China has undergone more than two centuries of relative decline. However, considering the success of Chinese transition, with an average growth rate of over 8 percent per year, it is difficult not to think that there is some kind of "reversion to the mean" and that the accumulated knowledge and culture from the country's past have helped in this process. Sachs and Woo (1992) present almost the opposite perspective, attributing China's recent high growth rates to the country's "backwardness" in the immediately preceding period. Seen in a long-term historical perspective, however, China has been anything but backward. For example, Chinese agriculture, which was the initial engine of growth early in the transition, has in a historical perspective been among the most productive in the world. I therefore suggest that one of the clues to the success of China's transition is not its "backwardness" at the onset of the transition but the inherited high level of knowledge and culture relative to its economic performance.

Based on its existing stock of cultural knowledge (which differs strongly from that in the West), China, like other Asian countries, has developed unique fast-moving institutions in achieving its recent growth trajectory. Thus, China is experimenting with its own institutions for the market economy instead of importing Western institutions. Whether Asian capitalist institutions are more efficient is not the right question to ask here. A more appropriate question relates to the one posed earlier about institutional transplantation: what would have happened if Western-style institutions had been directly imported into a cultural context that exhibits fundamental differences from those of the West?

Concentration of power affects institutional change

The form of fast-moving political institutions may greatly affect the manner in which institutional change occurs, with important consequences for economic development and growth. In particular, this subsection focuses on the implications of the relative (de)centralization of political power for the dynamics of institutional change.

Although much work remains to be done, recent research suggests that decentralization through federalist democracies encourages experimentation. American federalism is often considered a "laboratory of the states", where some states initiate and experiment with innovative institutions. Other states may imitate the successful results (see the framework of Qian, Roland and Xu 1999 on flexibility and organizational forms). At the other extreme, totalitarian regimes are likely to prevent not only technological and cultural but also political innovations, resulting in pronounced institutional uniformity and rigidity. Even in centralized democratic states, such as France and Japan, major changes in government programs, such as education and banking reforms, require initiation by the responsible ministries and coordination by the central government.

The degree of centralization and power concentration has important implications not only for institutional experimentation but also for the nature and speed of political change. Political institutions that concentrate power in the hands of a few tend toward patterns of infrequent and abrupt change because, relative to institutions in which power is more dispersed, institutions with concentrated power leave more room for discretionary behavior and abuse of power by those holding office. As a corollary, the high economic stakes of political power in centralized regimes tend to translate into a more pronounced temptation to resort to coercive methods to retain power.

Many historical examples illustrate this phenomenon. One is the well-known comparison between the evolution of the British Crown and that of absolute monarchy in France. The English monarchy was historically relatively weak, and in consequence the king had to share powers with feudal lords. Frequent attempts to strengthen the power of the king were largely defeated. Although the episode of the Glorious Revolution of 1688 and the subsequent separation of powers between the monarch and the House of Lords – one of history's most important political innovations – has been documented at length (e.g., North and Weingast 1989), previous episodes, such as the drafting of the Magna Carta in 1215, reveal a constant check on the king by the feudal lords in medieval England. Importantly, the English political system is probably also the prime example of an evolutionary political system that has adjusted in a flexible way throughout the last centuries.

Consider, by contrast, the consequences of centralized power in France: ironically, the French king began much weaker relative to noble lords than the English monarch and remained so for centuries. It was only much later, in a Europe divided by religious wars, that the power of the French monarchy began to strengthen until it achieved its absolutist status under Louis XIV. It took the French Revolution, centuries later, to trigger abrupt political change. Unlike the flexible and evolutionary political system that arose due to the separation of powers in medieval England, then, the centralization of power in France under an absolutist monarch made political change particularly discontinuous.

Another example comes from the comparison of the Ottoman Empire and feudal Europe. Machiavelli noted in *The Prince* that it was much easier to conquer feudal France than the Ottoman Empire, but it was much more difficult to occupy the former than the latter. In France, prior to the concentration of power by an absolutist monarch, feudal lords were relatively independent and did not rely much on the king. Therefore, they were not very loyal to the latter and would change allegiance whenever it best suited their interests. They could therefore be easily bribed by a would-be conqueror into betraying the French king. By the same token, however, feudal lords could also betray any occupying power. By contrast, the governors of the Ottoman empire had no property of their own and depended for their resources on the emperor, who threatened to have them executed if they lost territory to an enemy. Therefore, they would fight to the death against any occupant. On the other hand, once successfully invaded, Ottoman territory was easily occupied because the Ottoman institutions collapsed like a house of cards. More centralization in the Ottoman Empire therefore meant that change through successful invasions was less frequent and more abrupt when it came, whereas greater dispersion of power in pre-absolutist France allowed for more frequent foreign influence and institutional change.

Some policy implications

The interaction between slow-moving and fast-moving institutions implies that different cultural paths (slow-moving institutions) may affect the appropriate choices of fast-moving institutions. This discussion carries a number of possible policy implications.

First, one should take a skeptical attitude toward transplantation of institutions, because the different dynamics of slow-moving institutions may make some fast-moving institutions inadequate in some countries. Thus reforms of fast-moving institutions in a given country must in part build on existing slow-moving institutions that have arisen in countries with different cultural and historical pasts. Ignoring these pasts in designing institutional reforms is likely a recipe for failure. The interaction of slow- and fast-moving institutions therefore provides an important cautionary to any development specialist seeking to export "best-practice" institutions.

Second, our current relative ignorance about the interaction between fast-moving institutions and the slow-moving institutions of different countries provides a strong rationale for certain kinds of experimentation and gradualism and, conversely, a strong reason for opposing the imposition of irreversible institutional change in a given country (Dewatripont and Roland 1995; Roland 2000). This gradualist approach has been followed in the Chinese success story of transition from socialism to capitalism. The transition process started with de-collectivization in agriculture, which itself was preceded by experiments of de-collectivization in different provinces. The experimental approach was later used again and again, whether with the special economic zones or with privatization (see Naughton 1995; Qian 2002). The territorial organization of the Chinese government, which follows the M-form pattern of organization (Chandler 1962; Williamson 1975) in contrast to the functional organization of the Soviet government (more along the lines of the U-form organization) has provided a more flexible framework for setting up reform experiments (see Qian and Xu 1993; Qian, Roland and Xu 1999). The dual-track approach to reform has also provided a clever way of gradually reforming while respecting the complementarity of reforms. Thus with dual-track price liberalization, the planned production obligations and planned delivery rights of enterprises under the plan were frozen at a preexisting level, and enterprises had continuing obligations and rights under the plan track. On the other hand, enterprises were given freedom to set prices, contract and retain profits from transactions on the new market track. The dual-track system therefore allowed for the introduction of liberalization across all markets – which avoids the distortions that arise from liberalization only in some markets – while avoiding the disruption of output collapse by maintaining a frozen plan track (Roland and Verdier 2000). Moreover, price liberalization at the margin has the same efficiency properties as full liberalization (Lau et al. 1997) and the dual-track has the attractive property of being Pareto-improving – that is, hurting no-one while improving the welfare of others (Lau et al. 2000). Notice also that the dual-track approach reduces reversal costs, which makes adopting it even more attractive.

A third implication of this discussion is, therefore, that policy dialogue may be needed more than trying to impose "one-size-fits-all" solutions for different countries. Policy dialogue has been viewed with suspicion in the past on the grounds that a doctor does not dialogue with his patient about making a health diagnosis. This suspicion was based on the doubly erroneous view that technocrats in international financial institutions possess superior knowledge about economic development and that local elites either have mostly "wrong" views about solutions for their countries or lack the incentives to do something about it. As the preceding discussion has suggested, however, while slow-moving institutions may hamper the proper functioning of implanted fast-moving institutions, local knowledge about a country's slow-moving institutions is not part of the problem but part of the solution. Therefore, only dialogue can help formulate adequate development policies. This does not mean that there are no local elites with vested interests in maintaining inefficient institutions. Yet those are not the local elites with which a fruitful dialogue can be established; rather, one should enter into a dialogue with elites who have an interest in development. Such elites are not necessarily represented in governments but are very active in civil society. Policy dialogue therefore entails not just a dialogue with governments but also with different components of civil society at large.

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