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The new comparative economics: a first look.

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Abstract

In recent years, comparative economics experienced a revival, with a new focus on comparing capitalist economies. The transition from socialism, the Asian financial crisis, and the European economic and political integration, have challenged our understanding of how capitalist economies and societies work. Capitalist economies differ in important ways in how they regulate market activities, including the extent of public ownership, regulation of social harms and externalities, contract enforcement, modes of dispute resolution, etc. Capitalist countries also differ in how they regulate political competition, including the structure of electoral systems, the nature of checks and balances, legal procedures, and so on. These institutional differences among countries are both highly systematic, and have important consequences of economic and social outcomes. As an important example, the historical origin of a country's legal system has proved to be a crucial factor shaping institutions. A growing body of theoretical and empirical research documents and analyzes how history as well as current conditions shape institutions. This research -- which we call the new comparative economics -- helps explain many differences in performance, and informs the design of economic and political reforms.

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I. Introduction.

The traditional field of comparative economics deals with the comparisons of socialism and capitalism[1]. Socialism is defined as an economic system in which the principal mechanism of resource allocation is central planning. Under capitalism, this principal mechanism is the market. The field of comparative economics, which dates back at least to the discussions of market socialism in the 1930s, tries to explain under what circumstances either the plan or the market might do better in terms of both economic efficiency and economic equality.

The collapse of socialism in Eastern Europe and the Soviet Union a decade ago destroyed the traditional comparative economics as a field. The economic and political failures of socialism were too empirically apparent for any serious scholar to continue contemplating its comparative benefits. While the academic discussions have probably lasted longer than they should have, by 1990 it became abundantly clear that socialism produced little but misery and inefficiency – not to mention mass murder by the communist dictators who practiced it. Capitalism, in contrast, produced growth and wealth. With capitalism triumphant, is comparative economics dead?

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[1]This field has its own category in the *Journal of Economic Literature*, called Economic Systems. The subcategories are capitalist systems, socialist systems, socialist institutions, other economic systems and comparative economic systems.

The answer, we argue in this paper, is NO. From the ashes of traditional comparative economics has emerged a new field. This field, which we call the new comparative economics, shares with its predecessor the notion that by comparing alternative economic systems, we can understand better what makes each of them work. But it sees the key comparisons as being of alternative capitalist models that prevail in different countries. Every capitalist economy has a large number of public and private institutions. These institutions function to choose political leaders, to maintain law and order, to secure property rights, to redistribute wealth, to resolve disputes, to govern firms, to allocate credit, and so on. Recent research demonstrates that these institutions differ tremendously among countries, and that these differences have significant consequences for economic and political performance. Some institutions bring growth, others stagnation at all levels of economic development. The comparison of these institutions and of their effectiveness is what the new comparative economics aims to study.

The new comparative economics shares with institutional economics the recognition that the pure competitive model is not a useful way to think about capitalist economies, and that the political and economic institutions crucially shape performance. Unlike institutional economics, however, which stresses the common features of capitalist economies such as protection of private property, the new comparative economics recognizes that different capitalist economies solve the problem of security of property in very different ways, and focuses on these differences. The new comparative economics also shares with the fields of political economy and public choice its emphasis on politics. Most crucial institutional differences among countries -- whether regulating markets or regulating politics -- are governmental. It is therefore impossible to understand either the formation of institutions, or their consequences for performance, without

understanding the political forces that drive institutional evolution.

In this paper, we do not survey the developments of the new comparative economics. Rather, we discuss some of the main intellectual themes, as well as some of the crucial unanswered questions. The next section deals with three economic changes of final decades of the 20th century which have shaped the intellectual agenda of the new comparative economics. Section III deals with the regulation of markets, while Section IV with the regulation of politics. Section V consider some lessons for policy reform.

II. Events and Questions.

Three enormously important economic events in the ending decades of the 20th century have spurred the interest in the new comparative economics. The first – perhaps the defining economic event of the end of the 20th century – is the collapse of socialism, and the transition of the economies in Eastern Europe and the former Soviet Union, as well as of China, into capitalism. The transition experience has been, to say the least, diverse. Many of the countries of Eastern and Central Europe, especially Poland, Slovenia, Hungary, and the Czech Republic, have successfully established both secure democracies and many of the legal and regulatory institutions of capitalism during the 1990s. They have grown rapidly, and are expected to fully integrate into Europe over the next few years. Countries further East, such as Romania and Russia, also moved to establish democracies and market institutions, but their experience has been more checkered. Some of the Asian countries, from Kazakhstan to (most importantly) China, did not embrace democracy, but undertook significant economic reforms and grew, in China's case spectacularly. Finally, some of the transition economies, including Cuba, Belarus

and many countries of Central Asia, did not reform and experienced most severe stagnation.

By and large, early discussions of the transition experiences ignored institutional differences, and focused on the speed of reforms -- big bang versus gradualism -- as a crucial determinant of performance. Although it is now clear that the absence of reform – as in Belarus – is associated with both economic and political stagnation, the emphasis on speed turned out to be little more than a journalistic diversion. The important differences among countries had to do with the effectiveness of the newly created institutions rather than with the speed of change. The countries of Central Europe have in fact succeeded in creating moderately successful institutions of a market economy, while Russia – having moved as fast or faster on many of its reforms – has faced greater problems of corruption and capture of its economic and political institutions, with adverse consequences for economic performance.

These divergent experiences raised new questions about transition. Is democracy the best political system for economic reform or is dictatorship efficient when radical change is required? China's economic success under a communist dictatorship, contrasted with the difficulties of Yeltsin's democracy in Russia, animated the advocates of one party rule; the successes of democracies of Central Europe pointed in the opposite direction. Within democracies, do reforms proceed better under divided or under consolidated governments? Many economists started with a prior that consolidated government is essential to implement reforms, yet here again, the deeply divided governments of Central Europe had more success with some of the market reforms than the much more consolidated governments of Russia and Ukraine. How interventionist and regulatory should the government be in transition economies? The transition experience saw both successful regulation of markets, in Poland for example, and the

degeneration of regulation into corruption and selective abuse of new business in many other countries. How much government ownership is compatible with transition to capitalism? Some countries, such as Poland, the Czech Republic, and Russia, pursued extensive privatization programs, while others, most conspicuously China, retained large state sectors. Is a federal structure desirable from the viewpoint of economic transformation? Scholars of China credited its federalism and resulting competition among regions with the success of the Chinese reforms; scholars of Russia credited its federalism and the resulting conflict between the regions and the center with the difficulties of Russia's reforms, particularly in the fiscal area.

All these questions share two common elements. They all deal with capitalist economies, and ask what shape such economies take. They also all deal with the institutions of capitalist economies, which appear to differ a great deal. The presumption of all of these questions is that these differences among the institutions of capitalist economies actually matter for economic performance. This, indeed, is the central theme of the new comparative economics.

The second crucial economic event for the new comparative economics is the Asian financial crisis of 1997-1998. The economic wonders of the world through much of the post-war era – South Korea, Hong Kong, Singapore, Taiwan, Malaysia, but also to a lesser extent Indonesia and the Philippines – saw collapses of their currencies, financial systems, and economies. And the very factors seen as responsible for the rapid growth – political guidance of the economy, state direction of credit, openness, the dominance of large diversified groups in the economy – turned into the culprits of the collapse. The Asian growth miracle (World Bank 1995) was re-christened as crony capitalism.

Initially, economists sought to understand the Asian crisis from a purely macroeconomic

perspective, but it quickly became apparent that political and economic institutions had a lot to do with it (Johnson et al. 2000). Was the collapse a consequence of political liberalization that many East Asian countries have experienced? More generally, is Asian growth compatible with democracy? Some champions of the Asian experience, such as Singapore's Lee Kwan Yew, indeed argued that the particular Asian growth model depended on authoritarian discipline. Others saw democratization in Korea and Taiwan as signs of progress. Was heavy-handed government guidance of the Asian economies the source of their success, as many observers of Korea, Singapore, and Taiwan in particular insisted, or was it the cause of over-borrowing, expansion into inefficient and unprofitable activities, and corruption that precipitated the crisis? Were Asian business groups, with their extreme diversification, integration with banks, and rapid decision making under family control, a source of economic dynamism, or an adaptation to the extreme politicization of economic life that ultimately manifested itself in a crisis? Was Asian corruption, which for decades was seen as efficiently greasing the wheels of commerce, in reality the hidden cancer that ultimately metastasized and ruined the Asian economies?

The Asian crisis is of great interest in part because, despite their many similarities, the Asian economies have many differences as well. The countries belong to different legal systems (common law in the cases of Hong Kong, Singapore, and Malaysia; civil law in the cases of Taiwan and Korea); they include democracies like Korea, the Philippines, and Taiwan, and authoritarian states like Singapore, Indonesia and Malaysia; they differ in the aggressiveness of state intervention and so on. Moreover, the depth of the crisis varies among the economies, with Singapore and Hong Kong fairing relatively well, while Indonesia and Philippines plunging into most extraordinary depressions. These experiences also drew attention to the variety of

capitalist institutions, and their divergent effectiveness in coping with a severe economic shock.

European economic integration was the third great event of the 90s. It raised many issues of the functioning of economic institutions in a constituency with a great variety of local preferences, laws, customs, and interests. As the politicians in Brussels contemplated the common legal rules for Europe, they needed at least to check what rules are actually good. Should European companies have restrictive labor laws -- so common in continental, and particularly Mediterranean, Europe -- or should they use a more laissez-faire approach to the regulation of labor? Is the Anglo-Saxon corporate governance system, with widely held firms, strong protections of minority shareholders, and developed stock markets preferred to the German system of powerful banks, family firms, and weak minority rights? How interventionist and regulatory should be the future European state, especially if it wants to compete with the United States in world markets? Again, all these questions that deal with alternative models of capitalism, and they have stimulated the growth of new comparative economics.

In thinking about these issues, it may be useful to distinguish two categories of institutions: those dealing with the regulation of markets, and those dealing with the regulation of politics. The institutions of market regulation delineate the scope of government: what services should the government provide, how and what should it tax, what should it own, what and how should it regulate, how should it deal with social harms and externalities, which contracts it should enforce and how? The regulation of politics shapes the trust in government: how are politicians chosen (if at all), what mechanisms exist to keep them in check, how are policies selected, how are powers allocated between different branches and levels of government, how are judges and regulators controlled? Of course, the institutions regulating politics and those

regulating markets are not entirely separate, and indeed are highly interdependent. How much the government *should* regulate depends to a significant extent on how corrupt it is -- a consequence of its regulation of politics. How much the government *does* regulate of course also depends on its venality. For our purposes, however, it is convenient to begin by discussing the regulation of markets and of politics separately.

III. The Regulation of Markets.

Since the days of the Enlightenment, most economists agreed that good economic institutions secure property against expropriation by either neighbors or the government (see, e.g., Rothschild 2001). Such security encourages individuals to invest both in capital and in themselves, and so fosters economic growth. Good economic institutions also allow people to contract and resolve disputes, so that they can reap the gains from trade. Many economists would also agree that, in addition to providing the security of property, good governments should engage in at least some social insurance and provision of public goods.

This normative perspective, however, does not get us very far in understanding reality. The public sector has grown tremendously in the 20th century, coming to account for nearly half of the Gross National Product in successful *market* economies. Governments provide public goods, but also own banks, mines, industries, railroads, airlines, and many other businesses in both developing and developed countries. Government run courts that resolve disputes and enforce contracts, but in many countries a great deal more protection of property is pursued through regulation than through litigation. And in all these respects, institutions differ tremendously among *capitalist* economies.

These differences matter for economic performance. Kaufmann, Kraay, and Zoido-Lobaton (2002) combine data from 15 experts polls and surveys of business people or citizens in general to construct six measures of institutional quality for 175 countries. The study finds high correlations across measures within a country, as well as enormous dispersion in institutional quality among countries. Beck, Demirguc-Kunt, and Maksimovic (2001) use data from the World Bank's World Business Environment Survey, which collects opinions from entrepreneurs in a large number of countries of the quality of institutions affecting their businesses. The authors find significant variation among countries in institutional quality, as well as consistent evidence of lower business growth in countries whose institutions are seen as lacking.

This variation in the nature of market regulation among countries raises two related questions. First, are the existing institutions of market regulation efficient, and if not, what shapes them? Second, are the factors that shape the institutions endogenous to the geographic, ethnic, and other fundamental conditions of a country, or are they alternatively exogenously determined by a country's history of institutional adoption?

There are good reasons to believe that many existing institutions are efficient, and getting more so over time. After all, the world is surely a better and richer place than it was 100 or 200 years ago. The case for such efficiency has been forcefully made by institutional economists. Demsetz (1968) and North (1981,1990) argue that there are fixed costs of establishing institutions. As countries get richer and markets get wider, more and more of the good institutions become efficient because the benefits exceed the costs. Demsetz (1968) uses this reasoning to explain the transition from common to private property in land as the size of the population, and therefore the land's scarcity, increases. In this logic, the causality is from the

level of development to the quantity and quality of institutions, and not just the other way around.

In a related vein, Glaeser and Shleifer (2001, 2002a) consider the endogenous adaptation of institutions to the law and order conditions of a country. They argue that an important property of a successful institution is its invulnerability to subversion by the powerful citizens. Peaceful, relatively equal societies can adopt decentralized, community rules in areas such as dispute resolution, because local justice is more efficient and there is relatively little fear of it being subverted. Less orderly, more unequal societies, in contrast, must rely on rules promulgated and enforced by the sovereign, even when such rules sacrifice basic fairness, because local justice is likely to be subverted by powerful interests. Glaeser and Shleifer (2002a) use this theory to explain why the jury-based common law system developed in the relatively peaceful England, while the state-employed-judge civil law system developed in the warring France. Glaeser and Shleifer (2001) present a related theory to explain why, during the Progressive era at the beginning of the 20th century, the United States replaced litigation with government regulation in many areas of social control of business. The reason was the vulnerability of courts to subversion by the newly powerful economic interests – the robber barons.

While some institutional diversity reflects efficient adaptation toward meeting the basic goals under different circumstances, much of it does not. As argued by public choice theorists, many institutions are created by dictators, by powerful interest groups, and by political majorities to benefit themselves at the expense of the rest of the population. The public choice perspective has proved to be extremely helpful for the understanding of institutions. For example, it sees state ownership as a mechanism of dispensing patronage and maintaining political support for the

incumbent politicians (Shleifer and Vishny 1998). It shows how various regulations, which often have benign goals, end up protecting incumbent firms from competition, and offering extensive corruption opportunities to their enforcers (Stigler 1971, De Soto 1989, Djankov et al. 2002a). At the most basic level, it explains socialism itself – the system that concentrates all the economic decisions in the hands of a small elite, thereby providing this elite with the most powerful lever of perpetuating its power, namely making the whole population of a country dependent on it economically.

Much of the evidence -- both within and across countries -- is consistent with this perspective. In the former genre, economists took advantage of institutional diversity in federal states, such as the U.S. and India. Besley and Burgess (2002), for example, examine the differences in the legislation concerning worker rights among the Indian states. They find that pro-worker amendments to the Industrial Disputes Act are associated with lowered investment, employment, productivity and output in registered manufacturing. The evidence suggests, in line with much other evidence on regulation, that attempts to redress the balances of power between capital and labor can end up hurting the poor.

Djankov, La Porta, Lopez-de-Silanes and Shleifer (2002a) collect data on the regulations faced by entrepreneurs trying to officially open a business in 85 countries. They find that entry regulation is extremely heavy in most countries in terms of both the time and the number of procedures that an entrepreneur must complete. Moreover, heavier entry regulation is not associated with superior quality of products, but rather with greater corruption and larger unofficial economies. Last but not least, heavier regulation of entry is pursued by the less democratic and less limited governments. All these results support the public choice view that

entry regulation benefits bureaucrats and politicians rather than consumers.

Evidence like this raises the obvious question of whether institutional diversity reflects the highly idiosyncratic political and economic conditions of each country, or whether there are systematic factors that shape institutions? It appears that at least a significant portion of institutional variation is systematic, and the factor that shapes many of national institutions is the origin of a country's laws. As we already noted, England and France developed very different legal traditions as far back as the 12th century. The English – or common law – tradition is characterized by the relative independence of judges, the importance of juries, as well as on reliance on broad legal principles such as fiduciary duty to resolve disputes. The civil law tradition is derived from Roman law, was rediscovered by the Roman Church in the 11th century, and eventually adopted by most Continental European states. In the early 19th century, civil law was incorporated into formal legal codes in France and Germany, and indeed some writers date the divergence between civil and common law to Napoleon's Codes. The Civil law tradition is characterized by state-employed judges, relative unimportance of juries, and extensive control and oversight of lower level judicial decisions through superior review.

When European powers conquered and colonized other nations, they brought with them many of their political, legal, and regulatory institutions -- and most importantly their laws. England transplanted its laws to the United States, Canada, Australia, New Zealand, as well as South Asia, East Africa, and other areas it colonized. Napoleon exported France's legal system to many European lands he conquered, including Portugal and Spain. French civil law was then transplanted to the parts of the world controlled by the Portuguese, the Spaniards, the Dutch, and the French themselves, and today remains the basis of the legal systems of Latin America, North

and West Africa, as well as parts of Asia. Similarly, the colonizing English transplanted their legal system to the U.S., Canada, Australia, as well as colonies in the Middle East, East Africa, and South Asia. As a consequence of this colonial transplantation, legal origin became an important factor shaping the legal and regulatory institutions of many countries.

La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997, 1998) identify legal origin as a crucial determinant of the laws governing the protection of outside investors from expropriation by corporate insiders, with common law providing better protection than civil law. The authors measure the laws protecting outside shareholders and creditors against expropriation by corporate outsiders in 49 countries. They find that better investor protection is strongly associated with broader and more valuable capital markets, higher pace of public offerings, more dispersed ownership structure, and other indicators of financial development. Subsequent research shows that civil law countries generally exhibit heavier government intervention in economic activity, including more burdensome regulation and red tape (La Porta et al. 1999), greater government ownership of banks (La Porta et al. 2002), and more burdensome regulation of new business entry (Djankov et al. 2002a). Moreover, the evidence identifies no benefits of the more interventionist institutions for economic or social outcomes. To the contrary, French legal origin is typically associated with worse public sector outcomes, as well as greater corruption.

Recent research points to another potentially important aspect of institutional transplantation, which might account for institutional variety. Acemoglu et al. (2001) show that settlers suffered very different rates of mortality in different colonies, and accordingly were much more likely to stay and develop their institutions in the colonies where they survived. The transplantation of Western institutions, with its benefits for the security of property rights and

economic development, was consequently more effective in the places where the settlers survived than in places where they did not. This theory, like legal origin, accounts for some exogenous variation in institutions among countries.

The fact that many institutions in developing countries have taken their shape through transplantation rather than an organic (and perhaps efficient) response to local conditions suggests that these institutions are unlikely to be efficient. Indeed, as Glaeser and Shleifer (2001, 2002a) show, the institutions of regulation will be least efficient when the interests of the sovereign diverge the most from those of the public, and when the rules are most subject to subversion. Their theory might explain why public choice theories, which stress institutional inefficiencies, have been more successful in explaining consequences of transplanted institutions for economic efficiency than the public interest theories.

IV. The Regulation of Politics.

The ideas about the regulation of politics are even older than those about the regulation of markets. Political power needs to be contestable, and politicians need to be kept in check while in office to prevent abuse of power. Some degree of separation of executive, legislative, and judicial power is desirable. Both the tyranny of the majority, and the capture of government by narrow special interests are undesirable, and a balance must be struck between the two.

Despite some agreement on the goals of the regulation of politics, institutions performing this function vary greatly around the world, and some appear to be more successful than others. As before, some of the evolution in the regulation of politics is driven by efficiency. Brennan and Buchanan (1980) and North and Weingast (1989) emphasize the benefits of rigid

constitutions as a mechanism of restraining the sovereign and committing the state to particular beneficial policies. More recently, Aghion, Alesina, and Trebbi (2002) examine the design of political institutions in light of the tradeoff between restraining the sovereign and providing him with sufficient discretion to pursue good policies. They show how exogenous characteristics of the society, such as polarization of voter preferences and aggregate uncertainty, shape the efficient choice of political institutions.

But, as with the regulation of markets, efficiency is obviously not the only factor. More often than not, politicians themselves design and modify institutions to keep themselves and their political associates in power. Voting arrangements, constitutional rules, financing of campaigns and political parties, and other institutions are introduced to keep the incumbents in office. Recent research in the new comparative economics has addressed these issues as well. Olson (1982), Aghion and Robinson (2000, 2002), and Glaeser and Shleifer (2002b) examine political models of institutional choices designed to entrench the incumbents.

What is most interesting from our perspective is that the differences among countries in the regulation of politics are highly systematic as well. Consider two examples from recent research. The first deals with constitutional design, particularly with respect to the judiciary. According to Hayek (1960), there are two very distinct aspects of the constitutional role of the judiciary. The first is the English common law idea of judicial independence: once laws are passed by Parliament, they are enforced by courts without political interference. According to this idea, the courts cannot interfere with Parliament, and the Parliament cannot intervene in courts except by passing laws. The second is the American constitutional idea of checks-and-balances: the courts themselves have the power to check the decisions and laws passed by the

legislature against the constitution. Unlike in the English conception, here the courts can very much interfere with legislative choices.

Interestingly, both the English and the American constitutional ideas were transplanted throughout the world in the last 200 years, as most countries wrote their constitutions. But they spread differently. The idea of judicial independence has spread to Britain's colonies along with other elements of common law. It generally did not get adopted in the civil law countries. The American idea of constitutional review has spread in part to countries influenced by the U.S. constitutions, especially those in Latin America, but after World War II to many other parts of the world, including Continental Europe, as the institution of constitutional courts became common.

La Porta, Lopez-de-Silanes, Pop-Eleches, and Shleifer (2002) examine recent constitutions of xx countries, and measure whether these constitutions adopted either (or both) of the two ideas about the judiciary. They find significant but highly systematic variation among countries, generally following the patterns of transplantation described above. They also consider the relationship between these constitutional rules and measures of political and economic freedom around the world. In the data, independent judiciary is associated with greater economic and political freedom, whereas constitutional review is associated with greater political, but not economic freedom. It thus appears that different constitutional treatments of the judiciary lead to very different patterns of benefits.

Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2002b) examine another dimension of regulation of politics: the operation of courts in 109 countries. Specifically, they focus on the formalism of judicial procedure – the extent to which the law regulates dispute resolution. To this end, they examine in detail the procedures that need to be followed to take each of two cases

– the eviction of a non-paying tenant and the collection of a bounced check – through a nation's court. From this examination, they construct indices of procedural formalism – or regulation of dispute resolution -- for each country. They find that French civil law countries exhibit much greater levels of procedural formalism than do common law countries, just as appears to be the case with other kinds of regulation. They also find that greater procedural formalism is associated with significantly longer delays in bringing cases through courts, but *not* with greater measures of efficiency, consistency, fairness, or accessibility of the legal system. The evidence on the regulation of dispute resolution mimics that on other kinds of state intervention: legal origin is a strong predictor of greater interventionism, and there is no evidence that such interventionism improves social outcomes.

The papers we described point to some patterns in the nature of institutions regulating both markets and politics. Specifically, in many instances, legal origin appears to shape both. Civil law countries are more centralized and interventionist than common law countries across a range of institutions – they exercise tighter central control of new entrepreneurs, banks, but also courts. In the mother countries – England and France – this difference in institutional design may have been a response to the different law and order conditions, as Glaeser and Shleifer (2002a) argue. But in colonies, these institutional features were often transplanted, and thus do not have as apparent efficiency justifications. The fact that, along many dimensions, the greater political control associated with French legal origin is also associated with inferior economic and social outcomes casts further doubt on the efficiency explanations. At the least, the upshot of this research is to recognize that institutional characteristics are not just outcomes of each country's idiosyncrasies, but rather of systematic patterns of legal transplantation.

V. Some Lessons.

Which forces are deemed to be crucial to the evolution of existing institutions is helpful in thinking about institutional reform. To the extent that institutional arrangements are efficient responses to local conditions, it is wrong to look for universally "best" institutions. Regulation might be an efficient solution to the problems of social harm in highly unequal, moderate income societies, where regulators are better able than the courts to withstand the pressures of subversion. On the other hand, in relatively poor countries, where all public institutions are highly vulnerable to subversion, it might be better for the society to accept market failures than to try to control them using regulations that are only likely to be subverted. Likewise, regulation might be undesirable in the less democratic countries where they can be used to further the interests of the sovereign rather than the public. A lot less government regulation might be appropriate for poor, less democratic countries than for the rich, more democratic ones. But this, unfortunately, is not what we see in reality.

The empirical analysis of actual institutional arrangements might help us decide what is appropriate, and to make specific reform recommendations. For example, measures of the exact structure of regulation of particular activity in a large number of countries, be it entry of new firms or dispute resolution, allow an assessment of the consequences of regulation in different environments. Rather than just make the statement that regulation of a particular activity is especially burdensome, corrupt, and disruptive, one can then identify which aspect of regulation is particularly damaging and where. This, in turn, can inform specific policy recommendations.

But there is an important caveat, namely that different institutions are not independent of each other. In particular, as we have argued in this paper, legal origin appears to be a common

determinant of political, legal, and economic institutions in many countries. But even if one thinks that a country's institutions have been transplanted into it for reasons unrelated to efficiency, there is no reason to conclude that institutions cannot be changed. Indeed, transplantation might itself be the reason for inefficiency, as institutions that work well in middle income and advanced countries are put into political and economic environments where they are misused or subverted, and only breed tyranny and corruption. Legal origin is not destiny: it does not preclude institutional reform, though it might limit the options.

The fact that different institutions might "go together" poses a crucial challenge for reform. If civil law judges rely on codes and cannot work with broad principles like fiduciary duty, then introducing these common law ideas into a civil law jurisdiction would not solve the problem of corporate governance. Similarly, if disputes over social harm are addressed primarily through private litigation, introducing statutes and regulations might gravely disrupt the system. Understanding how the different institutions of a capitalist economy fit together and work together is essential for assessing the possibilities of improvement. This, indeed, is both the hope and the promise of the new comparative economics.

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