Institutions, Growth and Development: a Conceptual Assessment

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Abstract

The paper analyses the relationships between institutions and growth in the perspective of developing countries and development economics, through a critical assessment of the existing literature and the elaboration of an original theoretical approach of the concept of the institution. Development economics has witnessed over the last decade a spectacular increase in studies of these relationships, which stemmed from the observation that traditional determinants of growth appeared insufficient to explain the growth trajectories and income levels of a certain number of countries and was influenced by several theoretical currents (on the one hand, neo-institutionalism or evolutionary game theories, and growth theories on the other). These studies usually explore whether economic and political 'institutions' are in fact the preeminent determinants of growth and in particular the determinants of the catching up processes of developing countries to higher levels of income. This literature thus highlights institutions that would be harmful for growth and institutions, or the type of institutional change, that would be beneficial to it (e.g., securing property rights). Many studies, however, do not find any link between institutions and levels of development. Similarly, the institutions considered in the literature are very diverse, and causalities as well as their directions remain highly controversial and inconclusive.
Through the use of stylized examples from low-income developing countries, and particularly from Sub-Saharan Africa, the paper firstly critically reviews the popular theoretical and empirical studies in development economics, which rely on institutions in order to explain the process of development. It assesses the limitations of the concepts they use, arguing that most studies rely on a simplistic view of institutions (conceived as separable and stable units whatever the space and time) as well as superficial functionalism, a key cause of these weaknesses being methodologies that are based on modelling and econometric exercises. Similarly, it underscores the simplism of the dichotomy between 'formal' and 'informal'

institutions, which is yet widely used in development economics. These simplifications have been compounded by the influence of the international financial institutions towards an operational use of the concept of institution. Secondly, the paper lays down the elements of an alternative theoretical framework regarding the concept of ‘institution’. This framework more accurately accounts for the complex mechanisms that underlie the transformation of institutions and their relationships with growth and highlights the simplism of approaches that view institutions as autonomous entities that would ‘cause’ an economic process such as growth. This framework underscores the composite character of an ‘institution’ – made of highly heterogeneous elements (cognitive individual processes such as beliefs; shared norms; written rules; legal systems) – and the necessity to distinguish the ‘forms’ from the ‘contents’ of institutions (the individual or shared representations). Given institutions in space and time are an outcome, among many possible others, of the multiple combinations that involve these two analytical levels as well as their interactions with other existing institutions, some cognitive processes (credibility, relevance) and power relationships explaining the resilience or the transformation of certain institutions. The paper finally argues that specific institutional outcomes are difficult to predict ex ante and that they are observed *ex post*, as they result from the transformation of forms and contents under the influence of many determinants: historical, political and economic. The contrast between countries that seem caught in stagnation (such as African low-income countries) with the countries that succeeded in catching-up (e.g., in Asia) suggests that certain combinations (of beliefs, institutions, levels of development) may stabilise and generate ‘poverty-institutions’ traps, for example when group memberships thrive on the weakness of the meta-institutions provided by states.

Keywords: institutions; growth; development; cognition; Sub-Saharan Africa

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1. Introduction[1]

The paper analyses the relationships between institutions and growth in the perspective of developing countries and development economics. It will do so through a critical assessment of the vast existing literature and the elaboration of an original theoretical approach of the concept of the institution.

Development economics has witnessed over the last decade a spectacular increase in studies of these relationships: on the impact of institutions on growth and, to a lesser extent, the impact of growth on institutions. This increase stemmed from the observation that traditional determinants of growth, such as investment, appeared insufficient to explain the growth trajectories and income levels of a certain number of countries (this questioning having also been applied to social groups at the micro level) and was influenced by several theoretical currents. These included, on the one hand, neo-institutionalism, economic history, political economy of development, social

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[1] Elements of this research have been presented at several conferences, for example the conference ‘Economics for the Future’, Cambridge, 17-19 November 2003, and the Institute of Social Studies (ISS) Economic Research Seminar Series, The Hague, 28 April 2005. The author is very grateful to Machiko Nissanke and Raymond Toye for their relevant comments, although the usual caveat applies.

interactions theories, evolutionary game theories and studies of social norms outside developed countries; and growth theories on the other, in particular those seeking to explain why, contrary to neoclassical growth assumptions, income levels appear to diverge across countries and those exploring poverty traps and lock-in processes. These studies usually explore whether economic and political 'institutions' are in fact the preeminent determinants of growth ("institutions rule", as coined by Dani Rodrik): in particular the determinants of the catching up processes of developing countries to higher levels of income, of the divergence in economic performances and of the heterogeneity of countries' responses to policy reforms that were identical in appearance, such as liberalisation. This literature thus highlights institutions that would be harmful for growth and institutions, or the type of institutional change, that would be beneficial to it (e.g., securing property rights). Many studies, however, do not find any link between institutions and levels of development. Similarly, the institutions considered in the literature are very diverse, and causalities as well as their directions remain highly controversial and inconclusive.

In this context, through the use of stylized examples from low-income developing countries – and particularly from Sub-Saharan Africa – the paper firstly critically reviews the popular theoretical and empirical studies in development economics, which rely on institutions in order to explain the process of development. They generally rely on theoretical assumptions regarding the nature of institutions, which greatly limits the understanding of their nature, their effects and their transformation in developing countries. The paper assesses the limitations of the concepts they use, arguing that most studies of the relationships between institutions and growth rely on a simplistic view of institutions (conceived as discrete and stable units whatever the space and time) as well as superficial functionalism, a key cause of these weaknesses being methodologies that are based on modelling and econometric exercises, which reduce institutions to their formal existence and variables in models, especially in growth econometrics. It underscores the simplism of the dichotomy between 'formal' and 'informal' institutions, which is yet widely used in development economics in order to explain the variety of conditions of institutional change and the impacts of institutions on growth. These simplifications have been compounded by the influence of the international financial institutions (IFIs) – which characterises concept formation in development economics – towards an operational use of the concept of institution.

Secondly, the paper lays down the elements of an alternative theoretical framework regarding the concept of 'institution'. This framework more accurately accounts for the complex mechanisms that underlie the transformation of institutions and their relationships with growth – characterised by uncertainties, the possibility of non-linearities, threshold effects, and lock-in mechanisms. It also highlights the simplism of approaches that view institutions as autonomous entities that would 'cause' an economic process such as growth, or that would be outcomes of purely economic mechanisms (e.g., minimising costs). This framework underscores the composite character of an 'institution' – made of highly heterogeneous elements (cognitive individual processes such as beliefs; norms of behaviour, which can be shared; written rules; legal systems, and so on) – and the necessity to distinguish the 'forms' from the 'contents' of institutions (the individual or shared representations). It argues that institutions cannot be viewed in isolation; they are path-dependent and interact with each other. Institutional forms and contents are shaped by their coexistence and combination with other institutional forms and contents. Rather than static *ex ante* entities, institutions' forms and contents are in a continuous process of combination with others in given settings. Given institutions in space and time are an outcome, among many possible others, of the multiple combinations that involve these two analytical levels as well as their interactions with other existing institutions, some cognitive processes (credibility, relevance) as well as power relationships explaining the resilience or the transformation of certain institutions.

The paper finally argues that specific institutional outcomes are difficult to predict *ex ante* or deduce from institutional forms alone, and that they are observed *ex post*, as they result from the transformation of forms and contents under the influence of many determinants: historical, political and economic. The contrast between countries that seem caught in stagnation (such as African low-income countries) with the countries that succeeded in catching-up (e.g., in Asia) suggests, however, that certain combinations (of beliefs, institutions, levels of development) may stabilise and generate 'poverty-institutions' traps, particularly in low-income countries, which are often characterised by the weaknesses of the meta-institutions provided by states, an example being the combinations related to group memberships.

The paper is structured as follows. Firstly, it examines the limits of mainstream approaches, which use institutions as causal variables in growth regressions, and the contribution of international financial organisations to the conventional views of the relationships between institutions and development. Secondly, it presents the elements of the conceptual framework of a 'relational' or 'compositional' view of institutions, which distinguishes the forms and contents of institutions, and examines factors of credibility and resilience of institutions. Specific economic performances result from particular combinations between institutions, or between institutions and domestic and international economic environments. Finally, the paper shows that the economic outcomes of the combinations of the different levels of institutions can be assessed only *ex post*, as they may trigger bifurcations and self-reinforcing mechanisms either towards growth or traps - towards developmental states, as in Asia -, or towards underdevelopment (low) equilibria, as in Sub-Saharan Africa. There is no *ex ante* and intrinsic developmental outcome that is attached to a specific type of institution: bifurcations are not predictable *ex ante* and depend on multiple changing conditions:

2. The conceptions of institutions in development economics and their limits

This section critically reviews the increasing use of the concept of institution in empirical growth and development economics studies and underscores its limits. These limits stem from the pre-eminence of modelling and quantification over any other methodology, in particular analytical and qualitative ones, and are reinforced by the demand by donor agencies that concepts of institutions be 'operable'.

The conceptions and uses of the concept of institutions in economics: some key features

Institutions remain under-theorised objects in economics, as neoclassical economics progressively marginalised old institutionalism and the multidimensionality of its perspective (Rutherford, 2001), as well as its legacies – e.g., evolutionary economics and concepts such as path dependence, learning or cognitive routines (Nelson and Winter, 1982, 2002). When using the concept of institution, economics – including development economics – tends to follow the definitions and reflections put forward by neoinstitutional economics, which gained full recognition after the 1990s and the awarding of the Nobel Prize to Douglass North and Robert Fogel in 1993. As is well-known, in line with Coase (1937), Alchian (1965) or Demsetz (1964, 1967), institutions have been explained through a limited number of concepts, in particular those of property rights and transaction costs. Distributive issues do not matter here and if property rights are well-defined, outcomes are Pareto efficient (Stiglitz, 2000).

According to Douglass North's oft-quoted definitions, institutions are constraints that structure political, economic, and social interactions and consist of informal - i.e., self-enforcing - constraints (sanctions, taboos, customs, traditions, codes of conduct) and formal regulations (constitutions, laws, property rights). Institutions take the form of regulations as well as ethical and behavioural norms. Functionalism is at the core of the neoinstitutionalist paradigm, and the functions of institutions constitute an intrinsic part of their definition: the major function of institutions is to reduce uncertainty by "establishing a stable (but not necessarily efficient) structure to human interaction" (North, 1990: 6). A conception of human interactions as transactions and games, and of activities as motivated by incentives is also at the core of the neoinstitutional approach: defined by North as 'rules of the game' shaping the incentives of the players as to how to transact, institutions have thus been widely analysed in game-theoretic perspectives, focusing on notions of enforceability in terms of Nash-equilibria, shared beliefs, and contracts (Aoki, 2001a). Interestingly, North increasingly views institutions as outcomes of mental models and learning processes (North, 2005).

The concept of institution is also widely used by other currents within economics, for example the asymmetries of information theory and the principal-agent theory. The evolution of norms - e.g. on discrimination or inequality -, may thus be explained as evolutions of incentives (Laffont, 2003), norms being incentives mechanisms since they are associated with social rewards and constitute substitutes for regulations (Fershtman and Weiss, 1998). A recurrent feature of neoinstitutionalist theories and neoclassical political economy is the 'under-theorisation' of the state, which is either an 'invisible hand' (minimal state), the 'correcting hand' (of market failure) or the 'grabbing hand' (according to the emblematic expression of Shleifer and Vishny, 1998, regarding transitional economies).

The concept of institution is also used by 'political macroeconomics' and positive political economy, which in the 1990s elaborated a variety of models of interaction between economic outcomes and governmental structures and policies – e.g., the economic consequences of democracies or oligarchic regimes, interest groups, the effects of political cycles on growth (Alesina *et al*., 1997), the links of economic institutions with political power (e.g. the independence of central banks), the political feasibility of reforms (timing, sequencing, time-consistency) - all possible variations can be considered in regard to the influence of interest groups on government policies, e.g. wars of attrition, preference for status quo, and so on (Fernandez and Rodrik, 1991). Likewise, in the market failure perspective, institutions, e.g., legal structures, or corporate governance institutions, result from market imperfections (Blanchard, 2000: 39). Institutions are endogenous responses to market failures, and government policies are generally aimed at protecting interests and rents.

These approaches rely on methodological individualism, the representative agent (typically the median voter) and the rational choice framework. The use of models that can be handled strongly constrains the assumptions and conceptualisation of government and institutions - even if the models are increasingly complex (Alesina, 1998; Drazen, 2000; Bourguignon and Verdier, 2000; Persson and Tabellini, 2000, 2003).

The literature regarding the nexus growth-incomes-institutions-social norms: an outcome of econometric exercises

As regard to development economics, the use of the concept of institution is strongly influenced by growth theories, since analyses of the processes underlying development and of the factors of divergence between regions and countries cannot be separated from analyses of the determinants of growth and levels of incomes. The determinants of growth that have long been viewed as the most important in growth theories are physical capital – investment- or human capital, under various modalities, such as factor accumulation or increasing returns (TFP, technology, knowledge and the like). Neoclassical models assumed convergence between countries, however: the observation of divergence over the 20th century and of a 'twin-peaks' world distribution of income, with some countries appearing to be lagging behind and not catching up, led to the exploration of different categories of determinants of growth as well as different families of models, such as models with multiple equilibria, threshold effects and traps (Azariadis, 1996; Quah, 1996; Beaudry *et al*, 2002). Non traditional determinants, and institutions in particular, thus became the subject of a growing number of studies in growth theory and development economics after the 1990s, and 'institutional variables' were increasingly integrated into growth models. Studies assessing the factors of development were not only shaped by growth theories and empirics, but also borrowed from a variety of conceptual frameworks, including neoinstitutionalism, economic history, political economy, evolutionary game theories and theories of social interactions and social norms. The analysis of the causalities mainly focuses on the impact of institutions on growth, but also on the reverse causality, the impact of growth on institutions.

Some empirical studies, which use the concept of institutions in order to explain the process of development, have become highly popular in development economics. They may, however, be called into question because of their underlying conceptual framework: indeed, they rely on a simplistic view of institutions, conceived as discrete and stable units whatever the space and time: in this view, the form, the function or some aspects of an institution are considered synonymous of the entire institution. These simplifications, which are facilitated by the neoinstitutionalist framework, are reinforced by the methodologies of the quasi-totality of these studies, i.e. the building of models and the use of econometrics, in particular growth econometrics and cross-country regressions: institutions must have the required properties to be used as variables, and in particular must be quantifiable and translatable into numbers. These simplifications have also been compounded by the influence of the international financial institutions (the IMF and the World Bank), which is a key feature of concept formation in development economics, as the latter need concepts and results that may be easily operationalised into policies.

This literature gathers under the concept of institutions phenomena that are very diverse. These studies usually distinguish 'economic' and 'political' institutions, which are implicitly 'formal', with 'social norms' viewed as more 'informal'. Economic institutions are often defined by their functions, the securing of property rights, the reduction of transaction costs and the enhancing of coordination (or the overcoming of coordination failures) being the most important (Bardhan, 2005). A great number of econometric studies thus explore whether economic and political 'institutions' are the preeminent determinants of growth, relatively to 'traditional' determinants such as investment or policies, and less traditional determinants, such as geography. They may find that the institutional variables are the most significant, thus allowing for the conclusion that "institutions rule" (Rodrik *et al.*, 2002). Such studies find that the determinants of countries' catching up (or divergence) and the heterogeneity of countries' responses to policy reforms, in fact refer to the specificities of local institutions. Such econometric studies also typically investigate the institutions that would be harmful or beneficial for growth, and often get results that are in line with neoinstitutionalist assumptions, e.g. the positive impact of the securing of property rights (Keefer and Knack, 2000; Dollar and Kraay, 2003).

Since the first studies in development economics that used institutions as explanatory variables of growth in cross-country regressions (e.g., Barro, 1991), a large number of econometric studies have used existing datasets or built ad hoc databases that provide 'institutional variables' to be added to the usual explanatory variables in growth cross-sectional regressions in order to explain the poor performance of some regions (e.g., International Country Risk Guide (ICRG), Business Environment Risk Intelligence (BERI), the Polity database, the Freedom House index, etc.) (Knack and Keefer, 1995; Mauro, 1995; Clague *et al*., 1997; Hall and Jones, 1999).

Results cannot be convincing, as the quality of data is often very poor, which is a key characteristic of developing countries, especially in Sub-Saharan Africa, and proxies are most often loosely related to 'institutions', which are themselves often ill-defined. These datasets provide data that are supposed to be comparable across countries and time periods on 'risk', 'governance', 'investment climate', 'rule of law', 'corruption', 'security of property rights', 'constraints on the executive', and so on, and which are from the outset presented in the form of indicators and figures – moreover, these datasets often measure outcomes, not even permanent characteristics (Glaeser *et al.*, 2004). These data are considered as proxies for other institutional dimensions, such as the 'quality' or 'weakness' of institutions - examples being the World Bank series of indicators entitled "governance matters", which provide measures of the rule of law and protection of property rights (Kaufmann *et al*., 2009, or the World Bank 'Doing Business' annualised database, World Bank, 2009). The econometric model tests the explanatory character of these variables for aggregates such as per capita growth rates or incomes or any other economic variable, for example investment.

The methodological flaws of cross-country growth econometrics are well-known – for example, implausibility of assumptions, simultaneity bias, lack of robustness of specification and multicollinearity, uncertainty regarding the determinants of growth that should be included in the model (Brock and Durlauf, 2000; Durlauf *et al*., 2008). Flaws are still more visible when growth equations use variables that refer to complex entities such as institutional dimensions (Temple, 1999; Aron, 2000; Kenny and Williams, 2001). Variables are underlain by simple views of institutions: the latter take the part for the all and equate the existence of an agency, or certain formal attributes of institutions that can be quantified or can be taken from a database, (e.g., numbers of elections, parties or newspapers, the composition of parliaments or courts, numbers of civil servants), with the 'internalisation' of these institutions in the mental representations, reasoning and behaviour of individuals. For example, the number of elections (a part) is equated with 'democracy' (the all), a simplification that econometric studies do not even feel disturbing: elections can be translated into numbers, while 'democracy' cannot, hence this variable sounds more 'scientific' for an econometric exercise than 'democracy'. This conception of institutions also supposes that the meaning and relevance of a particular institution is fixed regardless of historical change, and that they are identical for all the inhabitants of a given country (but strangely stopping at its borders in the case of cross-country regressions), regardless of their social and individual characteristics.

These cross-sectional studies consider institutions as discrete, autonomous and separable variables – 'economic freedom', 'rule of law', 'judicial independence', 'political accountability', 'protection of rights', 'market regulation' and so on. Hence, these studies consider that they can enter in causal relationships with other variables to which they are supposed to be comparable, such as rates of growth, income levels, flows of foreign investment, human capital, and so on, resulting in causalities of the type: "the rule of law has a positive impact on the level of investment", etc. Institutions, however, are multidimensional processes, which in some cases may be expressed by a quantifiable variable that has a non-ambiguous and non-overlapping reference comparable to the usual notions of economics, e.g., prices, volumes and so on; in other cases, institutions do not constitute stable, separate, quantifiable entities. This is aggravated by the use of proxies that may have only very indirect relations with the institutions they are supposed to represent: e.g., number of parties or elections as proxies for democracy, number of regular interactions as a proxy for integration in a 'community', etc. This use of proxies may itself be aggravated by the use of composite indices – a proxy for institution may thus be the protection against 'risk of expropriation' index from the database built by the think tank Political Risk Services (Acemoglu *et al*., 2001c).

Endogeneity is a recurrent dimension of the causalities that link institutions to other economic phenomena. Institutions constitute not only causes, but outcomes that endogenously emerge over time. These problems of endogeneity are acknowledged by neoinstitutionalist theories - typically, game theories (Aoki, 2001b) -: their critiques, however, remain weakened by their choice of keeping the neoclassical framework, hence reasoning at the level of the individual and extrapolating from the individual to more aggregate levels. To take 'private agents' as the point of departure of the argumentation renders difficult the determination of relevant causalities between concepts that refer to collective phenomena. Nevertheless, these studies continue to investigate whether ‘democracy’ conducive to growth or growth conducive to ‘democracy’, as well as their reciprocal influence. Therefore, the findings regarding the relationships between institutional variables and economic aggregates (e.g., growth) inferred from cross-country regressions are highly diverse and are most often limited to general statements, such as the importance of stability of anticipations or political institutions, or the observation that ‘institutions matter’ (Przeworski *et al*., 2000). Many studies thus do not find significant links between institutions and levels of development, and causalities as well as their directions remain controversial and inconclusive.

One example of a simplistic view of institutions that is recurrent in empirical econometric studies is to view them as a variety of ‘capital’ (as in Persson and Tabellini, 2009). Some regions would possess abundant stocks of institutions that are of a ‘better quality’, while other regions or countries would lack them. Transferring or building these institutions in these latter countries has hence a positive impact on their growth. For instance, a popular explanation of the economic stagnation of Sub-Saharan Africa refers to the types of colonialism (settlers and non-settlers). The colonisers who settled in the colonised countries are said to have created in these countries ‘institutions’ such as secure property rights that fostered growth. When colonies had poor geographical and natural endowments, colonisers could not settle and this prevented the formation of institutions and therefore the triggering of the growth process (Acemoglu *et al.*, 2001a; Nunn, 2007).

Institutions are viewed here simply as guarantors of private property or as ‘extractive’ institutions via questionable proxies. Such arguments deny the diversity and (implicitly) the very existence of local institutions (e.g., political and social hierarchies - kingdoms, village communities -, and the organisation of markets and production). They overlook the fact that colonisation, as any process involving two entities, generated complex interactions, including power relationships. The creation or transfer of institutions never operates on a *tabula rasa*, which simply does not exist. Depending on the particular combinations involving imported and local institutions, colonisation has been destructive in Sub-Saharan Africa in some cases, while producing institutional innovation and development in others. As is well-known, certain coordination mechanisms have been optimal in some contexts and not in others, as shown by Greif *et al.* (1994) regarding the reputational mechanisms of the medieval Maghribi traders in the context of long distance trade and ruler hostility, contrasted with the individualistic institutions that have developed at the same time by other groups, such as the Genoa traders.

Likewise, there are no types of institutions that are *per se* intrinsically favourable or unfavourable to development across time and space: only arrangements and compositions of institutions are, which depend on the way external institutional elements combine with the recipient country’s institutions and broader economic and political contexts. There are no single and immutable causalities in economics. This is what, in a different perspective, a concept such as the ‘fallacy of composition’ expresses: certain policies may be positive when applied to a limited number of cases, but become harmful in the event of a change in scale and when extended to other countries.

The irrelevance of the formal-informal dichotomy

Developing countries are said to be characterised by important so-called ‘informal’ activities. Indeed, many models and econometric studies in development economics widely use the conventional dichotomy between ‘formal’ and ‘informal’ institutions, which loosely and implicitly equates ‘informal’ with ‘unwritten’, and contrasts ‘social norms’ that would be ‘informal’ to ‘institutions’ that would be ‘formal’. The formal-informal distinction is often viewed as an explanation for the failure of reforms aiming at creating market institutions in post-communist countries or in Sub-Saharan Africa, ‘informal institutions’ being, for example, obstacles to ‘ownership’ or internalisation of market institutions by individuals.

Most studies, however, oppose formal institutions and informal norms in accordance with functionalist arguments. For example, the emergence of informal norms has been viewed as a response to particular market organisations: networks and reputation effects are informal mechanisms of contract enforcement that are optimal in settings characterised by incomplete information and free riding (Greif, 1989 on the example of the medieval Maghribi traders). These informal institutions are said to entail inefficiencies in developing countries: interlocking contracts involving several markets and networks are considered to be sub-optimal, transactions being repeated within narrow spheres of exchange and within the ‘limited morality’ of communities, which contrasts with the ‘generalised morality’ of the market (Platteau, 1994). In developing countries, individuals may prefer the ‘exit option’ from state ‘formal’ institutions (e.g. when perceived as irrelevant or illegitimate), which is a vicious circle that perpetuate institutional erosion and social fragmentation. Likewise, the poor performances of some transitional countries has been said to result from the superimposition of ‘formal’ laws on existing ‘informal’ rules, which has induced institutional dysfunctionality if formal rules contradict or do not complement existing norms (Stiglitz, 1998; Berkowitz *et al.*, 2003).

This dualism is simplistic and superficial (Sindzingre, 2006). Labour markets in developing countries reveal that differences between the ‘formal’ and ‘informal’ constitute a continuum of activities rather than a duality of polar opposites. Similarly, informal’ rules are not weaker than ‘formal’ ones in terms of obligation and precision. Both ‘formal’ and ‘informal’ rules coexist within the reasoning of individuals and with a comparable strength of obligation – informal rules sometimes being more compulsory than the written ones. Depending on the environment, individuals chose the situations where formal and informal rules apply respectively. ‘Informal’ institutions may include highly complex rules, in regard to, for example, land allocation, inheritance, hierarchies of social exchange, credit, and so on, and these rules are sometimes more complex than ‘formal’ institutions. In the course of history the rules, norms, organisational forms and functions of ‘informal’ institutions have changed and been shaped by evolutionary processes, in the same way as ‘formal’ institutions have. The fact that certain sets of rules are written or decreed by a government is only a particular feature of the multiplicity of institutional forms. Whether they are formal or informal, all plainly constitute institutional entities that transform and combine with other institutions, as well as other elements of their environment.

Most econometric exercises that rely on the informal-formal distinction between institutions therefore do not find conclusive relationships between these institutions and growth. Indeed, regulations and norms, either formal or informal, may have congruent or opposing focuses and effects. The fact that contract enforcement follows 'formal' or 'informal' mechanisms does not provide insights as to the contract's effects in terms of efficiency or growth. There is obviously a reciprocal influence between formal rules (such as legislation) and informal norms (Sunstein, 1997: 36) as well as significant variations between regions in the normative strength of legal rights or unwritten rules.

The effects of social norms in terms of equity and efficiency are inconclusive as well and as diverse as norms themselves. Indeed, growth and higher income levels can encourage norms that are efficient and egalitarian as well as discriminatory (Young, 1998: 821). Social norms may be either opportunities for or obstacles to well-being. Norms can reflect the preferences of interest groups (Weiss and Fershtman, 1998: 815), but many studies (empirical or theoretical - for example, based on game theory) show that individuals may follow norms from which they derive no benefit (Heinrich *et al.*, 2004; Gintis *et al.*, 2005). Altruism may prevail, even if it seems to be more the case in small groups than in larger ones where the predicted free-riding seem to hold (Caldas *et al.*, nd). Institutions may facilitate collective action as well as reinforce the status quo. Norms may or may not move towards improving social justice, regulate excesses of poverty or wealth, and help to reduce inequalities, as well as create discrimination and exclusion.

The strengthening of these conceptions of institutions by the international financial institutions and donor agencies

These approaches of institutions have permeated the conceptual framework of international financial and aid agencies, in particular the World Bank and the IMF (as illustrated, for example, by the 2001 World Bank World Development Report on institutions), while these agencies in turn reinforce and legitimate these approaches within academic research. Indeed, one of the specific features of academic development economics is its constant exchanges of conceptual paradigms with donor agencies, because they also act as producers of concepts in both a positive and normative manner (Banerjee, 2002: 2). Concepts of development economics circulate between academia and donor agencies with the latter's financial support, which gives these concepts additional visibility and validity ('institution', 'poverty', 'social capital', for example), but also provides them with some ambiguity, as concepts simultaneously belong to the theoretical and operational spheres (Sindzingre, 2002, on the rise of the concept of poverty within aid agencies and academic studies after the 1990s; Sindzingre, 2004a, on the contribution of international agencies to the production of 'truths' in development economics).

In addition, the view of institutions promoted by international agencies necessarily removes the political dimension that is inherent to the concept of institutions, because these agencies officially rely on an apolitical and technocratic mandate that is supposed to ground their credibility (as is well-known, the IMF and World Bank Articles of Agreement forbid them to interfere in the domestic politics of their client countries).

Their analyses remain within a ‘depoliticised’ framework that ignores power relationships and equates ‘politics’ and ‘government policies’. Successful reforms or countries are explained by the existence of ‘strong institutions’, ‘stable expectations’ and a ‘social contract’ between states and individuals. The underlying model of society is made of individuals voluntarily contracting in markets, including political markets: this concept of contracts denoting individual and voluntary participation erases the dimension of political power. The concept of ‘social capital’, which is embraced by mainstream development economics in order to explain the determinants and outcomes of social interactions in non-industrialised contexts (but in developed countries as well, Putnam, 1993), thus implies a view of society where individuals voluntarily acquire, stock and capitalise relationships with other individuals, these relationships thus being ‘assets’. Such a conceptualisation then allows for quantification and econometrics and usually finds that this ‘capital’ has a positive effect on growth (Fine, 2001; Englebert 2001 for in-depth criticisms). Societies, however, and perhaps more so in developing countries, are characterised by multiple and complex memberships and allegiances, which blur the boundaries between ‘interest groups’ (Haggard and Webb, 1993). Many institutions, norms and group affiliations are not the product of social contracts, nor are they negotiable on markets or modifiable by individuals.

After the 1980s, for developing countries and especially in Sub-Saharan Africa, the analytical framework of international financial institutions has been characterised by the discrediting of the state and of the civil services, which are seen as inefficient, oversized and corrupt. This framework has been strongly influenced by the rational choice and public choice literature, and the state was presented as the source of economic failure and having been ‘captured’ by rent-seeking politicians. In the 1990s - more in research than in policy practice - the state has been ‘rehabilitated’ within in the IFIs by theories of market failure and information asymmetries (as shown by the 1997 World Bank’s World Development Report on the state in developing countries). This integration of the state and institutions into the theory, as well as reforms, gave rise to an ‘expanded’ version of the ‘Washington consensus’ (Williamson, 1990). Beyond the usual policies (e.g. fiscal discipline, liberalisation, secured property rights), in the ‘post-Washington consensus’, states and institutions are necessary to the provision of public goods - and supra-state institutions to the provision of ‘global public goods’ (macroeconomic stability, effective and accountable legal, regulatory, and political institutions).

Institutions have become widely used concepts within donor agencies from the 1990s onwards, for both political and operational motives, and have mostly been analysed in terms of their contribution to growth. Institutional defects were viewed as the main reasons for the failure of reforms and became the motives of additional conditionalities. The responsibility of failures has been allocated to the developing countries’ ‘bad policies’ and ‘poor institutions’, and not to the reforms, whatever the studies showing that unsuited reforms recommended by the IMF and the World Bank (e.g., financial or trade liberalisation) have been the key factors in a significant number of crises. The global crises of the 1990s and 2000s have been described as resulting from the ‘weakness’ of local legal, regulatory and financial institutions, corruption, or ‘bad governance’ of governments and firms’ corporate governance.

The analysis of institutions is also linked to the paradigm of poverty reduction, which, at the end of the 1990s, had been established as the basis of action and legitimacy by all aid agencies (Sindzingre, 2002a). A ‘consensus’ has developed within aid agencies that builds around a series of causalities, e.g., the poor are hurt and excluded from markets and development is hindered by ineffective institutions (for example, opaque laws, corrupt courts, biased credit systems). Institutions are needed to make markets work and this constitutes a major mechanism for poverty reduction (the World Development Report on institutions being typical of this approach, World Bank, 2001). Economic reforms fail not because they may be inappropriate but because states are weak, either subjected to the pressures of particular groups and of populist demands, or 'captured' by the ruling elite (Williamson, 1994; Bates and Krueger, 1993). Vested interests and lobbies resist reform efforts in order to maintain access to rents. Hence a strong emphasis is placed by donors on the building or reform of legal systems and the altering of inefficient rent-creating regulations and state organisations (Johnson and Shleifer, 2001). These reforms are presented as welfare and equity enhancing, through the dismantling of state institutions that allow small groups to siphon off public resources – among others, marketing boards, state-owned enterprises, capital-intensive projects, crony financial firms speculating on short-term capital flows, trade barriers (Tanzi and Davoodi, 1997; Wei and Wu, 2001). Reforms are considered to be beneficial for the majority when they weaken traditional institutions that perpetuate social discrimination, inequality, arbitrary power, and, in this sense, are anti-developmental (Stiglitz, 1998).

The underlying political economy model relies on the superficial distinction between the 'winners' and 'losers' created by reform (e.g., liberalisation) (Obstfeld and Taylor, 2001: 1). The costs of adjustment are postulated to be temporary and leading to a more efficient allocation of resources, as markets and prices are supposed to adjust in the medium term. This dichotomy, however, divides social groups as if they constituted distinct and exclusive categories, which is unrealistic, especially in developing countries, where the coexistence of multiple types of allegiances, both 'traditional' and 'modern', is quite common.

The design of reforms in developing countries, whose bargaining power is limited, did not incorporate an understanding of local institutions, which contributed to resistance and the erosion of the reforms. In Sub-Saharan Africa for example, many civil service reforms of the 'first generation' of the financial stabilisation programmes of the 1980s were aimed at downsizing staff size and wage expenditures (Lienert and Modi, 1997). Fiscal crises, however, accelerated the loss of credibility of public institutions, especially the judiciary, customs, and internal revenue administrations. In the 1990s, the IMF recognised that public expenditure contraction had undermined the already problematic capacity of African states (Tanzi, 2000a). While in theory the 'second generation' of civil service reforms has focused on 'improving incentives' (Lienert, 1998), in practice it has relied on simple notions of institutional reorganisation, such as creating 'enclave' public agencies financed and managed by donors. The latter are caught in the dilemma of prescribing local 'ownership' (an oxymoron) and disbursing funds rapidly. The key objectives of reforms for the IMF and the World Bank are *in fine* financial stabilisation and debt servicing, and therefore institutional 'capacity building' has focused mostly on financial departments. Reforms claim to be primarily technical and fail to understand the political economy issues, i.e. the shifting of rents and political influence that can arise in the wake of liberalisation (this has been the case of reforms equating 'institution building' with computerisation, for example of revenue collection). Moreover, for geopolitical motives international financial institutions have continued to lend to regimes with little regard as to whether they have met the previous conditionalities (Easterly, 2001a: 108). This has eroded their credibility and efforts at building institutions in developing countries (e.g., judicial courts, investment agencies).

Reforms that target institutions have often failed because their contents are considered exogenous and irrelevant by the recipients. Institutional change is an endogenous process involving credible institutions, which are built with multiple external elements in a continuous process of borrowing. Institutions may be imposed by force (e.g., by colonisers, lender conditionality or domestic governments) but their particular arrangements, credibility, degree of acceptance are the products of flexible and unpredictable historical processes of evolution and adoption.

3. Institutions as composite processes: elements of an alternative theoretical framework

An alternative theoretical framework is presented here, which more accurately explains the mechanisms that underlie the transformation of institutions and their relationships with growth and demonstrates the simplism of neoinstitutionalist or econometric causal assessments. This framework underscores the composite character of an 'institution'. Institutions are the outcomes of composite processes involving many levels – cognitive, economic, political -, the dissemination of individual beliefs to other individuals, i.e. the transformation of an individual belief into beliefs collectively held by a group, and the interactions of an institution with other existing institutions. Institutions are not 'concrete' objects: they are made of heterogeneous elements, which include cognitive processes that are both individual (beliefs) and social (norms, written rules, legal systems, and so on).

In particular, the 'forms' of institutions should be distinguished from their 'contents' (the individual or shared representations). Institutions cannot be analysed in isolation, since they are path-dependent and interact with each other: i.e. institutional forms and contents are shaped by their coexistence and combination with other institutional forms and contents. Rather than static *ex ante* entities, institutions' forms and contents are in a continuous process of combination with others in given settings: given institutions in space and time are an outcome, among many possible others, of forms and contents' multiple combinations as well as these two analytical levels' interactions with other existing institutions. Some institutions, however, appear to be more 'credible', recurrent and resilient than others: spheres of human activities such as memberships and power relationships contribute to the stabilisation or the transformation of institutions.

Institutions as complex entities: many definitions and levels

Institutions are highly diverse: they may be economic, political or social, and organise market or non-market relationships, with the state being a specific arrangement of institutions based on legitimate coercion and legal apparatus. Some institutions derive from the state while other institutions may not be linked to it, which may be political institutions (e.g., village-level politics), economic institutions (e.g., regulating traditional exchanges and markets), social institutions (norms of behaviour, customary rights, institutions regulating the life-cycle such as marriage, and so on) – and indeed, the focus on non-state institutions, e.g. related to 'culture', was central in the old institutionalism (Lawson, 2003). State institutions are the result of human intentionality ('agency') and explicit rules - i.e. of individuals (e.g., politicians, civil servants) who want to build or reform institutions and have the power to impose rules to wider groups. State institutions thus incur a risk of not being 'internalised'. They are also, however, the result of individual interpretations shaped by history. All institutions constitute a provisional stabilisation of infinite individual interactions and mental representations with variable degrees of flexibility and paces of change.

Institutions exhibit variable degrees of influence on individual behaviour - rules of politeness obviously incorporate a different intensity of obligation from other conventions (driving codes, or religious rules) (Lewis, 1969). Moreover, the relevance and degree of the obligation of rules varies according to the situation and the characteristics of the individuals involved (e.g. rules decreed by a religious institution in some situations and decreed by a state in others). Likewise, a set of rules may be adopted by a group but in fact only applied to a category of individuals: in developing countries, the delivery of a public service may typically be viewed as applying only to a civil servant's relatives, which obviously modifies the effective content of these rules. Similarly, elements of public institutions may be sold on a market - e.g., justice, security, education -, and in turn market exchanges may be reserved for individuals having power or entitlement to it, e.g. entering a particular job market or producing a particular good. The modification of a rule may alter the entire coherence of an institution.

The crucial distinction between the 'forms' and the 'contents' of institutions

The distinction between the forms and the contents of institutions allows for a better understanding of their economic impact. The 'forms' of institutions refer to their name, the rules that govern their internal organisation, their alleged function (which may be 'formal' or 'informal', written objectives or oral traditions). They differ from their 'content', which refers to sets of mental representations, meanings, inferences, emotional states, and the rules of behaviour (rights, obligations, prohibitions) with which they are associated. Contents change with time and may be interpreted differently from one individual to another. Although the perspectives differ, this distinction may be a way of understanding the concept of 'embeddedness' - forms being embedded in the particular meanings layered by individual and social histories, as explored by Karl Polanyi and later by Evans (1995). The form of an institution *per se* gives no automatic information on the related content, i.e., the meanings and values attached to it, the intensity of the rules that it conveys, and the degree of its 'internalisation' in the minds of individuals.

Most studies in neoinstitutional economics rely on a functionalist framework, and incentives is a pivotal concept, often used though the principal-agent theory.

Institutions, however, cannot be only explained by incentives involving two entities, ‘principals’ and ‘agents’, and their calculations in regard to their utilities (this asymmetry may be viewed as an outcome of power relationships, as signalled by their very names, i.e. ‘principal’ and ‘agent’). The concept of incentives encompasses simultaneously less than norms, as there are a variety of norms that do not derive from incentives (certain sets of social or religious norms) and more than norms, as there are many incentives that do not give rise to norms (e. g., killing, stealing). The initial situation (the fact that one is a ‘principal’ and the other is an ‘agent’) remains unexplained in this conceptual framework, as it results from rules that themselves resulted from other individual incentives.

In the functionalist perspective, institutions are defined *ex ante* by their functions, for example general functions such as reducing transaction costs or specific functions such as securing property rights. This functionalist perspective makes it possible to assert general causal explanations on institutions, with historical change being explained by simple mechanisms and teleology (such as the securing of rights or the reduction of transaction costs). Applied to specific situations, however, functionalist arguments become rapidly self-contradictory, as shown by Elster (1982), i.e. presupposing a complete knowledge of the feedback mechanism. Functionalist arguments are also under-determined: for any phenomenon, any possible function can be found (optimising the allocation of resources, returning to equilibrium, and so on). Moreover, a functional explanation ignores historical transformation, and does not explain the emergence of infinitely diverse in time and space institutional forms and contents (Sindzingre, 1998). Functionalist arguments may also be tautological: they confuse causes and effects, as well as functions and forms, despite their differences. The regulation of markets is a function that does not necessarily correspond to specific institutional forms; and some functions, such as giving assurances to investors, may be achieved in the absence of private property rights, which are only a particular institutional form (Rodrik, 2004). Finally, functionalist views of institutions denote a superficial theory of psychology: individual preferences are deducted from the functions; in behaving so, individuals reveal their preferences for reducing transaction costs. Actions are here direct translations of beliefs; particular transactions are the direct expression of the beliefs and preferences of individuals: e.g., if individuals vote, it means that they would have a complete representation of democracy (and of the relationships between the concepts of elections and democracy) and reveal their preference for it.

Yet, individuals are exposed to a multiplicity of beliefs systems and institutions with heterogeneous historical backgrounds about which they have incomplete knowledge (e.g. knowing only a name, or knowing only some meanings but not the associated name), perhaps more so in developing countries. Institutions are not always created (and explained) by an *ex ante* ‘finalist’ function: their effective content – and credibility – results from various unpredictable layers of events and environments. Institutional artefacts or innovations are not always relevant and may be ephemeral. Institutions are transformed, or ‘processed’ by individuals according to their own beliefs, social environment and past. Individuals or groups may adopt institutions, e.g., from other countries or societies, without adopting the ‘complete’ nexus (‘package’) of forms and contents. It is indeed difficult to adopt the entire package because the various layers of meanings and functionings of a given institution are the sediments of historical processes and some layers are linked to specific groups or locations. Thus, individuals may integrate in their own mental representations only ‘fragments’ of institutional forms and contents: e. g., they may acknowledge some administrative rules but have no notion of the concept of public service; they may implement electoral systems but have no notion of democracy, a free press but with an authoritarian notion of freedom, an independent central bank or rules defining accountable government without the same concept of independence or accountability as in Europe or the United States. This underscores the simplism of distinctions between institutions that would be ‘economic’ vs. others that would be ‘political’.

The institution of ‘democracy’ is a typical example of this distinction between forms and contents. In several developing countries, formally democratic regimes are not at all democratic, and sometimes use the institutions associated with democracy, like constitutions, to set up perfect formal democracies, the contents of which are ‘perversions’ of democracy[2]. This is why cross-country regressions may find positive as well as negative relationships between democracy and growth, corruption or social conflict (Tavares and Wacziarg, 2001; Bardhan, 1993; Przeworski, 1993). Authoritarian governments may enjoy high growth rates and in developing countries ‘strong’ and stable institutions may be the least democratic. Econometric methods cannot capture the effective content and degree of adhesion of individuals to particular rules, and therefore cannot find linear relationships between types of political institutions and levels of development (Bratton and van de Walle, 1997, on democratisation processes in Sub-Saharan Africa), even if analytically the relationship is positive between growth and accountability or freedom (Rodrik, 1999b; Sen, 1999).

Forms and contents (‘meanings’) of institutions are shaped by their ‘neighbourhood’ or association with other institutions. Certain institutions may be complementary to other institutions; they may command over other institutions, their functioning and interpretation, and they constitute the internal content filling other institutional forms. For example, the notion of ‘court’ is associated with a mental representation that both presupposes and provides rules of action, and shapes the mental representation of ‘justice’; likewise, the notion of ‘civil service’ both presupposes and provides meaning and rules of action vis-à-vis the concept of ‘state’ or ‘government’. Some institutional forms may not even have a ‘family resemblance’ with their effective content (e.g., an ‘independent central bank’ in a totalitarian regime). Other institutions and rules, such as private property rights in communitarian polities, corporate regulation in oligarchic regimes, or ‘transparency’ in authoritarian regimes may have different values or economic outcomes according to the mental representations of the individual dealing with them, and the institutional environment. The ‘neighbourhood’ - or presence - of other institutions limits, circumscribes and specifies the functioning and meaning of a given institution.

[2] In many formally democratic Sub-Saharan African countries (Côte d’Ivoire, Togo, etc.), rulers drafted entirely ad hoc constitutions in order to stay in power or eliminate a political opponent.

Institutions as outcomes of cognitive processes: shared mental representations and norms

Institutions are, in the first place, the outcomes of cognitive processes: they are individual mental representations. These representations, however, do not constitute mental models in North's sense. North analyses mental models within a functionalist framework: as individual responses to uncertainty, which are formed through a learning process over time, with long run change coming from learning, and as 'filters' that interpret the environment and are driven by competition between institutions (Denzau and North, 1994; North, 1995). The 'compositional' perspective presented here subdivides institutions according different levels in terms of cognition and action ('forms' and 'contents'). The levels combine with each other according to determinants that do not necessarily involve competition or beliefs formed through learning.

The linkages between mental states, perception, rules, routines, learning are the subject of the growing field of cognitive economics: the latter is, however, affected by the heterogeneity of theories in cognitive science (e.g., computational theories, neural networks or multi-agent models of the mind, Egidi and Rizello, 2003) and the propensity of economics to favour theories that appear to be the closest to physics and allow for measurement, experiments and tests, such as neuroeconomics (Camerer *et al.*, 2005) (in contrast with the conception of knowledge of the old institutionalism, Loasby, 1999).

Mental representations do not constitute physical and external objects: for example, property rights or democracy are not concrete objects even if they are specified by concrete and distinctive attributes, language and procedures. Therefore, they do not constitute discrete entities or objects, which would directly 'cause' other events or institutions in a unilinear manner: *'p'* causes the event *'q'*; for example, democracy or accountability 'causes' economic growth; 'large government' 'causes' the slowdown of growth; or multipartisan elections 'causes' democracy. Such simple conceptions of institutions as concrete objects and terms of direct causalities, widely used in the growth regressions literature, are metaphors in the first place. Institutions as sets of rules are representations that develop in the mind of individuals. They require the beliefs of an individual in order to be adopted by him-her, to be disseminated to and adopted by other individuals, in order to generate behaviour and collective action and give rise to physical artefacts (symbols, buildings, written documents, etc.), which in turn reinforce particular sets of mental representations. The specificity of institutions is that they constitute 'meta-representations', i.e. individual 'representations of representations' or representations providing rules for other representations and for action, according to a process of 'dissemination of representations' organised by meta-rules (as demonstrated by Sperber, 1985).

Such a conceptual framework does not reduce institutions to a pure individualist perspective. There may be indeed no one to defend the latter (Hodgson, 2007), and even the neoclassical approach recognises that altruism may be a universal feature of humans, which can make markets more effective, reduce uncertainty and allow individuals to extend decisions into the future (such as social protection, insurance and risk-pooling mechanisms) or constitute an individual advantage – game theory indeed shows that altruism may be a dimension of self-interest, e.g. providing the benefit of the approval of others, the feeling of group membership (Sugden, 2000; on morality and contractarianism, Gauthier 1993; on morality as a rational behavioural strategy, Vanberg and Congleton, 1992; Vanberg, 1994). The representational 'content' of institutions (beliefs) is by definition shared, or at least presumably shared: when individuals use the same institution - an economic institution such as a market, for example – at the very moment they exchange on this market individuals attribute to others at least certain common beliefs (as highlighted by the debate on 'common knowledge'). A representation held by only a single individual is not an institution, which makes it so that institutions may be analysed both under the angle of methodological solipsism and as collective entities.

This refines the notion of the 'institutionalised individual' elaborated by the old institutionalism (Hodgson, 2000), i.e. that institutions shape individuals. This notion was affected by the problem of the ontological heterogeneity between this individual and a causal entity (the institution) that is not a physical object but a composite of norms, beliefs, objects, behaviour and representative individuals. Individual representations are in turn organised by beliefs that are shared by other individuals (who sometimes present them as norms). These shared beliefs allow an individual to hold stable, reciprocal and normative expectations about the behaviour of the other individuals and to make predictions on the latter' actions: reciprocity and normative expectations, i.e. norms allowing both predictive and normative expectations on the conduct of others are indeed at the foundation of rationality (Hollis, 1998). Institutions are thus both a product of individual representations – which give credibility to their rules or reject them - and the outcomes of composite layers of collective expectations and norms regulating social interactions, rights and obligations.

Institutions as processes of 'composition'

Institutions thus cannot be analysed *per se*, as discrete units isolated from their external environment. Institutions are created by rules and are also the expression of cognitive processes, collective representations, power and 'external events'. They are constituted by a continuous 'composition' of elements, past and present, and by their relationship with other existing institutions, which allows for a better understanding of institutional change and the reasons why some institutional devices are adopted and others become irrelevant or are rejected.

A given institution results from a double process of combination in time and space: it is a legacy and transformation of past institutions and is shaped by its 'neighbourhood' with coexisting institutions. Institutions evolve within a context created by other institutions (Evans, 2000). The presence or absence of other institutions provides the scope or the limits, the field of extension, the content and function to a given institution. In settings where, for example, there is no state, no political parties, no central bank, or no banking system, as is the case in many developing countries, other institutions may 'fill' these 'voids'. Likewise, if there are no churches, political institutions may include representational contents that are similar to religious institutions in other contexts; similarly, if there are no state judicial courts, 'traditional' religion may be the institution that regulates conflicts. In settings where these institutions exist but the other institutions that provide them with limits are 'missing', their meaning and function differ from those they have elsewhere: e.g. the judiciary in the absence of a parliament, or money in the absence of a market, or contracts in the absence of a state.

This concept of institutional composition differs from that of complementarity, which has been elaborated upon by Aoki (2001b: 225sq) from concepts defined by North, and refers to individuals' choices that are influenced by interactions between institutions providing some mental room to the individual. It is argued here that forms and contents of institutions combine with each other, for example with other economic or political institutions as well as the broader environment according continuous transformations. Combinations are the relevant level of analysis, as is the case regarding the debate that emerged in the 1990s as to whether geography, policies and institutions are the key determinants of growth: the most important factor may be the actual outcome of their interrelationship in a given setting (this is argued by Rodrik, 2001b, for China's growth, although he considers institutions as single and separable entities). Causalities interact both between the 'dependent' and 'independent' variables and among the 'causal' variables themselves.

To be effective institutions must find 'connections' in the forms and contents of other institutions: a free press or independent judicial court existing in isolation will not generate the same effects as, say, a free press articulated to an independent court. These links are achieved by the institutional arrangements themselves and the multiple mental representations associated to them (e.g. credibility, moral values), and *in fine* the political power structure, which will or will not make a given institution work and maintain itself. In a cognitivist perspective, at a given point in time and space, institutions receive their conceptual content, meaning, legitimacy, the intensity of obligation toward the rules associated with them, and their scope of competence because they coexist and are interlinked with other institutions. Each institution has a specific and unpredictable pace of change. Any institution, even 'imported' from outside, develops specific meanings and functions in its relationship with other institutions: it is the environment provided by the existence of other institutions that gives it scope, content and meaning.

A well-known example is the interlinkage of markets and other institutions. Markets are not only institutions but also shape and are in turn shaped by a variety of institutions – a strong society similarly shapes and is shaped by a strong state (Evans, 1997). Norms may discriminate between different spheres of exchange (market and non-market, such as intra-household exchanges, or 'religious' vs. 'secular') and provide guidance on the acceptability of particular goods and prices in specific markets. As is well-known, and particularly since the global crises of the 1990s and the 2000s, in developed countries, markets cannot function without state or supra-state regulation. In developing countries, weak states lead to weak markets, as illustrated by the failure of many privatisations, which have often only meant a shifting of rents from patrimonial states to private oligopolies, local or foreign (Bayliss, 2009).

Thus, there is no such thing as 'institutions' abstracted from history and the sedimentation of contents and forms that time and circulation in space create for a given institutional form (e.g., adopting a foreign institutional form). Economic history has shown that no particular institution is indispensable for growth (Engerman and Sokoloff, 2003) and there is no 'global standard' of institutions. Some countries have exhibited remarkable economic performances while not having the institutional forms -

secured property rights and contract enforcement -, that cross-sectional studies assume to be crucial factors of growth (Rodrik, 2001b on China). Historical change is path-dependent, but there are no unique sets of causalities, nor is there a selective or linear path leading to development (Adelman, 2001: 118).

The interlinkages of institutions both with other institutions and economic processes complicate efforts to transform them. Legal and organisational rules are obvious instruments of transformation but the actual content that may 'fill' them is never certain *ex ante*, as it depends on mental representations (shaped by history, 'tradition', and idiosyncratic features) and the external environment. Particular outcomes cannot be predicted *ex ante* and are observed *ex post*, as they result from the dynamic combination of multiple facts and institutions (political as well as economic). As shown by Yalçintas (2010) regarding the evolution of ideas, their many pathways do not necessarily lead to any predefined end point. Small events trigger shifts and bifurcations, which may move the system away from its original direction. Institutions change slowly, as they follow the paces of both internal and external forces. These paces may be distinct and institutional linkages may slow down the change of elements considered in isolation, as Veblen has pointed out (quoted in Arrow, 1998: 44). History has been famously said to move along three heterogeneous paces, the short one - politics -, the medium one - economics -, and the long one – the "*longue durée*" of geography, norms and customs (Braudel, 1949).

The capacity of certain institutional combinations to stabilise or change and the issues of credibility and power

There are constraints on these processes of composition, however. Firstly, institutional change is obviously influenced by initial conditions, the level of income of individuals or countries, and by the allocation of investment - local and international, public and private. The impact of these factors has greatly differed among regions of the world, e.g., East Asia and Sub-Saharan Africa in the 19th and 20th century, the latter being affected by the colonial 'scramble' that failed to support infrastructure and human capital (Booth, 1999; Kohli, 1999; Sindzingre, 2004b).

Equally, some 'spontaneous order' – to quote the expression of Sugden (1989) - may emerge from these combinations of institutional forms and contents. In an evolutionary perspective, some beliefs, norms and institutions are more relevant than others, have a deeper individual cognitive imprint than others. They are more resilient, they have a greater propensity to stabilise and at the extreme to lock in the entire cognitive abilities of an individual – to generate cognitive 'basins of attraction', or 'cognitive traps' (Egidi and Narduzzo, 1997). This is particularly the case of group memberships (typically, kinship, religion), since they give rights on resources and provide groups and individuals with an identity, and organise the survival of the group (Bowles and Choi, 2010) as well as the life-cycle of the individual within it - which makes beliefs more likely to be fixed by emotional mechanisms. This again underscores the simplism of the usual distinctions between 'economic' and 'political' institutions or social norms, as institutions like membership command all these domains: a membership in a given group, e.g. kin, opens rights that are simultaneously economic (e.g., access to land) and political (e.g., statuses) and prescribe norms of behaviour.

Likewise, institutional contents need to be credible in order to be ‘believed’, adopted by individuals, and to be resilient. Credibility is an individual perception, which is endogenous (not the outcome of exogenous and imposed rules) and influenced by various sets of beliefs, past events and by the interaction with other institutions. It is a ‘transitive’ quality or deficiency, which can be infinitely multiplied if the rules are not perceived as credible and enforceable, as shown by the well-known aporia of “who supervises the supervisors” (Stiglitz, 1999). For example, in many developing countries reforms have attempted to build credible economic institutions, such as independent central banks, through shifts of formal structures. Effective independence, however, stems from complex perceptions of institutions by individuals, in particular political institutions, and it depends on the types of political regime (e.g., independence may not be desirable in non-democratic regimes) and their particular contents (which may be, e.g., populism or pork-barrel politics). Another example of the dependence of the credibility of a given institution on other institutions is voting behaviour: in democratic elections in many developing countries, individuals may find ex-dictators more credible and end up voting for them and the credibility of ‘developmental’ programmes in the eyes of voters is sometimes very weak (Wantchekon, 2003; Vicente and Wantchekon, 2009; for the example of two West African countries). A new institutional form (elections) here is ‘filled’ with local allegiances and sets of reciprocal obligations.

Similarly, many civil service reforms have failed in developing countries, such as the creation of autonomous agencies for tax collection (internal revenue or customs) aimed at insulating them from political influence, because these reforms focused on the formal organisational design. These new institutions often had little credibility for the individuals concerned, as they had been created by discredited governments or donors and were competing with daily routines and expectations driven by local social norms (e.g., personal enrichment, redistributive norms). A key feature of political economy in developing countries is indeed that the promises made by a government may be non-credible: it is unable to credibly commit because there is no third party to enforce these promises (North and Weingast, 1989; Acemoglu, 2003; Acemoglu and Robinson, 2006). State credibility in poor countries is weak because the latter’s governments seldom provide effective social protection and because their fiscal and redistributive capacities are undermined by aid dependence (Moss *et al*., 2006). In a vicious circle, individuals give limited credibility to state institutions, and they tend to comply with the systems of rights and obligations, which stem from their various group memberships and provide protection and insurance against risk - corruption may be analysed in this perspective (Sindzingre, 2002; 2005).

Political legitimacy is also a dimension of institutions, which is likewise not an autonomous and top-down causal process and is not provided by external entities, e.g., international financial agencies’ technical reforms. Legitimacy arises *ex post* from the reciprocal interactions between various political levels, governments and the individuals. Legitimacy may be built by the groups in power: development, redistributive and social policies may coincide with their desire to stay in power (as in Korea where the quest for legitimacy has been at the root of developmental policies, initially directed at the military and civil servants, Kwon, 1999). Legitimacy may also be built by any other group through its support or dissent, with an outcome that is unpredictable *ex ante*. In developing countries institutions come from heterogeneous origins and establish heterogeneous sets of incentives, norms, rights and obligations, e.g., obligations vis-à-vis kinship and obligations vis-à-vis state's rules. Depending on the situation, institutions exhibit variable degrees of legitimacy. The existence of several simultaneous 'public' institutions and sources of obligation - 'traditional' and 'modern' - may induce competing allegiances and variation in behaviour. For example, the incentives for not being corrupt stem from individual mental representations that are shaped by the history of the institution of the civil service, the regime of power relationships (e.g., arbitrary), and tradeoffs between explicit and implicit rules. This challenges the concept of a 'social contract' as a universal institutional form linking individuals and states.

The actual forms and contents of institutions are also shaped by power - power relationships being often reduced by development economics to problems of government policies, property rights and competition on rents. Firstly, institutions and property rights correspond to a stabilisation of a particular balance of political power relationships, which subsequently retroact on them, e.g., between labour and capital, landowners and the landless, and so on. For instance, in many developing countries the 'encounter' of the poor with the state's 'rule of law', or with a judicial institution, may bring about more exploitation or injustice than an improvement of welfare or equity. Secondly, it is the politically powerful who decide the modalities, timing, enforcement and sanctions attached to the functioning of an institution and decide *in fine* which individual or group can claim its property rights.

In developing countries, the way rulers use and redistribute resources is one of the determinants of the effective contents of institutions, as are their time horizons and the degree of confluence of their own political interests with the country's interest and welfare. The fact that rulers may be predatory, rather than developmental, is more relevant than the form of political regime, democratic or not (Evans, 1992; Olson, 1993). Predatory rulers are usually associated with short-term strategies and rapid siphoning of public resources. Staying in power over the long term may, however, lead purely predatory rulers to destroy the institutions that could foster growth, which are viewed as useless or threatening (Robinson, 1996). Whatever the form of government, economic policies are shaped by internal politics and the consolidation of power more than by purely economic considerations or external recommendations (Evans *et al*., 1993; Sindzingre 2000 on Ghana).

4. Bifurcations and self-reinforcing mechanisms towards growth or traps: assessing combinations *ex post*

Particular institutional outcomes, and especially the effective content of institutions, are difficult to predict *ex ante* from institutional forms alone: they are observed *ex post*, as they involve the transformation of forms and contents under the influence of many determinants - historical, political and economic.

The contrast between countries that seem caught in stagnation (such as African low-income countries) with the countries that succeeded in catching-up (e.g., in Asia) suggests that certain combinations of institutions and levels of development may stabilise and generate either virtuous growth paths or ‘poverty-institutions’ traps – as is the case in many low-income countries, which are often characterised by the weaknesses of the meta-institutions provided by states, an example being the combinations related to group memberships.

Reciprocal strengthening of growth and institutions vs. trapping processes

The evolution of the states that could trigger the process of development, such as the Asian ‘developmental states’, confirms that institutions are the outcomes of complex combinations. The concept of ‘composition’ of institutions helps in understanding their success[3]. The complex balance of developmental ingredients and the interaction of institutions with domestic and international economic forces, and their mental representation by individuals can lead to different economic structures and outcomes. The outcomes of combination of institutional forms and contents – especially their ‘productive’ or ‘unproductive’ aspects – differ according to historical processes. The potentially unproductive aspects of Asian growth were thus noted well before the 1997-98 financial crisis - ‘ersatz capitalism’, corruption, cronyism (Yoshihara, 1988; Bello and Rosenfeld, 1990; Clad, 1989), or alliance capitalism’ - long-term relations between firms and the financial sector (Wade, 2000) - with these institutional arrangements often evolving into collusive practices. Corruption shows that the nature and outcomes of institutions can be understood in considering institutions as linked to and limited by other institutions: there is no *ex ante* good or bad effect of corruption on growth.

The ingredients that conventional development economics considers as unfavourable to growth - trade barriers, state intervention - have been at the roots of the economic successes of Asian states and most developed countries: no intrinsic economic outcome is attached *ex ante* to a particular set of institutions. The institutional ingredients of ‘developmental states’ included flexible public policies that supported market institutions, in particular industrial policies (Temple, 1997; Rodrik, 1998b; Knowles and Garces-Ozanne, 2003), and stable bureaucracies, which were intermingled with local institutions (family- and firm-based social protection). These public policies articulated with specific political economy arrangements, such as the congruence of the interests of some groups with objectives of economic growth (Kwon, 1999; Kang, 2002 on Korea).

In contrast, certain combinations of beliefs, norms and institutions as well as combinations of the latter with specific economic and political environments, such as narrow industrial sectors, distorted export structures, poverty, limited state capacity, social fragmentation and predatory political regimes (Matsuyama, 1995; Nissanke and Sindzingre, 2006; Sindzingre, 2010) may contribute to the formation and stabilisation of low growth or underdevelopment equilibria. These combinations are the ingredients of

[3] Among the vast literature on the developmental state, see Johnson (1982), White (1988), Amsden (1989), Wade (1990), Aoki *et al.* (1996), Johnson (1999), Woo-Cumings (1999).

poverty traps, i.e. self-perpetuating conditions “whereby an economy, caught in a vicious circle, suffers from persistent underdevelopment” (Matsuyama, 2009). Traps by definition are self-reinforcing processes which it is difficult to get out of (Sindzingre, 2007b). Social norms may strongly contribute to the formation of traps, and in particular the divisive norms created by group memberships, e.g., by kinship, territorial and religious affiliations that flourish on the absence of meta-institutions provided by a state, (Hoff and Sen, 2005; Bowles, 2005; Sindzingre, 2007a). Many Sub-Saharan African low-income countries appear to be caught in such low equilibria over the long-run.

Some states of Sub-Saharan Africa have benefited from this congruence of political interests and interests in development: Botswana’s success story has thus been explained by a combination of “prudent macroeconomic and budgetary policies”, investment in physical and human capital, and the building of a meritocratic administration (Acemoglu *et al.*, 2001b). The legitimacy of growth strategies was sometimes enhanced by attempts to rely on history, such as on precolonial political and social institutions (Englebert, 2000). However, many African states in the post-colonial period were characterised by the disruption in the continuity of local institutions and civil wars. Moreover, the illegitimacy of many rulers who took power often induced hostile attitude toward private accumulation, which was perceived as a potential political threat. This lack of congruence between the interests of the groups in power and long-term growth undermined the emergence of developmental states and emptied reforms from their possibly beneficial content. States and public institutions have been shaped by political redistribution, in order to create this legitimacy and counter centrifugal forces (e.g., secessions). State-building was mostly accomplished through massive recruitment in the civil service and large scale projects that left an accrued debt with few economic benefits. In addition, IMF stabilisation programmes did not contribute to structural change vis-à-vis the model of the ‘small open colonial economy’, which characterised African countries at independence and was based on the exports of primary commodities plagued by high international price volatility, and the imports of manufactured goods from developed countries (Hopkins, 1973). Vulnerability to commodity price shocks prevented African states from triggering a virtuous circle of higher savings and investment able to free them from perpetual aid dependence (Akyüz and Gore, 2001). Economies did not diversify and many African countries have increasingly relied on a handful of natural resource exports. As underscored by Easterly (2001b), in developing countries, the period of stabilisation programmes (in the 1980s-mid-1990s) has been associated with a median per capita income growth of zero percent.

Unpredictable institutional interactions: globalisation

The phenomenon of ‘globalisation’ that has characterised the end of the 20th century onwards increases the exposure of domestic institutions to external institutions and the introduction of new institutions. The forms and contents of the latter obviously result from heterogeneous historical trajectories. Globalisation constraints domestic institutions to adapt and recompose their previous internal and external balances in the presence of new environments, in particular to find the ways of maintaining credibility and legitimacy. Often confused with trade openness (a situation) and liberalisation (a policy), globalisation refers to growing flows of capital, goods, technology, people, and information, and the lowering of transportation costs. That globalisation is a factor of growth has become conventional wisdom, despite innumerable caveats (Rodrik and Rodriguez, 1999; Harrisson, 1995; Rodrik, 2001a; Irwin, 2002; Clemens and Williamson, 2002a; Rodriguez, 2006). The historical differences of the impacts of tariffs on growth are explained less by tariff policies per se than their articulation with institutions (colonial rule in Asia), geography, structure of internal markets and global tariff environment (Clemens and Williamson, 2002b).

Economic outcomes indeed result from particular arrangements of institutions, together with endowments (e.g., labour, land) and public policies. Economic outcomes and institutional arrangements cannot be predicted *ex ante*. They do not follow 'laws' that would have economic functions that are both unique and certain (increased efficiency, lower transaction costs), as these constitute the particular effects of multiple and constantly evolving combinations in space and time of economic, institutional, political characteristics. The recurrence of financial crises, for example, has called into question the 'laws' on 'always-beneficial reforms' – which in developed countries has induced institutional changes (e.g., creation of regulation institutions, increased state intervention). Globalisation has modified the balance of bargaining power between capital and unskilled labour in favour of capital because of their differential mobility, as is shown by the weakening of institutions dealing with labour markets (Ortega and Rodriguez, 2001) and the increase in global income inequality (Milanovic, 2005).

These recombinations of institutions impinge on social protection and fiscal capacity (Toye, 2000) - trade reforms have been advocated mostly because of their benefits for international investors (Rodrik, 2001a) -, but effects vary considerably, depending on, for example, initial endowments, income and institutions. Liberalisation may have undermined state credibility and institutional balances. The types of political regimes also shape actual outcomes - in authoritarian or oligarchic regimes, the ruling elites may entirely appropriate the opportunities offered by liberalisation. Trade openness seems to be positively related to the size of governments (Rodrik, 1996; Garrett, 2001); it increases the need for social protection, and bigger governments have greater social protection options vis-à-vis external shocks; countries that have strong institutions are better able to manage social conflict and reduce the impact of shocks (Rodrik, 1998a, 1999a: 141; Iversen and Cusack, 2000).

In the course of the 1990s the credibility of the poorest states, especially in Sub-Saharan Africa, dropped, on account of their dependence on external financing and the paradigm of the downsizing of the state. Democratisation in these countries has occurred during fiscal crises that render states less able to provide the economic transformation that was the purpose of social protest. Their fiscal capacity (tax/GDP ratio) has been eroded by liberalisation as their revenues are historically based on external trade (tariffs, commodity taxation) (Keen and Mansour, 2009), as well as by competition to attract international capital (Tanzi, 2000b). Actual institutional combinations, effects and causalities are observed only *ex post*.

5. Conclusion

In the poorest developing countries, many factors have contributed to the weakening of states and institutions, which in some countries have lost their credibility, although state capacity, along with particular combinations of institutional forms, perceptions, contents and functions, are key ingredients of growth. In Sub-Saharan Africa, reforms were focused on the minimising of state intervention and liberalisation but left unaddressed the causes of the lack of growth, in particular the combination of primary commodity dependence and specific institutional arrangements involving limited state capacity, the resilience of divisive membership norms and predatory political regimes.

The elements of an alternative theory of institutions in relation to development have been presented here, which calls into question the usual approaches of development economics that are exemplified by econometric studies. Institutions are multi-layered phenomena (cognitive, social, political, economic), with forms and contents that may have distinct historical trajectories and effects on economic development. The transformation and economic outcomes of institutions are shaped by their articulation to other institutions. Institutions are not *ex ante* 'effective' or detrimental to growth: the heterogeneity of the various elements and determinants of institutions render their transformation and economic impact difficult to predict *ex ante*.

There is no standard type of reform or automatic outcome. Changes in institutional forms alone are insufficient (such as elections or regulations aimed at a better functioning of markets). The transformation or resilience of institutions and their relationships with growth involve a multiplicity of dimensions.

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