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## Institutions, Development and Poverty

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# Contents

|  |           |
|--|-----------|
| <b>Executive summary</b>   | <b>3</b>  |
| <b>Introduction: Institutions, growth and poverty</b>  | <b>4</b>  |
| <hr/>  |           |
| <b>1. Institutions and reform: the changing conceptions of the international financial institutions</b>                                | <b>6</b>  |
| 1.1. Changing reform agendas: the Washington consensus   | 6         |
| 1.2. Redefinition of the roles of the state, institutions and public policy  | 7         |
| 1.2.1. The rehabilitation of the state and public institutions   | 7         |
| 1.2.2. Developments in privatisation theory and policy   | 8         |
| 1.2.3. Poverty reduction, growth and public services   | 8         |
| 1.3. Institutions and governance   | 9         |
| 1.3.1. “Good” and “bad” governance   | 9         |
| 1.3.2. The contribution of institutions to the working of markets and social networks  | 9         |
| 1.3.3. Reorganisation of the workings of institutions  | 10        |
| 1.3.4. Deficiencies of public management and budgetary transparency  | 10        |
| 1.4. Situations in which the state and institutions collapse   | 11        |
| 1.5. Key issues: institutions, growth, globalisation and aid   | 12        |
| 1.5.1. Institutions and growth   | 12        |
| 1.5.2. Institutions and globalisation  | 14        |
| 1.5.3. Institutions and international aid  | 14        |
| <hr/>  |           |
| <b>2. Institutions, poverty and development</b>  | <b>18</b> |
| 2.1. The multidimensionality of poverty  | 18        |
| 2.1.1. Monetary and non-monetary poverty: institutional and normative aspects  | 18        |
| 2.1.2. Multiple and retroactive causalities  | 19        |
| 2.1.3. Measurement of poverty  | 20        |
| 2.2. Institutions, social norms and poverty  | 21        |
| 2.2.1. From social norms to poverty, from poverty to social norms  | 21        |
| 2.2.2. Social norms and poverty: ambiguous effects   | 22        |
| 2.3. Macroeconomic poverty traps: natural resources and commodities  | 24        |
| 2.3.1. The debate over poverty traps and their determinants  | 24        |
| 2.3.2. The “natural resource curse” and dependence on commodities  | 25        |
| 2.4. Relationships between economic policy, institutions and poverty   | 26        |
| 2.4.1. Redistribution, employment, social protection policy and poverty  | 27        |
| 2.4.2. Trade liberalisation policy, industrial policy and poverty  | 27        |
| 2.5. The multiple determinants of growth and the role of institutions  | 28        |
| 2.5.1. Growth, poverty, inequality, institutions: multiple and two-way causalities   | 28        |
| 2.5.2. Institutions, structures or economic policy? The endogeneity of the determinants of growth, threshold effects and poverty traps | 30        |
| <hr/>  |           |
| <b>Conclusion: The endogeneity of causalities and the key role of institutions</b>   | <b>33</b> |
| <b>Bibliographical references</b>  | <b>37</b> |
| <b>Notes</b>   | <b>42</b> |

## Executive summary

This paper explores the relationships between institutions, growth and poverty, presenting the multiplicity of the causal links connecting these three terms. There is currently a consensus that institutions play a crucial role in both development and poverty reduction, but the definitions of these three concepts, as well as the links between them, are still matters of controversy. The paper shows that institutions play a critical role in the processes leading to or out of poverty. The position and role of institutions explain the endogenous nature of these processes, as institutions are the underlying causes of many threshold effects and poverty traps.

The fight against poverty has become an important issue for development economists as well as for bilateral aid agencies and multilateral institutions. The crucial role of institutions in both growth and poverty processes is now recognised as well, thanks largely to institutional economics. Nevertheless, analysis of the role of institutions in poverty processes and in the formulation of poverty reduction policies is no easy matter, for a number of reasons.

First of all, definitions of poverty and of the concept of an institution vary widely. Second, it is difficult to analyse the role of institutions in the processes of economic growth and poverty reduction, because many causal links come into play and the three variables – institutions, growth and poverty – are endogenous to each other. For example, threshold effects may just as well lead to virtuous circles as to poverty traps. It therefore proves to be extremely difficult to make *ex ante* predictions as to the impact of institutions and of certain measures on economic growth or on poverty reduction.

The first part of this paper presents the concept of institution as defined by the international financial institutions. The second analyses the complexity of the concept of poverty and the relationships between three terms: institutions and social norms, growth and poverty. These debates are far from being purely conceptual. Rather, they are vital to assessing the actual effectiveness of reforms: depending on whether the respective roles of institutional and non-institutional factors are properly understood, reforms will or will not have an impact on the factors that determine growth and poverty.

## Introduction: Institutions, growth and poverty

The fight against poverty is currently a major theme in development economics as well as in the agendas of bilateral aid agencies and multilateral institutions. This “new issue” is not all that new: even before the 1980s and structural adjustment programmes, poverty reduction was one of the World Bank’s main objectives. Today, however, it has once again become a priority, to the point where it has raised concern that it will take the place of efforts to promote development in the traditional meaning of the term.

Poverty reduction is thus a less recent issue than it appears, and one on which there is no consensus. It has given rise to vigorous debate, which continues to this day, over how poverty is to be defined and measured, over the processes leading to it and over the most effective reforms and policies for reducing it.

The role of institutions in poverty processes has also become a mainstream topic of development economics research and the strategic thinking of the international financial institutions (IFIs), namely the World Bank and International Monetary Fund.

This increased recognition of the role of institutions in growth and poverty processes is linked to developments in economic theory, and in particular to the new institutional economics, which earned the 1993 Nobel prize for Douglass North and Robert Fogel.

Another reason why economic theory now accords more importance to the notion of an institution is the mixed results of reform programmes and aid flows, which have not succeeded in preventing economic stagnation or even impoverishment in some regions of the world, such as Sub-Saharan Africa.

### INSTITUTION: A SINGLE TERM FOR MULTIDIMENSIONAL PHENOMENA

Institutions operate at both the macroeconomic and micro-economic levels. They may be classified in various ways,

e.g. state and non-state institutions, market or non-market, formal or informal. They may also be either internal to states or external, as in the case of the supra-national institutions involved in global governance. These supra-national institutions play an important role in developing countries, whose economies and national institutions are often dependent on the international financial institutions and multilateral agreements.

These dichotomies are apprehended and understood in very different ways depending on the various theoretical approaches to the concept of an institution.

### THEORETICAL APPROACHES TO THE CONCEPT OF AN INSTITUTION AND TO ANALYSIS OF ITS ROLE IN GROWTH AND POVERTY

Douglass North defines institutions as the “constraints that structure political, economic and social interactions”. These constraints may be either formal (e.g. constitutions, laws and property rights ) or informal; in the latter case, they are self-enforcing. Examples of informal constraints include traditional customs, codes of behaviour and conventions. North also uses the notion of transaction costs to define institutions, as had already been done by other economists, including Ronald Coase, who views institutions as a consequence of the existence of transaction costs (*The Nature of the Firm*, published in 1937).

Other analysts approach institutions through game theory – repeated games, evolutionary games, which highlight the possibility of multiple equilibria<sup>2</sup>. Lastly, some evolutionist conceptions regard institutions as the effects of learning and competition processes. Institutions may also be defined in relation to the concept of law or of contract, an example being the social contract in welfare economics.

Analysis of institutions has been deepened with the concept of path dependence developed by Paul David, among others<sup>3</sup>. Analysis of their economic role has also gained considerably from the concepts of poverty traps, vicious

circles and threshold effects: below certain income thresholds, poor countries can no longer benefit from increasing returns, making massive capital injections necessary. Thus the founders of development economics, such as Paul Rosenstein-Rodan, explain that breaking the processes associated with poverty traps requires “Big Push” policies, to be implemented through either state intervention or development aid<sup>4</sup>.

In showing that lack of coordination between sectors limits spillover effects and leads to poverty traps, Rosenstein-Rodan deeply influenced the modern approach to institutions. Institutions and social norms are now regarded as a major cause of this lack of coordination, and hence a major cause of poverty traps.

This brief overview of a few major aspects of contemporary theory on the role of institutions in development and poverty shows that this work extends and confirms the intuitions of the first development economists: growth results from a set of cumulative processes, some positive and some negative, in which economic, political and social institutions play a major role.

This paper explores the relationships between institutions, growth and poverty, presenting the many dimensions of these three terms and the complexity of the causal relationships between them.

The definitions of the concepts and the two-way causalities involved remain matters of controversy. The concept of an institution is very general, encompassing a wide variety of phenomena whose significance varies greatly with the context. In addition, there are numerous causal relationships linking institutions to the growth and poverty reduction processes. Lastly, the endogenous nature of these processes engenders country-specific threshold effects and multiple equilibria that may lead either to virtuous circles or to poverty traps which are difficult to predict *ex ante*.

Although there is now a consensus that institutions are important for development and poverty reduction, it is no easy matter to determine how best to take them into account operationally to make poverty reduction policies more effective. Disagreement persists on many points: the role of the state; the direction of causalities (from institutions to growth, or from growth to institutions); the endoge-

nous nature of institutions with respect to other explanatory factors of growth and poverty, such as market structure, geography, integration in the international economy and dependence on commodities exports; the relative weight of all these factors; and the channels through which these causalities work. Reforms may act on institutions directly or on other factors that in turn improve institutions, as in the case of liberalisation reforms.

The paper shows that, these areas of disagreement notwithstanding, institutions are a key aspect of the multidimensional processes that lead into or out of poverty. Confirming the views of Rosenstein-Rodan, it shows that institutions explain the endogeneity of these processes. For example, institutions can engender obstacles to coordination and cumulative effects, thus creating threshold effects.

The first part of the paper considers the concept of institution as used by the international financial institutions. The second analyses the multidimensional nature of poverty and the complexity of the channels through which countries fall into and remain in poverty. Poverty itself is conceived of not simply in terms of income, but from the standpoint of the intrinsic aspects of human development, such as health and education. This second part explores the complexity of the causal relationships between the three terms of the relationship: institutions and social norms, growth and poverty. It also considers the endogenous nature of institutions with respect to other factors of growth and poverty reduction. Analysis of these causalities has given rise to serious debate over the nature and the respective impacts of the various factors – institutions, economic policy, market structure, geography, factors endowments – over both the short and long terms.

These debates are far from being purely conceptual. Rather, they are vital to assessing the actual effectiveness of reforms: depending on whether the respective roles of institutional and non-institutional factors are properly understood, reforms will or will not have an impact on the factors that determine growth and poverty.



# 1. Institutions and reform: the changing conceptions of the international financial institutions

The introduction to this paper explains that most researchers now understand the concept of an institution in a very broad sense. However, this first part is devoted to changes in the international financial institutions' analysis of the role of institutions and therefore uses the more restrictive conception of a public institution, which is in fact the standpoint from which the IFIs view institutions.

## 1.1. Changing reform agendas: the Washington consensus

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In the 1980s, the IFIs adhered to the neoclassical conceptual framework, which associates efficiency with market forces. An example is the “new political economy” developed by Anne Krueger, who has held leading posts at the World Bank and the International Monetary Fund. The deficits that plagued Latin America after the 1982 debt crisis and above all Sub-Saharan Africa after the shocks of the late 1970s and mid-1980s forced countries in these two continents to rely on financing from the IFIs. They were thus also obliged to agree to the conditionalities attached to such financing as well. These conditionalities were strongly influenced by a conception of the state as the “culprit”, responsible for the lack of growth and the implementation of “bad” macroeconomic policy.

The first stabilisation programmes recommended by the International Monetary Fund and the structural adjustment programmes of the World Bank therefore tried to reduce the intervention of the state and state institutions in the economy. In particular, they targeted the public institutions responsible for export products – stabilisation funds and boards, management of export sectors, public development banks, etc. – accusing them of creating distortions and rents that were harmful to growth and benefiting only the wealthiest groups. To reduce public spending, stabilisation programmes sought to cut the civil service wage bill

and workforce. To get prices right, they recommended economic liberalisation and the privatisation of public enterprises. The latter were regarded as causing budget overruns and economic distortions owing to the subsidies they received.

These programmes to dismantle and privatise state institutions, which were perceived as obstacles to market forces and signals, began in the 1980s. The rationale for these reforms was not based solely on economic arguments; the IFIs also used social arguments, explaining that the inefficiency and costliness of these bodies were mainly borne by the poorest.

Interestingly, the state and national institutions were seen as obstacles to proper implementation of reforms and to growth, while external institutions – namely the IFIs – enjoyed full legitimacy to bring about the transformation of a country from outside, through the use of conditionality.

When the two Bretton Woods institutions harmonised their programmes for the poorest countries via the Enhanced Structural Adjustment Facility (ESAF), these programmes consisted of a relatively standardised set of reforms known as the “Washington consensus”. This expression was coined by John Williamson in a famous article in which he listed the smallest common denomina-

tor of the policies recommended to Latin American countries by the Washington-based financial institutions<sup>5</sup>. This list comprised the following policies, which are worth remembering in view of the unexpected turn this expression was to take:

- fiscal discipline;
- redirection of public spending towards activities that are profitable and apt to improve income redistribution (primary health care, primary education, infrastructure);
- tax reform (reduction of marginal rates and broadening of the tax base);
- liberalisation of interest rates;
- introduction of a competitive exchange rate;
- trade liberalisation;
- liberalisation of foreign direct investment;
- privatisation;
- deregulation;
- security of property rights.

The Washington consensus has been widely criticised.

Some observers point out that in fact there has never really been such a consensus within the IFIs, as shown by the responses to the Asian crisis of 1997-98. The crisis revealed disagreement between the Bretton Woods institutions and among the community of economists on key issues such as financial and trade liberalisation and how to build global governance and a global financial architecture.

Amendments to this consensus have been proposed. Joseph Stiglitz, during his period at the Bank, proposed a conceptual framework that he called the “post-Washington consensus”. Dani Rodrik put forward an “augmented Washington consensus” that adds a number of recommended reforms to the above list: improvement of corporate governance; fighting corruption; flexibility of labour markets; signature of international treaties (WTO); adoption of international codes and standards; cautious opening of the capital account; unintermediated exchange rate systems; independent central banks; social safety nets; and targeting of policy on poverty reduction.

## 1.2. Redefinition of the roles of the state, institutions and public policy

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### 1.2.1. The rehabilitation of the state and public institutions

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The so-called first-generation reforms focused on macro-economic change and on reduction of state intervention in the economy. In view of the lacklustre performance of these reforms, however, the International Monetary Fund during the 1980s advocated “second-generation” reforms focused on building the capacity of governmental bodies, if only to make them capable of implementing economic reforms. The notions of optimisation of organisations, incentives and merit were emphasised<sup>6</sup>. These reforms explicitly stressed institutions and rules. At a conference in 1998, the International Monetary Fund, citing academic research such as that of Amartya Sen and Dani Rodrik, supported the idea that growth was associated with “high-quality” institutions and public sector.

The state and its role, considered ten years earlier as the cause of problems, were thus rehabilitated by the IFIs in the mid-1990s. The success of theories of market failure and information asymmetries, put forward by Joseph Stiglitz among others, undoubtedly contributed to this change in perspective on the role of the state, particularly because Stiglitz was appointed chief economist at the World Bank in the late 1990s. The World Bank thus played a significant role in this recognition of the virtues of public intervention. The *World Development Report 1997* draws for example on theoretical analyses of information asymmetries: it is no longer recommended that the state in developing countries be minimal; rather, it should play a role as regulator and be capable of providing public goods (security for investments, macroeconomic stability and stable rules of the game), introducing the needed incentives and supporting institutions in a position to improve the functioning of the markets for goods, labour and credit.

The rehabilitation of the state and public institutions displays some conceptual limitations. It pays no attention to history – path dependence – and reflects a somewhat narrow conception of political phenomena, most of which are reduced to governance issues. Straddling the fields of research and policy-making, it confuses positive analyses with normative analyses. As for the functions assigned to the state, they remain fairly restricted: macroeconomic stability, provision of regulation and incentives, monitoring and reward of performance, and encouragement of competition.

### 1.2.2. Developments in privatisation theory and policy

Conceptions of the state and public institutions continued to change since the late 1990s. Theories of privatisation offer a good example of these changes. In developing and transition countries, the first waves of privatisation were based on a minimalist view of the state and on the need for financial resources to reduce public deficits. These privatisations met with mixed success, and it was recognised that the state played a vital role as guarantor of property rights and contracts (public and private). Reservations as to the economic efficiency of privatisation were reinforced by political economy considerations on the motivations of private interest groups and on problems of social equity. Jean-Jacques Laffont and many other scholars have demonstrated that collusion and information monopolies are widespread. Regulatory policies and specific institutional arrangements thus proved to be essential, as did separation of powers and the prevention of collusion and corruption.

In the developing countries, infrastructure is a strategic sector regarding the provision and management of public goods. A belief in the greater efficiency of private sector management nevertheless led the World Bank to promote special forms of privatisation in this sector, such as “public-private partnerships” (PPP) and “private sector participation” (PSP), which have also been used in other sectors. Other notions that the Bank put forward at the time to guide privatisation in this sector were the establishment of appropriate contractual relationships (concession, “affermage”, etc.) between the public entity and private firms and the introduction of a legal and regulatory framework.

### 1.2.3. Poverty reduction, growth and public services

During the 1990s, poverty reduction gradually emerged as the central paradigm of the Bretton Woods institutions, and bilateral aid agencies as well. *The World Development Report 1999-2000* on poverty was a key step in this process. It voiced new doubts about the direct relationships between growth, liberalisation and poverty reduction. It also attributed considerable importance to institutions and political economy as conditions for growth, as well as to social “participation” and “inclusion”, and hence to the poorest groups.

Another key event in the years since 2000 was the adoption of the Millennium Development Goals by all donors. The World Bank and the International Monetary Fund adjusted their programmes to these new paradigms, specifically through the Bank’s Poverty Reduction Strategy Papers (PRSPs), the Poverty Reduction and Growth Facility (PRGF) and the Heavily Indebted Poor Countries (HIPC) initiative. All of these programmes emphasise poverty reduction and growth as leading objectives.

Public services and access to public services for the poor have thus become a major theme. They constitute an important instrument of this new growth strategy based on inclusion of the greatest number of people, and particularly the poorest, in development policies and processes. The *World Bank’s World Development Report 2004* on services stresses the importance of effective access to public services for all and the state’s responsibility for ensuring this. Provision of services – health, education, water supply, sanitation, electrical power – is thus seen as the key function assigned to the state, in conjunction with the private sector.

The new approach of the IFIs tends to restrict the role of the state to provision of public goods and services. Implicitly, public institutions are still conceived of as having predatory tendencies with respect to the poor and powerless. It therefore proves necessary to place public institutions under control. User participation – which is in fact a variant of the notion of voicing put forward by Albert Hirschman – and monitoring of budget allocations are the preferred instruments for exercising such oversight.

### 1.3. Institutions and governance

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#### 1.3.1 “Good” and “bad” governance

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The 1990s saw the growing influence of analyses of developing countries’ public institutions in terms of governance and corruption (“bad governance” being a euphemism for the latter). The IFIs used these two concepts to explain the weakness of certain countries’ institutions and their poor growth performance. In both their operations and their research, the IFIs gave increasing importance to corruption, which is often perceived as a key aspect of institutions and a major cause of economic stagnation and the failure of reform programmes. The “bad governance” of developing countries takes a variety of forms, in particular corruption, lack of accountability and lack of transparency.

For the World Bank and the International Monetary Fund, the blame for failed reform programmes and sluggish economic growth falls to the states concerned by these programmes. The possibility that the reforms were misconceived is not really considered. Nor is there any real analysis of causes related to weaknesses of the IFIs, their programmes and the conditionalities associated with them, and particularly their lack of credibility and poor reputation, as well as their difficulties in instituting credible agreements that are adhered to by the contracting parties.

This analysis of the failures of reform and the shortcomings of developing country institutions often led to the introduction of additional conditionalities in aid policies. A review of these conditionalities was thus one of the first tasks of the IMF’s Independent Evaluation Office. The work of David Dollar at the World Bank popularised the notion of “good policies”, i.e. suitable economic policies that followed the recommendations of the financial institutions: the combination of “good policies” and “good governance” is supposed to lead to growth. These approaches in terms of “good” governance and “good” policies also, as part of the same trend, included the notion of sanctions. An example is the concept of aid selectivity, in which aid serves as a reward for countries that follow “good policies”.

To monitor changes in individual countries’ situations more closely, a number of databases have appeared that track indicators of governance and other variables relating to economic and political institutions – economic freedom, state of law, etc. (for example, Daniel Kaufmann’s regularly updated databases on governance).

Today, the IFIs are putting the emphasis on new growth factors: rule of law, democracy and governments’ accountability for their actions.

In so doing, the World Bank and the International Monetary Fund are venturing into areas that lie outside the scope of economics and becoming involved in politics. They are structurally ill-suited for action in these areas, given the apolitical nature of their mandates (Articles of Agreement) and the political issues facing their executive boards, which take decisions on broad policies and paradigms.

#### 1.3.2. The contribution of institutions to the functioning of markets and social networks

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*The World Development Report 2002* on institutions refined the IFIs’ outlook in the light of the new institutional economics and the new (“positive”) political economy. Institution building in developing countries was considered a necessity owing to the contribution of institutions to the proper functioning of markets.

The World Bank then began to rely more on the concepts of institutional economics, such as the notion of trust (which is both a cause and an effect of the stabilisation of institutions and norms) and the associated concepts of reputation, incentive, reward, etc. Priority is given to more operational concepts, such as social cohesion and inclusion, or else to *ad hoc* notions such as social capital. Many studies (generally econometric) make use of these concepts, considering institutions as factors of poverty reduction and even as essential components of growth because they reduce transaction costs and provide a basis for the expectations of economic agents.

The World Bank has many assets for conducting such studies, in terms of formulating concepts and models, developing methodology and collecting empirical data. The Bank has the resources needed to conduct surveys and compile databases on controversial concepts like trust and social networks.

These approaches have their limits, however. The concepts are very general, inclusive and sometimes poorly defined; in some cases, the attributes of the concepts are the same as the concepts themselves – for example, incentives or transaction costs may either define institutions or be attributes of institutions<sup>7</sup>. Another limitation is that they often lack an historical dimension, particularly when based on cross-country regressions. They can neither explain institutional processes and transformations nor be used to analyse certain processes that are crucial to understanding the role of institutions, such as cumulative causation and path dependence, whose importance had been demonstrated by institutional economists such as Thorstein Veblen.

### 1.3.3. Reorganisation of the functioning of institutions

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Another shortcoming of these conceptions of institutions is that they do not take account of the underlying political rationality and issues relating to the sovereignty and legitimacy of institutions. Improvements in state institutions are conceived of in technical terms, the aim being to improve the way they function. Various reforms are recommended: decentralisation, streamlining of budget management, modernisation of central government ministries and agencies. The feasibility of reforms is analysed in terms of giving them better incentives.

The World Bank focuses in particular on improving public expenditure: the “quality” and pattern of expenditure, the structure of sectoral allocations and the fungibility of external financing have all been given specific attention. In order to translate reform programmes into workable budgeting processes, governments were advised to adopt “medium-term expenditure frameworks”.

This desire to improve the role of the state by approaching the issue primarily from the standpoint of financial flows and reorganisation of the functioning of public institutions also raises the issue of the unexpected effects of external aid and the aid dependence of low-income countries – with aid programmes that are often designed more by donors than by recipients. The effectiveness of these disparate reforms (macroeconomic reforms, reforms targeting public expenditure frameworks and meso-organisational reforms) may dissipate quickly.

### 1.3.4. Deficiencies in public management and budgetary transparency

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*The World Development Report 2004* highlights the role of developing country governments as providers of public services. The report addresses this function of states and public institutions in a way that is still marked by a conception of the state as a source of problems rather than solutions.

The report is primarily concerned with dysfunctions and deficiencies in public management: poor incentives for performance and effort, corruption, lack of control. The participation of poor population groups is presented as a preferred instrument for achieving budgetary transparency, reduction of corruption and better results. This approach may be too simple as the control of public institutions is also a top-down process.

To make public management more efficient and combat corruption, the Bank proposes reforms aimed at budgetary transparency, such as public expenditure tracking, and in particular tracking of the “leakage” of public expenditure or its “capture” by local bureaucrats and politicians.

Such measures can sometimes bring good results. Ritva Reinikka and Jakob Svensson have shown that in Uganda, such tracking – and the fact that it is known to the public – has brought spectacular improvement in the allocation of budget resources. It has reduced a rate of capture that, in the case of funds allocated to schools, caused 87% of the budget simply to disappear<sup>8</sup>.

In the case of states whose public institutions have seriously deteriorated, the IFIs put forward the notions of capacity building, institution building or even nation building.

The conceptions of public institutions – political, economic or social – on which these approaches are based are characterised by a superficial understanding of both political phenomena, in terms of power relationships, and social phenomena, in terms of the complexity of their determinants and historical paths and their possible uniqueness within given contexts.

The reforms stemming from these conceptions of the state also face the more general problem that the effectiveness

of external aid has its limits when focusing on a notion as multidimensional as that of institutions.

Since the 1990s, donors have all recognised, in agreement with academic economists such as Dani Rodrik, Kenneth Sokoloff and Stanley Engerman, that “institutions matter” and believe that a share of aid should go towards institution building. There are still many traps and unexpected effects, however, regardless of whether the aid in question consists in the building of legal systems or in financial flows.

#### 1.4. Situations in which the state and institutions collapse

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The 1990s saw an upsurge in analyses of the role of civil wars, the emergence of conflicts and the collapse of institutions as major causes of failure to achieve development. It was during this period that the concepts of “failed states”, “state failure” and “collapsed states” first appeared in both academic research and the publications of the IFIs.

Economists such as Paul Collier and Anke Hoeffler produced economic analyses of conflicts and civil wars for the World Bank. They found that the roots of civil war lie not in the political and social demands of individuals or groups, but rather, for given level of grievances, in the existence of opportunities to organise and finance a rebellion. The determining factors are thus considered to be economic. Subsequently, a conflict offers further opportunities for economic appropriation, particularly of natural resources. This provides incentives to maintain a “low-intensity” conflict, as is often seen in Sub-Saharan Africa, which involves lower risk and costs and brings higher gains than outright wars<sup>9</sup>.

Most approaches stress the rational nature of conflicts (although this rationality is limited) and analyse them in terms of the protagonists’ incentives to make them last. Among the many underlying factors of conflicts, the literature points to perceptions of relative poverty, competition for access to resources and the poor credibility of the various parties’ undertakings to bring peace, including those of the international community<sup>10</sup>. Models of self-perpetuating conflicts have been developed, showing that a sufficient condition for such conflicts is the existence of politi-

cal entrepreneurs and both domestic and external resources, particularly international aid. The latter may intensify conflict indirectly through access to convertible currency and additional resources.

The stabilisation of behaviour through normalisation and institutionalisation is also explained through the use of concepts such as incentives and gain. Analysis of causalities has given rise to heated debate, particularly on the respective importance of greed and grievances. The use of these solely economic concepts to analyse conflict limits the scope of neo-institutionalist approaches, in that a small number of conceptual tools are supposed to explain all institutional forms. The unique development paths of institutions and their specific forms and content remain unexplained.

Conflicts affect not only relationships between states but also relationships within states. They are now considered a major factor of poverty and development failure, and they are analysed in terms of institutions, particularly in Sub-Saharan Africa. Nevertheless, the question of causality and the endogeneity of causalities is still under debate. On the one hand, weak institutions are conducive to conflict, while on the other, conflicts destroy existing institutions. The IFIs are trying to formulate optimal methods of rebuilding state institutions in post-conflict situations, but these programmes are subject to the limitations of external aid in general: problems of internalisation, ownership and absorption capacity.

## 1.5. Key issues: institutions, growth, globalisation and aid

### 1.5.1. Institutions and growth

The growing importance of the concept of institutions in development economics has led to renewed research on the relationships between institutions and growth. Analytical and qualitative studies have been less convincing than those stemming from econometric studies based on empirical data. The debate over the factors that explain the divergence between countries in terms of growth has given added importance to the role of institutions.

Endogenous growth theory has called Solow's growth model into question, giving rise to many different analyses of the causes of these divergent paths. Analysis must consider not only physical but also human capital, not only factor accumulation but also the combination of factors, total factor productivity, technological capacity, knowledge, and hence, ultimately, the institutional and political context, rules and norms. In many cases, economic variables alone cannot explain growth or the absence of growth. For example, they do not explain why certain low-income countries do not "catch up" as predicted by economic theory. To address these limitations, research turned to exploring new lines of analysis, such as those concerning institutional or political-economy factors, as well as models capable of providing more convincing explanations.

Thus the 1990s saw a proliferation of studies based on cross-country growth regressions. The growth models used in these studies include institutional variables as explanatory factors of cross-country growth differentials, in addition to more traditional economic variables such as investment and economic policies such as financial deepening or trade liberalisation.

Many institutional variables are used in the literature: rule of law, separation of executive and judiciary powers, independence of central banks and institutions that govern labour markets (e.g. unions), civil liberties, stability of property rights and contracts, good governance, government accountability, freedom of the press, corruption and so forth. In the "post-Washington consensus" literature, as

summarised by Philippe Aghion, certain institutions are viewed as playing a universal – and growth-promoting – role: protection of property rights, macroeconomic stability, stronger education and health systems, and a "good investment climate", in a context that allows competition<sup>11</sup>.

To validate growth regressions, it is essential to have accurate empirical data. The problem is that institutional data are difficult to collect and use in developing countries, particularly in the poorest countries. As is well known, such countries present statistical problems even with regard to basic economic variables such as price and income data, and the difficulty is still greater for qualitative variables such as institutional variables, which vary over time and with individual perceptions.

These econometric studies have provoked lively debate, reflecting the importance of the economic policy issues involved. The strategies of both governments and donors depend on which variables are considered the determinants of growth: quality of institutions, economic reforms, structural causes such as a landlocked geographical situation and inadequate infrastructure, or unequal endowments of production factors such as physical and human capital stocks.

A number of institutional studies have met with a measure of celebrity. Among these are studies that try to establish a link between the kinds of institutions introduced by colonisation and the subsequent growth of developing countries. The performance of "extractive" colonial institutions has been compared to that of institutions built to last, such as those established in settler economies, which are considered to have been more favourable to growth<sup>12</sup>.

These regression-based analyses have been subjected to much criticism, particularly concerning the definitions of the concept of an institution and the inconclusive results obtained when these methodologies are used to address such a multidimensional concept. The definitions of many institutional variables are still problematic: property rights, regulation of the business environment, democracy, rule of law, political and economic freedoms, and the accountability, legitimacy, credibility and representativeness of govern-

ments. Moreover, as such definitions have an historical dimension and are context-dependent, they oblige the analyst to define still other institutional variables. For example, to define the concepts of the representativeness or accountability of a government or parliament, it is necessary to define with respect to whom it is representative or accountable, and which institutions ensure such representativeness or accountability. Institutional variables are notoriously difficult to define and isolate and are subject to serious endogeneity problems.

Another problem concerns the variables used as proxies for institutions. In some cases, these variables stand in only a very indirect relationship to what they are supposed to approximate, and they often cater to the exigencies of modelling and quantification more than they reflect any empirical facts. Examples of proxy variables include financial deepening (Robert Bates), the urbanisation rate, etc. The regressions are often based on instrumental variables, which are supposed to ensure better statistical accuracy. The mortality rate among colonial settlers, for example, has been used to measure the quality of institutions, as mortality was assumed to have an impact on the nature of the institutions built in the colonies: either exclusively “extractive” or, where the settlers encountered an environment less hostile to their health, protective of property rights and the rule of law<sup>13</sup>.

Other recurrent examples may be given of the sometimes reductive nature of institutional variables, and these examples raise doubts about the reliability of certain proposed causalities. Thus, institutions may be proxied by the existence of property rights, which in turn are proxied by registered property deeds. In another example, the formal existence of judicial, economic or political institutions – such as the existence “on paper” (*de jure*) of democratic rules and formal legal systems – is used as proxy for their actual existence. The problem with this is that the spirit of formal rules and laws can be profoundly distorted by certain political regimes and mechanisms, such as predatory regimes or inequitable social norms based on the *de facto* exclusion of entire social groups on the basis of criteria such as gender, caste or social status.

The effects of institutions inherited from colonisation on local institutions are still the subject of heated debate. Some cross-country studies have concluded that they

have a negative impact on the subsequent growth of countries, while others have reached the opposite conclusion, and still others, such as those of Branko Milanovic, conclude that there is no significant impact<sup>14</sup>.

The logical weaknesses of research on the relationships between institutions and growth have also been criticised. On the one hand, Fernand Braudel and Kenneth Arrow have shown that the historical pace of change varies with the type of institution – political, economic or social. Institutions thus have heterogeneous impacts on growth, as growth itself may be considered in the short or the long term. On the other, as William Easterly points out, the growth of developing countries is volatile, and thus cannot be convincingly related to institutional variables that change more slowly than growth and are too different to generate a simple causal relationship.

A special place should be granted to analyses relating growth to a particular type of political institution, particularly democracy. Since the pioneering work of Pranab Bardhan and Adam Przeworski, many studies have looked for correlations of this type. In some of them, a positive impact of democracy on growth has been isolated empirically, through cross-country regressions. To date, however, these regressions sustain no definitive conclusions as to the influence of democracy on variations in growth rates. The relationship does seem positive in analytical terms, however, since democracy is a desirable goal because it is instrumental with respect to growth, or, as Rodrik puts it, because it is a “meta-institution”. A *contrario* studies also show that authoritarian regimes place growth at risk and that democracy is associated with less volatile economic performance<sup>15</sup>. But the factor that really seems to be a robust determinant of growth is political stability<sup>16</sup>, which seems to have a more significant positive impact on growth than does any specific form of political regime.

Like other institutions, democracy is multidimensional, and its effects depend on which channels are considered: some may be positive (for example, in terms of human capital), others negative (for example, in terms of public spending)<sup>17</sup>. The impact of democratic institutions has also been analysed as non-linear, as subject to threshold effects, as corresponding to given levels of development, as dependent on the time horizons considered, and so forth<sup>18</sup>.

There is no consensus concerning the link between political rights and growth, nor between democracy and poverty reduction. Some authors have asserted that at a low level of development, authoritarian governments or “benevolent dictatorships” can be more efficient (based on the example of Singapore or the military regimes in Korea during the “developmental state” phase).

A major problem of democracies in developing countries is that they must provide economic benefits quickly, within the short time horizon of the electoral cycle. Here again we find the divergence, well known in political economy, between the short time horizon of elections – and reform programmes – and the longer time required for institutional change and improvement in human development indicators (education and poverty reduction as determinants of future incomes). Democratisation and democratic institutions can thus give rise to frustration and gradually lose credibility, while this credibility is a key channel of their impact on growth.

The causal links among institutions, political regimes, growth and poverty are highly complex, and the literature on the subject is inconclusive when it considers formal political institutions only. The literature, particularly growth regressions, gives too much importance to the forms of institutions<sup>19</sup>. The mere presence of formal democratic institutions provides little information and few assurances regarding the processes actually at work.

### 1.5.2. Institutions and globalisation

From the 1990s, liberalisation, particularly trade liberalisation in conjunction with the rise of the WTO, brought a spate of studies on the specific effects of “globalisation”. The relationships between globalisation and poverty, and especially globalisation and inequality, are still a matter of sharp debate and the subject of a huge literature. There are many grounds for disagreement, depending for example on whether one considers rates or levels (of growth and poverty), the short or the long term, etc.

Some economists, such as Robert Wade, hold globalisa-

tion – specifically the trade liberalisation aspect of globalisation – responsible for increasing poverty or inequality in and/or between countries. Others, such as Dani Rodrik, are sceptical as to whether the positive correlations between trade liberalisation and growth are robust. They emphasise that liberalisation can also be harmful for growth, as it can stifle infant industries and the learning-by-doing process. Still others, particularly in the IFIs, argue that the negative impact of globalisation has not been demonstrated empirically. Many of them even regard globalisation as an opportunity for poverty reduction.

The effects of globalisation may be viewed as non-linear. For example, an effect such as increased poverty or inequality may be identified at a given level of development, then be reversed at another level<sup>20</sup>. The underlying causes of these different effects of globalisation on poverty and inequality are equally the subject of debate. They may arise, for example, from different factor endowments, or, as shown by William Easterly, from differences in productivity<sup>21</sup>.

The triangular relationships among globalisation, institutions and social norms, and poverty are also complex. They are highly dependent on how the concepts of institution and norms are defined, as well as on the types of institution considered – macroeconomic institutions, central government institutions, or the social norms governing villages, households or individual interactions.

Many economists, particularly within the Bretton Woods institutions, agree that these variables have positive effects on growth and poverty reduction. David Dollar and Aart Kraay, for example, show that countries having “better” institutions and being more open to international trade exhibit higher growth rates over the long term. They also assert that countries having such “better” institutions are more trade-oriented. This combined effect of institutions is considered to have a positive impact on long-term growth<sup>22</sup>.

These effects are difficult to identify *ex ante*. Depending on their specific content and on the context, the same state institutions (e.g. stabilisation funds) may be either predatory or protective with respect to the fluctuations of international markets. Social norms such as norms of membership (to castes, ethnic groups etc.) may exclude certain social groups and deprive them of the possible benefits of

globalisation, but these same norms may also generate mechanisms of trust between individuals that can offset market failures and offer access to capital and new markets – and thus to some of the opportunities offered by globalisation. Diasporas are an example of this, as Avner Greif has shown for the Maghribi traders in medieval times. On the other hand, exposure to globalisation, world markets and their incentives can destabilise the positive aspects of norms of reciprocity and risk-sharing mechanisms, as Jean-Philippe Platteau and Elinor Ostrom have revealed with respect to the management of village “commons” and traditional insurance systems<sup>23</sup>.

The effects of globalisation on the political, economic and social institutions of developing countries (for example, institutions governing labour markets) have been the subject of many studies, as have the mutual causal relationships involved.

What is the nature of the institutions that, in a given country, serve to channel and transform the effects of globalisation? A series of studies, notably by Dani Rodrik, have shown that countries need strong, effective institutions in order to dampen the negative effects of globalisation while reaping the benefits. In particular, one effect of globalisation is to destabilise the existing relations between capital and labour, reducing the latter's negotiating capability leverage. Globalisation thus makes it crucial to have institutions governing labour markets, such as trade unions. It also makes the role of the state decisive, particularly in terms of its capacity for economic intervention and its “size” in terms of public spending.

Globalisation is often associated with external shocks. Rodrik considers that social conflicts arise at the interface between such shocks and the national institutions responsible for controlling them<sup>24</sup>. According to Rodrik, globalisation can exacerbate social conflicts, particularly those over redistribution, and can increase demand for social insurance. He also considers that conflicts have a negative impact on growth and that socially fragmented societies, lacking institutions capable of managing conflicts (such as the rule of law or social safety nets), show lower growth performance. The existence of political, economic and social institutions capable of channelling these conflicts, maintaining social cohesion and social consensus,

is thus an important factor of growth and of a country's ability to take advantage of all the opportunities offered by globalisation. Examples of such institutions would be states capable of appropriate public expenditure or large enough to satisfy the social demand generated by trade openness.

Study of the impact of trade liberalisation and globalisation has led economists to refine their analyses of institutions. The latter seem to have a positive impact on growth even in the absence of the institutional forms or variables traditionally considered to be necessary to growth, such as secured property rights, a low level of corruption, government accountability and transparency. Studies of “developmental states” (Korea, Taiwan) had already shown that unorthodox institutional ingredients (state intervention, bureaucracy) had enabled these states to exhibit spectacular growth rates, and what is more, this growth was export-led and associated with trade openness.

More recently, China's growth has added fuel to the debate over what types of institutions are likely to help countries reap the benefits of globalisation. According to Rodrik, China has registered high growth rates in the absence of institutions that secure and formally delimit property rights. China has emphasised market forces and their competitive aspects more than rules concerning private property. The country has experienced unprecedented growth, but the growth process has generated inequality between coastal regions and the hinterland. Rodrik compares this institutional framework to that of Russia, which has formal institutions such as property rights but has no market rules. According to Rodrik, these different institutional forms and functions are the true determinants of the differing growth performances of the two countries.

### 1.5.3. Institutions and international aid

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In post-war economic theory (e.g., the “two-gaps” models), the rationale for external financing, particularly aid, was based on inherent constraints on economic take-off, low levels of development and poverty. In the 1990s, the mixed results of development aid gave rise to serious questions as to its effectiveness, particularly in Sub-

Saharan Africa. There is a huge literature on the “ritual dance” and repeated games between developing country governments and donors. These aspects, which indeed are often analysed using the concepts of game theory, were perpetuated by the rollover of stabilisation and structural adjustment programmes, lasting for more than two decades in the case of some countries. In response to the disappointing results of reforms, donors often responded with further conditionality.

An increasing number of studies have highlighted several negative effects of aid. For example, a series of studies, including internal studies of the International Monetary Fund<sup>25</sup>, have pointed to the volatility of aid flows, as well as its negative consequences for growth and for the building, consolidation or even existence of local institutions. The volatility of aid entails that of budgetary revenue. The past and future volatility of aid flows complicates economic agents’ expectations, and this clearly has a negative impact on institutions as, according to the neo-institutionalist definitions, institutions are frameworks of rules that facilitate expectations.

Another negative consequence of aid is that the economies of the poorest countries have difficulty in absorbing aid flows. Aid may amount to more than 10% of GDP and a substantial share of budgets; it can cause an increase in inflation and appreciation of the real exchange rate. Aid was regarded, for example, as responsible for “Dutch disease” effects similar to those produced by financial windfalls stemming from sudden rises in export revenue, generally from commodities exports. The negative effects of the “Dutch disease” on local institutions have often been noted. It is now agreed that aid detracts from competitiveness. Within the International Monetary Fund, doubts are being voiced about whether aid can be effective at all, irrespective of the policies implemented by governments<sup>26</sup>.

The external resources provided by donors may, of course, also have positive effects on the institutions of developing countries. For example, aid flows can finance the costs of reform (new regulations, state of law, assistance in holding elections, etc.) or serve to compensate social groups that lose from the reforms. Outside assistance can also strengthen young, fragile institutions or improve the legal and regulatory framework, for example by eliminating legal provisions

that are discriminatory and inegalitarian with respect to specific social groups, such as women and certain castes.

Aid can also have destructive effects on local institutions through many other channels, however, and particularly through its impact on the capacity of states, public institutions and civil services. These effects may be qualitative and act at the microeconomic level. For example, aid may be perceived as a rent, an external resource similar to the other natural resources available, and thus lead to conflicts over funding, jobs in aid agencies, etc. Moreover, the salaries paid in aid agencies (or by the projects they finance) push consumption models to higher standards, causing a “drain” of skilled personnel towards jobs in these aid agencies and their projects, to the detriment of local public institutions.

Aid can also foster corruption and perpetuate “low equilibria” of corruption, and it can help to maintain predatory governments in power. Another problem is that recipient governments may exhibit a weak “ownership” of the reforms on which these financial flows depend. These reforms and financial flows are perceived as external and hence irrelevant, as “freebies”. Aid flows can also give recipient governments an incentive to exploit their fungibility to finance projects refused by donors and can generate free-rider behaviour.

The economic and political context of aid in the long term, increased conditionality and the repeated games between donors and recipient governments have all eroded the credibility of donors and, by the same token, of their reforms, however altruistic, poverty-oriented and carefully formulated they may be. Recipients rationally expect that donors, defined by their function of giving, will continue to provide aid even if objectives are not met.

Many studies have pointed out the contradiction between conditionality and local ownership. Analyses of the cross-relationships among aid, institutions and growth and of the determinants of aid effectiveness, in terms of both growth and institutional capacity, are rendered more complex by questions regarding the credibility of institutions. Low credibility of domestic institutions can be compounded by the lack of credibility of international institutions and of their conditionalities and sanctions<sup>27</sup>.

The major debates over aid conditionalities and effective forms of aid – grants or loans, programme aid or budget support, *ex ante* or *ex post* control – are handicapped by the structural exteriority of donors and these rational expectations of recipients, whose ultimate effect is to make opportunistic behaviour the optimal behaviour.

The paradoxes associated with external imposition of ownership show the limits to what aid can do to assist institution building. Indeed, if institutions do not consist simply of formal rules, but also internalised content, rules and norms, then institution building can hardly be driven from outside. It must necessarily result from processes that are endogenous to social groups. It can, however, be helped along by external initiatives, such as the creation of legal systems, changes in property rights, etc. Despite the time required for any institutional change – and overcoming institutional inertia can take a very long time – such change stems also from interactions between formal legal rules and social norms.

Aid can also have negative effects at the macroeconomic level. Many studies point to the use of aid flows for consumption rather than for investment or infrastructure that would help to strengthen institutions. Aid may also erode the tax effort and collection capacity. Expectation of aid inflows may constitute a disincentive for governments to raise domestic resources, strengthen tax administrations, encourage savings and keep deficits under control. There is a negative impact on institutions as well. For example, while aid flows ease the financial constraint and increase resources, they erode the decision-making and operational autonomy of governments, and hence their credibility in the eyes of the governed. Most important, the negative effects consist in dependence on aid, which reinforces the vicious circle of lack of ownership and autonomy with respect to reforms and projects that are perceived as externally imposed or unsuitable for local situations.

These negative consequences are exacerbated by the difficulty of harmonising and coordinating the actions of multiple donors operating in a given country. Dealings with donors often account for a large proportion of government activity, and donors sometimes make contradictory requests that destabilise recipient governments or engender opportunistic behaviour, as government managers and

staff take advantage of the loopholes created by these inconsistencies. These negative effects of aid on institutions have been analysed by, among others, William Easterly, who considers that aid has had little effect on growth overall<sup>28</sup>.

The relationship between aid and institutions is characterised by two-way causality: local institutions may have an influence on the effectiveness of aid. Certain studies show that aid has no effect in the absence of appropriate local institutions, but that it is effective where such institutions exist. Aid effectiveness is not linear; rather, it depends on institutional thresholds. Below a given threshold, i.e. where institutions are too weak, aid cannot generate the same positive effects as it does above this threshold. It may even have negative effects on local institutions if the latter are already fragile<sup>29</sup>. These issues are still a matter of vigorous debate. As shown in the review of the debate by McGillivray et al., other studies find that aid has a positive impact on growth<sup>30</sup>.



## 2. Institutions, poverty and development

The concept of poverty, like that of an institution, has many dimensions and may be defined in many ways. The causal relationships between poverty and institutions are multifold, two-way and complex.

### 2.1. The multidimensionality of poverty

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#### 2.1.1. Monetary and non-monetary poverty: institutional and normative aspects

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The conception of poverty in development economics underwent a profound change during the 1990s, notably owing to the influence of Amartya Sen. Partly as a result of Sen's work, poverty is no longer conceived of in monetary or income (or consumption) terms alone, but as deprivation in other respects, such as human development and participation in society. Poverty consists of an insufficiency of capabilities in the domains of health, education, shelter and social norms – and ultimately in political institutions. Over time, Sen's works have gradually attributed an increasingly important role to the concepts of freedom and democracy. In his view, democracy is necessary for growth and poverty reduction. This dimension implies a normative system and social choices, such as the ability to live with dignity in society: it is as important a poverty criterion as income. Freedom and democracy are intrinsic dimensions of the capabilities of an individual<sup>31</sup>.

Sen has shown that the relationships among the various dimensions of poverty are not linear. A well-known example is the decoupling of income performance and indicators from human development (health and education) performance and indicators in the Indian state of Kerala and, until recently, in Sri Lanka. Owing to, among other things,

a higher level of democracy and public debate than elsewhere, Kerala's human development indicators are better than those of other Indian states; some, such as the fertility rate, are comparable to those of Western countries, despite Kerala's much lower income level.

The multidimensional approach to poverty explicitly emphasises the importance of institutions and norms in poverty-related definitions and processes. The availability of and access to each dimension – monetary and non-monetary, health, education, dignity, freedom, social life – is established by the systems of social and political rules and norms developed by all societies. Moreover, the institutional and political systems of each society also determine the relative weight of these dimensions in the social choices of governments and the provision of public goods, and these choices in turn change the relative level of each dimension. Lastly, institutional and political systems organise the relative weightings of these dimensions to form value systems that are internalised by individuals<sup>32</sup>.

The debates over the concept of multidimensional poverty, which concerns not only income but also capabilities, are inextricably tied to differing points of view on how poverty should be defined and measured. There are, in fact, many possible criteria. From an institutionalist standpoint, the distinction between absolute poverty and relative poverty is an important criterion. Relative poverty, which is often

associated with the notion of exclusion<sup>33</sup>, is also sometimes linked to that of inequality. Although these three concepts are different, levels of relative poverty and exclusion clearly reflect the normative and institutional contexts in a given place and time.

Poverty also includes a regional dimension. In a given country, poverty may be specific to certain regions or social groups, making researchers disaggregate its incidence and construct “poverty maps” right down to household level. These approaches oblige institutional analyses to consider a finer level of detail: causal mechanisms - economic (growth) and institutional - will not necessarily be similar from one level (region, household, individual) or geographical area to another (e.g. urban vs rural environments, an isolated region or one exposed to international trade).

### 2.1.2. Multiple and retroactive causalities

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The various dimensions of poverty stand in causal relationships to one another. These relationships imply multiple channels of transmission, concerning all levels of the individual’s activity in society: micro- and macroeconomic, social, political. By linking income, education or health to the existence of democratic institutions (freedom, living with dignity in a society), the multidimensional conception of poverty shows how difficult it is to define poverty and well-being outside the context built by a society’s institutions, social norms and beliefs. The fact that there are many dimensions underscores the relative nature of poverty, once the needs of basic subsistence are satisfied. It therefore points to the impact of a given society’s systems of institutions and norms on well-being: institutions and norms may generate either inclusion or discrimination, either egalitarian values or inequality.

Dilemmas of social choice and the weighting to be given to the various dimensions, often mentioned by Sen, are a good example of this. How, for example, can one rank, weight or otherwise order the following two situations in terms of well-being: on the one hand, having a low income

in Kerala, in a lower middle-income society, but being in good health, and on the other, having a higher absolute income than the average individual in Kerala but mediocre health indicators (as is the case for a majority of African Americans, whose health indicators are lower than those of their society)? Sen has analysed other dilemmas of this sort, such as criteria for choosing between long-term unemployment with relatively good benefits, as in France, and having few unemployment benefits but the likelihood of finding another job quickly, in societies that place greater value on social mobility, such as the United Kingdom and the United States<sup>34</sup>.

At the microeconomic level, channels of transmission and causality among the dimensions of poverty – education, health, nutrition – also prove to be complex. Poor health has a negative impact on income and on the ability to find and keep a job. Conversely, low income has a negative impact on the health of an individual and more complex effects on household members, depending on their status, gender and age. The opportunities that a society offers an individual according to his or her situation (income, social status etc.), i.e. the potential mobility of the individual, are a crucial non-income dimension. Mobility is a matter not solely of income, but also of access to institutions that increase or maintain human development (e.g. schools and health clinics) as well as to economic and political institutions. Such access is in turn facilitated by the institutions and social norms of a given society. In developing countries, inequality of opportunity, often due to circumstances beyond the control of individuals (being born into a given racial group, region of origin, parents’ occupations), accounts for a large share of income inequality, as shown by Bourguignon *et al.* in the case of Brazil<sup>35</sup>.

The dimensions of poverty are dynamic processes with different time horizons. These processes can lead to intergenerational poverty traps where low levels of education and health are combined with lack of employment and a high birth rate. This last in turn perpetuates low levels of health, education and so forth<sup>36</sup>. Gary Becker and Kevin Murphy have shown that fertility rates are endogenously determined by levels of human capital (health and education), and that rates of return to human capital increase in line with the stock of human capital in a society. These

processes lead to two equilibria: a low equilibrium in which human capital is scarce and the fertility rate high, and a high equilibrium combining a high level of human capital with lower fertility<sup>37</sup>. In this way, income poverty can have a negative impact across generations, for example on the health and education of children.

These relationships are not linear, however. Better nutrition and health are associated with higher wages, but health itself is also a multidimensional measure of human capital (and which may be captured by several indicators)<sup>38</sup>. The relationship between income and nutrition is thus non-linear, as it depends only partly on income level: in poor countries, higher income offers protection against many risks (disease etc.), but the relationship is less clear in rich countries, where nutritional imbalances may be harmful to health (the best-known examples being obesity, alcoholism, etc.). Relationships between income and health are also influenced by other variables, such as education. The links between income inequality and health thus require further analysis<sup>39</sup>.

At the macroeconomic level, the channels of transmission among the various dimensions of poverty and relationships with growth are also complex. The inconsistencies in relationships between educational level and income or poverty offer a good example of this: these relationships are positive for a given individual, but indeterminate at the aggregate and macroeconomic level, as Lant Pritchett has shown<sup>40</sup>. The question of the proper scale of analysis is thus added to that of the non-linear causal relationships among the various dimensions of poverty. Causalities do not always aggregate from one level of analysis to another: an observation at household level is not necessarily valid – or may be only indirectly valid – at the regional or national level<sup>41</sup>.

Location, at the scale of a neighbourhood or a region, may also intensify the dimensions that create microeconomic poverty traps. As Durlauf has emphasised<sup>42</sup>, the neighbourhood where people live may have an influence on incomes, including in the developed countries: living in certain places means less education, income, health care and access to the institutions of the rule of law. In a dynamic way, place of residence may also restrict future opportunities, for example as a result of discrimination.

### 2.1.3. Measurement of poverty

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The lively controversy over the possible increase in global inequality in recent years and over the causes of this increase (such as globalisation) highlights the difficulty of measuring concepts such as poverty and inequality: the data depend to a great extent on the methods used (for example, “within-country” or “between-countries”) and the period considered<sup>43</sup>. The definition of monetary poverty is also debated, as are the most appropriate methods of measuring it: by income, by consumption or by calculation of a basket of subsistence goods. Poverty is generally measured by calculating poverty indicators – the best known being the Foster-Greer-Thorbecke (FGT) measure – and establishing poverty lines.

Internationally, monetary poverty is often measured against a poverty line set at \$1 or \$2 per day (for transition and emerging countries), which makes it possible to compare countries using purchasing power parities as conversion factors. This type of measurement is often criticised for its extremely aggregate nature. It does not account for the dynamic aspects of poverty processes, particularly vulnerability, exposure to certain risks, and the institutional context, as well as social affiliations and status, which increase the risk that certain individuals will fall into or remain in poverty. Nor does it account for vicious circles: deprivation in one dimension, such as health, may have a negative impact on another dimension, such as education or employment, and create intergenerational poverty traps. In addition, this type of international measure has limited meaning because it takes no account of the non-income aspects of poverty, such as those related to capacity and rights of access to health, education, a decent life and the right to exercise citizenship.

The World Bank’s figures<sup>44</sup> on global poverty trends are regarded as authoritative, though they are sometimes criticised for underestimating<sup>45</sup> or overestimating poverty<sup>46</sup>. The results depend indeed on whether poverty is measured on the basis of national accounts or on household surveys, on whether income or consumption is considered, on whether the basic unit is the individual or the household, and on the purchasing power parity used.

Measurement of other dimensions of poverty, which are non-monetary and relate to human development and institutional contexts, has also given rise to controversy. These debates over poverty indicators have an importance that goes beyond the merely technical aspects. Depending on the measures used, it can be shown that poverty has decreased or increased at the national or global levels. Causal processes involving growth and institutions are analysed differently depending on whether they are based on an analysis of rising or falling poverty.

The views of Sen have strongly influenced aid agencies. The conceptual framework of capabilities and of poverty as deprivation in the various dimensions of human development is now pre-eminent within the IFIs and the United Nations. Sen's influence can be seen, for example, in the notion of empowerment espoused by the World Bank since the year 2000, according to which one of the dimensions of poverty is the inability to make one's voice heard and to participate in political decisions. This conception explicitly attributes an institutional and political dimension to pover-

ty, though its *de facto* depoliticisation detracts from its relevance. Donors are poorly equipped to foster institutions, particularly political institutions, from outside, as institution-building processes are first and foremost internal to countries. This dimension of poverty is particularly difficult to address operationally when "empowerment" is taken to mean democratisation.

Sen's approach raises new questions on economic policy and social choice. In view of the plurality and circularity of the channels of transmission, as well as the retroactive nature of the causalities, how should the various dimensions be ranked, and according to which criteria? Which causal relationships should be given priority (between health, education, income)? Which public policies would be effective? In low-income countries, under strong financial constraints, the choice of priorities and sectors raises similar issues. Choosing a given objective, such as growth, may mean adopting policies that relegate other objectives, such as extending health services, to the back burner.

### 2.2. Institutions, social norms and poverty

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Like institutions, social norms may be linked to a country's level of development. The concepts of institutions and social norms are often treated as one, whereas the economics literature generally distinguishes between them. The concept of social norms refers to the unwritten – customary – norms and rules that structure individuals' behaviour and interactions in any society, while that of an institution has a more formal – more "instituted" – connotation. At the empirical level, however, this distinction is hardly operative, as formal and informal rules are often simply different dimensions of the same institutional phenomena<sup>47</sup>. Whether formal or informal, all social norms and institutions take on unique forms and contents. These contents and their relevance change over the course of history. Some forms may be stripped of their initial content; the credibility of the coercion of a norm may change over time, etc.<sup>48</sup>

Social norms constitute a catch-all concept that refers to heterogeneous rules and beliefs. Their content may be

either flexible or stable over time, and they govern various areas of social interaction: the status of individuals (based on various criteria such as gender, age, occupation, place of residence, etc.); social, political and economic interactions among individuals; the life cycle (e.g. marriage, death). In particular, norms constitute signals of membership to specific social groups: for example, they indicate one's age, gender, geographical origin, ethnic group and occupational category, etc.

#### 2.2.1. From social norms to poverty, from poverty to social norms

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The causal relationships among institutions, social norms and poverty are two-way. Some categories of institutions and social norms can cause certain groups to remain in poverty. Conversely, poverty can lead to the emergence

and stabilisation – or the absence – of some types of institutions and norms that in turn perpetuate poverty. Situations of anomy, for example, have long been recognized in sociology. Samuel Bowles has also shown that poverty can limit the ability to build coalitions, to achieve large-scale collective action that would enable the poor to create more egalitarian institutions, to seize opportunities and thus to emerge from poverty. The reason, according to Bowles, is that the poor suffer from a shortage of information and from greater information asymmetries than do other individuals<sup>49</sup>. Thus, poverty engenders the types of institutions that create and perpetuate poverty traps.

These self-reinforcing institutional processes can be particularly problematic because the poor do not form a homogeneous group or sociological category with common political or social characteristics. Studies such as those of Paul Rosenstein-Rodan showed long ago that these coordination failures lead to multiple equilibria and poverty traps, through processes of cumulative causation and the locking-in of individual behaviours<sup>50</sup>. Multiple equilibria and path dependence may stem from events or norms that at first sight seem of little importance. Bowles, for instance, developed the concept of the “institutional poverty trap”, defined as a set of institutions that “implement highly unequal divisions of the social product” as well as widespread poverty, and which “persist over long periods despite their lack of productive superiority over alternative more egalitarian institutions”<sup>51</sup>.

The cognitive dimension of norms is an important aspect of their role in poverty and poverty traps. As shown by the neo-institutionalist approach, norms are processes resulting from equilibria of beliefs and behaviour. They rely on cognitive internalisation of institutional environment perceived by an individual and reinforce endogenously that individual’s beliefs about the characteristics of other individuals: for example, the belief that a given individual is incapable of doing this or that because he or she belongs to a particular social group, which has been constructed by racial perceptions or any other criterion. This creates cognitive, institutional and economic vicious circles that perpetuate the poverty of some individuals – which is the “statistical discrimination” that has long been studied by sociologists (e.g. Robert Merton). These vicious circles have

been analysed by Steven Durlauf, who elaborated a “membership theory of poverty traps”, and by Glenn Loury regarding the process of mutual reinforcement between discrimination and poverty in the case of African-Americans in the United States<sup>52</sup>.

There is no link between poverty and specific types of social norms, for example those governing status, family relationships, and interactions and obligations between individuals. Being poor can nevertheless determine one’s actual access to political, financial, educational, health and other institutions. Many studies of rural economies have shown that in developing countries the wealthier people enjoy better access to markets and institutions, particularly financial institutions and credit markets, and as a result can take more risks and acquire assets offering higher returns. Poorer groups, having more limited access to the same institutions, are forced to take fewer risks, to hold only low-return assets and to sell in the event of economic shocks. Since they are poor, they have limited savings and cannot smooth their consumption<sup>53</sup>.

In rural economies, poverty can also perpetuate inefficient institutions and norms : traditional village norms of redistribution, which function as risk-sharing and insurance mechanisms and have demonstrated their efficiency in certain contexts, are no longer efficient in the event of collective shocks, or when the poverty of all members of the community reaches a threshold under which they have no capacity for saving.

### 2.2.2. Social norms and poverty: ambiguous effects

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It cannot be determined *ex ante* whether the impact of social norms is positive or negative for growth, just as for poverty. Their impact can be observed *ex post*, according to the individuals involved, interactions and contexts. From one society to another, these norms may be egalitarian, as in democracies that value citizenship, or highly discriminatory, as in societies that are stratified by caste or by an aristocracy.

Social norms of membership are particularly crucial because they discriminate, by definition, between the members and

non-members of a group. Belonging to a group generates mechanisms of trust, reciprocity or altruism that can offset market failures – in particular, allowing easier access to capital – and also provide social protection. Such mechanisms have, for example, helped to raise the living standard of diasporas. Conversely, some institutions and social norms – sometimes the same ones that help individuals emerge from poverty – are factors of poverty and may reinforce the microeconomic processes of poverty traps. This is the case for norms governing membership of social groups, and particularly those that restrain mobility. They are based on characteristics that the individual is born with and generate discrimination and exclusion via criteria (ethnicity, gender, caste, etc.) that individual behaviour (e.g. effort or merit) cannot change. Moreover, the individual who is not a member of any group, by birth or for demographic reasons (disappearance of the other members of his or her group, owing for example to migration), is thus excluded from these protection mechanisms.

Traditional norms, such as those governing interactions among members of a household or a village, can trigger poverty processes for certain individuals. In developing countries, most productive activities, resource management, allocation of profits and consumption choices are differentiated within households by status, gender, age and other criteria. Social norms regarding redistribution generate insurance, risk-sharing and credit mechanisms that may be efficient, but that lead to unequal access to resources and opportunities depending on the status of individuals<sup>55</sup>. Where traditional norms are eroded by migration and urbanisation, they leave the door open to opportunistic behaviour. In governing membership of social groups, social norms may thus increase the vulnerability of some individuals. The fact that redistributive social norms apply only to members of a group makes them ineffective when the number of members declines (due to a demographic shock, migration, etc.).

Institutions and norms that engender strong political inequality, for example via the behaviour of elite groups, may also have the effect of excluding certain groups and keeping them in poverty, as can be seen in some Latin American countries. Social norms and economic situations work endogenously, through incentives to elite groups to

maintain the status quo in terms of property rights and to limit mobility and access to education; this process is endogenous if education is considered a factor of political participation and hence of democratisation<sup>56</sup>. The strategies of elites and interest groups may also lead to the institutionalisation of inegalitarian norms by state institutions, as Barbara Harris-White has shown for groups of beggars in India, individuals who are defined by the fact that they “have nothing, are nothing and have no political rights”<sup>57</sup>.

Access to a production factor as crucial as land in agrarian societies offers another example in which the impact of social norms on growth and poverty is unclear *ex ante*. In countries with predominantly agricultural economies, property rights and the distribution of such rights have a considerable impact on farm productivity, on scale effects (increasing or decreasing returns) and hence on growth. In addition, property rights are endogenous to the country's endowment of production factors. Low-income countries having abundant land but scarce labour have therefore developed complex systems of property rights covering not only land but also individuals (via the rights conferred by kinship systems). As Abhijit Banerjee and Lakshmi Iyer found in the case of India, different systems of land rights stemming from colonial history affect economic performance differently: productivity and investment are lower when property rights are held by large landowners than when they are held by those who actually farm the land<sup>58</sup>.

“Traditional” norms structure the allocation of land rights, property rights and most important, particularly in Sub-Saharan Africa, communal rights of access and use, which may be temporary to varying degrees. The power to allocate land rights to an individual or a group is often the prerogative of particular groups (lineages that claim to have been the first to settle the land, households that have acquired rights through their *de facto* farming of the land) and particular individuals within these groups (such as “land chiefs”). These individuals change their land allocation strategies according to a number of variables, land-related, demographic and political (depending on the balance of power, which involves, for example, lineages, self-made individuals, migrants, etc.). These rights in land are of several types: property rights, rights of access or rights of use. They also vary with the type of crop: for example, they

apply more to the use of land in contexts of extensive rotating-fallow farming or of a herding economy. In this case, ownership of a delimited plot of land is less important than it is for perennial and export crops such as cocoa. These social norms governing the allocation of property rights and use of land may give rise to inequality, poverty and exclusion for individuals who, for various reasons, stand outside the traditional channels of decision on land allocations.

The neoclassical and neo-institutionalist literature stresses the inefficiency of these traditional systems, particularly in the context of predatory, corrupt states. In the latter case, politicians may appropriate land rights arbitrarily and with impunity, and collusion may develop between politicians and traditional chiefs. Social norms that structure property rights can also be inefficient because they are fragile and vulnerable to economic change. Jean-Philippe Platteau has shown that, in many developing countries, customary property rights had in many cases lost their function of ensuring equity and social security owing to the individualisation of land rights and the concentration of land ownership caused by the increased number of transactions on land markets and by population pressure<sup>59</sup>.

Many studies recommend the introduction and stabilisation of individual private property rights, as these would be more efficient. This reform of property law is held to be necessary to boost investment and hence growth and poverty reduction. Such reforms have often been called for in the conditionalities associated with World Bank loans.

However, these traditional communal land rights are often

flexible rights of access or use, which make it easier for local institutions to adapt to change (migration, for example) and to high-risk contexts (the vagaries of the weather and of harvests)<sup>60</sup>. In this sense, these institutional arrangements can be efficient, as Joseph Stiglitz and others have shown in the case of sharecropping.

Efforts to transform customary rights into definitive, private property rights of individuals, secured by a deed, have met with mixed success. In some cases these reforms have allowed more equitable access to market opportunities and increased the well-being and security of households, particularly in urban areas when the reforms provide security for the housing of the poorest.

In rural economies, however, the development of definitive individual property rights has in some cases eroded traditional norms regarding cooperation, though, in poor countries, these norms are not replaced by state-supplied social protection. The institution of definitive property rights may also have increased inequality and led to conflicts over redistribution. There are also cases where the new legal system is superimposed on the old, exacerbating existing tensions. The new rights may be allocated inequitably: in a context of a clientelist political economy, some individuals (urban residents, civil servants, etc.) may have special access to them. Moreover, some land reforms have not reduced poverty because they were not supported by other public policies, such as measures to reduce the inherent risks of farming or to offer technical support to new landowners.

### 2.3. Macroeconomic poverty traps: natural resources and commodities

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#### 2.3.1. The debate over poverty traps and their determinants

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The notion of poverty traps has inspired a growing literature at the macroeconomic level, following the concepts developed by Paul Rosenstein-Rodan: development traps, spillover effects, the importance of externalities in explain-

ing the differences in growth rates across regions and countries. For many economists, the concept of a poverty trap, applied on the scale of a whole country, explains why the convergence predicted by theory has not come about. This notion is deemed to explain why low-income countries, notably in Sub-Saharan Africa, find themselves trapped in slow-growth “low equilibria” that are self-rein-

forcing, and hence why they cannot seize the opportunities offered by trade liberalisation and globalisation.

Poverty traps have many causes. Examples include market structure (incomplete markets) and “kleptocratic” behaviour on the part of governments<sup>61</sup>. Poverty traps have also been interpreted as resulting from the inability to bring about structural change and diversify the economy, particularly exports. So-called “heterodox” positions view diversification and industrialisation as the optimal instruments for emerging from poverty, particularly for low-income countries, which often depend on very few natural resources and have a very small industrial base. The debate is still open, however, as to which industrialisation processes are appropriate, particularly for newcomers to international competition such as the countries of Sub-Saharan Africa. Some researchers recommend diversification and industrialisation based on commodities and natural resources, using labour-intensive methods since these countries generally have abundant unskilled labour<sup>62</sup>.

Some economists, such as Aart Kraay and Claudio Raddatz, have recently questioned whether poverty traps exist. William Easterly<sup>63</sup> also argues that studies which detect poverty traps and consequently recommend “Big Push” policies financed by either the state or international aid (Jeffrey Sachs is a tenant of this position) are based on a false concept. Strictly speaking, poverty traps do not allow episodes of growth, yet Easterly points out that the countries of Sub-Saharan Africa, which are always held up as examples of poverty traps, have experienced growth, albeit often slow, over the last 50 years. According to Kraay and Raddatz, most of the causes identified by the literature on poverty traps, and in particular low saving rates and low productivity at low levels of development, do not offer convincing explanations. Interestingly, however, Kraay and Raddatz agree with the literature on the role of institutions in the formation of poverty traps.

It has also been argued that the low growth recorded in some countries results more from asymmetric profiles of shocks, or from asymmetric effects of “starts” and “stops” episodes respectively, than from poverty traps. The negative impact of recessions is stronger in manufacturing sectors, which does more harm in low-income countries where these sectors are weak and small<sup>64</sup>.

### 2.3.2. The “natural resource curse” and dependence on commodities

Two broad sets of determinants of the poverty traps holding back the growth of the poorest countries have been identified in the literature. The first is the result of abundant natural resource endowments, which lead to the “natural resource curse”. Earlier theories of the “Dutch disease” had already demonstrated the negative impact of unexpected windfalls (such as oil bonanzas) on a country.

From another standpoint, an abundance of natural resources – and dependence on these resources for exports and access to hard currency – has been linked to lack of growth. This dynamic makes it impossible for a country to develop economic institutions of “good quality”: economic activity is more “extractive” than productive and located in landlocked areas – it may not even be located on the country’s territory, as in the case of off-shore oil. This process of abundance-cum-dependence erodes public institutions and fuels corruption in both civil services and political institutions. In the extreme case, public institutions become irrelevant, as do the rule of law, infrastructure and an educated workforce, since the only thing that interests those in power is control over the location where the resource is extracted. Jeffrey Sachs analyses this type of causality as one of the negative effects of initial natural resource endowments, with other negative effects being due to geography, climate, being landlocked, etc.<sup>65</sup>

Auty<sup>66</sup> has pointed out that natural resources abundance reduces the efficiency of investment. It leads to competition for the rents derived from these resources – competition that often becomes predation and a cause of social fragmentation and conflict. It fosters types of states that are not “developmental” as Korea and Taiwan were. Historically, “developmental” states have emerged in resource-poor countries, which had to build models of competitive industrialisation and relatively balanced and egalitarian growth.

Natural resources abundance is thus viewed as an obstacle to the development of efficient institutions, as a factor that encourages corruption and, at the same time, as an obstacle to growth. It explains the persistent poverty in many countries of Sub-Saharan Africa, in addition to civil wars and

secession conflicts. Indeed, as has been shown by the example of Nigeria, the direct impact of plentiful natural resources on growth is less serious than the indirect impact, in terms of the weakening of economic institutions<sup>67</sup>.

The second major cause of country-level poverty traps is dependence on commodities for exports. This was identified by the founders of development economics and has been the subject of a large literature since the 1960s, for example the studies by the ECLAC (UN Economic Commission for Latin America and the Caribbean) and the Prebisch-Singer theory on the deterioration of the terms of trade and the long-term decline in commodities prices. This work has been continued by UNCTAD, for example in its periodical reports on the Least Advanced Countries.

According to UNCTAD, the poverty trap created by dependence on primary products for exports is the main cause of the poverty of low-income countries. This poverty trap stems as much from the volatility of international prices as from the deterioration in the terms of trade for tropical commodities vis-à-vis manufactured products (world growth being driven by exports of high-technology, high-value-added products). This deterioration is exacerbated by mechanisms of “fallacy of composition” (prices fall as the number of countries exporting the same product rises).

Public institutions cannot be sustained when it is impossible to form expectations, when budgets and financing cannot be planned, nor commitments met. Trade liberalisation and the decline in tax revenue from external trade, which is

an important resource for poor countries with little domestic taxation, have exacerbated this negative impact on economic institutions and policy. Dependence on commodities thus has a devastating effect on the strength and credibility of state institutions, and by contamination, on other social institutions. UNCTAD considers that the lack of institutions capable of promoting economic diversification and providing economic agents with a stable time horizon (a function initially assigned to institutions such as stabilisation funds, marketing boards or guaranteed prices) can also be a factor of poverty. Poverty thus also results from the lack of institutions that can reduce uncertainty and hence facilitate investment and reduce capital flight.

UNCTAD has also emphasised the links between dependence on commodities and the vicious circle of unsustainable debt, which is a dimension of poverty. Such indebtedness is inevitable when repayments must be made from volatile and unpredictable resources. According to UNCTAD, the solutions proposed by the international institutions (for example, the Heavily Indebted Poor Countries – HIPC – initiative) do not address the real causes of debt and poverty because they uncouple the two problems (commodities and debt).

The institutional conditions prevailing in most poor countries both result from these various determinants, particularly the difficulty of overcoming dependence on natural resources, and at the same time perpetuate them.

## 2.4. Relationships between economic policy, institutions and poverty

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Economic policy exerts influence on institutions (economic, social and political), on poverty and on the links between them, regardless of whether such policy is explicitly targeted on growth or poverty reduction. The “Washington consensus” reforms have been much discussed in the literature, particularly tax reform, trade liberalisation, labour market liberalisation and privatisation.

Economists at the IFIs have developed a series of models to measure the outcomes of reforms and public policies for poverty or employment, as well as their redistributive

impacts in developing countries, adapting the models to capture particular policies and characteristics specific to countries and socio-economic groups (e.g. unskilled workers or poor urban dwellers). These models explore the micro-macro linkages between the macroeconomic models and household surveys. They highlight the role of specific institutional features such as the segmentation of labour markets, the functioning of informal markets, the imperfections of credit and other markets, the effects of public spending and of its allocation, and the effects of social policy<sup>68</sup>.

### 2.4.1 Redistribution, employment, social protection policies and poverty

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Public policies and institutional changes may be directly focused on redistribution and poverty reduction. This is the case for social protection policies, which, as François Bourguignon and Tony Atkinson have shown, have been effective in European developed countries, in particular as regards reducing inequality<sup>69</sup>.

In poor countries, such as those of Sub-Saharan Africa, such policies are severely constrained by the low level of tax resources, the weakness of taxation systems, and lack of institutional and administrative capacity. They are also difficult to implement owing to the existence of large informal sectors. The programmes advocated by the IFIs in these countries have minimised the role of the state or assigned to the state the job of providing a limited number of public goods and services. They have urged the transfer of many functions relating to redistribution, social security and correction of market failures to non-governmental projects or entities – functions that are vested in the state in developed countries, particularly in Europe. Thus, like donors, NGOs often take the place of the state, with all the attendant problems of non-ownership of projects.

During the structural adjustment period, the IFIs arrived at the conclusion that, in many low-income countries, public redistribution policies did not really benefit the poorest, but rather the urban middle class. They therefore proposed reforms based on social safety nets that were more in keeping with governments' limited budgets, and targeted to the poorest groups or the losers from the reforms: targeting of vulnerable groups through public works, food-for-work programmes, food subsidies, etc.

These projects have often bypassed existing public institutions and have been driven more by donors than by states. Many studies, notably those of Martin Ravallion, have shown the effectiveness of these types of transfers with respect to their objective: providing safety nets for the poorest. Ravallion considers that the traditional trade-offs between equity (the function of the safety net) and efficiency, as well as between insurance functions and efficiency, have been exaggerated by the literature<sup>70</sup>.

Employment or wage policies focused on labour markets can also play an important role in poverty reduction. Such policies have been constrained by budget restrictions and the conditionality of the IFIs, which prefer an approach in terms of targeted projects (involving highly labour-intensive public works) rather than an integrated public system of social security.

The IFIs see flexibility as the key lever of growth. The institutionalisation of labour markets, for example via better coordination or efficiency wages, remains a subject of sharp disagreement. The effects of unionisation offer a good example of this: Dani Rodrik and others see trade unions as favourable to poverty reduction, while the World Bank shows only limited interest in them.

### 2.4.2. Trade liberalisation policy, industrial policy and poverty

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Other economic policies have indirect impacts on local institutions and on poverty. Examples include privatisation and trade liberalisation. The channels of transmission between trade openness and poverty reduction may be either economic or political-economic: macroeconomic policy, allocation and redistribution effects, transmission of technology<sup>71</sup>.

The IFIs have often been ambivalent in their recommendations for liberalisation and reforms. It remains uncertain what benefits these reforms bring to the poor. Most economists and the IFIs consider that, in developing countries in the catching-up phase, trade liberalisation has a crucial impact on growth and poverty reduction. The well-known studies by David Dollar and Aart Kraay conclude, for example, that "trade openness is good for growth". China is described as the most striking example, as the liberalisation period has seen both growth and a large decrease in the number of poor<sup>72</sup>.

The World Bank considers not only developing country policies but also developed country policies to be important. The latter are responsible for the economic stagnation of developing countries, as reflected in its recurrent criticisms of the trade barriers erected by rich countries to protect their markets from poor countries' exports, particular-

ly exports of manufactured goods. These protectionist measures have a high cost for developing countries in terms of growth and poverty reduction.

According to the Bank, trade liberalisation and privatisation are related to other beneficial policies, such as those promoting foreign investment and the entry of multinational corporations. The latter are viewed as positive for employment and wages, although the fact that multinationals pay higher salaries than domestic firms remains a matter for discussion.

Foreign investment is also perceived as positive for technology transfer, and hence for poverty reduction and for local institutions. Such investment leads to improvement in the regulatory framework, the rule of law, and economic and judicial institutions. The debate remains open, however. Many economists, including those at the IFIs, point to possible negative effects of foreign investment<sup>73</sup>.

At the beginning of the adjustment period, privatisation was assumed to reduce public deficit, to be beneficial for growth and to strengthen economic institutions such as financial and stock markets. The World Bank now takes a more cautious stance concerning the gains from privatisations. It also recognises that they have negative effects on formal sector employment and unemployment, as well as causing distributional changes and increased inequality<sup>74</sup>.

The benefits of trade openness for growth and poverty reduction are a matter of controversy. Much of the debate

is concerned with the role of local institutions in the transmission of the various causalities involved. First, there are four terms involved in the relationships: openness, growth, poverty reduction, trends in distribution profiles and inequality. These relationships can be positive or negative depending on the specific characteristics of each country, as François Bourguignon has shown<sup>75</sup>.

On the other hand, some “heterodox” economists have affirmed, contrary to the arguments of Dollar and Kraay, that countries displaying spectacular growth and poverty reduction, such as China, have achieved this performance as a result not of liberalisation policies but policies closer to those adopted by the Asian “developmental states”: industrial policy, selective state intervention to guide markets, dynamic creation of comparative advantages, etc. These economists, like those of UNCTAD, consider that public policies may be effective for promoting growth and emerging from poverty, such as active industrial policies.

Another advantage of industrial policies is that they indirectly build local capacity, skills, firms and institutions, because they are associated with learning-by-doing effects. However, the same economists also argue that these policies have become nearly impossible to implement for the latecomer poorest countries, for several reasons: the widespread trade liberalisation supported by the WTO, heightened global competition and the fact that world growth is driven by technology-intensive products, as UNCTAD also emphasises<sup>76</sup>.

## 2.5. The multiple determinants of growth and the role of institutions

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### 2.5.1. Growth, poverty, inequality, institutions: multiple and two-way causalities

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The links between institutions and poverty are complex. First, both concepts are multidimensional, and they are defined in different ways. Second, these links involve not only the direct relationships between institutions and poverty, but also indirect relationships: poverty itself is linked to growth, which implies the analysis of the relationships

between institutions, growth and poverty. As François Bourguignon has often noted, mentioning the “two million regressions” performed by Xavier Sala-i-Martin, the determinants of growth are multiple and complex: Sala-i-Martin has isolated more than 60 variables having a significant impact on growth, not counting “those yet to be discovered”. Moreover, for a given variable, such as education, the causal processes and the nature of the impact may vary with the level of development of the country considered<sup>77</sup>.

The causal relationships work in several directions and involve intermediate causes: from institutions to growth, from institutions to poverty, from institutions to poverty and then to growth, or from poverty to institutions and then to growth, and vice versa. Given the highly inclusive nature of the concept of an institution, the literature identifies causal relationships that move from strong institutions towards growth; but also from failed institutions towards poverty, or from poverty to weak institutions; or yet again, from a high level of income towards stable, credible institutions. These causal relationships also vary with the level of aggregation considered: individual, household, village, region or country.

The literature is in general agreement, however, on one causal relationship: the positive impact of growth on poverty reduction, with limitations stemming from the growth elasticities of poverty reduction in a given context. The elasticities themselves, however, are a matter of sharp controversy. The benefits of growth for poverty reduction will clearly depend on whether this elasticity is equal to, greater than or less than 1. Dollar and Kraay have revived this debate by asserting that over the last four decades, for a sample of countries, the average income of the poorest quintile increased proportionally with average income. The fact is that the income share of the poorest varies neither with average income nor with most of the institutions that determine growth, such as the rule of law<sup>78</sup>. According to Kraay, this proportionality shows that growth may be given a “pro-poor” bias if *ad hoc* institutions are introduced<sup>79</sup>.

These results have been qualified by other studies, some of which were conducted within the IFIs. These studies emphasise the role of other explanatory factors, which explain the heterogeneity of elasticities depending on the countries and periods considered, as Bourguignon<sup>80</sup> has revealed. Within a single country, India, Ravallion and Datt have shown that poverty reduction depends on the type of growth considered: the elasticity of poverty with respect to agricultural yields varies little from state to state, whereas that of poverty with respect to the growth of non-farm production varies a great deal, with the latter being determined by educational level<sup>81</sup>. Even within the International Monetary Fund, it has been asserted that although growth raises the income of the poor, the income elasticity may be less than 1<sup>82</sup>.

The relationship between growth and poverty becomes even more complex when one considers all four terms: growth, poverty, inequality and institutions. The influence of institutions, whether positive or negative, varies according to the type of institution and the contexts and groups involved. Within a given broad category of institution, causal processes need to be disaggregated and some institutional characteristics seem more significant than others.

The existence of democratic institutions, for example, is not necessarily a positive factor, although such institutions are an intrinsically desirable good. The same is true of education, as Lant Pritchett has shown. Political stability, in contrast, seems to be a crucial factor, as noted by Adam Przeworski among others. Political conflict and civil war are particularly damaging: they seem to be one of the main causes of low growth and poverty in low-income countries<sup>83</sup>.

Similarly, the influence of economic policy varies with the context and with the nature of the reforms. According to Easterly, for example, the adjustment programmes prescribed by the IFIs seem at best to have had only a slight impact on poverty<sup>84</sup>.

Inequality is another concept that refers implicitly to a political and institutional context. *The World Bank's World Development Report for 2006* asserts that inequality can have a negative impact on growth. The issue is still debated, as is the converse relationship (for example, the existence of the Kuznets curve).

Many studies have sought to demonstrate the links between inequality and types of political, economic and social institutions, particularly in Latin America (by, among other authors, Stanley Engerman, Kenneth Sokoloff, Daron Acemoglu, James Robinson). Inequality may be linked, for example, to a democratic system (greater inequality being associated with less democracy and less respect for property rights) or to social heterogeneity (where greater heterogeneity, in ethnic terms for example, is associated with greater inequality). Economic policies, particularly those concerning education and redistribution<sup>85</sup>, have a complex impact on these processes.

Development may also be viewed as distinct from growth, especially if the term is used to refer to human development – for example, health, education, living with dignity in

society. In this case, each of the above-mentioned relationships is reinforced by the relationships of each variable with health, education, etc. Or the concept of poverty may be disaggregated into absolute and relative poverty, where the latter incorporates the human development aspects (education or health relative to other members of the society). These relationships pass through many channels, which may be differentiated by whether the causal relations are direct or indirect or by the aspect concerned (income; human development; the economic, governmental and political spheres, etc.).

Initial conditions and levels of development also have an impact on the causal relationships among institutions, poverty and growth, as well as on the direction of these relationships, and explain their non-linearity, which the literature has long since identified. If the process is non-linear and if there are threshold effects, a causal relationship observed at a given level of development can be reversed at another level, as in the classic examples of growth stemming from spillover effects analysed by Rosenstein-Rodan or in U curves such as the Kuznets curve (inequality increases during the initial stages of industrialisation and decreases thereafter). Robert Barro has also suggested that an institution such as democracy is favourable to growth only at certain levels of development. Depending on the initial income distribution and the distributional effects of growth, growth can increase inequality, as shown in the debates over the returns to education and skills, which, as François Bourguignon has shown, can heighten wage inequality between groups.

### 2.5.2. Institutions, structures or economic policy? The endogeneity of the determinants of growth, threshold effects and poverty traps

Along with other determinants of growth, to which they are linked in complex ways, direct and indirect, institutions are crucial factors of growth and poverty. In addition to generally agreed determinants such as investment, three broad sets of determinants have recently been put forward: first, institutions; next, reforms and economic policy; and lastly, initial structures, endowments and characteristics. An

extensive literature tries to isolate the most important determinants<sup>86</sup>.

For some economists, such as Rodrik, Engerman and Sokoloff, institutions are the fundamental determinant of growth. Others, such as Jeffrey Sachs, point instead to structural characteristics and factor endowments, i.e. geography in the broad sense (landlocked regions, latitude, climate, soil quality) as well as resource endowments (population, stock of education, etc.). For yet others – and unsurprisingly for aid agencies which make reforms a condition of their financing – the key factors of growth are appropriate economic policies, such as liberalisation or openness to trade.

The “natural resource curse”, for example, involves many causal relationships: its existence seems to have been demonstrated in the case of exports of oil and tropical commodities. Yet the growth and industrialisation of some countries, such as the Scandinavian countries, were initially driven by primary products exports, as Magnus Blomström and Ari Kokko<sup>87</sup> have shown for Sweden and Finland. Their success was due to a combination of economic policy and strong institutions, based on both market forces and state intervention, with the state implementing policies that promoted innovation and better coordination of sectors and economic agents.

The question remains: are institutions one of the necessary determinants of growth and poverty reduction? It must be asked in terms of the institutions concerned: certain specific types of economic and political institutions, or no institution in particular but any institution as long as it is effective and promotes growth? The latter hypothesis assumes that any institution can be growth-promoting in theory, but whether it is so in practice can only be observed *ex post*, as no particular institution is favourable to growth *ex ante*. The reason is that, where growth is concerned, the content of institutions matters more than their form, as does the way the various institutions in a given society are combined<sup>88</sup>.

This position is supported by a problem facing economists that is growing in importance as the body of research on institutions accumulates: the gap between the macroeconomic literature on relationships between institutions and

growth, based on cross-country regressions, and the literature on specific institutions, which is based on microeconomic data on individual behaviour, such as the effects of land tenure systems and family norms on saving and investment by individuals. Rohini Pande and Christopher Udry have stressed that the results of these two bodies of literature are not connected and that the macroeconomic literature has difficulty in identifying the effects of specific institutions on growth<sup>89</sup>.

A number of analysts argue that “institutions matter” (i.e. the fact of having institutions at all matters more than which specific institutions). Engerman and Sokoloff, for example, interpret on this basis the long-term divergences between regions of the world. Rodrik sees this as explaining the contrast between China and Russia: the case of China shows that predefined types of institutions and rights (e.g. democratic institutions, transparent markets and contracts) are not necessary to growth<sup>90</sup>. What is necessary is a government capable of taking action and institutions capable of easing social conflicts, including those arising from globalisation and trade liberalisation.

Other economists, especially in the IFIs, believe that judiciary institutions, regulatory systems, the rule of law, and security of contracts and property rights are necessary for growth and poverty reduction.

Each of the major sets of causes seems to contribute simultaneously to a country’s growth. But this leads to other questions related to the previous ones: What influence do institutions have relative to the other determinants, i.e. structures and economic policy? Although growth is a necessary condition for poverty reduction, do the same institutions promote both growth and poverty reduction?

These debates are far from being academic. They are crucial, because if it is demonstrated that one set of determinants is more effective than another, this means that it is futile for politicians and donors to try to influence the other determinants, particularly when the budget constraint makes it necessary to set priorities. For example, if institutions are the only things that matter, reforms and economic policy play a minor role. As Easterly points out, institutions, which are stable entities by nature, cannot explain the volatility of growth rates. Moreover, the implementation

of “good” economic policies did not prevent developing countries from experiencing zero per capita growth during the structural adjustment period (1982-95)<sup>91</sup>.

Institutions are also the product of long-term historical and geographical conditions, which are specific to each context and thus produce different institutions, as Engerman and Sokoloff have shown with respect to the diversity of institutional paths in North and South America. Countries’ structural endowments seem to have more explanatory power<sup>92</sup>, along with global external shocks: world interest rates, technological change that disadvantages unskilled labour, the debt burden and low growth in the industrialised countries. According to Easterly<sup>93</sup>, shocks explain a great deal of the growth profiles of developing countries. UNCTAD, for its part, has repeatedly stressed the fact that reforms and economic policy levers (such as trade liberalisation) have had mixed effects on growth in the case of countries that export commodities, even if they are “good pupils”.

Some economists, however, still contest the notion that institutions play a pre-eminent role in explaining low levels of development. Glaeser *et al.* assert, for example, that human capital and “good policies”, even when implemented by non-democratic regimes, are more robust growth factors than the quality of political institutions<sup>94</sup>. Sachs considers that geography offers a much better explanation of growth and poverty than institutions do<sup>95</sup>. It is asserted that institutions sometimes have no influence on growth and that factors such as demography, initial endowments and geography are more fundamental constraints that determine the unique configurations of institutions in a given country at a specific point in time.

Endogeneity affects all of the causal relationships among these variables (institutions, economic policy, structures, growth) and is an essential aspect of them. Some countries may have “good institutions” because they are already at a high level of development, as institutions are influenced by growth and level of development. Conversely, some countries have become wealthy by building “good” institutions.

Moreover, the three sets of determinants of growth stand in relations of endogeneity not only with respect to the variable considered (growth or poverty reduction) but also with

respect to one another. Institutions clearly influence economic policy, but they are also influenced by policy. Similarly, structural constraints – geography, demography, health and education – influence institutions, as Acemoglu et al. argue in the case of “extractive” institutions in environments that are hostile, isolated, afflicted by endemic diseases, etc. Some of these constraints, however, are also influenced by policy and by institutions. For example, educational level is the product of demographic and institutional characteristics and the policies implemented by governments. Similarly, geographic variables are not exogenous variables. Some of their dimensions, such as settlement and endemic disease, are the consequence of individual decisions and policies, particularly with regard to migration, just as demographic characteristics (fertility and mortality) are the result of social norms and government policy.

Economic policy “matters” as well. Public policy modifies individual incentives to accumulate physical and human capital. It influences long-term growth and explains countries’ different growth rates. Tax policy is especially significant in small, open economies, where capital mobility can be important<sup>96</sup>. The relationships between growth on the one hand and institutions, structures and economic policy on the other may be forged through economic policies and specific reforms, such as trade-opening measures. This is a matter for the debate over the impact of globalisation.

These relationships may also be shaped by local institutions, such as political institutions. In this case, the debates concerned are those over political economy, governance and which political systems are optimal for poverty reduction. According to Sen, for example, democracy is a better political system from the standpoint of poverty reduction. The relevant institutions and reforms may also be non-political or only indirectly political, such as institutions governing labour markets, social policy, financial flows or remittances – the latter being particularly important in the poorest countries. All of these relationships are constrained by structures and initial endowments – geography, demography, capital-labour ratio, labour-land ratio – which determine the manoeuvring room available to economic policy and institutions.

Lastly, causation and endogeneity change over time and according to whether one takes the short- or long-term point of view. In the long run, all of these variables change under the influence of many factors and cannot be considered exogenous. One may conclude, as Przeworski has shown, that no cause can be regarded as a “first”, fundamental cause in terms of growth and economic development. Institutions and development are “mutually endogenous”. The sole aim of research should therefore be to identify their impacts on one another<sup>97</sup>.

Endogeneity provides the basis for the concept of poverty traps. The endogeneity between institutions and development generates threshold effects, and hence the possibility of multiple equilibria (“high” and “low”). Each factor combines with, reinforces or cancels out the others. Vicious circles or poverty traps may be formed, which involve inefficient institutions, poor initial endowments and inappropriate policies that are mutually reinforcing. Each factor and each new fork in the road is path-dependent, as Paul David has shown. Small unpredictable events can cause a country to fall into a vicious circle or trigger a virtuous equilibrium and its stabilisation.



## Conclusion

### The endogeneity of causalities and the key role of institutions

This study has analysed the many meanings and multidimensionality of the concepts of institutions and poverty. These concepts may be apprehended at both the macro- and microeconomic levels. They may equally well refer to the sphere of the state or to that of social norms. This multiplicity of references and dimensions implies that there are multiple relationships between these concepts. Study of the relationships between institutions, growth and development shows that the possible formation of poverty traps and vicious circles is a crucial issue.

The causal variables and processes are endogenous: weak state institutions with little credibility, predatory political regimes, social norms that engender discrimination and exclusion, ineffective economic policy and structural conditions (e.g. geographic conditions) marked by dependence on natural resources, little diversification of economic activity, poor infrastructure, etc. Exploration of the relationships between institutions, development and poverty shows that, taken one by one, these factors are not necessarily causes of poverty. The analysis suggests rather that events and historical paths can create processes in which the various factors are mutually reinforcing and act to stabilise equilibria characterised by economic and institutional stagnation, as Rosenstein-Rodan found. Emerging from a poverty trap – through institutional innovation, effective reforms, better coordination of economic agents – therefore becomes more difficult and costly, and it requires incentives that are more difficult to introduce. Many poor countries in Sub-Saharan Africa have been trapped in these devastating endogenous processes.

At the same time, the multidimensionality of the concept of an institution and of its relationship to development may suggest a more optimistic picture. The example of China, and previously the Asian “developmental” states, showed

that growth and a spectacular decline in poverty could take place even in the presence of institutions and policies that appeared to be inappropriate, and in any event were far removed from the recommendations of theory, and even though these countries’ initial endowments were not devoid of handicaps.

This leads to another central point: the difficulty of predicting *ex ante* the causal sequences, and their direction, between growth on the one hand and the institutional, political and economic contexts that would be the most efficient on the other.

Many economists now recommend that analyses be based on case studies, an approach that limits the possibilities of extrapolation to other countries. A certain modesty is required with respect to the results of quantitative analyses, regardless of whether they are based on cross-country studies or case studies. The uniqueness of historical trajectories and contexts, the random nature of events and the unpredictable results of interactions need to be emphasised. These themes were already present in the debates over structure/agency theory.

This volume points out the limits of our certainties regarding economic causality. Institutions clearly “matter”<sup>98</sup>, but the nature and types of the institutions in question remain matters for investigation.

#### OPERATIONAL IMPLICATIONS

The implications, in operational terms and for improving donor policies, are not easily isolated. In the neoclassical framework, policies or reforms are assessed in terms of Pareto efficiency. It is therefore unnecessary to consider institutions, or else they are considered as exogenous and

given. When institutional factors are included, these standard tools for evaluating public policy become more difficult to use. To take institutions into account from an operational standpoint, it is necessary to think in terms of the transformation of institutions, in particular under the influence of public policy, and hence in terms of their endogeneity to a number of variables, one of which is precisely public policy.

The impact of economic and political institutions and of social norms cannot be predicted with certainty *ex ante*. The link between a given form of institution – a set of property rights or a political regime – and growth is not automatic. Institutions are endogenous to many other factors and engender threshold effects and multiple equilibria (“high” or “low”, virtuous or vicious circles). Such analyses do not offer donors any practical indications for reform or project proposals.

The limitations of cross-country econometric exercises point up the virtues of pragmatism and adaptation on a case-by-case basis. The historical character and path dependence of institutions show that their relationships with poverty depend on the context. Moreover, the theory of institutions set forth here, which distinguishes between their form and their content, shows that a given institutional form, such as democracy or market-economy institutions, does not guarantee that the actual content will correspond to the apparent form. The content may not be “internalised”, may be turned aside from its initial spirit or may be “filled” by the content of other institutions. Market institutions, for example, may be driven by social norms – i.e. content – stemming from “traditional” institutions such as kinship or caste hierarchies. Similarly, institutions that are democratic in form may in fact be driven by authoritarian political mechanisms.

Donor-driven reforms may be targeted to have a direct impact on institutions, or they may work indirectly on factors that improve institutions, such as liberalisation reforms. Where states are credible and formal institutions effective, reforms and public policies geared directly towards improving the legal framework to the benefit of the poorest groups can have a positive impact. Public policies, however, are always exposed to the risk of being ineffective or having an unexpected impact on growth – and to

the classic dilemma of any public policy, namely choosing between equity and efficiency. The effectiveness of economic reforms acting indirectly on institutions and the poverty caused by institutions is somewhat unpredictable, as shown by the example of liberalisation reforms. The responses of economic agents, and hence the *ex ante* identification of winners and losers, remain difficult to predict with any certainty.

Moreover, many other political and social factors interfere with the channels of economic causality. Microeconomic norms, individual status, and individual political and economic rights make it a more complex matter to calculate averages at group level, making it difficult to predict the effects of the reforms. Where states and institutions are weak, the impacts of public policy, particularly aid policy, are blocked or filtered by the microeconomic norms structuring villages and households, and by their reconstituted urban counterparts. Multiple causes may thus be intertwined in local contexts that may be unique, requiring case-by-case analysis. Aid agencies must abandon the “one-size-fits-all” approach.

Some *a contrario* suggestions are nevertheless possible. The credibility and legitimacy of institutions are seen to be essential. Moreover, although it is impossible to define precisely *ex ante* what should be done, it is at least possible to identify what does not seem favourable to growth or poverty reduction. Some causal relationships may prove to be more probable than others, and certain targets of public policy may prove to be more strategic. The details of public policy may also be improved, particularly consistency and the links between the macro and micro levels of norms and institutions, which are often disconnected. The legitimacy of an institutional reform depends precisely on these linkages and on whether a state institution or donor project is internalised in local systems of norms.

Improvement of public policy may therefore focus on linkages, as asserted by Albert Hirschman and other founding fathers of development economics. Many poor countries, particularly in Sub-Saharan Africa, are characterised by social segmentation and inequality of status and access, as well as what Hirschman called “exit options” or, to the contrary, the take-over by certain interest groups of government machinery held by other interest groups. Paul

Rosenstein-Rodan, and subsequently Karla Hoff, have demonstrated the importance for development of spillover effects and coordination, their absence being one of the causes of poverty traps<sup>99</sup>. Donors can promote these coordination mechanisms and attenuate the information asymmetries revealed by institutional analysis.

Lacking certainty as to which institutions promote growth and poverty reduction, governments and donors may focus on improving the institutions that currently engender exclusion and divisions, which hamper the mobility of both groups and individuals. For example, some institutions exclude certain groups from opportunities created by markets. This is true of institutions based on membership, where factors over which the individual has no control (e.g. birth) reduce his or her prospects for increased income and for achieving gains through effort and individual merit. Lacking the ability to transform these institutions directly in the short term, reforms may seek to circumvent them, for example by offering more market opportunities to those who are excluded.

These reforms concern the impact of institutions on poverty. Reverse causality – i.e. the impact of poverty on institutions – may also be addressed by public policy. The impact of income levels on social norms is very indirect and uncertain. It is difficult to establish a link between income increases and types of – and changes in – social norms. However, being poor can prevent access to economic and political institutions, such as those focusing on credit, education, health and political participation. Public policy may seek to lower these barriers, with some possibility of creating virtuous circles in which broader access to institutions modifies the inegalitarian social norms that often underlie problems of access.

The developmental states that have succeeded in catching up – those where spillover effects were generated or where “Big Push” policies have been effective – are those where government policies have created mechanisms for coordination among economic agents and sectors, and have encouraged the introduction of these mechanisms by market forces. The presence of multiple donors and the often criticised lack of harmonisation of their projects have negative effects on poor states troubled by fragmentation and inadequate information systems (information asymmetries,

failure to delegate, etc.), as well as political economies unfavourable to coordination mechanisms and institutions, such as those based on interest groups in the context of illegitimate or clientelist states.

As indicated by Rajan and Subramanian’s recent studies for the International Monetary Fund, the effectiveness of development aid remains disappointingly low, although the poverty reduction strategy papers and tools such as budget support have improved coordination among donors. Aid continues to have little influence over local institutions. In practice, it is poorly harmonised and subject to the well-known perverse effects of conditionality – incentives for aid-dependent countries to agree to any conditions, even if this means resisting or “digesting” them later on – and to the effects of fungibility, whereby aid ultimately allows anti-development political regimes or inefficient institutions to endure.

Rosenstein-Rodan asserted that growth stems from spillover effects. The problem is that projects are often dependent on donor financing and may end up functioning as economic and institutional enclaves within inefficient environments driven by other mechanisms. In contrast, development, and particularly institutional development, are endogenous processes in which the comparative advantage of donors lies in providing seed money and fostering spillover effects and coordination mechanisms.

Analyses of the calls being heard today for massive international aid, particularly to Sub-Saharan Africa, question the poorest countries’ capacity to absorb such aid. This critique refers not only to economic absorption capacity but also the capacity of local institutions (both governmental and non-governmental, economic and political, as well as social norms) to absorb a massive inflow of aid, with its attendant financial flows, flows of goods and new incentives (those provided by projects, for example: jobs, infrastructure, travel, etc.), as well as the impact of such aid on these local institutions.

The old questions regarding “more aid” and quantity of resources versus quality of aid and of government policy are still relevant. International aid unquestionably played a role in the Asian developmental states. Examples include the controversial role of Japanese aid, exporting its models

of the state and institutions, and that of United States aid – both of which, moreover, pursued explicit political ends. However, William Easterly, in his critique of the concept of poverty traps and the use of this concept to justify aid-financed “Big Push” policies, points out that the growth of the Asian developmental states was slow and gradual, and did not follow this profile<sup>100</sup>.

Developmental states did not emerge only in East Asia. The Scandinavian countries have indicated avenues for development policy, though their initial endowments depended on primary commodities. The economic growth of these countries testifies to the effectiveness of the policies adopted. They focused simultaneously on the market and on the state, taking account of the twofold role of the latter: coordinating economic agents and sectors, and providing security in the flexible environment now required in the era of globalisation.



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- 85 A review may be found in Glaeser (2005).
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