

**Poverty, Growth, and Globalisation in Developing Countries:  
The Key Role of Institutions**

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**Presentation at the Renner-Institut  
Vienna,  
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## **Abstract**

The paper focuses on the relationships between poverty, growth, globalisation and institutions in developing countries. It emphasises the multidimensionality of the concept of poverty, as well as the importance of inequality and institutional arrangements in the relationship between poverty and growth. Moreover, these relationships are made more complex as a result of globalisation and trade openness. The paper demonstrates the non-linearity of the transmission of the impact of globalisation on poverty and the existence of threshold effects. Institutions constitute a critical factor for the creation of threshold effects in the impact of globalisation on poverty. Institutions – their credibility, ability to be transformed by globalisation, and the ways they give the poor access to the beneficial effects of globalisation – determine whether the benefits of globalisation are spread to the poor or are locked in by particular groups. They also determine whether or not the negative shocks associated with globalisation are transmitted in an unfettered manner. The paper presents a theory of institutions that distinguishes several components. These components evolve differently and explain the threshold effects that institutions generate upon the impact of globalisation on the poor. The paper then shows that social institutions and norms have a critical role in the generation of these threshold effects. It finally examines the interactions between social institutions and state policies institutions, which may contribute to the formation of poverty traps.

## **Introduction<sup>1</sup>**

Globalisation and poverty represent broad, multidimensional concepts which refer to phenomena that transform themselves in space and time. The literature on the impact of globalisation on poverty points to highly variable outcomes, both positive and negative, as well as multiple causalities, channels and mechanisms that link globalisation and poverty. Studies observe different results depending on the channels, historical period, and the region or country considered. As is known, the inconclusive or variable character of these findings is a matter of intense debate, as are the concepts of globalisation and poverty themselves. This paper argues that this variability of outcomes stems from a key feature of the impact of globalisation on poverty, which is the non-linearity of transmission of globalisation's impact and the existence of threshold effects. It also argues that institutions constitute a critical factor in creating these threshold effects in the transmission of the impact of globalisation on poverty. Analyses that focus on globalisation and global poverty increasingly stress the

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<sup>1</sup> This paper is a modified version of an UNU-WIDER Research Paper entitled 'Explaining Threshold Effects of Globalisation on Poverty: an Institutional Perspective', Helsinki, WIDER, 2005, which was originally presented at the UNU-WIDER Conference 'The Impact of Globalization on the World's Poor: First Project Meeting on Conceptual Issues', 29-30 October, 2004; the author is extremely grateful to Erik Thorbecke, Kaushik Basu and especially Machiko Nissanke for their invaluable comments, though the usual caveat applies.

importance of institutions. No existing work, however, has examined institutions in relation to the threshold effects that characterise the links between globalisation and poverty. The paper also shows that institutions create discontinuities and generate threshold effects upon the impact of globalisation on the poor. Institutional environments and the presence or absence of critical institutions indeed determine whether the benefits of globalisation are harnessed and spread to the poor, whether these benefits are locked in by particular groups with the poor excluded from them, or the negative shocks associated with globalisation are transmitted to the poor in an unfettered manner. Institutions introduce these threshold effects because of their composite nature: institutions are indeed made of distinct components – forms and contents (functions, mental models, for example) –, which evolve differently. In particular, institutions may generate processes of cumulative causation and self-sustained poverty traps. The impact of globalisation on poverty in a given setting is positive or negative depending on multiple characteristics of the various components of institutions: among others, their historical depth, credibility, the way they combine, their ability to be transformed by globalisation, and the ways they give the poor access to the effects of globalisation that are beneficial to them.

The paper is structured as follows. Section 1 discusses the definitional issues associated with the concepts of poverty, globalisation and institutions, as well as the varieties of causalities and the heterogeneity of the processes that link globalisation, poverty and institutions. Section 2 presents a theory of institutions as composite arrangements: this composite character explains the existence of the threshold effects that institutions generate upon the impact of globalisation on the poor. Section 3 highlights the influence of the domestic political economy on institutions and its contribution to the threshold effects that modify the impact of globalisation. Section 4 shows the critical role of social institutions and norms in the generation of these discontinuities and threshold effects. Section 5 examines the interactions between social institutions, public institutions and policies and macroeconomic conditions, which may contribute to the formation of poverty traps. The final section offers brief concluding remarks.

## **1. Poverty, growth, globalisation and institutions: definitions and causalities**

### **The rise of poverty in theories of development: the multidimensionality of poverty and the capabilities approach**

Having received the Nobel Prize in economics in 1998, Amartya Sen has consistently promoted an innovative approach to poverty. Following his analysis of famines built on the notion of food entitlement, it is based on the concepts of capabilities and functionings. This approach is now widely influential in academic research as well as among policy-makers, especially with respect to the debate on income poverty vs. human development, the respective importance of money income (or consumption), and other dimensions of poverty. The concepts of capabilities and functionings refer to the philosophical and economic perspectives of well-being and poverty, in particular the theories of social choice and distributive justice. For Sen, well-being is related to social judgments and values. Social arrangements must be evaluated in terms of the capabilities they allow, i.e. the ‘substantive freedoms’ of people to achieve the kind of life they aspire to, the ‘beings and doings they have reason to value’. The ‘capabilities set’ defines the ‘actual freedom of choice a person has over the alternative lives’ that he/she can lead<sup>2</sup>. The capabilities approach contrasts with ‘welfarist’ theories and utilitarianism, which focus on the total utility of a group and ignore its distribution. It also contrasts with the theories of John Rawls advocating equality of means (‘primary goods’) or those of libertarians who consider justice in terms of rights and liberty. Distinguishing ‘capabilities’ and ‘functionings’, Sen does not advocate equality of means but equality of capabilities. “A functioning is an achievement, and a capability is the ability to achieve”<sup>3</sup>.

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<sup>2</sup> Sen (1999a).

<sup>3</sup> Sen (1987).

Poverty is one of the worst forms of human deprivation: it is the “deprivation of basic capabilities” rather than the low level of incomes<sup>4</sup>, it is the failure of basic capabilities to achieve minimum acceptable levels. In the space of income, poverty is the inadequacy of income to generate acceptable minimal capabilities. This is not incorporated in poverty lines<sup>5</sup>. An understanding of capabilities requires broader knowledge than information on actual functionings, such as income or consumption. Income-based poverty measures concentrate on deprivation in only one variable, that of income<sup>6</sup>.

The current paradigm of the multidimensionality of poverty has been strongly influenced by Sen’s analyses. The functionings are the ‘doings’ and ‘beings’ of a person; they constitute the quality of life. They vary from those that are elementary - being well-nourished, in good health, and with adequate shelter - to more complex achievements, like self-respect and respect of others and participation in social activities, which includes “appearing in public without shame”<sup>7</sup>. Poverty is multidimensional in the sense that one person can be in good health but illiterate, while another one may be in the opposite situation, but both are deprived in terms of capabilities and choices. The use of only one criterion or information is therefore insufficient.

This approach does not deny that low income is a major cause of poverty. Low income reduces opportunities and can be a major cause of illiteracy or ill health, while better education or health can lead to a higher income. However, poverty refers to deprivations that are “intrinsically important”, unlike low income which is only “instrumentally important”. Capability deprivation can be generated by influences other than a low income. Also, the instrumental relation between low income and low capability is variable, depending on the individuals and societies. This allows for evaluations of public policies aimed at reducing poverty.

Sen distinguishes the ends and means, as well as the constitutive and instrumental values. The capability perspective views poverty and deprivation not in terms of means (such as income) but of the ends people want to pursue and the “freedom to be able to achieve these ends”<sup>8</sup>. The different dimensions of poverty are analysed according to their ‘constitutive’ and ‘instrumental’ importance, i.e. the links between the various dimensions. A deprivation may be of intrinsic importance on its own; however, there are relational deprivations that are not intrinsically damaging, but may lead to negative outcomes. They may be the cause of other deprivations: for example, the lack of access to credit markets may result in income poverty. They may not be impoverishing in themselves but they may lead to the impoverishment of life. A dimension like education can be valued for itself and also because it is related to income. The constitutive importance is normative and gives weight to the values of the poor<sup>9</sup>. Democracy and social participation have not only an intrinsic and an instrumental value but also a ‘constructive role’, in particular in the formation of values through public debate. These values influence other dimensions of the quality of life, e.g. human development as in the well-known example of the Indian state of Kerala.

A key issue is the evaluation, hierarchy and priorities of dimensions and policies related to poverty. The consideration of several dimensions of poverty and the heterogeneity of the different functionings imply the need to weigh them, i.e. the difficult exercise of social evaluation - the values and norms of whom? The conversion of income into basic capabilities, and the resources or commodities needed to attain them, varies according to individuals and societies. The capacity to achieve minimum acceptable levels of basic capabilities is accompanied by different levels of adequate minimum incomes, depending on personal and social characteristics<sup>10</sup>. There are different views, depending on the societies in question, on what constitutes poverty. However, there are also commonalities. For Sen, democracy and public debate help to build consensus on the importance of certain capabilities and functionings (for example, participating in social life) rather than on their

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<sup>4</sup> Sen (1999b).

<sup>5</sup> Sen (1992).

<sup>6</sup> Anand and Sen (1997).

<sup>7</sup> Sen (1999a).

<sup>8</sup> Sen (1999b).

<sup>9</sup> Sen (1999c).

<sup>10</sup> Sen (1993).

particular form. Poverty is a capability failure rather than a deficiency in satisfying needs for pre-specified goods. Functionings such as health, adequate food, and participating without shame in social activities, are intrinsically valuable in all cultures but the goods they require vary. The problem of the hierarchy of dimensions is solved by the capability approach. The latter allows for explicit valuation in determining the relative weights of different functionings to assess individual advantages and social progress<sup>11</sup>.

### **Concepts, debates and policies**

The concept of poverty has re-emerged in academic research as well as the agenda of international financial institutions in the 1990s<sup>12</sup>. As noted by Deaton, economic development has been increasingly conceived as poverty reduction rather than economic growth<sup>13</sup>.

Poverty, as is well-known, has many dimensions - subjective and objective, relative and absolute, and monetary and non-monetary. Indeed, a series of broad dichotomies underlie the poverty debate: in particular, between income and non-income poverty, absolute and relative poverty, permanent and transitory poverty, poverty and inequality, poverty and vulnerability<sup>14</sup>, objective and subjective poverty. Subjective poverty may be translated in different poverty lines, and subjective perceptions on the meaning of poverty are heterogeneous. People may know approximately the level of their actual income, and an individual's evaluation of income levels depends on the level of his/her own income<sup>15</sup>. This dichotomy is related to Sen's dichotomy between identification and aggregation<sup>16</sup>. The first step is to identify or count the number of poor, and then to aggregate the information into an indicator of poverty<sup>17</sup>.

Conceptual debates are reflected in controversies on measurement issues. Different models of poverty imply different indicators. Money-metric indicators rely on information on consumption; the capabilities approach uses indicators of human development - health and education – and so on. Different indicators have different and complementary uses in terms of identifying the poor and appropriate policies. Measurement remains a key issue. As highlighted by Ravallion<sup>18</sup>, divergences in the assessment of the impact of growth or globalisation on poverty mostly stem from differences in definitions, data, and measurement assumptions. Institutions intervene in all these aspects: their definitions, the ways their effects are assessed also contribute to divergences in the analyses of this impact.

The concepts of poverty that have been elaborated in the academic world are integrated in the operational framework of the international financial institutions and donors – 'poverty reduction strategies' -, with a series of changes resulting from their mandates and structure. A characteristic of development economics, stemming from the hegemony of the Bretton Woods institutions as providers of funds and paradigms, is the exchange of ideas and legitimisation between research and donors' operations and policies. The World Bank World Development Report 2000/1 on poverty, following the one of 1990 that was also centred on poverty, has been a milestone in the evolution of thinking and policies regarding poverty. The 1990 Report highlighted the positive effects on the poor of labour-intensive macro-policies and the provision of social services. The 2000 Report put to the forefront issues such as inequality<sup>19</sup>, 'inclusion', 'empowerment' of the poor, participation, 'good governance' and 'effective' institutions. The 2006 Report also focuses on the links between equity and development. The relationship between poverty reduction and growth is a debated issue, as well as the respective roles of government policies and exogenous factors<sup>20</sup>, for example the relationship between poverty reduction and trade openness. Aid agencies now include

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<sup>11</sup> Sen (1999b).

<sup>12</sup> Kanbur and Lustig (2000).

<sup>13</sup> Deaton (2004).

<sup>14</sup> Banerjee (2000a) thus distinguishes poverty as 'desperation' and poverty as 'vulnerability'.

<sup>15</sup> Kapteyn et al. (1988).

<sup>16</sup> Sen (1976 and 1981), quoted by Callan and Nolan (1991).

<sup>17</sup> Bourguignon and Chakravarty (1998).

<sup>18</sup> Ravallion (2003), Chen and Ravallion (2004).

<sup>19</sup> Kanbur and Squire (1999), Kanbur and Lustig (2000).

<sup>20</sup> A review of these issues is in Srinivasan (2001).

institutional dimensions in their analyses of poverty. However, the political economy context as a factor of poverty is often analysed within a 'depoliticised' framework<sup>21</sup>.

### **The evolution of global poverty**

There is much debate regarding the situation of global poverty and its recent evolution. Studies diverge and depending on the concepts, definitions, data sets, time span, and methodology, they may find an increase or a decrease in global poverty. World Bank studies, for example, have found a decrease in poverty since the early 1980s. By the \$1 per day standard, there were 1.1 billion poor in 2001, i.e. almost 400 million fewer than in the early 1980s<sup>22</sup>.

These results have been challenged, however. Some studies consider that they may be flawed by problems of measurement and data, and that global poverty has in fact increased. For example, usual poverty lines are based on the assessment of the basket of goods and services that is required to avoid poverty. However, it is a difficult task converting this basket into a cost that is consistent across countries and time. The international poverty line of 'one dollar per person per day' (at 1985 purchasing power parity/PPP) devised for international comparisons has been called into question<sup>23</sup>. Its revaluation to \$1.08 at 1993 PPP has been viewed as understating the fall in the purchasing power of the US dollar. International comparisons of poverty via international measures depend on the reliability of PPP that is used to translate a common poverty line into local currencies. Different methods may lead to under- or overstatements of the relative incomes of countries, as well as to fallacious comparisons of poverty rates. For some studies, the calculations of the World Bank underestimate the real extent of global poverty.

The issue of measurement remains an ongoing debate. Among the key controversies is the role of China and India. Their size blurs assessments of world poverty according to whether poverty is considered at the level of a given country or at the international level (conceived as an addition of individuals). Between the early 1980s and early 2000s, the number of poor outside China rose slightly while it declined significantly within China<sup>24</sup>. The results also vary depending on the methodology that is used for assessing the trends, in particular whether the data sets stem from national accounts or country-level household surveys<sup>25</sup>.

### **Poverty and growth in developing countries**

The relationship between poverty and economic growth is the subject of heated controversy in development economics. For most economists – and this view is supported by international financial institutions such as the World Bank – economic growth is the main factor in poverty reduction. It is considered to be more efficient than other instruments, such as state policies. A key matter of debate is the nature and the sensitivity of this relationship, in particular the elasticity of poverty to growth. A well-known World Bank study by Dollar and Kraay<sup>26</sup>, based on international data sets, argued that the elasticity of income of the lowest quintile (i.e. the poorest) with respect to mean income is not different from one. This means that reduction in poverty is proportional to the rate of growth. For many economists, however, growth is not enough. The elasticity of poverty to growth may also be less than one. As emphasized in an IMF study, growth may raise the income of the poor. Yet if this relationship is less than one-to-one, economic growth is not sufficient to reduce poverty. It may even leave the poor worse off relative to the average population<sup>27</sup>.

The conclusions of Dollar and Kraay have been called into question by several studies. The robustness of the model has been criticised, as has its linearity<sup>28</sup>. The results are also said to differ if different data and specifications are used. Likewise, a key debate regarding the direct link between growth and poverty reduction arises from the existence of intermediary

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<sup>21</sup> On the trajectories of the concept of poverty within the World Bank, Sindzingre (2004a).

<sup>22</sup> Chen and Ravallion (2004).

<sup>23</sup> Reddy and Pogge (2002).

<sup>24</sup> Chen and Ravallion (2004).

<sup>25</sup> Deaton (2004).

<sup>26</sup> Dollar and Kraay (2001a).

<sup>27</sup> Tsangarides et al. (2002).

<sup>28</sup> Bourguignon (2002).

causalities between growth and poverty. There is no doubt that the poor gain with growth and lose with recessions. However, this is true only on the average: countries exhibit large differences in the modalities of these gains of growth and how much the poor share in them. The impact on various categories of poor may also differ within a given country: there may be losers – individuals or groups – even during spells of growth<sup>29</sup>.

A crucial causal process is the impact of distribution: inequality within a given country may interfere with the direct linkages between growth and poverty reduction. Growth is a key factor in income poverty reduction, but under the assumption that the distribution of income remains constant; at the same time a worsening of the distribution tends to increase poverty. As underlined by Bourguignon<sup>30</sup>, growth, poverty and inequality form a ‘triangle’: growth has an impact on distribution and inequality has an impact on the rate of growth. A change in poverty is a function of growth, distribution, and the change in distribution. In another study, Bourguignon<sup>31</sup> demonstrates the links between the rate of economic growth, the pace of poverty reduction, and changes in the distribution of income in a given country. Bourguignon shows that distributional changes explain the variations in poverty reduction as do growth rates. Growth therefore reduces poverty if it comes with falling inequality, with the distribution of the gains from growth depending on initial inequality and changing inequality<sup>32</sup>.

Far from being purely technical this debate is crucial, as it explains the causalities underlying poverty, the plurality of channels between poverty and income growth, and the public policies and public expenditures that are appropriate in terms of poverty reduction. Depending on the causal process that is deemed to explain empirical facts most accurately, the relevant policies for reducing poverty will focus in the first place on the promotion of economic growth, assuming that poverty will be automatically reduced in the short or medium term - for example promoting trade openness or any type of policy that is supposed to foster growth<sup>33</sup>. If other conceptions of the links between growth and poverty are preferred – which insist on the role of inequality in particular – public policies that are firstly centred on growth will be viewed as insufficient in themselves. The appropriate public policies will have to explicitly target poverty or intermediary factors such as inequality and distributional changes.

A related discussion has emerged within both the academic and donor communities regarding the type of growth that would be the most beneficial to the poor, the so-called ‘pro-poor growth’. As highlighted by Kraay<sup>34</sup>, once the poverty measure considered falls with growth, the impact of growth follows two main mechanisms: growth of average incomes (‘broad-based growth’); and a poverty-reducing pattern of growth in relative incomes, while the sensitivity of poverty to growth in average incomes appear to be less significant. For some economists growth is beneficial to the poor if it raises their income in absolute terms and leads to a drop in some measures of poverty<sup>35</sup>. For others growth is viewed as ‘pro-poor’ when it raises the incomes of the poor proportionally more than it does the incomes of the non-poor<sup>36</sup>. In all cases there is broad agreement among economists regarding the importance of the ‘pattern’ of growth for growth to have a positive impact on poverty.

### **Globalisation and poverty**

The concept of globalisation remains the object of intense debate, in particular over the definitions and indicators of globalisation: for example, integration in the commodity, labour and capital markets<sup>37</sup>, ‘freedom and ability of individuals and firms to initiate voluntary economic transactions with residents of other countries’, and ‘greater mobility of capital and labour’<sup>38</sup>. Globalisation encompasses heterogeneous elements: facts (flows, such as trade, capital, labour, migration, information, and market integration) and policies (reduction of barriers on trade, financial flows and migration, liberalisation). Depending on the aspects of

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<sup>29</sup> Ravallion (2001a).

<sup>30</sup> Bourguignon (2003).

<sup>31</sup> Bourguignon (2002).

<sup>32</sup> Ravallion (2004a).

<sup>33</sup> Dollar and Kraay (2001b).

<sup>34</sup> Kraay (2004).

<sup>35</sup> Ravallion (2004a).

<sup>36</sup> Kakwani et al. (2004).

<sup>37</sup> Definition provided in Bordo, Taylor and Williamson (2003).

<sup>38</sup> As defined by the World Bank, quoted in Milanovic (2003a).

globalisation considered, the functions of institutions differ: providing credibility to government's commitments and policies, enforcing property rights for foreign investment, and reducing information costs and allowing the pooling of risks for small-scale farmers. The channels of transmission from globalisation to poverty reduction are numerous and include economic as well as political economy channels (government policy, domestic allocation, technology transmission) that affect wages, employment, household production and consumption<sup>39</sup>. As shown by a number of studies, one has to differentiate the impact of globalisation on growth and the impact of growth on poverty – globalisation impacting poverty directly through change in relative prices and indirectly through growth effects<sup>40</sup>. There is a consensus, despite a few dissenting studies<sup>41</sup>, on the fact that globalisation is positive for growth and hence for reducing poverty.

Globalisation has improved the situation of the poor in certain countries and regions but not in others. Sub-Saharan Africa is the region the most affected by poverty and where the impact of trade openness since the reforms of the 1980s has been mixed. Many explanations for this have been provided: economic and geographical constraints (climate), policy (resistance to reform) and institutional factors.

Sub-Saharan Africa is a clear example where, in addition to economic determinants, the presence or absence of certain institutions constitutes additional factors that make positive or, on the contrary, hinder the transmission of global forces to the poor, as well as induce discontinuities and unexpected consequences.

### **The difficulty in defining institutions**

Institutions mediate the various channels and mechanisms of the effects of globalisation and explain the latter's diversity, heterogeneity and non-linearity. Definitions of institutions remain, however, a debated issue. Institutions are coextensive to societies and economies, as there cannot be a society without institutions<sup>42</sup>; institutions are simultaneously a particular dimension in the regulation of human activity. Institutions in essence depend on contexts, whether in the definitions based on transaction costs set up by the new institutional economics, in the game equilibrium perspectives (evolutionary or repeated games)<sup>43</sup>, or in the evolutionary theory that focuses on learning processes and competition<sup>44</sup>. Douglass North's definitions are the best known: institutions are constraints that structure political, economic and social interactions and consist of informal - i.e., self-enforcing - constraints (sanctions, taboos, customs, traditions, codes of conduct, conventions, norms of behaviour) and formal regulations (constitutions, laws, property rights)<sup>45</sup>.

Definitions and functions of institutions are sometimes confused in the literature. The boundaries of institutions are also often fuzzy. Institutions may be defined as sets of property rights as well as devices aiming at the protection of these property rights. They are also defined as devices reducing transaction costs, instruments allowing stable anticipations, strengthening incentives, channelling resources, flexible responses to uncertainty, and so on. Characteristics of institutions, such as trust or credibility, are also often confused with the institutions themselves. Institutions may also be equated to a type of infrastructure (besides physical infrastructure). Similarly, the distinction between institutions and policies is sometimes unclear. Policies are the outcomes of state institutions, such as trade or taxation policies (institutions and policies or policy outcomes may even be synonymous in some studies), but policies also determine institutions – they create or reform institutions<sup>46</sup>.

Institutions are also alternatively viewed as both causes and effects. As argued by North and Thomas, 'innovation, economies of scale, education, capital accumulation...are not causes

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<sup>39</sup> Goldberg and Pavcnik (2004).

<sup>40</sup> Nissanke and Thorbecke (2004); another well-known issue is the elasticity of poverty reduction to growth and initial inequality, see Bourguignon (2004a).

<sup>41</sup> Rodriguez and Rodrik (1999); see in a historical context Clemens and Williamson (2001).

<sup>42</sup> As highlighted by Kaushik Basu in his comments of this paper (2004).

<sup>43</sup> A conceptual framework is in Aoki (2001).

<sup>44</sup> Nelson and Winter (2002).

<sup>45</sup> North (1990 and 1991).

<sup>46</sup> Levels of taxation or infrastructure are assimilated to institutions in the World Bank's World Development Report 2005 on the investment climate.

of growth; they are growth<sup>47</sup>. Likewise, property rights may be viewed simultaneously as institutions and the outcomes of institutions, as state institutions protect property rights. The literature, however, recognises that many institutions have no link with property rights (for example, the easing of exchanges and transactions).

### **The various categories, domains and levels of institutions**

Institutions may be categorised according to a series of dichotomies: state and non-state; market and non market; 'formal' and 'informal', though these dichotomies are weakened by many problems of definition, logical consistency and conceptual overlap<sup>48</sup>. Institutions are also domestic or external to countries (supra-state), which is a dimension of globalisation (the so-called 'global governance'). In poor and weak states, this is compounded by their dependence on aid and policy conditionality.

Institutions also regulate different domains of human activity: economic (when generating market-oriented incentives or protecting property rights), political (when managing conflict or enhancing political stability<sup>49</sup>), and social. Institutions regulating social relationships consist of sets of social norms that operate at the household, territorial, and group levels, which have been analysed by transaction costs theories and theories based on asymmetries of information. The latter have explained several agrarian institutions in poor countries, such as interlinked markets (credit, insurance, land, for example)<sup>50</sup>.

At a microeconomic level, institutions and norms introduce thresholds in the causal link between globalisation and poverty: for example, the institutions that favour or prevent collective action, regulate personal exchanges, social relationships and inequalities for individuals, households and groups - in particular redistributive institutions and insurance mechanisms, which may either redistribute or concentrate the gains of liberalisation.

At a macro level the state partitions globalisation flows (trade, capital, labour) between external and internal flows that fall under state prerogatives and rules. Thresholds in the impact of globalisation stem in the first place from artefacts such as borders, which show resilience in a context of globalisation<sup>51</sup>. As is well-known, dynamics of global inequality differ according to whether or not it occurs within or between countries. The state provides credibility - as the state represents the highest level of the capacity to commit-, to the other levels of public institutions (legal, parliamentary, economic) and to government policies. The state has a key role in the channelling of the impact of global integration. Early development economists viewed the roles of the state, domestic policies and institutions as analytically pre-eminent in developing countries, as the state is better able than markets to reallocate the factors of production towards growth. This has been the framework of the 'big push' policies or of the 'developmental' states' industrial policies in East Asia. The state, however, has also intensified the negative impact of globalisation on poverty, as shown by cases of 'weak' and predatory states, such as in Sub-Saharan Africa.

State institutions may or not be able to provide rapid and flexible policy responses to external shocks, help the poor to cope with these shocks (such as volatility in the price of inputs), address the market failures that primarily affect the poor (such as information asymmetries), support particular market structures that are more effective in terms of risk management such as economic diversification. Likewise state institutions may or may not help to develop savings and investment as well as the entrepreneurial capacities of the poor, promote the marketisation of the goods that are produced by the poor, or reduce vulnerabilities that stem from the dualism and imbalances of employment structures – such as the pre-eminence of the primary sector (agriculture or natural resource extraction) compared to off-farm employment.

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<sup>47</sup> North and Thomas (1973), quoted by Hoff (1995).

<sup>48</sup> Sindzingre (2004b).

<sup>49</sup> On the links between institutions and growth, Rodrik, Subramanian and Trebbi (2002).

<sup>50</sup> Bardhan (1989).

<sup>51</sup> States have rather tended to multiply in the 20<sup>th</sup> century, see Alesina and Spolaore (1997).

## **Institutions, poverty and globalisation: multiple-way causalities and heterogeneous processes**

The relationship between institutions, on the one hand, and economic growth and development on the other, is the object of a vast literature. The effects of institutions on poverty, however, have been less investigated, as has the relationship of institutions with globalisation and how this has influenced its impact on poverty – or, conversely, the transformation of institutions as well as the transformation of their effects on poverty<sup>52</sup>. It is argued here that the effects of institutions are not linear: they follow processes of cumulative causation, create threshold effects, discontinuities and self-sustained poverty traps<sup>53</sup>.

Causalities and threshold effects work according to several retroactive channels: from globalisation to poverty and from poverty to ways of coping with globalisation (for example, trade policies), which in turn induces specific impacts of globalisation. The impact of globalisation on poverty through institutions may be positive or negative.

Two causal processes may be distinguished. The first one is the impact of globalisation on institutions. Globalisation is a factor in institutional change, which in turn may have positive or negative effects on poverty reduction. This causal process is, however, confronted with the asymmetry between the causal event (change in prices, mobility of factors) and its objects (institutions, norms). It is also confronted with the heterogeneity of the rhythms of transformation of the causal event (globalisation) and its objects (institutions), the latter exhibiting far more persistence than the former - which is why explaining growth rates by institutions remains puzzling<sup>54</sup>. Institutions create stable expectations, with the rhythm of institutional evolution thus tending to be very slow, with more or less rapid institutional transformation depending on the category and domain of the institution.

According to Fernand Braudel's seminal distinction, three types of institutions correspond to three rhythms of change: social institutions and norms - which incur the slowest transformation<sup>55</sup> -, economic structures, and political institutions that are transformed the most rapidly<sup>56</sup>. Globalisation as a set of flows and policies is more likely to induce transformation on the aspects of institutions that are already experiencing rapid change (for example, formal political or economic rules), and less likely on slow-changing institutions such as social norms.

The second causal process is the impact of institutions on globalisation. Globalisation is 'filtered' (intensified or hindered) by institutions at the country and micro levels (village, households). The mediation by institutions introduces unexpected consequences and non-linearities in the transmission mechanisms that orient them towards either beneficial or detrimental outcomes for the poor.

In summary, causalities follow three dichotomies: the positive effects of globalisation vs. its negative effects, respectively, i) on the domestic institutions that are causes of poverty (exclusionary ones, like caste, for example); ii) on institutions reducing poverty (household structure allowing accumulation, for example); iii) on the institutions that enhance the positive aspects of globalisation (such as economic freedom) or intensify its negative aspects (such as weak support for economic diversification).

## **Assessing causalities: issues of measurement and endogeneity**

An increasing number of studies have put forward institutions as key determinants of growth<sup>57</sup>, which has given rise to heated controversies as to their exogenous character. Studies often rely on growth cross-country regressions, where institutions are used as

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<sup>52</sup> With exceptions, of course: on the necessity of appropriate institutions for harnessing the benefits of globalisation, Kozul-Wright and Rayment (2004).

<sup>53</sup> Non-linearities of the effects of globalisation on the poor have been highlighted in many studies - while cumulative causation are featured in theories of economic development since the 1950s -, though not focusing on institutions, see Agenor (2002b).

<sup>54</sup> Easterly et al. (1993): this indeed fuels the heated debate on institutions, geography, policies or structures (commodity dependence, terms of trade volatility) as fundamental determinants of growth.

<sup>55</sup> Rhythms of change also vary within categories of institutions: monetary institutions may be changed more rapidly than labour institutions; in social institutions, codes of conduct may be changed more easily than kinship institutions.

<sup>56</sup> Arrow (1998); Braudel (1996).

<sup>57</sup> Rodrik et al. (2002), Acemoglu et al. (2004); for an opposing view, see Glaeser et al. (2004).

determinants of growth in addition to more traditional variables (such as investment). Institutions are also used as explanatory variables in regressions explaining poverty or globalisation. The variables that approximate institutions, however, are generally broad notions, such as trust, rule of law, protection of contracts and property rights, civil liberties, political stability, and social cohesion and homogeneity. There is now a consensus on the fact that 'institutions matter', but no consensus exists as to which institutions matter or on what the direction of the causalities is<sup>58</sup>. Instruments are sometimes confused with explanations<sup>59</sup>, and models are often affected by implausibility and econometric flaws<sup>60</sup>. Causalities are subjected to the endogeneity of the institutional variables vis-à-vis those they are supposed to explain (growth, level of income)<sup>61</sup>, for example, between institutions, trade openness and poverty. Economic policies are particular outcomes of institutions, but policies, such as trade barriers, have sometimes been used as a proxy for weak institutions. Simultaneously, openness policies transform domestic institutions and their influence on poverty, and trade creates institutional forms<sup>62</sup>. Endogeneity also affects the many studies that try to isolate the determinants of growth among the three categories of policies, geography and other endowment variables, and institutions<sup>63</sup>: policies and institutions may be endogenous vis-à-vis each other and even geography is not necessarily an exogenous variable (as shown by migration). Political institutions are also endogenous vis-à-vis growth<sup>64</sup>, as well as social and micro-political mechanisms such as trust and accountability.

### **The problems of observing thresholds and aggregation**

The emergence of 'trust' or 'cohesion' and their causal relationship with particular forms of institutions and their effectiveness represents complex processes that depend on contexts and are best observed through case studies. Econometric exercises work at an aggregate level and observe aggregate threshold effects. They are ill-equipped, however, to apprehend the multiple micro-mechanisms and norms, as well as the underlying threshold effects that stem from the influence of institutions. These norms indeed work at the individual or group level and contribute to the effectiveness of an institution (and its credibility), hinder or intensify the gains or losses from globalisation, build local poverty traps or trigger opportunities for escaping them.

Institutional variables may be discrete, stable in space and time, and lend themselves to quantification and aggregation. Many institutional variables, however, do not exhibit such properties of stability in time and space (the former on account of historical transformation and the latter because of adaptive, borrowing processes). Isolating threshold effects in the impact of globalisation, however, requires aggregate data, which are typically not used by qualitative analyses. The latter in turn only observe particular before-after processes, which are *sui generis* cases and cannot be aggregated, particularly in the case of micro institutions and institutional change. A methodological difficulty remains in this tension between, on the one hand, models that assess non-linearities but with questionable concepts of institutions and, on the other, case studies that may have appropriate concepts but do not use aggregate data.

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<sup>58</sup> Engerman and Sokoloff (2003b).

<sup>59</sup> Rodrik (2004).

<sup>60</sup> Durlauf and Quah (1999).

<sup>61</sup> Basu et al. (1987).

<sup>62</sup> See Greif (1989) on the contrast between the Maghribi and Genoese traders, creating different institutions and trust-building devices in the course of their trade activities.

<sup>63</sup> For defenders of geography, see Bloom and Sachs (1998), Easterly and Levine (2002).

<sup>64</sup> Bardhan (1993), Przeworski and Limongi (1993). Aghion et al. (2002).

## **2. Threshold effects due to the very nature of institutions: institutions as composite arrangements**

### **The different components of institutions: forms and contents**

Institutions are composite sets of rules that shape various levels of human cognition and activity. They are simultaneously constituted by forms – i.e., names, organisations – and contents – i.e., functions, meanings – which display distinct evolutions and rhythms of change. Institutions that bear similar names do not possess identical credibility, capacities of regulation and generation of incentives from one environment to another. The actual forms and contents of institutions are determined by several factors – history, cumulative processes, level of economic development, and state capacity, among others. Their rules organise the behaviour of different agents – individuals, households, firms, governments –, settings – market (agricultural production, labour markets, access to capital, human or financial, for example) and non-market activities (state institutions, for example) –, and economic sectors (rural, industrial and financial, for example).

Therefore, the impact of globalisation on the poor cannot intrinsically be a linear process. Institutions do not constitute discrete entities that enter into unambiguous relationships with other similar variables. The channels and mechanisms of the impact of globalisation are altered by local institutions that are in fact constituted by distinct components: under apparently similar forms, the effective contents of given institutions may differ; these apparently similar institutions therefore channel the impact of globalisation on the poor in different ways – for example, depending on contexts, positive, negative, first positive then negative, or both positive and negative according to the domains considered (economic, financial, social, or political).

### **Efficiency of institutions as an outcome of relationships between components**

The ‘formal’ existence of institutions provides individuals with little information as to their effectiveness, and few stable expectations on the ways individual behaviour is ruled by these institutions, and hence on their effective functions *ex post*. The ‘formal’ existence of institutions provides little information on the effective enforcement of rights or rules (property rights, rule of law) or on the ‘capture’ of institutions and legal systems by interest groups. Functions of institutions do not map into unique forms, as argued by Rodrik in the case of weak property rights in China: their various functions (such as providing stability for investment) are achieved by other institutions, in contrast with Russia, where institutions formally exist but do not fulfil their functions<sup>65</sup>. The formal existence of institutions does not imply the similarity of their local content across time and across countries or settings (for example, the content attached to ‘accountability’, investment regulation, or safety nets). The mechanisms leading from globalisation to poverty via institutions are therefore under-determined *ex ante*. Threshold effects, positive or negative, stem from the effective content and functions of institutions that underlie their formal existence, and may be more accurately analysed on a case-by-case basis.

The efficiency of institutions stems indeed not only from their constitutive elements (forms and contents) but also from the relationships between these components, and from their relationships with other institutions<sup>66</sup>. As composite sets of rules, institutions are more or less pervasive and effective; their effects are observable *ex post* for they result from combinations of institutions in addition to exogenous variables (such as endowments, land abundance, climate). For example, redistributive institutions, such as those supporting a land reform, have different effects on poverty depending on whether they combine with land abundance or scarcity.

Therefore, the effectiveness of institutions aimed at helping the poor to cope with trade liberalisation is made up not only of various constituents (policy measures, organisational rules) but by the relationships between them. It depends, for example, on human capital, political economy, social ‘trust’ or ‘cohesion’, as well as on relationships with other institutions

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<sup>65</sup> Rodrik (2004).

<sup>66</sup> Sindzingre (2003).

(such as those supporting technology, information, the rule of law). For example, the effectiveness of business regulation is influenced by the presence of effective judicial institutions. The impact of policy measures, such as trade policy, industrial policies, or diversification incentives focused on the poor, is influenced by these institutional combinations, particularly state capacity.

Forms do not correspond to unique contents and functions, and growth results from contingent combinations of policies, structures (economic, geographic endowments) and institutions. For example, institutions dealing with safety nets have often been inefficient in Sub-Saharan Africa, while limited state-provided safety nets did not prevent Asian countries from exhibiting a positive link between globalisation and poverty. Authoritarianism has combined with poverty reduction in Korea (a 'developmental state') but not in the predatory political regimes often found in Sub-Saharan Africa. Authoritarianism in Taiwan has also combined with an output based on small and medium enterprises (absent in Sub-Saharan Africa), according to specific models of growth, poverty reduction and combinations of economic structure, initial conditions, geography, political regimes, policies, and external integration.

Mental models, as argued by North<sup>67</sup>, and perceptions by individuals (of poverty, inequality, and security) also shape the relationships between the various components of institutions. 'Failed states' are thus characterised by self-reinforcing traps of social fragmentation compounded by domestic poverty, the internationalisation of resources<sup>68</sup>, and the negative perceptions of all players, local and external (investors, donors). New institutional economics recognise the credibility of institutions and credible commitment by governments as essential determinants of growth – as is well-known, promises that are not credible in contexts of uncertainty are responded to by low investment and preference for the status quo<sup>69</sup>. Its view of credibility as a commitment to secure private rights<sup>70</sup>, however, remains unclear as to the combination of ingredients that render an institutional form effectively credible ('believed') and binding, given that political power possesses by definition the power to denounce this binding. In addition, securing private rights may be not the main element of credibility or growth, especially in low-income countries. In the latter, state institutions and government commitment to policy reforms are often perceived as having been 'privatised' by political clienteles and special interest groups, and thereby display low credibility.

### **Discontinuities between micro and macro levels**

Institutions introduce discontinuity in the channels that lead from globalisation to poverty and poverty reduction, this discontinuity being determined but not easily predicted *ex ante*. The influence of institutions depends on functions, contents, and effectiveness that are observed *ex post*, especially credibility, social cohesion, and the coherence of policies with institutions. Moreover, institutions introduce discontinuities between micro and macro levels: causal mechanisms at the household level are not necessarily homologous to those operating at the macro level (regional or country level), for example, those linking growth and education, or income and education or health<sup>71</sup>. Discontinuities also stem from individual perceptions, which assign differing weights to different dimensions of poverty and inequality<sup>72</sup>. Aggregate threshold phenomena hide multiple microeconomic mechanisms that explain possible unexpected effects. For example, micro group structures and hierarchies regulating the access to capital and credit may transform the outcome of trade liberalisation into an oligopoly controlled by a small number of traders.

Micro norms shape the unintended transformations of macro institutions: unwritten, customary ('informal') norms may modify the apparent missions of formal public institutions - they may work against them (corruption) or on the contrary may provide legitimacy. Policy

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<sup>67</sup> On shared mental models, Denzau and North (1994).

<sup>68</sup> See Reno (1998) on the globalisation of warlordism in Sub-Saharan Africa.

<sup>69</sup> Fernandez and Rodrik (1991).

<sup>70</sup> On the credibility of political institutions in the 17<sup>th</sup> century England as a key factor of growth, see North and Weingast (1989).

<sup>71</sup> Kanbur (2001).

<sup>72</sup> See Ravallion (2004b) on perceptions of inequality that differ depending on whether weights are given to people or countries.

credibility is also a mechanism that introduces discontinuities between the macro and the micro levels, as well as problems of time consistency and anticipations of policy reversals. A well devised reform (such as liberalisation), may fail if civil servants follow different customary norms that are better-enforced (and may build self-enforcing equilibria). For similar reasons, groups of the poor targeted by an otherwise well-designed safety net may never be reached.

### 3. Threshold effects created by the political economy of institutions

#### The political economy dimension of institutions

Institutions may be conceived as primarily shaped by political economy, for example, reflecting the interests of the groups in power at the expense of efficiency and the welfare of the society, while no outside agency provides credibility to their commitments<sup>73</sup>. Political economy, however, is also a channel for the positive effects of institutions on growth, via political participation, social cohesion and management of social conflict, in particular when the latter is caused by external shocks and globalisation<sup>74</sup>.

The impact of globalisation on the poor is intermediated by domestic political economy structures and institutions such as social polarisation, oligarchic structures, and predatory regimes, which may bias, confiscate or nullify the gains from globalisation for particular groups of poor. As is well-known, one of the channels of the negative effects of inequality on growth is explained by a country's political economy (pressures for redistributive fiscal policies, for example<sup>75</sup>). The positive or negative influence from political economy is contingent on the nature of the groups that devise the rules, these groups' behaviour (productive, rent-seeking, exploiting institutions as resources), their time horizons, and the intergenerational calculations that shape their interests in redistribution and social cohesion. As shown by the example of Latin America, institutions stemming from the legacy of high economic and political inequality (in land rights, schooling, financial institutions), in preventing large segments of society from benefiting from economic opportunities, explain its poor growth performance<sup>76</sup>. Their combination with tropical commodity factor endowments has led to the emergence of parasitic elites and low levels of public goods (mass education, for example), which have contributed to slowed growth<sup>77</sup>. Low income and commodity-exporting countries indeed exhibit high levels of inequality and polarisation.

Political economy mechanisms contribute to threshold effects not only at the level of institutions but at the level of government policies, as both levels are endogenous to each other. For example, domestic political economy impinges on trade policies and therefore transforms the impact of globalisation on the poor. Threshold effects depend on particular contexts (for example, income levels, inequality, factor endowments, the possible poverty traps created by resource abundance<sup>78</sup>, budget constraints and government's redistributive preferences, the balance between interest groups, or the skewedness of political representation) and follow various channels, such as higher public spending<sup>79</sup>. In low-income countries characterised by inequality, rich elites appear to benefit more than the poor from trade openness, while in higher-income countries, the middle classes and the poor draw higher benefits from openness<sup>80</sup>. The gains from global integration, when combined with democratic pressures, may also improve the situation of the poor through expanding the

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<sup>73</sup> Acemoglu (2002 and 2003).

<sup>74</sup> Rodrik (1998a, 2000), Thorbecke and Charumilind (2002).

<sup>75</sup> Benabou (1996), Alesina and Rodrik (1994), Bourguignon (2004b).

<sup>76</sup> Engerman and Sokoloff (2003a), Robinson (2000) on the determinants of inequality in Latin America as primarily political.

<sup>77</sup> Engerman and Sokoloff (2000); on oligarchic political economy, Bourguignon and Verdier (2000).

<sup>78</sup> Against the thesis of the 'curse' defended by Sachs and Warner (e.g., 2001), see Blomström and Kokko (2001) on Sweden and Finland; on the positive relationship between resources and growth when associated with appropriate political institutions, Sala-i-Martin and Subramanian (2003), Acemoglu et al. (2001).

<sup>79</sup> Rodrik (1998b), Garrett (1999), Boix (2002); see Barro (1997) on the non-linear relationship between political institutions (democracy) and growth.

<sup>80</sup> Milanovic (2003a).

access to education and lowering inequality, but may be eroded by demands for government consumption and redistribution<sup>81</sup>.

### **Public institutions against the poor**

Rational choice approaches have highlighted the role of incentives and interests, with public institutions serving as political markets for organised groups competing for power. Particular groups may 'capture' existing institutions. They may also refuse access to institutions and their associated rights (such as land rights) to certain groups and individuals, although the latter are entitled to benefit from these rights and enjoy access. Institutions intrinsically include political contents and power relationships, for rules by definition constitute both inclusionary and exclusionary devices, and inherently create beneficiaries and losers<sup>82</sup>. The particular design of institutions and actual enforcement of contracts and rights may *in fine* be analysed as the outcomes of political power relationships.

'Empowerment' has been put forward as a key mechanism of poverty reduction<sup>83</sup>. It requires necessary conditions such as the existence of legal rules, which are, however, not sufficient. The institutions' (empowerment) impact on poverty is channelled by the type of political power that backs the enforcement of the rules, rights and contracts. Individuals may have rights, but if the apparatus of political power or competing traditional institutions make it so that they are not enforced, formal institutions may be a dead letter. The effective content – function, meaning, credibility – of public institutions is not the pure translation of formal institutions (such as courts and elected parliament). With the same form, contents may be growth enhancing, poverty reducing, or emerge as predatory institutions. It may even be in the interest of a predatory ruler to prevent the consolidation of developmental institutions, as this could threaten his power and monopoly on rents<sup>84</sup>.

Clientelism and corruption also crucially affect the redistribution of gains and losses created by globalisation in general and for the poor in particular. They prevent the poor from acceding to credit, investing, diversifying their economic activities and benefiting basic public services like health and education that are necessary to harness the opportunities offered by globalisation. For example, state service provision is recognised as essential for improving social indicators. Depending on its effective contents (organisation, degree of corruption), however, it may either reduce poverty or function as an extortionary device. Credibility and accountability of public institutions and policies are the contents that account for the discontinuity in the beneficial effects of institutions on poverty. In some low-income countries, because of political economy characteristics and weak institutionalisation, the poor indeed perceive state institutions as being one of the causes of their poverty. Under certain thresholds courts, health or education infrastructures may act against the poor; above these thresholds these institutions help the poor.

Therefore, in polarised contexts where rules are devised by and for the groups in power, the functioning of state institutions may work against the poor, exclude them from the gains of global integration, and reproduce inequalities. As institutions intrinsically include a political dimension, the types of winners and losers, domains and effective contents of rules and rights, and the groups that have access to these rules and rights result from events that are contingent and unpredictable *ex ante*. They depend on the balance of power, on which groups exercise or see their rights denied, and whether redistribution or equality constitute objectives for groups that have the capacity to devise or manipulate the rules.

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<sup>81</sup> Tavares and Wacziarg (2001).

<sup>82</sup> Wars and conflicts have been viewed as the historical root cause for the emergence of states in the Western world, see Tilly (1985).

<sup>83</sup> For example, by the World Bank, in the line of Amartya Sen's conception of poverty.

<sup>84</sup> Robinson (1996).

#### 4. Threshold effects and poverty traps induced by social institutions

The diversity of the threshold effects of globalisation via institutions is examined here at the level of social institutions and norms (household, group institutions, or 'micro institutions').

##### **Effects of globalisation on micro institutions and poverty: a slow transformation**

The impact of globalisation on poverty is mediated by local institutions, which create threshold effects both in modifying this impact and in transforming themselves under this impact. Aggregate observations – such as the fact that globalisation and growth have been pro-poor in some regions and not in others – in fact correspond to a multiplicity of micro mechanisms. In rural areas connections to markets, education and access to land are key endowments<sup>85</sup> and which are regulated by social institutions, for example allocating rights to education or land according to gender, age or status.

Local and social norms at the micro level change slowly and the impact of globalisation is more likely to be channelled by local institutions than by transforming them in a spectacular way. Certain social norms show significant resilience, such as partitions of groups according to particular membership criteria (occupations, classes, races, and so on) or political allegiance systems<sup>86</sup>. Self-enforcing mechanisms and status quo bias may be a feature of social rules that explain their resilience though their intrinsic inequality and, in some cases, inefficiency<sup>87</sup>.

Institutional changes tend to work at the margin, 'inside' institutional forms. Traditional institutions may erode under the pressure of market integration, with the content and functions of institutions evolving under similar forms (forms may evolve later). For example, customary land tenure may lose its social security and equity functions through the individualisation of land rights and land concentration that stems from market transactions (especially when combined with demographic pressure)<sup>88</sup>. Similarly, a market 'content' may progressively characterise non-market institutions such as kin groups (using kin as an unpaid labour force, for example). The trust mechanisms that accompany traditional networks may likewise be used in order to facilitate collective action towards entrepreneurial objectives<sup>89</sup>.

##### **Globalisation transforming micro institutions, or channelled by them**

Global integration - the transmission of world prices (and for the farmers in the export sector, their volatility) - changes local prices, return to assets and incentives. The move towards lesser state intervention (stabilisation schemes, for example) also alters customary rural institutions such as insurance mechanisms and tenancy contracts<sup>90</sup>. Land-abundant and labour-scarce low-income countries enjoy historically elaborated property rights in man (kinship systems, rights on labour) and not only in land. Global integration and economic transformation have historically constituted key factors of change in these sets of rights<sup>91</sup>. On the other hand, local social institutions channel and modify the impact of globalisation in negative and positive ways, depending on their history, and their particular structure and combination with other economic variables, as in the case of land tenure arrangements, inequality in land rights (ownership or access), and modes of revenue collection. History and path dependency indeed contribute to non-linear effects, for the impact of institutions on economic performance persists over time. As shown by Banerjee and Iyer on the example of land rights and tenure in India, different historical (colonial) property rights have led to different economic outcomes, with areas where rights were given to landlords exhibiting lower agricultural investment, productivity and investments in public goods than the areas

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<sup>85</sup> Christiaensen et al. (2003).

<sup>86</sup> On the persistence of racial markers because of distorted cognitive processes, see Loury (2004).

<sup>87</sup> Bowles (2004).

<sup>88</sup> Platteau (2002).

<sup>89</sup> On the 'network advantage' of traders in Sub-Saharan Africa, Fafchamps (2002).

<sup>90</sup> As in the Ivory Coast, where increasing competition and direct exposure to international markets have called into question the customary rights allocated to Burkina Faso tenants, sometimes leading to their expulsion.

<sup>91</sup> In particular the disappearance of rights in man (slavery, forced labour), see Engerman (1973), and Feeny (1989) on the replacement of rights in man by rights in land in Thailand in the 19<sup>th</sup> century.

where rights were given to the cultivating peasants<sup>92</sup>. Land tenure and distribution is a key source of agricultural productivity and scale effects (increasing or decreasing returns<sup>93</sup>).

### **The ex ante indeterminacy of the effects of social institutions**

Micro institutions and norms have ambiguous effects. There is an ex ante indeterminacy in their response to globalisation as well as in the effects of their response on poverty, depending on their actual contents and how the opportunities created by globalisation alter the previous institutional interactions and equilibria and induce new incentives. Institutions change depending on contexts and may be adaptive or dysfunctional. They may create self-reinforcing traps, lock in economic change in path dependency, or in contrast induce increasing returns, as in the case of the adoption of a particular institution or technology. Micro institutions are fragmented: a specific element (a form or a content) of an institution may have positive effects but which may be nullified by other elements. When coupled with weak states and a predatory political economy (in customs services, for example), market integration and lower trade barriers may intensify 'informal' norms and routines. Changes in technology or the value of a resource may be harmful as well as beneficial<sup>94</sup>.

In rural areas social inequality is likewise an important source of inefficiency, as it may be an obstacle to collective action<sup>95</sup>. Local institutions, however, organise inequality according to discriminatory criteria based, for example, on age, gender, and group membership within separate domains (production, consumption, technology, education, or communal politics). Inequality in a particular domain (rights on land, production, labour, kinship) can therefore be attenuated by different hierarchies or by egalitarian arrangements in other domains. Similarly, as is well-known, Sub-Saharan African households rarely follow the unitary model, with women and men exercising different agricultural activities that correspond to separate uses and ownerships of incomes<sup>96</sup>. The changes in relative prices and new market opportunities induced by globalisation may modify and even reverse previous income inequalities.

In developing countries, property rights coexist with other rights and uses, such as variety of flexible arrangements governing the exploitation of natural resources – although institutional economics often equates institutions with property rights and views the latter's stability as a factor of efficiency, and hence growth and poverty reduction. Flexibility and instability have even been viewed as key features of 'communal rights' as opposed to private rights.

Secondary rights or derived rights (access to and use of land) constitute flexible arrangements that are adaptations of local institutions (for the migrant farmers, for example)<sup>97</sup>. These flexible arrangements may be efficient: the formalisation of customary rights into property rights, which accompanies market integration, does not necessarily lead to greater efficiency in reducing poverty and creating markets, as in Sub-Saharan Africa - where private property rights have sometimes eroded customary cooperation rules, increased the perception of inequality and intensified distributive conflicts.

Social institutions, however, may be inefficient in contexts of norms that are shared by groups of limited size, as in the case of customary arrangements in rural areas (for example, risk-sharing and insurance)<sup>98</sup>. Formalised state institutions and legal systems, though possibly inefficient (corrupt, for example), may provide the poor protection against local institutions, which may be highly inequitable - and the collapse of these inefficient legal systems may be harmful for the poor, as has been the case in various transition countries.

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<sup>92</sup> Banerjee and Iyer (2002).

<sup>93</sup> Mwabu and Thorbecke (2004); Banerjee (2000b) on the returns of land reforms.

<sup>94</sup> Alchian and Demsetz (1973), on the example of the increase in value of the furs for the American Indians that led them to devise private rights in land for being consistent with a market economy.

<sup>95</sup> Baland and Platteau (1999).

<sup>96</sup> On separate accounts in the case of Ivory Coast, see Duflo and Udry (2003).

<sup>97</sup> Lavigne-Delville et al. (2001), Lambert and Sindzingre (1995).

<sup>98</sup> On the inefficiencies of traditional social arrangements, Platteau (1997 and 2000).

### Poverty traps created by social norms

The negative or positive outcomes of social norms are illustrated by the well-known issue of the fragmentation effects of group affiliations<sup>99</sup> and their controversial impact on growth and poverty reduction. As noted by Bowles, the poor find themselves at a disadvantage in implementing large scale coordinated collective action that aims at more equal institutions; moreover, they lack information more than others do<sup>100</sup>. Norms allow cooperation, risk-sharing, provide insurance and local public goods via various enforcement mechanisms (trust, reputation, reciprocity). They may alleviate - but cannot suppress - the other poverty trap mechanisms: 'social assets' may alleviate elements of persistent poverty such as low returns on uneducated labour and financial constraints<sup>101</sup>. However, the scope for exchanges and opportunities and the capacity to enforce rules and punishment and to limit free-riding tend to be confined to members of networks<sup>102</sup>.

Groups create solidarities and protection but also exclude. Lack of social affiliation implies greater degrees of freedom, but also more limited access to capital or credit. Shared norms (based on occupation, ethnicity, or location) sustain networks that encourage capital accumulation, are better able to take advantage of globalisation (such as international trade networks<sup>103</sup>). They alleviate poverty by reducing the costs of access to capital, credit and labour and via mechanisms supporting mutual assistance.

Shared norms simultaneously induce discontinuities and threshold effects in the potential benefits of global exchanges<sup>104</sup>. They foster social fragmentation (discrimination, prejudice). They build separated social identities which receive different payoffs for their actions, orient choices and economic behaviour<sup>105</sup>, lower participation in social activities, hinder collective action, and bias the redistribution of public resources towards certain groups and against others. The multiplication of nation-states in history reveals the relevance of state institutions in creating and attenuating redistributive conflicts. Ethnic membership is also an expression of an unequal access to and competition over public goods, infrastructure, political and natural resources and of the incapacity of state institutions to provide credible solutions<sup>106</sup>. Globalisation's positive effects may be locked in by group-building institutions, which politically or economically exclude the other groups from its benefits (for example, politicians using public revenues from external trade for redistribution towards their ethnic group). Parallel with other factors, though, globalisation may exacerbate competition and social fragmentation, while eroding the previous mechanisms of control of opportunistic behaviour (extreme cases being the conflicts fuelled by the international exploitation of natural resources).

Finally, self-reinforcing poverty traps may be built by social institutions, on which globalisation may have an aggravating impact. Social discrimination against occupational or ethnic minorities, for example, give rise to poverty traps in creating differences in returns to productive characteristics<sup>107</sup>. Likewise, when exposed to a market economy kinship institutions and their rules of reciprocal exchanges and obligations may distort labour markets. Institutional forms (kinship, modern organisation of the firm) seem to be stable but their contents are twisted towards new functions and effects (recruiting on the basis of kin and not competence, excluding non-members). Globalisation may even reinforce kinship institutions, as opportunities of improvements in contexts of uncertainty may lead to a preference for status quo ('collective conservatism'<sup>108</sup>) and hence build poverty traps. This is compounded by conservative risk-coping and investment strategies, as the poor are close to

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<sup>99</sup> Easterly and Levine (1997).

<sup>100</sup> Bowles (2004).

<sup>101</sup> Adato et al. (2003).

<sup>102</sup> Greif (1989 and 1994), Platteau (1994), Fafchamps (1992).

<sup>103</sup> Malaizé and Sindzingre (1998).

<sup>104</sup> On the detrimental effects of social heterogeneity and fractionalisation, see Alesina and La Ferrara (2001) and Alesina et al. (2002).

<sup>105</sup> Akerlof and Kranton (2000).

<sup>106</sup> Sindzingre (2002).

<sup>107</sup> Van de Walle and Gunewardena (2001) on the example of ethnic minorities in Vietnam.

<sup>108</sup> Hoff and Sen (2004), relying on Fernandez and Rodrik (1991).

subsistence and invest in assets with low returns while the wealthier invest in higher-risk and higher returns, which induce poverty traps<sup>109</sup>.

### **Virtuous processes induced by globalisation**

In contrast, globalisation may induce positive institutional changes in local institutions as well. They rely on social transformation and may be mediated by public policies, such as legal reforms regarding social status or land (right, contracts), which have positive effects in terms of poverty reduction, efficiency and productivity<sup>110</sup>.

Conversely, the pre-existence of certain micro-institutions when economic activities are exposed to globalisation may trigger virtuous paths that reduce poverty. Higher levels of 'participation' lead to better economic outcomes and better public goods provision<sup>111</sup>. Following the dismantling of state marketing boards, producers who constituted membership-based organisations and associations were more able to overcome collective action problems and the fragmentation of customary institutions- while relying on the latter- and act as intermediate institutions vis-à-vis international markets.

Within the same rural areas, households that have organised themselves (choices of crops, for example) in order to diversify their source of income have better exploited globalisation, and vice-versa: households that were the least diversified incurred more negative effects. In Mali for example, certain households simultaneously engage in cash crop (cotton) and food crop agriculture, in tandem with tenancy arrangements on cocoa plantations in the neighbouring country (Ivory Coast, the world's main exporter) - thus adding the remittances to their income - through the use and adaptation of traditional household structures (such as large households<sup>112</sup>).

## **5. Poverty traps compounded by macro conditions**

Threshold effects may emerge at an aggregate level, which translate threshold effects occurring at a micro level - the micro-macro distinction is used only for heuristic reasons, as there is a continuum between these levels and a combination of institutional forms and contents. This is shown by the examples of poverty traps created by trade structure and the institutions coping with external shocks. Poverty traps may be generated through reciprocal interactions between the macro and the micro levels, involving public institutions and policies, and individual responses mediated by social institutions. The continuum between micro institutions (organising statuses and rights according to age, gender, occupation) and macro institutions (the public or 'modern' sectors) may build traps that separate the poor from individuals who can trigger a process of wealth accumulation<sup>113</sup>.

### **The cumulative processes created by the interaction between public policies and institutions**

In low-income countries, particularly commodity-exporting ones, the cause of poverty is less globalisation than the structure of economies and exports. The increase in trade does not reduce poverty in low-income countries (the well-known 'international poverty trap' that stems from commodity export dependence)<sup>114</sup>. State institutions and policies, however, contribute to cumulative processes and threshold effects, in creating devices that either maintain, aggravate or reduce dependence and modify the existing economic structures. Price stabilisation schemes, monopsonies, and marketing boards have been the institutions that states have implemented as interfaces between global markets and producers. In some countries these institutions, combined with political economy and economic elements, have

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<sup>109</sup> Among a vast literature, see Zimmerman and Carter (2003).

<sup>110</sup> Banerjee et al. (2002) on the reforms of tenancy laws in West Bengal in the late 1970s.

<sup>111</sup> Banerjee and Iyer (2002).

<sup>112</sup> Hillborst et al. (1999).

<sup>113</sup> Azariadis (2004).

<sup>114</sup> UNCTAD (2004).

been inefficient, inequitable or even predatory (for example, when taxing producers in order to finance political interest groups)<sup>115</sup>.

International commodity price volatility, however, includes thresholds below which peasants limit risk, investment, loans and diversification in more productive crops and non-farm activities (and above which they do)<sup>116</sup>. Depending on particular institutional and economic combinations, interlinked contracts implemented by state stabilisation and marketing schemes have smoothed the pass-through of world price changes and protected commodity producers from volatility. They have been efficient risk management tools in the context of inefficient market mechanisms, in financing agricultural inputs, providing credit, stabilising income expectations, providing insurance, as for cocoa in Ivory Coast or cotton in West Africa<sup>117</sup>.

Domestic trade liberalisation policies starting in the 1980s have exposed commodity producers to the large and asymmetrical effects of world price volatility<sup>118</sup>. After the dismantling of stabilisation schemes, non-state institutions did not fully substitute for their functions, domestic and external. Market mechanisms alone may be unable to provide the security previously provided by state schemes. Local market mechanisms controlling opportunistic behaviour among intermediate private buyers may be inefficient, with producers having to cope with the unpredictability of prices and profits, limited access to credit, capital and inputs. In Sub-Saharan Africa, the historical weakness of the domestic private sector sometimes made it so that the opportunities offered by liberalisation were captured by intermediaries<sup>119</sup>: market power here shifts from producers to a small number of concentrated private actors. The liberalisation of the coffee market, for example, did not improve price transmission, and private actors became concentrated at processing and retailing levels<sup>120</sup>. In the Ivory Coast, for example, subsequent to the liberalisation of the palm oil sector producers reduced production and quality, due to the cost of inputs, segmentation of production, and the disappearance of the public institutional framework that provided security, learning, coordination and sanction of opportunism<sup>121</sup>.

Rural institutions, however, may also be inefficient because of covariate risk (climatic, for example). Rural associations may be affected by problems of inadequate information, transaction costs stemming from limited scale, problems of coordination and collective action, weak market bargaining power vis-à-vis a few international trading firms, efficiency-equity dilemmas that are detrimental to the poorest producers<sup>122</sup>. Producers have responded to exposure to international price fluctuations with permanent income strategies leading to over-production, as for cocoa in Ivory Coast, in turn increasing price volatility. The well-known threshold effects stemming from the fallacy of composition typically constitute a trap that results from information and collective action problems. There have been winners, but inequalities may have also been created: when benefiting from better access to markets (such as roads), for example, commodity producers may have benefited more from liberalisation than those producing food crops<sup>123</sup>.

The ways public and social institutions, as well as the interactions between them and with market structures (for example, increasing returns), are modified by liberalisation channel the latter's impact on the rural poor. The discontinuous and non-linear character of this impact was pointed out by Rosenstein-Rodan<sup>124</sup>: rural markets at early stages of development suffer coordination failure, multiple equilibria, and underdevelopment traps with lack of growth under certain thresholds. Combining the macro and micro levels, underdevelopment traps create threshold effects. As shown by Hoff in the example of China, micro features

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<sup>115</sup> Deaton (1999).

<sup>116</sup> Among a vast literature on shocks (price fluctuations, weather), vulnerability, rural risk management, Fafchamps (1999, 2000), Dercon (2002).

<sup>117</sup> On the effects of liberalisation of cotton, see Poulton et al. (2002).

<sup>118</sup> Cashin et al. (2002); on the asymmetric effects of downturn on poverty, Agenor (2002a).

<sup>119</sup> On the oligopolies in the cotton sector in Zimbabwe, see Larsen (2002).

<sup>120</sup> Sheperd (2004).

<sup>121</sup> Cheyns et al. (2001).

<sup>122</sup> On the cocoa and cotton sectors in West Africa after liberalisation, Araujo-Bonjean and Combes (2001).

<sup>123</sup> Bourguignon and Morrisson (1992).

<sup>124</sup> Rosenstein-Rodan (1943).

(modernisation, diversification) may determine local poverty traps among farm households<sup>125</sup>. Various spillovers effects (externalities) may lead to a series of traps (in terms of investment, technology) with low innovation and inefficient institutions.

### **Public institutions and policies as instruments of transformation**

Globalisation may trigger institutional change. State institutions and policies, however, reorient the effects of globalisation on institutions and poverty as well as the effects of local institutions on poverty – for example, industrial, trade, social policies. Government policies, and not only institutions, contribute to the formation of poverty traps and are endogenous to these institutions ('state failure', 'political failure'<sup>126</sup>). Depending on the environment (for example the political economy), policies may be affected by credibility problems and be unable to reduce poverty or attenuate shocks<sup>127</sup>.

Public policies, laws, and institutions also have the capacity to sustain a change in social norms and micro political economy mechanisms in a way that benefits the poor, when combined with political institutions, for example democracy – though democracy is endogenous to the political economy (the effective content of democratic forms may be clientelism). A wider distribution of benefits not confined to the rich or to individuals who are affiliated with particular groups falls within the domain of public policy and the legal apparatus<sup>128</sup>. Effective local democracy and accountability in rural areas have positive effects on poverty<sup>129</sup>, and democratic countries seem to be less ensnared in the 'fractionalisation-as-politics' trap<sup>130</sup>.

Public policies have positive impacts on institutions, on their effect on the poor, and on the effects of globalisation, when they correct market failures - for example through facilitating access to finance<sup>131</sup> and supporting rural industrialisation<sup>132</sup> and basic public services, such as female education<sup>133</sup>. Public policies may support market-related institutions, as they did historically for merchants during the transition to capitalism<sup>134</sup>. They may likewise ease the global demand for goods produced by the poor<sup>135</sup>. Particular combinations of institutions, policies, and economic structures, however, are what determine *in fine* the impact of globalisation. Elements taken separately have unpredictable effects but the outcomes of their combination may be growth and poverty reduction.

### **Conclusion**

This paper has focused on the relationships between globalisation, poverty and institutions. While the latter's relationship with growth is now a matter of increasing attention, this has been less the case regarding the whole causal chain linking globalisation, institutions, and poverty. Assessments of the impact of globalisation on the poor have revealed marked divergences in the literature. It has been shown that the threshold effects created by institutions constitute a dimension of the explanation of these diverging impacts. The triangular causalities that relate globalisation, poverty and institutions constitute multiple, endogenous, cumulative and non-linear processes.

Institutions mediate the impact of globalisation on the poor. Institutions have been analysed following an original theoretical approach, which views institutions as composite arrangements. It disaggregates the concept of institution according its various components (forms and contents) and their particular combinations.

Because institutions are composite arrangements, they create discontinuities and generate threshold effects upon the positive or negative effects of globalisation, with social institutions

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<sup>125</sup> Hoff (2000).

<sup>126</sup> Besley and Coate (1998), quoted in Hoff (2000).

<sup>127</sup> Ravallion (2001b).

<sup>128</sup> A well-known example being affirmative action.

<sup>129</sup> Foster and Rosenzweig (2001).

<sup>130</sup> Milanovic (2003b) on the case of Sub-Saharan Africa.

<sup>131</sup> On India, see Burgess and Pande (2003), Besley (2003).

<sup>132</sup> Foster and Rosenzweig (2003).

<sup>133</sup> Ravallion and Datt (2002).

<sup>134</sup> Milgrom, North and Weingast (1990).

<sup>135</sup> Basu (2003).

and norms being a case in point. Institutions may also generate poverty traps. These threshold effects may be compounded by public institutions and policies. On the other hand, globalisation may induce a positive transformation of institutions. Institutions may likewise enhance the impact of globalisation and trigger virtuous paths that reduce poverty.

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