Introduction

Faced with disappointing performance under the 'Washington Consensus', international organisations and bilateral development agencies switched to what was called the 'post-Washington consensus'. This extended set of principles was seen as a way of compensating for the neglect of institutional considerations in the original consensus. Market-oriented reforms thus had to be accompanied by other reforms, including the regulation of various sectors, making governments more efficient, and increasing the capacity of human capital. Most importantly, however, emphasis was also placed on good governance as a necessary adjunct to market-led development, especially in regard to its capacity to protect property rights and guarantee contract enforcement. With time, governance then became a key criterion among donors for allocating aid across low-income countries, and also to monitor its use.

It is fair to say that, practically speaking, governance has been defined and evaluated in a rather ad hoc way, based on expert opinion, firm surveys, and simple economic parameters like the rate of inflation or the size of the budget deficit. The relationship with the nature and quality of institutions is thus very indirect. This still seems to be the case today, even though the recent World Development Report, entitled 'Governance and the Law' (World Bank, 2017), intends to go further by showing how governance, or policymaking in general, including institutional reforms, depends on the functioning of institutions, the role of stakeholders, and their relative political power. Practically speaking, however, there remains something mechanical and schematic in the way institutions are represented in the 2017 report, which is actually more about effective policymaking than about the diagnosis of institutional weaknesses and possible pathways for reform.

If there is absolutely no doubt that institutions matter for development, and for development policies and strategies in the first place, the crucial issue is knowing how they matter. After all, impressive economic development

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achievements have been observed, despite the presence of clear failures in particular institutional areas. In other words, not all dimensions of governance may be relevant at a given point in time in a given country. Likewise, institutional dimensions that are not included in governance criteria may play a critical role. Despite intensive and increasing efforts over the last few decades, there remains limited knowledge about how institutions affect development, how those institutions are formed, and how they could be reformed in specific contexts.

I SEARCHING FOR EVIDENCE ON THE ROLE OF INSTITUTIONS: THREE APPROACHES

Three approaches have been developed to identify the institutional factors that may hinder or promote development, and to think of ways of remedying or enhancing specific factors. Each of these approaches have their drawbacks.

The first approach consists of historical case studies, understood as in-depth studies of successful and unsuccessful development experiences in history or in the contemporary world. The formation and success of the Maghribi traders' coalition in the eleventh-century Mediterranean basin, the effects of the Glorious Revolution in Britain, the experiences of land redistribution in South Korea and Taiwan after the demise of Japanese colonial rule, the reform programme known as the Rural Household Responsibility system in China, or the violent fight for the appropriation of natural resource rents in several post-independence African states, all epitomise various possibilities of institutional change: while some of them led to vigorous development headed by developmental states of different types, others caused underdevelopment under the aegis of predatory states. Such studies are of the utmost interest because they show, at work, the mechanisms that may govern the transformation of institutions, often under the pressure of external circumstances, and they show the unequal success that can be attributed to institutional change. In *Why Nations Fail*, for instance, Acemoglu and Robinson (2012) masterfully highlight the role of institutions in several historical and contemporaneous cases of development, and in failed development experiences. They place a special emphasis on the key role of inclusive institutions, as compared with predatory ones, and, most importantly, on the role of politics in encouraging or impeding development. The problem, however, is that the lessons from most history-oriented studies are rarely transferable across time or space, and they are not necessarily – or completely – relevant for today's developing countries.

The same conclusion applies to studies emanating from the quickly proliferating strand of economic history research based on natural historical experiments. Variation in some key determinants, whose presence or absence was observed a long time ago, is considered as exogenous, and therefore is used as a valid instrument to explain today's different outcomes. Because many geological and geographic characteristics have the appearance of being deterministic,

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they are often seen as the deep causes behind the institutional divergence that is responsible for different growth and development trajectories. Two particular difficulties arise here. First, as underlined by Dany Rodrick (2004) and others, it is not because a researcher finds an appropriate econometric instrument that s/he is able to offer an adequate explanation. We tend to agree with Avinash Dixit (2007: 137) that 'the notion that geographic and historical variables are merely instruments for institutional determinants of economic success is supported more by the intuitive appeal of the stories told than by the statistical significance of the tests performed'. Second, results that highlight the role of historical factors, particularly when they are rooted in physical determinants, give no guidance when the problem affects the relevant institutions directly: 'the recommendation to change one's geography or history is useless' (Dixit, 2007: 137).

The second approach to identifying institutional factors that may hinder or promote development involves cross-country studies in the contemporaneous era. It relies on indicators that describe the strength of a particular set of institutions in a country – for example, property rights, legal regimes, the extent of democracy, the strength and nature of controls on the executive, corruption, and so on – with the aim being to identify whether there is a correlation between these indicators and growth or other development outcomes. Institutional and governance indicators are generally based on the opinions of experts, who compare the performance of different countries on which they have specialised knowledge along a number of selected dimensions. As such, they are grounded in largely subjective assessments and lack the precision needed for statistical analysis. This being said, correlations between these indicators and development outcomes are sometimes significant, and they are often intuitive. However, the use that can be made of the results of such cross-country studies is limited since, by construction, they essentially refer to an abstract 'average country'. They may therefore be of little use when it comes to a specific country. Most importantly, they say nothing about causality, and still less about the policy instruments that could improve particular institutions. For example, corruption is generally found to be bad for development. However, we would like to know the direction of causality, and whether this conclusion is true in all countries and in all circumstances. And what should we think about cases where corruption serves to 'grease the wheels' of the bureaucratic system, speeding up procedures in the presence of too stringent administrative constraints? In sum, cross-country analysis is an interesting exploratory approach, yet we need to delve deeper into the issues when focusing on a particular country and trying to conceive of potential institutional reforms.

To understand the third approach to identifying institutional factors that may hinder or promote development it must be borne in mind that in some cases institutional weaknesses or strengths are readily observable, as in the delivery of public services like education or healthcare. For instance, the absenteeism of teachers in public schools reveals a breach of contract between civil

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servants and their employers, and/or a monitoring failure by supervisors. This state of affairs raises two interesting issues. On the one hand, there are ways of incentivising teachers so that they show up to school. Numerous experiments that have been rigorously evaluated by randomised control trial (RCT) techniques in various community settings have successfully explored such incentive schemes in various countries over the last two decades or so. On the other hand, it is not clear whether there is always the political will, or an adequate coalition of interest groups, to fully correct this institutional failure of civil servants who do not comply with their official duty, and to make successful experimental schemes universally compulsory.

Identification of institutional weaknesses at the microeconomic level, and experimentation to identify ways to correct them, has multiplied over recent years. Yet this line of research generally addresses simple cases that can be suitably designed for experimentation. Identifying institutional failures and devising remedies is much less easy, if not impossible, in more complex situations where a bundle of attributes rather than a single or a few factors seem to play an important role. Moreover, if RCT studies (and this is their strength) are able to establish causality between well-specified institutional interventions and outcomes of concern, they are often less successful when it comes to shedding light on the underlying mechanisms. This limitation makes thinking about the generalisability of their conclusions difficult. This is especially so because the impact that is assessed typically consists of short- or medium-term effects and we therefore need a good theory to persuade us that these effects will endure. Doubts are of course reinforced when comparable studies of the effects of a given intervention in different countries do not converge (see Dal Bo and Finan (2020), for a recent survey of results).

The three empirical approaches to institutions and development summarised above leave a gap between an essentially macro view of the relationship – stylised historical facts or cross-country correlations between GDP growth and governance or institutional indicators – and a micro view that is grounded in, say, the direct observation of the behaviour of absentee civil servants or corrupt tax inspectors. Indeed, it can reasonably be held that economic growth results from the combination of many factors, including structural changes, which depend themselves on the way institutions work. Industrialisation may be made easier because of institutions that are conducive to local entrepreneurial initiative, or more difficult due to institutions that protect importers' rents. Agricultural productivity may grow faster if land rights are well defined and well implemented, yet the need for the state to intervene may be confined to certain situations, which themselves have to be specified. To understand the relationship between institutions and development we must be able to identify how institutions facilitate or hinder the basic changes that govern economic growth.

Moreover, development is not exclusively about economic growth. It is about the structural transformation of the economy and the society. It is

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about inclusiveness, and therefore the way institutions distribute the products of growth. And it is about sustainability. For another thing, focusing on micro aspects is fine as long as one does not lose sight of the bigger picture. It is almost trivial to say, but it is still worth emphasising, that the fundamental institutional factor(s) behind a specific dysfunction must be uncovered in order to reach a correct diagnosis and to correctly identify the policy implications. There are innumerable instances where, because only proximate causes have been identified, the problem at stake quickly resurfaced after the remedy inferred from an incomplete diagnostic was applied. There are thus many possible causes of corruption among tax collectors, including lack of monitoring, or the propensity of supervisors to take their cut, or of rich taxpayers to bribe the budget minister for looser tax controls. Even if some experimental anti-corruption device is found to work for a given tax and a given group of tax collectors, there is no guarantee that the government will make the decision to implement it on a broad scale and on a permanent basis.

Moving from the rigorous identification of what appears to be an efficiency-improving policy or institutional arrangement to an understanding of the conditions in which it may be effectively put into practice requires that we decipher the surrounding political economy context. In other words, considerations of political feasibility need to be added to considerations of economic efficiency. As we have learned from the political economy approach discussed earlier, politics may act as a constraint, and it is not clear *a priori* how a trade-off between economic efficiency and political objectives should be resolved. Even working in partnership with a government agency and obtaining its agreement on the soundness of a particular treatment that has been revealed in the course of an experiment that was run with its full support does not ensure that this treatment will actually be implemented. Interests or considerations that were abstracted away at the time of the experiment may come into play or may emerge only at the time of implementation.

These limitations of standard analyses of the relationship between institutions and development have motivated the exploratory research undertaken within the Institutional Diagnostic Project (henceforth labelled IDP). Even though we do not claim to be able to close the gap between research on the role of institutions and a diagnostic that will be directly relevant for policymakers, we believe that we can narrow it down somewhat. At least, this is our hope – and that is the purpose of this project. One of the main reasons why we believe that it was worth undertaking is that the above gap is currently quite large – too large, actually. Here, we cannot resist the temptation to cite Avinash Dixit (2007) extensively:

> the econometric and theoretical studies are not the best way to generate policy prescriptions. Most cross-country regressions are a far from perfect fit: the myriad explanatory variables that have been tried explain only a fraction of the variance. Theoretical modelling explores the implications of one cause or mechanism in depth, deliberately isolating

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it from others, whereas policy prescriptions require that one consider all the different causes or mechanisms at work in a country and how they interact. The question policy prescribers must address, is not what creates success on average across countries, but what is going wrong in this country, and how can we put it right. (p. 150)

A similar type of warning has been issued by Jean Drèze (2020) when he stresses that 'policy is not a matter of evidence alone'. Besides evidence, which is about facts, good policy requires understanding, which is often gained through personal experience. Moreover, 'policy-making calls for serious reflection about values and objectives', equivalent to asking for what purpose and for whom findings about 'what works' (as revealed by a RCT, in particular) are to be implemented. Lastly, since policy is a political decision, it requires deliberation. It is when people differ in their understanding and values that deliberation is especially needed and that care should be taken not to de-politicise public policy through exclusive reliance on the advices of experts working behind closed doors.

In short, we readily admit that researchers cannot be good substitutes for policy practitioners and advisors. What we claim, however, is that it is possible to get closer to policy-relevant diagnostics by following an approach that is at the same time more comprehensive and more detailed than conventional approaches. In this new approach, special attention is paid in particular to the roles of context and political economy factors, and to the nature of mechanisms linking critical institutions to relevant outcomes.

II INSTITUTIONAL DIAGNOSTICS AS A NEW APPROACH TO INSTITUTIONS AND DEVELOPMENT

This volume summarises the lessons learned from the IDP, a multi-country IDP project that aimed to design a methodology able to diagnose development-impeding institutional weaknesses, or disruptions, in a country, and to propose lines of reform which take the political context into account. An 'institutional diagnostic' of development must first be seen as an exploration of the way in which various types of institutional features affect the functioning of its economy, its dynamics, and the policymaking process, the ultimate goal being to detect the most serious flaws or ill-boding imperfections in the institutional scaffolding of the country or, by contrast, healthy tendencies which seem to portend continuous progress on the way to development.

But the diagnostic must also come with a reflection on those reforms likely to succeed in removing institutional obstacles and the political economy context in which they would have to be decided and then implemented. It is a new approach to institutions and development in the sense that it departs from the three lines of research mentioned earlier. It is a country-centred approach differing from historical case studies because the focus is not on a particular event, circumstance, or episode but on the overall functioning of a country's

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economy. It also goes beyond the mere use of governance or institutional indicators, which are deemed much too rough or imprecise when dealing with a real economy, even though they may sometimes be informative. On the contrary, institutional diagnostics are meant to apply to economies taken in all their complexity, including their socio-political dimensions. Of course, they also make use of microeconomic evidence on institutional failures or deficiencies and, where available, of experimental studies conducted in the country concerned.

Within IDP, such an institutional diagnostic was performed on four low-income countries, two of them graduating to lower-middle-income status. This restriction in the choice of case studies was imposed by the funding agency behind this research project, the UK Department for International Development (now the Foreign and Commonwealth Development Office). Accordingly, and within the constraints of the available resources, the following four countries were selected: Bangladesh, Benin, Mozambique, and Tanzania. The rationale for this choice is explained in detail in each individual case study. At this stage, it may simply be noted that, together, they cover a broad range of initial conditions, development trajectories, and achievements. These case studies are published in four companion volumes (Bourguignon and Wangwe, 2023; Bourguinon et al., 2023; Cruz et al., 2023; Raihan, Bourguignon, and Salam, 2023).

The objective of the present volume is twofold. On the one hand, it offers a reflection on the institutional diagnostic methodology in the light of the experience gathered in the case studies. In contrast to the well-known 'growth diagnostic' approach to development developed by Hausmann, Rodrik, and Velasco (2005), there is no simple theoretical framework in the literature that could be used as a logical basis for a comprehensive diagnostic of how institutions may hinder the development of a country. A heuristic approach had to be followed and it should be evaluated. On the other hand, the volume attempts to synthesise the results of the diagnostic established in the four case studies in terms of what they teach about the relationship between institutions and development. In particular, a reflection is undertaken on the comparability of the institutional challenges identified in the various case studies, and some other countries. It leads to a list of 'generic institutional issues', which are of interest per se but also should help in establishing the institutional diagnostic of a particular country.

III STRUCTURE OF THE CASE STUDIES

A brief presentation of the methodology and the content of the case studies may be helpful at this stage to get an idea of the material available for the synthesis undertaken in the present volume.

Each study proceeds in three steps. The first step is rather 'mechanical': it consists of reviewing the economic, social, and political development of the

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country, surveying the existing literature, examining governance or institutional quality indicators, and soliciting from various types of decision makers, top policymakers, and experts their views on the functioning of the economy and institutions in their country. Based on this material, it will be possible to identify the most obvious ‘binding economic constraints’ on economic development and the perceived institutional weaknesses by various actors. Regarding economic constraints, hypotheses about whether and how they relate to institutional factors have also to be put forward. This rather straightforward approach to institutions and development in a particular country is also expected to point to several thematic areas of utmost economic importance and where critical institutional factors seem to be at play: commercial agriculture and the legal or informal system of land use transfers, manufacturing development, and the regulation/incentivising of firms, tax collection, delivery of particular public goods, and so on. Yet problem areas are likely to be strongly country dependent.

The second step consists of a thorough analysis of the critical areas revealed by the exploration in the first step. The challenge here is to identify the way in which an economic weakness is the result of institutional dysfunction, and then to unearth the root causes of this particular dysfunction and understand how they could be remedied, while taking account of the stakes involved in the reforms. Using these detailed analyses of key thematic areas as well as the evidence gathered in the first part, the third step of the case studies then consists of synthesising what has been learned into a repertoire of some basic institutional problems that are common to the different problem areas, their negative consequences for development, and, most importantly, their causes, proximate or more distant, as well as the potential for remedies and reforms. This is the essence of the ‘diagnostic’ that each case study intends to deliver. Practically, all that analysis is summarised in a ‘diagnostic table’, which thus appears as a short statement of the diagnostic.

What is thus intended is a diagnostic, not a reform agenda. Because there are winners and losers of most reforms, political economy factors, as well as political and economic circumstances, will determine whether they can be undertaken or not. This is thoroughly discussed in the case studies, but it must be clear that no firm conclusion about the political economy feasibility can be reached without a precise evaluation of the distribution of political power in the society – something that goes far beyond the present exercise. From the strict point of view of the diagnosis, however, its most important contribution is to put squarely on the table the nature of the institutional problems, the needed reforms, and the stakes involved. In other words, it is to make sure that all key actors are aware of the most serious implications of the reforms, the ensuing collective gains, and, possibly, the losses for various categories of agents. In theory, and if successful, our approach should clarify among all stakeholders and the public the cost of not undertaking a given institutional reform, the gain of doing so, and who is likely to lose and gain.

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In line with what has been said earlier, the ambition of an institutional diagnostic is not to formulate precise policy prescriptions. Moreover, such recommendations would be fraught with uncertainty. The aim is essentially to unveil weak points that have the potential to cause severe problems in the future and the effects of possible remedies. This is with a view to hopefully prompting policymakers to become more aware of them, monitor their evolution, and ponder feasible reforms. For instance, the role of informal rules and institutions, and their interactions with formal institutions, receive great attention throughout the various studies. This is justified, given the important role and the great resilience of traditional local rules and institutions in many developing countries. They permeate the whole social fabric and the question as to how they are antagonised by newly established formal institutions, or complement them, or accommodate them in some way or other, cannot be escaped. This is particularly evident in matters of contract enforcement and land property rights. Reforming by simply changing the law or trying to implement it more strictly, as frequently done by policymakers after long political debates, often proves ineffective.

IV THE ASIAN TIGERS' TAKE-OFF AS A BENCHMARK

Some of the four IDP countries may be considered as development successes according to some criteria, whereas the development performance of others or according to other criteria appears as modest. No country can really be considered as over-performing the others or not subject to substantial uncertainty about its future development. To enrich the comparative perspective of the reflection in this volume, two countries were added to the list of our four in-depth country case studies. These new countries, for which we rely on second-hand literature, are South Korea and Taiwan – at the time they were at a comparable level of income per capita as the IDP countries today, that is, the time of their take-off in the 1960s and early 1970s. The two East Asian tigers are indeed known for their spectacular development records and provide an interesting basis for comparison. However, it bears emphasis that the idea is not to erect these two cases as benchmarks against which institutional imperfections in other, less successful countries must be measured. That one-size-fits-all solutions are inadequate is a principle that should be applied to any attempt to mechanically transplant institutions not only from economically advanced countries of the Western world but also from successful Southeast Asian countries, even at the time of their take-off. The objective is different. It is to use the experiences of South Korea and Taiwan at the beginning of their stellar development to get a better idea of the key issues that a country must tackle in order to develop in a sustainable manner.

To make things more concrete, the point is not to claim that, because these two Asian countries followed such a path, a military-based authoritarian regime is a prerequisite of sustainable development. It is evident that this sort

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of advice is fraught, if only because it is not known how a benevolent, or at least a development-minded despot can arise in a particular country. In fact, many examples from the contemporaneous world seem to indicate that malevolent military rulers are the rule rather than the exception, as attested by the present-day regimes of countries such as Mali, Myanmar, Pakistan, Thailand, and many others. What is of interest here, and where a lot can be learned from the study of South Korea and Taiwan, is that their military regimes succeeded in preventing business interests from capturing the state and influencing its development policies, as observed under one form or another in the IDP countries. This is an issue which must be addressed and solved in some way or other, and the experiences of these two countries should be considered as sources from which to get inspiration and not as models to copy *in toto*.

V OUTLINE OF THE VOLUME

The outline of the book is as follows. In Chapter 1, we define the concept of institutions and then move forward by discussing interactions between formal and informal institutions and then presenting and illustrating the main existing economic theories of institutional change. In Chapter 2, the methodological approach of the institutional diagnostic is explained and justified. In the four subsequent chapters, the results of the institutional diagnostics based upon the thorough analysis of development in the IDP countries in companion volumes, as well as the salient points of that analysis are summarised: Bangladesh and Tanzania in Chapter 3 and Benin and Mozambique in Chapter 4. We then try to apply a comparable methodology to imagine what would have been the conclusions of an institutional diagnostic drawn at the beginning of the development of the two big achievers: South Korea in Chapter 5 and Taiwan in Chapter 6. Then come the synthesis chapters. First, Chapter 7 summarises on a comparative basis the nature of the obstacles and enablers of structural transformation in the six countries' economies and suggests possible links with institutional factors. Those are taken up more explicitly in the next two chapters, which focus on the set of generic institutional issues found among the case studies and the two Southeast Asian countries. Chapter 8 probes the role of politics and the initial conditions prevailing at the time development efforts were initiated, while Chapter 9 focuses on issues of state capacity and property rights. Finally, Chapter 10 offers a general conclusion, in which basic lessons from the analysis, and the implications for development assistance, are identified.

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