ECONOMIC DEVELOPMENT & INSTITUTIONS

BENIN INSTITUTIONAL DIAGNOSTIC WP19/BID00

INTRODUCTION TO THE BENIN INSTITUTIONAL DIAGNOSTIC

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About Economic Development & Institutions
Institutions matter for growth and inclusive development. But despite increasing awareness of the importance of institutions on economic outcomes, there is little evidence on how positive institutional change can be achieved. The Economic Development and Institutions (EDI) research programme aims to fill this knowledge gap by working with some of the finest economic thinkers and social scientists across the globe.

The programme was launched in 2015 and will run until 2021. It is made up of four parallel research activities: path-finding papers, institutional diagnostic, coordinated randomised control trials, and case studies. The programme is funded with UK aid from the UK government. For more information see http://edi.opml.co.uk.

1 Introduction

1.1 'Institutions matter'

'Institutions matter' became a motto among international organisations in the late 1990s, when it became clear that the so-called 'Washington Consensus' and its emphasis on markets was not generating the growth and development that was expected. The slogan was open to different interpretations. It sounded a note of disappointment for those liberalist reformers, sometimes jokingly called the 'marketeers', who promoted the generalised shift to market mechanisms and the pre-eminence of private actors in developing countries at the time of the development crisis of the 1980s. Giving more space to the market was perhaps a good idea from a theoretical point of view. Practically, however, it was another story. What the 'marketeers' had not realised was that a well-functioning market economy requires an institutional background, which most often was missing in the economies to be reformed, and that liberalising and privatising might in effect be counterproductive without concomitant institutional changes.

The 'institutions matter' slogan today stands for a fundamental truth about development, which seems now to be widely accepted by the development community, including international organisations and the old marketeers, as well as academics. It now seems obvious that there is indeed complementarity between the market and the state. The economic efficiency to be expected from the former requires some intervention by the latter through adequate institutions or rules imposed on the various economic actors, including the state itself. Practically speaking, however, these rules are the product of history or specific circumstances, and are not necessarily well adapted to today's economic context or the specific circumstances of a country at a given point in its development process. This is precisely how 'institutions matter'. The debate is therefore not so much about this basic fact but about the way institutions should be reformed. This is where the old opposition between marketeers and state interventionists comes back into the picture, with, to simplify, the former most often pleading for rules that facilitate business and increase economic efficiency and the latter more attentive to promoting social welfare and protecting public goods. This is also where political economy plays a major role, as all economic and political actors try to bend the rules in their own interest.

'Institutions matter' quite evidently to those academic economists who for a long time have emphasised the link between the process of economic development in a country, the nature of its institutions, i.e. the structure of political power and the norms and rules inherited from the past, and their joint evolution with economic development. As a matter of fact, institutional economics has a long history, from Karl Marx and Thorsten Veblen to the so-called New Institutional Economics, associated in its development component, in particular, with Douglass North. The New Institutional Economics borrowed from the other streams of institutional economics their extension of the neoclassical paradigm to a view in which economic institutions are seen a way to solve the inefficiencies arising from the existence of transaction costs, asymmetric information, and limited commitment capacity. Hence the emphasis put in that literature on institutions that aim to protect property rights and enforce contracts as positive factors of development. At the same time, such a view of the role of institutions in development is criticised by the Institutional Political Economy approach, which relies more on a socio-political view of institutions as having consequences for the

functioning of the economy than it does on a view of institutions as addressing sources of economic inefficiency. It is also fair to say that both schools of thought rely very much on a historical view of institutions and development, drawing their examples from, and grounding their case in, development history or observed contemporaneous differences between so-called advanced countries and emerging or developing ones.

1.2 How institutions matter in development policy today

Faced with the disappointing performance of the 'Washington Consensus', international organisations and bilateral development agencies switched to what was called the 'post-Washington consensus', or what Stiglitz nicknamed the 'Washington Consensus plus'. This extended set of principles was seen as a way of compensating for the neglect of institutional considerations in the original consensus. Some recommendations about institutions were simply added to those about economic policy. Market reforms are not enough. They have to be accompanied by other reforms, including competition policy, the regulation of the financial sector, the improvement of government efficiency, and the improvement of human capital formation. The accent was also put on good governance as a necessary adjuvant to development, especially in 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.

A major difficulty with this 'new' approach to development policy is that there is no real theory behind this extended set of principles – to such an extent that Rodrik, commenting upon a volume reviewing the evolution of the economic thought of the World Bank over the 1990s, entitled his review with the question: 'Goodbye Washington Consensus, Hello Washington Confusion?'. In effect, the main difficulty of extending the former orthodox development paradigm to include institutions is that there is limited knowledge on the way institutions can be reformed. It is one thing to adopt rigorous fiscal and monetary policies, and to observe that badly governed countries tend to perform less well than others, but it is quite another thing to change institutions, i.e. to regulate private monopolies, to change the law on land rights, or to improve governance and fight corruption. The latter policies will most likely be opposed by part of the political or economic elite, so that their implementation – or lack of it – will depend on the structure of political and economic power. Identifying development obstacles in a country necessarily touches upon economic and institutional challenges, but addressing the latter requires dealing with a country’s political economy.

In their best-selling book *Why Nations Fail*, Acemogulu and Robinson (2012)[1] masterfully showed the role of institutions in several historical and contemporaneous developments, or experiences of development failure. They stressed, in particular, the key role of inclusive institutions as compared with predatory ones, and most importantly the role of politics in changing institutions and triggering development or, on the contrary, retarding it. If there is absolutely no doubt that institutions matter for development, the real issue is to know how they matter, how they should be reformed, and how such reforms could be implemented.

[1] Acemoglu, D., and Robinson, J. (2012) *Why Nations Fail: The Origins of Power, Prosperity, and Poverty* (Pbk. ed.), Crown Business, New York.

Despite intensive efforts over the last two decades or so, researchers have not gone very far in resolving these questions.

1.3 Searching for evidence on the quality of institutions and development

Three approaches have been developed to identify the institutional factors hindering development, or ways of remedying specific factors. All of them have their drawbacks, however.

The first approach is historical case studies. Scholars have carried out in-depth studies of the history of successful, and unsuccessful, development processes, to identify the factors responsible for success or failure. The Glorious Revolution in Britain, the redistribution of land in Korea after the Japanese departure, the success of Maghribi traders in the 11th-century Mediterranean basin, or the violent fight for the appropriation of natural resource rents in several post-independence African states are examples of the establishment of institutions that led in some cases to vigorous development headed by developmental states of diverse natures, or to underdevelopment under essentially predatory states. These studies are all of the utmost interest as they show the way in which institutions are transformed, often under the pressure of economic circumstances, and how this sometimes leads to fast development while at other times it prevents development from happening. The problem is that these experiences are rarely transferable in time or in space, and they are not necessarily very relevant for developing countries today.

The second approach is the contemporaneous era cross-country analysis. This relies on indicators that describe the strength of a particular set of institutions in a country, e.g. property rights, legal regimes, the strength and nature of controls on the executive, extent of democracy, corruption etc., and that show whether there is a correlation with growth or other development indicators. These indicators are generally put together by asking experts in various areas to evaluate, on a comparative basis, countries on which they have specialised knowledge. Correlations between these various indicators and various economic development indicators, primarily GDP growth rates in the first instance, are then established.

Results, which do not necessarily show the direction of causality, are sometimes significant. But the use that can be made of them is problematic. They essentially refer to an abstract 'average country' and may be of little use for a specific country. Most importantly, they say nothing about causality and still less about the policy instruments that could improve particular institutions. Within such a macro approach, corruption is generally found to be bad for development, but in what direction does the causality go? Is it the case in all countries and all circumstances? What about the cases where corruption 'greases the wheels' and reintroduces economic efficiency in the presence of too stringent administrative constraints? Cross-country analysis is therefore a nice first approach but it has a long way to go to be of direct relevance for policy makers at the country level.

Institutional weaknesses are also sometimes readily observable, as is sometimes the case in the delivery of public services in education or health. For instance, the absenteeism of teachers in public schools reveals a breach of contract between civil servants and their

employers, as well as a monitoring failure by supervisors. If there is no identification problem in that case, there is an issue in remedying this state of affairs. Numerous experiments, on the role of institution for economic development, have taken place in various community settings over the last two decades or so, which have been rigorously evaluated by randomised control trial (RCT) techniques. There is certainly something to be learned from a that fast expanding literature, even though the transfer of effective policy measures from one social context to another is not necessarily automatic. Moreover, this kind of approach to resolving institutional weaknesses refers to relatively simple cases. Experimentation and the use of RCT techniques may be much less easy in other situations.

It is these limitations of the standard analysis of the relationship between institutional weaknesses and development that motivated the EDI research programme, the aim of which is precisely to provide better methods and tools for dealing with all kinds of institutional obstacles to development and, in the first place, to identify them. Within the EDI research programme, this identification is the main objective of the 'institutional diagnostic' research activity (Research Area 2 (RA2)).

1.4 Institutional diagnostic as a new approach to institutions and development

The 'institutional diagnostic' research activity aims to develop a framework that would permit the identification of major institutional obstacles to development in a specific country at a specific point in its development process, as well as possible lines of reform and the political economy issues associated with them. This is a country-centred approach that differs from the historical case studies mentioned above in the sense that the focus is not on a particular event or episode in a country but on the overall functioning of its economy. It is not a straight application of the econometric approach because the usual governance indicators used in cross- country analysis appear much too rough when dealing with a real economy.

Institutional diagnostics bears an obvious resemblance to the 'growth diagnostics' approach developed by Hausmann, Rodrik, and Velasco to identify the binding economic constraints to growth. The resemblance is only semantic, however. Practically speaking, the growth diagnostics approach relies on a model of growth that is based on the accumulation of capital and its determinants among entrepreneurs, on the availability of infrastructure, on financial facilities, on the control of risk through appropriate insurance mechanisms, and on the development of human capital. Constraints in one of these dimensions should translate into a relative shadow price paid for that resource or that facility. No such implicit simple model is available in the case of institutions and there is no shadow price that is easily observable for the availability of a fair judiciary, an honest civil servant, or an effective regulatory agency. Another, more heuristic approach had to be developed.

RA2 decided in a first stage not to choose diagnostic tools *a priori* and then to test their accuracy by applying them to various countries, but rather to proceed to in-depth studies of the relationship between the state of a large range of institutions and the nature of the development of a limited number of countries, and then to see whether these in-depth studies suggest common analytical tools to more systematically identify possible institutional obstacles to development. It was a requirement of the organisation funding EDI, the UK Department for International Development, to work on low- income and lower middle-income

countries. The first country selected for such a deep-dive study was Tanzania; the study of that country was released in September 2018. The second country selected, which is the focus of this volume, is Benin. The third and the fourth country studies are ongoing in Bangladesh and Mozambique, respectively.

The main general definition of institutions within the EDI project derives from that of North (1990)[2]: 'Institutions (are defined) as rules, procedures or other human devices that constrain individual behaviour, either explicitly or implicitly, with a view to making individual expectations about others' behaviour converge and allowing individual actions to become coordinated'. It is that definition that is used in the institutional diagnostic research activity, even though it is very much restricted to economic and political-economic relations and frequently involves rules emanating from the public authority.

Equipped with this definition, the procedure for establishing the in-depth review of possible obstacles to development in a given country comprises two steps. The first one is 'mechanical'. It consists of asking various types of decision makers, top policymakers, and experts about their views on institutional obstacles in their country. This can be done by conducting a questionnaire survey or simply by carrying out qualitative interviews. The literature also has to be consulted and a complete survey of the economic and development performance and constraints faced by the country has to be established to see whether the most obvious 'binding economic constraints' are caused by clearly identified institutional factors. From such a direct and unbiased approach the goal is to select several thematic areas where critical institutional factors seem to be predominant. Some of these areas are obvious. For instance, various aspects of the functioning of the state have to be scrutinised, the same being true of the relationship between economic and political power or the nature of the political leadership. Other areas will be country-dependent.

The second step consists of a thorough analysis of these critical areas in order to understand what it is that does not function on the institutional side, why, how things could be fixed, and what would be at stake in such reforms. Are the observed institutional weaknesses due to a lack of skills among civil servants, the fact that they shirk or are corrupt, that the law or administrative rules are too complicated and possibly inconsistent, or that the administration is badly organised? Why is it that reforms that seem adequate to remedy these weaknesses have not been undertaken? Who would be the gainers and the losers of such reforms, and therefore who would promote and who oppose them?

Based on these detailed analyses of key thematic areas, the challenge is then to synthesise what has been learned into some basic institutional weaknesses common to various areas, their negative consequences for development and, most importantly, their causes, proximate or more distant, and the potential for remedies and reforms. This is the essence of the diagnostic that is delivered at the end of each case study, together with a list of all the potential reforms that have been suggested in the course of the thematic studies and the synthesis exercise as a possible remedy to a variety of institutional weaknesses.

This whole approach should should deliver a diagnostic, not a reform agenda. Because there are gainers and losers in most reforms, political economy factors, as well as political

[2] North, D. (1990) *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge.

and economic circumstances, will determine whether they can be undertaken or not. From the point of view of the diagnostic, the important contribution is to put squarely on the table the nature of the weaknesses, possible reforms, and what is at stake in them. In other words, it is to make sure that all decisive actors are aware of all that reforms would entail, collective gains, but also, occasionally, losses for various categories of agents.

1.5 The Benin study

Why has Benin been chosen, after Tanzania, as the second in-depth case study of the relationship between the quality of institutions and development? The first reason is the need to diversify the features of the economies to be studied. Diversity here is first geographical and historical. Tanzania is an East African country with a British colonial past. Benin is a West African country with a French colonial history. But diversity is also about economic endowments. Tanzania is a rather diversified economy, with both mineral and agricultural exports. Benin is officially a mono-agricultural export country, with cotton as it main resource. On top of this, Benin exploits its lengthy common border with Nigeria for profitable illegal cross-border trade, thus partly sharing the oil rent of its neighbour. Benin is thus much closer to the many resource rich sub-Saharan countries than Tanzania. Another key difference lies in the size of the two countries. Tanzania's population is approximately five times larger than that of Benin, which is more representative of the many 'small' sub-Saharan countries. It is well-known that the development context of a country greatly depends on its size. Finally, it turns out that both countries were roughly at the same level of development, when measured by GDP per capita, in the early 1990s. Almost 30 years later, Benin lags behind Tanzania by some 25 percentage points in GDP per capita terms. Both countries thus also differ in their long-run growth performance.

But there are also some features that are common to Benin and Tanzania, which as a matter of fact they share with several sub-Saharan African countries. They both went through a socialist episode after, or not long after, independence. These were the Ujamaa era launched by Nyerere in Tanzania and the Marxist-Leninist regime imposed under Kérékou's dictatorship in Benin. In both cases, the liberalisation and the transition to a market economy took place in the early 1990s, very much under the pressure of donors. Yet the trajectories have been quite different since then. If both countries behave according to democratic rules and are often praised for this, their political landscape is different and the relationship between politics and the economy takes very different forms today.

The comparability or diversity of the two countries will matter at the final stage of the EDI institutional diagnostic project, when lessons from the various case studies will be put together. The present volume focuses exclusively on Benin and essentially tries to identify the institutional weaknesses, together with the political economy factors, that have prevented the country's GDP per capita from growing faster than 1.2% on average over the last 25 years, that have prevented a fall in its poverty rate, and that have prevented a reduction in its dependency on foreign official resources – and all of this behind a peaceful democratic façade that has been praised by donors. The current version of this volume will be updated based on the comments we will receive during the official dissemination workshop in Benin planned later in 2019.

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