Spotlight 2: Institutions and governance

Institutions matter for structural and rural transformations as they matter for economic growth, poverty reduction, political stability and social inclusion. Understood as the formal and informal "rules of the game," institutions shape the behaviour of political, social and economic actors (including civil society and farmers' organizations), their interactions, and the formal or informal arenas in which those interactions take place (Scartascini et al. 2010). They not only foster transformation, but also make it more inclusive by ensuring that all people, particularly those left behind, have access to rights, services and resources.

The institutions that influence the economic social, and political life of people do not appear in a vacuum: they are embedded in a context and are influenced by historical events and culture. As seen in the Introduction, initial conditions shape, and are shaped by, institutions. Natural endowments, human capital, traditional identities and historical legacies affect the range and nature of choices open to governments and other key actors. Some initial conditions do not change, like geographical attributes, but others evolve. In the last few decades, a raft of institutional arrangements in developing countries has helped hugely to lift human capital in education and health by improving access to primary school and to vaccines, antibiotics and micronutrient supplementation, especially for the poor.

Asking which institutions matter the most to fostering sustainable and inclusive rural transformations would be misleading. Institutions matter and are a cause and an effect of economic growth (Rodrik et al. 2002; Rodrik 2004). There is no unique set of formal and informal rules (or dynamics) that foster economic growth and social inclusion. But even if we establish a causal link between institutions, on the one hand, and sustainable and inclusive transformations, on the other, the relationship does not specify the rules, laws or institutional designs responsible for the outcomes (Rodrik 2004).

For instance, Brazil, Cameroon, Malawi, Turkey and Viet Nam are examples of countries that have experienced fast structural or rural transformation (or both) and significant poverty reduction in the last few decades. They have done so with different combinations of political and economic institutions, policies, enforcement mechanisms and levels of investment. Hausmann et al. (2004) identified more than 80 cases of growth acceleration, of which the vast majority were not fully related to the conventional major economic reforms associated with economic liberalization. They concluded that it is not an extensive set of institutional reforms that initiate the growth of countries, but identification and unleashing of the "binding constraints" on economic growth that prevented them from growing.

The decentralization process in Asia is another example of a common institutional arrangement that led to different outcomes in different countries. As presented in chapter 2, China, Viet Nam, the Philippines and India have adopted fiscal and administrative decentralization since the 1990s. In China, the provincial and county government responsibility system attracted business and investment, triggering local economic growth and remarkable structural change (Qian and Weingast 1997; Jin et al. 2005). Viet Nam is also a reasonably decentralized country (Duc 2005). However, subnational governments do not always have discretion to decide how to allocate the funds that they receive from central government (De Wit 2007). That is why some analysts prefer to use the term "deconcentration," understanding subnational governments as "only spending units" (Duc 2005). The Philippines has followed much larger administrative decentralization but, because it was not accompanied by a proportional fiscal change, local governments are fiscally constrained. India amended its Constitution in 1992 to support rural and urban decentralization, but again, limited fiscal and administrative decentralization generated challenges and constraints preventing the country from accomplishing its goals at local level.

Institutions, then, are not good or bad, in themselves. Acemoglu and Robinson (2012) have made a distinction among them, depending on how they distribute political power and economic benefits among social groups. They define "inclusive institutions" as those which lead to "a more equal distribution of income, empowering a broad segment of society and making the political playing field even more level." "Extractive" ones are those that allocate political power narrowly and reinforce extractive economic institutions to hold power. In line with other studies, the authors support the notion that inclusive political and economic institutions lead to inclusive economic growth that benefits society as a whole, also contributing to poverty and inequality reduction. This argument is consistent with studies that link high levels of inequality with high levels of concentration of political and economic power (World Bank 2006). A good case can be made about relationships that tie levels and trends in inequality, the inclusiveness of political and economic institutions, and structural and rural transformation processes that lift large numbers of poor rural people out of their condition (chapter 1).

Even when the outcome (for economic growth and social inclusion) of specific political and economic institutions depends heavily on context, certain principles remain crucial. Rodrik (2002) compared China and Russia to demonstrate that "most of first order economic principles come institution-free. Economic ideas such as incentives, competition, sound money, fiscal sustainability, property rights do not map directly into institutional forms." What is important is to ensure the rule of law and secure property rights so that investors consider their investments protected. It is then up to each country to decide on its own institutional mechanism to enforce that protection, through common law, civil law or even Chinese-type socialism.

Democracy is not sufficient to achieve fast economic growth (Przeworksi 1999). However, participatory regimes favour inclusion and a more equitable distribution of political, economic and social benefits. The analysis in chapter 1 confirms the strong and statistically significant relationship between some quality of governance indicators and rural poverty reduction. When democracy is not a condition for economic growth, basic political rights such as freedom of speech or freedom of association favour more inclusive societies.

Institutions for, and of, poor people

Two types of institution can be distinguished as of immediate concern to poor people: providers of goods and services, and enabling agencies (IFAD 2009). Enabling agencies are those which establish the policy and legal frameworks that "enable" the conditions for inclusive transformations to happen and, therefore, the role poor people will play in them. They may support expansion of financial services and access to them by poor people, access and management of natural resources by local communities, and expansion of markets and value chains by smallholders.

For rural transformation to be inclusive, institutions also need to be so, for which a key condition is that civil society itself must be inclusive (World Bank 2000). Thus organizations – understood as actors or *players* (North 1991) – are key elements of inclusive institutions. Together, institutions and social organizations are key vehicles for poor, rural people to overcome their isolation from centres of power and influence (IFAD 2013). By supporting collective action and empowerment of rural people and their organizations, public institutions can enhance and expand the inclusiveness of rural transformations. In other words, institutions and social organizations, including farmers' organizations, allow poor rural people access to productive resources, political and civil rights or public services, and so help to increase opportunities for poor and disadvantaged people to participate in political, economic and social processes.

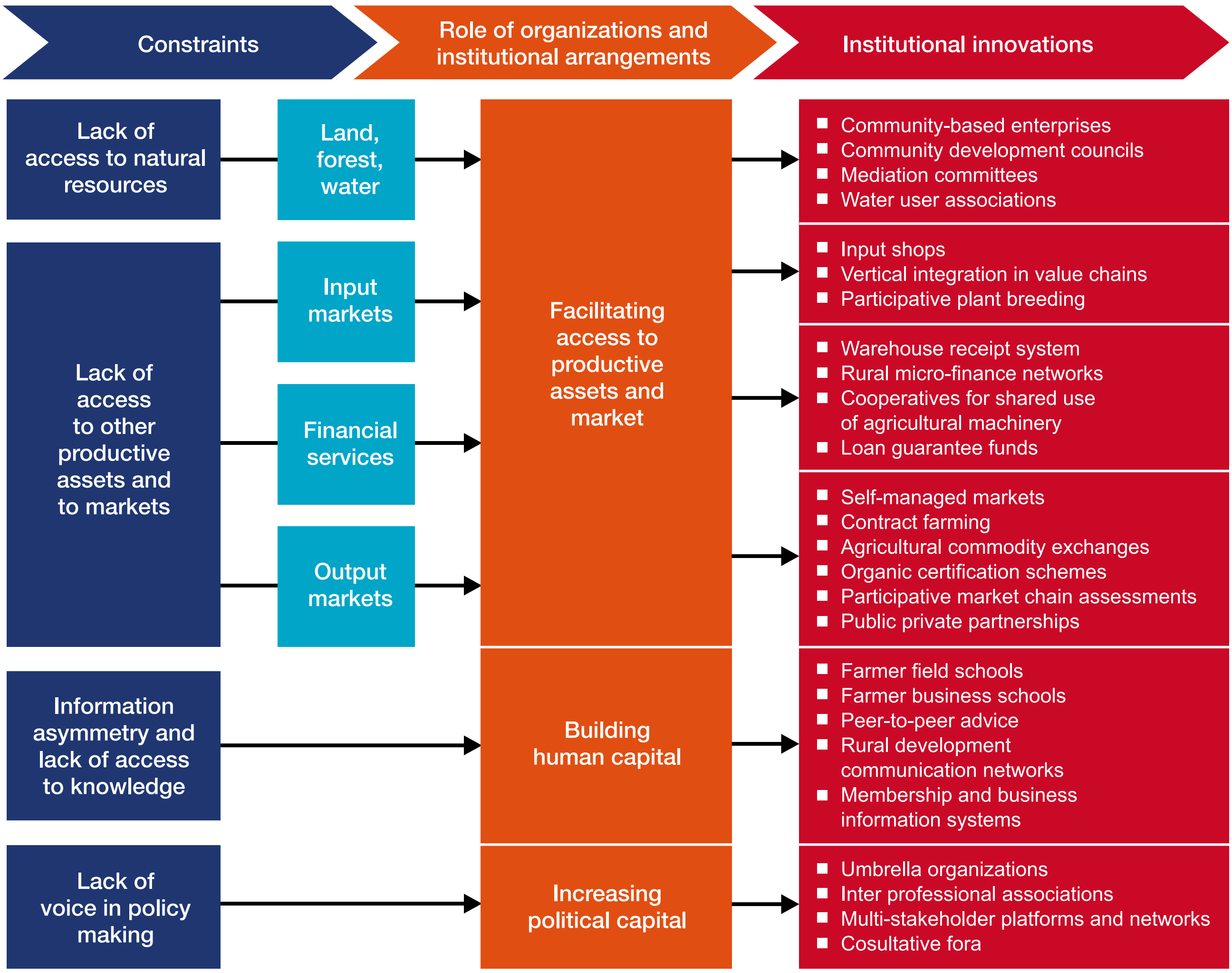
Global interdependence, decentralization and the rapid development of civil society organizations all present opportunities to increase the participation of poor people in society, provided they are organized to influence the institutions, policies and decisions that affect their lives and determine the economic benefits of their activities (IFAD 2013). In the last few decades, small-producer organizations have developed good practices that have allowed them to overcome the key constraints they faced to fully engage in rural transformation and seize the economic opportunities that derived from them. IFAD and the Food and Agriculture Organization of the United Nations (FAO) have identified these good practices and have shown how, under certain conditions, rural organizations enable small producers to access and manage natural resources, to access markets for goods and services, to access information and knowledge, and to participate in policymaking (FAO 2012; see figure S2.1).

An important element to promote inclusive institutions is to have strong vertical and horizontal institutional and organizational linkages. The best method is to focus on the functional aspects of institutions and organizations, specifically increasing information flow and exchange, sharing financial resources, and ensuring better decision-making, and technical and managerial skills (FAO 2012).

Institutions for sustainable and inclusive transformations

Institutions are important to establish common rules and create incentives. They can open opportunities for poor people and their organizations to better seize economic, political

FIGURE S2.1 **Small producers' constraints and institutional innovations**



Source: FAO (2012).

and social opportunities, but they could also increase their challenges. Similar institutional arrangements could lead to different outcomes and vice versa. Therefore, it is not possible to determine which institutions better foster economic growth and poverty reduction.

Even when sustainable and inclusive transformations do not necessarily require macro institutional reforms, they need common political and economic rules – to ease the binding constraints on the rural economy, to ensure property rights (thus attracting more investment in agriculture and the rural sector), and to promote the participation of rural people and their organizations – so they, too, are active actors in transformation.

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