GETTING INSTITUTIONS RIGHT

DANI RODRIK

Institutional quality holds the key to prevailling patterns of prosperity around the world. High quality institutions are perhaps as much a result of economic prosperity as they are the cause.

However important the reverse arrow of causality may be, a growing body of empirical research has shown that institutions exert a very strong determining effect on aggregate incomes. ①

Institutions are causal means that a country is able to revise the rule of the game (most of the time to secure the property rights).

In the policy field, the new focus on institutions has lead to an overly ambitious agenda of "governance" reforms (aimed at reducing corruption, improving the regulatory appartus ...)

Simple policy changes are ineffective, the argument now goes, unless they are grounded strongly in institutional reforms.

The perspective of the author is that the empirical litterature on institutions and growth has pointed us in the right direction but that much more needs to be done before it can be operationalized in any meaningful ways.

An instrument does not a theory make

The difficulty with the empirical analysis of institutional development has been that institutional quality is as endogenous to income levels as anything can possibly be.

AJR proposed using colonial history to achieve econometric identification.

According to them, the roots of underdevelopment lie in contrasting encounters with colonizers but how can we explain the fact that countries that have never been colonized by Europeans are among both the poorest and richest of today's economies?

According to Rodrik, the correct interpretation of AJR is that colonial experience simply provides a convenient "instrumental variable" without in itself holding much explanatory power for patterns of global inequality.

Geography-based instrumental variables do not imply geography-based explanations.

Since few things other than geography are exogenous in economics, most instruments for institutional quality are likely to have a significant geographical component (ressource endowments, latitude, and so on).

Jeffrey Sachs: geography exerts a strong independent effect through its impact on the public health environment and on transport costs.

Jared Diamond: shown how apparently innocuous accidents of geography (ex: alignment of continents) can have long-lasting effects on patterns of technological development and diffusion.

Exemple of Berlin: Geography (longitude), ~~is the case~~ in interaction with history, simply provides a convenient source of exogenous variation to identify the role played by institutions.

RST: they tried a large number of geography variables and found their direct impact on income to be either insignificant or non-robust ⇒ institutions rule

Sachs: climate, malaria ecology, latitude ~~[illegible]~~ have a role. ~~for~~

Hibbs et Olsson: East-West orientation have a impact

scholarly opinion remains divided on the significance of geography as a direct determinant of income level.

But the centrality of institutions does not preclude an important indirect role for geography

At the same time, there is wider agreement on the indirect role played by geography.

Engerman and Sokoloff: have linked the constrasting patterns of institutional development in North and South America to the differences in ressource endowments large-scale plantation agriculture is much more conductive, compared to smallholding, to the emergence of inequality and of autocratic institutions that repress non-elites.

Sala-i-Martin and Subramanian: provides systematic evidence that shows abundance of natural ressources and rents to be damaging to the quality of institutions.

RST: distance from equator is a significant (positive) contributor to institutional quality.

Sachs: Institutions don't rule => direct effects on geography on R/capita.

=> Even if geography and endowment do not exert an important independent impact they may have a significant indirect impact through institutions.

The challenge for the empirical litterature on institutions is to explore these patterns without falling into the trap of reductionism or of historical and geographical determinism.

Institutional quality, as it is typically measured, remains a nebulous concept.

Kaufmann et al capture investors' perceptions. This in turn raises 2 difficulties:

- Perceptions are likely to be shaped not just by the actual operation of the institutional environment, but also by many other aspects of the economic environment. But no pb if the researcher has a valid strategic in econometric identification.

- More seriously, the result do not tell us what specific rules, legislation or institutional design is actually responsible for the institutional outcome being measured => exemple of china and Russia.