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Institutions as Meso-factors of Development: A Human Development Perspective

By Nadia von Jacobi*

Abstract

This study borrows from Amartya Sen's capability approach in order to enrich the analytical tools with which to study the institutions and development link. By expanding on the theoretical notion of *contextual conversion factors*, I elaborate a conceptual framework with which it is possible to identify the *channels* through which institutions can affect development. I follow the human development paradigm for the conceptualization of development and visualize institutions as features that characterize the context within which the life of individuals is embedded. In the attempt to refrain from a one-size-fits-all logic, I concentrate on the study of institutions at a level lying in between the country (macro) and the individual (micro). Therefore, I refer to the *meso* level for the analysis of institutions, which implies that the framework is adequate for studying institutions at a subnational level. This study attempts to contribute to the understanding of the institutions-development link through (i) the analytical framework proposed, (ii) an extension to commonly referred-to definitions of institutions and (iii) an accurate literature review that combines approaches of development economics and of institutional analysis. A *meso* approach to the study of institutions is thought to contribute to a better understanding of complementarities between local state capacity and macro-level policies and to the role that institutions can play in decreasing *within-country* poverty and inequality.

JEL Codes: O15, O17

1. Introduction

The research interest that I pursue in this study centres around two key issues: (i) the role that institutions play in development and (ii) the need to avoid a one-size-fits-all logic when it comes to understanding the causes and dynamics of poverty and inequality. Institutions are a fascinating object of study within development economics, partially because they seem to represent a cumulative collective statement, a bit like culture itself, and partially because we

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still notice profound differences in institutional design, scope and development throughout the world. Institutions are thought to make huge differences for societies, but – at the same time – are little understood in their emergence, evolution and dynamism.

I depart from the assumption that institutions are part of the context in which the life of individuals unfolds, and that context plays a role in constraining or facilitating life achievements of individuals. The focal point of my conceptual framework rests in the capability approach literature (among others Sen 2009; Sen 1999; Sen 1987; Sen 1985; Nussbaum 1987; Nussbaum 1998; Nussbaum 2011), which provides (a) the evaluative framework for my study and (b) the notion of *contextual conversion factors*, from which I depart for the framing of *an institutional effect* on human development. This implies identifying the *channels* through which context can make a difference for the people that inhabit it.

My starting point is the notion of *conversion factors*. These are elements that allow an individual to convert resources at his or her disposal (e.g. money) into desirable outcomes (e.g. human development achievements). The theory distinguishes between conversion rates – different abilities or efficiencies with which the resources can be converted – and conversion factors: elements that *affect* the conversion rate. Apart from the ability to convert resources, clearly the availability of resources (*endowments*) also remains relevant for final achievements. The framework within which I propose to analyze institutions is one in which they can play a role for both:

- (i) the provision of better starting positions or the average availability of opportunities and resources (e.g. through a dynamic labour market) and
- (ii) the conversion of resources into achievements, (e.g. due to prevalent social norms).

These are the main channels that I identify for the contribution of institutions to human development. In the analytical framework, I focus on *contextual conversion factors* and extend the theory by integrating notions of institutional analysis.

I visualize the context as a spatially delimited mixture of institutions and structural characteristics which are highly interconnected and intertwined (von Jacobi 2018). Within this net of interlinkages, single contextual characteristics play a role for individual achievements by providing *reasons* and *resources* to the individual who is *embedded* within the context. Through this mechanism, institutions – as other structural characteristics – can play a relevant role for human development by emphasizing or buffering individual factors of vulnerability (identified at the micro level) or by *mediating* macro-policy impulses in differentiated ways (von Jacobi 2014b).

As I am interested in how context affects the life of individuals, I have decided to employ a disaggregated (*micro*) measure of development. At the individual level, I could have chosen to evaluate poverty and inequality in terms of monetary measures or non-monetary measures. In line with the substantial research proposed by Amartya Sen, I believe that monetary measures are better interpreted as *means* than *ends* of development. Therefore, I have followed the human development paradigm. In this study, higher development implies that individuals have higher *achievements* in dimensions that contribute to life quality (for example health, education, employment or housing).

In order to separate the context and its features from individuals on one side, and from policy inputs on the other side, I refer to the key notion of *levels*, which allows us to view policy-inputs, contextual differences, and life-conditions of individuals as phenomena that exist within a nested (or hierarchical) structure. As I understand context and its characteristics here at a level that “makes a difference“ within the same country, I have conceived it to be lying at an independent, intermediate level of analysis (*meso*), which lies between *macro* (policy-input) and *micro* (individual) phenomena. Throughout the study, *meso* therefore, refers to the level of analysis at which I conceive the context and the features – institutional and structural – that characterize it.¹

As I interpret institutions as relevant but not as the only feature of “the context,” I have searched for a *common ground* on which I could analyze the role of institutions in similar ways to that of other structural factors. I have found this common ground in the notions of *structures* and *mechanisms* (Martins 2006), whereby institutions can be interpreted as “socially defined structures” (von Jacobi 2014b, 38). In the attempt to reframe the role of institutions for development, in particular for human development, I have elaborated a functional definition of institutions that embodies (i) the mechanisms through which the institution can act as a contextual conversion factor, and (ii) a pluralistic and context-specific approach. Apart from contributing to the existing literature of institutions and development, the definition allows for the smooth integration of institutions into the theoretical framework of the capability approach.

Elsewhere, I have elaborated an empirical application of the theoretical concept presented which allows to investigate (i) the effect of specific institutions on life quality (ii) the role of specific institutions for policy transmission and (iii) how institutions themselves can improve starting positions and improved conversion rates (von Jacobi 2014a; von Jacobi 2014b; von Jacobi 2014c).

This study is articulated in the following way: in section 2, I introduce the theoretical framework of the capability approach. Section 3 focuses on the ma-

¹ By focusing on the effect of institutions on individual human development achievements, I neglect the dynamics according to which individuals modify their context and institutions. See section 2 for clarifications.

major elements of Amartya Sen's framework that can contribute to an innovative interpretation of institutions. This effort is taken further by proposing a definition of institution that is inspired by the human development paradigm. I outline commonalities and differences between the chosen definition and other approaches, mainly different strands of new institutionalism and of development economics. In section 4, I have set out on the difficult quest to combine the relevant literature of development economics and of institutional analysis. Although perceived as separate, both strands of literature share the notion that institutions matter for societies. The literature section tries to identify the major approaches to studying institutions and development. In section 5, I outline some drawbacks of current approaches and how a *meso* view can partially overcome these limits. I try to synthesize the innovative contribution to conceptual and empirical treatment of the institutions and development link that a meso perspective could give. Section 6 concludes briefly.

2. Background Notions: Getting Inspired by the Capability Approach

The following section introduces the capability approach, representing a theoretical framework on which I build. I outline conceptual tools and terms that can also be of interest for studying the role of institutions for human development.

2.1 Qualifying Development: Beyond the Money-Metric

Development is an object of profound interest to many different social sciences. Development economics by definition requires (though it does not always receive) an interdisciplinary approach. Instead it often maintains a predominantly economic approach to the measurement of development in terms of GDP per capita (at the macro-level) or income (micro-level). Within the discipline, however, recognition of the need to overcome a mere money-metric has steadily been growing. Ever since the adoption of the Human Development Index in United Nations Development Programme's annual reports, non-monetary measures of development have increasingly been accepted as equivalent, if not superior, among at least some scholars of the discipline.²

² The debate about transparency and interpretability of non monetary measures, especially of composite indexes remains vivid, see for example: Ravallion (2012); Lustig (2011). For an introduction to the academic literature dealing with the holistic concepts of human well-being and their measurement including the human development and capability approach see for example Alkire (2002); Burchardt (2008); Fukuda-Parr (2003). For the happiness literature Bruni and Porta (2005); Di Tella and MacCulloch (2006); Easterlin (2001); Chiappero and von Jacobi (2012).

Grammar of the capability approach: The capability approach, as first developed by Amartya Sen identifies well-being with the expansion of *opportunities to choose a way of life* the individual “has reason to value.”³ Development is therefore not what one *does*, or *has*, or *is* but the improvement in what one *can choose to do*, *to be* or *to have*. What one ultimately chooses is called a *functioning* or achievement.

Functionings are “the various things a person may value doing or being” (Sen 1999a), which can be specific activities and states of being, such as being healthy, having a secure job, being educated or moving about freely.

Capability is a derived notion (Kuklys 2005, 10) as it refers to the pool of potential functionings an individual has access to. Capabilities thereby relate to the notion of substantive freedoms: they refer to the range of life choices an individual can opt from when ultimately choosing the life she/he has reason to value.

Functionings and capabilities are therefore the final outcome of the well-being process, which in general aims at expanding substantive freedoms. Freedom, not growth, is the ultimate goal of development in Sen’s view. While freedom (and freedom of choice) itself is attached to a precise set of values typically associated with the European Enlightenment of the 17th century, it also embeds a profound notion of pluralism.⁴

Factors of development: The Capability Approach does not only provide a definition for the outcome of the development process. It also provides a framework for possible explanatory factors of greater or reduced development performance. First, there might be resources that are at the disposal of the individual: *endowments*, which are goods and resources the individual is initially endowed with.⁵

Secondly, the framework refers to the ability to transform these resources into the desired outcome. In transforming endowments (inputs) into achievements (outputs), a *conversion function* (technology) is used by the individual,

$$(1) \quad Q_i(X_i) = \{b_i \mid b_i = f_i(c(x_i) \mid z_i, z_s, z_e)\}$$

³ For an introduction and better understanding of the capability approach, see, among others, Sen (2009); Sen (1999a); Sen (1987); Sen (1985); Nussbaum (1987); Nussbaum (1998); Nussbaum (2011); Comim, Tsutsumi, and Varea (2007); Robeyns (2003); Kuklys (2005).

⁴ The fact that Amartya Sen’s capability approach has had such a wide-reaching success in different areas of the world and found applications in diverse social sciences demonstrates that its focus on a flexible conceptualization of substantive freedom can be useful for framing and evaluating diverse circumstances of socio-economic development.

⁵ Sen refers to *commodities* in earlier work, e.g. Sen (1985).

where $Q_i(X_i)$ is the capability set, defined over the potential functionings b_i that result from the endowments x_i and the conversion function f_i which transforms the endowments into potential functionings and is constrained by conversion factors such as z_i , z_s , z_e that stand for, respectively, individual, social and environmental factors. All authors treating the conversion function specify that the model should not imply a unique mechanism of conversion for all individuals, but that the individual conversion function $f_i \in F$, where F is the set of all possible conversion functions. The capabilities literature agrees that conversion factors can be conceived at different levels; they have been contemplated in particular so far at the individual, social and environmental level (Kuklys 2005; Chiappero-Martinetti and Salardi 2008; Binder and Broekel 2011). At the individual level, conversion factors are typically identified with “personal heterogeneities” (Chiappero-Martinetti and Salardi 2008, 6). At the social and environmental level, rather vague concepts referring to *social factors* (Sen 1985), environmental diversities, economic settings and social norms (Sen 1992; Sen 1999b) have so far been included into the conceptual framework as potential conversion factors. Within the *conversion function*, a number of characteristics (*conversion factors*) combine to determine the degree of “efficiency” with which resources are converted into achievements (*conversion rates*). The *conversion factors* “act as technical constraints and determine the conversion rate” (Chiappero-Martinetti and Salardi 2008, 7) of the single individual.

The common understanding behind this framework is that it is not sufficient to just consider the resources an individual is endowed with. It is also necessary to consider the extent to which the individual can make *use* of these endowments, to lead to personal satisfaction and to human development achievements. The framework is synthesized in figure 1 in which we see how achieved functionings can be interpreted as the outcome of a complex interplay of endowments identified at multiple levels and of conversion factors (individual and contextual) which affect the conversion rate with which an individual transforms endowments into achievements.

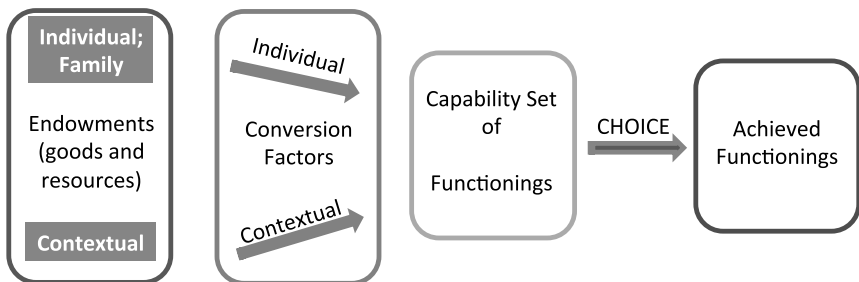


Figure 1: The Capability Framework

The capability set can be interpreted as the “individual space of potential functionings” (Sen 1985, 11; Chiappero-Martinetti and Salardi 2008, 5). Capabilities themselves are not observable as they include a counterfactual residing in those achievements that the individual did not choose: what we can observe are functionings – that is, the ultimate outcome of the conversion of resources, or the ultimate choice made among *possible* lives. The focus of this study is to highlight the influence that contextual factors, such as institutions, can have on the levels (poverty or wealth) and the *variance* (inequality) of human development achievements.

2.2 A Focus: Conversion Factors

With its analogy to *efficiency*, the study of conversion enables the researcher to detect whether an individual or a subgroup needs relatively more or less endowments to achieve some level of functioning.

Low scores in conversion efficiency can show subgroups of individuals that are *vulnerable* in the sense that they need *more* resources to achieve *similar* functionings levels as [compared to] less vulnerable individuals (cited from Binder and Broekel 2011, 262, emphasis added).

Conversion factors can therefore also be interpreted as factors of *marginalization* as they tend to locate individuals and groups into a position where they enjoy less achievements, even when the resources are distributed in an equal way. If we are interested in using the conversion factor framework for the identification of relatively more vulnerable groups and individuals, then an important assumption is necessary: that conversion factors are characteristics that cannot be actively and consciously modified by the single individual.

With reference to individual characteristics there are good examples such as sex and age which cannot actively be modified, at least not in the short run. The same holds for all factors defined at the contextual level: in the short run, the individual cannot directly modify the context in which she/he lives. Clearly this argument changes in the long run, when agency, effort or the simple choice of migration can change a number of contextual characteristics. In the short term, however, the features of the context can be treated as exogenous.

Let us look at a concrete example. A young girl whose parents have just migrated to another country, may wish to be reading stories. She may or may not have many books at home. If she does not, she may be in search of a library. If she finds appropriate books in a library, then we may consider her to have achieved what she was longing for. In this example, the girl’s possession of own books resembles private *endowments*. If these are lacking, the role of the surrounding context becomes more important: is there a library close to her? Does she have access to transportation means that can take her there? Does she have the permission of her parents to go? And if she reaches the

library: are there any books in a language she can understand? The example shows: there is a complex web of interdependent details that make up the ability of a young girl to convert resources (e.g. public money for libraries) into own achievements (actually reading, enjoying and learning from a book).

Summing up, a conversion factor might therefore be *any* characteristic of the individual, the society or the environment that might help in the transformation process and that cannot be changed in the short term. Institutions, which in this study are conceived to be contextual characteristics, can therefore be treated as contextual conversion factors. By applying the notion of conversion factors to institutional analysis, I intend to better explain *how* and through *which features* institutions can influence the *conversion rates* of individuals.

3. A Human Development Inspired Theory of Institutions

3.1 Institutions are Contextual Conversion Factors

In the previous section, I have outlined how conversion factors are understood to function in the literature. In what follows, I elaborate on contextual conversion factors by adopting the following assumptions:

- Conversion factors are explanatory factors for human development achievements
- They combine with individual characteristics to define a personal technology for the transformation of resources into achievements
- They are factors that, although detectable at different levels, are exogenous to the action of the individual, at least in the short run.

I expect the context to matter for human development in the way that its characteristics resemble “material and non material circumstances that shape people’s *opportunity* sets, and (...) circumstances that influence the *choices* that people make” (Robeyns 2005, 99, emphasis added).

The focal point of *how* the contextual impact works comes down to the mechanism through which the context provides “*reasons* and *resources* for the realization of the particular capability” (Smith and Seward 2009, 225, emphasis added). *Reasons* are the many ways in which the context can influence individual choice, for example through social norms, or average schooling, or local history. *Reasons* therefore play a role in the selection of a particular life over others. As mentioned, this process is rarely observable empirically. The way in which the context provides *resources*, on the other hand, has to do with the expansion of *opportunities*, for example through a dynamic labour market, or a high density of secondary schools. Therefore, institutions should be relevant for development when they affect individual choices and the availability of opportunities.

Structure versus Agency: Both ways in which context can have an effect relate to individual agency: on the one hand, context can amplify those spaces in which the individual can act, by providing more resources and increasing opportunities of action. On the other hand, context can restrain the agency of the individual by shaping her/his reasons, beliefs, emotionality, memory and desires (Bhaskar 1998; Sayer 2000; Archer cited in Longshore Smith and Seward 2009, 222).⁶ To clarify this double effect, I propose to identify any institution through the notions of *structure* and *mechanism* as suggested by Martins (2006, 6):

Structures are the underlying conditions of possibility that enable or facilitate the occurrence of a given phenomenon. (. . .) *Mechanisms* refer to the mode of operation of structures.

A range of differently-natured structures and mechanisms are at work in each context. These build the boundaries and the available spaces within which individual action can take place. How can this interpretation of institutions help us understand their impact on individual human development achievements?

Mechanisms and discriminatory characteristics: Let us accept that several structures and their mechanisms characterize the context in which an individual is located. While being external to the immediate action of the individual, these structures have an effect on individual achievements by shaping reasons and resources. This implies that some structures will improve starting positions and the conversion of resources into achievements, while some other structures may not. In our previous example, the availability of libraries and an articulated web of public transportation will improve starting positions of girls wishing to read stories. Permission of parents to read and to go to a library affect the conversion of such resources: without permission, such public and contextual *endowments* cannot be used. The availability of books in the specific language understood by the girl resembles another conversion factor: in this case, an institutional *vision* is necessary to supply public libraries with books in different languages.

Figure 2 outlines the analytical framework in which we can identify institutional settings that provide either better starting positions (greater contextual *endowments* as seen on the intercept) or higher conversion rates (the slope indicates the conversion of public expenditure per capita into human development). In figure 2, institutional setting 1 is preferable to institutional setting 2, because it tends to provide better starting positions for its citizens: ΔE indicates this. In our example, ΔE may stand for the difference in public supply of libraries and of transportation means connected to them. Note that in both insti-

⁶ The (social) structure-agency debate is wide ranging, from sociology to the capability literature itself, for a good introduction see for example: Cleaver (2007); Ballet, Dubois, and Mahieu (2007); Longshore Smith and Seward (2009).

tutional settings (1 and 2) the conversion of public expenditure into human development achievements is identical (equal slope). In institutional setting 3, citizens start from average human development levels that are equal to those in institutional setting 1: however, some feature of institutional setting 3 is responsible for higher conversion rates among its citizens. This implies that in institutional setting 3, higher development achievements can be obtained with the same amount of public expenditure per capita. In our example, we may imagine libraries in setting 3 to diversify their stock of children books in order to offer books in different languages to recently migrated children who still do not know the local language. Institutional setting 4 represents a case in which public expenditure is not being converted into higher human development: thus the expenditures might actually cause a deterioration of life quality among citizens. In our example, libraries may become places of xenophobic manifestations, such as posters, writings on walls or offensive talk. It is likely that parents may withdraw their permission to allow their children to go to libraries to protect their children from such offenses. In that case, public expenditure into libraries will not help reduce but instead contribute to widening the social cleavage between migrants and locals.

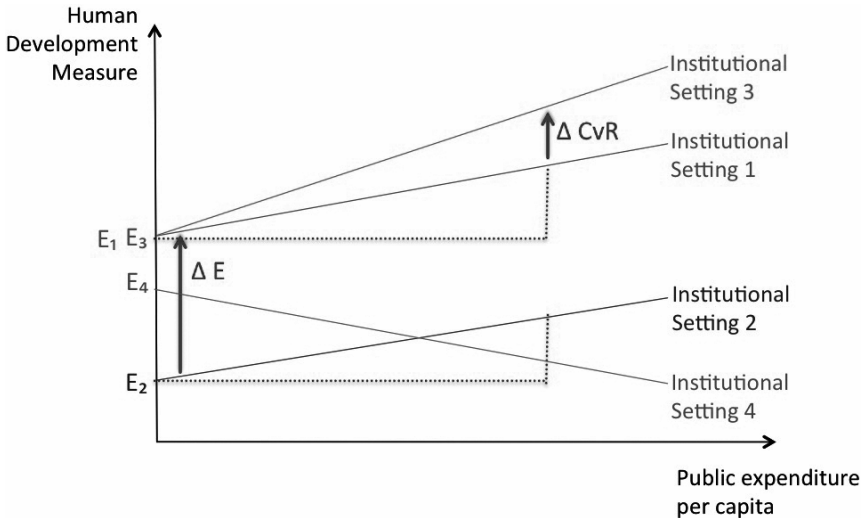


Figure 2: Analytical Framework for the Effect of Institutional Settings on Poverty

Thick arrows in figure 2 summarize the channels through which particular institutional settings can reduce poverty levels, either through an increase in contextual endowments or through an increase in conversion rates.

Apart from playing a role for poverty in terms of human development, institutional settings can also contribute to substantial inequalities, when their structure shape reasons and resources in *differentiating* ways. What is meant by *differentiating* is that the mechanism with which resources and reasons are provided is not homogeneous across different individuals. A particular *mechanism* within a structure can have features that *de facto* discriminate among individuals through specific individual characteristics – in our previous example, the language a young girls speaks. Through the mechanism, natural differences among individuals are amplified, reinforced and remapped into new dimensions of inequality. On the other hand, other natural differences might collapse within the mechanism and lead to a convergence in reasons and resources for the individuals. Seen from this point of view, institutions contribute to inequality and its dynamics in terms of convergence or divergence of different social groups.

Figure 3 exemplifies the implications of a particular institutional setting for inequality analysis. Social groups (1, 2, 3 and 4) are traced along individual characteristics which might be age, ethnicity or income class. In our example, these may be locals and migrants from different origin. The figure shows how a particular institutional setting can contribute to inequality by interacting with individual characteristics in differentiating ways. The institution in this case interacts with group 1 and group 2 in the same way (the conversion rates are identical). However, this implies that the structural gap (different starting posi-

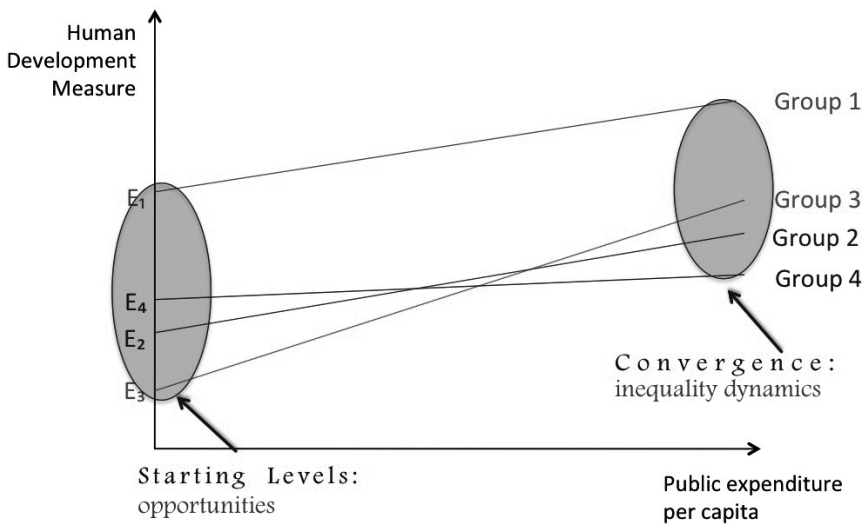


Figure 3: Analytical Framework for the Effect of a Given Institutional Setting on Inequality

tions) between the two groups is not being closed. Group 3, on the other hand, which starts from lower average levels of human development is being “favoured” by the institutional setting (willingly or unwillingly): what we can notice is that the conversion rate of this group is greater and therefore a *catching-up* is taking place. In our example, group 1 and group 2 may have access to children books in their respective language. Group 3 may either be benefiting from some specific help – like targeted educational support provided to children in libraries, or might have access to bilingual books which help the child acquire local language skills.

Here, where differences in conversion rates lead to the closure of structural gaps, the institutional setting is contributing to *convergence*, or a decrease in overall inequality.

Let us imagine a machine with a mechanism, in which small cubes (regular solids of six equal sizes) can be transported from one place to another. Imagine trying to use the same machine for the transport of small balls (roundish bodies of mass). The way the mechanism is designed clearly makes it more appropriate for the transport of cubes than balls. In this example the *body shape* of the element – regular or roundish – determines whether the element occupies an advantageous or disadvantageous position within the mechanisms.

This reasoning can be applied to more concrete examples: imagine a non-profit, civil association that defends bikers’ rights in a small town. They organize a public meeting in which all bikers meet in the central square of the city to exchange views and ideas, and to publicly defend bikers’ rights. Now, the population of bikers is composed of different individuals, some that are rather social and enjoy meeting new people, and some that are shy and feel uncomfortable when in large groups. Who will turn up for the bikers’ meeting? Not the shy ones – who however might be a consistent part of the bikers’ population. In this case, the mechanisms are the *type of action* with which the group wants to defend its rights. The discriminatory characteristics that determines whether an individual is in an advantageous position (apt for participating) or disadvantageous position (inapt for participating) is her/his sociability. For the less sociable individuals, a petition on the web would have been a more adequate mechanism of representation.

A rather general conclusion that can be drawn from this argument is that institutions tend to be more *inclusive* if they provide a variety of mechanisms through which different individuals can access the resources and opportunities provided.

3.2 An Extension to Common Definitions of Institutions

So far I have stated that institutions can be considered to be contextual characteristics. By referring to the capability approach, I have underlined that contextual characteristics can have an external effect on individuals by providing *reasons* and *resources* for action. In this section I provide a definition of an “institution” that is in line with the Human Development paradigm. My aim is to derive a common analytical framework for institutions and other structural factors that characterize the context and that can play a role for human development achievements in terms of *contextual conversion factors*. The definition that I propose is the following:

Institutions are *socially defined structures* which enable and shape human interaction. These structures are defined by *constraints* and by *spaces* withheld by the same constraints. The spaces (i) reflect a collective aim that resulted from a bargaining process and (ii) themselves become the *arena of action* for those who want to modify the constraints. The structure itself is therefore dynamic and *continuously reshaping*.

Common elements: In choosing this definition as my preferred one, I position myself between the work of Douglass North and other institutional economists that mainly belong to different branches of the new institutionalism on the one side, and Pranab Bardhan who adopts the view of a development economist on the other. Among the most famous definitions of institutions in economics are “the rules of the game in a society or the humanly devised constraints that shape human interaction,” (North 1990, 3) and the formal and informal rules a society decides to give itself (Bardhan 2005). In what follows, I outline to which extent my definition is different from these two, using them as reference points.

Some elements are common to both (North’s and Bardhan’s) and to my preferred definition such as the inclusion of formal and informal elements; where Bardhan states this explicitly, North also specifies his constraints as being informal or formal (North 1990, 35). The definition I propose does not refer explicitly to the nature of structures, but implicitly includes formal – intended as state-guaranteed – as well as informal arrangements.⁷

A second common element is the understanding that institutions originate with a precise goal, namely to shape human interaction, usually in the attempt to reduce uncertainty and to simplify a smooth coexistence of diverse strategic

⁷ I do not distinguish between formal and informal institutions to imply different degrees of enforcement, or credibility, or differences in functioning. I simply distinguish in terms of their “form,” namely among those that belong to the terrain of state-action, and can therefore be the direct object of policy-intervention, and those that evolve and act outside of the state-terrain. For a theoretical appraisal of the usefulness of distinguishing between formal and informal institutions and an introduction of the concepts of *form* and *content* when analyzing institutions, see Sindzingre (2006).

behaviors. This notion is commonly accepted among institutionalists, for example by March and Olsen: “institutions create elements of order and predictability” (2006, 4). New institutional economists tend to under-emphasize other goals of institutions, however, such as enshrining specific values (see e.g. Searle 2005; Gran and von Jacobi 2016).

A third and directly deducible ground of agreement among scholars is that order and predictability, or the shaping of human interaction requires a *structuring process*. For the rational choice institutionalists it is North’s *constraints* or *scripts*, *behavioural repertoires*, *sequences*, etc. which can be either exogenous (cf. Shepsle 1979; North 1990) or endogenous (cf. Riker 1980; Schotter 1981; Calvert 1995).⁸ Historical institutionalists also focus on “rule structures that are human creations” (Sanders 2006, 40), although they are more interested in the processes that shape these structures in time, often referring to the concept of path dependence (Pierson 2004). The “logic of appropriateness” that belongs to sociological institutionalism also refers to conventions, norms and cognitive frames (Hay 2006, 58) which enable a structuring process, just as the “stable and recurrent patterns” that are dear to the network institutionalists give structure to repeated interaction or exchange (Ansell 2006, 75).

Conceptual differences: agents. Beyond these commonalities, there are some conceptual differences which have implications for the empirical and practical application of the definition. A first relevant difference between North’s and Bardhan’s definition derives from the authors’ choice of *who* ultimately creates institutions. Where North refers to “humanly devised” constraints, Bardhan explicitly identifies the “society” as the creator. Of course we could argue that human action does not exclude collectives, such as a society, but North explicitly states that his theory is individual-centered (North 1990, 27).

The location of the individual *within* a society is dealt with in a theory of transaction costs, which however implicitly constrains the analysis to a one-to-one game, whereas in society multiple players and multiple interactions occur contemporaneously.⁹ My definition follows Bardhan’s intuition that institutions can only be created by a collective, and implicitly refuses to regard collective behavior as the simple sum or aggregation of individuals, as isomorphism in individual and collective behavior cannot explicitly be assumed.

In my definition, the institution reflects a collective aim, which results from the convergence of interests. The institution therefore works as a cumulative collective choice and is therefore better defined at the societal level.

⁸ For rational choice literature reviews that distinguish between exogenous or endogenous constraints see for example Shepsle (2006) or Weingast (2002).

⁹ While North brilliantly understands the logic of societal interaction of human beings, his need to insert his theory into the theoretical framework of neoclassical micro-economics is stronger and leads him to prefer the adoption of behavioral hypotheses of a representative individual.

Conceptual differences: underlying elements. While the notion of “structure” is accepted and shared, there are differences as to which ought to be their elementary components. My definition slightly detaches from North’s and Bardhan’s conception of institutions by introducing the other side of the coin to their delimiting concept of *constraints* and *rules*: I stress that institutions create *spaces* that are delimited by constraints.¹⁰

Why is it relevant to go beyond the mere notion of constraints or rules? North himself states that “[i]nstitutions reduce uncertainty by providing stable structure to everyday life” (1990, 3), and therefore implicitly states that the ultimate outcome of *constraints* are structures. While it is hard to counter that structures are made of constraints, I argue that a focus on constraints only is limiting. Apart from their delimiting power, institutions have wider instrumental value in providing opportunities or *space* for human action: be it agency, interaction or evolution and change. This is particularly true within a Sen-style view in which context is considered a conversion factor, meaning that the institutional setting is ideally evaluated in terms of the degree to which it enables its society to achieve greater capabilities.

A *structure* implicitly defines shapes and paths which lead to and consist of meaning. This intuition is partially in line with the argument of the idealist institutionalists (for example Johnson 1989; Nicholson 1990) who state that “institutions express *ideas* and *embody* a continuing approach to resolving the issues which arise” in human interaction (Johnson 1989, 131). This passage is very much in line with the part of my definition where “spaces reflect a *collective aim* that resulted from a *bargaining process*.”

Embedded ideas and practices are crucial to a theory of institutions that maintains a pluralistic and context-specific approach. It is further highly useful for analyses that are interested in investigating *how* and in *which cases* institutions contribute to perpetuating inequality and poverty, as common in macro institutionalist research.¹¹

Once it is realized that institutions embed an *idea* or particular *will*, we should ask ourselves *whose* idea and will it is. Institutions reflect the struggle and temporary resolution for the distribution of power and resources: “institutions are defended by insiders and validated by outsiders” (March and Olsen 2006). They do *not* automatically imply an equitable resolution. Often, they incorporate and reflect distributional inequalities. When the ideas and wills that are incorporated into an institution come from a leading minority that withholds most power and resources, this will typically be reflected in the type of *me-*

¹⁰ While such view tends to be absent within institutional economics, it is much more common within organization studies.

¹¹ A focus on spaces is also helpful for conceptualizing institutional change, as the spaces are the arena within which the institution itself can be changed.

chanism with which the institution works. By designing the mechanism of the institution in a way that only a restricted group of individuals can occupy an advantageous position within it, the institution becomes an instrument for the perpetuation of existing social inequalities. Differently, institutions that guarantee opportunities with broad access can recast the distribution of capabilities within a society.

While I can place ideas into the notion of structure as previously defined, ideas and meaning seem to be slightly out of place in those theories that concentrate only on limits, such as constraints and rules. Let us consider this argument in the case of a simple example of *structure* we can think about: a rack. Clearly, the rack has a known shape that is made of constraints, namely its edges and its boundaries. We could focus our attention on the fact that the rack does not permit to place anything *beyond* its boundaries, which would follow the conceptualization of a structure as merely being made of constraints. We could also adopt a slightly different perspective and appreciate the useful space that the rack provides to give our life more predictability. It helps with putting some of our material belongings into order and facilitates the moment in which we will desire to find them. This view focuses on the space notion. We will further realize that some objects will fit well into the rack, while others will not – maybe due to their size or weight or shape.

The *structuring* process so dear to institutional analysis starts with the structure and the subsequent choice and convention to use the structure in a certain way, namely to place objects into its space. Clearly a rack can serve as example for a structure, but not for an institution, which I describe as *socially defined*.

Conceptual differences: implementation. We could argue that the existing definitions that focus on constraints and rules *implicitly* comprise spaces and ideas, and that it is not necessary to mention them separately. While this might be true in theory, my point is that differences in perspective, as the one just outlined, can have important effects in the phases of implementation: by explicitly mentioning spaces for agency and ideas, institutions can assume a different role within development economics.

In particular, the focus on constraints leads to an implementation logic where developing countries adhere or do not adhere to certain types of rules – for example to the so-called Global Standard Institutions (GSI). These are supposedly “better institutions” that improve governance in developing countries and are proposed within mainstream economic theory and promoted by e.g. the World Bank, IMF, OECD, G7 or the World Economic Forum. They typically derive from neoclassical economic theory and are thought to maximize market freedom and to protect private property rights best (Chang 2010, 2).¹²

¹² For a critical review, see for example Chang (2005).

This logic however has a number of flaws: it is ethically questionable as it forces places and people with very diverse history, values and culture to adhere to *resolutions* of human issues that have evolved outside of their *own values and collective choices*. Secondly, profound *ownership* of the social solution is required in order for it to be accepted by the society, which in turn is a necessary element for the credibility of any institution. As Pritchett (2013) puts it: “The only way to get to the rule, is having to get to the rule through *struggle*.” He emphasizes that it is the struggle, the process of resolution, that is based on the consolidation of successful experiments that leads to institutions that work.¹³

In spite of extensive cross sectional analyses, it is far from being empirically proven that a one-size-fits-all approach to institutions is efficient in terms of human development, or even in terms of growth. In a world where a multitude of capitalisms have arisen, and within a discipline in which the neat connection between institutions and economic performance has not been found so far, a more cautious approach is needed. Pluralism of views and exploration might do a better job than top-down solutions which tend to simplify the complex connections between formal and informal institutions, economic structure and people.

4. Institutions and Development: Interpretations

4.1 Institutions in Development Economics

The existing literature that investigates how institutions affect economic development is broad and provides relevant insights: it mainly describes and explains through which direct and indirect ways institutions can interact with people and thereby contribute to economic and human development performance. In this section I try to synthesize the main understandings that the different literatures have produced, while I also present some systematic drawbacks. By comparing several and quite diverse contexts of the *same* institutional variable, economists often fail in understanding something that institutionalists have long recognized. Institutions cannot be analyzed under the hypothesis that a particular form or design can be *the equilibrium outcome* that maximizes welfare in each context adopting it. Indeed, *multiple* equilibria are understood to be the reality of institutions which are highly adaptive to specific local experiences (Binder et al. 2006). This initial misunderstanding of the nature of institutions translates, in most economic approaches, into the methodological framework chosen, which typically forces institutions into a position in which they are merely exogenous factors.

¹³ See, among others, Pritchett’s speech at the annual lecture of the UNU-WIDER institute (2013).

Institutions and development macroeconomics: Institutions have been a particularly favoured object of study within macro development economics since the mid-1990s. Predominantly, they have been studied with a focus on their role in promoting economic development. These studies are typically empirical and structured in order to test how specific institutional forms affect growth by comparing a large number of different countries.¹⁴ The output variables that the cross-sectional studies typically use are GDP per capita, its growth rate and macro indicators such as investment/GDP.¹⁵

Institutions typically enter the regression function as independent variables. Past research has mostly concentrated on the following institutional measures: private property rights (Acemoglu, Johnson, and Robinson 2002) social infrastructure (Hall and Jones 1999; Bockstette, Chanda, and Putterman 2002; Kogel 2005; Masters and McMillan 2001), political institutions including the rule of law¹⁶ (Rodrik 1999; Rodrik, Subramanian, and Trebbi 2004), labour market institutions (Rodrik 1999), ethnic fractionalization (La Porta et al. 1999; Esfahani and Ramirez 2003), corruption (Mauro 1995; Esfahani and Ramirez 2003) and legal origins (La Porta et al. 1999; La Porta, Lopez-De-Silanes, and Shleifer 2008).

Most of these studies admit the possibility of reverse causality which might lead to greater institutional quality where economic growth has been more sustained. Once controlled for endogeneity, however, the clear message coming from cross-sectional studies is that institutions are significant explanatory factors for global differences in growth performance.¹⁷ A smaller amount of re-

¹⁴ For a clear overview of cross-section studies with a macro approach see Pande and Udry (2005) in which the authors organize the literature around a set of 5 first chore papers and subsequent incremental attempts that go into similar directions. See also Ros's (2011) overview in the special issue of the *Journal of Institutional Economics*.

¹⁵ Alternative dependent variables are: output per worker (Hall and Jones 1999; Masters and McMillan 2001) – public sector characteristics such as overall size, interference with the private sector, output of public goods and efficiency (La Porta et al. 1999) – production characteristics such as capital per worker, TFP growth rate, average wages and more general indicators of socioeconomic development such as urbanization (Acemoglu, Johnson, and Robinson 2002), political freedom (La Porta et al. 1999), water pollution, quality standards, unofficial economy, product market competition (Djankov et al. 2002) or output volatility (Acemoglu et al. 2003).

¹⁶ Rule of law has increasingly become of interest to political and development economists. While this concept could be a precious measure of access to justice, it has often been reduced to indicators of market liberalization, such as enterprise entry, debt enforcement and property rights protection (Djankov et al. 2002; Djankov et al. 2003; La Porta, Lopez-de-Silanes, and Shleifer 2006; La Porta, Lopez-de-Silanes, and Shleifer 2008).

¹⁷ How widely reversed causality running from economic development to institutional quality is accepted is the object of a lively academic debate, see among others Chang (2010); Wallis (2011); Nugent (2011); and Keefer (2011) in a dedicated volume of the *Journal of Institutional Economics*.

search has so far been advanced on the role of institutions in promoting human development.¹⁸

A noteworthy aspect of the cross sectional literature, which currently represents the mainstream in the analysis of institutions and development, has to do with its implicit assumption of *convergence*. As Debraj Ray nicely explains, where Solow's model is kept in the back of the mind of the researcher, "development is largely a matter of getting some economic and demographic parameters right (...) A failure to observe convergence must be traced to one or another of these parameters" (2007, 2). This logic can of course also be applied to institutional parameters. Ray himself warns of adopting the hypothesis of convergence non-critically, as nonconvergent behavior is totally plausible.

Institutions and development microeconomics: A different approach to analyzing institutions and their role in development economics has been adopted within microeconomics, in an attempt to understand how certain institutional settings could influence and shape individual behaviour. In this literature, poverty is often interpreted as a self-reinforcing mechanism which changes the way individuals behave and act.¹⁹ Institutions, on the other hand, enter the analysis as relatively *limiting* or *enabling* parameters in the way they interact and modify individual behaviour and preferences. Where the context leads poor individuals to preferring poverty-replicating choices, so called *poverty traps* can be identified and, eventually, be resolved through targeted policy design.²⁰ In a similar way, the overlapping structure of land, credit and input markets is recognized as potentially leading to pockets of exploitative local monopoly (Ray and Sengupta 1989; Mansuri 1997; Ray 2007), just as the incompleteness or ambiguity of land titles deploys a complementary role in excluding the poor from the credit market and from production upscaling.²¹

¹⁸ Exemptions are studies focusing on quality of democracy and participatory rights. In these studies, institutional variables naturally gain greater statistical significance when the dependent variable is a human development indicator instead of a monetary measure (see for example Bardhan 2005). Other studies use average schooling of workers as the dependent variable (Clague et al. 1999; Rodrik 1999; Rodrik, Subramanian, and Trebbi 2004).

¹⁹ "Being poor almost certainly affects the way people think and decide" (Duflo 2006 in Ray 2007, 6).

²⁰ Through the analysis of institutions some typical mechanisms that create "poverty traps" have so far been understood and explained: the imperfection of credit markets (Stiglitz and Weiss 1981) with the classic notions of *adverse selection* and *moral hazard* leading to a *de facto* exclusion of the poor from credit which could play an essential role for consumption smoothing and productive investments. Among others, see Aghion and Bolton (1997); Ghosh, Mookherjee, and Ray (2001).

²¹ Among others, see Besley (1995); Banerjee, Gertler, and Ghatak (2002); Goldstein and Udry (2008).

The analysis of credit and land markets – or of educational support policies – are just examples of studies in which institutional settings are included as potential obstacles to overcoming poverty. Typically, these studies rely on some behavioral model and subsequent microeconomic data analysis.

A relatively newer approach to institutional analysis in development microeconomics consists in random experiments and program evaluation studies. This approach focuses on the decomposition of programs into their parts in order to detect intervention design that works (or that works better than others). This strand therefore is promising for new insights on policy-induced institutional change and its recognizable impact on socioeconomic outcomes among the population.²² While the experimental approach has significantly expanded the ability to evaluate the impact of policy interventions, its methodological features do not easily allow for the identification of the *channels* or *mechanisms* through which the policy works. Furthermore, while these studies are valuable for policy evaluation they are less adequate for the study of institutions, which cannot be identified with a policy, but rather as the cumulative outcome of a sequence of political efforts.²³

4.2 Development within Institutional Analysis

Institutional analysis comprises a variety of different approaches that focus on several aspects and derive their research questions from different disciplines. Rational choice institutionalism is understood to be the economic derivative of institutional analysis: in fact, this approach is founded on microeconomic behavioral assumptions and concentrates on the way that rules and institutional constraints alter individual behavior.²⁴ Development is abstractly seen as the maximization of an individual's utility function. In a similar fashion, institutions themselves are interpreted as equilibrium outcomes (Shepsle 2006).

Within political science and the law and development literature, researchers focus their attention on what North (1990) would call the *organizations*, or the agents that implement their strategies within the institutional framework (Trebilcock and Mota Prado 2011). Sociologists consider both rules (procedures) and the agents of change (organizations) (Blondel 2006, 721). They mainly care about social transformation and *how* differences between current and past conceptualizations of human interaction resolve. Typically, any hypothesis of

²² For examples of policy evaluations using experiments or quasi-experiments, see among others see Banerjee and Duflo (2009); Banerjee et al. (2007); Duflo, Glennerster, and Kremer (2006).

²³ Examples of studies that try to study institutions with program evaluation techniques are Olken (2010); Wantchekon (2003).

²⁴ For this reason, rational choice institutionalism is *de facto* very similar the approach outlined under development microeconomics.

convergence is absent, and a much more case specific approach to the study of institutions is prevalent. Traditions, values and norms work as equilibrating forces and therefore explain the persistence of some institutional forms in time.

Historical institutionalism does not distance itself very much from the research questions of the rational choice or the sociological school. It clearly puts more emphasis on historical processes and prefers collectives and groups to individuals as agents of institutional change (Sanders 2006). Network institutionalism underlines how institutions can genuinely be compared to networks, as they both are social constructs that shape human interaction: through their role in facilitating communication, their contribution to development is mainly found in the ability to provide successful exchange and to contribute to the strengthening of mutual obligations, reciprocity and trust (Hay 2006).

This section has outlined how different disciplines treat the important question of “how institutions contribute to development.” In what follows, I argue that only a wise combination of these different approaches can help us to better understand the links occurring between institutions and development. By referring back to the conceptual framework proposed above, I try to outline how approaches to studying institutions and development could be improved in order to identify institutional forms that seem to be promising for the advancements of human development.

5. Going Beyond: The Value-Added of a Meso Approach

In this section I try to make a case for the adoption of a two-level perspective for the study of institutions and development. By highlighting the limitations of macro and micro approaches, I outline the advantages of a *meso* approach, which implies studying institutions at a sub-national level of analysis.

By identifying development outcomes at the individual level, in line with the capability approach, and institutions at the meso level, I aim at contributing to the literature in the following way: i) through the adoption of a new level of analysis (*meso*) for consolidated research questions that have arisen within the macroeconomic development and the institutionalist literature (see section 4); ii) by pushing for the use of more diversified and informative data sources that allow for a better management of control variables and greater precision in the measurement of institutions; iii) through a conceptual framework in which I clearly state the role that *meso* factors can play for development, namely that of *mediating* factors lying *in between* macro (level) policies and micro (level) achievements in human development (see sections 2 and 3.2); and iv) by paying greater attention to complementarities that can exist between different contextual characteristics.

5.1 Beyond the Limits of the Macro-Approach

What is it that we need to go beyond with an innovative framework? The research questions of the macro approach are tempting and intelligent: what if we find institutional solutions that solve more problems more efficiently? The drawbacks of the macro approach are mainly three: the first one relates to the ambition to compare different countries using the same institution, the second refers to the missing role of complementarities, and the third one comprises methodological limits that such an approach intrinsically faces.

Comparing different countries: Formal institutions, which cross-sectional studies typically restrict their focus to, are strongly intertwined with informal or unwritten constraints, such as culture, religion, social norms, tradition and local history. Not considering the complex nature of interaction *between* different institutions implies seeing only the tip of the iceberg. When a cross-section study compares 100 nations in terms of a particular institution, the possibility to understand this complexity is lost. Clearly, control factors are added to the regressions, but the *meaning* that a particular institution, a control factor or their inter-relation have in different contexts cannot be accounted for in a macro comparison.²⁵

The result is an over-simplification of complex interlinkages, which can lead to dubious policy recommendations if applied uncritically. Furthermore, the need to test several country settings against the same hypothesis is valid only if the hypothesis of *convergence* is truly and fully embraced. Yet, the new institutionalism literature has reinforced the recognition that *local adaptation* is what drives institutional forms. A comparison at the country level is deemed to oversee important details of the *local* features to which institutional forms adapt. For this reason – and in line with other work implemented by scholars influenced by Sen and Nussbaum – I propose a *meso* approach in which institutions are analyzed and measured at the subnational level.

Missing role of complementarities: Complementarities between different institutions are rarely the object of study of the macro literature, although historical analyses that point out elements of *path dependency* implicitly refer to a complementary evolution of history, population and economic structure.²⁶ Complementarities should be better understood in order to derive useful policy recommendations from institutional analysis. Different authors from several

²⁵ For an argumentation on why international comparisons and rankings based on complex objects of measurement can be misleading, see for example Chiappero-Martineti and von Jacobi (2012).

²⁶ Complementarity has been defined by Edgeworth as “being given between two factors, A and B, when the increase of factor A causes a higher rate of returns of factor B.” For references on empirically investigated complementarities in development economics, see Ray (2007, 5).

disciplines agree that an over-simplification of causal links is detrimental: “Mainstream institutional theories wrongly see the relationship between institutions and economic development as linear and uniform across time and space” (Chang 2010, 10), while

more subtle theories of institutional origins and change must be built around careful argument about the *preconditions* for *functional outcomes* to occur. This requires the specification of *where* such claims might break down and the *circumstances* that make the presence of such unfavorable conditions more or less likely (Pierson 2004, 130, emphasis added).

Methodological constraints: Apart from considerations that regard the nature of research questions, a number of methodological constraints further limit the success of the macro approach in unfolding the relevant connections between institutions and development. First of all, the use of internationally comparable data leads to measures of institutional quality that Pande and Udry call “coarse” (2005, 5). The sources of data that are typically used come from subjective evaluations of experts, tend to be urban biased, and cannot reflect the different institutional landscapes that coexist even within the same country.

Further, different institutions are often combined into a multidimensional index of institutional quality, which does not allow accounting for different roles and interactions among the components of the overall index.²⁷ Multidimensional indexes indeed lose their explanatory power when they try to account for phenomena that are too wide-ranging: the compensation effect between different dimensions combined in the indicator might make the overall measure less transparent and less useful. To put it in Pande and Udry’s (2005) words, “we estimate a ‘composite’ effect of institutions on growth” (9) but we indeed cannot distinguish which institutional design is the more adequate to promote growth, or alleviate poverty or foster human development in general.

A third methodological bottleneck faced by the cross-sectional approach is the predominant use of instruments in order to account for endogeneity. This of course is a limitation encountered in other disciplines, too, but, again, Pande and Udry (2005, 7–10) rigorously explain how the recurrent use of instrumentation has literally “saturated” this strand of literature: the authors mainly argue that instruments are i) scarce since only a limited number of feasible instruments are available; and ii) “the same variable is often used in different studies as an instrument for different indices of institutions, and interpreted in varying ways.” The authors argue that, while instruments help in overcoming endo-

²⁷ While multidimensional measures can be a brilliant tool for measuring complex phenomena, it is most important that each single methodological step of their construction – such as the *beta*-order, the identification function and the weight system – is transparent and open to public debate. For a detailed account on how methodological choices impact on the results of multidimensional indicators, see Chiappero-Martinetti and von Jacobi (2012).

geneity, they can “rarely isolate the causal pathways.” Ray makes a similar point when he states that

good instruments are hard to find, and when they exist, their effect could be the echo of one or more of a diversity of underlying mechanisms (...) by relinquishing more immediate institutional effects on the grounds of, say, endogeneity, it becomes that much harder to figure out the structural pathways of influence (2007, 12).

Yet that causal links are particularly shaped by cumulative and indirect effects, complementarity and threshold levels has widely been recognized within institutional analysis (e.g. by Pierson 2004).²⁸ If the elimination of reverse causality requires us to over-simplify causal relations and to neglect a variety of mechanisms through which the outcome of interest is achieved, maybe this price is too high. As Ray suggests: “the convergence predicted by technologically diminishing returns to inputs should not blind us to the possibility of non-convergent behavior” (2007, 4).

Nonconvergence is indeed a rather plausible and common hypothesis among institutionalists, who rarely adopt the point of view that institutions are *equilibrium* outcomes or necessarily efficient. Multiple equilibria and the consolidation of inefficient institutions are recognized as a natural outcome of complex social interactions in which formal rules, informal constraints and enforcement intertwine (among many others North 1990, 53).

Remedies: In order to partially overcome these limits, and in line with the conceptual framework outlined in sections 2 and 3.2, I propose an approach to the study of institutions and development in which the level of analysis at which institutions are being measured is *meso*. This implies scaling down the unit of analysis from the country to the sub-national level, which significantly increases the quantity and quality of usable data. Further, this choice eliminates a number of comparison difficulties in which countries with very different cultural or historical background have to be analyzed jointly. While sub-national differences should not be overlooked, the risk of incorrect interpretation of meaning is way less severe at the subnational level. On the other hand, within a *meso* approach it is possible to not only analyze more different types of institutions but also to provide more advanced and helpful measures of institutional characteristics, including multidimensional measures that focus on specific institutional aspects instead of proxying institutional quality in very general

²⁸ Pierson constructs his analysis around the argument that institutions and their evolution are slow-moving processes. When looking for causality in the determination or the effects of institutions, he recommends keeping in mind that “slow-moving causal processes might be due to their cumulative nature or/and because they involve threshold effects, or require the unfolding of extended causal chains” and that “both in what we seek to explain and in our search for explanations, we focus on the immediate – we look for causes and outcomes that are both temporally contiguous and rapidly unfolding. In the process we miss a lot” (Goldstone cited in Pierson 2004, 79).

terms. This, in turn, can finally help in better analyzing complementarities and other types of complex interactions between several institutions.

Second, the use of sub-national, public and administrative data, allows for the empirical analysis to concentrate on information that is available both to public debate and to public administration, which in the end should be the major *audience* of discourse on institutional quality and the identification of best-practices.²⁹

Third, instruments could be used within the *meso* approach, too. Indeed, the abundance of data allows for a greater variety of possible instruments. The hint outlined above, however, suggests that a greater variety of methodological approaches should be experimented with, especially those that consider endogeneity not only as an econometric problem, but as a natural feature of complex phenomena.

5.2 Beyond the Limits of the Micro-Approach

So far I have concentrated on the limits of the macro-approach. By proposing a *meso* view, however, I am implicitly distancing myself from those microeconomists who represent the main critics to the cross-sectional analysis of institutions and development. In fact, development microeconomists overcome most of the limits just exposed by extending the pool of data resources and by scaling the research objects down to a more narrow context. Yet the nature of their research questions and the methodological toolbox typically employed represents other limits to the analysis of institutions and development. In extreme synthesis, I will argue that restriction to an exclusively individual-centered approach, such as typical of microeconomics, neglects important aspects and dynamics that shape institutions, their change and their role within economic development.

Agents and levels of analysis: By limiting the analysis to the individual, the micro-approach considers only *one type* of agent of change, while institutions typically derive from the interaction of groups and the collective. Groups and collectives could be understood as the mere aggregation of a number of individuals. Yet, such a conception fails to understand the delicate nature of social bodies: “Individuals congregate to form associations [...] these bodies con-

²⁹ We could argue that the reliability of public data does not guarantee the same objectivity as the opinion of experts – it being the public administrations directly responsible for the outcomes of their policy, and often interested in producing data that provide a more *generous* evaluation of their activities. The public nature, wide coverage and potential familiarity that the public administrations have with these sort of data, however, make them a very attractive source of information for the identification of institutional patterns, complementarities and best-practices. Often, public data sources are reliable and rich in information. I am thankful to Giovanni Andrea Cornia for this comment.

strain individuals. Institutions cannot just be based on rules; they have to include the way collective arrangements, in groups, affect the behavior of individuals” (Blondel 2006, 721–722).

Choosing the right *level* of analysis indeed has a range of important implications: “Levels involve the generation of a mechanism from some combination of simpler mechanism” (Holland 1998, 190). *Combination* could be a simple aggregation, but could clearly also imply more complex relationships among the elements.

Level–application errors have mostly been analyzed in terms of the dangers of *disaggregation*, famously ever since the recognition of the “ecological fallacy” (Robinson 1950; Hofstede 1980; 2001), which explains that where the statistical object is a *group* of people (ecological correlation), the results should not be used to make inferences about individual behavior. The reason why collective features cannot naturally be applied to the individuals composing the group has to do with *within group* inequality.

A less studied level–application error is the “individual difference fallacy” (Richards, Gottfredson, and Gottfredson 1990), also known as “atomistic fallacy” (Hox 2002), whereby the aggregation of individual characteristics does not give a *correct* picture of group characteristics. Two fundamental oversights lie at the heart of the atomistic fallacy: the hypothesis of cross-level equivalence (also known as isomorphism), and the failure to recognize the variety of interactions that may exist between simple elements and the aggregate mechanism they compose. Isomorphism is the assumption that two phenomena are linked with a monotonic function, which implies that the *meaning* of a concept is identical at the individual level and the level of context. The opposite of isomorphism is nonisomorphism.³⁰

The second weakness consists in not accounting for interactions among different individuals:

the atomistic model of action by an isolated actor does not consider the mechanisms for coordinating action through which interpersonal relations come about (Habermas cited in Ibrahim 2006, 402).

This point might sound rather abstract, but within institutional analysis, which has drawn important inspiration from organizational theory,³¹ interaction and

³⁰ A famous example of nonisomorphism within the cross-cultural psychology literature is the notion of *individualism–collectivism*. While these two extremes of a continuum are adequate for characterizing a context, they are inadequate if applied to the individual, as an individual can be *idiocentric* or *allocentric*, but hardly *collective* when on his/her own (van de Vijver et al. 2008).

³¹ See for example Egeberg (2004) or authors that start from organizational theory to explain networks and institutions, e.g. Benson (1975); Chrisolm (1989); Powell (1990); Menard (2004); Grandori and Soda (1995).

interdependence between humans can be more relevant than individual aspirations in explaining the emergence, *raison d'être* and evolution of institutions.³²

A third, intrinsic drawback of the atomistic fallacy is to flatten the perspective on collective features. Characteristics of groups or of a context can be of various types, namely analytical, structural or global (Luke 2004). Analytical properties are those that can be derived from aggregating information on individuals. This is a well-known and widely-used type of aggregate measure in microeconomics. Global properties of the context are characteristics of the collective itself – not based on properties of the individual members (O'Brien 2000). For example, a school can be public or private, independent of the characteristics of its attendees.

While global characteristics might be easily deduced, as in the example of the school, they might not be recognizable at all if the level of analysis is not correctly specified. Structural properties, finally, are relational characteristics of collective members, e. g. the friendship density within a classroom. As can easily be noted at this point, the simple aggregation of individual information into aggregate measures limits our perspective and can leave out important notions such as *relations, structure and nature* which can be expected to be most relevant for the analysis of institutions.

Limits of the methodology: In terms of methodology, similar arguments apply. In particular, the microeconomic behavioral assumptions have been extensively criticized as being limited.³³ North (1990, 19) himself, who maintains an individual-centered approach, criticized most of the behavioral assumptions as exposed by Sydney Winter, highlighting in particular how there is a continuum of theories upon which individuals act, how preferences are far from being stable, how maximizing can be severely hampered by insufficient information-feedback, and that there is more than rational and noncooperative behavior.

The rational choice school has indeed attracted a variety of critics to their behavioral assumptions, having subsequently produced a wide array of alternative approaches such as behavioural economics which incorporates the notions of bounded rationality and further explores new foundations of individual behavior.³⁴

³² Olson (1965) has underlined how pooled and intensive interdependence are forms that govern collective action more than transactions and exchanges. Pooled interdependence refers to *belonging* to the same organization and to share a goal while pooling resources. Intensive interdependence implies the joint application of complementary resources and requires alignment of objectives.

³³ Analyzing the shortcomings of the neoclassical behavioral assumptions is not the scope of this study. The literature is extensive, see, for example, Green and Shapiro (1994).

³⁴ The results deriving mainly from experiments are valued as being more accurate in *descriptive* terms, but less useful in *predictive* terms (Posner 1998 in Segatti 2012)

Remedies: In general, the scope of defining any behavioral assumptions for a *representative* individual implies losing the multidimensional, complex texture of antagonistic and pluriform strategies and motivations that characterize a society. While simplifications are typically a necessary element of models, I prefer calling for a more explorative type of analysis, in which it is not necessary to restrict the focus *ex ante* with regards to individual choices. It is therefore possible to circumvent representative, behavioral assumptions.

I agree with Pande and Udry (2005, 2) when they argue that “a more fruitful research agenda is to exploit the synergies between micro-data based research and the questions posed by the institutions and growth literature.” Beyond the actual efforts of the microeconomic approach, I prefer a conceptual view in which two separate levels of analysis are considered: while maintaining the individual as an ethically and methodologically relevant unit of analysis, I explicitly position institutions at a higher level of the hierarchy. Individuals are nested within contexts, which partially determine individual achievements. Institutions characterize contexts, jointly with other structural characteristics. In empirical terms, such an approach would require institutions to enter the analysis as *meso* variables. By adopting this intermediate level for the study of institutions it is possible to detect institutional characteristics not only through aggregate individual-level information but also through global and relational aspects. The introduction of the *meso* level into institutional analysis itself therefore promises the recognition of a range of new, global characteristics that can improve our understandings of relevant features.

6. Conclusion

This study has tried to contribute to the understanding of how institutions can promote or hamper development. By adopting a human development perspective, I call upon analytical concepts from Amartya Sen’s capability approach in order to combine them with prevalent point of views within the new institutionalism. In the attempt to avoid the cross-sectional logic of “one-size-fits-all,” I elaborate an analytical framework with which institutions can be studied at the sub-national (*meso*) level, as features that characterize the (meso-level) context. The major channels through which institutions can affect human development can be summarized as follows:

- Institutions are elements that characterize the context in which people’s lives are embedded.
- The context is a *mediating* factor lying in *between* macro (level) policies and micro (level) achievements.
- Institutions provide *reasons* and *resources* that affect people’s life choices and opportunities to lead the life they want.

- Institutions affect individual achievements either by providing better starting positions or by improving conversion rates, or both.
- Institutions tend to be structures with mechanisms that might advantage some individuals/groups over others.
- Differences in institutional features can explain *within-country* inequality dynamics in terms of convergence or divergence in group/contextual achievement levels.

In addition to applying the capability framework to the analysis of institutions, I have elaborated an extension to two commonly referred-to definitions of institutions (by Douglass North and Pranab Bardhan). The extension introduces a human development perspective into the study of institutions and development.

After exposing this theory of the institutional effect on development, I reviewed relevant literature coming from both strands – development economics and institutional analysis. In order to highlight the relevance of a *meso* approach to the study of institutions and development, I integrated the literature review with an outline of major limits of existing approaches with arguments for how a *meso* approach can partially overcome them.

The approach I have introduced presents some limitations in empirical application that mainly refer to data quality. In fact, a *meso* approach is only implementable and sensible when data abundance is guaranteed. It is based on extensive data transformation work as it combines two different levels of analysis (nested data) and requires detailed and reliable data sources at the individual *and* at the meso level. By suggesting the inclusion of administrative data, I call for a greater role of public data in the analysis of institutions: improved data collection skills within the public administration and transparency of information could be implicit collaterals to a wide-ranging adoption of *meso*-level analyses.

Analyzing different institutional settings at the local (sub-national) level could provide greater knowledge on the drivers of local state capacity, namely – institutional quality at the meso level. This might play an important complementary role to macro policies that aim at eradicating poverty or at alleviating inequality. Where the local reality is incapable of providing complementary opportunities and motivations to its citizens, large scale development policies also do not achieve the expected results – mainly because conversion of policy inputs might be insufficient.

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