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INSTITUTIONAL DIMENSIONS OF TRADE LIBERALISATION AND POVERTY

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ABSTRACT

Trade policy liberalisation requires institutional change, in the sense of a change in the rules of the game. The question is whether these changes produce “superior institutions” judged in terms of a reduction of transactions costs; improved coordination; stronger strategic commitment to investing in needed specific assets; and allocative efficiency. In conventional approaches to the analysis of liberalisation, changed institutional arrangements are studied, but they tend to be considered in the category of “practical details”: important but not especially intellectually interesting. In contrast, this paper argues for a parallel approach to the study of the effects of liberalisation on the rural poor, in which institutional matters are central. A broad range of institutional issues is considered, informed by a theoretical framework provided by the various strands within institutional economics. The framework set out and discussed leads to the contention that smallholder agriculture in poor countries needs coordinated market economy (CME) type institutions if it is to develop, at least at the earlier stages. Ideally, these would be based on deliberative institutions, working horizontally inside a sector, and also vertically along the supply chain. It is argued that the way forward is likely to involve a rethinking of the role of the state (at sub-national, national and international - aid donor - levels) and of the roles of producer organisations and other stakeholder (including trader) associations. The aim must be to find a way in which the state and other powerful actors can initiate deliberative processes and take a lead in encouraging appropriate asset specific investments, while at the same time planning to fade into the background as initial success is achieved. These conclusions challenge conventional analysis of trade policy liberalisation in poor countries and also challenge institutional specialists to provide insights, ideally quantifiable, into the consequences of those liberalisation policies which drive changes in such features as “non-standard institutional arrangements”; non-market coordination; and the roles of government.

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INSTITUTIONAL DIMENSIONS OF TRADE LIBERALISATION AND POVERTY

1. Introduction

1.1 *Trade Liberalisation drives Institutional Change*

1. Except where relatively minor adjustments are made to tariff rates, trade policy liberalisation requires institutional change, in the sense of a change in the rules of the game. Furthermore, it is rare not to find a link between trade liberalisation and domestic policy liberalisation more generally, as trade liberalisation renders particular domestic policies inoperable, or at least requires substantial modification. This is particularly so in the case of agriculture, where government intervention is commonplace, with policy instruments which include a mixture of trade and domestic instruments such as: tariffs, quotas (including trade bans), licensing, variable levies, state trading to defend minimum prices and maintain maximum prices, credit subsidies, input subsidies, state marketing monopolies (which may, relative to world prices, tax, subsidise or cross subsidise), restrictions on inter-district or inter-provincial movement of produce, transport subsidies and public sector research and extension. Trade liberalisation entails substantial changes items on this list.
2. Therefore, in a general sense, it can be said that liberalisation brings about institutional changes, often quite profound. The obvious question is whether these changes produce “*superior institutions*”: judged in terms of a reduction of transactions costs; improved coordination; stronger strategic commitment to investing in needed specific assets; and, finally, allocative efficiency. Even if this is the case, perhaps liberalisation policy might be reconsidered to produce even better results in terms of institutional change.

1.2 *Liberalisation and the rural poor: institutional dimensions*

3. This paper is concerned with a large section – probably a majority – of the world’s poor people, who are rural dwellers, and whose livelihoods are highly dependent, directly or indirectly, on agriculture. Improvement of their incomes from agriculture is must be a leading component of pro-poor growth trajectories out of poverty, so it is crucial that trade liberalisation and related domestic market liberalisation supports broad based agricultural growth.
4. In agriculture, conventional approaches to the analysis of the effects of trade liberalisation tend to focus on understanding the effects of policy changes on prices at borders and other key reference points; the price transmission mechanisms; and the implications for the spatial and temporal distribution of prices across the national economy. Building on this, producer responses can be modelled and general equilibrium effects considered. The specific poverty dimensions of the analysis tend to be handled by ensuring that the models are relatively well disaggregated with respect to effects of particular relevance to poorer groups, on the consumption and production sides.
5. In these conventional approaches, institutions enter the analysis in a number of ways. It is frequently remarked that the credibility of government commitment to new policies is an important influence on firms’ response. Furthermore, liberalisation frequently alters, replaces or abolishes those policy instruments which have had the character of institutional arrangements (e.g. arrangements for market quotas, variable levies, producer subsidies,

marketing monopolies etc). The operation of these changed institutional arrangements are studied, but they tend to be considered in the category of “practical details”: they are important but not especially intellectually interesting, and hence are not studied in much detail, and are not given much emphasis. In some situations this may be a major omission, as some of the disappointing impacts and failures of liberalisation may be due to the importance of these ‘practical details’.

6. This paper argues for a parallel approach to the study of the effects of liberalisation on the rural poor, in which institutional matters are central. A broad range of institutional issues must be considered, informed by a theoretical framework provided by the various strands within institutional economics, especially the new institutional economics (NIE). The results of this work will yield insights, which are valuable on their own, but especially valuable when combined with conventional modelling approaches. A group at Imperial College Wye (ICW) is currently collaborating with IFPRI in such an endeavour.
7. Several years ago, the ICW group was stimulated to develop an institutional economics perspective on liberalisation by the observation that, in poor countries, smallholder farmers frequently face market failure, or at best weak markets (Dorward, Kydd & Poulton, 1998). Prior to liberalisation, approaches to dealing with these problems had included: state sponsored cooperatives; crop authorities, usually operating under state direction; parastatal marketing agencies; and various kinds of credit suppliers, operating the “old credit model” which included subsidised credit. The framework of international trade policies was usually coordinated with these domestic institutional arrangements, if only loosely, and often incoherently. This coordination with international trade instruments had objectives which included (a) maintaining the financial viability of state marketing and credit providing organisations and (b) concerns for farmer incomes and national consumer welfare (through modifying price levels and volatility).
8. These institutional arrangements in developing country agriculture had been heavily criticised in the course of the 1980s, with criticisms focused on rent-seeking; allocative inefficiency; low operational efficiency; and failures to foster connections with world markets, with inhibited access to market opportunities and new technology. In the subsequent decade, they were reformed to a greater or lesser extent in their international trade and domestic market dimensions. The driving ideas behind the reforms were to introduce more competition; to gain allocative efficiency by aligning domestic price relativities with world prices; to encourage capital inflows by removing constraints on investors and strengthening links to international supply chains.
9. The ICW approach to liberalisation debates recognised the considerable merit in these general arguments, but argued that, for specific cases, these had to be tempered by an understanding of the challenges of transacting in rural areas of poor countries. Detailed understanding of the causes of market failures and of weak markets led to the conclusion, in an important number of cases, that transactions costs can only be reduced to an acceptable level by “non-standard” institutional arrangements. In other words, by arrangements other than the “free market ideal”, which can be characterised, for the case of farmers, as the availability of an independent competitive offer in all relevant markets, including inputs, finance, and outputs markets.
10. An example of a non-standard institutional arrangement is interlocking (the basis of what is often called “contract farming”), whereby a producer has a relationship with a trader who covers more than one market, and where transactions in one market (say finance) are

conditional on the producer also transacting with the same trader in other markets (say, output). In certain situations, interlocking can reduce transactions costs, by providing lenders with an improved likelihood that they will be able to recover their loans, and also providing farmers with greater certainty that there will be a market for their produce. Interlocking can take many forms. In the past, it was practiced by parastatal marketing agencies (promoted by the World Bank, among others, in the 1970s and 1980s). Post liberalisation, it is emerging in Africa as the most viable institutional arrangement for the enabling transactions in certain cash crops (most obviously cotton).

- 11 Under liberalisation, interlocking poses some delicate challenges for policy makers: excessive competition renders the model unviable, but strong competition in liberalised markets will not necessarily provide a better performance, indeed, often the reverse as competitive markets may undermine the interlocking transactions which are needed to overcome high transaction costs. Yet absence of competition can lead to exploitation of farmers. Often what is required is a balance in which suppliers of interlocked services engage in both competition and non-market coordination. For example, in the manner of insurance companies, they may compete to provide services to customers, but coordinate to reduce adverse selection by exchanging information about individuals who have behaved dishonestly, or otherwise defected on contracts.
12. A key question about interlocking as a desirable institutional arrangement for poor farmers is that of the limits of its applicability. It may not be appropriate for staple foods, because a proportion of these crops may be consumed by the producing household. Furthermore, it is easy to market foodstuffs through channels which are invisible to providers of credit and/or inputs. Another challenging issue arises from the hypothesis, based on observation of the pre-liberalisation era, that encompassing marketing organisations, with effective spatial monopolies, can operate institutional arrangements which overcome market failures affecting poor producers, in ways in which straightforward competitive markets could not. The dilemma here is that the area monopoly of such organisations would normally derive from a relationship with the state: these could be old-fashioned parastatal marketing agencies, or private firms operating under a state licence and/or regulation. In the extreme case of “weak states”, local organisations may develop state-like characteristics (in the sense that the state has a monopoly of legitimate violence) in which producers face local mafias.
13. In all countries, the involvement of the state in productive activities is problematic, especially so in poor countries, where accountability is typically weak and the quality of government administration is unsatisfactory. However, as will be argued later in this paper, it is often impossible to get the state entirely out of the picture, as spatially dispersed poor producers have great difficulties in undertaking the coordination necessary to reduce transactions costs. There may be powerful non-state actors who can perform coordinating roles, but their motives and accountability pose major questions.?)

2. Theoretical frameworks

- 14 The approach taken by the ICW group has been to adopt theory developed largely for developed economies, and to adapt the ideas to the circumstances of the agricultural and agribusiness sector of poorer economies, with a particular interest in poor farmers.

2.1 *Transactions costs, institutions and the processes of economic development*

15. The broad orientation comes from North (1990) and Davis and North (1971), whose writing is sufficiently general to encompass both the richer and poorer economies of the contemporary world. Key ideas include:
- (i) the distinction between *transactions costs* which are the costs of doing business, and *transformation costs* which are the costs incurred directly in making a product and/or providing a service.
 - (ii) There are two broad types of transactions costs:
 - a. *transaction risk reducing costs*, i.e., the conventional (Williamsonian) definition of transactions costs include identifying and screening counter-parties; defining and measuring what is to be exchanged; agreeing the terms of the exchange (prices and relevant time periods); monitoring contract performance; and in the case of disputes, arbitration, adjudication and enforcement. Firms invest in these costs to reduce their exposure to risk.
 - b. *system compliance costs*, which fall into two categories: *rents* and *market compliance*. The former have been the subject of much attention from development economists and political scientists. Both of these are costs incurred in meeting the requirements of trading in a particular market, but whereas the latter support the efficient operation of the market by reducing the transactions risks facing market players, the former are, at best, an unproductive cost.
 - (iii) North's highly stylised account of long-run economic development follows Adam Smith in specifying increased exchange and specialisation as the key drivers. However, this necessarily increases transactions costs in business, as individuals have to deal with more distant counter-parties, of whom they will have little personal knowledge. Also, as the economy becomes more diverse and sophisticated, it will require more complex transactions. So it is inevitable that with economic development, the share of transactions costs in total economic activity will increase. However, the basis of successful sustained economic development is a growth path that minimises the increases in transactions costs needed to undertake distant and more complex transactions.
 - (iv) the definition of *institutions* and the distinction of these from *organisations*. The former are the "rules of the game" and the latter the "players of the game". Nonetheless, organisations will have specific institutional characteristics embedded in them, and these contribute to the overall institutional framework. There are macro, meso and micro level institutions.
 - (v) the distinction between formal and informal institutions, and the recognition that the latter may be persistent and equally, if not more influential, in determining both the performance of the economy as a whole and the feasibility and outcome of individual contractual arrangements.
 - (vi) recognition that particular institutions may be development enhancing, if they are crafted to facilitate trade and exchange, or development retarding, if they are crafted to control and limit trade and exchange.

- (vii) institutional change is strongly influenced by the interests of elites, as perceived through the ideas by which they interpret their economic interests. In some cases, elites tend to create transactions facilitating institutions because they see their interests being served by the expansion of trade. That this is also in the interests of other less influential groups is incidental, i.e., in this case, poorer and less influential groups in the economy may benefit as free-riders from actions taken by the elites in their own self-interests. In other cases, elites may see that their self interest lies principally in rent-seeking, in which case they will support institutions which restrict trade and exchange.
 - (viii) “path dependency” is a key Northian idea. For a particular political economy, there has been over time a co-evolution of institutions, economic structures and elite interests, which defines a path from which it is hard to break out.
16. To bring together these points: economic development will be based on a path whereby transactions costs will rise as a proportion of total economic activity, yet the increase in transactions costs is parsimonious, such that it is more than compensated for by transformation cost reductions (efficiency gains) arising from specialisation in production. However, some countries may develop only slowly, or may fail to develop, because of insufficient evolution/introduction of transactions enabling institutions, and/or emphasis on the maintenance or introduction of rent-seeking (transactions inhibiting) institutions. Much depends on how sections of the national elites perceive their self-interests, perceptions which will have been conditioned by their historical experience. In a study of north and south America, North argues that from the time of European colonisation of these continents, north American elites have been relatively better disposed to transactions enabling institutions than their southern counterparts. This is partly a matter of the institutions that the colonists brought with them (British rule in north America being looser, less extractive and less bureaucratic than the Spanish empire) and partly a matter of the resources which the early colonists encountered (in the north, resources for farming, fishing, forestry and hunting were found, encouraging production, innovation and trade; in the south, precious metals encouraged a bureaucratic approach to controlling extraction).
17. North’s account of economic development is perhaps rather pessimistic. The concept of path dependency implies that countries making only slow progress with economic development do so because they suffer an institutional framework crafted in the interests of rent-seeking elites. This raises the issue of how ingrained paths may be changed. Historically, one way of changing path has been for successful polities, dominated by elites favourable to transactions reducing institutions, to conquer those that have been rendered weak due to the rent-seeking predictions of their elites. However, there are also examples from history of the opposite process. In the contemporary world, to achieve a change of path, we have to rely on national elites revising their perceptions of what kinds of institutions may be in their longer-run self-interests.
18. In the contemporary world, developing countries appear to be split between those which are participating in globalisation (as measured by increased integration in recent years) and others which are moving in the opposite direction (“deglobalising” in the sense of being less integrated) (World Bank 2002). It may be speculated that in the former group the balance of interests among the governing elite has swung behind the view that it is their interests to reform national institutions to conform to the “basic rules of globalisation”, whereas in the latter group the elite may be unprepared to give up existing mechanisms of rent extraction and/or may be intellectually unconvinced of the long run benefits of participating in globalisation.

19. However, as this paper argues below, there needs to be a well-informed discussion about what should constitute the “basic rules of globalisation”. In poor countries, a purely competitive model may prove unable to achieve broad based rural development, and the large scale poverty reduction which would flow from this.

2.2 *Transactions costs and economic organisation*

20. The ICW group [Dorward et.al. 1998] has hitherto largely taken the account by Williamson of the economic organisation of capitalism and adapted it to the circumstances of developing countries and, in particular, poor rural areas. Key points from Williamson include:
- (i) producers create and structure firms to reduce overall costs by structuring and balancing against each other transaction costs, transaction risks and those production costs discussed in conventional microeconomics. Thus, except in a centrally planned economy, the organisation of sectors in terms of size of firms and extent of vertical integration is a function not only of such matters as technology and economies of scale, but also of the particular transactions challenges found in the sector. Transactions challenges include both *information problems* affecting the degree of uncertainty in transactions (issues of moral hazard, adverse selection and incomplete contracts) and *problems of risk exposure*. We first consider information problems which increase uncertainty in transactions.
 - (a) In the case of moral hazard, people are able to cheat or shirk on contracts because the other party (e.g., a purchaser of a good or an employer of a worker) cannot, at acceptable cost, obtain sufficient information about the real qualities of a good, or the true effort and skill level of a worker.
 - (b) Adverse selection is a transaction problem whereby a firm unwittingly contracts with parties with characteristics that make them less reliable and desirable transaction partners. Adverse selection problems are particularly acute and well known in insurance contracts, where the insurer does not have sufficient information on clients and in the absence of action to address the problem is likely to contract with individuals with risks higher than those expected by the insurer.
 - (c) Incomplete contracts occur most commonly in employment contracts, as it is frequently impossible to state the employees’ duties in great detail as these cannot be anticipated precisely.] The solution is to create hierarchical organisations in which employees are required to follow directions from their superiors, subject to limitations set out in formal rules and in the general culture of the organisation.
 - (ii) Williamson examines risk exposure problems in terms of *specific assets*, meaning assets which have little value except when used in a certain process or transaction. In investment decisions, asset specificity looms large as an issue. Before committing funds to a specific asset, investors seek institutional arrangements to ensure that such investments retain their value. An aspect of the problem is that once investors have committed to an asset that is specific to a particular set of transactions with other parties, power relationships shift. The investor in the specific asset is then to some extent at the mercy of other actors in the supply chain. An obvious developing country example is that the owner of a sugar mill is vulnerable to decisions by cane farmers (who may stop growing, or divert raw material to another mill) and also to decisions by buyers (who may source elsewhere) and governments (who may reduce protection). However, we also need to recognise a critical distinction between conditions in the developed economies

examined by Williamson and those prevailing in the rural areas of many developing countries. In the latter case, many product markets are “thin” and disposal of second-hand assets can be subject to high transportation or other costs. Thus, a large proportion of investments (even, say, the decision by a rural input stockist to order a consignment of fertiliser) entail a degree of specificity in a way that would not be the case in a more developed economic setting.

The policy dilemma created by asset specificity is that firms and individuals need to make such investments, and it is in the interests of the economy as a whole that this investment takes place (as long as this is in industries which have good prospects for being competitive, i.e., “sunrise” rather than “sunset”).

(iii) Williamson describes firms’ responses to these transaction challenges in terms of three broad categories of economic organisation : “market”, “hierarchy”, and a third intermediate ‘hybrid’ category. Markets are generally used for firm-to-consumer relations and for many inter-firm relations and are often a very efficient framework for transactions. Compared to hierarchies and hybrid arrangements they are more competitive and flexible. However, where the transaction information and risk problems discussed above are acute, market relations do not provide firms with enough protection against losses arising from opportunistic behaviour by transacting parties and other forms of economic organisation become necessary. *Vertical integration*, encompassing upstream and/or downstream activities within a single hierarchy, provides a degree of assurance that the specific asset has a secure position within the supply chain. However, it also carries a cost in terms of the attenuated performance incentives for individual actors within the chain. *Hybrid market-hierarchy arrangements*, in which firms at different levels in a vertical supply chain make strategic commitments to each other, based on formal contacts or informal understandings, aim to combine some of the investment security provided by vertical integration with stronger performance incentives than vertical integration can provide. [An example is the procurement activities of the major supermarkets in a number of OECD countries, which often have close relationships with their suppliers, who tend to be smaller firms with less market power. Supermarkets tend to manage the relationship in order that well-performing suppliers (in terms of quality, prices and ability to be flexible about volumes) are kept in business, even if this involves paying them relatively generously in bad years.]

The boundaries between markets, hierarchy and hybrid relations are constantly shifting, driven by technological change on the “transformation” side, but also technological and wider institutional change affecting information and management, which could either reinforce or undermine the rationale for different organisational forms.

2.3 *Transactions in Smallholder Agriculture*

21. Another example of industry organisation, alluded to in the introduction, is the possibility of horizontal relationships between firms based on “*competitive coordination*”. Here firms compete in one market, but agree to coordinate in a linked market. Typically the coordination consists of information sharing, as in the insurance company example given above. (Dorward, Kydd, Poulton 1998) examined cases where “interlocking” is the most feasible institutional arrangement for providing credit to smallholder producers of cash crops in poor rural areas. This is due to credit market failure in relation to poor producers, who lack collateral, face severe production and price risks, and require small loans, which entail high unit transactions costs. The “interlocking” solution, widely encountered in African and Asian peasant agriculture, is for firms to advance inputs to farmers and to require the resulting produce to be marketed through them. The farmers will be paid a price that, in a normal year, allows the

“interlocker” to recover the cost of credit, plus a margin. The Achilles Heel of these arrangements is that borrowing farmers may avoid repayment, in whole or in part, by diverting produce to other buyers. (The feasibility of farmer defection will vary from crop to crop: for example it will be low if the product is highly perishable (such as plucked tea which has to be within the processing factory within hours or else it has no value) and high for food crops). There are a number of possible solutions to the repayment problem, including:

- (i) Interlocking firms gain area monopolies, enforced by law and/or extra-legal coercion. It is possible to imagine the state granting monopolies for limited terms subject to regulation and performance criteria. Unfortunately, in weak states, the area monopoly may be enforced by feudal elements or by more recently emerged mafias, giving three possible forms of monopoly:
 - (a) A state supervised area monopoly, run by the private sector – in poorer countries there must be worries about the quality of governance and the likelihood of rent-seeking;
 - (b) The state controlled area monopoly - this was often the pre-liberalisation solution and was typically characterised by rent-seeking and inefficiency. Nevertheless, in some places and particularly for food crops, it can be seen, in retrospect, to have performed a tolerable job relative to the post-liberalisation situation of widespread market failure (Kydd, Dorward and Poulton, 2002).
 - (c) The feudal/mafia outcome of area monopolies in weak states.
- (ii) Competitive coordination, whereby firms compete to supply services, but coordinate in sharing information about defaulting farmers. This approach requires considerable trust and strategic commitment to the industry by the players, because, in the short term, a way for the firm to beat the competition is to seek a more effective private mechanism avoiding adverse selection, while hoping that competitors suffer from greater adverse selection, and hence drop out of the market. (In other words, if a supplier of interlocking services thinks that it has a much better way of reducing adverse selection – in selecting non-defecting farmers - then it may judge that its business strategy should be based on driving its competitors out of business, rather than cooperating with them to share information about farmer performance.) Competitive coordination seems to be a highly desirable, if not always attainable, goal in the organisation of smallholder agriculture, and probably of other poor rural and urban producers because it tends to look attractive in relation to the alternatives outlined above.

22. It must however be kept in mind that none of these alternatives may be present or work, in which case, there will be credit market failure, and farmers will not be able to produce the crop(s) in question, unless they can obtain finance from some other source (such as remittances, off-farm employment etc). In wealthier and more diversified rural areas, quite large numbers of farmers may be able to finance agriculture from other sources, but in the poor rural areas of the developing world this is unlikely to be possible on a large scale.

The achievement of strategic coordination is problematic in poor rural areas, not least because its importance is not appreciated by many policy analysts and advisers who see it as a non-standard institutional arrangement, not widely understood or approved of in the political economies from which they originate.

2.4 *Roles of co-ordination and deliberative mechanisms*

- 23 In recent work following broadly in the tradition of North and Williamson, Hall and Soskice (2001) (hereafter “H&S”) have set out an approach termed “Varieties of Capitalism”. As is the case with Williamson, H&S are concerned with developed OECD economies, but their approach is rich in implications for poorer economies. H&S describe their theory as “work in progress rather than settled wisdom” and they are interested in cross country differences in political and economic organisation, which they argue can be seen either as:
- A. Deviations from best practice, which will dissolve as laggards catch up with the technological or organisational leader;
 - B. Or, as H&S prefer, the distillation of durable historical choices, because economic institutions condition certain degrees of social protection, distribution of income, availability of collective goods etc., i.e., features of the social solidarity of the nation.
- 24 H&S use North’s distinction between institutions and organisation, but offer a broader set arguments as to why people follow rules: “Institutions are a set of rules, formal or informal, that actors follow for normative, cognitive or material reasons”. Organisations are durable entities with formally recognised members, whose rules also contribute to the institutions of the political economy. For H&S, markets are a category of institution that support particular types of relationships (arms-length relationships characterised by high levels of competition).
- 25 The “Varieties of Capitalism Approach”, is used to understand institutional variation and its relation to questions concerning:
- 1. Choice of appropriate policies for improving the performance of a particular economy;
 - 2. The nature of trade-offs for a particular nation as between developing one kind of political economy or another;
 - 3. Causes of differences in structures and strategies of firms;
 - 4. National differences in the pace and character of innovation;
 - 5. National interests in international trade negotiations;
 - 6. Expectations of institutional convergence between nations due to technological progress and the competitive pressures of globalisation.

2.5 *Basic elements of the varieties of capitalism approach*

26. H&S construe the key relationships in the political economy in game theoretic terms, and *focus on the kinds of institutions that alter the outcomes of strategic interactions*. They see an economy as being populated by different actors seeking to advance their interests in a rational way through strategic interaction with others. Businesses are the key agents of adjustment to technological change, international competition etc., and their aggregated activities determine economic performance of the economy. The conception of the firm is relational, following Williamson and subsequent work by business economists:

- firms are actors seeking to exploit core competencies or dynamic capabilities
 - various relationships are critical to a firm establishing these: (i) with its own employees; and (ii) with external actors (suppliers, customers, collaborators, shareholders, trade unions, business associations and governments).
 - all of these relationships are problematic: hierarchies are used to ensure cooperation of internal actors, but there is still the problem of moral hazard, adverse selection and shirking.
 - effective operation within the firm is often based in implicit (and incomplete) contracts. Even contracts with outsiders are often incomplete (as in the supermarket supply chain example above).
27. These relationship challenges can be expressed as *coordination problems*, and *the success of firms depends on their ability to coordinate with a wide range of actors*. H&S set out five spheres in which firms have to develop relationships to solve coordination problems relevant to their core competencies.
- *Industrial relations*: how to bargain over conditions with employees, their representative organisations and other employers.
 - *Vocational training and education*: firms need a workforce with suitable skills, and workers need to decide how much to invest and in what skills.
 - *Corporate governance*: “the sphere in which firms turn for access to finance and investors for assurance of returns”. The solutions adopted affect the availability and price of finance.
 - *Inter-firm relations*: relations up and down the supply chain to secure stable demand for products, appropriate supplies of inputs, access to technology (examples are standard setting, technology transfer, collaborative research and development). Issues include sharing of proprietary information when there is the risk of exploitation by one partner in a joint venture (common issues in private sector agricultural research).
 - *With their own employees*: key issues include employees’ competencies, cooperation and willingness to share information, given that workers have ability to withdraw information and effort. Particular solutions to these problems are a key part of a firm’s competencies.

2.6 *Liberal market versus co-ordinated market economies*

28. National political economies can be compared in terms of the means by which firms within these economies solve coordination problems within these five spheres. H&S distinguish two “ideal types”, at poles of a spectrum:
- *Liberal Market Economies (LMEs)*, which coordinate activities via hierarchies and competitive market arrangements, classically described by Williamson. The LME system is based on arms length exchange of goods and services, in the context of competition and formal contracting. Actors adjust to the price signals generated by markets. In many cases an effective coordination is achieved and equilibrium outcomes of firm behaviour are given by supply and demand.

- *Coordinated market economies (CMEs)* are distinguished by the fact that they make more use of “non market relations to coordinate endeavours and to construct core competencies”. Key elements of non-market relations are, compared to LMEs:
 - more extensive relational investment;
 - more incomplete contracts;
 - network monitoring – based on the exchange of private information within networks (as opposed to competitive behaviour).
- 29 In CMEs, equilibrium outcomes are less a function of supply and demand in competitive markets and more a function of supply and demand within firms. Of course, LME and CME are ideal types: even in LME countries firms enter into relationships which are not fully mediated by market forces. And markets and hierarchies are important to all capitalist economies. H&S contend is that “in any national economy, firms will gravitate towards the mode of coordination for which there is institutional support”.
- 30 H&S argue that LMEs broadly fit the Williamsonian description of the organisation of the capitalist economy. In LMEs, the principal institutions on which firms rely for coordination are markets and hierarchies (firms), together with vertical hybrid arrangements between firms in a supply chain. CMEs differ because they draw on a further set of organisations and institutions, those supporting more horizontal or networked *strategic interaction*, both across and within supply chains. In general these will be institutions which reduce the uncertainty that actors have about the behaviour of others and will allow them to make credible commitments to each other. In the tradition of the Ostroms, H&S suggest that these are institutions providing capacity for:
- (i) exchange of information;
 - (ii) monitoring of behaviour;
 - (iii) sanctioning of defection from cooperative endeavour.
31. Examples of institutions which can support strategic interaction include: powerful employers’ organisations; extensive networks of cross-shareholdings; and legal or regulatory systems designed to facilitate information sharing and collaboration.

2.7 *Deliberative institutions*

- 32 An example, which is likely to be particularly relevant to developing country agriculture, is the role in CMEs of *deliberative institutions*. These are institutions within which actors engage in collective discussions which, when successful, endow participants with a strategic capacity which they would not otherwise enjoy, because it leads to cooperation. More specifically, deliberative institutions achieve cooperation by:
- thickening common knowledge and increasing confidence in the strategies likely to be taken by others;
 - facilitating agreement about what may constitute a broadly acceptable distributive outcome, which is often a pre-requisite for effective cooperation;

- enhancing the ability of actors to take strategic action in the face of shocks, through common diagnosis and common action.
- 33 H&S argue that strategic interaction is dependent on informal rules based on experience with a familiar set of actors; the shared understandings that accumulate from this experience (a “common culture”); and a set of shared understandings of available “strategies for action” developed from experience of operating in a particular environment. This shared set of understandings is evolutionary and fragile: H&S conclude that institutions of the political economy need constant reinforcement by the active endeavours of the participants.
- 34 The key competitive advantage for CMEs, which results from effective non-market coordination, is that firms and other actors should then be willing to invest more in *specific* and *co-specific* assets (assets which cannot readily be turned into another use, and assets the returns to which depend heavily on the active cooperation of others). In LMEs there is a greater interest in *switchable assets*, such as general skills or multipurpose technologies.

2.8 *The theory of comparative institutional advantage*

- 35 In discussing the performance of LMEs and CMEs, H&S claim not to be partisan, stating that both seem able to deliver satisfactory long-run performance. However, they argue that the two types of economy have distinctly different capacities for innovation, and have different income distributions.
36. These different capacities for innovation are the basis for a theory of *comparative institutional advantage*. Neoclassical trade theory implies that free trade will, under certain assumptions, raise available welfare for all participants. It is used to explain the expansion of world trade and international product specialisation. Stolper-Samuelson theory predicts that a nation will specialise in the production of goods using most intensively its most abundant factor. Whilst this basic contention is still defended by many, challenges to neoclassical views have come from the observation of huge expansion in inter-industry trade and greater mobility of capital. Post-neoclassical trade theories have, therefore, focused on new explanations: concentration of production to achieve returns to scale and positive externalities from industry agglomeration (so similar companies will band together). However, H&S argue that while arguments about returns to scale and agglomeration are valuable, they do not go far enough because they cannot tell us what types of activity will take place in particular places.
37. To answer the “what activity” question we need *a theory of comparative institutional advantage*. For H&S the institutional structures of a particular political economy provide firms with advantages for engaging with specific types of activity, a contention which receives support from literature on endogenous growth, which suggests that the institutional setting for production seems to matter (the residual after explaining increments to capital stock and technical change). Endogenous growth theorists have been particularly interested in network externalities among firms engaging in same activity and also in the nature of property rights. But, hitherto, attempts to specify the institutions needed *have focused on market relations and the legal framework*. In contrast, H&S’s notion of comparative institutional advantage encompasses the importance of variations in institutions for non-market relations. In essence: different modes of coordination condition the efficiency with which firms can undertake various categories of activity.

38. Here, H&S focus on a firm's capacity to innovate, which is key to its long-run success. A key distinction is between:
- *radical innovation*, which requires substantial shifts in product lines, entirely new goods or major changes in the production process. Thus for example LMEs are good at fast moving technology, biotech, software, and semi-conductors, and they are also good at complex system-based products such as telecoms, advertising, airlines, and corporate finance. Here competitiveness demands a capacity both for taking risks on new product strategies and for rapid implementation of these strategies within large, tightly coupled organisations with diverse personnel.
 - *incremental innovation*: continuous small-scale improvements to product lines and processes (for example capital goods, machine tools, and consumer goods).
39. LMEs have limited capacity for incremental technical innovation, as the workforce will cooperate less fully in innovation processes due to (i) financial market relationships that emphasise current profitability at the expense of employee job security and (ii) corporate structures that concentrate universal control at the top. It is more rational for employees to focus on their own personal careers rather than the success of the firm and the development of industry and company specific skills. Contract and anti-trust law limits firms' capacity for intra-sector cooperation.
40. However, LME institutions do foster radical innovation:
- Flexible labour markets reduce the risk of investing in new enterprises as staff can be laid off if these fail;
 - Firms can enter new businesses easily by acquisition;
 - Equity markets with dispersed ownership plus venture capital allows scientists and engineers to bring ideas to the market quickly;
 - Concentration of power at the top of the organisation makes it relatively easy for new management to implement new business strategies.
 - Subsidiaries can be acquired or divested quickly.
41. Typical CME institutions include training systems for high levels of skills; contract laws which support dense networks of inter-corporate linkages; and systems of corporate governance that insulate firms against hostile takeovers. These characteristics support processes of incremental innovation. Finally, a reputation for risk taking and cut-throat competition is *not* an asset.
42. H&S test the theory of comparative institutional advantage against data from OECD countries, and it performs well empirically. First, the LME/CME distinction within the OECD turns out to be a distinction between the English speaking countries and the rest. Second, the CMEs are specialised in activities characterised by continuous technical innovation, and the LMEs are in areas of radical innovation, with the exception of pharmaceuticals, where it is argued that LME institutions will lead to substantial investment as property rights are strong.

- 43 For the purposes of later discussion, it is worth remarking that H&D distinguish three subtypes of CME.
- Industry based (or intra-sectoral) coordination, typically Northern European based on intense intra-sectoral cooperation.
 - Group-based (Japan and Korea) where cooperation is based within a family of companies (vertical keiretsu). Firms offer lifetime employment within the group and hence strong employee loyalty, but this system does not induce intense intra-sectoral cooperation.
 - State-led coordination, where senior industry managers have strong connections to the state (France and Southern Europe). For reasons explored in the next section, H&S are sceptical of the state taking a strong role in coordination.

3 Implications of comparative institutional advantage

3.1 Roles of Government: General principles

44. H&S argue that the key policy challenge is to induce economic actors to cooperate with each other, as *“When firms coordinate more effectively, their performance will be better, and the result will be better overall economic performance. ... Accordingly, one of the principal ways in which policy makers can improve national economic performance is to secure better forms of coordination among private sector actors.”*
45. In some cases markets can be used to secure this coordination, so the task of policy makers is simply to improve the functioning of markets. In other cases, the challenge is to improve coordination in the context of strategic interactions. Much less is known about how to accomplish this, but *“It entails persuading private actors to share information, improving their ability to make credible commitments, and altering their expectations about what others will do.”*
46. H&S see the “strong state” as a potential source of disadvantage. The key challenge to states is that they cannot simply tell economic actors what to do, as they lack the information needed to specify appropriate strategies. States can establish agencies – but what agencies can do is limited. So much depends on the existence of appropriately organised “social organisations”. Where such organisations exist, then it is possible to work with them to improve their cooperation (e.g., if the state improves the way in which it regulates), *but “it is difficult to induce such cooperation ex nihilo.”* Thus effective economic policies have to be “incentive compatible” which from an H&S perspective means *“complementary to the coordinating capacities embedded in the existing political economy.”*
47. Strong states can be problematic because “incentive compatible policies to improve coordination” have to be backed by credible commitment. Firms will be wary of committing themselves to strategic cooperation (based on intense information sharing) where they have grounds to fear that government may change the rules of the game in a more LME direction, allowing individual firms to gain advantage by defecting from strategic cooperation.

48. This leads to some basic insights as to how appropriate policies may differ by types of political economy:
- For LMEs successful intervention policies to improve performance are likely to require quite blunt instruments such as subsidies for basic research or regional development schemes based on tax incentives.
 - In CMEs there has been a co-evolution as participants in strategic coordination led by non-government actors have over time pressured governments to be supportive in terms of further policy and legal changes which support their strategic coordination. This tends to lead to regimes based on coalitions and multiple veto points. These political regimes are well placed to provide the incentive framework to support asset-specific investments.

3.2 *National interests in international negotiations*

49. H&S take the example of the bargaining that has occurred over the construction of the institutions of the EU, which has been an area of struggle between different states' conceptions of their national interests. There is a strong tension between (the majority) "who seek institutions conducive to the formation of implicit contracts between public authorities and business associations" and the only LME within the EU (i.e., Britain – perhaps also Ireland) which wishes to avoid crafting agencies interventionist enough to interfere with the operation of market mechanisms. Thus Britain negotiated hard for its opt-out under Maastricht Treaty, behaviour which can be interpreted as an attempt to protect institutions of a LME. Similarly, German resistance to deep financial deregulation is not simply a defence of rent-seeking, but a concern to preserve the capacities for network monitoring, in order to sustain the attractive growth-supporting terms in which domestic capital is available to firms.

3.3 *Globalisation will reinforce institutional differences*

50. The conventional view is that globalisation will drive all participating economies towards a common institutional framework, the LME model. Three reasons are given for this: (i) firms are seen as the same across countries in terms of basic structure and strategies; (ii) competitiveness of firms is based on unit labour costs – so firms will move abroad in search of lower costs, thereby spreading the dominant LME framework; (iii) governments are thought to be weakened in bargaining with large businesses, which can threaten to move abroad: i.e. firms face lower exit costs than governments. So governments will have to concede what businesses are thought to want, i.e. altered institutional frameworks to lower labour costs, reduce taxation and expand internal markets via deregulation.
51. H&S are sceptical of this view, arguing that:
- (i) globalisation has not (yet) had as far reaching effects as claimed;
 - (ii) there is evidence that firms are different and react differently to globalisation;
 - (iii) firms will not necessarily exit in search for cheaper labour if a substantial part of their comparative advantage is based in institutions of the political economies in which they are presently located.

52. H&S concede that firms based in LMEs may be more footloose in the search for lower labour costs. However, their more general hypothesis is that firms may engage in a form of *institutional arbitrage*, i.e., they may distribute activities around nations to maximise the fit between the economic activities and the political economy within which they are located. (So they will put design facilities in LMEs, to benefit from the fostering of radical innovation, but production facilities in CMEs to benefit from capacities for incremental innovation.) The implication is that as each political economy plays to its institutionally based comparative advantage, national institutional frameworks may diverge further. In summary, there will be divergent political dynamics: within LMEs, the pressure will be on them to become better LMEs through further deregulation to sharpen competitive edges. In contrast, CMEs will resist deregulation, as this undermines the basis of national competitive advantage. H&S claim that this bifurcated response is the observed pattern in OECD countries in recent years.
53. H&S recognise an important objection to their argument that globalisation will cause national institutional frameworks to diverge. Massive expansion of international financial flows have put huge pressure on CME firms to deliver “shareholder value”. However, while CME firms are undoubtedly under pressure to increase returns, H&S think that they are likely to achieve this via internal management practices which maximise comparative institutional advantage. It is not a rational option for shareholders to insist on LME practices if this lowers the rate of return. In summary, in CMEs, market for corporate governance is changing, but at a pace which allows firms to retain many of their long-standing relationships.

4. Implications for research into trade liberalisation and rural poverty

4.1 *Institutional Factors to Consider in Studying Liberalisation and Poverty*

- 54 The foregoing discussion has discussed a number of factors which are rarely considered in research on agricultural liberalisation in poor countries. We argue that the following concepts and themes need to be borrowed from the predominantly rich-country focused literature of institutional economics:
- asset specificity versus switchable (generic) assets, especially in light of the general observation about asset specificity made earlier;
 - incomplete markets;
 - non-standard contractual forms (interlocking and competitive coordination as examples);
 - high levels of investment in specific assets is often essential for economic development, and encouraged by non-market coordination which leads to strategic commitment;
 - the role of deliberative institutions in facilitating non-market coordination to achieve strategic commitment;
 - the importance of consensus around a broadly defined concept of distributive justice for effective operation of deliberative mechanisms;
 - strategic commitment and deliberative institutions are somewhat fragile, and need constant maintenance though repeated engagement by the players;

- the distinction between LME and CME political economies;
- the notion that LME and CME institutions support different types of economic activity, having comparative advantages in, respectively, *radical* versus *continuous innovation*;
- the theory that comparative advantage can be based on institutional differences as well as factor endowments, with the former often being very influential;
- the implications of this theory that globalisation will not lead to full convergence among economies with respect to institutions. Rather, increased trade and capital flows will cause countries to focus on their areas of comparative advantage, which are partly determined by their institutional endowment. This will reinforce the largely institutional differences between political economies, because specialising in activities in which they have a comparative institutional advantage will deepen their commitment to the kinds of institutions which are a source of comparative advantage¹.
- negotiations about supra-national institutional changes (whether at a global level, or the level of the EU or similar) will always be difficult, because countries will struggle to maintain the institutional basis of their competitive advantage
- a scepticism about the value of over-strong states (and equally of very weak states, unable to enforce the law). The ambiguous attitude to the state is based on the notion that while states should participate in deliberation and strategic coordination, nevertheless, when the state dominates this process this can act as a disincentive to strategic commitment by other parties, who are concerned that the state will change the rules without being subject to serious constraints. H&S argue that strategic commitment is highest when all parties to deliberation are able to sanction each other, implying that non-state actors need to be able to sanction the state.

4.2 *Institutional pre-requisites for agricultural development in poor countries*

55. The agriculture sector's contribution to poverty reduction will be made, principally, where broad-based growth is achieved in smallholder farming communities. Important historical examples of the strategic contribution of agriculture to development are the Green Revolution areas of India and China. Both of these occurred within specific and well-defined institutional frameworks, including strong state intervention in irrigation infrastructure and in delivery systems that influenced prices, transaction costs and transaction risks in inputs, finance and output markets. In contemporary India and China the emerging challenges are to find means to modify the institutions which underpinned the Green Revolution to support urbanisation and a diversifying rural economy. However, in much of Sub-Saharan Africa, and some parts of South Asia, sustainable broad-based agricultural intensification has yet to occur. In other words, agriculture has not yet made its strategic contribution to economic development.
- 56 In Sub-Saharan Africa, the following institutional aspects of the challenge of smallholder development need to be noted:

¹ An example of this interaction between comparative advantage and institutional endowment, at sector rather than macro level, is provided by Ponte (2001) which discusses changes in the international coffee trade and how the three different East African producers have responded.

- development of smallholder agriculture requires high investments in co-specific assets by a variety of different players, in situations with significant information problems, high opportunity costs for capital and, for some parties, significant risk aversion. Therefore, a CME institutional set may be more appropriate than an LME set;
- it is also an industry in which continuous technical innovation seems more likely and appropriate than discontinuous innovation, again suggesting that the CME institutional set may be more appropriate than the LME set;
- there is currently a serious (desperate) lack of the asset specific investment needed for development in input supply systems, in agricultural finance, in processing and marketing, and in transport and water infrastructure;
- if strategic commitment to asset specific investment could be secured, both horizontally (among specific categories of players such as traders and farmers), and vertically (within supply chains) then it seems very likely that much higher growth rates could be achieved;
- institutions needed to promote strategic commitment to asset specific investment are largely lacking
- with regard to the previous point, up to the end of the 1980s, the state had (with mixed success) played the central role as a provider of infrastructure and subsidised finance and of input and output marketing services. Processors were often state owned and/or operated under policies of protection. In the last 10 to 15 years, however, liberalisation policies have been pursued, mainly under pressure from the Washington institutions (to a much lesser extent WTO pressures) and informed by what the present authors (Kydd and Dorward 2001) have called “The Washington Consensus on Agriculture” (WCA).
- The results have, by and large, been unsatisfactory, and a debate has been joined between:
 - Those who argue that liberalisation policies have not yet been pursued with sufficient determination and credibility to elicit a strong supply response;
 - The current authors (for example Kydd and Dorward 2001; Dorward et al. 2002), who, while not unsympathetic to many of the aspects the WCA, nevertheless argue that it has tried to introduce elements of institutional change which are regressive, while failing to see opportunities for progressive institutional change.
- The view of the current authors can be summarised by saying that the WCA is trying to impose LME institutions on poor rural areas, whereas what is needed is an evolution in a more CME direction. To paraphrase further, an Anglo-Saxon model is being pushed, whereas elements of the European/East Asian institutional model could be more helpful. [Ultimately African economies should have more freedom to develop models which seek to understand and build on their own comparative institutional advantages.]

4.3 *The rural impasse in SSA*

57. The present authors (Kydd & Dorward 2001) have written about “AID” the “agricultural investment dilemma” in smallholder agriculture in poor countries. Most analysts agree that this is very important, but few can see how it may be done, particularly done profitably.

Institutional economics provides insights into the current impasse in rural Africa. Non-market coordination is urgently needed to induce asset specific investment, but this turns on the availability of effective deliberative institutions. Furthermore, these deliberative institutions need to be able to develop a vision shared by all participants of what might constitute socially just outcomes. This is notably absent in many African states, where high levels of inequality persist or are increasing and liberalisation itself remains highly contentious. Thus, when policy towards a given agricultural sector is discussed in public fora, technocratic debate is readily displaced by political point-scoring that pits traders against producers against government agencies.

58. Given the spatial dispersion of smallholders, the small size of their businesses and their poverty, low levels of education, large cultural variation (e.g. in language and inheritance traditions) and weak information (in terms of accessible reliable media, and farmers' understanding of the roles of other actors in the supply chain), it can be seen that the development of effective deliberative mechanisms is highly problematic.
59. From the late colonial period to the end of the 1980s (alternatively, the point at which the liberalisation agenda could no longer be ignored by African governments) we argue that governments often attempted to fill this gap, with different degrees of success (often related to varying participation in or control of the rent seeking opportunities that these institutions also offered). In other words, governments intervened as a substitute for autonomous, deliberative mechanisms to promote intra-industry coordination and strategic commitment, because the material conditions were unfavourable to this being done spontaneously. Thus governments made the lumpy asset-specific investments thought necessary (usually with development aid), and encouraged asset-specific investment from farmers by a policy framework which attempted to boost the profitability and reduce the risk of farming. (However, these last two aims were often outweighed, over time, by the negative effects on agricultural tradables caused by inefficiency, patronage, corruption, exchange rate overvaluation and industrial protection).
60. As discussed above, H&S theorise that state-dominated institutions for encouraging strategic commitment by the actors within a sector are likely to be less effective than those in which the state is co-equal with other actors. Reasons for this include:
 - (i) where the state is dominant, its commitments are less credible, as it can quickly reverse policies without suffering severe sanctions from other actors;
 - (ii) weak accountability and limited information allows state employees considerable scope for rent-seeking;
 - (iii) state actors are usually less sensitive to the dynamics of an industry than its private participants, so state dominated activities tend to fall behind in terms of product quality, technological development and productivity.
61. However, it could be argued that, in Africa, there was little choice but for the state to take the lead in efforts at non-market coordination. Except in cases where private processors were present on a large scale, there were few alternatives to a state led approach. The alternative, feasible for certain cash crops only, of coordination being led by a dominant private interlocker, was politically very unpalatable, and perhaps had nearly as much scope for rent-seeking.

62. This discussion gives us a very different perspective on liberalisation in poor rural areas. Rolling back the state is, for sure, eliminating organisations and a policy framework which has created scope for rent-seeking, while being technologically and managerially slothful. However, what has been largely ignored in the liberalisation literature was that the state was involved in the first place because:
- (i) coordination to encourage asset specific investment was vital, and frequently the state was the only actor available for this;
 - (ii) the state itself made asset specific investments that others would not have made (given the material conditions and institutional environment of smallholder agriculture);
 - (iii) the state sometimes overcame market failure, particularly the near pervasive issue of credit market failure, though practising a form of interlocking, based on area monopolies and state power.
63. The current predicament in liberalised smallholder farming areas of Africa is the assumption that policy reform has created space for the flourishing of LME-type institutions, markets and hierarchies, with little non-market coordination. We argue that this is somewhat of an illusion, as neither the demand nor supply conditions nor the infrastructural or informational prerequisites are in place for a self-sustaining LME growth path to be attained. Players (farms and input and output marketers) are typically small, lacking in effective loan collateral and subject to high climatic and price risk. Transport costs are high and other forms of communication are underdeveloped. There is widespread market failure in smallholder finance, leading to weak use of inputs and failure to make much headway in intensifying production. This is a discouraging market for processors to invest in. The result is a low level equilibrium trap, arguably aggravated by the “institutional naivety” of liberalisation policies

5. Conclusions

64. We should approach the topic of liberalisation and poverty with a broader theoretical framework, informed by the considerations discussed above. Our contention is that smallholder agriculture in poor countries needs CME-type institutions if it is to develop, at least at the earlier stages. Ideally, these would be based on deliberative institutions, working horizontally inside a sector, and also vertically along the supply chain, based on a consensus about what may constitute a “just” outcome. (If participants in deliberation do not accept the outcome of the process, then they will simply argue, and fail to engage in strategic commitment).
65. In practice, the conditions of smallholder agriculture may force the government to take a greater role than is suggested by any of the OECD models (LME or CME) studied by Hall and Soskice. Intervention by the state almost inevitably encourages some rent-seeking, inadequate deliberation, and a certain lack of dynamism. At the same time, however, as in the achievement of India’s and China’s Green Revolutions, a degree of success may be achieved which is difficult to imagine under a pure LME model² due to inadequate strategic

² A key question here is: what were the incentives that led state agents (individually and collectively) to pursue development goals with sufficient vigour that this more than offset the costs imposed by rent-seeking? Can similar conditions be created in Africa?

commitment to asset specific investment and, possibly, an unwillingness to support non-standard contractual arrangements (such as interlocking).

66. The present authors believe that the way forward is likely to involve a rethinking of the role of the state (at sub-national, national and international - aid donor - levels) and of the roles of producer organisations and other stakeholder (including trader) associations. The aim must be to find a way in which the state and other powerful actors can initiate deliberative processes and take a lead in encouraging appropriate asset specific investments, while at the same time planning to fade into the background as initial success is achieved. The second stage of a successful path of institutional development will have the state and other stakeholder (prominent among these producers) acting as equal partners.
67. Research on liberalisation and poverty needs to be “institutionally informed”. The challenge to the institutional specialists is to be able to provide insights, ideally quantifiable, into the consequences of liberalisation policies driving changes in such features as “non-standard institutional arrangements”; non-market coordination; and the role of the government. Those of us engaged in institutional analysis are still far from meeting these challenges.

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