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Poverty Reduction and Institutional Change

by Robert Picciotto

No one can seriously question that a better quality of life for everyone is the unimpeachable universal goal of humanity.

—Edward O. Wilson

Poverty reduction is the overarching global policy challenge today. Poverty breeds despair, promotes social dislocation, adds to environmental stress, aggravates ethnic tensions, and engenders political instability. There can be no peace without equitable and sustainable development.

What new forms of organization are needed to meet the poverty-reduction challenge? How must organizations adapt to take account of the cultural context in which their activities will be carried out? What new concepts, instruments, and partnerships are best suited to tackling the poverty problem? And what are the implications for development assistance?

CULTURAL ANTECEDENTS

Throughout history, inadequate food supplies have limited the size of human populations. Even in the now industrialized countries, the race between food production and nutritional needs remained close until the last century.¹ France, a relatively privileged rural economy, endured countless local famines and suffered a major countrywide famine an average of once every ten years from the tenth to the eighteenth centuries. The food situation was even more precarious in other parts of Europe.

The advent of productive agriculture required the abolition of serfdom and the advent of private farming, but it also entailed major investments in education and infrastructure, as well as sustained government action to promote technological change and create a national market for agricultural produce. This process is still under way in the developing world.

According to Deepak Lal,² the economic ascent of the West is due to fortuitous historical circumstances:

- the fragmentation of the Roman empire into a number of feudal states, each too weak to extract high rents without commensurate recognition of quasi-legal obligations vis-à-vis their subjects;

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- the invention of commercial law by mercantilist city-states, which facilitated the expansion of trade, nurtured the capitalist spirit, and promoted self-interested rationality in economic transactions;
- the Greek legacy of the self-governing city-state, which established the supremacy of the concept of citizenship over other forms of human association; and
- the promotion of the nuclear family system by papal decisions in the seventh century.

These innovations provided the cultural foundation for scientific invention, individual initiative, recognition by the state of private property rights, and the assumption of social responsibility for the old and destitute by the church and the state. Together, these cultural features promoted a social order consistent with restless economic innovation, market exchange, and social cohesion—until the most recent decline in religious values.

Appropriate choice among institutional alternatives, taking account of the cultural context, is a critical ingredient of success.

Two competing views of the state eventually emerged. The first, inspired by the Greek city-state, is the *civil association*, under which the state acts merely as the custodian of laws that aim to facilitate individuals' pursuit of their own goals. The United States is the exemplar of this model. The second is the *enterprise association*, which legislates morality and seeks to use the law to achieve national goals.

The end result was that Europe originated a capitalist model of production grounded in *individualism*, while state-centered, *communist* doctrines (and the extreme *collectivist* solutions of unchecked totalitarianism) dominated institutional development in the rest of the world. Development patterns in the West varied from country to country but had one thing in common—a judicious balance among the state, market, and civil society. Given their distinct traditions, the mix of the three sectors varied, but pluralism and built-in constraints against the predatory tendencies of the state were common traits among them all. By contrast, many developing countries have been characterized by weak private and voluntary sectors and an overextended and “soft” public sector.

TODAY: GLOBALIZATION

The global trends we are witnessing today are correlated with rapid technological change combined with inadequate institutional adjustment. With currencies floating against one another and global exchange markets now accounting for sixty times the volume of trade and investment flows, national economic policies have become constrained by the perceptions (and sometimes the whims) of private investors. Whereas business corporations (and some voluntary associations) have adapted to the new

economic geography—and indeed have encouraged its emergence—national institutions have had considerable difficulty keeping up with the historic shift.

Much of the world is now seeking to adopt market-friendly policies. However, relatively few countries have nurtured the norms and the complementary institutions needed to achieve harmonious connectivity to the global economy. The chronic instability associated with economic interdependence has favored countries with well-established market institutions. In parallel, given the growing global mismatch between economic and political organization, the new economic order has been characterized by a huge deficit in global public goods, penalizing those at the very bottom of the economic ladder.

Global trends are correlated with rapid technological change combined with inadequate institutional adjustment.

To be sure, the impact of globalization has been highly differentiated. Most developed countries and a few developing countries (e.g., Taiwan, Chile, and Mauritius) have benefited. Continental and populous nations such as China and India were also able to make major strides in poverty reduction. Conversely, countries endowed with weak governance, limited skills, and fragile banking sectors have suffered major setbacks. In particular, much of Africa has been marginalized due to civil strife, policy weaknesses, adverse terms of trade, lack of domestic capacities, and excessive debt. The average African household consumes one-fifth less than it did twenty-five years ago.³

According to former U.S. secretary of labor Robert Reich, under globalization, “the gainers tend to be better educated, and have higher incomes. The losers tend to be worse educated and have lower incomes to begin with. They have the hardest time moving into the better-paying jobs.”⁴ This is the predicament of many poor countries that lie at the periphery of the global economy. As recently highlighted by Harvard economist Jeffrey Sachs, 700 million people living in 42 highly indebted poor countries are afflicted by “a combination of extreme poverty and financial insolvency which marks them for a special kind of despair and isolation.”⁵

Knowledge-based services have replaced mass production as the major source of wealth. The advent of the information age—combined with major breakthroughs in the biological sciences—should help accelerate a shift towards sustainable development strategies. But this implies rapid institutional change to adapt to an integrated global ecology and an interdependent international economy.

According to Francis Fukuyama,⁶ even in the industrial democracies, the transition toward a knowledge-based economy has involved a “great disruption,” which has lasted for more than three decades and induced major dislocation in social bonds (due to the erosion of religious and community values) while at the same time generating extraordinary economic expansion and ecological stress. Whether the social order in the West is currently being reconstituted, as Fukuyama maintains, or has been irretrievably damaged by the “anything goes” culture that emerged in the West during the 1960s, as prophesied by Lal, remains an open question.

Certainly, more emphasis on environmental protection and greater international solidarity will be required to achieve sustainable poverty reduction on a global scale. Without increased help from the developed world, the rapid transformation under way in developing countries will be far more disruptive and problematic than in the West. The resulting instability may even endanger the security of the planet. The cultural upheaval could be long lasting given the need to strengthen market institutions (still in their infancy in most developing and transition economies) while at the same time maintaining the communalist values needed for social cohesion.

The stakes are high. Without institutional adjustment, the social consensus on which sustained reform depends will break down, thus damaging a critical component of the ongoing globalization process. This happened earlier in the twentieth century, when the “creative destruction” that Joseph Schumpeter equated with rogue capitalism produced a backlash. The risk of history’s repeating itself is not negligible, given the growing number of politicians (such as Le Pen in France, Buchanan in the United States, and Haider in Austria) who are exploiting public apprehension with market-oriented policies and preaching a return to interventionism and protectionism.

POLICY DETERMINANTS

In terms of values, poverty reduction is hindered by a lack of individualism, a deficit in altruism—or a combination of both. The former gap cripples growth; the latter hinders equity. A deficit in group loyalty and hierarchy is also damaging to growth and equity. Most developing countries need capacity-building in all sectors—public, private, and voluntary. But for the required capacities to be built, an appropriate balance among government, the market, and civil society must be struck—both in the aggregate and at the level of microinstitutions.

Ironically, the policy basics of how poverty reduction can be secured are now solidly established. In terms of perceptions, the consensus that has been constructed during the past decade is an advance over the situation that prevailed when there was a misplaced free-market triumphalism in the wake of the dissolution of the Soviet Union—let alone three decades ago, when central planning was still perceived as fundamental for economic and social development.

The essential conditions required for poverty reduction are no longer in dispute. Rapid economic growth is a prerequisite for substantial poverty reduction. It calls not only for sound and flexible macroeconomic management (the “Washington consensus”) but also for a well-educated labor force, transparent and accountable government, an independent and credible judiciary, and a well-regulated financial sector. These are the requirements of entry in the new global economy. In order to translate intensive growth into sustainable poverty reduction, it is necessary to promote rural development and labor-intensive industries, provide equitable access to social services, construct resilient social safety nets, and create an environment-friendly regulatory framework. Thus, a new development consensus has emerged, and with it a new concept of capital (see Fig. 1).

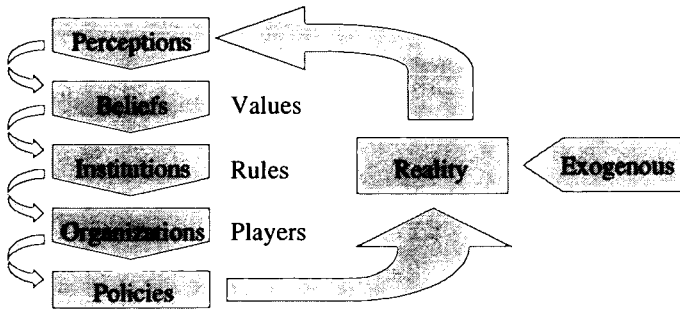


Fig 1. *Unbundling the concept of capital.*

THE NEED FOR INSTITUTIONAL ADAPTABILITY

The neoinstitutional perspective, conceived as a social learning process (see Fig.2), gives a special role to cultural factors. It incorporates institutional development and political participation within an integrated view of social transformation, giving pride of place to policy experimentation and objective evaluation of what does and does not work.

By screening information about the real world, mental constructs are critical to the creation and adaptation of social institutions (i.e., rules, norms, conventions, and organizations). Hence the critical importance of advocacy and opinion-making in human affairs—and the fundamental role of good public-policy advice. It is out of *ideas* about what is taking place in the real world that customs, incentives, organizations, and policies are shaped. These are the rules of the game that ultimately determine human interactions, aggregate economic performance, and who the winners and the losers will be.

Organizations and norms help to minimize transaction costs by increasing predictability in human behavior and generating trust. At the same time, they induce stability (“path dependence”) in social protocols. Conversely, customs and rules can become dysfunctional when changes in the natural, technological, and/or demographic environment are frequent and/or large.

Societal beliefs and values may take generations to change. Consequently, the adequacy of the cultural context vis-à-vis existing factor endowments and evolving technological resources can be a powerful determinant of long-term economic performance. But even if the culture is flexible enough to accommodate adjustment, the policy response may not match the transformation of the external environment.

Difficult initial conditions, lack of public understanding, inadequate leadership, or the inability to resolve divergent interests can lead to inadequate policy responses. In addition, more often than not, inadequate social structures and/or misdirected institutional change come into play. Without judicious adjustment in social structures and institutions, a crisis eventually ensues; hence the relevance of periodic if not continuous redesign of policies and institutions.

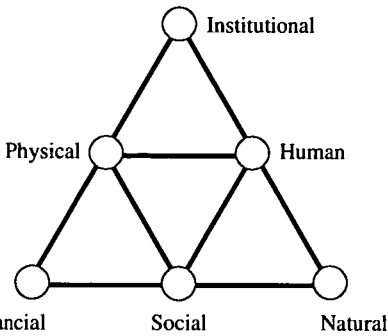


Fig. 2. *Development as social learning.*

In certain circumstances, crises induce social learning—even as they destroy capital resources and cause great human hardship. Crises deliver tough policy messages, open up new modes of thinking, offer opportunities for fresh political and organizational leadership, and facilitate institutional adjustment. For example, it took a devastating world war to trigger the development crusade. The food crisis in the 1960s imposed changes in rural policies and ushered in the green revolution. The oil crisis of the 1970s shifted

economic policies toward conservation and favored the ascent of the environmental movement.

Similarly, the debt crisis of the 1980s induced widespread adoption of market-oriented policies and accelerated the realignment of economic functions away from the state and toward the private sector and civil society. The most recent crisis, which started in Thailand in 1997 and spread to the rest of East Asia, Russia, and Brazil, provided dramatic confirmation that hooking up to the mighty engine of the global economy involves major benefits but also unprecedented risks—unless institutional conditions are adjusted to promote effective resource allocation and social cohesion. What distinguishes the latest crisis from its predecessors is that it has brought to light fundamental implications for the development business. Just as technology-driven economic interdependence operating in a borderless world introduced microeconomic changes within the policies and structures of international business firms, new development concepts, instruments, and relationships will need to be forged to achieve global poverty reduction. Appropriate choice among institutional alternatives, taking account of the cultural context, is a critical ingredient of success.

BEYOND GOVERNMENT AND MARKETS

Let us turn our attention to the relative capacity of alternative forms of organization to achieve defined public-policy goals. What I propose is a scheme that considers civil society as a distinct organizational alternative—alongside government and the market. There are empirical grounds for introducing this third institutional dimension.

Political liberalization and the advent of new information technologies underlie the emergence of globally interconnected private voluntary associations. Given the limits of governments and markets, accurately documented by Charles Wolf, Jr.,⁷ these organizations are increasingly active in shaping public opinion, delivering services to the poor, and mediating between government and citizenry in the design of public policies.

Voluntary associations have had a long tradition of public action in the United States—as Alexis de Tocqueville observed in his travels across the young republic. What is new is the growing clout of nongovernmental organizations in the developing world. According to Lester M. Salamon, director of the Center for Civil Society Studies at Johns Hopkins University, the rise of citizen-led organizations “will prove to be as momentous a feature of the late 20th century as the rise of the nation-state was of the late 19th century.”⁸ Twenty years ago, only one nongovernmental organization was concerned with environmental protection in Indonesia; today there are more than two thousand.⁹ In Slovakia, where only a handful of such organizations existed in the 1980s, there are now more than ten thousand. In the Philippines, the number of registered nonprofit organizations grew from eighteen thousand to fifty-eight thousand between 1989 and 1996.¹⁰

Hooking up to the mighty engine of the global economy involves major benefits but also unprecedented risks—unless institutional conditions are adjusted.

On the other hand, social capital may not have increased as much as suggested by these statistics, since traditional forms of self-organization have lost considerable influence while scarce cultural assets have been allowed to deteriorate. Furthermore, free riding is a severe problem for large voluntary groups. Small, privileged, well-funded constituencies are often extraordinarily effective at advocacy, and this is not always used in the public interest. Lack of accountability can be a problem too, especially where the regulatory framework for nonprofit organizations is weak. Lastly, the dark side of self-organization can be discerned in racist and exclusionary groups. Thus, the voluntary sector is not necessarily a superior alternative to the private sector or the public sector, as it too suffers from distinctive limitations. Accordingly, the power of the civil society needs to be balanced by the workings of the market as well as the regulatory environment of the state.

PROMOTING GLOBAL POVERTY REDUCTION

While seeking to accelerate institutional adjustment, special difficulties associated with globalization need to be recognized. While most politics is local, economics is increasingly global. The mismatch between political sovereignty and economic interdependence arises from the successful adaptation of the business sector to the borderless economy and the lack of effective global governance regulating private enterprise.

The growing role of corporate cross-border capital and trade transactions (combined with the need for companies to adopt global strategies in order to compete) has created a global public-policy gap.¹¹ During 1985–1995, foreign direct investment grew at 16% annually, compared to 2 and 7% for output and trade, respectively. The combined value of global trade and foreign direct investment only accounts for six days of turnover on the global exchange markets.

Through the fusion of markets and the free movement of goods and capital across borders, territoriality (on which the nation-state relies for control) has become irrelevant for a wide range of economic decisions. The volatility of exchange rates and the chronic recurrence of financial crises flow directly from this state of affairs. Lacking the exit option available to capital and knowledge, labor has seen its competitive advantage severely eroded. Conversely, knowledge and capital have secured higher rewards.

In addition to bearing the burden of financial crises, the poor have been penalized in other ways. They have been disproportionately affected by natural disasters and are especially vulnerable to civil strife, ethnic divisions, and regional conflicts. Without adequate access to health care, they have fallen prey to new diseases—and old ones as well. Lastly, they have been severely affected by the stress imposed on common property resources.

For global strategies to succeed, it is no longer feasible to rely exclusively on national programs. If severe financial crises persist, it is because of inadequate international standards and mechanisms to prevent and mitigate them. If global environmental problems are becoming more serious, it is less because of a deficit in beliefs and values (opinion surveys regularly highlight the popularity of environmental protection) than because of the collective-action dilemmas that stand in the way of balancing the costs and benefits of conservation. Institutional adjustment will need to take place at the global as well as the country level.

In particular, if global poverty trends continue to worsen, it will be because the current development system has not been reengineered. The solution to the global poverty crisis lies in articulating new concepts, deploying new instruments, and forging new partnerships both at country and at global levels.

Specifically, with the advent of the global knowledge economy, countries that have not invested in human capital or that have failed to create market institutions will have to undergo a wrenching transformation—or risk joining the growing ranks of failed and failing states. Supporting the vital transition towards prosperity in the new economic order is the central challenge of development assistance. Therefore, under the *Comprehensive Development Framework*¹² initiative of James D. Wolfensohn, president of the World Bank, poverty reduction is being sought through a holistic, results-oriented approach to development with a special focus on improved governance (see Fig. 3). This initiative, which is being piloted in thirteen developing countries, emphasizes domestic ownership of policy reform; partnerships among government, the private sector, and voluntary agencies; and a results orientation in development assistance.

NEW CONCEPTS

Just as a modern business sets its corporate goals consistently with the authorizing environment, the competencies of the corporation, and market competition, it behooves any developing country to take a long view of its potentials and aspirations and to do so realistically, taking account of the regional context and global factors.

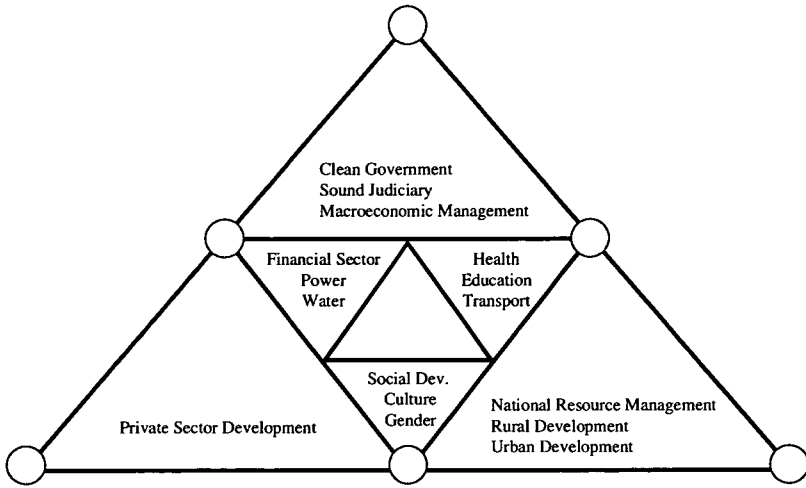


Fig. 3. *The Comprehensive Development Framework.*

Poverty-reducing programs take time to create, social protection policies require time to take root, and it may take a generation or more to overhaul the human capital base and implant the skills and the organizations needed for equitable and sustainable development. Under the Comprehensive Development Framework initiative, through improved aid coordination, poor countries will receive the advisory services they need to design long-term poverty-reduction strategies focused on results.

A results orientation is fundamental. Civil-service reform and improvements in the management of public expenditures are essential components of poverty-reduction strategies. They aim at shifting the focus of government toward the effective provision of services to its citizenry. In this context, poverty-reduction programs make clear distinctions among inputs, outputs, outcomes, and impacts. Performance indicators are collected and help monitor program implementation.

Modern poverty-reduction programs are *participatory*: they involve the private sector and civil society. Where globalization is perceived as a threat, the preservation of cultural heritage can be achieved through hybrid organizational arrangements combining private financing for tourism facilities with special financial assistance to poor residents to upgrade their dilapidated housing, as well as appropriate investments and safeguards directed at preserving cultural specificity and historic value. Similarly, introduction of property rights and involvement of farmers' associations can help promote sustainable cultivation and forestry practices.

The provision of infrastructure is no longer the exclusive province of the public sector. For example, the enabling environment can be adjusted to shift power services from the public sector toward the private sector by conceiving of them as toll goods; making use of new technologies that favor small-scale generation (e.g., gas-fired turbine generators); and designing networking policies (dissociating distribution from production) that enhance competition, promote the involvement of local communi-

ties, and facilitate access to the services by the poor. Similarly, trading of pollution rights can make use of market principles to achieve abatement levels in a more cost-effective way than command and control regimes.

NEW INSTRUMENTS

Change in the rationale of development assistance from an instrument of geopolitics to an important concomitant of global economic integration—with special emphasis on poverty reduction—has already led to diversification of the development assistance toolkit.

Increasingly, development assistance is moving away from the fulfillment of resource transfer targets toward the nurturing of new policy ideas, the sharing of development knowledge across countries, and the promotion of domestic capacity. Greater selectivity is being practiced to ensure that assistance flows are directed to countries committed to policy reform and poverty reduction.

Evaluation results confirm that the overall policy and institutional environment has as much influence on project outcomes as project-specific factors. A major improvement in development practice has taken place with the use of participatory country-assistance strategies prepared by the countries themselves in consultation with the private sector and elements of civil society. Such inclusive strategies offer the promise of connecting projects with policy reform and technical assistance with institutional development. In certain circumstances, programmatic forms of assistance are used to improve coherence among development partners and to reduce aggregate transaction costs.

NEW PARTNERSHIPS

The poverty problem is in part a classic problem of public-goods underproduction. The need for participation in the provision of public goods is even greater once the global dimension of the problem is recognized.

The current aid-delivery system is characterized by excessive fragmentation, frequent duplication, and high transaction costs. It is isolated from the most dynamic and powerful elements of the global economy—the private sector and the voluntary sector. Global poverty-reduction targets have been set, but they have not been linked to results-oriented alliances among governments, the private sector, and civil society.

New partnerships are urgently needed to deal with transnational problems—in support of debt relief, postconflict reconstruction, humanitarian crisis prevention, preservation of cultural heritage, environmental protection, disease surveillance and prevention, and science and technology development. Models for such programs exist: mission-oriented international collaborative programs have proven effective in disease surveillance and eradication, as has scientific research along the lines pioneered by the World Bank and its UN partners with respect to river blindness and international agricultural research.¹³

At the country level too, more involvement of the private sector and civil society is imperative. More effective coordination among donors and greater selectivity of aid flows in line with government commitment to reduce poverty will be required. Furthermore, mutual accountability to deliver results will be needed to sustain the credibility of the partnership between donors and beneficiaries of aid. Lastly, at the local level, greater involvement of the poor themselves in the design and operation of development programs is desirable. This will require businesslike alliances between official agencies and the voluntary sector, the vision of the Comprehensive Development Framework.

Institutional adjustment will need to take place at the global as well as the country level.

Whether it is the lack of policies and programs to protect the poor against the vagaries of nature, or the lack of access to clean water, schooling, health clinics, or credit, the main constraint the poor face is a lack of empowerment and a sense of exclusion from the decisions that affect their lives. In most cases, *participation* is the missing ingredient. A similar predicament exists at the global level, where the voice of the poor is muted.

The basic dilemma of collective action faced by the poor is that they are too weak: too numerous, too dispersed, and too diverse in their interests to form effective coalitions. How to give voice to the voiceless poor; how to give them a seat at the table when development programs are debated and policy priorities are set; and how to channel their scattered energies and extraordinary survival skills into productive pursuits is the fundamental challenge of development assistance.

At the local level, partnerships among the central government, local communities, and voluntary organizations are critically important both to ensure that the voices of the poor are heard and to guarantee that solutions adapted to the local circumstances are designed and implemented. Greater opportunity for the poor to engage in productive activities requires that partnerships with the private sector be forged to provide the poor with employment opportunities. Here again, civil society has a critical role to play in mediating among the business sector, the public sector, and individuals in poor communities.

Social entrepreneurship has begun to mobilize local communities. Provision of microcredit has been pioneered by private voluntary organizations. Advisory services or independent verification by nongovernmental organizations are gradually ensuring that multinational companies investing in developing countries behave as good corporate citizens and engage in local consultations so as to show the way to their domestic counterparts, facilitate community development, and ensure full compliance with sound environmental practice.

Lastly, in recognition of the fact that government goods are critical ingredients of effective governance, civic advocacy groups are challenging the workings of the state to ensure that it is responsive to the needs of all citizens, including the poor. Con-

versely, politicians and public servants dedicated to transparency, accountability, and the rule of law deserve privileged external support. Basic capacity-building is a worthy development assistance priority in pursuit of poverty reduction.

CONCLUSION

There is still time to banish absolute poverty from the face of the earth and to avoid ecological destruction. Fifty years after the development crusade began, much has been learned about the development process. There is now broad-based consensus with respect to the determinants of equitable and sustainable development. The strategies to achieve poverty reduction are well known. With appropriate leadership, a consensus for reform can materialize at local and global levels.

Poverty-reduction programs make clear distinctions among inputs, outputs, outcomes, and impacts.

Poverty reduction requires extensive production of a wide variety of goods. In turn, these goods need to be produced through a diversity of organizations adapted to the requirements of each type of good. To achieve sustainable results, the overall institutional framework must reflect the needs of the market, the aspirations and knowledge of the people, and the judicious support of the state.

This implies multiple partnerships among the private, public, and voluntary sectors. Culture matters, but the lessons of development experience show that organizational mismatch (e.g., efforts to substitute the state for the market) is a fundamental constraint. Until pragmatic principles of institutional design become part of the belief system, the poverty-reduction crusade will not succeed.

The world has ample resources to get the job done. The specific challenge of poverty reduction lies in the construction of *institutional capacity* in the government, private sector, and civil society of developing countries and transition economies. This must be combined with the forging of purposeful global partnerships focused on critical public-policy gaps and grounded in the comparative advantage of different institutional actors. Underlying the overall challenge is the urgent need to shift beliefs and values from unbridled individualism to environmental realism—and from heedless competition to social cooperation. This cultural shift may be the most critical of all.



Notes

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