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International Seminar on

Informal Institutions and Development– What do we know and what can we do?

Overview Paper: Roundtable Discussion

INFORMAL INSTITUTIONS AND DEVELOPMENT: THINK LOCAL, ACT GLOBAL?

by

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1) Informal Institutions - What do we know?

The granting of this year's Nobel Peace Prize to Mohammed Yunus in recognition of the success of the Grameen Bank illustrates a case where informal and formal rules coexist to shape important development outcomes. Grameen's success is a story about how 'trust,' 'solidarity' and 'informal social pressure' have done more to alleviate poverty and drive investment among the very poor than formal banking institutions. There are also numerous examples where the opposite is true: formal and informal institutions work against each other with less happy consequences. For example, current governance reforms in many developing countries that try to introduce "new" public management may in fact upset entrenched forms of patronage politics that perhaps 'buys' social stability, an important precondition for broader development. Laws addressing gender rights in Pakistan, for empowering women, are hampered by informal institutions such as norms and attitudes among particular segments of Pakistani society in ways that may have massive consequences for the development prospects of poor women.

The objective of this primer is to review the literature on what we know about informal institutions: Do they matter for development and how? What is the relationship between the formal and informal institutional set-up? And most importantly, can one change a "bad" informal institutions and how and who should go about doing it.

The proposition that 'institutions matter' for economic growth and development has received intense attention. In fact, what this statement really means is that 'incentives matter,' because institutions shape the incentives that people face for behaving in one or another way. It is increasingly being recognized, however, that formal institutions alone do not shape human behavior, but that much of what goes on can be explained also by informal institutions that are grounded in and emanate from a society's culture. This aspect, however, has been fairly neglected. The reasons are that informal institutions are difficult to identify, measure, quantify, and often relate to dimensions of a society's culture that economists and other social scientists prefer to shy away from, not least because of hard policy-related issues. There seems also to be much confusion about what people refer to as institutions when it also involves features, such as norms, morals, values, and attitudes embedded in culture (Hechter and Opp 2001).

Institutions are generally defined as the "rules of the game," or "humanly-devised constraints that shape human interaction" (North 1990)pg3. Since human beings live in an uncertain world, they devise institutions to control their environment so as to bring about some certainty, to minimize transaction costs, which may be thought of as the costs of doing business, or the costs of relations between people. There are different ways of classifying institutions – according to their speed of change (slow or fast moving), the arena where they are situated (social, political, economic and cultural), and the degree of formality (informal and formal) (Jütting 2003). Finally, all informal institutions (rules governing behavior outside official channels) should not be confused with culture. However, we recognize a close association between what Paul DiMaggio terms the 'constitutive' and 'regulatory' effects of culture and informal institutions (DiMaggio 1994). The *constitutive* effects relate to aspects of culture that shape economic behavior by guiding relative valuation, categorizations and understandings of economic processes and outcomes, which are passed on through the generations by parents, schools, peers. The *regulatory* effects refer to the way in which the values and beliefs of a society are manifested through social norms and attitudes in ways that regulate behavior: promises must be kept, contracts must be honored.

This primer addresses three fairly broad questions but is by no means an exhaustive treatment of this complex subject:

- how do informal institutions contribute to development outcomes?

- how do informal institutions interact with formal ones, and what determines their emergence and change?

- who and what could be the drivers of change?

2) Informal Institutions and Development: Channels and Mechanisms

The following flowchart illustrates a basic framework for understanding how institutions affect development outcomes[1]. In a nutshell this figure shows that Development Outcomes (D) can hardly be attributed to one single institution (A). Take the example of "growth and poverty reduction" as important goals in development. Figure 1 shows that (D) depends critically on the complex interaction between i) the behavior of individuals, ii) institutional outcomes and iii) the institutions themselves and finally v) external factors like geography and history. From this it becomes immediate clear that the search for "high quality institutions" such as "good governance", "conflict resolution mechanisms" and "effective property rights" is a very tricky task and the result depends heavily on context and external factors. Next, we spend sometime on definitional issues and discussions around the diversity of institutions in order to bring as broad a perspective as possible for assessing how institutions, rather than 'something else,' matter for shaping development.

In the following, the key elements of the framework – "institutions" are defined and examined before discussing their interaction and impact on development outcomes.

Following North (1990), institutions include any form of constraint that human beings devise to shape human interaction. These constraints include both what individuals are prohibited from doing and the conditions under which individuals are permitted to undertake certain activities. In other words, they are the "incentive framework" for human action. Institutions consist of formal written rules as well as typically unwritten codes of conduct and regularized behavior that underlie and supplement formal rules. In fact some view rules as 'tools' that allow individuals to solve collective dilemmas. 'Institutions are among the tools that fallible humans use to change incentives to enable fallible humans to overcome social dilemmas' (Ostrom 2005: 125). Thus, understanding how institutions shape outcomes is particularly useful for policymakers.
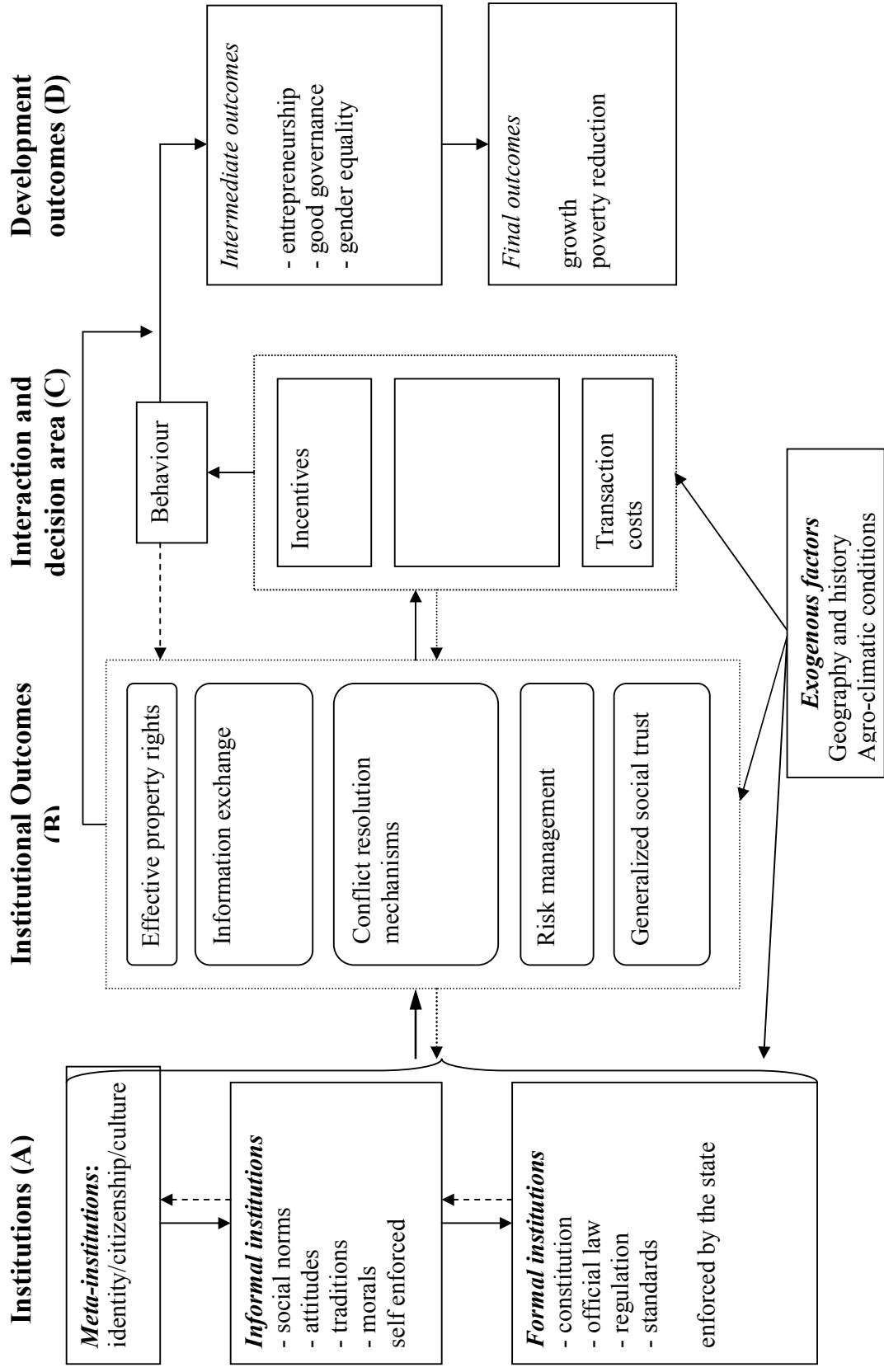
What are informal institutions?[2] The following definition is applied: informal institutions are: a behavioral regularity based on socially-shared rules, usually unwritten, that are created, communicated, and enforced outside of officially-sanctioned channels (Helmke and Levitsky 2003; Pejovich 1999). While formal rules are enforced by official entities, such as courts, judges, police, bureaucrats etc, informal institutions are largely self enforcing through mechanisms of obligation, such as in patron-client relationships or clan networks, or simply because following the rules is in the best interests of individuals who may find themselves in a 'Nash equilibrium' where everyone is better off from cooperation. While informal rules are generally not codified, it is normally widely accepted as legitimate and are therefore 'rules in operation' (in use) rather than just rules on the books, or what Ostrom terms 'rules in force' (Ostrom 2005). Informal rules are:

— extensions, elaborations, and modifications of formal rules outside the official framework;

— socially sanctioned norms of behavior (attitudes, customs, taboos, conventions, and traditions);

— Enforcement characteristics are self-enforcement mechanisms of obligation, expectations of reciprocity, internalized norm adherence (standard operating procedures), gossip, shunning, ostracism, boycotting, shaming, threats and the use of violence

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[1] This framework is adapted from de Laiglesia (2006) who used it to analyse institutional bottlenecks in agricultural development.

[2] Some question the usefulness of the informal formal distinction. For actors on the ground, what matters is the situation they find themselves in, and the distinction is easily blurred. Ostrom (2005) suggests the term 'shared strategies' since the actors respond to the known rules of enforcement, whether it is done by the police or a community of individuals or add-mixtures of the two.

Figure 1. **A Framework**

Institutions (A)

Meta-institutions:
identity/citizenship/culture

Informal institutions
- social norms
- attitudes
- traditions
- morals
self enforced

Formal institutions
- constitution
- official law
- regulation
- standards

enforced by the state

Institutional Outcomes (R)

Effective property rights

Information exchange

Conflict resolution mechanisms

Risk management

Generalized social trust

Interaction and decision area (C)

Behaviour

Incentives

Transaction costs

Exogenous factors
Geography and history
Agro-climatic conditions

Development outcomes (D)

Intermediate outcomes
- entrepreneurship
- good governance
- gender equality

Final outcomes
growth
poverty reduction

Formal rules and constraints are made up of:

— constitutions, laws, property rights, charters, bylaws, statute and common law, and regulations;

— enforcement characteristics include official sanctions, such as criminal punishment, fines, incarceration etc.

These formal rules are generally thought to be codified entities that officials (rulers) ostensibly apply through regularized enforcement mechanisms.

Institutions and institutional outcomes

Formal institutions, such as constitutions, legal systems, property rights systems, and regime types influence institutional outcomes and these links are rather well analyzed (Persson and Tabellini 2003; Barro 2000; Clague 1997). Political scientists find that particular institutions generate predictable outcomes. For example, a two-party system is likelier under plurality electoral rules, whereas proportional electoral systems generate multi-party systems. The implications of these rules are important for understanding why small parties, such as the Greens in Germany, are able to influence politics compared with Britain and the US. Formal rules, thus, generate some polities to be more accountable, more representative etc compared with others (Powell 2000; Przeworski et al. 1999; Lijphart 1984). However, formal rules do not generate the exact same institutional outcome everywhere to similar degrees. As Rodrik et al. (2002) conclude on the question of formal institutions and development, "desirable institutional arrangements have a large element of context specificity, arising from differences in historical trajectories, geography and political economy or other initial conditions…" (p.24). Hence, whether or not institutions lead to better economic and investment climates, expand trade, encourage technological development, foster better governance and accountability, encourage trust, reinforce property rights, ensure competition, and avoid the exclusion of sections of the population from the fruits of development is as much a question of the incentive and enforcement mechanism of the institutions themselves as the environment it operates in.

Since the effectiveness of formal rules, such as penal codes, the rule of law, and democratic governance, depend on informal institutions, such as norms and attitudes and existing levels of social capital, or the patterns of interaction that individuals assume in any shared activity, understanding where informal institutions come from and how they change is crucial to understanding how the interaction between formal and informal institutions can be harnessed to effect desirable policy goals.

The fact that not everyone finds strong effects from formal institutions, such as the rule of law to development outcomes, however, is not surprising (Glaeser et al. 2004). The point here is that changing formal (macro- and micro-level) institutions that might be compatible with particular structural forms might yet not fit very well with informal institutions given underlying cultural factors that remain resistant to change, factors that have a more proximate bearing on the outcomes we are interested in, such as corruption, education, governance, or questions of gender equality (witness countries such as Saudi Arabia that have wealth but little modernization in gender relations). Neither did the inheritance of the formal institutions of democracy by many developing states lead to the governance outcomes we often associate with democracy in rich countries (Bauer 1988). Thus, the question of institutions and development may depend greatly on how informal institutions moderate formal ones as they affect outcomes (North 2005).

Relationship between formal and informal institutions

Informal institutions interact with formal institutions as they affect outcomes in four stylized ways (Helmke and Levitsky 2004):

1. complementary
2. accommodating
3. competing
4. substituting

Typology of informal institutions:

Outcomes	Effective Formal Institutions	Ineffective formal Institutions
Convergent	Complementary	Substitutive
Divergent	Accommodating	Competing

This typology is taken from Helmke and Levitsky (2004: 728).

In terms of the first, informal institutions are complementary with formal ones when they converge and the formal institutions are effective. Suppose that a new state decides to adopt better anti-corruption laws. The content of the specific laws may matter very little if in fact pre-existing norms already form informal checks and balances on public officials. In this scenario, knowing what about anti-corruption law matters requires that one understand how the norm and law interacts to form the beneficial outcome. Both might reinforce the check on corruption, or the formal laws (due to some quirk) may hinder the informal checks in place. Yet again, the formal law may evolve to be an even better check than previously existed, since the informal 'norm' might have evolved only as a second best solution.

Second, the informal institutions may accommodate the formal ones when they diverge and formal institutions are effective by not violating the letter of the law but violating its spirit. In other words, it coexists with the formal institution and drives the outcome that is not entirely intended by the formal rules. The hiring practices of many universities, where departments tend to hire each others students despite formal search committees that go through the motions of interviewing other candidates and writing reports might be a good example of accommodating institutions. The letter of the law is followed; committees are set up, they meet, they review applicants etc, but the spirit of the law is violated because the committee has already agreed informally on the outcome. Here again, the outcome might be more efficient because hiring committees may run the risk of being hamstrung by veto players, delaying the process and perhaps souring good relations within departments. Formal committees might spend time and money debating candidates. Thus, even if the informal institution may be identified as corrupt, it might be more efficient. The desirability of the rules depends on the criteria for judging (efficiency versus fairness). It should be recognized that much formal institutions are products of politics, which means fairness criteria will have mattered as much as efficiency ones in what has determined them (Soltan 1998).

Third, informal institutions compete with formal ones when formal institutions are ineffective and the two diverge. This is true where formal law is poorly enforced, or simply ignored by authorities. The literature on legal pluralism shows how people resort to multiple sources of justice where competing laws and norms operate at various levels, particularly where inherited legal systems after colonial rule operate side by side with customary law. This situation exists because states do not feel the need to enforce the laws (they ignore it) or they do not necessarily have the capacity to enforce (costs are too high). In this instance, not accounting for state capacity to enforce formal institutions in any analysis of any relevant outcome potentially yields highly biased insights. Here again, the criteria used to judge the outcomes are crucial. Jim Crow laws competed with formal laws against discrimination in many parts of the US, and the power of the federal authorities was required to break those practices. Also, while many laws protecting women and human rights in poor countries may exist on the books, customary laws contravene these rights in practice.

Finally, informal institutions can substitute for the lack of effectiveness of formal institutions. Like complementary institutions, these informal institutions are designed to achieve what formal institutions should be doing but is ineffective or ignored by official sources. Informal credit markets and insurance schemes might very well be thought of as substitutions for formalized market or state organs that usually provide such services. Informal neighborhood associations that form to prevent crime or collect garbage off streets may be substituting a city government's function. Since many of these voluntary associations pose little threat to formal institutions, they are usually encouraged by state authorities. However, such voluntary groups may also form vigilante groups, such as the 'Minutemen' in the US that have taken upon themselves the task of policing the US-Mexican border. The effectiveness of formal versus informal would have to be judged on the desirability of the outcome—again efficiency versus fairness.

Culture, history and institutions: anticipating change

Norms matter because they substitute for law in complex economies given that every aspect of interaction between people cannot be governed by a written law (Cooter 1994). Some, particularly scholars of social capital, see the operation of formal institutions as moderated by available civic traditions that are in turn shaped by historical trajectories begun way back in a society's history (Putnam 1993). The degree of trust available in a society apparently matters for political and economic development because it substitutes for formal systems of monitoring and enforcement, making collective action easier (Putnam 1993; Woolcock and Narayan 2000; Coleman 1986). Rules on paper make little difference compared with underlying social norms and attitudes that moderate the effects of formal institutions. Thus, despite changes in formal institutions that affected both Northern and Southern Italy, the South underperforms the North due to lower levels of preexisting social capital, or norms of trust and reciprocity (Putnam 1993). Government effectiveness is enhanced where there is a high level of civic engagement because the mass of people will be better consumers of politics, more attentive clients of bureaucrats, and cooperate more easily among each other to solve collective dilemmas. Where social capital and the norms of reciprocity and obligation that it represents comes from, and how they are generated, are highly disputed topics (Boix and Posner 1998). For many, history matters.

Others dispute the relevance of deeply ingrained, historically-determined factors, arguing instead that all humans engage in optimizing behavior within the constraints of rules, and in response to a particular socio-economic environment, referred to generally as structures (Jackman and Miller 2005). In other words, it is formal structures, not the mental models that culture determines that matter. It is impossible to address issues of norms, attitudes, values in the context of institutions without addressing issues of culture, but we follow Ostrom (2005) and others by conceptually separating rules that govern a particular collective endeavor from norms and attitudes thought to emanate from deep, historically-determined cultural forces. Rules can be devised by individuals to solve social dilemmas, such as governing common property resources, or fighting neighborhood crime. Norms too, do not necessarily emanate from deep historical sources but could be thought of as 'shared expectation' about behavior (Helmke and Levitsky 2004). Norms can also change rather rapidly as witnessed by the end of foot-binding practices, dueling, or lighting up a cigarette at a dinner party without asking others whether they mind.

To sum up, formal and informal institutions, alongside with "meta-institutions," shape the "observable" institutional outcomes such as "good or bad governance", "weak or enforced property rights" and "social trust or disharmony".

Institutional outcomes and development outcomes

Institutions through institutional outcomes affect the behavior of individuals by providing incentives or placing restrictions. Institutions are thought to facilitate economic development in two broad ways: reducing the costs of doing business (transaction costs) and ensuring competitive processes (Islam 2001). In the first instance, development is the expansion of economic activity (markets), the degree to which individuals and groups are able to enter into arms-length transactions. If the costs of transacting are high, then economic activity would be constrained. Institutions ease the effectiveness with which transactions take place, minimizing the costs of doing business. As Avner Greif has shown, Genovese traders were able to expand their economic activity successfully because their individualist ethos led to the building of institutions that facilitated the expansion of anonymous arms-length transactions relative to Muslim traders who were constrained by a closed, communal ethos that relied on inter-communal, face-to-face dealings based on collectivistic modes of sanctioning (Greif 2006). This instance demonstrates how culturally-determined norms and attitudes, and the rules of the game they prescribe determine the nature of economic activity.

In the second instance, competitive processes drive development by ensuring efficiency. Since institutions determine the incentive structure for affecting individual and group behavior, the rules governing the market affects the nature of how competitive that market will be. Regulation of industry, tax laws, distributional issues, the adoption of new technologies, or in other words, the degree to which rent-seeking is prevalent are determined by the nature of formal and informal institutions and their interplay. Most countries, for example, have laws governing bribery and corruption. Norms and attitudes about what corruption exactly is and how one deals with it determine the extent to which formal rules on corruption will be effective. Giving expensive gifts to government officials in China in the course of transacting is a norm that would sit very uncomfortably in most Western, developed

states, where free and fair competition requires impartial official conduct. The system of *Amakudari* in Japan where high-level public servants retire as top corporate executives is another example. On the other hand, even in Western democracies, lobbying and other forms of rent-seeking exists to different degrees among informal channels. University hiring practices is an example where some unwritten rules about hiring the students of colleagues is a way of getting around some formal rules designed to ensure a competitive labor market in academia.

Institutional outcomes and context

It is imPortant to note that one particular "institutional arrangement" could have different effects in different environments, depending on context. For example, mutual help, family assistance, and social capital are examples of "informally" organized solidarity, making up the corner stone of informal social security systems. Credit and saving groups (*les tontines*), community-based health insurance schemes (*les mutuelles de santé*), and funeral associations bear testimony to the variety of different organizational forms that this form of mutual-help systems can take. The same institutions, on the other hand, can have perverse effects in some settings, becoming a "tax on success." A hard-working farmer in Benin, who has accumulated some wealth over the years, has to share the fruit of his efforts with his extended family, including distant relatives. This implies that he is expected to pay the school fees for his nieces and nephews, or bear the health costs if anyone in his entourage gets sick. The question of institutions based purely on examining outcomes, thus, does not allow one to identify clearly what about institutions matter, and serving what purpose (Stiglitz 2001). On the other hand, one needs to identify the outcome and then correlate the relevant institutional feature (rule) with that outcome, eliminating other possible determinants of that outcome.

People in both rich and poor countries rely on informal institutions to varying degrees to facilitate transactions, but these institutions are relatively more important in poor countries and small, traditional communities where formal institutions are less developed and the reach of formal law and state power relatively weak (Bardhan 2001). Moreover, poor people in developing countries are often ill-served by the limited formal institutions available. In poor countries, and poor regions in particular, informal institutions substitute more frequently for formal institutions, a subject that is relatively less-well studied (Bardhan 2001). The effectiveness of formal law, even in rich countries, however, may depend to a large extent on how well the law corresponds with norms, making enforcement less costly, thus norms and attitudes matter for how well even formal institutions can work (Posner 1998). Responding to the impacts of informal institutions on economic development, therefore, can considerably reduce the costs associated with badly functioning formal institutions, making reform more effective because communities can go a long way towards resolving information and enforcement problems without using their formal public legal systems (World Bank, 2002). The outcomes of the interaction between formal and informal institutions, however, cannot simply be understood by how well they fit and do not, but rather by finding out which of the rules in use have a bearing on the outcomes we do want to explain.

3) What determines the change of informal institutions?

It is particularly useful to understand how informal institutions that are culturally determined change over time. Norms prescribe the 'oughtness' of behavior. It is regularized behavior because when oughtness is violated it is sanctioned. What is normal of course changes for complex reasons. Broadly speaking, the encroachment of market-based activity change norms so that as market institutions get stronger norms governing altruistic behavior among pastoral communities change (Ensminger 1992). Those who believe that economic and social structure determine norms and values argue that culture changes with structural change. Industrial development and increases in wealth (modernization) will change tradition-bound societies (Lipset 1959; Rostow 1960; Lerner 1958). With increasing wealth and the change of rich countries to service economies apparently correlate with post-modern attitudes and values when it comes to how economic growth on environmental protection are perceived (Inglehart 1997). Some argue that many parts of the Middle East are bound in tradition and resist change despite being rich because the easy money from oil wealth allows the luxury of closing off to modernizing influences and the liberal ideas of openness and competition (Bellin 2004). On the other hand, industrial modernization means increasing rationalization of economies that lead to structural changes that require rationalized, bureaucratized states for dealing with complex society. Others focus on culture as a precondition for driving economic development (Hayami and Aoki 1998). In either case, culture and economy moderate one another.

Modernization thinking permeated the study of development in the post-war years and many assumed that with enough aid and the transfer of technology, countries will 'take off' into self-sustaining development, following the European experience since tradition will be overpowered by modernity. However, as some argued later, modernity has come to be expressed in diverse ways, even in Europe, due to cultural factors, and that rather than homogeneity, 'multiple modernities' are possible (Eisenstadt 2000). The welfare state and support for high taxes between Europeans and Americans, for example could be seen as being governed by norms and values. Thus, even change in structure, such as wealth, political democracy, and equality have led to multiple visions about the constitution of society. In fact, some argue that rather than formal institutions, such as the rule of law, human capital is what matters (Glaeser et al. 2004), so that higher human capital tends to raise wealth and the demand for better political capital and functional institutions.

There are two broad approaches to understanding where institutions come from and for evaluating their effects—the *calculus* approach and the *cultural* approach (Hall and Taylor 1998). The calculus approach relates to the rational choice institutionalism and functionalist approaches in sociology from which the NIE gathers much of its inspiration (also game theory). As such, institutions are 'purposive' devices that reflect preferences and expectations of actors. Thus, institutions are consciously devised by individuals to reduce transaction costs and increase efficiency. Informal rule making by groups of individuals engaged in some common endeavor is ubiquitous in everyday life. Accordingly, while rules can be changed relatively easily by actors that come together in some activity, norms, values, and attitudes change only slowly, even if they originate as 'constructed' entities that have persisted, outlasting the original intent for their formulation. Some institutions may work well while other may not. Why inefficient institutions persist, however, is somewhat of a mystery, if in fact questions of power, political economy, and the distributional aspects of institutions are neglected as part of the story, not to mention the unintended consequences of institutions (Lal 1999; Stiglitz 2001; Ensminger 1992; Knight 1992). Where institutions work badly, those ill-served by those rules may have high costs to changing institutions once established simply due to rent-seeking by narrowly established groups who benefit from the existing rules (Ostrom 2005). Thus, in many developing countries, where state elites have enormous access to resources and power, formal rules could not be enforced due to the capture of the state and the informal channels by which the elites affected governance.

The "cultural," sociological approaches, on the other hand, see institutions as far less purposive (rationally devised), and social relations not simply as "atomistic," rational individuals engaged in maximizing behavior within the constraints of functional (or dysfunctional) rules. Some ways of doing things might be thought of as the 'natural state' of things. Thus, women can come to believe that girls are inferior to boys etc (Douglas 1986). The cultural view is that people engage in satisficing behavior within social milieus made up of networks of association. Norms of reciprocity and obligation pervade markets and firms without them having been consciously devised (Granovetter 1985). According to this perspective, markets are bound up with networks of personal relations, and the actual functioning of day to day activities of markets and firms show that networks of association governed by norms and convention and 'face to face' dealings are far more ubiquitously in operation than are formal (arms-length) contracts (Platteau 2003). Understanding more about how norms, obligations, and conventions work, and the nature of networks that structure behavior, not only allow us to understand whether and why some institutional environments work against development while others are complementary, but also to assess how they change.

Witness that patron-client relationships are ubiquitous in many developing countries. In fact, in many situations, the clients vote for political platforms and proposals inimical to their long-term interests, largely because they obtain more immediate benefits from the patrons, whose wishes they follow. Thus, knowing the exact nature of the short-term benefits of the mass of individuals that are part of these clientelist arrangements and affecting those is a first step to affecting the way in which politics might reflect better outcomes for the poor. Becoming wealthy, having access to careers and secure employment is one way in which feudal social relations dissipate because ordinary people become less beholden to powerful elites. Clearly, the neo-classical view of institutions is incomplete and needs supplementation by the more 'culturalist' position.

Consider the case of genital mutilation among societies in many parts of North and Sub-Saharan Africa (Sudan, Egypt, Kenya etc). Genital mutilation is carried out to discourage sexual activity by females because it makes sexual intercourse uncomfortable. Yao girls in Malawi, however, are encouraged to have sex and are initiated into the practice as young girls. Why would adults (men and women) encourage two different norms? Can one factor explain both outcomes? Apparently, the mechanism that explains the difference is that men, in matrilineal and matrilocal societies as opposed

to patrilineal and partilocal societies, are confident that their offspring will be brought up and supported by the mother's village and households. In patrilineal society, men are concerned that they would have to support children that they themselves have not fathered (Horne 2001). Thus, men in partilineal society strongly prefer the norms of curtailing sexual activity of women. If in fact this explanation is true, changing this norm from outside is bound to be difficult and slow but a place to start might be by paying particular attention to educating men in partrilineal societies, particularly regarding child-rearing practices. Social insurance schemes and public action targeting children may also help.

As mentioned earlier, policies aimed at changing deeply ingrained norms without the underlying structural conditions will be difficult, slow, and uncomfortable process. These norms and value issues are conducive to be politicized. Witness the debates on the spread of political Islam, or the debates on East Asian values versus Western values etc (Lal 1999). There is a more immediate role for policy if one focuses on more rapidly changing, malleable rules identifiable in many situations where people try to solve collective dilemmas. These rules are regularized in the sense that most agree that they are a good thing.

At very micro levels, informal institutions, or simple informal rule making occurs all the time among individuals who organize collectively for mutually beneficial activities (Ostrom 2005; Fine 2001). For example, a groups of women with little access to formal credit markets may come together to create a micro credit association governed by a set of rules that prescribe the terms of lending and borrowing and how those rules will be enforced. These poor women may devise the rules from scratch, but more than likely they may imitate others among whom these rules have worked well for this specific purpose—in other words, they may borrow. Imitation and borrowing best practices has been a feature that explains the development of human beings from time immemorial (Soltan et al. 1998). Witness the way in which the Grameen movement has spread throughout the world after originating in rural Bangladesh. However, the rules that individuals find productive depend on already-operational norms and patterns of reciprocity in the larger context of that society (Ostrom 1997). Informal rule making through imitation and borrowing will depend to a great extent on preexisting levels of social capital (trust) and particular kinds of norms. For example, whether or not poor women are even allowed to participate in micro finance schemes might be determined by the norms around how women are viewed as bread winners, their access to information and some level of independence. Whether or not a particular micro-finance scheme will work in one setting relative to another might be determined by the communal norms governing the acquisition of wealth. Thus, even though we are constantly devising informal rules to which we adhere to, the shape of those rules may depend greatly on larger 'enabling' contexts. The rules adopted will reflect more pervasive norms about hierarchy (deference to elders), or norms around retribution will guide the rules on sanctioning. As mentioned above, the extent to which the macro-level norms guide micro-level behavior will depend on the larger context of social and political change. Nevertheless, governments can be instrumental in encouraging local communities to come together to solve collective dilemmas by providing the legal and institutional framework that enables experimentation, trial and error, and the necessary support to devise those 'rules' that become 'tools' for solving community dilemmas.

Whether one considers heavily culturally-determined factors, such as the nature of patron-client relations, or patrilineal rather than matrilineal arrangements, or the more fluid 'rules' devised for solving collective dilemmas, institutional change will take place with the interaction of actors and the evaluation of the outcomes over time. This makes institutional change 'overwhelmingly incremental and path-dependent' (North 2005)pg. 59. However, an open polity where competition for ideas, alternative modes of doing business, and protection from capricious processes are available, where contestability of the substantive outcomes and investment in skills and for competing for survival exists, institutional change that elicits better outcomes for economic development is likelier.

4) Informal institutions and how they matter: the example of conflict resolution mechanisms

The role of formal and informal institutions in many respects is about managing social relations, and therefore the management of conflict. When humans come together in any form of activity they require rules to govern behavior and maintain the public good of harmony. Where these rules work poorly, social frictions may arise to increase transaction costs and reduce the effectiveness of these institutions. Examples from international relations are extremely illustrative since states are not governed by a world government where international law applies uniformly. Thus, as Thomas Hobbes famously put it, life would be 'nasty, brutish, and short' without a Leviathan to enforce order. Yet, order without government can be achieved. As a very broad example, the norms around the 'sovereignty' of

nation states, or the rights of princes over the church, came about as a devise to reduce the incidence of papal interference in the internal affairs of princes. The idea of sovereignty was codified in the treaty of Westphalia in 1648 that ended the Thirty-Year war because it was thought to be an effective way to solve papal interference in the affairs of states. The norms around the violation of sovereignty, however, has changed in recent years with calls for intervention by the United Nations and other powerful states based on the idea of humanitarian intervention. This is clearly a case of one norm trumping another and leading to institutional change; i.e. the norms around human rights and the prevention of genocide has led to the violation of norms on sovereignty. However, in this case, power has come to play a crucial role since the norm of humanitarian intervention is driven largely by the interests of powerful states, perhaps as some accuse driven largely by the desire to preempt refugees from flowing across borders.

Much of what happens in international relations could be classified as informal institutional behavior. There are networks of norms and trust among several actors, and conventions and shared beliefs lead some to 'hang together.' While realists believe that the international system is anarchical and requires a hegemonic power (Thomas Hobbes' Leviathan) to keep peace and stability, others argue that states cooperate out of self interest in international institutions, such as the UN, OECD, the WTO, etc to ensure collective goods (Keohane 1984). A number of these institutions existed informally in the past but have expanded and become codified. Many countries voluntarily adhered to free trade arrangements before the GATT was ever introduced, afforded free passage to ships, and treated diplomats and citizens of other countries according to certain conventions. Thus norms and informal rules can become adopted into general law. Many of the norms governing the relations between states have evolved through time with frequent interaction and regularized behavior. Recent activities of informal networks of activist has also led to value changes around the environment and human rights (Keck and Sikkink 1998).

Likewise, the norm of democratic governance had spread around the globe by the early parts of the last century. Even communist dictatorships and many of the 'tin pot' dictatorships in Africa and Latin America had to pretend to govern on behalf of the 'the people.' However, the formal rules that were devised in order to affect the near-universal norm around 'democratic rule' differed greatly from place to place. The liberal-style democracy in the West valued rules that limited the power of the state through systems of checks and balances. Formal democracy, however, has not worked the same way as a generalized system of conflict resolution in all places in all times. Neither have the same formal mechanisms of democratic processes yielded the same outcomes in every place. Yet, the fact that there is a near universal norm around the right of people to choose their government and the fact that the norm of universal human rights is spreading illustrates the diffusion of certain norms across cultural spaces (Simmons et al. 2004). The only 'law-like' empirical regularity in international relations, the so-called 'democratic peace' thesis, which is that democracies do not have militarized disputes between them, is supposedly partly due to the shared norms among democracies for peaceful resolution of disputes and the existence of trust (Russett and Oneal 2000). Apparently, peace and democracy often cluster due to shared norms across space and the process of diffusion.

While the peaceful adherence to democratic rule is nearly universal, the way in which democracy works in different places is dependent on the extent to which informal institutions operate (Helmke and Levitsky 2003). Many argue that preexisting political cultures moderate the way in which democratic institutions function and survive due largely to the extent to which an active civil society exists (Diamond 1994). The question of democracy and civil peace is not fully understood, since most find that only long-established democracies are able to avoid civil conflicts (Hegre et al. 2001). This finding suggests that autocratic regimes are also able to keep the peace. What is still little understood is how exactly informal rules and norms are related to this issue—if formal democracy does not ensure peace, how do autocrats manage it? Ethnic peace, even in rich countries, is affected through informal channels. The so-called theory of 'consociational democracy' as practiced in the Netherlands requires informal bargains between elites on avoiding particularly contentious issues (Lijphart 1993). Some suggest that ethnic peace in many African states is 'bought' by political elites through informal channels (Azam 2001). Thus, any reform of political systems, for example through anti-corruption drives, risk upsetting regularized channels of ethnic peace buying. This is clearly a case of how good governance reforms, which do not fully take into account informal institutions, could end up doing more harm than good. There may of course be a number of informal ways in which ethnic leaderships cooperate short of democratic party competition, which need to be fully understood before elections are forced on people from the outside (Weingast 1998). Clearly, where the informal bargains are complemented by formal institutions, such as mechanisms that allow mutual commitment not to violate

bargains for electoral gain etc, should be in place before formal democracy is initiated. Elites may matter greatly for deciding the shape of decent governance and peace.

The tensions between formal and informal institutions are starkly apparent when it comes to access to justice. State law and customary law often clash, as in the celebrated case of the Pakistani woman that was gang-raped under customary tribal law. In this case, the state intervened due to the fact that NGO activists and others brought the case to the notice of authorities, who perhaps acted in this instance to avoid the global spotlight. Whether or not the Pakistani state is able to safeguard the human rights of women in any meaningful sense relates greatly to its capacity to implement education and awareness programs that would change particular norms and regularized practices that harm women.

We have already mentioned patron-client relationships. In Sri Lanka, political elites dominating the various political parties have historically mobilized their clients at election time to intimidate voters and win supporters, leading to violent encounters among the masses of supporters. Despite laws on the books against election violence the practices have continued, greatly damaging the cause of democracy. It has been customary that elites be not held accountable for election violence. Recent high profile cases that led to the prosecution of elites for electoral violence have seen a greatly reduced incidence of violence in the most recent election (Höglund 2006). Thus, a state's actions may have a strong bearing on some forms of regularized behavior that occur because of tacit informal bargains.

5) Informal institutions: Who could be the drivers of change?

Governments can have a major impact on informal institutions based on the capacity and willingness of a government to enforce its will. States, in most cases, set the larger rules of the game. Norms that need changing can be affected by governments by outlawing a particular behavior pattern (smoking in public spaces). Governments have the ability to reach mass audiences through campaigns and by deciding the educational content of school books. Governments can induce particular types of behavior by offering tax breaks and subsidies for particular types of behavioral changes, whether recycling practices for garbage disposal, conservation issues, to civil activism for providing collective goods.

But there are also strong limitations to the role that the government can play in changing informal institutions. The crucial question concerns a government's legitimacy when it tries to change religious practices, laws and traditions, all of which form an important part of the private sphere of citizens. One could argue that a democratically elected government has a legitimate mandate to change informal institutions. Even in OECD countries, however, some religious minorities like Jehovah's Witnesses might still contest laws not in agreement with their beliefs. Establishing democracy is important, and it can positively influence the chances for the reform of informal institutions. Yet it is not a cure-all. Democracy alone is often not sufficient. Discrimination against women still exists in many poor countries with democratic structures, because governments' influence on family life remains limited or non-existent, particularly in rural areas.

Civil society groups have been instrumental in changing particular types of regularized behavior. Activists across borders, such as Amnesty International, were central to developing and spreading the norms of human rights, not to mention the various environmental groups such as Green Peace that campaigned to drive norms around ending the nuclear arms race (Keck and Sikkink 1998). Thus, in international relations, activists have been crucial in changing existing norms and promoting institutions for cooperation around solving social dilemmas. These institutional changes, however, have been effective in some areas and failed in others (Young 2002). The history of the development of gender equality in Western countries also reveals that lobby and pressure groups have often organized and channeled support for changes, which political parties eventually incorporated into their agendas.

Key personalities are another strategy that many agencies use to bring about awareness and change of a particular type of bad behavior or encourage a desired one. A historical example of such authoritative leaders that brought about substantive changes in ways of behaviour and traditions are Kemal Ataturk in Turkey in the 1920s after a war and a revolution and Habib Bourguiba in Tunisia in 1956 after a long fight for independence. NGOs have used celebrities to champion their causes with varying degrees of success. The anti land-mine issue clearly led to regularized ways in which

governments approached the issue of landmine use, procure weapons, and challenged the very norm of national defense policymaking.

Clearly, this primer has shown that formal and informal institutions interact to shape development outcomes. It is a subject, however, that is very messy, particularly from a policy perspective. Since context matters, we need better, clearer understanding of complex interaction. Where informal institutions have evolved to be second-best solutions, we would have to be certain that pushing formal institutional change does not upset a delicate balance. Careful, comparative research strategies will lead to greater understanding of the limits and possibilities of achieving policy objectives when making interventions.

If the fundamental value of institutions and rules is to allow people to cooperate, governments have a clear role in encouraging institutional building and institutional change for driving development. Governments have done much harm in the past by imposing their will on people. A better approach might be that governments foster enabling environments for people to come together to solve collective dilemmas. Governments could promote education, laws that encourage structural change, such as the reduction of inequities, which will allows communities to treat each other as equals, build trust etc.

Changing a country's institutional system and tinkering with its balance is a delicate affair that needs to be done with caution and sometimes against common reform dogma. Policies that work in one country may very well fail in another and are rarely optimal elsewhere. "Think globally, act locally", therefore, no longer seems a valid motto, at least for institutions.

If we fail to understand the mind sets of people and the incentive structures that govern their behaviour, we will not be able to bring about changes promoted at the national or supra-national level. This holds true for conflict resolution, gender equality, investment promotion and good governance. We should be wary of absolute answers, best practices and blueprints of how to achieve development. Rather, we need to accept that sometimes good enough is enough by affecting change gradually through the rules in effect on the ground.

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