

**Unclassified**

**COM/DCD/DEV(2007)2**



Organisation de Coopération et de Développement Economiques  
Organisation for Economic Co-operation and Development

**25-Jan-2007**

**English - Or. English**

**DEVELOPMENT CO-OPERATION DIRECTORATE  
DEVELOPMENT CENTRE**

**COM/DCD/DEV(2007)2  
Unclassified**

**INFORMAL INSTITUTIONS: WHAT DO WE KNOW, WHAT CAN WE DO?**

**International Seminar jointly organised by the OECD Development Centre &  
the Development Assistance Committee Network on Governance (DAC-GOVNET)**

**Summary**

**Paris, 11-12 December 2006**

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**JT03220808**

Document complet disponible sur OLIS dans son format d'origine  
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## **Background**

1. Institutions play an essential role in shaping the development process in both OECD and non-OECD countries. As is increasingly being acknowledged, informal institutions such as traditions, customs and social norms are of particular importance, especially in the absence of efficient formal regulations; this is a situation frequently observed in developing countries. The OECD seminar on “Informal Institutions and Development – What do we know and what can we do?”, organised jointly by the OECD Development Centre and the Development Assistance Committee’s Network on Governance (GOVNET) on 11-12 December 2006 in Paris deepened the knowledge on the role of informal institutions in development. The 1 ½ day event was attended by approximately 90 participants including high level policy-makers, representatives of civil society and international experts. Comprised of two roundtable discussions and three breakout sessions, the seminar addressed linkages and possible conflicts between informal and formal institutions and looked at ways in which donors and partner countries can foster the contribution of informal institutions to a more enabling environment for development.

### **What are “informal institutions”?**

2. Although informal institutions are gradually receiving proper recognition, their exact definition remains challenging. Following Douglass North’s groundbreaking work, institutions generally describe the “rules of the game”. They should consequently be distinguished from organisations, which can be considered as players acting within a set of rules and regulations. Informal – as opposed to formal – institutions describe all these norms and conventions that are not enforceable through formal (i.e. legal) means. This rather simple classification becomes more complex, however, when one considers the continual interactions and exchanges between, on the one hand, institutions and organisations and, on the other, the formal and the informal. Thus, institutions are the basis of organisations, yet are influenced by them at the same time. Similarly, formal laws frequently mirror informal conventions while formal regulations can also affect people’s norms and values: anti-smoking campaigns, for example, have gradually been reducing the propensity of smokers to light a cigarette in the presence of non-smokers.

3. As discussed during the conference, informal institutions influence and shape development in various ways. They are the basis of self-help groups in India; a regulatory mechanism for the mini-bus industry in South Africa; a limiting factor to the effectiveness of formal laws in Mali; a restraint for women to participate in social and economic life in the Middle East and North Africa (MENA); and an integral part of current reform initiatives in Chile that try to include marginalised individuals into the formal economy. While these examples illustrate the range of possible impact channels of informal institutions, they also stress the need for a better understanding of what informal institutions are and how they should be approached.

### **The importance of informal institutions in the development process**

4. Informal institutions are the underpinning of each society and thus pivotal to the promotion of sustainable development. Despite their importance for development, one must also be careful and selective in deciding which institutions to keep and which ones to replace by formal regulations. Based on the experiences of its member states, the OECD can support this process in developing countries, as explained by the Secretary-General of the OECD, Mr. Angel Gurría, in his welcoming remarks.

5. The relevance of informal institutions – especially in the context of developing countries – can be illustrated by numerous examples. In her keynote address, Deputy Minister of Foreign Affairs in South Africa, Ms. Susan van der Merwe, outlined the importance of the informal mini-bus industry that – outside of any formal laws and regulations – holds approximately 65% of the commuter market share. The industry

developed as a response to the non-provision of rail and bus services to certain sectors of the community, and in this respect helped overcome a market failure. However, Ms. van der Merwe also reminded participants of the perils of a market that is solely based on informal conventions: the lack of formal safety standards and regulated route allocation, for example, has caused much damage (e.g. high accident rates due to overloading and poorly maintained vehicles; violent conflicts over contested routes). Similarly, she explained, informal markets burden the public through foregone tax revenue.

6. In his opening remarks, Chile's Vice-Minister of Planning, Mr. Gonzalo Arenas Valverde, emphasised the importance of effectively integrating informal institutions into the development process. He explained that since 1990 this has been one of the cornerstones of Chile's social and economic development strategy. Development is a multi-dimensional process, encompassing the social, political and cultural sphere in addition to mere economic considerations. Not paying attention to the relevance of informal institutions in the development process would ignore the identities and particularities of gender, generations, ethnicities, religious groups, and preferences of particular social groups. In the "Chili Barrio" programme, Valverde continued, the Chilean government actively fostered the re-integration of socially and economically marginalised individuals by investing in stressed areas and improving the institutional capacities on the local level.

### **ROUNDTABLE DISCUSSION #1**

7. In the first roundtable discussion, which laid the conceptual foundation of the following sessions, Mr. Indra de Soysa (Norwegian University of Science and Technology) and Mr. Johannes Jütting (OECD Development Centre) provided an analytical framework for how informal institutions could be incorporated into the development process. They differentiated between two distinct approaches: while "modernisers" believed that development was primarily a process of replacing traditional practices with formal regulations – running the risk of creating an institutional set-up which is alienated from the day to day life of people –, "romantics" favoured the preservation of century-old traditions despite the fact that some of these institutions might delay or overtly obstruct development objectives. Neither approach provides a blue-print of how to deal with informal institutions. De Soysa and Jütting argued that institutional change was possible and is indeed frequently necessary to foster development. A pragmatic policy mix is required in order to decide which changes are possible and which ones necessary to promote development.

8. Ms. Mona Makram-Ebeid (American University, Cairo) discussed the changing role of women in the MENA region. She strongly favoured a modernist approach: gender discriminating informal institutions must not be tolerated and should therefore be abolished. She drew attention to the role that family structures and power relations play in shaping gender outcomes. Changing these structures would require a new institutional set-up that provides the right incentives to renounce old practices and adapt to a new regulatory framework.

9. The importance of defining an adequate set of incentives was also highlighted by Mr. Jean-Philippe Platteau (University of Namur). He cited many examples from sub-Saharan Africa where people were living in two separate spheres: one formal, the other informal. Formal rules would only be applied if they were in harmony with existing patterns of behaviour, or if they offered a better mechanism of social order. Mr. Platteau recounted from his experience in Mali where a judge would only apply formal laws if s/he could be certain that no informal institution was in opposition to the legislation. Ruling against the common (informal) consensus of people would be a hopeless endeavour.

10. Ms. Anne-Marie Goetz (UNIFEM) focused on the extent to which informal institutions have an impact on social mobility and human equality. In her view, informal institutions clearly shaped development. They also, and most importantly, create hierarchies based on gender, age and ethnicity. The

state, being based on informal norms and reflecting them through formal regulations, frequently excluded certain social groups by putting them beyond the law. Institutional change is nevertheless possible, either through a change from the inside (e.g. Islamic feminism), the exposure of hypocrisy (e.g. child abuse scandals in the Catholic Church), attrition over time (e.g. exit by disgruntled members), or a contractual change that introduced new standards of accountability which would make the power-holders answerable to those affected by their actions.

11. Power as one important element of the persistence and possible evolution of institutions was highlighted in the subsequent plenary discussion. Reformers would always have to consider the power structure that held the institutional framework together: Who benefits from the current status quo? What are the incentives for change? Which factors could induce an evolution of enduring patterns of behaviour? Such questions would be of particular relevance to reach out to marginalised individuals, as explained by Ms. Gita Sen (Indian Institute of Management) for the case of gender equality.

## **PARALLEL SESSIONS**

12. In order to deepen the knowledge of how informal institutions shape development outcomes, the seminar split into three parallel sessions, each focussing on particular issues that are influenced by informal institutions: (i) gender equality, (ii) governance, accountability and capacity development, and (iii) private sector development. For each session, an input paper was provided and presented by its author in the introductory remarks.

### **Informal Institutions and Gender Equality**

13. Given the importance of hierarchical patterns that are established or sustained by informal institutions, the seminar devoted a separate session on the impact of informal institutions on gender equality. In her introductory remarks, Ms. Gita Sen emphasised the importance of formal regulations to counter the gender discrimination caused by informal institutions. When analysing the interplay between formal and informal institutions, one first needs to assess whether the formal institutions in place favour gender equality. If this were not the case, the resulting institutional vacuum would always be filled by informal norms that either favour or oppose gender equality. But even in cases where formal institutions promoting gender equality exist, the success of these regulations would always depend on the specific institutional setup that either supported or countered their effectiveness.

14. Ms. Sen provided an analytical framework to differentiate six possible interactions between formal and informal institutions. Specifically, for cases where formal institutions are in place she distinguished interactions as: (i) complementary (e.g. informal institutions favour gender equality and are supported by strong formal institutions); (ii) accommodating (e.g. strong formal institutions face informal institutions that are opposed to gender equality), (iii) substitutive (informal institutions that favour gender equality act in place of weak formal institutions); and (iv) competing (weak formal institutions rival informal institutions that oppose gender equality). Finally, for cases where formal institutions favouring gender equality were not in place, informal institutions would always be dominant: either (v) to promote gender equality (e.g. informal credit programmes for women) or (vi) to oppose gender equality (e.g. female genital mutilation).

15. Ms. Neema Mgana (African Regional Youth Initiative) shared her experience of women's entrepreneurship in sub-Saharan Africa. She outlined the economic importance of women in Africa: they provide approximately 70% of agricultural labour and produce about 90% of all food. However, women are predominantly (approximately 60%) employed in the informal sector; informal institutions frequently keep women from participating more actively in the economic life of a country. Mgana presented several strategies to better evaluate the linkages between formal and informal institutions and their effect on

gender equality. These include working with women's groups at household or community level to identify and measure the impact of informal institutions, providing women's groups with tools to link informal and formal institutions, and generating sex-disaggregated data to better monitor and evaluate policies that try to promote gender equality.

16. Mr. Denis Drechsler (OECD Development Centre) presented the Gender, Institutions and Development Data Base (GID-DB), a new tool for researchers and policy makers to measure and analyse gender equality around the world. With its comprehensive set of 60 indicators that are provided for 161 economies, the GID-DB could be used to compare the status of women across countries, to construct indicators of gender equality and to analyse obstacles to women's social and economic development. The database focuses in particular on social (mostly informal) institutions that are key to understanding gender discrimination. Building new schools for girls will not be effective, explained Mr. Drechsler, if families would not allow their daughters to leave the house or arranged their marriages at young ages. In addition to aspects of family law, the GID-DB featured information on informal institutions concerning the physical integrity of women, their civil liberties and their ownership rights. Participants of this session emphasised that compiling information on informal institutions would be a welcome new approach that filled a gap in the gender debate. However, the variables presented in such a database needed to be carefully selected so as to avoid bias from exogenous factors.

### **Informal Institutions and Governance, Accountability, and Capacity Development**

17. Improving accountability is one important way to bridge the divide between informal and formal institutions. A lack of good governance or insufficient capacity on the part of the authorities frequently allows informal institutions to replace inefficient formal regulations. In his introductory remarks, Mr. Nils Boesen (Process and Change Consultancy) explained how the formal and informal interplay and change. Similar to the matrix presented by Ms. Gita Sen, Mr. Boesen distinguished four such situations: (i) complementary formal and informal institutions (convergent formal/informal objectives coupled with effective formal governance), (ii) substitutive formal and informal institutions (convergent formal/informal objectives, but ineffective formal governance), (iii) accommodating formal and informal institutions (effective formal governance, but divergent formal/informal objectives), and finally (iv) competing formal and informal institutions (divergent – and competing – formal/informal institutions due to ineffective formal governance).

18. Based on this categorisation, Mr. Boesen recommended a pragmatic approach to dealing with informal institutions. They were not always the enemy of development and needed to be actively integrated into the development process. In fact, introducing formal mechanisms might sometimes do more harm than good. Carefully selecting which institutions to change and which ones to keep is consequently particularly important. Institutional change requires a long, tedious, complex, modest and unrewarding road of multiple small steps, keeping country specificities in mind.

19. Mr. S.S. Meenakshisundaram (National Institute of Advanced Studies, India) provided numerous examples of how informal institutions shape development outcomes in India: e.g. they were the basis of forest management committees, water users associations and other self-help groups. He outlined the advantages of promoting development through informal institutions that include all members as stakeholders, ensure direct accountability and provide a built-in transparency. However, such an approach also has negative implications as interests can be conflicting, groups might not be homogenous, and long-term planning can be very difficult. Development through informal institutions therefore warrants a careful analysis of the specific advantages it might entail. In fact, both formal and informal institutions were necessary to reach sustainable development, so both types of institutions should be linked at the operational level in order to find areas of complementarity.

20. Ms. Upala Devi Banerjee (UNESCO) focused on informal institutions and the linkages to human rights-based approaches. While experts currently recommended working towards an “acceptable reconciliation” between traditions and human rights, Banerjee pointed out that not all informal institutions were acceptable from a human rights perspective, especially as regards gender rights that were massively weakened by such customs as genital mutilation or honour killings. Building on the local country context, Banerjee suggested a mid-point to make institutions compatible with a human rights-based approach. Such strategy would include an identification of all elements in informal institutions that corresponded to human rights laws in order to use them as a basis for building a universal framework.

21. Mr. Mark Nelson (World Bank Institute) discussed demand-driven institutional change through the power of data and information. According to North, human evolutionary change involves intentionality of the actors. Finding ways of influencing the intentions of development partners, and coming to a common view of those intentions is not easy. Data and information are powerful tools in this endeavour. They provide a tool for advocacy, priority setting and the generation of consensus. Development co-operation should thus pay particular attention to data and information and stimulating the demand side as a force for positive change. Increasing the flow of data and information is one way to achieve this. He discussed how the work on capacity development provided lessons learned from the Bank’s more extensive work on governance. He reported that an analysis of capacity development approaches in World Bank projects had revealed several shortcomings, among which a lack of attention to the higher-level, demand-side factors and informal institutions that we know have a huge impact on success. Instead, many projects rely on technocratic reforms and conditionalities that have a decidedly mixed record. In order to move from technocratic to dynamic approaches to capacity development, Nelson suggested demand-driven programmes that emphasise local leadership and consider the critical political dimensions of change.

### **Informal Institutions and Private Sector Development**

22. Both formal and informal institutions are important for private sector development – the former by providing the constitutional framework in which organisations and individuals interact, the latter by comprising the norms and conventions that govern the ways of doing business. In this respect, informal institutions can reduce the costs of undertaking economic, political and social interactions and provide information to firms that allows them to undertake business activities. Mr. Stephen Nicholas (University of Newcastle) highlighted that today’s development challenges do not lie in finding technological solutions to production and distribution constraints, but in structuring institutions to promote economic exchange and growth.

23. As informal institutions are more prominent in environments with weak formal institutions, their effect on business outcomes is particularly pronounced in developing countries. Though informal institutions can potentially reduce transactions costs, they frequently neither reduce uncertainty nor provide sufficient information or effectively enforce economic exchange. This situation becomes particularly problematic when markets are growing so that informal business can no longer rely solely on the reputation of members. Finding adequate contractual arrangements that consider the country’s formal and informal institutions is therefore a prerequisite for high performance and development. Nicholas encouraged development agencies to focus on informal institutions that support private business, especially those that can replace kinship structures with open business networks. In order to reduce the cost of designing and managing contracts, development agencies should support programmes that enhance the flow of information about the availability, reliability and skill levels of suppliers, distributors and partner firms.

24. Giving a private sector perspective, Ms. Elena Panaritis (Panel Group) presented a success story on how private sector development and informal institutions can effectively be bridged. Based on the experience of the property rights reform in Peru, she explained how social and economic benefits could be

achieved by successfully aligning the incentives of all key players: the private sector, citizens and the State. In order to construct functioning formal institutions, it was crucial to understand the history and current set-up of the informal institutional framework. Given the high importance of informal property assets in developing countries, transforming them into tradable assets offered an important entry-point for institutional reform, explained Panaritis. The 1990 reforms in Peru created a new property rights system that facilitated the titling and official registration of land parcels which had previously only been recognised by community members. Such formal property assets drastically increased in value and could now be used as collateral in the financial markets.

25. Ms. Marion Eeckhout (Netherlands Ministry of Foreign Affairs) discussed the disconnection between formal and informal institutions in the Tanzanian business sector. She explained that Tanzanian firms were not held back by the lack of markets and finance but by inappropriate formal institutions. In order to cope with this situation, firms have created a self sustaining system of small scale networks. As such networks solely rely on cash payments that do not allow credit relationships, the business sector in Tanzania is characterised by stagnating productivity growth, little scaling up of networks and insufficient access to financial services. Bridging formal and informal institutions would require the strengthening of formal institutions through trust building processes at the national and local level. There was, she explained, “no shortcut to improve the investment climate with stroke of the pen measures”.

26. The Chairman of Solid Investment Securities, Mr. Kithinji Kiragu, explained how informal institutions can have positive and negative effects on private sector development. On the positive side, Mr. Kiragu illustrated how informal institutions helped in managing community land use, ownership and lease. He outlined furthermore the instrumental role of informal institutions in promoting savings and credit practices among women groups. However, informal institutions also obstruct the development of the private sector in Kenya. Community-based resistance, for example, has prevented foreign direct investment in the mining industry. Kiragu noted an apparent confusion among multinationals on how to actively integrate informal institutions into their strategies. He explained that they relied too strongly on their home and/or host country to resolve existing problems and challenges. A successful strategy would nevertheless require an active engagement of local initiatives and more inclusive democratic practices.

27. Mr. Juan R. de Laiglesia and Mr. Christian Morrisson (both OECD Development Centre) presented their work on culture, family ties and saving behaviour. They noted the remarkable diversity in family structures around the world with varying household sizes and dependency ratios. These result from family institutions, both formal and informal, such as polygamy, marriage practices and child fostering. Saving patterns and investment behaviour vary across household structures and compositions. Specifically, polygamy is associated with lower savings and investment. Indeed, polygamous households have, on average, lower net wealth per capita than monogamous households. This assessment emerged from a statistical analysis of household data from Côte d’Ivoire and Ghana and coincides with the finding that high frequency of polygamy is associated with lower investment rates across countries. Family institutions should thus be taken into account in policy making as they create incentives for investment decisions. At the same time, the sensitivity of family institutions to policy changes should also be considered when designing regulatory changes.

## **PLENARY SESSION AND ROUNDTABLE #2**

28. Drawing on the findings of each parallel session, the final plenary session and roundtable discussion focused on policy implications. What can donors and partner countries do to foster the contribution of informal institutions to a more enabling environment for development?

29. Secretary of State for Good Governance in Côte d’Ivoire, Ms. Ginette-Ursule Yoman, emphasised the importance of informal institutions for her country: they provide approximately 20% of all

contributions to social investment and rural development projects. She explained that the prevalence of informal institutions in developing countries is primarily a response to malfunctioning state institutions – changing this situation would therefore depend on the extent to which good governance could be promoted. Given the impact of informal institutions on development outcomes, Ms. Yoman suggested the formal recognition and active integration of informal institutions in development projects, which donors are still reluctant to do. On the contrary, donors' approaches are frequently not streamlined and often contradictory to the interest of the receiving country. In the post civil war period, for example, Côte d'Ivoire's National Secretariat had clearly identified the support of the media as a major priority to strengthen good governance and democracy. Donors nevertheless decided against this approach until the socio-political crisis in 2002 led them to change their minds. Claiming that partner countries possessed ownership of their development process remained wishful thinking. Nevertheless, in order to achieve good governance and sustainable development, recognising the leadership of recipient countries would be indispensable, she explained.

30. In a similar vein, Ms. Shahrbanou Tadjbakhsh (Centre for Peace and Security) criticised the apparent inability of international donors to adequately incorporate informal institutions into their development strategies. Donors sometimes even appeared unsure of their ultimate objective: is it to promote development in the larger sense or specific aspects such as economic growth, poverty eradication and conflict prevention? Institutional change does not mean imposing Western models and norms on developing countries. Such approaches would only create ineffective parallel structures that are bound to fail as they did not link to the glue that holds societies together. Effectively changing institutions cannot happen over night and requires the implementation of a new culture of trust.

31. Based on his work on informal institutions and development, Mr. Subir Lall (IMF) outlined that institutional change was possible with the right set of policies. He suggested that a key difference between (short-term) policies and (long-term) institutions was their time horizon. As a result, effective and durable institutions could evolve endogenously with the right set of policies, creating a virtuous cycle between institutions and incentives. Institutional change could be induced through trade liberalisation, increased awareness of policy decisions and resource allocation, education, and international co-operation by providing an external anchor and/or a demonstration effect. Focusing on several output measures (e.g. private investment, productivity and growth) Lall demonstrated how changes in the institutional quality of a country positively impacted a country's development process. It is not the specific design of institutions that mattered, which can vary by country, but their effectiveness in promoting the efficient allocation of resources. From an economic point of view, effective institutions should reduce the opportunities and rewards from rent-seeking behaviour, promote greater private sector participation and a level playing field for economic opportunity, and allow a better allocation of public resources for growth and poverty reduction.

32. Mr. Naresh Singh (Commission on Legal Empowerment of the Poor) underlined that development co-operation should above all seek to enhance the effective allocation of internal resources, which would release the "dead capital" that is slumbering in many developing countries. Such resources could be activated through smart policies that promoted convergence between formal and informal institutions. Singh warned participants of the perils of increasing aid transfers, which are projected for the future. Increasing aid receipts could allow policy makers to solely deliver the "low hanging development fruits" while avoiding the institutional transformation that would be required for sustainable wealth generation. Aid should act as a catalyst to facilitate institutional change by building on principles such as good governance, local ownership, harmonisation and alignment.

33. Eduard Westreicher, speaking in his capacity as Chair of the OECD-DAC Network on Governance (GOVNET), thanked the Development Centre and the DAC Secretariat for the organisation of this seminar, the importance of which had been highlighted by the presence of the OECD's Secretary

General and the participation of several ministers and state secretaries. He recommended that the issue of informal institutions be taken into consideration more systematically in future work of the DAC and its subsidiary bodies. One potential anchor for this might be the DAC's work on capacity development to which the GOVNET contributes significantly.

34. In their closing remarks, Mr. Johannes Jütting and Mr. Sebastian Bartsch (both OECD) emphasised that this seminar was intended to give added impetus to the debate on the importance of informal institutions in the development process. Though some lessons have already been learned, the impact of informal institutions is only gradually being understood. Improved knowledge on their effect on development outcomes would be a precondition for their better integration into development strategies. Effective reforms could only be initiated through dialogue and education. Both formal and informal institutions should be recognised as key elements of sustainable development. Rather than using a “big bang approach”, institutional change would require appropriate sequencing of small steps that take into account the power structures underlying existing institutional set-ups. Improving knowledge, statistics, indicators and the circulation of information will help to identify good practises and bench-marking.