

Introduction and Overview

**Informal Institutions:
An Emerging Topic**

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This book collects the main deliberations of an international seminar on “Informal Institutions and Development: What Do We Know and What Can We Do?” that was held in Paris on 11-12 December 2006. The meeting was organised jointly by the OECD Development Centre and the OECD Development Assistance Committee’s Network on Governance (DAC-GOVNET), bringing together more than 100 participants including policy makers, scholars, business people and representatives of civil society from around the world.

The specific aims of the seminar were threefold: First, to raise awareness by sharing experiences that illustrate how ignoring the role of informal institutions for development can be costly for developing and developed countries alike. Second, to provide examples of programmes and policies that have successfully integrated informal institutions to achieve growth and poverty reduction. And third, to start a policy dialogue among policy makers and senior civil servants, academics, and representatives from donor agencies and partner countries on how to improve policy design and implementation in the light of the findings of the seminar. By focussing on selected key areas in which informal institutions impact on development outcomes — notably gender, governance and private sector development — and by placing emphasis on practical examples from the field, this book bridges the important divide between the academic and policy maker communities.

Participants of the seminar agreed that informal institutions have a key influence on development which is often unknown or ignored. Their impact on development can be positive or negative, depending on the specific country context. In fact, even within the same country context, the impact of informal institutions might change over time, as is illustrated in the following example that was presented at the seminar:

South Africa's booming mini-bus taxi industry developed in response to severe shortcomings in the country's public transport system — one which is plagued by high prices, low quality service and a chaotic operating network. Mini-bus taxis operate outside of formal laws and regulations. What makes the industry work is a commonly agreed, informal business "culture" that is flexible, innovative and keeps operating costs down. The results are undeniable: at peak times mini-bus taxis hold 65 per cent of the entire commuter market share. However, high accident rates due to insufficient security regulations, violent incidents over un-commissioned routes and fare levels, and tax evasion have imposed high costs on society, prompting South Africa's government into action to regulate the service. What once started as a welcome solution to South Africa's transport problems now requires significant reform.

This book does not provide ultimate answers but raises important questions. The report deliberately does not present a strict definition of informal institutions. For some of the contributors, informal institutions are closely linked to the informal sector. Some include organisations such as saving clubs and self-help groups; others exclusively focus on institutions as "rules of the game". Although the authors of the chapters do not adopt a single definition, they all share the notion that informal institutions — such as family and kinship structures, traditional practices and social norms — are of great importance and can help or hinder development.

Informal institutions affect development processes in multiple ways. Mutual help, family assistance and social capital are examples of informally organised solidarity that often provides the cornerstone of informal social security systems. Credit and saving groups, community-based health insurance schemes and funeral associations further show the large variety of organisational set-ups that such assistance can take. In other cases, informal institutions — such as the moral authority of village chiefs — help to mediate disputes and constitute key informal accountability mechanisms. This is particularly important in countries where the power of formal government is limited.

In many developing countries, the social order is predominantly shaped by informal agreements that are not written on paper, but exist outside of formal laws and regulations. As the South Africa example shows, such situations must not be disadvantageous and can sometimes even promote a country's development. Village associations that are solely based on trust and peer pressure provide access to credit and insurance, help in times of distress, and facilitate the construction of public roads and sewage systems. The rapid expansion of community-based health insurance schemes all over Africa provides a good example.

Unfortunately, while informal institutions can increase the well-being of people, they sometimes also prove detrimental to development. The very institutions that are the basis of informal security systems can have perverse effects and become a "tax on success". For instance, forced solidarity will oblige any hard-working farmer in Benin who has accumulated some wealth over the years to share the fruit of his labour with his enlarged family, including distant relatives. In economic terms, the informal institution of "sharing" potentially becomes a disincentive to invest and may result in opportunistic behaviour as there is no obligation to reciprocate.

Other informal institutions lead to discrimination, of which women are most often the victims. Women might be excluded from participating in informal networks, or have no voice and limited influence in appropriating the accrued benefits of collective action.

These few examples show the difficulty in grouping and labelling informal institutions, as well as, analysing their short-term consequences and long-term impact on development outcomes. This book aims to awaken understanding that — despite the complexity and sensitivity of the issue — clear understanding and positive interaction with informal institutions are a pre-condition for achieving long-term sustainable development and poverty reduction.

Structure of the Book

The three parts of this book follow the course of the seminar. Part I sets the stage with two introductory chapters: one from a policy angle provided by South Africa's Deputy Minister of Foreign Affairs, Susan van der Merwe; and the second from a research perspective, written by Indra de Soysa and

Johannes Jütting. Both chapters are complementary in nature. Van der Merwe reflects on South Africa's recent history and economic development before giving two telling examples (the mini-bus industry described above and community saving clubs) of how informal institutions have played – and continue to play – a crucial role in South Africa. She concludes by highlighting the role of social relations that influence the dynamics of informal institutions. De Soysa and Jütting start from a different angle, reviewing the literature on institutions in general and on informal institutions in particular. Following Douglass North, they opt for a narrow definition of informal institutions as the “rules of the game”. They argue that the same informal institution might lead to different institutional and development outcomes, depending on the specific country context. To summarise the different definitions of informal institutions used in this book, an “In Focus” box at the end of Part I gives an overview of the conceptual variety of informal institutions.

Part II is composed of three main chapters that each introduces a field of development in which informal institutions are key: gender, governance and private sector development. The seminar organisers called for discussion of practical examples of day-to-day life by focusing on particular (mostly cross-cutting) areas in development. The contributions by Gita Sen, Nils Boesen, and Stephen Nicholas and Elizabeth Maitland served as input papers for the conference and were followed by discussions in separate parallel sessions (also documented). To illustrate specific examples, Part II also features three “In Focus” boxes: one on the OECD Gender, Institutions and Development Data Base; one on governance indicators and informal institutions; and one on the role of informal institutions for the business climate in Tanzania.

Gita Sen explores the importance of informal institutions for gender equality. She provides theoretical background of the interaction between informal and formal institutions, and describes many real-life examples to support her analysis. Sen highlights the importance of offering formal institutions to counter traditions and other informal institutions that may harm gender equality. Such formal institutions need to gather support from local groups to obtain the necessary legitimacy to compete successfully with existing informal institutions.

Nils Boesen looks closely at the interplay between formal and informal institutions, making a distinction between rule-based and relation-based governance systems. In particular, he points to the competition that can arise between diverging formal and informal institutions when the former are only weakly enforced. Boesen discusses the political conflicts that result from

such a situation, and the clamour for institutional change that follows. He calls for realistic policy objectives in transforming (negative) informal institutions that need to respect the existing power balance in order to gain maximum support of different political actors.

Stephen Nicholas and Elizabeth Maitland focus on alternative institutional arrangements to foster trade and economic growth in their analysis of private sector development. The authors discuss how relationship-based informal institutions can provide cheap contractual mechanisms to enforce “good behaviour”. They contrast the success of Hong Kong investors in the Guangdong Province, who rely on informal relation-based contractual enforcement mechanisms, with less successful Australian investors in that same area, who were obliged to use less efficient formal enforcement mechanisms. The authors explain how policy makers give support for such pro-business informal governance mechanisms while, at the same time, transforming such mechanisms into more formal ones. In this context, Nicholas and Matiland acknowledge the importance of democratic political structures that minimise elite resistance to institutional change.

Finally, Part III discusses emerging policy conclusions. The Chair of the DAC Richard Manning and GOVNET Chair Eduard Westreicher share their views on what has been learned at this seminar and outline policy implications for international development assistance. The authors also explore how the emerging agenda of informal institutions could be taken forward in the context of the OECD work on development. In a concluding chapter, the editors of this book summarise the current status of the debate on the role of informal institutions in development and highlight questions for future research.