Institutions, Legal Systems and Development: A Theoretical Contribution

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International Conference: "Change, Rules and Institutions: Law and Economics in the Context of Development"
School of Oriental and African Studies (SOAS), University of London
29-30 September 2007

Provisional draft, not to be quoted

Abstract

The analysis of the relationships between economics and law, and of the possibility of pooling their respective conceptual frameworks on particular issues is the subject of a growing amount of literature. It has mostly remained, however, focused on developed economies and their specific problems, such as regulation, competition, anti-trust policies and the like. The assessment of law and economics in the light of development economics is a field of research that has been under-investigated. For development theory, the questions posed by the law and economics approach are likely to intersect with theories of growth, institutions and social norms respectively. The paper examines the conditions for applying the law and economics approach via a critical analysis of concepts that are linked to the economics of institutions, in particular those of institutions, norms or contracts, and a critique of the quantitative methods that are usually employed in development economics literature. The paper presents an alternative theory of institutions that distinguishes between their elements, primarily their forms and contents, and highlights their cognitive basis. It therefore shows the complexity of the processes involved in institutional transformation, the introduction of legal systems and their economic outcomes. Distinguishing the different elements of institutions and norms is particularly important in developing countries: it allows for a better understanding of change in beliefs, norms and institutions, or, in contrast, of their resilience, when economic and legal reforms - aimed at establishing formal institutions that are viewed as more 'efficient' - are implemented. The paper critically analyses firstly the recurrent views of institutions in development economics, then the conceptual framework of law and economics in the context of development and its interpretation by the international financial institutions. It underscores the cognitive dimensions

of institutions and norms, as well as the difficulty of disentangling state legal norms from social norms from the point of view of individual cognition, which emphasizes the irrelevance of the distinction between 'formal' and 'informal' rules. The paper finally shows that in developing countries the reform and transformation of local social norms towards formal legal systems, and of economic institutions according to market mechanisms that are viewed as more efficient - as recommended for example by international financial institutions -, come up against specific sets of beliefs. The latter may be characterised as difficult to revise - or falsify in the Popperian sense; they refer in particular to the beliefs and associated norms that organise group membership, the latter being part of broader political and economic relationships, which explains their resilience.

Introduction

Dilemmas are inherent in obligations, as highlighted by Immanuel Kant. Individuals have to make difficult choices between a universal moral law, e.g. on the one hand, the denunciation of the thief, and, on the other hand, the consideration of other competing norms inherited from other valued sources—such as family or membership group—or of circumstances that may modify their judgement, the latter suggesting not denouncing the thief. Political and moral philosophy have long stressed that legal obligations emanating from the state have a content and a deontic force diverging from those of other norms, e.g., ethical norms that would disapprove of causing suffering in another individual—analytical philosophy has, moreover, emphasized that it is not only an ethical problem, but an epistemic one, as respecting appearances may be wrong; whether the thief is "really" a thief remains to be proven...

The question of the presence of heterogeneous institutions and norms and determinants of individual choice is a concern everywhere: it is, however, more acute in developing countries, as in industrial societies, state legal obligations and social norms have become more or less homogenous, after centuries of state consolidation, construction of law and superposition of jurisprudence. In developing countries, the building of states according to Western models has sometimes been a quite recent and rapid phenomenon. Institutions built over centuries in specific historical and spatial contexts have been 'exported' into different ones. New legal systems may be implemented in states built over centuries, such as China. These legal systems may just differ from former institutional systems, but they may also contradict those elaborated by previous political arrangements (as in pre-colonial and colonial states of Sub-Saharan Africa). State apparatuses may also collapse, as has happened in some low-income countries: anarchy takes hold, or only non-state norms subsist and 'capture' the remains of state legal institutions.

The analysis of the relationships between economics and law, and the exploration of the possibility of pooling their respective conceptual frameworks on particular issues is the subject of a growing literature. Yet it has mostly remained focused on developed economies and their specific problems, such as regulation, competition, anti-trust

policies and the like. The assessment of law and economics in the light of development economics is a field of research that has been under-investigated. For development theory, the questions asked by the law and economics approach are likely to intersect with theories of growth, institutions and social norms, respectively.

This paper examines conditions for applying the law and economics approach via a critical analysis of concepts linked to the economics of institutions, in particular those of institutions and norms, and the simplistic dualistic conceptual framework on which theories of institutional change often rely—replacing informal norms by formal institutions, 'old' ones by 'efficient' ones—or 'non-market' ones by 'market' ones. It develops a critique of the quantitative methods usually employed in the development economics literature. The paper presents an alternative theory of institutions, distinguishing between their numerous elements, in particular their forms and contents, and highlights their cognitive basis. It therefore shows the complexity of the processes involved in institutional transformation, the introduction of legal systems and their economic outcomes. Distinguishing the different elements of institutions and norms is particularly important in developing countries: it allows for a better understanding of changes in beliefs, norms and institutions, or, in contrast, of their resilience, when economic and legal reforms, aimed at establishing formal institutions that are viewed as more 'efficient,' are implemented.

The paper is structured as follows. Section 1 analyses the views of institutions that are recurrent in development economics. Section 2 presents the law and economics conceptual framework in the context of development and its interpretation by international financial institutions. Section 3 underscores the cognitive dimensions of institutions and norms, as well as the difficulty of disentangling state legal norms from social norms from the perspective of individual cognition, which emphasizes the irrelevance of the distinction between 'formal' and 'informal' rules. Section 4 shows that in developing countries the reform and transformation of local social norms towards formal legal systems and of economic institutions towards market mechanisms that are viewed as more efficient—as recommended, for example, by international financial institutions, come up against specific sets of beliefs. The latter may be characterised as difficult to falsify in the Popperian sense; they refer in particular to the beliefs and associated norms that organise group membership, the latter being part of broader political and economic relationships, which explains their resilience. Section 5 emphasizes the risk of inequality, divisions and detrimental outcomes that are inherent in institutions organising membership and therefore the key role of a meta-entity such as the state, as the state is better able to address these institutional failures, as well as the fundamental role of public legal systems and policies in development.

1. The views of institutions in development economics and their limits

Definitions and confusions

Institutions are canonically defined by Douglass North as "the rules of the game in a society," and as "the humanly devised constraints that shape human interaction" (North 1990, p. 3). Institutions consist of "informal constraints (sanctions, taboos, customs, traditions, and codes of conduct) and formal rules (constitutions, laws, property rights)" (North 1991, p. 97). They "structure incentives in human exchange, whether political, social or economic" (North 1990, p. 3). The assimilation of formal and legal institutions, as well as the dichotomy between formal (legal) and informal (norm and beliefs) institutions is a key assumption of New Institutional Economics, defined as the study of the determinants of both types of institutions, as well as the impact of institutions on property rights, transaction costs and contracting (Alston 2006).

Besides the evolutionary perspective, represented by Geoffrey Hodgson (for example Hodgson 1999), and progressively adopted by North in its cognitive version, institutions are mostly analysed through the lens of the rational and selfish economic agent. These are the assumptions of the public choice and rational choice approaches, exemplified in development economics by, e.g., Robert Bates (1995 and 2006), which allow for mathematical modelling and maximisation programmes.

With time, the literature on institutions has become increasingly confused. It often assimilates institutions, norms and rules. It may be found, however, that institutions are equated with 'formal' institutions, which seems to mean enacted by a state and the fact of being based on written texts. They also often refer to any social rule. Norms are frequently equated with social norms, i.e. the set of rules that organise interactions between individuals in a social group, at a micro level below the state level.

There is much confusion regarding the concepts used; the confusion touches the definition of concepts, which may be vague and inadequate. It also refers to a confusion of conceptual levels: the concept is confused with its attributes, e.g. institutions may include property rights or be assimilated to them; institutions are also often confused with the rules that are attached to them, to the policy they recommend (Lindauer and Pritchett 2002), or to the events they trigger (e.g. autocracies and coups, freedom with plurality of opinions or political parties, etc.). Most often, institutions are confused with their function, i.e. reducing transaction costs. They are also confused in two principal aspects: institutions associated with transaction costs and exchange, and addressing coordination failures, with institutions that protect property rights (Bardhan 2005).

Dualistic assumptions and use of modelling

Moreover, a number of studies rely on dubious assumptions that do not correspond to empirical observations and facts, regarding the definition of 'institutions' and their properties, as well as the method of investigation. Economic demonstrations are mostly based on modelling and econometrics, typically cross-sectional exercises. Therefore, they assume that 'institutions' are autonomous, stable in time and space (with identical

references across time and regions), discrete and quantifiable objects, which may enter into causal relationships with economic aggregate concepts such as growth.

Secondly, particularly when addressing developing countries, most economic analyses rely on the easy distinction between 'formal' and 'informal,' because they have difficulty explaining phenomena which involve and mix institutions stemming from industrialised countries—sometimes via colonisation—and local institutions. This distinction and partition of the world into stable dichotomies, however, is an over-simplification of the processes at stake, and is seriously misleading.

Likewise, economic and institutional change is often conceived as 'replacing' 'old' entities by 'new' ones, even if it is in the more subtle form of substituting new arrangements for old ones. Development is here viewed as the erasing of 'old' institutions, with the implicit idea of dualistic categories including objects—'new' objects replacing the 'old' ones: Stiglitz (1998 a and b) thus emphasized that development requires the transformation of 'whole societies,' even if it is via local participation and not from outside. (A critique of these views of transition may be found in Dabrowski et al. 2001).

In development economics, typical studies are cross-sectional regressions that seek to explain growth. Growth is regressed on a variety of variables that can be quantified and are said to approximate institutions or 'governance.' For example, the database built by Kaufmann et al. (2007) thus isolates the aggregate indicators of voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption, based on "hundreds of specific and disaggregated individual variables measuring various dimensions of governance, taken from 33 data sources provided by 30 different organisations." The dependent variable is not only a country's growth, but, among multiple examples, firms' growth, which may be analysed as a function of a variety of financial, legal and corruption variables (Beck et al. 2002). These variables, however, are often just particular attributes of the phenomenon examined (e.g., financial depth as a proxy for 'institutions' or the rate of urbanization and population density as a proxy for 'economic prosperity'), with causalities often tested via the use of instrumental variables. It may therefore be shown that certain 'institutions' 'cause' growth, and their lack would cause the stagnation of certain countries today.

Well-known analyses such as Acemoglu et al. (2001a and b) thus argued that growth in developing countries was caused by colonisers bringing favourable institutions to the colonised countries when they decided to settle. These institutions introduced by European colonisers similarly explain the 'reversal of fortune' of countries in the last five centuries (those being rich in 1500 being now relatively poor): European colonisers created this 'institutional reversal' in bringing institutions that were fostering investment. A recurrent feature of such approaches is a limited reflection on the nature of time, history and historical transformation—or path dependence and lock-in effects—as well as the importance of context: institutions would not be shaped by their political and economic contexts and would be comparable across centuries and geographical settings. The word 'institution' is here enough and subsumes very heterogeneous phenomena, rules and social norms.

Institutions are conceived as concrete objects that exist on their own. Nonetheless, institutions cannot be detached from the beliefs, which represent the properties of these institutions in the minds of individuals, assign them a dimension of obligation and disseminate them to the minds of other individuals: institutions result from collective representations and behaviour, but the minds of individuals are the necessary support for their creation and transmission. The key question is, therefore, the conditions of their persistence: in particular, the development economics literature puts little emphasis on power relationships, though the latter are crucial mechanisms that determine the survival of certain institutions and explain why some institutions spread, are adopted or disappear. As shown by Berkowitz et al. (2000), these approaches do not explain the complexity of the conditions for 'transplanting' institutions and institutional change in developing countries.

2. Law as a specific set of formal institutions and its economic effects

Law, economics and development

The two disciplines of economics and legal studies started to assess the commonality of their concepts and questions and constitute an autonomous field in the 1970s. The latter addresses the interrelations between law and the economy and explores the economic impact of law and legal institutions. The role of enforcement of laws, rules and contracts has long been emphasized in economics, e.g. by Becker (1968), who emphasized that individuals calculate their costs and benefits when they breach the law. The law and economics (L&E) literature has focused on issues such as the breach of contracts and the role of the law, with the key study by Posner (1973). Among many others, it mostly focuses on issues such as regulation and competition policy, antitrust law, optimal law enforcement and the like.

The discipline, however, extends back long before Ronald Coase, Richard Posner, or Gary Becker, and its questionings regarding the links between legal frameworks and economic systems may be found in the works of Adam Smith or Jeremy Bentham. The field of L&E has mostly stemmed from microeconomics. It has divided into several schools of thought, varying in their emphasis, either on the 'Law' or the 'Economics' aspects (Garoupa and Ulen 2005). It is often defined as the economic analysis of law, which has been viewed as an expression of economic 'imperialism' (Medema 2006).

Under its positive legal-economic aspects, L&E has explored the determinants of economic welfare and efficiency, in particular the interrelations between the economy and government, e.g., the evolution of property rights, and the concepts of power or coercion. A second strand of L&E uses economic theory to compare the economic impact of different legal rules and property rights, via studies of legal-institutional change under a given legal regime, or econometric analyses of the impacts of various legal arrangements on, for example, efficiency (Mercuro and Medema 2006). This second strand is one of the fields more familiar to development economics, as it may assess the impact of legal institutions on growth.

L&E refers to legal systems, relies on the rational choice model of behaviour, and analyses the efficiency of legal arrangements involving rational and self-interested individuals. Despite the rational choice premises, L&E has also examined social norms, habits, and customs - social norms being defined as rules that neither stem from official public institutions nor are enforced by legal sanctions (Posner 1997 and 1998). The role of social norms has also been explored by Sunstein (1997) or Cooter (2002) within a legal-economic approach. An important point is that social norms are often conceived as 'substitutes for law' (McAdams and Rasmusen 2005) or comparable to 'lawlessness' (Dixit 2004).

Developing countries, however, constitute an under-investigated topic—L&E has addressed problems of economic transformation in transition economies, however, as after the collapse of communism, they were submitted to drastic reforms in their economic and legal systems simultaneously. This is particularly the case for the poorest countries, e.g. in Sub-Saharan Africa, often characterised by 'weak' states and institutions captured by interest groups, large 'informal' sectors, judicial systems plagued with corruption, recurrent civil conflicts, authoritarian political regimes, poverty and illiteracy—the latter also severely limiting access to information regarding the law and legal rights—and lack of enforcement of contracts.

The studies by Laffont are an exception (e.g., Laffont 2001): institutions are here conceived as outcomes of contracts, and the effectiveness of institutions depends on the design of contracts, given the characteristics of the environment (availability of public funds, and level of corruption). For the examples of privatization and liberalization reforms in Sub-Saharan Africa, Laffont has stressed that it is easy to transfer legal systems into local institutions 'on paper,' but the problem of their enforcement persists due to limited resources, corruption of enforcement institutions and weakness of regulating agencies. He examined the concept of regulatory contracts in Sub-Saharan Africa and the failure to enforce them via models assuming asymmetric information and imperfect enforcement, where either the regulator succeeds in forcing the regulated firm to fulfil the contract or renegotiation takes place. Laffont shows that the probability of renegotiation decreases with the level of enforcement expenditures chosen by the regulator, and that the endogenous level of enforcement decreases with the proneness to corruption. In developing countries, the problem is the great number of contingencies that affect contracts and the resulting transaction costs, and many actions specified in contracts cannot be verified or contractible, for example corruption, lying or hiding. Laffont therefore focuses on whether formal legal systems can deal with these specific issues, in particular whether the legal enforcement of contracts can solve the problems of asymmetric information (i.e., the very high costs of solving these problems), associated with limited public funds, which characterise developing countries. For Laffont, the more corrupt the country, the lower the optimal level of enforcement.

The view of corruption as a key determinant of the outcomes of the introduction of legal systems in developing countries is indeed recurrent in the development economics literature, which stresses the poverty traps created by 'corruption equilibria' and the powerlessness of legal or economic incentives (e.g., higher wages) to modify equilibria of widespread corruption once they have stabilised (Besley and McLaren 1993; Van Rijckeghem and Weder 1997).

Institutions as endogenous outcomes and products of evolution

The economic literature on institutions, in contrast, views them as evolutionary devices, as underscored by the well-known analyses by Greif (1989, 1992 and 1993) on the Maghribi traders and North (2005), where specific institutional arrangements emerge as responses to given environments, in particular as solutions for problems of contract enforcement: depending on the environment, they may be based on trust and reputation, and consist of self-enforcement devices or be ensured by third-parties. The analyses of North and Greif, however, rely on the dichotomy between 'formal' and informal institutions and norms.

Credibility is an essential problem of institutions, policies and enforcement. Credibility of a public policy is defined as a capacity to commit (Kydland and Prescott 1977). Credible enforcement may be achieved by a third party's coercion—typically, that of a state and its political and legal institutions (or delegation of its powers to independent or veto agencies)—or by the players themselves, as in mechanisms based on reputation or trust (e.g., merchant guilds, Milgrom et al. 1990). Providing rules and institutions with some autonomous existence, in political, religious, and kinship domains, e.g., via physical symbols and rituals, enhances their credibility. To be credible, institutions do not need to have an origin that can be traced to individual intentionality.

A key question is why an individual complies with a rule in a given context of enforcement on one occasion, but not on another, though in the same enforcement context. Formal institutional rules include enforcement devices but do not include automatic compliance with them. In other words, there is no meta-level, no 'police of the police,' 'ruler of the ruler,' or 'court of the court,' which ensures compliance at each level: who guards the guardians? (*Quis Custodiet Ipsos Custodes*?, Stiglitz 1999). Failure to devise the appropriate arrangements explains the collapse of economic and legal reforms, as in some transition countries in the 1990s. The problem to solve for any institutional system is, therefore, the endogenisation of the law and institutional rules.

Governments accept institutions, political or judicial, that limit their actions, and comply with their rulings, but under what conditions? This may be in order to solve collective action problems (Carruba 2007). Rulers may have an interest in limiting their predation in order to stay in power if they have a long-term time frame, and, for example, accept the regulation of their actions, such as with taxation (Olson 1993). Rulers have to solve the problem of commitment, i.e. solve the problem that there is no meta-institution above them: their decisions always runt the risk of lacking credibility, as they have the power to reverse them, as shown by Acemoglu (2002) exploring the possibility of a 'political Coase theorem.'

The legal reforms promoted by international financial institutions

International financial institutions (IFIs), the IMF and the World Bank, have a massive influence in policy reform of developing countries, particularly the low-income ones,

through conditional lending. In the 1990s, the failure of economic programmes to restart growth, especially in Sub-Saharan Africa, incited the IFIs to put forward other sets of causalities for poor performances in low-income countries, i.e. not only lack of economic reform (e.g. liberalization) but local government's behaviour, e.g., poor governance, rent-seeking, corruption, weak regulatory frameworks, unattractive investment climates and the like. Since the 1980s, the IFIs had included the reform of civil services in their programmes, and increased the focus on reforms of local institutions, and legal and regulatory frameworks. After they put in place a conceptual framework of lending conditional on 'good governance' in the early-1990s, in the mid-1990s, the IFIs launched loans (related to, e.g., technical assistance or investment) focused on reforms of judicial and regulatory systems.

The IFIs have thus recommended programmes and projects that introduce new legal systems from the outside and a standardisation of legal frameworks according to global standards to developing countries, in particular regarding financial, corporate and economic issues, the aim being to improve the functioning of markets. As highlighted by Harris (2007), legal reform focuses on the ability of legal systems to facilitate market transactions by defining property rights and guaranteeing the enforcement of contracts, in line with the 'Washington consensus,' with the additional risk that the World Bank enters here into countries' domestic politics, which is forbidden by its own legal mandate (Articles of Agreement). In this case, the IFIs assume that in supplying legal frameworks and incorporating them into domestic legal systems, the existing legal framework will be improved, thus fostering growth.

Over time, the World Bank has increased its resources committed to 'good governance,' with a substantial share going to legal and judicial reform. In the 21st century, legal and judicial reforms constitute one of six main themes in the World Bank's work on governance, besides anti-corruption, civil service reform, decentralisation, public financial management and tax policy administration. The Bank has also launched indicators of institutional performance (besides economic indicators, in the 'Country Policy and Institutional Assessments'/CPIAs) as well as indicators of the 'investment climate' in developing countries, which underline the procedural obstacles imposed by governments on the activities of firms (the 'Doing Business' annual reports). These indicators are used in the Bank's country assessments and its lending policies.

For the example of international accounting standards, securities legislation, insurance standards, and the principles of Corporate Governance recommended by the OECD, Pistor (2000) shows that more than the content of the law, what matters is the process of the development of law itself. The effectiveness of reform depends on the compatibility of new laws with existing legislation and legal institutions, because most legal rules refer to other rules, and law enforcement cannot bypass voluntary compliance. Compliance has often remained purely formal, thus undermining the signalling function of international legal standards, which may be confirmed by the low level of FDI in developing countries or their confinement in enclave extractive sectors (e.g., oil and mines).

3. The cognitive dimensions of institutions and norms

The cognitive dimensions of institutions, norms and rules

What is a rule, or a norm? This has been amongst the most complex issues in philosophy for more than two millennia. A physical regularity does not make a physical 'law,' as emphasised by the analysts of induction (e.g., 'will the sun appear tomorrow?' analysed by Nelson Goodman). An observable regularity of behaviour does not allow a witness to infer that the individual follows a rule or a norm: as shown by Ludwig Wittgenstein (1953) and Saul Kripke (1982). A rule seems to be followed by an individual. It is a public representation: this does not imply that a rule is followed in the mind, as a mental representation (a typical example may be a religious prohibition).

Institutions are highly composite devices: they involve individual mental representations (beliefs, meta-beliefs), public representations (e.g., language, action), objects (symbols, writings) and enforcement devices (power relationships or self-enforcement devices). An institution, and an obligation stemming from an institution, are difficult concepts. An institution is not a concrete object (concrete objects are attributes of institutions) and may be defined as a meta-representation. It is not only a representation of things within a human mind, but a representation of a representation, a representation embedded in propositional attitudes (deontic attitudes: obligation, permission, prohibition and so on - propositional attitudes belonging to the domain of the intentional, Sperber 1985; Searle 2005; Ross 2005).

The concept of contract, pivotal in L& E, is equally complex. Many obligations often viewed as contractual in economics may not be viewed as contracts; in particular, individuals may have no room to choose another mode of transaction and status (e.g., a different group membership), as in the case of characteristics conferred by birth, in contrast with voluntary affiliations. Rules organising society may not result from a social contract (as shown by anthropology, for example Claude Lévi-Strauss viewing marriage exchanges as the foundation of the social link), in contrast with the artefact, the particular set of rules, enacted by a state. Some of the rules organising social interactions may not be contractual, but may still be unavoidable. The rule cannot be ignored and individuals have no choice.

There are intense debates as to whether some rules or regularities of behaviour are the product of the evolution of social groups. For evolutionary psychology, some seem to be domain-specific and correspond to cognitive 'modules' resulting from human evolution and adaptation. The resilience of beliefs and rules of behaviour is explained by individual learning and domain-specificity: they work separately according to specific domains (Tooby and Cosmides 1992). Other views put more emphasis on evolutionary processes, with the resilience of beliefs and norms of behaviour resulting from the evolution of psychological decision-making processes in the face of common environmental challenges (Boyd and Richerson 2005; Richerson et al. 2003).

A key issue is that institutions are by definition collectively shared, which means that the associated beliefs are communicated. As shown by Grice (1975) and his 'cooperation principle,' human beings optimise communication and maximise meaning at minimal costs. The beliefs that have the property of disseminating and replicating

themselves the most extensively, to be the most widely shared, are those that provide the largest cognitive gains for the least effort: they are more 'relevant'. What matters is relevance, which is context-dependent (Sperber and Wilson 1986; Sperber 2000). Depending on the context, specific inferences are triggered and specific information is more likely to be remembered, learned and disseminated.

In addition, institutions exhibit forms and contents, besides many other elements: all these elements combine and produce institutional outcomes that vary in time and space (Sindzingre 2005, 2007a and b). Saying that an 'institution' can be 'exported' to a different environment is a meaningless assumption; institutions are not discrete objects that may be displaced. Specific institutional outcomes refer to multiple layers that involve individual cognitive processes and collective mechanisms and result from processes that have developed in a given space and time. Time may be very long, as shown by Fernand Braudel, who highlighted the different pace of institutional transformation in history according to the type of institutions, with political institutions changing more rapidly than economic institutions, and with social institutions, norms, and customs changing the most slowly (Braudel 1996; Arrow 1998).

From this perspective, cross-country regressions are here spurious and meaningless. The conditions for cross-country regression to be rigorous are precise and not respected by most studies that correlate growth and all possible 'institutional' variables, e.g. social capital, the rule of law and the like (Durlauf 2000; Durlauf et al. 2004). Institutions or norms do not have the required properties to be variables that can be used in a regression, i.e. being separable entities with a stable reference in space and time. For example, regarding democracy at the time of Tocqueville and in 21st century Great Britain, the word is the same but there can be only an assumption of a similarity of reference, a 'family resemblance' in the sense of Wittgenstein. As underscored by Kittel (2006), findings are most often not robust because statistical analysis cannot deal with complex macrophenomena; the latter do not involve independent individuals with identical behaviour that could be described via the representative agent.

What is quantifiable are the attributes of institutions and norms: the number of newspapers or parties is an attribute of a political regime, not 'democracy' or 'dictatorship' themselves. What these studies correlate is only a quantity (from the quantifiable attribute) and another quantity, for example growth. Conversely, the attributes of a given institution alone do not say much about the functioning of that institution; democracy may exist without the conventional attributes agreed upon in Western democracies. Non-democratic attributes (e.g., one-party systems, unwritten rules) maybe attached to democratic mechanisms and formal democratic attributes may be associated with dictatorships and predatory regimes.

No dualism in individual cognition: the difficulty of disentangling legal and social norms

Social contract theories usually consider that before the emergence of the state in its public and legal dimensions, individuals were living in a state of nature or permanent conflict (with divergences as to whether in this state of nature humans are good or

selfish). The state, therefore, emerged because it allowed for the protection of individuals against violence (from reason, Kant; or as a contract of all with all, Rousseau) or as a contract of submission with a ruler (Hobbes) (Pires 1998). The rule of law, however, or some written legal apparatus, is not a necessary attribute of the state. As shown by anthropology, hierarchies and states have appeared in small societies without a bureaucracy and written laws.

From the point of view of the individual mind, normative beliefs and deontic representations ('I must do this') cannot be disentangled by their source, i.e. being norms enacted by a state legal system vs. norms received from the family or other membership groups. They may be clear-cut cases at the extremes of the range, e.g. parents rarely teach their children about bankruptcy laws, while rules of politeness are rarely detailed in legal texts. From the point of view of human cognition, most situations involve a multiplicity of sources of obligations. The latter are received from kin, friends and other membership groups (e.g., 'what is not done'), as well as imposed by law. Dilemmas and choices are therefore constant features of human reasoning and behaviour: 'even if I have the right, it is not done'.

This continuum and difficulty of disentangling state legal norms from the multiplicity of social norms from the perspective of the individual have been used by neoclassical economics in order to legitimise methodological individualism and the exclusive use of individual choice and preferences in economic analysis. This has been achieved, however, via the conceptual reduction of treating the events occurring inside the human mind as a 'black box' and ignoring these events therefore keeping only external expressions such as utility.

From the perspective of individual cognition, the distinction between formal and informal has no meaning (Sindzingre 2006). Beliefs and associated obligations can be 'borrowed' from any exposure to other individuals and institutions, local or foreign, formal or informal, which makes this distinction useless. Formal institutions and laws do not conflict with informal norms - as if they were solid objects: formal laws do not 'destroy', eliminate or 'override' informal norms as antibiotics eliminate bacteria. Formal and informal rules do not constitute a superposition of layers, like a cake, with, for example, the formal rules on the top of the informal ones. They do not constitute a dichotomy that would separate the world into two exclusive sets of phenomena. There are few attributes that are definitional, i.e. necessary and sufficient, which characterise formal rules and activities to the exclusion of informal ones. Modes of enforcement are sometimes said to differ between informal and formal rules, and the state would emerge as an entity able to solve problems of trust and protection of individuals (Mantzavinos 2001). In given situations, however, informal, implicit and unwritten rules may be much more compulsory than written ones.

'Informal' in fact has several meanings according to the activity that is referred to, and using the precise word related to the activity would be more rigorous than aggregating heterogeneous activities into a single word. In particular, the word 'informal' refers to activities where taxes are not paid or are not registered, but also refers to unwritten rules. The first criterion is not even always true—informal sectors pay taxes and are registered (Morrisson 1995) —and it would be more accurate to use the appropriate terms. This has generated many misleading conclusions: the consequences of being

unwritten are specific, and not those stemming from the spurious dichotomy separating human activities into 'informal' and 'formal.' As shown by Goody (1977), the fact that something is written down has precise effects: allowing memory to expand into a storage device and reducing the possibility of playing on memory and forgetting. The latter may express current power relationships (e.g., forgetting sensitive kinship issues, land rights, and so on). Writing may freeze power relationships, and written rules may therefore conflict with competing sets of oral rules.

Moreover, unwritten rules may be more credible and may have a capacity for coercion that is greater than written rules, such as rules generated by allegiances (e.g., kinship, religious, territorial, etc.). The distinction between the 'spirit" and the 'letter' of a rule was outlined long ago, as was the distinction between rules *de jure* and *de facto* (Acemoglu and Robinson 2005). The law may say that one should denounce the thief: this may challenge other beliefs and, depending on the situation, the trade-off will lean towards the side of belief or that of the law. This explains that sets of norms, legal and other, coexist in the minds of individuals; they apply according to circumstances, and do not cancel each other out.

Consequently, a law does not need to 'correspond' to existing informal rules to matter. There are no divisions in the human mind with a part of the brain for the formal and another part of the brain for the informal. Relevance in given situations matters: from Grice's perspective (in an economic approach, Rubinstein 2000), individuals calculate and maximise the relevance, the gain, for them of using a particular rule in given environments. Outcomes depend on the combination of many elements, e.g., rational reasoning, available information, routines and so on. In given contexts and not in others, certain sets of rules are more relevant, their enforcement capacity more credible. For example, there are prohibitions in all societies (e.g. on food), and legal rules are irrelevant here (e.g., requiring a high degree of coercion if obliging someone to eat). Whether or not rules are written is of minor importance in the choice of whether or not to comply with them—but is important from a consequentialist perspective, i.e. the consequence of breaching state rules or traditional rules differ.

4. Resilient beliefs and legal systems

The resilience of membership norms

Institutional and legal reform and the introduction of external legal systems seem to be powerless to affect certain sets of beliefs and norms, which appear to be highly resilient. Some beliefs and associated norms have a special capacity: they generate beliefs that are difficult to revise, i.e. to falsify in the sense of Karl Popper, as well as obligations that it is not 'thinkable' to ignore. Cognitively speaking, adhering to these beliefs cancels a whole range of alternative mental representations and key mechanisms of rational reasoning, such as critical deliberation on their origin and validity.

These norms are in no way specific to developing countries or 'irrational' thinking. They are universal 'modules' of the human mind; they coexist with other ways of reasoning, which may appear to be more 'rational,' and have been adaptive in given contexts. For example, beliefs in non-observable entities allow for a complete and coherent explanation of the world, and fill 'holes' in knowledge: they provide causal antecedents when only consequences are observed (e.g., a physical event, e.g., a natural disaster in pre-scientific societies, Horton 1967). The words that refer to them (e.g., gods, spirits, etc.) are deliberately 'empty' and able to receive multiple contents. This is the basis for flexible inferential reasoning and the efficient spread of beliefs among individuals, as 'empty concepts' are flexible entities that permit the explanation of events: individuals may assign to these words the meanings and representational contents that are most relevant to them in a given situation (which vary in space and time) (Sindzingre 2005).

Believing in non-observable entities that explain misfortune has obvious effects in enhancing individual welfare, especially in environments characterised by poverty and uncertainty, as unobservable entities maintain links within a group (e.g., such as ancestors, mythical founders, etc.). These entities may persist even if individuals are rational and imply very sophisticated inferences—"if p, then q"— as shown by the code of Hammurabi analysed by Fudenberg and Levine (2006) (the code specified an 'appeal by surviving in the river' as a way of deciding whether an accusation was true), or the codes of the European Inquisition used until the 18th century (e.g., 'if the man with a stone on the neck does not sink, he has a pact with the devil; if he sinks, he is innocent', etc.). A key point is that inferences lead to a focal outcome that is anticipated *ex ante* (e.g., 'this outcome is a proof that the devil exists'): they lead to the confirmation of *ex ante* beliefs.

Circumstances obviously vary from one context to the other. Crucial examples of such beliefs and the rules attached to them are the beliefs organising individual identity, i.e. the linkage of an individual to a membership group (Sindzingre 2007). Two main sets of beliefs and rules are constituted by those related to kinship, neighbourhood and territory - i.e. group membership -, and social interaction within and between groups, and beliefs regarding the non-observable world and causalities, which organise the main steps of the life-cycle (e.g., birth, death, misfortune and reproduction, usually constituting a religion). They refer to the essential processes that build the identity of an individual as a member of a group. These beliefs involve emotions (Elster 1998; Damasio 1999), increasing the difficulty of revising them. Religious beliefs (beliefs about non-observable supernatural entities and mechanisms) may be particularly resilient: from an evolutionary perspective they include ontological concepts that are easily acquired, stored and transmitted, with some of these beliefs being particularly successful when they organise group identity and membership and social interactions within and outside groups (Boyer 2000 and 2001).

Holding these beliefs and the associated norms and obligations defines membership: membership means believing in these specific beliefs and complying with these obligations. There is little room in this case for falsifiability and the reasoning here is circular. Social rules and prohibitions have been analysed in functionalist ways, but prohibitions may be viewed as constitutive of a group, a mark of distinction and a delineation of boundaries. Such rules are therefore modified with difficulty, which

would not be the case if they were corresponding to specific functions (e.g., a prohibition on food explained by climate).

Beliefs can be destructive from an evolutionary perspective. They can be highly dysfunctional, which is why evolutionary functionalism remains unsatisfactory (e.g. slavery, eliminating women, etc.), because of the classical prisoner's dilemma mechanisms where individual maximisation results in a loss of collective welfare. As these beliefs organise individual survival and are supported not only by cognitive reasoning but by emotional states, 'evidence' does not eliminate false beliefs and does not prevent these beliefs from enduring.

A resilience shaped by political and economic contexts

The key point is that these beliefs and the associated norms that organise group membership are part of broader political and economic relationships, which are further determinants of their resilience. Many aspects of economic interactions are not governed solely by contracts, and non-contractual aspects of interactions are governed by "norms and power" (Bowles 2004, p. 10).

As shown by the psychologist A. L. Luria (quoted in Boyer 1986), an individual's reasoning is determined by his/her links with other individuals and his/her social status within a group. The latter leaves him/her with the possibility of developing and expressing 'utterable' inferences: in the example of Luria, where Uzbek peasants are presented deductive syllogisms aimed at testing their cognitive capacities, the answers were: "I have to ask someone who is more knowledgeable than me."

These beliefs and associated norms therefore change according to the broader transformation in economic environments and power relationships; they recombine with other beliefs and institutions due to broader political and economic change, as has been the case when peasant societies have transformed into industrial ones. For example, societies where rights in men prevailed transformed into societies based on rights in land (Feeny 1989). Political power and relationships thus determine the effectiveness of legal 'transplants', as shown by Lambert-Mogiliansky et al. (2006) with the example of the enactment of a new bankruptcy law in Russia in the late 1990s: enforcement of the bankruptcy law has indeed been subverted by local governors when they have had the political capacity to do so.

Moreover, these norms are flexible within a given group and vary according to context. Land rights are an important case in point in developing countries. The flexibility in claiming rights that is inherent in oral societies is shaped *in fine* by changes in political equilibria: land rights may be 'remembered' and claimed in certain contexts, which depend on unstable power relationships (in the example of Cameroon, Shipton and Goheen 1992; in Ghana, Berry 1997). This is why legal reform, such as introducing new property rights or fixing former tenure rights and land titles into definitive property rights, often generates conflicts or inefficiencies (as when peasants cannot exploit land because of poverty and resell it). Combining and basing statutory land law on customary land law appears to be the best way to build viable property systems, as

highlighted by Blocher (2006) in the case of Ghana. The writing of constitutions in developing countries and its effects on the attenuation or exacerbation of conflicts is subject to the same uncertainties (Widner 2005).

It is common in most societies that rights over assets are accompanied by beliefs organising group membership, that in turn maintain hierarchies of status and rights (e.g., aristocrats and commoners) and inequality in wealth. Caste systems are well-known examples. As shown by Udry, inequality in lineage in Ghana allows higher statuses to secure their land rights and invest, thus accumulating more wealth than lower ranks in traditional hierarchies.

In developing countries, in contexts of very high uncertainties, these norms play a crucial role, in organising the primary identities of individuals and in terms of their security. In the absence of social security provided by a third party, i.e., the state, individuals have no other choice but to build their own insurance devices, which are mainly based on group membership—often provided by kinship and religion. These insurance devices are grounded in circuits of redistribution and exchange of debts and obligations that refer to any goods and services (dependent individuals, e.g., women of the kin group, money, labour, and so on). Flows of goods and services have to continue for the system not to become bankrupt, as with any mutual insurance system. Legal rules may forbid corruption in the firm or in the civil service: for an individual, they have little coercive power in comparison with keeping alive the networks that provide protection against the vagaries of life, losing a job, illness and the like (Hoff and Sen 2006).

5. A case for state intervention and legal systems

The negative effects of membership norms

The point here is that the state in its modern sense is not an institution like any other. From an evolutionary perspective, the necessity to maintain groups and organise exchanges within and between groups has generated kinship systems (interestingly, a very limited number, which cover all possible modalities of filiation and matrimonial exchange) and political systems. The latter may take multiple forms: age classes, village councils, kingships, castes, land entitlements, hierarchy of lineages, and many others.

The social norms that organise groups (e.g., kinship, political) may reduce transaction costs and enhance cooperation, trust and access to information in uncertain and noisy environments; they provide social security and insurance via precise rules of reciprocal exchange of goods and services. These norms, however, are divisive, they create boundaries and divisions in social interactions, and their positive aspects express themselves only within the group (Nissanke and Sindzingre 2006). Social norms are the product of evolution and selective processes, but this does not prevent them from being highly inegalitarian, and high inequality does not prevent their persistence (Bowles 2006).

Membership norms may be severely detrimental to collective welfare: they are in essence lock-in and exclusionary devices (the 'we' against 'them'). Norms organising membership may exclude entire groups from acceding to particular institutions, rights, assets or markets (and may even imply the extermination of entire groups, as shown throughout history): women may thus be excluded from labour markets, access to land or inheritance and property rights. Moreover, membership norms may induce high inequality when they create hierarchies and statuses. Inequality generated by statuses work *ex ante* (e.g. castes) or *ex post*, via endogenous processes of group formation (education, language, endogamy, and so on). If one adheres to the view that traditional rules of organisation are long-term contracts, those based on birth (e.g., castes) are obviously the most rigid ones and likely to generate lock-in processes.

These beliefs may build 'inequality traps' (World Bank 2006), i.e. inequalities that are reproduced across generations among individuals and groups. In contrast, poverty traps refer to the fact that the poor are trapped in poverty because a lack of resources prevents them having access to the possibility of acceding to resources. Inequality traps stem from the stability of distribution because the various dimensions of inequality (in wealth, power and social status) prevent social mobility. For example, norms regulating the status of women generate a trap when girls receive less education and women increase their economic dependence and poverty relative to men. These beliefs and norms are typically resilient. They are reproduced by the individuals who are the victims: inequality traps, hence, endure over generations. These beliefs are difficult to revise and persist even when confronted with markets, due to their cognitive characteristics, the ability to disseminate themselves, their relevance, and the fact of being constitutive of group membership.

These beliefs and norms, operating at the micro level, may lead to the weakening of several determinants of growth at the macro level. A channel is the limitation of a public good such as knowledge or scientific research[1]. Compliance with group norms prevents openness to innovation, which at the aggregate level may be detrimental to growth, as shown by Munshi and Myaux (2006) in the example of the difficulty of achieving fertility transition in Bangladesh. Another channel is social fragmentation, which has a negative effect on growth, e.g., via the inefficient redistribution of resources—this channel has also been highlighted in rich countries (Alesina et al. 1999).

These beliefs can even threaten group survival. Well-known examples are traditional norms promoting preferences for boys in Asia, which have led to ratios of 100 men to 130 women in some areas, obliging individuals to import women from outside if the group is to reproduce. Examples of such prisoner's dilemmas are numerous, such as those related to the management of common resources (the 'tragedy of the commons'). Traditional norms combining collective management and fecundity (as an insurance device) may be optimal when taken separately, but may result *ex post* in detrimental outcomes for the survival of the society.

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[1] An example is creationism, which has emerged in a developed country, and shows the modularity of norms that coexist with rational thinking.

Building public institutions in developing countries: escaping institutional traps

These processes typically constitute a case for state intervention and public policies, as well as building credible formal judicial institutions, which have the capacity to shape individual beliefs, preferences and behaviour, either via coercion or incentives. The first theorists of development economics, e.g. Paul Rosenstein-Rodan, have demonstrated that the state was necessary in development as it was the only entity that was able to efficiently reallocate factors, capital and labour, across sectors (Bardhan and Udry 1999; Adelman 2000 and 2001). In addition, as shown by Platteau and Seki (2001) in the example of fisheries in Japan, changes in economic environment and incentives have induced changes in institutions.

A key issue for developing countries is that it cannot be just 'any' state intervention, e.g., an intervention that would emanate from a predatory state. Moreover, formal democracy and formally independent legal institutions are no guarantee of genuine democracy or independence. Asian developmental states suggest the importance of several ingredients: among others, some degree of benevolent strong government, a long-term time horizon and commitments to growth.

As underscored by Glaeser et al. (2003), legal, political and regulatory institutions (e.g., courts) are often subverted by the politically powerful or the rich for their own benefit (via influence and corruption), this institutional subversion - or 'capture' by vested interests, being compounded by inequality in economic and political resources. This is detrimental to welfare, capital accumulation and growth. Beyond the trade-offs of efficiency vs. equity, there is a case here for public redistributive policies (Nissanke and Thorbecke 2007). The provision of social security by the state is crucial, hence the building of efficient tax systems, as the detrimental lock-in dimensions of the microeconomic behaviour and beliefs associated with group membership (e.g., divisions, low trust and redistribution to cronies) often stem from the lack of social protection that would be provided by a third party, such as the state.

The state fosters social linkages via citizenry - though it creates divisions at a higher level, i.e. against other states. At least within its boundaries, citizenry is a recognition of common membership (if not equality), which works against the divisions of lower level membership[2]. State laws may change beliefs and behaviour, since the state has by definition the most powerful enforcement and coercion capacity. The state may prohibit group norms that harm members of other groups, or harmful market mechanisms, because it has a longer-term time horizon—this view, however, conflicts with the public choice approach, which emphasizes state capture by vested interests and politicians pursuing their private interests and the objectives of staying in power.

Developing countries, however, are confronted with difficult dilemmas. States are often governed by predatory rulers, so that public policies, supervision and judicial institutions may have no credibility. The private sector is also very limited and sometimes comprised of ex-politicians with short-term interests, and taxation weighs on the visible (formal) sector: the time horizons of politicians, as well as investors, are

[2] For example, the Jews made French citizens by the French Revolution.

therefore not long-term ones. In this context, the private sector is not in the best position to replace or complement the state in its role of supervision and regulation.

In developing countries, vicious circles and 'institutional traps' can therefore emerge, based on microeconomic routines, with risks of low equilibria and path dependency effects. A key issue is, therefore, the identification of ways of escaping from these traps. Economic policies and 'formal' judicial and economic institutions may aim at fostering growth or implementing an equitable reallocation and redistribution of assets (e.g., land and education). However, they may not be credible in political systems based on predation or cronyism. They may not have the necessary cognitive relevance for individuals, nor the necessary properties of 'impersonality' *à la* Max Weber, merely reflecting personal interests. They may remain *de jure* and have no impact *de facto*.

Conclusion

This paper has assessed the approaches that link law and economics via a critical analysis of the concepts of institutions and norms. It has shown that many studies rely on simplistic dualistic theories of institutional change—'old' vs. 'efficient,' 'informal' vs. 'formal' institutions. The paper has presented an alternative theory of institutions that emphasizes the plurality of their elements from the point of view of human cognition. This alternative approach shows the complexity of the processes involved in institutional transformation and the introduction of legal systems. It also reveals the limits of the quantitative methods that are usually employed in development economics. Regarding developing countries, a theory that distinguishes between the different elements of institutions in considering their cognitive basis provides a better explanation of change or resilience in beliefs and norms when legal reforms are implemented.

The paper has also highlighted the existence of specific sets of norms and beliefs, which may be characterised as difficult to revise and more resilient when confronted with legal reform, i.e. those organising group membership. The latter are part of broader political and economic relationships, which also shape the dynamics of their resilience. The negative outcomes inherent in institutions organising group membership underscore the necessity of a meta-entity such as the state, which is better able to address institutional 'traps', as well as legal systems. A recurrent difficulty in developing countries, however, is the low credibility of political systems that are based on predation, which may also have little cognitive relevance for individuals, and hence remain only *de jure*.

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