WHY INSTITUTIONS MATTER

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The word 'institution' conjures an image of a grand, imposing and aloof brick and mortar structure, behind whose calm and stately façade, safe from the prying eyes of the public, persons of authority engage in lofty deliberations over important and complex matters. However, this view of institutions reflects only one side of the picture. While it is correct that the term 'institution' is used interchangeably with an 'organisation', particularly one that is long-standing and performs a public function, it equally and perhaps more importantly, refers to a custom or practice that has existed for a long time in a country and is accepted as an important part of a society.

'Institutions' as understood in this second sense, form the foundations of New Institutional Economics which argues that economic activity is not only shaped by economic principles but also by the social and legal norms prevalent in the society. In the words of the Nobel prize winning economist, Douglass C. North these social and legal norms are in fact 'institutions' in that they are the 'rules of the game' which form the framework within which all human interaction—including economic interaction—takes place and which therefore constrain and shape this interaction. These institutions may be further organised into several overlapping categories: as market or non-market institutions, explicit or implicit institutions, and organically developed or borrowed institutions.

So, how do these institutions affect economic development? North argues that these "institutions affect the performance of the economy by their effect on the costs of exchange and production". This important observation recognises that the 'cost' of a transaction is not merely the monetary price paid for it. For instance, in simple terms it means that the cost of doing business in a country not only includes the investment required to set it up, but also the ease (or lack thereof) with which licenses or approvals for conducting the business may be obtained and disputes relating to the business may be resolved. The computation of the cost of business is therefore a complex exercise which requires knowledge not only of express rules but also or implied traditions and practices—and arguably the higher the overall cost of doing business or the greater the difficulty in computing it, the lower the possibility of business.

Institutions impact economic development at both the macro and the micro level. The most significant macro institution in this regard is the constitution of a country which in addition to being a primary institution in itself, establishes other legal and political institutions necessary for its governance. Some scholars (Tony Prosser, for instance) argue that constitutions establish the institutional infrastructure for the 'management of the economy' therefore implying that they are superior to it. However, those from the neoliberal school (such as Friedrich Hayek) are of the view that constitutional institutions simply provide an enabling framework for the operation of free markets and are therefore subordinated to economic exigencies.

In practice this means that a country may have to make difficult choices between its social priorities and its economic reality. The direction in which it resolves these choices is determined by its underlying economic philosophy as well as the capacity of its domestic institutions to strike an appropriate balance between these competing concerns. This capacity, in turn, is determined by the level of domestic knowledge and capability as well as the historic depth, strength and experience of these institutions which in turn is linked to how the country has acquired its institutions. Arguably, a country that has organically developed its institutions or adapted these through bottom-up, participatory and inclusive deliberations is more likely to negotiate its social and economic needs for the well-being of its citizens. Even leaving aside the repeated interruptions to Pakistan's democratic process, the ability of its constitutional institutions to realise their social justice agenda is compromised by the fact that these institutions are borrowed rather than having developed organically from the Pakistani context: the legal and political institutions largely replicate those of the Government of India Act 1935, the fundamental rights echo the UN Declaration of Human Rights (Articles 8-28), whilst the economic principles align with the values of free market economy (Articles 18 and 23-24). It may be argued that General Zia-ul-Haq's Islamisation of the Pakistani constitution in the '80s was perhaps born out of the need to indigenise its institutions, however, this attempt was largely superficial and semantic and left the institutional structure almost entirely intact.

Very like its constitutional institutions, Pakistani economic institutions are not fully grounded in its context. In a bid to integrate into the global economy Pakistan had become a member of the IMF and the World Bank in 1950 and of the WTO in 1995. In time Pakistan carried out the first-generation macro-economic reforms by liberalising exchange and interest rates and the second-generation micro-economic reforms by establishing a range of authorities such as the SECP, CCP and NEPRA to regulate activities throughout the country. Most of these reforms were decided between the executive and multilateral agencies behind closed-doors without any consultation with stakeholders and were often introduced in the country through temporary ordinances and later ratified by extra constitutional orders or parliaments not inclined towards meaningful engagement with the legislative process.

However, Pakistan's large scale borrowing of legal, political, and economic institutions was not entirely thoughtless and perhaps was even a necessity given the unusual circumstances of Pakistan's creation. By adopting institutions that declared its liberal values and aligned it with international best practices, Pakistan derived much needed international legitimacy and gained an entry into the ranks of progressive nations. However, in super-imposing borrowed institutions on institutions pre-existing in the Pakistani context, without any meaningful effort to engage, aggregate or even to inform public opinion, this large scale borrowing also drove a wedge in the legal fabric of the country, creating in effect two legal systems: one stated in the explicit rules, and the other impliedly understood by all who operated within it.

While North reminds us that these sub-conscious institutions or informal constraints are resistant to change, Rodolfo Sacco, in his seminal work on legal formants, in which he refers to these as 'cryptotypes' argues that these implicit patterns of behaviour have considerable outward effects and must be included in any analysis which aims to understand why the same explicit rules result in different outcomes in different contexts. Examples of cryptotypes operating in the Pakistan include the preference of both civil and military-led governments to make laws through ordinances rather parliamentary legislative procedures or the penchant for adjournments in the Pakistani legal system. Although the explicit rules provide for both these practices, the manner in which these are practiced in the country are beyond the limits provided for in the law hinting at another, more sub-conscious rationale.

Therefore, to understand reasons for which Pakistan has remained unable to realise its economic aspirations it is important not only to study the institutions it claims to be governed by but also the institutions that operate almost entirely at an implicit level where they may neither be detected nor reformed, and yet are powerful enough to render the country's explicit rules superfluous to the functioning of its legal, political, and economic life. The aim of this exercise would not be to eliminate these implicit rules or informal constraints but to relate them to the explicit rules so that there may be congruity rather than clash between the two. This, in turn, is only possible through bottom-up, participatory, and inclusive institutions, whether explicit and implicit, that have the capacity to aggregate local knowledge and the incentive either to adapt borrowed institutions to reflect this knowledge or to educate the public of reasons for not doing so.

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