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# Formal and informal institutional change: the experience of postsocialist transformation

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## Abstract

Diversity of trajectories of post-socialist transforming economies is a stylized fact of this experience of system change. The paper explores the relations between change in formal and informal rules in historical perspective, discussing new institutional views about rationality of formal institutions and detrimental inertia of informal institutions. It submits that an open and complex approach of the centrality of formal/informal rules interaction may give a better explanation to the multiplicity of national post-socialist pathways.

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## 1. Introduction

The wide-ranging experiences of post-socialist transformation in about 30 countries during the 1990s and 2000s have led to a number of surprises and puzzles for the social sciences. Two stylized facts of transformation are the striking diversity of national paths of change and the general importance of informal relations and rules, even though the process of system change from socialism to capitalism has generally been understood as a process of rationalization and formalization.

The variety of trajectories of transformation has been remarkable indeed, be it observed at the national level (Chavance and Magnin 1997; Magnin, 1999; Van de Mortel 2002; Lane, Myant, 2007) or at a more aggregate level where the differences or contrasts between a Central European, a post-Soviet and an Asian trajectory are apparent. The specific and evolving relations between formal and informal institutional change have been a key element in the array of causes of such an emerging and enduring variety.

The role of informal relations and rules has been underlined in numerous analyses of a wide range of phenomena: networks, social norms and values in general, but also spontaneous privatization, corruption, cronyism, mafia-ization, tunneling, arrears, labor hoarding, barter, tax evasion, informal economy or, on the other hand, trust, social capital, new work and business ethics and informal cooperation. The manifest significance of the informal realm in systemic change has contributed to a gradual shift in economic theory from a de-institutionalized and market-centered analysis to a more institutional approach.

The distinction and interaction between the formal and informal dimensions of social relations have long been analyzed by social theorists, particularly from the legal and sociological tradition but also by economic theorists dealing with institutions. Weber (1921) observed that the relationship between informal behavioral regularities and formal rules is complex and reciprocal. Commons (1934) wrote that customs are

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produced spontaneously and that authoritative figures operate an “artificial selection” among them in trying to manage conflict, leading to formal and legitimized rules; this is the “common law method,” which is at work in the numerous going concerns that constitute capitalist society (including the larger going concern, the state). Hayek (1973, 1988) emphasized (informal) law or moral rules that had evolved over long periods before some were eventually transformed into legislation; beneficial informal rules were principally subject to a kind of selection through “cultural evolution” that was neither natural nor artificial. In his analysis of institutional evolution, North (1990) stressed the distinction between formal and informal constraints, with the latter both underlying and supplementing the former.

In examining the historical experience of post-socialist transformation, this question has recently been recognized as an important dimension of wide-scale organizational and institutional change. Different views of these interactions have been put forward in economic analyses of systemic change. In this paper, I discuss new institutional views about the relationship between formal and informal institutional change,<sup>2</sup> in order to explore how such analyses may contribute to clarifying questions concerning the variety of transformational pathways and national forms of post-socialist capitalism.

## **2. Diversity of Transformation Trajectories and Path-Dependence**

The search for commonalities in transformation experience may be carried out at various levels of abstraction. The lowest implies a comparison directly based on the national level of about 30 countries or a subgroup of them. The highest level of abstraction concerns “system change” in general (e.g. Kornai 2000). An intermediate level may deal with strong similarities within groups of countries that have experienced similar trajectories. The dominant transition doctrine initially applied a uniform analysis and strategy to most national cases (this excludes the Asian countries). Later, the contrasts among the various experiences were acknowledged but remained under-theorized in the mainstream approach.<sup>3</sup>

The broad experience of post-socialist transformation has not resulted until now in a consensual set of stylized facts among the different schools of thought, that may serve as a basis for various theories to test the light they can shed on such epochal change. The variety of trajectories in different economies and the diversity of post-socialist national capitalisms partly explain such a paradoxical situation. Different generalizations have been attempted about “transition” in general, but they remain unsatisfactory as they can often be refuted by one or more national counter-examples. Most of the time they rely on one or a few national experiences deemed “typical,” but fail to take into account contrasting paths of transformation. In order to draw “general lessons” from the transformation processes so far, the challenge of diversity has to be faced, and more inductive analysis has to be done of the variety of experiences that have

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<sup>2</sup> Here, institutions will be interpreted as social rules, and formal and informal rules will be treated as equivalent to formal and informal institutions. For a more detailed discussion of the concept of institution, see Chavance (2008)

<sup>3</sup> Roland (2000) lists national “differences” as stylized facts about transition: differences in reform paths and strategies; differences in macroeconomic performance after liberalization; and differences in enterprise performance in response to changes in ownership and corporate governance. But besides the fact that the “performance” itself should be problematized (see below), differences in performance should be related to differences in institutional configurations of post-socialist capitalisms.

surfaced. If not, we face the risk of wrongly generalizing from just one specific or partial experience or period, without dealing with historical specificity (Hodgson 2001) as a necessary component of general theorization.

### 3. Formal and Informal Institutional Change

In the recent period we find two influential but contrasted ways to conceptualize the relation of informal and formal rules or institutions.

The first is Hayek's theory of law. It is influenced by the *common law* experience and sees law (like morals) as evolved abstract rules that have been selected through a lengthy historical process of cultural evolution, where the advantageous rules have been filtered through group selection (Hayek 1988). Deliberate legislation may be positive inasmuch as it codifies — or remains compatible with — evolved general rules of conduct, or perfects them at the margins without replacing them with teleological and instrumental organizational rules that are totally unfit for an extended, spontaneous order (Hayek 1973). Followers of this line of thought consequently give great weight to informal, evolved rules, and view formal, deliberate ones as beneficial only when they correspond closely to the former. But formal rules may reflect a constructivist attempt to build an extended order following the pattern of a teleological organization, in which case they will endanger society and economy.

The second prominent theory is North's view of institutional change (North 1990). In his influential book, North distinguishes between formal and informal institutions, and underlines the inertial character of the latter. He writes about alterations produced by discontinuous institutional change, such as revolution or conquest: "What is most striking (although seldom observed, particularly by advocates of revolution) is the persistence of so many aspects of a society in spite of a total change in the [formal] rules" (North 1990, p. 36). Defining institutions as constraints, he notes that "informal constraints that are culturally derived will not change immediately in reaction to changes in the formal rules," leading to a "tension between altered formal rules and the persisting informal constraints" (North 1990, p. 45). While changes in formal rules are made and enforced by the polity, informal constraints are linked to cultural inheritance. North also strongly criticizes the mainstream approach to transition, emphasizing the limits to our understanding of institutional change, and opposing "a certain amount of hubris evident in the annual surveys of the World Bank and in the writings of orthodox economists who think we now have it right" (North 1997, p. 15), adding that "path-dependence can and will produce a wide variety of patterns of development, depending on the cultural heritage and specific historical experience of [each] country" (North 1997, p. 17). Another limit of orthodoxy is the lack of consideration of *enforcement* of formal rules: "Economies that adopt the formal rules of another economy will have very different performance" because of "different informal norms and enforcement" characteristics (North, 1994, p. 366). This discrepancy results in putting limits on expected revolutionary (formal) changes and in disappointment in terms of performance when imitating formal rules of successful countries.

Authors influenced by the Northian approach have a rather critical view of informal rules, often regarding them as a negative legacy of the past, and more readily admit that the correct or «adaptively» efficient combination of formal rules/enforcement characteristics/informal rules is not known in the present state of institutional economics.

Table 1: Formal and Informal Rules in Two Theories of Change

	Hayek	North
<b>Formal rules</b>	Legislation ought to correspond to evolved (informal) law	Laws, constitutions: often imitated from successful countries
<b>Informal rules</b>	Evolved and selected through cultural evolution, generally beneficial (constitute tradition); underlie formal rules but are effective beyond them	Norms of behavior, conventions, self-imposed codes of conduct (constitute culture); generally underlie and supplement formal constraints
<b>Potential conflicts</b>	Legislation contradicts evolved law	Rapid change in formal rules with inertial informal rules
<b>Consequence of conflict</b>	Constructivist attempts threaten the beneficial spontaneous order of society or the market	Revolutionary changes do not follow expectations and do not bring anticipated performance
<b>Criticism of mainstream transition strategy</b>	Constructivist (?) (Hypothetical criticism)	Focuses only on formal rules change, overlooks problems of their enforcement and the inertia of informal rules
<b>Doctrinal background</b>	Economic liberalism	Historical new economic institutionalism

These two theories have influenced the new institutional economists' attempts to interpret and guide the post-socialist transformation. As they are not directly compatible, tentative syntheses giving more weight to one or the other do not give convincing conclusions. Moreover, such syntheses have been blended with various degrees of neo-liberal confidence in the market as such, adding an element of heterogeneity to conclusions.

The first theory runs into serious difficulty when the « transition » to a capitalist order is at stake, as this starts from a revolutionary upheaval and not from a historical incremental evolution; the second may appear one-sided in treating informal institutions (equated with cultural legacies) primarily as obstacles to progressive change.<sup>4</sup>

#### 4. Extension of Formal/Informal Distinction

Several authors have elaborated on the Northian distinction between formal and informal institutions against the backdrop of the highly diverse and complex experiences of post-socialist change in many countries. A number of authors have extended the new institutionalist view in terms of the interplay between formal and informal rules.

Pejovich (1999, p. 170) has put forward the “interaction thesis,” where different instances of relations are distinguished: 1) Formal institutions suppress, but fail to change informal institutions; 2) Formal rules directly conflict with informal rules; 3) Formal rules are either ignored or rendered neutral; and 4) “Formal and informal rules cooperate” — as in cases where the state institutionalizes informal rules that had evolved spontaneously. Pejovich observes: “When formal rules conflict with the prevailing informal rules, the interaction of their incentives will tend to raise transaction costs and reduce the production of wealth in the community” (Pejovich 1999, p. 171).

<sup>4</sup> Building on the German tradition of Ordoliberalism might have reduced some contradictions in neo-liberal approaches to system change, but it has been barely present in transition debates. According to Leipold (2001), scrutiny of the political process and of the role of informal rules has been absent from this tradition.

In a discussion on norms and networks, Nee (1998) differentiates between congruent, decoupled and opposition (informal) norms according to their relations with formal rules. Congruent norms are closely coupled with formal rules, and both are mutually reinforcing. Decoupled norms allow activities to vary according to practical considerations while retaining formal structures, which may become largely ceremonial. Opposition norms encourage direct resistance to formal rules. According to Nee, the first relationship promotes, while the third is highly detrimental to economic performance.

Defining institutions as rules accompanied by an enforcement mechanism, Voigt and Engerer (2001) describe external institutions as rules sanctioned by the state and internal institutions as rules sanctioned by members of society. While not identical to the distinction between formal and informal rules (as the case of private rules linked to organized private enforcement may actually refer to formal internal rules), there is a strong overlap between the two definitions.

**Table 2: Internal and External Institutions**

Nature of rule	Nature of enforcement	Type of institution
1. Convention	Self-enforcing	Type 1 — internal
2. Ethical rule	Self-commitment of actor	Type 2 — internal
3. Customs	Via informal societal control	Type 3 — internal
4. Private rule	Organized private enforcement	Type 4 — internal
5. State law	Organized state enforcement	External

*Source: Voigt and Engerer (2001)*

The authors define four kinds of relationships between internal and external rules: neutral; complementary; substitutive (non-compliance is sanctioned either by the state or by private individuals); and conflicting. Complementarity is a necessary but not sufficient condition for economic success: everything depends on the content of an institution. Internal institutions change more slowly than external ones, as they are not subject to deliberate choice mechanisms.

Winiecki (2000), in a similar way to Pejovich, stresses the interaction between formal and informal rules, with the latter generally displaying resilience. The harmony between the two types of rules conditions economic success in the long term; however, discordance may prevail to varying degrees. Informal rules can slow down the positive effects of new formal rules, but they may also limit the negative consequences of new formal rules that are misguided. Winiecki defends the shock therapy approach and expresses reservation towards formal rules in general (he mentions an “institutional Laffer curve,” where beyond a certain threshold, formal regulations exercise a negative effect on wealth creation). A limited number of formal rules should, thanks to decentralization, allow for flexible evolution in informal rules (Winiecki 2000, p. 160–161). Winiecki opposes gradualism on the grounds that a critical mass of formal rule change is initially needed, and also because the “market for institutions” proposed by Pejovich (which implies a co-existence of different types of rules), is based on a false analogy with the emergence of capitalism (Winiecki 1998, p. 21).

Katharina Pistor, distinguishing between formal and informal law, notes that both tend to be complementary when they evolve over time, but in political and economic regime change, new formal and pre-existing informal institutions compete or operate independently (Pistor 2000, p. 4). Law is usually neutral, contrary to Marx’s

superstructure thesis, but it is not neutral in regime change, as existing socio-economic and political control rights are re-allocated (Pistor 2000, p. 9). Pistor seems inclined to follow North concerning power as a causal force on formal institutional change, contrary to authors like Winiecki or Pejovich, who mainly concentrate on formal/informal relations or have an efficiency-centered approach to formal rules,<sup>5</sup> but she limits the validity of this notion to “regime change.”

In the second half of the 1990s, the initial transition doctrine itself was somewhat modified. The importance of legal frameworks, administrative capacity and the enforcement of formal rules were underlined (Sachs and Pistor 1997). A number of “soft concepts” (Sztompka 1999) were also developed and studied, such as trust, social capital, etc. “Institutional” rhetoric became dominant.

## 5. Successive Periods of Change

The interdependence between changes in formal rules, their enforcement, and informal rules has assumed different forms during consecutive periods of socialist reform and post-socialist transformation.

If we consider the Central European countries, schematically distinguishing the last decade of socialism as pre-revolutionary, the first three years as revolutionary, the twelve following years as post-revolutionary (taking accession to the European Union in 2004 as the symbolic marker) and the following period as evolutionary, we have the Table 3.

Table 3: Four Periods of Change in Central Europe

Periods	Formal rules	Enforcement of formal rules	Informal rules
Pre-revolutionary	Significant but partial changes in reforming countries*, limited change in others	Uneven, often decreasing	Fast and opportunistic changes in reforming countries, slow but real changes in others
Revolutionary	Radical, wide-ranging and extended systemic changes	Generally weak	Fast, opportunistic and protective changes and innovations (systemic uncertainty)
Post-revolutionary	Continuing changes, systemic (e.g. privatization) and intra-systemic (driven by complementarity)	Consolidation, uneven depending on domains considered	Opportunistic change, learning processes in stabilizing formal framework (intra-systemic uncertainty)
Evolutionary	Incremental changes, intra-systemic	Consolidation, routinization	Changes principally through learning processes, gradual innovations

\* Poland and Hungary (in the 1980s).

But let us turn to the Asian experience of China and Vietnam, where the system shift took place through a protracted evolutionary process, without any clear

<sup>5</sup> Winiecki (2000, p. 150) refers to “cost-benefit calculation” concerning the introduction of new formal rules over time.

revolutionary period.<sup>6</sup> While differences arose in the chronology and process of change of the two countries, a somewhat similar sequence could be observed.<sup>7</sup> We can schematically distinguish a first period where formal socialist institutions and rules were relaxed, with decollectivization in agriculture and emergence of a small private or quasi-private sector, a second stage where dual-track reforms with dual price system and partial external opening took place, a third period where radical changes in formal rules and institutions were extended (touching state ownership and administration, the banking system, the monopoly of foreign trade), and a fourth period which can be roughly assessed as post-socialist where formal capitalist institutions are developed, like a dominance of private or quasi private ownership, capital markets, etc. This may be summarized in the Table 4.

**Table 4. Four Periods of Change in Asia**

<b>Periods</b>	<b>Formal rules</b>	<b>Enforcement of (existing or new) formal rules</b>	<b>Informal rules</b>
<i>Relaxing socialist institutions</i>	Limited, experimental change in formal rules, followed by formalization of actually transformed relations	Uneven, often decreasing	Fast changes following initiatives of local actors
<i>Dual-track reforms</i>	Changes intended at controlling a piecemeal reduction of the state sector and extension of a non-state sector	Generally weak	Fast, opportunistic changes and innovations (speculation on prices, profiteering in relaxed foreign relations)
<i>Radical institutional reforms</i>	Changes intended to reduce and transform basic socialist institutions	Consolidation, uneven depending on domains considered; relative hardening of budget constraint	Opportunistic changes, learning processes in persistently changing formal framework
<i>Postsocialist capitalist evolution</i>	Extension of formal capitalist institutions	Consolidation, uneven depending on domains considered, elements of routinization	Changes through learning processes, gradual or swift innovations

These periodizations are assuredly schematic, but they help to underline that the general interdependence between changes in formal rules, their enforcement, and informal rules, while central to all trajectories of post-socialist transformation, contributes through context- and specially path-dependence to the diversity of processes and configurations of system change. Concentrating on such causes of institutional change variety may help to adopt a less deterministic approach than those used in some new institutional economics (NIE) theories.

<sup>6</sup> Continuity has prevailed in the formal political system, - even though it has undergone significant changes (Walder, 1995); consequently no clear-cut starting point of the economic system transformation can be defined. Lubman (1996) nevertheless mentions a “legislative explosion” in China’s legal reforms.

<sup>7</sup> Among a vast literature, let us mention Naughton (2006), Beresford (2001) and Paquet (2004).

## 6. Rationality of Formal Rules?

In a number of NIE accounts of system change, new formal rules are seen as unproblematic as they are deemed rational and beneficial in principle. The main difficulty comes from informal rules, their resilience and lack of rationality.

Capitalism as a target model of transformation actually entails various levels of formality. There are different degrees of generality and specificity in formal institutions. For instance, private ownership of the means of production is a highly general institution that has taken numerous concrete forms in historical and present types of capitalism. As the literature on the diversity of contemporary capitalisms has shown, a variety of formal institutional configurations prevails and endures in different national contexts (Berger, Dore, 1996; Hollingsworth, Boyer, 1997; Hall, Soskice, 2001; Amable 2003). Consequently, the introduction and development of formal rules typical of capitalism in general in the post-socialist countries have assumed multiple forms according to the political context, and the influence of foreign models and international organizations.<sup>8</sup>

New formal rules can create problems of their own due to a number of reasons: they may have a low level of legitimacy, lack robust complementarity with other formal institutions, or produce unexpected and undesirable consequences.<sup>9</sup> The revolutionary and early post-revolutionary periods in Central Europe highlighted a significant instability in formal rules, with legislation frequently changed following internal conflict, external pressure or unanticipated consequences,<sup>10</sup> the prevalence of a kind of transitional *anomie* (not in the sense of a lack of formal rules but in the sense of weak stability and learning), and systemic uncertainty<sup>11</sup> (reduced by the teleological representation of the market economy).

Original institutional economics rightly argued that institutions in general — including formal ones — incorporate both knowledge and ignorance (Hamilton 1932). These formal institutions thus have an ambivalent effect on economic actors, their behavior and interactions.

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<sup>8</sup> While the Washington consensus promoted by the International Monetary Fund, the World Bank, the Organisation for Economic Cooperation and Development and the European Bank for Reconstruction and Development was dominant in the first period in Eastern and Central Europe, other international organizations (mostly linked with the United Nations), like the Economic Commission for Europe, tried to promote different policies or institutions despite being less influential. The International Labor Organization (ILO), for instance, served as a reference for the creation of tripartite councils to negotiate between governments, trade unions and employer organizations in most Central European countries in the early 1990s. As these bodies were at cross purposes with the dominant neo-liberal trend, they declined or disappeared from the scene after some time.

<sup>9</sup> This has been the case, for instance, with different schemes of mass privatization.

<sup>10</sup> For instance, early provisions for social protection, unemployment, etc., were soon reduced in many countries, privatization rules were frequently reshuffled, and tax rules took quite some time to be stabilized.

<sup>11</sup> Referring to Poland in the first half of the 1990s, Sztompka writes: “The general feeling of uncertainty is also due to normative disorganization or anomie. The legal system is a fragmented mosaic of partial-regulations, old and new, often inconsistent, repeatedly changed, and arbitrarily interpreted. The overload of rules, regulations, administrative codes, and conflicting interpretation of laws makes them incomprehensible. The next constitution is still missing, as twenty-seven projects are vigorously debated by a divided parliament, and the old one is a patchwork of ad hoc amendments. The rule of law is compromised by extra-legal decisions of the highest authorities, including the presidential office, and by the retroactive legislation occasionally passed by the parliament. Trust in the continuity, stability, and orderliness of social life is effectively undermined.” (Sztompka 1999, p. 77)



The notion that new formal rules constitute, in principle, a rational and beneficial anchor of systemic change is consequently somewhat misleading.<sup>12</sup> It is a simplification to put all the burden of difficulties observed in system change on informal institutions or on the enforcement of formal ones.

## 7. Inertial Informality

The reduction of informal rules to culture is sometimes deemed to explain development and performance, resulting in a kind of culturalist fallacy. Pejovich writes that “the culture of collectivism and egalitarianism in Central and Eastern Europe is stronger the farther east and southeast one travels. The interaction thesis suggests that differences in transaction costs arising from those cultural differences within the region explain differences in the results of transition” (Pejovich 2003, p. 351). He contends that “research and empirical evidence show that the ranking of countries with respect to economic freedoms correlates with their respective economic performances” (Pejovich 2003, p. 351). However, he forgot to travel further east, where transforming Asian countries — in which “economic freedoms” are not so conspicuous and where egalitarianism also has a long tradition — provide a refutation of his assessment. Culturalist theories are sometimes tautological. Japan’s backwardness in terms of capitalist development has for a long period been attributed to its Confucian culture (following Weber’s thesis), while later that same culture has been called upon as an explanation of Japan’s capitalist success (Morishima 1982).

Culture is a general concept; in the same society we find various “cultures” with different temporalities of change (e.g. long-term pre-socialist, socialist and late socialist cultures). Cultural change, extinction, revival and creation are dependent on the historical context. In some senses systemic change is accompanied by a “cultural revolution,” which does not preclude, as do all revolutions, strands of continuity.

Informal rules are formed at numerous levels of economic life and action.<sup>13</sup> Some have a cultural and long-standing nature, but many have a limited time span and a remote or weak relationship with cultural values and rules. While some are highly resilient, the degree of inertia varies considerably at different levels of economy and society, and in diverse periods of evolutionary or revolutionary change. Post-socialist transformation has not taken place in a uniform way in informal institutions: enduring legacies have co-existed with the rapid collapse of unwritten rules and with the swift emergence of new non-codified rules.

For instance, a culture and informal behavioral traits linked to shortage have declined rapidly in all countries where a shift from a resource-constrained to a demand-constrained economy has been realized in a few months or even a few weeks.<sup>14</sup> Changes

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<sup>12</sup> When new formal rules were contrasting with the dominant transition doctrine, as in China’s dual-track reform system (with two channels of price formation in the state sector), they were criticized by mainstream economists as irrational; but they later appeared to have been instrumental in system change (Naughton 1995).

<sup>13</sup> Discussing informal rules which are endogenous to formal institutional structures, Helmke and Levitsky (2004) point to their diverse origins; they are created by actors because formal rules are incomplete; informality may be a “second best” strategy for actors who prefer, but cannot, achieve a formal institutional solution. One motivation for creating informal rules may be the pursuit of goals not considered to be publicly (or internationally) acceptable.

<sup>14</sup> Kornai (2006) observes the volatility of memory: “People very easily forget; both collective and individual memories are highly unreliable. Decades ago, we were flooded with complaints from individuals because certain consumer items were unavailable: one had to wait many years for a car or an

in values and informal rules are often observed after a few years, as Ledeneva (1998) has documented in her study of transformational Russia with reference to success, individualism and efficiency.<sup>15</sup>

Apparently similar informal rules, like labor hoarding in large Russian enterprises, assumed very different characteristics in the late socialist period and during the transformational crisis. The same change is also true for networking, as observed in Chinese *guanxi* (Wank 1999), Russian *blat'* (Ledeneva 1998) or Hungarian “recombinant” networks (Stark and Bruszt 1998).

That many new conventions have proved ephemeral in the wholesale process of system change is shown by the gambling craze, the success of financial pyramids in many countries or the early rush to West German products in the former GDR. Informal rules established among Russian oligarchs for wide-scale plundering of state assets in the loans-for shares scheme remained for no more than two years (Freeland, 2000). « Robber barons » conventions in the middle of 1990s were followed after a period by increased submission to formal rules in business practices, some observers interpreting such change as a transformation of business “culture” ...

Conversely, the development of a barter economy in Russia during a period of acute monetary crisis that lasted around seven years in the 1990s gave rise to sophisticated and extended informal rules of exchange that even developed into elaborate schemes of compensation. Unwritten barter rules accompanying specific problems of Soviet planning had long existed in the previous system, but the post-Soviet barter economy and its specific rules represented a genuine novelty where new informal relations were established and developed in a short (and eventually transitory) historical period. Another set of rapidly emerging informal rules was linked to the introduction of a (formal) dual-track system in China in the 1980s<sup>16</sup> but this, too, proved to be relatively short-lived.

## 8. Detrimental Informality?

Mainstream economic theory has a strongly implicit normative reference — Pareto optimality — deemed to be a situation beneficial for all members of society. It gives many economists this extraordinary self-confidence and peremptory attitude, provided by the conviction that efficiency and collective interest can be perfectly reconciled, so that “performance” is unambiguous. In this approach, formal institutions showing the “one best way” to optimality are supposed to be known, and informal rules consequently are often interpreted as detrimental — except when they correspond closely to the good formal rules. This taken-for-granted normative standard has strong

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apartment or a telephone line. Nowadays it seems that I, once the author of a book entitled *Economics of Shortage* (1980), will be left as the single individual in Eastern Europe, who still remembers the shortage economy and feels genuine joy that it is over. Chronic shortages have been replaced by abundant supplies. Nowadays, people grumble that we are awash in an incredible number of products, that prices are prohibitively expensive and that people are tormented by the ‘consumer society’.”

<sup>15</sup> Ledeneva also noted that it had become difficult to borrow money from friends in the Russia of the mid-1990s, whereas it was the most frequent support among friends in Soviet times, and that children were fast becoming money-conscious. She also observed a change from cooperation to secrecy in the academic world. Connections (*blat'*) used to be value-oriented, they became driven by considerations of self-interest and mutual profit, etc. (Ledeneva 1998).

<sup>16</sup> It became very common, for instance, for state enterprises to sell planned and low-priced state supplies on the free market for much higher prices.

links with equilibrium thinking, which makes genuine change difficult to understand or reduces it to a teleological “transition” to the beneficial systemic equilibrium.

But efficiency and performance are problematic notions that make little sense in a historical context unless there is an answer to the questions, “efficiency for whom?”<sup>17</sup> and “which performance?” Likewise, different types of formal and informal rules and their interaction may create beneficial or detrimental consequences for different individuals or social groups. They may also have ambiguous or changing effects as time goes by.<sup>18</sup> A normative evaluation by social scientists of these configurations in terms of given values or standards would be welcomed, as long as it was based on an explicit and open theoretical approach.

The frequent reference to the standard of “transparency” in general, and in post-socialist societies in particular, is an example of the implicit normative stance of mainstream economic theory: it implies that perfectly informed agents will act in a rational way, bringing about the optimal equilibrium predicted by the mainstream approach. More often than not, transparency is turned into a normative concept disguised as a technical requirement for efficiency. Keynesian uncertainty, Hayekian complexity and ignorance, Simonian bounded and procedural rationality, or Stiglitzian imperfect information are simply ignored or forgotten. Notably, the standard use of the notion of transparency implies that rules are or ought to be exclusively formal and spontaneously enforced; it overlooks the universal duality of formal and informal institutions in the economy and polity. It carries a double bias in postulating the rationality of formal rules and in assuming a negative character of informality.

Beyond the mainstream transition doctrine, we also find little acknowledgment of the complexity of formal/informal relations. While Hayek gave positive weight to evolved or grown (informal) rules of just conduct, as mentioned earlier, the latter are of little help in explaining post-socialist change unless a very specific tradition is taken as genuine reference for cultural evolution,<sup>19</sup> while others are rejected as poisoned by various forms of constructivism. The cultural reduction of informal rules linked to a negative assessment of their inertial role in transformation, as developed by North or caricatured by Pejovich, leaves no room for positive path-dependent informality or for innovative informal rules in the process of change. The former can be observed in the revived traditions of entrepreneurship in Poland or China, while examples of the latter are numerous, be they detrimental (corruption, cronyism, law evasion), beneficial (tax compliance) or ambiguous (labor hoarding, barter). Symmetrical examples could be easily listed in the history (or present-day situation) of venerable capitalist economies.

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<sup>17</sup>Schmid observes that: “The problem with efficiency is that there are too many of them and thus efficiency gives no basis for choosing among them.” It takes a “moral choice of whose interests count” (Schmid 2004, p. 83).

<sup>18</sup>Official rules may be replaced or complemented by informal arrangements through an “informalization of the rules:” “First, formal rules are imposed by the public officials in a way which leaves room for their discretion and creates a high level of uncertainty for market actors. Second, confronting high costs of compliance with the formal rules, economic agents create specific governance structures to avoid formal rules on a systematic basis. Third, public officials establish selective control, in which formal rules are used for extortion and selective pressures on economic agents. Fourth, economic agents, in turn, bargain with the public officials on terms and conditions of the implementation of formal rules. Fifth, multiple arrangements and interpretations are produced to legitimate practices of informalization” (Radaev 2004, p. 94). *Informalization* here carries a negative connotation.

<sup>19</sup> Hayek’s theory has been characterized as “romantic anglophilia” (O’Brien 1998).

## 9. Beneficial Complementarity?

New institutional theories often display an implicitly normative stance where formal rules — or conversely, informal evolved rules — are given a positive value in general. The harmony of formal and informal institutions is predominantly seen as a good model or idealized type providing a normative standard to evaluate given situations or processes of change. However, post-socialist transformation has again shown the great evolving diversity of rule configurations that may arise in the process of historical change, suggesting that implicitly normative models may be misleading when confronted with historically specific trajectories of transformation.

The normative harmony model is sometimes qualified. Winiński (2000) suggests in a neo-liberal spirit that informal rules may reduce the detrimental effects of misguided formal institutions. Adopting a new institutional approach, the *2002 World Bank Development Report* stated that “one size does not fit all in institutional design,” seeming to admit context specificity. Furthermore, it observed: “Where informal institutions operate effectively, and when formal institutions require supporting institutions, building new formal institutions may not be a priority for policymakers.” It suggested “accepting informal institutions when formal institutions would not have their desired impact” (World Bank 2002). A less normative stance was thus suggested, but this has remained a minority position in the literature and in policy advice.

The notion of institutional complementarity (Aoki 2001; Amable 2003) stresses interdependencies and reinforcement processes between (formal) institutions in different economic or social domains or within the same domain. However, it does not deal with the relationship between formal and informal rules or institutions; neither does it consider the possibility of perverse reinforcement, as in a case where a given beneficial institution leads to the consolidation of negative but interdependent institutions. It may be made less static and extended for that purpose.<sup>20</sup>

## 10. Conclusion

Post-socialist transformation and the great variety of national trajectories of system change, as well as the diversity of emerging post-socialist capitalisms, confirm that informal institutions and rules do matter. The interdependence of formal and informal rules in the process of historical change is now widely acknowledged. However, reductionist or biased theories may perpetuate obstacles to an open approach on this important theme through a one-sided focus on either informal rules or formal rules, or a hypothetical equilibrium between both. Normative models of “good rules,” or of formality- or informality-centered harmony between the two types of institutions, linked to a one-sided assessment of efficiency and performance, can distort the analysis of system dynamics.

Differential change in formal and informal institutions takes very diverse forms in different evolutionary or revolutionary circumstances. Context dependence and historical specificity lead to a great variety of configurations of the relationship between formal and informal rule changes. A better understanding of such diversity poses a stimulating challenge for future research.

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<sup>20</sup> Systemic coherence (Kornai 1992) is a concept with an even higher degree of abstraction compared to institutional complementarity. The first concerns system families (such as capitalism and socialism), while the second is about stylised historical forms of national capitalisms.

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