



PIDE WORKING PAPERS

2009:50

Reforming Institutions: Where to Begin?

M. Idrees Khawaja

Sajawal Khan

PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS

PIDE Working Papers
2009:50

**Reforming Institutions:
Where to Begin?**

M. Idrees Khawaja

Pakistan Institute of Development Economics, Islamabad

and

Sajawal Khan

State Bank of Pakistan, Karachi

**PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS
ISLAMABAD**

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means—electronic, mechanical, photocopying, recording or otherwise—without prior permission of the Publications Division, Pakistan Institute of Development Economics, P. O. Box 1091, Islamabad 44000.

© **Pakistan Institute of Development
Economics, 2009.**

Pakistan Institute of Development Economics
Islamabad, Pakistan

E-mail: publications@pide.org.pk
Website: <http://www.pide.org.pk>
Fax: +92-51-9210886

Designed, composed, and finished at the Publications Division, PIDE.

CONTENTS

	<i>Page</i>
Abstract	v
1. Introduction	1
2. Theories of Institutional Change	3
2.1. Douglas North	3
2.2. Process of Institutional Change	3
2.3. Darron Acemoglu	8
2.4. Dani Rodrick	9
3. Institutional Change: Historical Experiences	10
3.1. 17th Century Britain and Netherlands vs. Spain and France	10
3.2. 19th Century Britain and Germany vs. Austria-Hungary and Russia	12
3.3. North America vs. South America in the 18th Century and 19th Century	12
3.4. Korea and Taiwan vs. Congo (Zaire)	13
3.5. Botswana vs. Somalia	14
4. The Enlightenment Era	16
5. Where to Begin?	17
5.1. Can Commercial Interests in Pakistan Force the De jure Power to Change Institutions for the Better?	18
5.2. Can Fiscal Constraints Force the De jure Power to Strike a Bargain with the Citizen for Taxation in Exchange for Good Institutions?	18
5.3. Strategic Interests of Foreign Powers: A Constraint to Institutional Development	19
5.4. Will a Revolution Bring about Institutional Change in Pakistan?	19
5.5. The Gradual Approach	20
6. Conclusion	24
References	25

ABSTRACT

No society is devoid of institutions but many live with poor institutions. Institutions promote growth. This is a view now held firmly and widely. The task then is to ‘engineer’ growth-promoting institutions. Endogeneity characterises institutions; for example, groups enjoying political power influence economic institutions, but political power itself is a function of wealth. Given endogeneity, if the task is to design institutional reforms, the question then arises, as to what to reform first. We use the theories of institutional evolution put forth by Douglas North, Darron Acemoglu and Dani Rodrik and the historical experiences of different countries in the context of development (or non-development) of institutions, to determine the starting-point of institutional reforms, if the objective is to design institutional reforms. We argue that in Pakistan, neither large commercial interest nor fiscal constraints can force the *de jure* power to reform institutions. Typically, large commercial interests in Pakistan have thrived on favours from *de jure* power, and therefore do not have teeth. Given strategic interests of foreign powers, foreign aid will alleviate the fiscal constraint and the ruler-citizens bargain—though reforming institution in exchange for tax revenue will remain a dream. The country does not seem ready for a revolution either; the thought process that typically precedes revolutions seems to have barely begun. The alternative, that remains, then is the gradualist approach preferred by North, Acemoglu, and Rodrik. Institutional reforms in Pakistan should begin with reform of the educational system—the introduction of a common educational system for all and sundry up to a certain level. Two reasons make us chose the educational system as the candidate to start the process of institutional reform. First, a common educational system will produce a shared value system which, in turn, will reduce the heterogeneity in the society. Lesser heterogeneity in society will then facilitate an agreement over the minimal set of institutional reforms. Second, politicians being myopic, the *de jure* power is more likely to concede to the demand for reform of the educational system as compared to the demand to, say, put an end to rent-seeking. The former will affect the *de jure* power a generation hence, while the latter will affect them today.

JEL classification: D02, D03, P16

Keywords: Institutional Evolution, Institutional Change,
Human Behaviour

1. INTRODUCTION

Institutions concisely put as “humanly devised constraints that shape human interaction” [North (1990)], have been defined along a broad spectrum from the establishment of rules to “actual organisational entities, procedural devices, and regulatory frameworks” [World Bank (2003)]. Most widely cited definition in literature is again from North (1981) “a set of rules, compliance procedures, and moral and ethical behavioural norms designed to constrain the behaviour of individuals in the interests of maximising the wealth or utility of principals”. He terms formal rules, informal constraints and the enforcement characteristics of the two as the complete set of institutions.

Institutions—the rules of the game, matter; this view now holds firm ground.¹ No society is devoid of institutions, however many carry poor institutions. The obvious question then is how a society gets hold of institutions that promote economic growth? Acemoglu, *et al.* (2005 a) argue that institutions are endogenous—political institutions influence economic institutions and vice versa. For example, political institutions, say democracy or autocracy, determine who enjoys political power. Who gets access to economic opportunities—masses or the elites, is determined by political power and hence political institutions. However who makes it to the echelons of power, especially in developing countries, is in part determined by wealth and therefore economic institutions. Given the endogeneity, an attempt to move from one set of institution to another, for example, from autocracy to democracy may be successfully thwarted by the would-be losers. For example monopolies (economic institutions) granted by the autocrat may thwart market-oriented reforms, if the monopoly or the autocrat himself is deriving rent from their existence. The endogeneity problem tempts one to suggest that institutions can be reformed only with a big bang—reform all institutions in one go, perhaps through a revolution. However this leaves us with the problem of how to stage a

Acknowledgements: We are grateful to Prof. Aurangzeb A. Hashmi, Ms Lubna Hasan, Dr Zafar Mahmood, Mr Mahmood Khalid, Dr Musleh-ud Din, Ms Rizwana Siddiqui, Mr Usman Qadir, Mr Nasir Iqbal, and other participants of the seminars on this subject at PIDE and also at a departmental meeting in PIDE for offering very useful suggestions and comments.

¹There is an enormous amount of literature including, but not limited to, Hall and Jones (1999), Acemoglu, *et al.* (2001, 2002), Easterly and Levine (2001), Dollar and Kraay (2003), and Rodrik, *et al.* (2002) have shown that institutions matter for economic growth. For an exhaustive survey of literature on the relationship between institutions and economic growth, see Acemoglu, *et al.* (2005a) and Hasan (2007).

revolution. Successful revolutions typically are preceded by a certain thought process [Masood (1991)] which at times may spread over a century. For example, the European Enlightenment thought, beginning as far back as the 16th century preceded the Glorious Revolution (1688) in England and the French and the US revolutions in the 18th century. Even when it becomes possible to stage-manage a revolution, the post-revolution institutional changes may not be too revolutionary. North (1990) has quoted examples from history to show that post-revolution institutional changes exhibit legacy of the past.

If one were to practice gradualism, reforming institutions one by one, the question arises, what to reform first? What conditions should an institution satisfy to top the agenda of institutional reform? We prescribe three conditions for this. One, the institution to be reformed first and foremost should be the one whose reform would face the least resistance from other institutions or whose reform will not be constrained by the absence of some other institution; two, its impact should be all encompassing; and three its impact should be long-lasting. We emphasise at the outset that the condition of least resistance by no means imply that we expect to find an institution that will meet little resistance from the stakeholders—the relative nature of the word ‘least’ should not be lost sight of. Suppose the level of discontent with *de jure* power is such as will thwart an attempt by the citizens to secure a change in the power structure, the existing *de jure* power must do one of the two: curb rent-seeking or reform the educational system to adequately groom the populace. Which one would the rulers choose; naturally the latter. Why? The former would hurt them now while the latter would hurt them, at best, a generation-hence. Path dependence being an essential feature of institution, these are difficult to change. Given the difficulty, the cost of change is high. Only an all encompassing and long lasting impact would justify the costs involved. Hence the condition two and three prescribed above.

The paper is organised as follows: In Section 2 we review the works of Douglas North, Darron Acemoglu and Dani Rodrik. Section 3 examines the comparative experiences of institutional change (or non-change) of 17th century Britain and Netherlands versus France and Spain, 19th century Britain and Germany versus Austria and Russia, 18th and 19th century North America versus South America, Korea and Taiwan versus Congo and last but not the least, Botswana versus Somalia. Section 4 contains a ‘brief’ on enlightenment era, the objective being to show to what extent the institutional evolution, has benefited from the thoughts of enlightenment philosophers. Based on the lessons drawn from the theories discussed in Section 2 and historical experiences discussed in Section 3, and the thoughts of enlightenment philosophers reviewed in Section 4, in Section 5 we turn to the primary objective of the paper—from where to begin the process of institutional reform. Section 6 concludes the paper.

2. THEORIES OF INSTITUTIONAL CHANGE

2.1. Douglas North²

The key elements of the North's theory of institutional change are: (i) The process of development of human perceptions and beliefs (ii) whose beliefs matter (iii) intentionality and comprehension of the issue by those whose beliefs matter (iv) path dependence exhibited by the institutions. These are only the building blocks in the process of institutional change. The element, in North's framework, that triggers the change in institutions is the change in bargaining strengths of parties to the contract.

2.2. Process of Institutional Change

To understand the process of institutional change let us begin from the state of institutional equilibrium. Institutions being rules of the game reflect a contract between two parties. The institutional equilibrium prevails when parties to the contract do not want to alter the terms of the contract. [North (1990)]. The state of institutional equilibrium does not essentially imply that the parties are satisfied with the terms of the contract rather it only reflects that given the cost and benefits involved in altering the terms of the contract, the parties do not consider it worthwhile to devote resources towards changing the terms. To illustrate, assume that majority of the populace of a country feels that the *de jure* power has persistently failed to enforce the terms of the contract, in letter and spirit i.e. has failed to implement the constitution. Given this failure the public wants a change in the *de jure* power. Further assume that the desired institutional change is possible only if the masses rise against those who currently wield the *de jure* power. This will require some sacrifices on the part of masses and may entail retaliation as well from the *de jure* power. Sacrifices involve putting in ones time, effort and money. The retaliation may take the form of arrests, loss of government job, and in extreme cases getting injured or even losing ones life in a violent protest. Given this scenario, the citizens will devote resources towards institutional change only if the perceived benefits from the change are greater than the costs involved [North (1990)]. For example, if the citizens circumscribe to the view that a change in *de jure* power will not affect their life's or at best the affect would be cosmetic, then they will not strive for a change in *de jure* power—masses in Pakistan who despite not being satisfied with the performance of the wielders of *de jure* power have not actively worked for change, seem to circumscribe to this view.

A noteworthy element of North's framework is that it is only the perception of cost and benefits of managing an institutional change that

²For exposition of North's theory of institutional change, we draw heavily upon North (1990 and 2005).

matter—agents’ decision do not depend on actual cost and benefits, which can be observed, but only *ex post*. Given this, the cost and benefits must be estimated. This implies that agents can be lured to undertake efforts towards institutional change by exaggerating the expected benefits and hiding some of the expected costs. The other extreme *i.e.* exaggeration of costs and playing-down the benefits will restrain an individual to work for a change.

So far we have determined that institutional change is a function of change in human perceptions that are ultimately translated into beliefs. Therefore to manage an institutional change by design, it is the beliefs system that should be influenced in a manner which is conducive to achieve the desired institutional change. The crucial question is, is it possible to influence the belief system and if yes, to what extent and how quickly. This brings us to the second key element of North’s theory of institutional change: the process of belief formation.

2.2.1. Formation of Perceptions and Beliefs

North argues that “institutions impose constraints on human behaviour” therefore to develop a theory of institutional change one must focus upon human behaviour. Belief formation being part and parcel of human behaviour, North (2005) rightly ventures deep into the field of psychology to understand the process of belief formation.

Drawing upon a huge literature from psychology North concludes, that human perception transform into beliefs, but perceptions themselves depend upon learning. North draws upon the work of a number of psychologists to understand the learning process. One view is that the learning process is guided by epigenetic rules—the development of an organism under the joint influence of heredity and experience. However the exact composition of genetic predisposition and experience remains a moot point. A similar view is that three sources, *viz.* genetics, cultural heritage and environment contribute to learning. Discussion of how these sources contribute to learning follows.

The first source of learning that contributes to belief formation, and hence the institutions, is genetics. The genetic predisposition of an individual provides what North (2005) terms the artifactual structure (*i.e.* foundation), the one which was transmitted and put in place by past generations. The informal norms, according to North are the most important carrier of this artifactual structure, though the structure comprises formal rules as well. North (2005) suggests that as changes occur in the human environment these are gradually assimilated into the socio-cultural-linguistic inheritance and embodied in the foundation.

Cultural evolution, the second source, in the North’s process of learning, according to Hayek (1960) consists of intergenerational transfer of knowledge, values, and attitudes etc. that have accumulated through the Darwinian process of evolution. Thus a society’s culture incorporates the distilled experience of the

past—an experience, more than what a single person can accumulate in his life time. Given the contribution of past knowledge, values and attitudes to the prevailing culture, it is very difficult to change culture. The culture can be manipulated by design only to the extent that the present day knowledge and experience contributes to culture. A certain fractional change in culture will occur in a generation's time depending upon the kind and quantity of knowledge that the society chooses to gain today and the experiences that it has to pass through today, of its own accord or by the act of others or by the will of nature. The process of cultural change is therefore, without doubt, highly incremental.

For the contribution of human environment, the third source of learning, North again portrays a slow evolutionary process. He says that “if the mind has been programmed by millions of years of hunter/gatherer tradition then the flexibility to adjust to a very different modern world may be very limited, as implied by evolutionary psychologist. The reason why change in environment is a slow evolutionary process is that millions of years of hunter/gatherer tradition cannot be altered by one-off experience—a steady stream of experiences is required to affect the change. However given John Locke's view on empiricism (<http://www.wsu.edu:8001/~dee/ENLIGHT/>), the environment can be influenced through education or, to speak more broadly, by creating the desired kind of awareness, even if Locke's stipulation about human mind being *tabula rasa* (i.e. erased board) at birth does not hold true.

Thus the institutional change being function of change in beliefs, to design a conscious institutional change we have to influence, what a person learns. Therefore education is at the heart of the matter. No wonder that the countries that boast of good institutions have been placing emphasis on education since long. We deal with the influence of education on institutional change more comprehensively later on.

2.2.2. Dominant Beliefs

North (2005) emphasises, time and again, that institutions depend upon beliefs or the subjective mental constructs that the agents possess. He raises the question, upon whose beliefs the choice of institutions is incumbent. Only to answer himself that it is the dominant beliefs—the beliefs of those in a position to enact institutional change that matter. North's view that it is the ‘dominant beliefs’ that matter, implicitly builds upon his own earlier view [North (1990)] that the change in relative prices alters the bargaining strength of the parties to the contract. The party enjoying greater bargaining power attempts to alter the contract. This is to say that the beliefs of the dominant players matter.

2.2.3. Intentionality and Comprehension of the Dominant Players

North (2005) argues that it is not just the dominant beliefs that matter but the intentionality, and comprehension of the issue, of the dominant players i.e.

mental construct of the players also matters. He goes on to suggest that the world economic growth has remained sporadic through out history because either the players' move was never intended to maximise social welfare or the flawed comprehension of the issue have caused the results to deviate from intentions [North (2005)]. The rise and fall of the socialist Soviet Union is a case in point—perhaps the intention were correct but the dominant players failed to comprehend all facets of the issue. The case of intentionality is available in Pakistan's domestic environment. Laws have been enacted in recent past to afford independence to SBP. However the tenure of the governor SBP has been fixed at three years with an option of renewal for another term of three years. It is note worthy that the tenure of the government is five years. How can person who intends to seek renewal from the incumbent government can frame policies independent of the powers that be. Another case in point is the ongoing debate over judicial reforms in Pakistan. Whether we will have 13 judges or 27 judges of Supreme Court depends upon the intentionality of the dominant players.³

2.2.4. Path Dependence

The most important element in North's theory of institutional change is path dependence—resemblance of today's institutions to yesterday's institutions. To reiterate, it's the beliefs system that decides the kind of institutions that a society will choose. Given the painfully slow learning process, described above, that influences the belief system, it is only natural to expect that institutions will exhibit, what North (1990, 2005) calls path dependence. If institutions do change, the change will be highly incremental. There are three important sources of path dependence; (i) increasing returns to scale; (ii) informal rules; and (iii) the organisation's that owe their existence to existing institutional arrangement.

North (1990) argues that institutions exhibit increasing returns to scale and this makes the change in institutions difficult. He explains that three sources make the returns to institutions, increasing in nature. (i) Initial set up costs, (ii) coordination effects, and (iii) reduction in uncertainty. North explains that when institutions are created *de novo*, organisations incur costs to learn and adapt their behaviour to the existing institutional framework. Overtime the organisations learn and evolve to take advantage of the opportunity set offered by the existing institutional framework. This learning and adaptation, cuts down the unit cost of operating within the current institutional framework. Secondly there are positive coordination effects, directly through contracts with other organisations and indirectly through investment in complimentary activities by the State. Finally contracting more and more under specific institutional framework reduces the uncertainty about the permanence of the rule. This makes the parties to the

³The proposal to have 27 judges is meant to dilute the independent stance of 13 judges.

contract more comfortable with existing institutional matrix. These three elements jointly make the returns to institutions increasing in nature. The increasing returns to institutions in turn create organisations and interest groups that enjoy a stake in maintaining the existing institutional matrix because the change would affect them adversely.

Besides the increasing returns another source of path dependence is the informal norms—an important component of the institutional matrix. While the formal rules can be changed with a stroke of pen, informal rules are more difficult to change. Pejovich (2006) eloquently lays down the formation process of informal rules. He argues that as human beings interact to survive, some interactions are repeated over and over again, not least because the public understands their utility but simply because these have worked. Eventually the interactions that pass the test of time are institutionalised into taboos, traditions, moral values, beliefs etc. To explain the process of change in informal institutions, Pejovich argues that when a person or a community develops a new idea this enlarges the opportunity set of human interaction. If the new exchange opportunities call for a behaviour which is not in conformity with the established ethos, the community would consider the behaviour of those exploiting the opportunities as sub marginal and therefore the community may react with sanctions like ostracism etc. However if the returns are high enough to sustain a large number of repeated interaction (between more and more groups) relative to costs (including sanctions) the success of new activities would force adjustment in the set of informal institutions. Such adjustment may include the addition of new norms to the set of informal institutions, change in an old norm or simply ignoring an otherwise established norm. It is the painfully slow process of change in informal rules that makes the overall institutions path dependent. The process of formation informal rules laid down by Pejovich confirms the path dependence argued by North and gradualism in institutional evolution favoured by Rodrick (2006).

Finally institutions may exhibit path dependence because some of the organisations born out of existing institutional matrix (the combination of formal rules, informal constraints and enforcement characteristics of the two) may owe their very existence to that specific institutional arrangement and a drastic change in such an institutional arrangement may sound a sudden-death for the organisation. Therefore existing organisations will attempt to block the institutional change.

To sum up, the increasing returns to institutions, preferences of the organisation born out of current institutional matrix and the informal rules together conspire to make the change in institutions highly incremental and the institutions path-dependant. North cites various examples to support his views on Path dependence e.g. the US constitution, Common Law and the North West Ordinance in US. In Pakistan we refer to number of institutions e.g. Civil Service, as legacy of our colonial past [Haque and Khawaja (2007)].

2.2.5. *Lessons from Douglas North*

The key lesson from North is that given path dependence, institutions are difficult to change and that any long lasting change must be incremental. North's emphasis upon institutions being a function of belief system provides room for designing an institutional change by influencing the belief system. His view that beliefs and the ability, to comprehend an issue, of the dominant players matter calls for influencing the beliefs and improving the comprehension of the dominant players. However since it is difficult to predict who would be the dominant players a generation hence, therefore a long lasting institutional change calls for influencing the beliefs and improving the abilities, of all and sundry, to correctly comprehend an issue at hand. How all this is to be done, this is the subject matter of Section 5.

2.3. **Darron Acemoglu**

Different set of institutions may induce a different kind of resource allocation—some institutions would allow competitive forces to play their role while others would promote rent seeking. Given this, for individuals to prefer one set of institutions over another is but natural. Acemoglu, *et al.* (2005a) argues that given the preference of different individuals over different set of institutions, the group with greater political power is likely to secure the institutions of its choice. (This is similar to North's viewpoint that belief of the dominant players matter or that the bargaining strengths of the players matter).

Acemoglu, *et al.* (2005a) argues that an ideal course for the groups with conflicting interest would be to agree over the set of institutions that maximise aggregate growth and then use their political power to determine the distributions of gains. In practice groups with conflicting interest do not follow this course. The reason is that there are commitment problems inherent in the use of political power i.e. a monarch or a dictator cannot credibly commit not use power to his advantage—a monarch or a dictator enjoying absolute power may promise today to respect property rights but in future nothing would restrain him to renege on his promise. Citing the case of England, Acemoglu, *et al.* (2005a) state “institutional changes in England as a result of Glorious Revolution (of 1688) were not simply conceded by the Stuart king; James II had to be deposed for the changes to take place”.

Acemoglu, *et al.* (2005a) argues that the distribution of political power in society is endogenous. It is the political institutions, for example, monarchy or democracy, that determine who holds the *de jure* power. However some individuals or groups, though not allocated power by political institutions, may still enjoy *de facto* power because of their ability to revolt, hold strikes (by trade bodies), hold protests (peaceful or violent), use military power, clergy power or mercenaries etc. to impose their will upon the society. The *de facto* power of a group largely depends upon the economic resources that it enjoys, which

determines their ability to use force and influence *de jure* power. It is often the *de facto* power that forces a change in *de jure* power. Acemoglu, *et. al.* raises the question why the *de facto* power does not settle for only forcing the *de jure* power to provide the institutions of their choice, rather than insisting upon change in *de jure* power. Drawing upon the works of Lichbach (1995), Tarrow (1991) and Ross and Gurr (1989), the authors answer that *de facto* power is often transitory in nature. The *de facto* power not being sure that its power will continue unabated wants to transform *de jure* power in a manner that it will continue to work in conformity with the beliefs of *de facto* power, even if such power has washed away with the passage of time.

2.3.1. Lesson from Acemoglu

The lesson then from Acemoglu is that the change depends upon the relative bargaining strengths of the *de jure* and *de facto* power. Suppose the bargaining strength of *de jure* power is greater and the existing institutions are poor, then in this case the institutions will remain poor. However if the bargaining strength of *de facto* power is greater and the existing institutions are poor, the *de facto* power will force the *de jure* power to provide institutions of their choice. The *de jure* power will either yield in favour of institutional change or will be replaced, no matter what *modus opredii* is adopted, by the people who share the beliefs of *de facto* power. The bottom line then is that institutional change will have to wait for the emergence of *de facto* power that can force the *de jure* power to yield. The question then is can the emergence of the requisite *de facto* power be designed. We take up this question in Section 5.

2.4. Dani Rodrick

Rodrick (2006) illustrates the process of institutional development by equating institutions with technology that transforms primary endowments of a society into a larger bundle of outputs. He explains that the requisite technology could be either general purpose or highly specific to local needs. He further argues that if the technology (institution) is general purpose in nature and is easily available on the world market then it can be adopted by simply importing a blueprint from the developed countries (or any country whose institutions are considered good). However if the technology is specific to local conditions, which stands a greater chance, then technology evolves by trial and error. This suggests that a society is able to build institutions, only gradually. Rodrick argues that one reason why gradualism prevails over the blue print approach is that much of the technology is tacit and therefore not available in black and white. This makes the blue print highly incomplete and of little use to the importers. However Rodrick feels that, imported blue prints can prove useful for some narrowly defined technical issues, but large scale institutional development, by and large, calls for discovering local needs and developing rules that serve such needs.

2.4.1. *Lesson from Dani Rodrik*

Rodrik's emphasis upon gradualism is akin to North's path dependence. Secondly Rodrik's view that imported blue prints have limited usefulness and that for large scale institutional change to happen first local needs must be discovered tells us that foreign consultants charged with suggesting reform of local institutions may not be ideally suited to do the task.

3. INSTITUTIONAL CHANGE: HISTORICAL EXPERIENCES⁴

3.1. 17th Century Britain and Netherlands vs. Spain and France

The institutions in Britain and Netherlands, on the one hand, and Spain and France, on the other hand, took divergent paths in late 17th century—while Britain and Netherlands moved towards institutions that promoted commercial activity, Spain, and France moved towards extractive institutions. Acemoglu, *et al.* (2005a) argues that whether or not the institutional change occurred depended upon how powerful the groups demanding institutional change were?

The rise of the constitutional monarchy in Europe is instructive. The following scene prevailed in the early sixteenth century UK. From 1603 onwards, England was ruled by Stuarts who continuously had revenue problems. To generate revenue the Crown sold lands, extended monopoly rights, seized private property and defaulted on loan repayments. The Parliament, though in existence, enjoyed little say in affairs of the country and the Crown could dissolve the assembly even upon minor differences with the Parliament. Supreme Judicial Power rested with the Star Chamber, which held legislative powers too, and primarily represented the Crown's interests. This was Britain, prior to the Civil War of 1646. The Civil War and then the Glorious revolution of 1688 led to sweeping changes in institutions; the Star Chamber was abolished, restrictions were placed on monopolies, cases involving property were to be tried under Common Law and the Parliament was to have regular standings. The Parliament gained a central role in financial matters with exclusive powers to raise taxes. This also gave more security to property rights of all and sundry, especially to the rights of those with financial and commercial interest. In sum UK was transformed into a parliamentary monarchy with powers of Crown significantly trimmed. The question that begs answer is how the commercial interest could become so strong in Britain. Acemoglu, *et al.* (2005a) argues that the Lords had gained a stronger position during the 14th and 15th century and were able to force the creation of Parliament, to put limits to the authority of the Crown (but certainly not to protect the commercial interests). The Lords forced the Crown to 'live on his own' with strict

⁴For this section we draw upon Acemoglu, Lecture notes.

restrictions on expanding his revenues. Perhaps these restrictions later on enabled the commercial interests to become stronger and demand more rights.

The 16th century Netherlands was the most important commercial area of Europe. The powerful groups in the country were for encouragement to commercial activity and enforcement of property rights. Netherlands being under Spanish control then, provided substantial revenue to the Spanish Crown. Potential economic development, in Netherlands threatened the interest of Spain. The towns in the Netherlands, under the leadership of Williams of Orange, rebelled against Spain, leading to Dutch independence in the 16th century. What is important is the fact that the merchants of Netherlands wholeheartedly financed the rebellion.

An explanation put forth by Acemoglu, Johnson and Robinson (2005b) for the transformation of Britain and Netherlands is that in 16th century the opportunities generated by 'Atlantic trade' increased the wealth and therefore the political power of the commercial interests. This enabled them to demand and obtain more rights.

This brings us to the question that why only the commercial interests in Britain and Netherlands were able to enrich themselves from the opportunities generated by Atlantic trade and why the commercial interests in France and Spain, failed to exploit such opportunities despite the fact that the two countries were also involved in Atlantic trade. Acemoglu, *et al.* (2005b) provides the answer. The authors explain that in England and Netherlands the trade was mostly carried out by individuals and partnerships while in France and Spain, trade was primarily under the control of the crown. The differences in organisation of trade in turn reflected the different political institutions of these countries. Grant of trade monopolies used to be an important source of fiscal revenues for the Crown; the more powerful monarchs could increase their revenues by granting trade monopolies or by directly controlling trade while for weaker monarchs this was a luxury which they could not afford. At the beginning of the fifteenth century the Crown was much stronger in France and Spain, than in Britain and Netherlands and this was the most important factor in the difference in organisation of the trade in these countries. Consequently in England and Netherlands, but not in France and Spain, a new class of merchants arose with interests directly opposed to the interests of the Crown. The new class of merchants later on played an important role, as described earlier, in subsequent political changes.

3.1.2. Lessons from the Institutional Evolution in Britain and Netherlands versus Institutional Evolution in Spain and France

Two lessons are apparent from the historical comparison of Britain and Netherlands on the one hand and France and Spain on the other. One, strong commercial interests hold the potential to emerge as *de facto* power that may

successfully challenge *de jure* power if the latter fails to provide the institutions that suits commercial interests. We learn from the European history that more often than not the *de facto* power that emerged in the form of commercial interest had to force a change in *de jure* power to acquire the institutions of its choice.

The second lesson from the comparison of institutional development in different European economies is that the fiscal constraints may force the authorities to strike a bargain with the citizens—the public provides for the fiscal needs of the government and the authorities in return provide good institutions—the institutions that the public prefers. This is the thesis of Moore (2002) who argues that the Nations that enjoy recourse to unearned income (i.e. income from natural resources and foreign aid) typically have to put up with poor institutions while the countries that rely mostly on earned income (from taxation) have relatively good institutions. To account for the difference Moore argues that to induce the citizens to pay taxes the authorities have to provide them good institutions and the citizens view taxes as the cost of such institutions. However since the rulers of the nations with unearned income do not have lean on citizens for revenues therefore they are not pushed to provide good institutions.

3.2. 19th Century Britain and Germany vs. Austria-Hungary and Russia

During the 19th century Britain and Germany went through rapid industrialisation. In contrast, the process of industrialisation was slow in Austria-Hungary and Russia. To account for the difference, Acemoglu (Lecture Notes, p. 200) argues that the elites in Britain had relatively more to gain from industrialisation than those in Austria-Hungary and Russia. Besides while the landed aristocracy in Britain enjoyed relatively secure position and was less threatened by the process of industrialisation, the aristocracy in Austria-Hungary and Russia stood to loose more rents if they lost political power.

The lesson from the above is all too familiar—the rent-seekers will thwart institutional change, with success depending upon the bargaining strength that they enjoy.

3.3. North America vs. South America in the 18th Century and 19th Century

In the 18th century some Caribbean and Latin American countries were richer than North America however while North America industrialised rapidly in the 19th century the Caribbean Islands and much of the South America stagnated during the period. Acemoglu (lecture notes)argues that the powerful groups in North America generally favoured policies that encouraged commercial interests and industrialisation while in Caribbean and South America the groups in power, opposed industrialisation.

We examine history to comprehend the difference in preferences between North and South America of 18th and 19th century. Systematic colonisation of

United States began with the establishment of Jamestown colony in 1607. The colony was created by Virginia Company as a commercial venture. Population density in United States, being rather low, sufficient native labour was not available. Therefore the Virginia Company contracted indentured labour at prevailing English wages to work for seven years, but the company failed to attract workers in sufficient numbers. It was only after the grant of more incentives and political power to settlers that the company managed to attract workers. The political power, for the workers, included the creation of a General Assembly with adult male suffrage. Thus the power of the settlers formed the basis for the institutions that created limited government in the colonial period and ultimately posed resistance to British rule and taxation. No taxation without representation was later to become the slogan of the American struggle against the British that culminated in the revolution of 1787.

In contrast in South America much of the population was native but the political and economic control was in the hands of European colonists while in Caribbean much of the population were African slaves and the settlers were in a position similar to landed aristocracy in Europe. An economic system based on slave labour and low wages called for concentration of political as well as coercive power. The economic interests of the politically powerful groups encouraged the development of extractive institutions with power highly concentrated in the hands of the élites.

3.3.1. Lesson from Institutional Evolution in North America versus South America, in the 18th and 19th Century

For the institutional development, the comparison highlights the primacy of economic interests and as to who enjoys power—those with interest in rent-seeking or those with interest in secure property rights. If the *de jure* power is with the aristocracy, it will not establish good institutions on its own. The good institutions must be forced onto the *de jure* power by some group deriving *de facto* power from one or the other source. The comparison of the consequences of colonisation of North America and Latin America also confirms Olson's (2000) 'Roving and Stationary Bandits' thesis—when a bandit (the ruler) is out there for a short time he attempts to extract all that he could (and therefore establishes institutions with the extraction end in mind), whereas if the bandit is in there to settle down he extracts only part of the income of his subjects—the intact earning capacity of the subjects allows the stationary bandit a steady stream of extraction in future.

3.4. Korea and Taiwan vs. Congo (Zaire)

In South Korea and Taiwan the leaders pursued developmental policies while in Congo General Mobutu practiced one of the most Kleptocratic regime. Acemoglu explains the reasons for the difference in choice of the rulers.

Acemoglu believes that the explanation lies in ‘constraints’—while Mobutu faced little constraints either from its neighbours or from the existing institutions, South Korea and Taiwan faced severe threats of communism via a revolution or invasion.

It was the threat of communist revolution from outside as well as inside that forced General Park Chung Hee in South Korea and *Kuomintang* regime, led by Chiang Kai-shek, in Taiwan to pursue developmental policies. Acemoglu believes that the primary motivation for investment in education and instituting the land reforms in Korea were the containment of unrest. *Kuomintang* regime—the rulers of China, before the revolution despite having a history of being corrupt, predatory and rent seekers in China were also forced to pursue the industrialisation path to avert the threat of communism in their new shelter—Taiwan.

The situation in Congo was very different from Taiwan. In Congo General Mobutu, the then Army chief, took over power, shortly after independence. Mobutu dismantled judiciary, removed the already weak institutional constraint, bought political support using State resources and proceeded to accumulate wealth. There were effectively no property rights and the GDP of Congo declined at the rate of 2 percent a year. Why Mobutu could get away with this? To ward off any threat to his rule, Mobutu bought off political support using money provided by US, IMF and World Bank as developmental aid which in fact were payments to Mobutu to keep Congo, non-communist.

The lesson from the experience of Korea and Taiwan is that the threat of a revolution may force the authorities to reform. Especially, the threat of an ideological change may induce the authorities to practice the ideology in vogue with more vigour thereby reforming institutions as a consequence. While the lesson from the experience of Congo is that if the world powers, especially the West and United States share interest with rent seekers then this may constrain institutional development. Put differently this may also imply that if the world powers have some strategic interests in a country then it might be easier for them to deal with a single person rather than a democratic regime. That single person drawing legitimacy from foreign powers rather than the citizens of the country that he rules, will not be too bothered to facilitate institutional change for the good.

3.5. Botswana versus Somalia

The British objective of colonising both Botswana and Somalia was only strategic therefore the pre-colonial institutions were largely left unaltered in both the countries.⁵ Despite the similarity—little harm to the pre-colonial institutions, the economic performance of the two countries shows marked

⁵For example the objective of colonising Somalia was to secure the sea-lanes between the Red Sea and India and the Far East that the country commanded.

contrast—while Somalia’s performance had been dismal, Botswana’s has fared relatively well. What explains the difference in economic performance of the two countries?

Reasonable economic performance of Botswana is owed to relatively good pre-colonial tribal institutions that encouraged broad-based participation and constrained the behaviour of politicians. After independence cattle owners were the most important interest groups in Botswana. Scholars have gone to the extent of recognising that “Botswana’s government was largely a government of cattlemen.” Ranching being the main economic activity this was done successfully by exploiting the EEC market. Ranching, in Botswana, had the full involvement of élites—the elites were enriched by the developmental policies adopted from 1966 and well-enforced property rights were in the interests of political elites. However by mid 1970’s the income from diamonds swamped the income from ranching, so one needs to account for why this did not induce the political elite to expropriate the revenues from diamonds? Acemoglu (lecture notes) argues that pre-colonial political institutions in Botswana, like the kgotla (the village council), ensured a certain degree of accountability of political elites and therefore placed constraints on the behaviour of politicians. These constraints may explain why the cattle owners preferred to remain content with the enforcement of their own property rights rather than attempt to expropriate returns from diamonds.

Another factor that may explain institutional development in Botswana is the political stability there, which was the outcome of Seretse Khama’s leadership. The respect he enjoyed resulted from both his position as heredity chief of the largest tribe and from the relatively broad coalition that he formed within the BDP (Botswana Democratic Party), including the tribal chiefs and cattle owners. Given political stability, Seretse Khama could build a relatively effective bureaucracy without the majority of economic groups fearing future expropriation.

An investigation into the nature of post-independence politics in Somalia suggests that the pre-colonial institutions may have contributed to political instability rather than help the creation of institutions of private property. Despite ethnic, cultural and linguistic homogeneity, the political structure of the Somalian clans was highly divisive, and institutions placing constraints on political elites were absent. This increased the stakes in controlling the state apparatus, and encouraged political elites to fight each other, forming coalitions along clan lines. Laitin and Samatar conclude that “one can scarcely think of a significant domestic or foreign development in Somali politics, since independence that was not influenced to a large degree by an underlying clan consideration.”

The lessons from the comparison of the history of Botswana and Somalia are:

- Institution exhibit path dependence—Post-colonial institutions bear resemblance to pre-colonial institutions. Path dependence also emerges, from the works of North, as one of the main characteristic of institutions.

- Political stability is likely to facilitate institutional development.
- Institutional change is not resisted if it is in the interest of the dominant group—more often the elites.

4. THE ENLIGHTENMENT ERA

The 17th century is generally referred to as the European enlightenment era. In the context of institution building the single most important contribution of the enlightenment thought is its successful attack on absolute monarchy. The thoughts of the enlightenment philosophers seem to have influenced institutional change in number of countries especially the framing of constitution in US seems to have benefited from the teachings of enlightenment philosophers like Hobbes, Montesquieu and Locke. A brief on the thoughts of the enlightenment philosophers is presented in Box 1.

Box 1

The Enlightenment Era⁶

Hobbes (1588-1679) was probably the first to argue that monarchs ruled not by the consent of heaven, but by the consent of the people. Hobbes held that all human beings, being selfish will fight for resources. Therefore to protect individuals from each other, humanity at some early point agreed to a 'social contract' that specified the rules, individuals would live by. Hobbes reasoned that as human being cannot live by their agreements therefore authority was created to enforce the terms of the 'social contract'. By authority Hobbes meant 'Monarchy'. For Hobbes, 'humanity is better off living under the circumscribed freedoms of a monarchy rather than the violent anarchy of a completely equal and free life'. However, later on, in a twist of fate, his methods of inquiry as well as his basic assumptions formed the basis, for arguments against absolute Monarchy. Marquis de Montesquieu (1688-1755), a judicial official as well as a titled nobleman was amongst the earliest critics of absolute monarchy. Montesquieu's, classic *The Spirit of Laws* (1748) recognises geographic influences on political systems, advocate checks and balances in government and defends liberty against tyranny in an uncompromising manner. Baruch Spinoza (1632-1677) held the view that human beings inability to preserve themselves forced them to form societies. In doing so, the individuals surrendered their 'individual right' to 'common right'—a notion very similar to Hobbes' 'social contract'. Spinoza held that an inverse relationship exists between the power of an individual and the power of the State. Given this view Spinoza argues for democracy to create a balance of power between the State and the 'individual'. John Locke (1632-1704) views human mind as completely empirical, rather he argues that the only knowledge is empirical knowledge. He also held that human mind at birth is *tabula rasa* (erased board). His empiricism coupled with the notion of *tabula rasa* meant that moral as well intellectual outcomes in human development can be altered to societal advantage, by changing the environment through education. Locke proposed an extension of education to every member of society. His view of education dominates the western culture even to this day. Voltaire (1694-1778) popularised Newtonian science, fought for freedom of the press, and actively crusaded against the church. In his endeavours he turned out hundreds of plays, pamphlets, essays and novels. He wrote around 10,000 thousand letters to different people in advocacy of his convictions. Even in his own time, he enjoyed the reputation of a legend, among kings as well as literate commoners.

⁶For this box we draw upon Lewis (1992) and wsu.edu:8001/~dee/ENLIGHT/.

5. WHERE TO BEGIN?

The discussion in the foregoing sections was meant to draw lessons for our main task, from where to begin the process of institutional reform? For the convenience of the reader, It will prove useful to very briefly recap the lessons that we have learnt from historical experiences of different countries discussed in Section 3.

Countries that experienced institutional change versus countries that (with similar circumstances) that did not experience institutional change	Lessons from Historical Experiences
17th Century Britain and Netherlands versus Spain and France	Fiscal constraints and then commercial interests forced the crown in UK to yield in favour of good institutions. Similarly in Netherlands commercial interests emerged as the <i>defeto</i> power that forced the change upon the rulers.
19th Century Britain and Germany versus Austria-Hungary and Russia	Rent-seekers will thwart institutional change, with success depending upon the bargaining strength that they enjoy.
18th and 19th Century North America versus South America	If the <i>de jure</i> power is with the aristocracy, it will not establish good institutions on its own. The good institutions must be forced unto the <i>de jure</i> power by some group deriving <i>de facto</i> power from one or the other source.
Korea and Taiwan versus Congo (Zaire)	<ol style="list-style-type: none"> 1. Lesson from the experience of Korea and Taiwan: the threat of a revolution may force the authorities to reform. 2. Lesson from the experience of Congo: If the world powers have some strategic interests in a country then it would be easier for them buy-off/install some rent-seeking rulers in the country concerned rather than the population at large. This may constrain institutional development in the country concerned.
Botswana versus Somalia	<ol style="list-style-type: none"> 1. Institution exhibit path dependence—strongly argued by North and implicitly evident from works of Acemoglu and Rodrik. 2. Political stability is likely to facilitate institutional development. 3. Institutional change is not resisted if it is in the interest of the dominant group—more often the elites.

5.1. Can Commercial Interests in Pakistan Force the *De jure* Power to Change Institutions for the Better?

If the institutions are poor and the *de jure* power is not willing to reform institutions on its own or has been held hostage by some *de facto* power that stands to gain from maintaining the status quo, then some *de facto* power must emerge that can force change upon the *de jure* power. This is what we learned from Acemoglu, *et al.* (2005a) and the experience of institutional change in 17th century UK and the Netherlands corroborates this stance.

The issue is that how such *de facto* power will emerge. Can the commercial interests, in Pakistan, emerge as a *de facto* power that may force the *de jure* power to provide good institutions and facilitate their formation when required.? This is unlikely because a rent seeking culture has characterised the economy through much of its history. For example, in '50s the trade policy relying on high tariffs and quantitative restrictions conferred windfall gains on a small group of import licensees [Hussain (1999)], while in '60s the import substituting industrialisation and the export bonus scheme allowed the exporters to amass wealth at the expense of other segments of the society.⁷ In '80s and '90s bureaucratic and political elite and those who could afford to buy-off bank officials benefited from bank loans that in essence, were mostly, not paid back. Given that large commercial interests, in Pakistan, have prospered by way of rent seeking (and is used to securing favours from the *de jure* power), it is difficult to expect that such interests will turn up into a viable *de facto* power, that may stand up against the *de jure* power to reform institutions. After all you do not bite your own hand.

5.2. Can Fiscal Constraints Force the *De jure* Power to Strike a Bargain with the Citizen for Taxation in Exchange for Good Institutions?

Pakistan has faced fiscal constraints in the past and the situation is no different today. Will the fiscal constraints force the *de jure* power, as these had forced the Stuarts kings in UK, to strike a bargain with the citizens, for taxation revenues in exchange for good institutions? Again this is unlikely. The times when the fiscal constraints could force the *de jure* power to strike a bargain with the citizens was when neither access to funds, by way of borrowing from the country's central bank (money creation) nor foreign aid were available. Now the instrument of money creation has enabled the governments to delay the day of reckoning till the people burdened with inflation decide to revolt against the government (which does not happen too often). Second, Pakistan because of its geo-strategic position has enjoyed access to sufficient foreign aid for better part of its history. The trend is likely to continue—foreign aid will alleviate the fiscal

⁷For an exhaustive account of rent-seeking reading through the host of books written on Pakistan economy is essential. These include Zaidi (2005), Amjad (1982), Hussain (1999).

constraint. This will close the possibility of citizens-de jure power bargain—taxation revenue in return for good institutions.

5.3. Strategic Interests of Foreign Powers: A Constraint to Institutional Development

Will the Congo like situation prevail in Pakistan, that is, will the strategic interests of foreign powers constrain institutional development in Pakistan? In fact Congo like situation has prevailed in Pakistan for a better part of its history since independence in 1947. It goes without saying that foreign powers, especially the United States, do have strategic interest in Pakistan and the population of Pakistan in general does not feel pressed to pursue the strategic interests of foreign powers. Therefore it is in the interest of the foreign powers to buy off and even install few rulers and ensure the continuity of their rule. During its history of 61 years, Pakistan has witnessed four military regimes, with three of these enjoying a rule of almost a decade each, with support from United States—explicit or implicit. US's support to the military regimes in Pakistan, despite its avowed criticism of dictatorship bears testimony to the buy-off and rule-continuity view. The regimes deriving legitimacy from foreign powers, rather than from its citizens, will obviously be not pushed to pursue institutional reforms, especially when it means shooting at one's own feet, e.g. judicial independence.

5.4. Will a Revolution Bring about Institutional Change in Pakistan?

Revolutions are not spontaneous. All revolutions have its philosophers whose thoughts ignite the revolutions. [Masood (1991)]. The monarchy in Europe did not collapse overnight. Around the time of the glorious revolution (1688) in UK and much before the French revolution, the enlightenment philosophers, like Montesquie, Spinoza and Voltaire had launched a strong attack against monarchy with their pen and voice. The thoughts of people like Allama Shariiti and Ayatollah Mutahiri had provided the fodder for the Iranian revolution of 1979 [Masood (1991)]. To stage a revolution that ends up in long-lasting institutional change rather than chaos, not only the society should have developed sufficient apathy with the present rule but it should also have at least some idea of how to proceed after the revolution. Above all if the human capital required for carrying out the institutional change is not available, even a revolution may fizzle out, if not turn into chaos. In sum to stage a successful revolution belief system of the society must be influenced. The question is how?

We have shown that fiscal constraints and commercial interest may not prove very effective to securing an institutional change in Pakistan. Besides, given the strategic interest of foreign powers in Pakistan, the possibility, of foreign powers thwarting any institutional change that would compromise their strategic interests also exists. We also discussed that given the state of intellectual

thought process and that of human capital, Pakistani society may not be ready as yet to stage a revolution that ends up in meaningful institutional change. How to go about institutional change then? The option that remains, is the gradualist approach strongly advocated by Douglas North and implicitly evident favoured in the works of Darron Acemoglu and Dani Rordrik.

5.5. The Gradual Approach

One of the key elements of North's theory of institutional change is path dependence exhibited by institutions. This implies that a quick-fix solution to poor institutions is not possible. We want to emphasise here that revolutions that appear to have reformed institutions with big-bang were rooted in the thought process that in some cases had begun almost a century before the revolution was actually triggered, for example the influence of 17th century enlightenment thought upon the French revolution and the framing of the US constitution. Other key elements of North's theory including (i) institutions are influenced by beliefs, (ii) dominant beliefs matter (iii) intentionality, and (iv) comprehension of the dominant players matter, provide hope that institutional change can be designed with the process of change extending over sufficient length of time. All these elements provide an opportunity to manoeuvre an institutional change by managing an increase in literacy rate and reforming the educational system. We consider below whether North's theory of institutional change can be put to practice by way of reform of the educational system in Pakistan.

Institutions, according to North, are a function of beliefs of the society. To design an institutional change, the task then is to influence the societal beliefs. The belief formation, we have learned is a function of genetics, culture and human environment. To recap, beliefs can be influenced only to the extent that the today's learning and experiences influence the culture and human environment. Thus the beliefs that are conducive to desired institutional change can be developed, by arranging for the education and human environment which is conducive to the preferred institutional change.

But it is not just the individual beliefs that matter rather it is the beliefs of the society that counts. This implies that in more homogeneous societies the task of securing an institutional change would be relative less difficult. The task then is to forge greater homogeneity in the society which is done by securing a convergence in beliefs amongst the individuals of a society? Beliefs, being function of learning and human environment, the answer lies in arranging for a similar kind of learning and similar human environment. How that can be done? The solution lies in similar education, for all and sundry. The first and foremost requirement to design an institutional change for the better, then would be to have universal system of education for all segment of the society, up to a certain minimum level, say till, Grade 12. By universal system we mean that not only the syllabi should be similar but the environment that pupils face in schools and

colleges would also have to be similar—two persons sharing readings are more likely to share beliefs as well.

Let us examine the educational structure in Pakistan. At school/college level Pakistan follows variety of systems that include: the O/A British system, that follows the syllabi prescribed by the authority which manages the O/A level system in UK, the English-medium private and public schools which follow the syllabi prescribed by the government, the *urdu*-medium government schools and the *madressah* system. The syllabus of the *madressah* system is primarily focused on religious education and little effort is made to impart knowledge of science and mathematics etc. It is but obvious that the population which is the product of such diverse educational systems is likely to be heterogeneous rather than homogeneous one required for institutional change. It is no coincidence that a similar education for all, up to a certain grade, by and large, is the norm in the developed world that boasts of good institutions. To make our case for universal educational system stronger, we again lean on North (2005):

“The process of learning is unique to each individual but a common institutional/educational structure will result in shared beliefs and perceptions”.

Our case for reform of the educational system also finds support from studies like Rajan (2006) and Azfar (2006). Rajan argues that strengthening the institutions like property rights etc. may help jump-start the economy for a while but the lack of endowments, like education, will leave the poor unprepared for reforms. He cautions that in this situation placement of pro-market institutions may fail to do the trick. Azfar (2006) points out that the shared belief system, which a universal educational system shall produce, will help bring about a consensus among the population, about the acceptable and unacceptable behaviour of the rulers and will therefore force-in an honest government.

The hardest to reform amongst the educational system being practiced in Pakistan is the *madressah* system. *Madressahs* are believed to be the breeding ground for the so-called *talbanisation* (the perception may or may not be true) and therefore attempts have been made, under foreign pressures, to reform the system. Such attempts have not born substantive fruit. The reason is that the objective has been to find a quick-fix solution. Unfortunately such a solution does not exist—the clergy that enjoys substantive *de facto* power is not willing to yield. To address the issue one has to account for, as to who goes to a *madressah* and is the enrolment by choice or is forced by circumstances. The *madressahs* in Pakistan, not only impart religious education but also offer food and shelter to the pupils. (The *madressah* system has been termed as the biggest NGO in Pakistan). The *madressahs*, are apparently funded by charity money. Anecdotal evidence suggests that mostly the wards of poor are admitted to *madressahs*, for the poorest of poor this is the easiest way to feed their children. In Pakistan, with around 30 percent of the population living below the poverty

line, the enrolment on this count is not likely to be small. So the solution lies in addressing the overall issue of poverty, which in any case is not an easy one to tackle, before a number of institutions have been reformed. An alternate is to make and enforce enrolment in school system other than *madressahs* compulsory. This again involves the cost of enforcement, compensating the parents for whom the non-school going child is a bread-earner and of course tackling the opposition from the clergy. The purpose of the forgoing discussion is not to offer a solution but only to provide a glimpse of the hurdles involved, when one attempts to reform the educational system.

The proposed universal education system will also takes care of the next element in North's theory—dominant beliefs matter. If all the subjects of a country have gone through similar education and have faced more or less similar human environment, then belief-convergence between dominant and non-dominant players is likely. Still the beliefs of the dominant players would matter but given convergence, the preferences of the non-dominant players would automatically be taken care of.

North's argument that comprehension, of an issue, of the dominant players, determines the kind of institutions that will be developed to confront the issue, again provides room for the education to influence an institutional change because it is the education, and of course the right kind of education, that would influences a person's ability to correctly comprehend the issue at hand.

That the dominant beliefs matter and that the intentionality of the dominant players matter calls for choosing such people (through electoral process etc.) to hold *de jure* power, who share the beliefs of the society and who intend to allow the kind of institutions that the society prefers. The beliefs and intentions of the candidates aspiring for the *de jure* power can be tracked from a run down of the personal profile of the aspirants. For example if the candidate or a political party is running for a second term, the performance in the previous term serves as a guide to judge the beliefs and intentionality of the players. However for the constituents to correctly perceive the beliefs and intentions of the players they must posses some education, whether formal or informal.

But this is a very truth-judgment kind of a thing to say that to reform institutions, to begin with the educational system should be reformed. The issue is who would reform the educational system? The natural candidate, in this context, is the *de jure* power. But the question is what motivates the *de jure* power to go for this. The reform of the educational system, we expect, would reduce the voters' ignorance and thereby lead to all-round institutional reform, including the change in the very structure of the *de jure* power or the change in *de jure* power itself. Given the damage that the reform of the educational system can inflict upon the rulers, why would *de jure* power shoot at its own feet? So it is difficult to believe, if not naïve, that the *de jure* power will undertake the reform of the educational system on its own.

To reform, the pre-requisite implicit from Acemoglu, *et al.* (2005b) is that some *de facto* power must emerge to force the *de jure* to go for the reform. The question that begs answer is that how that *de facto* power will emerge. What incentive mechanism will facilitate the emergence of a *de facto* or *de jure* power that will push the reform of the educational system? This is a difficult question to answer, perhaps the popular print and electronic media can play some role in creating awareness about the need for a universal education system. But the question then is what motivates the media to do this?

We have groped in the dark, perhaps without success, to find out as to what, and who would trigger the reform of the educational system however one thing is for sure, reform of the educational system is expected to meet with lesser resistance as compared to reform of the other institutions. For example, an attempt to begin the process of institutional reform from change in the structure of *de jure* power or the change in *de jure* power itself will, in all likely-hood, be resisted tooth and nail, by those who currently wield *de jure* power. Moreover if the change in *de jure* power is likely to adversely influence foreign interests of one or the other kind, staging a change would become all the more difficult. Support extended to Kleptocratic regime of General Mobutu in Congo to thwart communism is just one example of how and why foreign powers may block good institutional change. Similarly an attempt to establish institutions that do not allow rent seeking again may not be successful if the *de jure* power is itself deriving rents. It is noteworthy that reform of all the institutions referred above will adversely influence the *de jure* power today.

In contrast, given North's path dependence, the reform of the educational system, will at best, influence *de jure* power a generation-hence. Typically as the vision of the politicians extends up to the next election, they are not likely to be as scary of educational system's reform as they would be of the change in *de jure* power today, or reform of any other institution that adversely influences their fortune, today or in the near future. Therefore the education system with its all encompassing influence, global emphasis and relatively lesser resistance from the *de jure* power stands as the best candidate to begin the process of institutional reforms. The reforms of the system and the increase in literacy rate will in all likelihood lessen if not altogether eliminate voters' ignorance and misperception while voting, thus raising the possibility of choosing the right kind of people to hold *de jure* power. Secondly given the voters' improved ability to choose and the fact that the rulers would have passed through the same educational system as available to the subjects, the rulers and the subjects are likely to share beliefs. It is the shared belief system that will facilitate reform of the remaining institutions.

One question remains. What do we gain from the awareness that the education system should be the first one to be reformed if the society cannot force the *de jure* power to reform the system? Suppose that the discontent in a

country has reached a point where for the rulers to remain in power they must agree to one or the other institutional change demanded by the society, otherwise they face a weaker possibility of a revolution. It is at this point that the society should be clear, what kind of institutional change to demand. If the *de jure* power is deriving rents from different sources and the society demands an immediate end to rent seeking then the possibility of demand-acceptance is little as this will affect the fortunes of *de jure* power today. But if the society demands that, all children aged five should receive the same education then the possibility exists, that the myopic ruler, faced with discontent and a weaker threat of a revolution, will yield.

6. CONCLUSION

We set ourselves the task of finding answers to two questions. One, is it possible to reform institutions by design and if yes which institution should be chosen, to be the first one to be reformed. Given the path dependence exhibited by institutions, it is not possible to reform institutions with a big bang i.e. in one-go. This leaves the alternative of practicing gradualism in reforming institutions—the alternate preferred by North, Acemoglu and Rodrik. Once we decide to adopt the gradual approach the immediate issue that comes to forefront is what to reform first? Hence our second question.

We excluded the possibility of commercial interests, fiscal constraints and a revolution forcing institutional change in Pakistan. Commercial interests in Pakistan have typically thrived on favours from the *de jure* power and are therefore unlikely to emerge as a *de facto* power against its patron. Theoretically, fiscal constraints may encourage citizens-government bargain—taxation revenue in return for good institutions. But the *de jure* power feels constrained to enter into bargain only if funds from other sources are not available. Given strategic interests of foreign powers, foreign aid will alleviate the fiscal constraint and the rulers-citizens bargain is not likely to materialise. The country does not seem ready for a revolution either—the thought process that typically precedes revolutions seems to have, barely begun. The alternate, that remain, then is the gradualist approach preferred by North, Acemoglu and Rodrik. Institutional reforms in Pakistan should begin with reform of the educational system—introduction of a common educational system, for all and sundry, up to a certain level.

Based on North's theory of institutional change we took the position that institutions can be reformed by conscious design. North holds that institutions are function of the beliefs of the society and that beliefs among other things are a function of ones learning and experiences. He also holds the view that it is the beliefs of those in a position to enact institutional change that matter. Thus it is possible to mould ones beliefs by influencing what a person learns and what he experiences. Change in beliefs, would then induce an institutional change. The

notion of human mind, at the time of birth, being *tubla rasa* (erased board), put forward by the enlightenment philosopher, John Locke also supports our stance that education can mould beliefs to suit ones end. Therefore we concluded that institutions can be reformed by conscious design.

The answer to our second, but the main, question is that among the list of institutions that call for reform, the reform of educational system should top the agenda. Educational system as the top-most candidate for reform meets the three point criteria described in section 1 of the Paper. In relative sense, the resistance to reform of the educational system i.e. resistance to establishment of a universal education system, up to grade 12, is likely to be lesser than a direct attack on *de jure* power or to a demand to curb rent seeking, assuming that *de jure* power itself is deriving rents. The former would effect those who wield *de jure* power, a generation-hence while the latter will adversely influence them today. The general principle for the selection of an institution under the least-resistance criterion is that the longer it would take a change to influence the current stakeholders the lesser would be the resistance offered to the institutional change. The rationale is that politicians being myopic are not likely to be too concerned about a change that will cause impact, at the earliest, in a generation's time.

The educational system, as the top-most candidate for reform, also lives up to second and third element of our criteria of selecting the first. The proposed change in education system will bring about a convergence between the beliefs of masses and those in position to enact institutional change. With the rulers and the subjects sharing beliefs, bringing about a change in remaining institutions will be less difficult. Thus the change in education system will not only have an all encompassing influence but the impact will be long-lasting as well.

REFERENCES

- Acemoglu, D., S. Johnson, and J. A. Robinson (2005a) Institutions as the Fundamental Cause of Long-run Growth. In P. Aghion and S. Durlauf (eds.) *Handbook of Economic Growth*. North Holland.
- Acemoglu, D., S. Johnson, and J. A. Robinson (2005b) The Rise of Europe: Atlantic Trade, Institutional Change and Economic Growth. *American Economic Review* 95: June, 546–579.
- Acemoglu, Daron, Simon Johnson, and James A. Robinson (2001) The Colonial Origins of Comparative Development: An Empirical Investigation. *American Economic Review* 91: 5, 1369–1401.
- Acemoglu, Daron, Simon Johnson, and James A. Robinson (2002a) Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution. *Quarterly Journal of Economics* 118, 1231–1294.
- Amjad, Rashid (1982) *Private Industrial Investment in Pakistan 1960-1970*. Cambridge: Cambridge University Press.

- Azfar, Omer (2006) The New Institutional Economics Approach to Economic Development: A Discussion of Social, Political, Legal and Economic Institutions. *The Pakistan Development Review* 45:4, 965–980.
- Dollar, David and Aart Kraay (2003) Institutions, Trade and Growth. *Journal of Monetary Economics* 50:1, 133–62.
- Easterly, W. and R. Levine (2001) What have we Learned from a Decade of Empirical Research on Growth? It's Not Factor Accumulation: Stylised Facts and Growth Models. *World Bank Economic Review* 15, 177–219.
- Hall, Robert E., and Charles Jones (1999) Why Do Some Countries Produce So Much More. Hoover Institution, elsa.berkeley.edu/~chad/pon400.
- Haque, Nadeem Ul and M. Idrees Khawaja (2007) *Public Service: Through the Eyes of Civil Servants*. (Governance Series.) Islamabad: Pakistan Institute of Development Economics.
- Hasan, Lubna (2007) Myths and Realities of Long-run Development: A Look at Deeper Determinants. *The Pakistan Development Review* 46:1, 19–44.
- Hayek, F. A. (1960) *The Constitution of Liberty*. Chicago: University of Chicago Press.
- Hussain, Ishrat (1999) *Pakistan the Economy of an Elitist State*. Karachi: Oxford University Press.
- Lewis, Hackett (1992) The Age of Enlightenment: The European Dream of Progress and Enlightenment. history-world.org/age_of_enlightenment.htm
- Lichbach, Mark I. (1995) *The Rebel's Dilemma*. Ann Arbor: University of Michigan Press.
- Locke, John (n.d.) The European Enlightenment: Seventeenth Century Enlightenment Thought <http://www.wsu.edu:8001/~dee/ENLIGHT/>
- Masood, Mukhtar (1991) *Loh-e-Aayam*. Lahore: Sang-e-meel Publication.
- Montesquieu, Baron de (1748) *Spirit of the Laws*. <http://plato.stanford.edu/entries/Montesquieu>.
- Moore, M. (2002) 'Bad Governance' or the Development of Political Underdevelopment. Paper presented at the conference 'Towards a new Political Economy of Development: Globalisation and Governance' at the Political Economy Research Centre, University of Sheffield.
- North, Douglass C. (1981) *Structure and Change in Economic History*. New York: Norton.
- North, Douglass C. (1990) *Institutions, Institutional Change and Economic Performance*. Cambridge: Cambridge University Press.
- North, Douglass C. (2005) *Understanding the Process of Economic Change*. Princeton: Princeton University Press.
- Olson, Mancur (2000) *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships*. New York: Basic Books.

- Pejovich, Svetozar (2006) The Effects of Interaction of Formal and Informal Institutions on Social Stability and Economic Development. In Kartik C. Roy and Jorn Sideras (eds.) *Institutions, Globalisation and Empowerment*. Elgar: UK.
- Rajan, Raghuram G. (2006) Competitive Rent Preservation, Reform Paralysis, and the Persistence of Underdevelopment. (NBER WP 12093.)
- Rodrik, Dani (2006) Institutions for High-Quality Growth: What They Are and How to Acquire Them. In Kartik C. Roy and Jorn Sideras (eds.) *Institutions, Globalisation and Empowerment*. Elgar: UK.
- Rodrik, Dani, Arvind Subramanian and Francesco Trebbi (2002) Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development. National Bureau of Economic Research (October). (NBER Working Paper 9305.)
- Ross, Jeffrey I. and Tedd R. Gurr (1989) Why Terrorism Subsides: A Comparative Study of Canada and the United States. *Comparative Politics* 21, 405–426.
- Tarrow, Sidney (1991) Aiming at a Moving Target: Social Science and the Recent Rebellions in Eastern Europe. *PS: Political Science and Politics* 24, 12–20.
- World Bank (2003) *World Economic Outlook*. Washington, DC.: World Bank.
- Zaidi, S. Akbar (2005) *Issues in Pakistan's Economy*. Karachi: Oxford University Press. p. 8.