

**REVISITING INSTITUTIONAL THEORY:
EVIDENCE FROM LAND-TITLING AND MICROFINANCE PROGRAMMES**

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1. INTRODUCTION

A majority of people, particularly in developing countries, live outside the ambit of formal law, yet – within mainstream legal scholarship – we still lack an adequate theory of “informal law” (social norms, conventions and other non-formal rules that influence behaviour) and its relationship with formal legal systems. Drawing on a variety of theoretical traditions that address the issue of legal informality – ranging from law and development to sociological approaches (like legal pluralism) to economic approaches (like New Institutional Economics, and social capital theory) – this paper seeks to take a step forward in developing a fuller theory of institutions.

The paper uses a pair of in-depth comparative case studies – based on original qualitative data collected over several years of field research – to explore the relationship between formal and informal law. Both case studies are based on programs that aim at poverty alleviation through improving access-to-credit, but while the first, land titling in Peru, is a high profile instance of an attempt to achieve the formalist ideal (by distributing formal legal titles to the poor to enable them to access credit), the second, microfinance in Bangladesh, is a prominent example of a more informal, trust-based institutional intervention (distributing credit to the poor not against collateral, but based on peer-monitoring). On a ‘static’ analysis, the paper finds that microfinance is a more efficient institutional model than land titling – in terms both of credit disbursement and recovery, as well as cost effectiveness. But, on a ‘dynamic’ analysis, it finds a tendency towards convergence between the two models – in particular, the rapidly expanding microfinance sector in Bangladesh itself shows evidence of increasing formalisation.

The findings of this empirical study generate important insights into the theory of institutions. The first of these, inferred from the ‘static’ analysis, pertains to the sequencing of legal reforms – it establishes that a more informal, norm-driven intervention is far more likely to succeed in the first instance than a formalistic one, especially if it taps into a pre-existing system of norms. The second, drawn from the ‘dynamic’ analysis, is that formal and informal legal systems may be complements rather than substitutes – but that the process of institutional evolution involves grappling with a variety of transition issues, especially that of replication. While informal systems may have a number of short-term advantages over more formal systems, they are inherently limited by scale – and the process of embedding and replicating a successful informal solution to a collective action problem very often involves a move towards formalisation or codification. It is this tension between flexibility and replicability that lies at the core of the relationship between formal and informal systems.

Thus, while institutional theory has tended to dichotomise formal and informal legal systems – in practice, a legal system appears to work best when its formal and informal elements work in tandem, i.e., when the formal system underwrites a widely observed system of norms. The shift to theorising the formal and informal as complementary elements within a system – rather than competing systems – may prove fundamental in re-conceptualising institutions.

II. THEORETICAL BACKGROUND

The current literature on the role of institutions in economic development is characterized by a deep fissure: The dominant paradigm is constituted by what will be referred to the “institutions orthodoxy”, an amalgamation of law and economics, new institutional economics and the “rule of law” orthodoxy; but there exist a set of “emergent perspectives” – burgeoning voices that do not, yet, constitute a cohesive counter-point that contest its claims.¹ The difference underlying the two perspectives is that while the

¹ This echoes the schism identified by Trubek and Galanter (1974) in their classic article on law and development: One of these strains they discussed saw the central issues of law and development lying at the intersection of law and politics, and viewed the study of law and development as inherently infused with

dominant paradigm is essentially Hayekian² in its approach, the view adopted by the alternative perspective is Polanyian³. Hayek conceives of society as a “spontaneous order” and sees the market as a key illustration of such an order. The role of social institutions, on his view, is, thus, to create the conditions in which the market can operate. Polanyi, by contrast, sees the market as a means to an end (i.e. development, broadly defined), and accepts that society must regulate the market in order to preserve both the market and itself. To the extent that the Hayekian perspective takes a disembodied view of the market, it is able to see institutions as exogenous. On the other hand, since the Polanyian view sees the market as embedded, its view of institutions is endogenous.

The theoretical foundations of the “institutions orthodoxy” are based on the seminal contributions of Coase (1960) and North (1990) – establishing within mainstream economic theory the importance of institutions for economic growth. This perspective argues that, in the context of the market economy, growth rests on the ability of agents to enter into mutually beneficial exchange. This, in turn, depends on the protection of private property (so that the incentives for investment and innovation exist) and the enforcement of contracts (to provide certainty and security in transactions). The ability to enter into effective contracts rests, further, on the ability to solve the “collective action problem”, i.e. the problem of how agents can be made to cooperate when it is in the larger interests of all in the long run, but departs from the interests of individual agents in the short run. Institutions are, thus, a means of overcoming these problems. Although it is possible to envisage a wide range of solutions to collective action problems – or a broad spectrum of institutional arrangements – it is widely assumed within the institutional perspective that the most effective solution to the problem is provided by formal law. The initial focus of new institutional economics was not exclusively on the developing world, but, rather, on the institutional sources of growth more generally, the more prescriptive dimensions of institutional theory were formulated by a second wave of institutional theorists explicitly focused on developing regions – who attribute underdevelopment to

normativity. While the other strand of research conceptualised law and development as a subset of law and economics, and – stripping away all considerations of the normative and political – regarded the central concerns of law and development as a technical problem to be approached “scientifically”.

² See Hayek (1944, 1960)

³ See Polanyi (1944).

the failure to develop Western-style legal systems.⁴ The influence of these prescriptions has been strengthened by the support of the World Bank in both its research and policy initiatives.⁵ Within this perspective the “rule of law” is shorthand for the central tenets of the institutional perspective, and is considered to be an essential pre-requisite for economic development – if not a guarantee of it. This approach – termed here, the “rule of law orthodoxy” – has been tremendously influential, particularly in establishing two central prescriptions, i.e. that property and contract law are the most important legal protections from the perspective of development, and that formal law is superior to other more informal mechanisms as a solution to the collective action problem.

An emergent voice within academia is starting to contest the feasibility, and desirability, of achieving the “Weberian ideal” advocated by the formalist school – or the notion that development must necessarily entail the transition from informal societal authority to more formal State-based authority, and the establishment of a sophisticated State bureaucracy. For instance, one strain of the literature on “legal transplants” questions whether Western models can be applied in the developing world, and finds that whether a country developed its own legal system or not – and, if not, the degree of familiarity with the system by those on whom it is imposed and other “cognitive” factors – has a systematic impact on the efficacy of the system.⁶ The second strand of the literature starts to theorize informal solutions collective action problems – social capital theory provides an account of the economic importance of non-formal systems of social order,⁷ while crucially important work by Ostrom (1990) finds that spontaneously developed informal regulation can be far more efficient than predicted by conventional theory.

⁴ Acemoglu *et al.* (2002), Acemoglu *et al.* (2003) and La Porta *et al.* (1998) are representative. The lessons of new institutional economics have been applied explicitly to the context of the developing world by “first generation” theorists as well; see, for instance, North (1995) and Posner (1998).

⁵ See, in particular, the work of Kaufmann *et al.* – for instance, Kaufmann *et al.* (2007).

⁶ See Berkowitz, Richards, Pistor (2003a, 2003b).

⁷ See Putnam (1995) etc.

III. EMPIRICS

A. COMPARATIVE CASE STUDIES

In this section, case study methodology to compare two programmes that are illustrative of the alternative approaches to solving collective action problems presented by the theory. The first is an application of the principles of the rule of law orthodoxy – the land-titling programme in Peru established by Hernando De Soto. The second is an example of what is the emergent “alternative” perspective, the microfinance experiment in Bangladesh associated with Muhammad Yunus.

The land titling programme and the microfinance model make for interesting comparative case studies as a result of a twin set of factors. On the one hand, there is a high degree of theoretical overlap in the prescriptions put forward by Yunus and De Soto but, on the other hand, the “institutional” mechanisms adopted by the models they advocate are starkly different. Both focus on access to credit for the poor in the developing world as a means of alleviating poverty, but while De Soto proposes that land occupied by poor squatters be titled in their names so that they can use these documents to access credit through formal lending institutions, Yunus establishes an alternative banking system that lends to the poor without collateral, but rather, based on “trust-based” peer monitoring networks. Thus, while the former adopts a largely formalistic approach, the latter takes an essentially informal view of institutions.

Both programmes are extremely high-profile, and have generated an extensive literature individually. But this is the first study to conduct a systematic comparison of the two programmes, and this differs from the existing studies. It follows that the emphasis of this study is essentially comparative, i.e. it is not concerned with the absolute performance of either programme but rather their performance relative to each other. Finally, while most studies have focused on programme outcomes, the emphasis of the present study is on institutional learning. With this emphasis on the comparative and institutional aspects of the programmes in mind, the empirical study was conducted through qualitative

interviews with key stakeholders involved in the implementation of the programmes in both Peru and Bangladesh. Interviews stressed, in particular, the internal workings of the policy implementation process. Seventy-five in-depth interviews were conducted in across the two countries over a total period of six months, and covered a cross-section of key stakeholders in the implementation of the two programmes.

B. ANALYSIS OF PROGRAMME OUTCOMES

This section uses data from both primary sources (primarily qualitative field interviews, but also internal memos and participant observation) and secondary sources (especially published, large-scale quantitative impact-studies) to empirically evaluate the relative performance of the land-titling and microfinance programmes, using the traditional economic criteria of “efficiency” and “equity” in an attempt to engage with the economic orthodoxy on its own terms.⁸

1. In “Efficiency” Terms

a. The Model of Efficiency

This section compares the relative performance of the two models in terms of their levels of efficiency as systems of contract enforcement.⁹ In order for a contracting model to be effective, it must address the dual problems of “design” (or inducement to enter into a mutually beneficial contract – in this instance, loans to the poor) and “enforcement” (or the problem of effectively ensuring compliance with the terms of the contract – in this

⁸ In both the Peruvian and the Bangladeshi cases, there exist serious problems with the availability, as well as the authenticity, of data. It is emphasised however, that the programme outcomes are *not* the central focus of this study, and it does *not* purport to establish decisively whether the programmes have “succeeded” or “failed” in absolute terms. Rather, the evidence presented is intended to be indicative of the performance of the two programmes relative to each other, and to draw attention to the analytical factors that may contribute to institutional success or failure.

⁹ Although the efficiency of a legal system can be defined in many different ways, the measure adopted here – for a variety of reasons – is the relative efficiency of the two models as systems of contract enforcement. First, it provides analytical simplicity. Second, it is the definition emphasised in the literature due to its obvious economic importance in inducing individuals to enter into mutually beneficial transactions — the very basis of economic growth. In addition, it has the merit of engaging with the rule of law orthodoxy on its own terms.

instance, loan recovery). The two issues are related (i.e. the one impacts the prospects of the other) but separable (i.e. a model may achieve one but not the other).¹⁰

Dasgupta (2003) identifies four models that would theoretically lead to the “voluntary” performance of mutually beneficial contracts.¹¹ The first is “mutual affection” based on group members caring about each other. The second is “pro-social disposition” based on norms of reciprocity due to both evolutionary development and socialisation. The third is “mutual enforcement” based on fear of social sanction in the context of long-term, settled relationships in a community where people encounter each other repeatedly in the same situation. The fourth is “external enforcement” based on enforcement of an explicit contract by an established third-party authority that is typically, but need not be, the State (this is the model represented by formal, Western-style legal systems).¹²

b. Overview of Empirical Evidence

The ILD and COFOPRI report that a total of approximately 3.5 million Peruvian households received title under the land-titling scheme.¹³ While the exact number of titles distributed may be debated, it is widely accepted that a large number of informal properties have now been formally titled. Further, the ILD claims that “formalised urban

¹⁰ Design and enforcement are related in the sense that a party is unlikely to enter into a contract unless it considers the promise of enforcement credible. At the same time, if a party is not induced to enter into a contract at all, the question of enforcing it does not arise. However, they are distinct in that a party might be lured to enter into a contract on the basis of a belief in the enforcement system, but this belief may be false. The recent sub-prime mortgage crisis is a paradigmatic example of this. On the other hand, a party might be deterred from entering into a contract because the prospects of enforcement appear unsatisfactory where they might, in fact, be extremely sound. Person X might, for instance, be an extremely trustworthy person but, if Person Y does not believe that he is, he will not loan Person X \$500 even at a 40 per cent rate of interest. It becomes clear then, at the very outset, that *subjective beliefs* are of fundamental importance in making or breaking the contract.

¹¹ Another factor, of course, that might ensure compliance with the contract is sufficient coercive force. Although an element of coercion is contained in any State legal system, unless mixed sufficiently with a voluntary acceptance of the system, the normative implications of the use of force to keep contracts is highly questionable. In addition, enforcement achieved largely through coercion, even if feasible, is highly uneconomical.

¹² It is significant that this model rests, crucially, upon a sufficient number of individuals *opting in* to the system of authority.

¹³ ILD claims that 1.8 million rural and 1.7 million urban titles have been distributed. See ILD (2008).

owners have obtained \$852 million in loans”.¹⁴ This claim is extremely controversial, and does not appear to be supported by the independent empirical studies conducted on titling. Indeed, the consensus in the empirical literature appears to be that titling has largely failed to lead to the postulated increase in access to credit – particularly from the private sector (Field and Torero, 2004¹⁵; Calderon, 2004¹⁶). This consensus was echoed by interviews with high-level policy-makers in Peru. For instance, Galdos, at SUNARP, admitted that the importance of collateral for facilitating access to credit has been greatly over-stated: “The reality was not what we expected – maybe only about ten per cent of titled families have access to credit.”¹⁷ This shows evidence of problems of both design and enforcement.

By contrast, not only has *Grameen* entered into over seven million informal lending contracts, but has also devised an effective means of contract-enforcement – with a repayment rates in the region of 98 per cent.¹⁸ Again, this finding in the empirical literature is backed up by qualitative evidence from the field. Mustafa Kemal Mujeri, the Executive Director of Bangladesh’s top governmental research centre, the Bangladesh Institute of Development Studies (BIDS), confirmed this: “The rates of repayment are

¹⁴ ILD (2008). The report goes on to claim: “The number of loans provided to formalized owners increased by 280 per cent ... They represent 11 per cent of the borrowers in the formal financial system and have been reliable payers of their debts.” The report is, however, extremely vague about its sources. Consequently, it is difficult to either affirm or contest its empirical claims. See also World Bank (2004).

¹⁵ This study of the Peruvian titling programme finds a small positive impact of titling on public sector lending when titles are asked for in the first place and a beneficial impact on interest rates – but no impact on private-sector lending. This is hypothesised to be due to the fact that a titling programme detrimentally impacts the bank’s perception of its ability to foreclose. As Mitchell (2005) points out, this is an interesting result since the only increase in access to credit that did occur was not through the market process, but through public subsidy.

¹⁶ He estimates that by 2002 only about one per cent of titled families had obtained mortgages or mortgage loans, see p. 299.

¹⁷ Personal interview, SUNARP Head Office, Lima, 5th August 2008. This was reiterated in several other field interviews. These findings are not unique to Peru. Land-titling has been found to fail to lead to increased credit-access in a variety of different contexts: In the Argentinean context, Galliani and Schargrodsky (2005) find that effects of titling on access to credit are extremely modest. In the case of Colombia, Gilbert (2002), p. 14 finds that “possession of legal title makes little or no difference to the availability of formal finance”.

¹⁸ *Grameen Bank* (2007) and Hossain (1988). Similarly, a study by Sharma and Zeller (1997) finds comparable repayment rates for several other microfinance organisations in the Sub-continent. This study considers the performance of the two biggest microfinance organisations in Bangladesh other than *Grameen* – BRAC and the Association for Social Advancement (ASA), as well as the Ranjpur Dinajpur Rural Service (RDRS).

genuinely very high, especially when compared with commercial banks. They are at least about 90 per cent.”

Thus, counter to the predictions of standard theory, the informal microfinance mechanism is far more successful in inducing entry into mutually beneficial contracts and ensuring that the contracts are performed.¹⁹

c. Land-titling: Detailed Empirical Evidence and Analysis

The elements of the land-titling model are simple: The design innovation of the model is the attempt to use collateral to overcome the problem of entry into the lending contract, premised on the assumption that the ability of the poor to provide collateral will overcome the reluctance of conventional banks to provide loans to them. Further, the land-titling programme adopts the external enforcement model where responsibility for enforcing the contract is vested in a third party — the State legal system. There are problems with both aspects of the contract between bank and borrower, as envisaged by this model.

i. Contract Design

With regard to the design of the contract, the fundamental problem is that it fails to create a sufficient inducement to enter into the contract for both parties — the lender and the borrower — for credit flow to increase.

Collateral and Credit

To begin with, it is doubtful whether the access-to-credit problem that the poor face is a function of the lack of collateral. Indeed, other factors like future cash flows may be more important factors. Field interviews appear to confirm this. As Pedro Ramirez, a

¹⁹ These repayment rates are even more impressive when contrasted with the very poor repayment record of the government credit initiatives that pre-date *Grameen*. See Dowla (2006), pp. 5-7.

Programme Officer at SUNARP, commented: “The bank does not want another property. It is much more important that people repay – which is why an employment record is far more important.”²⁰

Second, even if collateral were a material consideration, land markets robust enough to support the use of land as collateral are absent in most parts of the developing world.²¹ Carolina Trivelli, economist at well-known Peruvian research centre, *Instituto de Estudios Peruanos* (IEP) pointed to the issue of “missing markets”.²² A partial explanation may be that, given the constraints of affordability and housing stock, occupants consider themselves to be too poor to move up the property ladder and regard their land as family assets rather than as capital.²³ But, even more fundamentally, the model may fail to grapple with the ontological meaning of land for several communities in the developing world as something almost sacred, rather than a saleable asset.²⁴

Third, even if the markets existed, they would have to be perfect to overcome the problem of the low value of land offered as collateral. This problem is especially acute when compared with the high costs that the bank would have to incur to claim the land via the formal legal system.²⁵ Laureano Del Castillo, an eminent Peruvian property rights lawyer, now associated with the think tank *Centro Peruano de Estudios Sociales* (CEPES), made this argument: “According to De Soto, titling will fix everything. But 97 per cent of families in the rural areas are small individual farmers. What is the value of such a small piece of land? And, worse still, poor quality land?”²⁶

²⁰ Personal interview, on a field trip to the Patchacutec settlement outside Lima, 6th August 2008.

²¹ See, on this, Platteau (2000).

²² Personal interview, IEP office, Lima, 1st August 2008.

²³ See, on this, Finmark (2004); Tomlinson (2005).

²⁴ This is, in general, particularly true of indigenious communities of which Peru has a substantial number, particularly in the Amazon.

²⁵ See Arrunada (2003).

²⁶ Personal interview, CEPES office, Lima, 30th July 2008. See further, Del Castillo (2005, 2006a, 2006b, 2006c) in Appendix C.

The Rigidity of the Contract

Gilbert (2002), in a study on Colombia, argues that titled families may themselves be reluctant to take loans – intimidated by bank formalities or fearing default – preferring informal sources of credit. This is borne out by the evidence on the ground in Peru. For instance, Martín Valdivia, Research Director at one of Peru’s most prestigious think tanks, *Grupo de Análisis para el Desarrollo* (GRADE), asserted that the main provider of credit in the Peruvian shantytowns is the microfinance sector²⁷ – comprising both NGOs and government-run *cajas*²⁸. Further, Valdivia described the establishment of “credit bureaus” that have been collecting data for the last five years, and maintaining records on individual borrowers.²⁹ Carolina Trivelli elaborated on this theme:

“After the repayment crisis following the El Nino in 1997-8, commercial lenders have become very sceptical about lending. The compensating factor is a very strong microfinance sector. In particular the *cajas rurales* and the *cajas municipales* established in 1994 are the major source of credit. Initially, the *cajas* asked for land title but then realised that it is more or less useless. What can you do with 2 hectares of land in case of default? Even when the *cajas* hold the title, it is mostly for safekeeping. Although it appears to the borrowers that it is the same as taking collateral, the *cajas* keep it mostly so that they don’t use it as collateral elsewhere. The lender just wants to know that they have some sort of document from a government agency. In terms of access to credit, title makes no big difference, there are a lot more people titled than there are people using credit. There are issues on both the supply and demand sides. In particular, there are significant transaction costs involved and very little awareness in the countryside about using land as collateral.”³⁰

The microfinance sector in Peru is very competitive, she added, forcing formal lenders to relax requirements.

²⁷ Personal interview, GRADE office, Lima, 19th July 2008. This observation is interesting from the perspective of those who dispute that the Peru-Bangladesh comparison is valid; it would appear that the microfinance model outperforms the land-titling model even in a common context.

²⁸ Literally, “boxes”.

²⁹ Personal interview, GRADE office, Lima, 19th July 2008. He mentioned Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Micro y Pequeña Empresa (COPEME) as a particularly important network of MFIs. See further www.copeme.org.pe/

³⁰ Personal interview, IEP office, Lima, 1st August 2008.

Victor Endo – a Vice President at ILD – conceded that formal property ownership is just one of the factors determining the overall success of the programme in achieving poverty alleviation, and that there are several other factors at play including the ability to execute the collateral, reversions to informality, the expenses involved in the system (pertaining to land valuation, credit officials, lawyers and the like), banking regulations and the existence of land markets. He acknowledged, further, that the secondary markets may not come into existence spontaneously, and may need to be generated.³¹

ii. *Contract Enforcement*

On the issue of the enforcement of the contract, the problem is that the promise of enforcement is not credible.³²

High Information Costs

To begin with, at the theoretical level, the land-titling model is highly uneconomical in terms of information costs. Since the external enforcement model or formal law requires that breaches be both *observable* and *publicly verifiable*, the information costs associated with it are extremely high, particularly in the context of the information asymmetries of the developing world, making its prospects of success exceedingly weak.³³

Assumption of State Legal Capacity

The introduction of an isolated legal intervention, as the titling scheme attempts, is substantially meaningless in the absence of a “broader respect...for legal authority”.³⁴

³¹ Personal interview, ILD Head Office, Lima, 25th July 2008.

³² Since, in the case of the De Soto model, the credit contract does not, for the most part, come into existence, the discussion of enforcement problems is essentially hypothetical.

³³ See Stiglitz (1990); Hoff and Stiglitz (1990).

³⁴ Andre and Platteau (1998), p. 43. As Dasgupta (2003) argues the efficacy of a formal legal system is ultimately determined by enough agents opting in to the system of authority which is, in turn, a function of the twin factors of confidence in the enforcement agency and trust in the propensity of other agents to comply. Consequently, in the absence of the use of pure coercive force, the determinants of the success of a formal legal system are essentially *internal* rather than external. Similarly, in the Hoff and Stiglitz (2008)

This issue was a near-universal concern with policy-makers interviewed. Alexis Laguna, a public-interest lawyer, explained some of the problems with the Peruvian legal system:

“Problems exist at all levels. First, the best lawyers engage in private practice, so the quality of the public lawyers is very poor and only the worst lawyers choose to become judges. Second, there exists a strong Roman tradition that says that the judge must follow the law. Third, despite attempts at reducing corruption by removing ‘stained’ judges and increasing salaries, corruption persists. Finally, the sense of social responsibility is very limited, so there is minimal civic engagement with the judicial process. As a result there is a fundamental lack of faith in the legal system.”³⁵

Enrique Álvarez Calderón Alzamora of SUNARP added that for banks to foreclose, they would have to go through the judicial process, which is extremely long-drawn and expensive: “The bank typically wants to see that you own the property but it is not really interested in claiming it.”³⁶

Legitimacy Deficit

To be successful, an institutional reform needs to be considered legitimate. This, in turn, demands that it be seen as, at least largely, equitable.³⁷ Given that the courts are likely to consider the transfer of property from the poor to the banks highly inequitable, they are unlikely to enforce the formal law in the case of the land-titling model, thereby bringing it closer to the *de facto* informal system of regulation. Andre and Platteau (1998) further reiterate that the costs of implementing unpopular decisions by new legal bodies are likely to involve tolerating constant contestation, criticism and harassment not only from the disputant but also other stakeholders in the customary system.³⁸ Thus, the legitimacy

model, a sufficient number of agents have to believe that the “rule of law” will prevail in order to support it and act accordingly.

³⁵ Personal interview, *Pescadoes Capitales* Restaurant, Lima, 1st September 2008.

³⁶ Personal interview, SUNARP Head Office, Lima, 6th September 2008.

³⁷ The property rights reform attempted in Russia is a case in point. The highly unpopular reforms — making the wealthy elites better off at the expense of the masses — led to the rich actually taking their money out of the State rather than investing in it, as traditionally hypothesised, as a result of their insecurity. See further, Hoff and Stiglitz, 2008.

³⁸ p. 43-4.

of the reform ends up being crucial to its prospects of success. As Trivelli put it: “The community will be so hateful of any organisation that confiscates land that no one will want to become a client.”³⁹

Increased Uncertainty

Any system of contracts needs to balance the competing claims of certainty and flexibility. The theoretical merit of the land-titling programme is that the clear assignment of property rights is supposed to achieve *certainty* in transactions – and thereby efficiency. But this attempt at certainty comes at the cost of excessive rigidity. The more formal and rigid a contract, the clearer it is but also the more inflexible. The result of this inflexibility is a higher chance of default, higher concentration of land, greater inequality and more agency problems. Thus, even if the functional problems associated with the land-titling programme could be overcome, it may not achieve the most efficient outcome.

Moreover, even in legal terms, property is a relative rather than absolute concept – and may be limited in a number of situations.⁴⁰ Indeed, even in the developed world the protection of the right to private property is not absolute, and is fundamentally impacted by norms of use. This dimension of property is ignored within the absolutist interpretation of the land-titling model.

Finally, the scheme may actually heighten rather than reduce uncertainty as a result of the legal dualism it is likely to create: If the formal legal system fails to decisively trump the customary or informal system, the central goal of the titling process — increasing certainty in transactions — is defeated. The abrupt introduction of another tier in property dealings that fails to take root leads to the speculative use of the system — formal or

³⁹ Personal interview, IEP office, Lima, 1st August 2008.

⁴⁰ For instance, by the rights of a neighbour to trespass on property if it is the only way that he can administer insulin to his highly diabetic mother. Indeed, the relative nature of property rights has long been stressed by property rights lawyers; see, Gray and Gray (1998). See also Kennedy (2008).

informal — more convenient to the party in question, thereby increasing confusion in transactions.⁴¹

The reasons for the inefficacy of the land-titling programme are perhaps best summed up in the words of a key interviewee, Trivelli:

“There is a lack of understanding of the underlying issues that titling seeks to solve. For instance, a huge splash was created by the estimates of increase in real wealth of the poor, but this is premised on the working of markets and full institutions. But the markets for titled houses and assets don’t exist, and the legal system is not really a system but several unconnected pieces. Moreover, additional constraints of literacy, time, corruption and so on are huge barriers to the poor using the system. There are fundamental issues to do with access to justice that need to be confronted. Rural poverty, especially in the highlands, is deeply entrenched. For these communities, treading on the poverty line, the central issues are the basic provision of a social security net and creating market access. Finally, the problem of distribution of land has given rise to social conflict.”⁴²

d. Microfinance: Detailed Empirical Evidence and Analysis

The design of the implicit contract in the microfinance model is characterised by the absence of any formal barriers of entry. In contrast to the land-titling model, there is no collateral requirement. Further, no formal legal contract is relied upon by the Bank to ensure repayment.⁴³ The enforcement mechanism traditionally associated with the *Grameen* has been the mutual enforcement model, peer monitoring or joint liability (i.e.,

⁴¹ Several scholars have made this argument, see Mackenzie (1993), Platteau (2000) and Andre and Platteau (1998).

⁴² Personal interview, IEP office, 1st August 2008.

⁴³ It is a matter of some controversy whether a legal obligation – and hence a contract – between Bank and borrower “exists” in law or not. While there is certainly no written contract between Bank and borrower and the Bank neither intends that a contract exist nor takes legal action against borrowers in a court of law – it may be that the law, nonetheless, imputes a contract contrary to the intentions of the Bank. Since no legal action has in fact been taken by the Bank against a borrower, this remains a point of academic debate.

one group member's ability to borrow depended on the others repaying) – but is shifting to the pro-social disposition model.⁴⁴

i. *Contract Design*

In design terms, microfinance turns out to be extremely effective in inducing entry into the credit contract. This can be analysed in terms of two central factors – the absence of formal constraints (such as a collateral requirement) and the informal terms of the contract.

The Issue of Collateral

The insight that collateral is not central to the success of a credit-delivery mechanism in the developing world context is key to the success of microfinance. As former Bangladesh Bank Governor Ahmad Salehuddin put it:

“The key lesson for conventional banks is that collateral is not so important, especially given how difficult it is to claim through the judicial process. Since it is difficult to transpose the microfinance model socially, another lesson that conventional banks can learn is monitoring, especially a careful review of the lender profile.”⁴⁵

Some commentators – like human rights activist and founder of the Bangladeshi NGO *Nijera Kori*, Khushi Kabir – claim that microfinance loans are, in fact, collateralised.⁴⁶

⁴⁴ The shift from one model to the other is associated with the shift from *Grameen I* to *Grameen II*. While *Grameen I* can be seen as the “learner” microfinance model characterised by simple, rigid rules, *Grameen II* is meant for borrowers familiar with the microfinance philosophy but requiring greater flexibility. In addition, there is extensive evidence to suggest that even when “group liability” operated in theory, the group worked more as a monitoring, motivational and support device rather than financial joint-liability being strictly enforced. See, for example, Jain (1996).

⁴⁵ Personal interview at his residence in Baridhara, Dhaka, 21st April 2009. He adds an interesting insight: it may be possible to introduce some elements of “peer monitoring” or “peer pressure” into commercial lending by getting Chambers of Commerce and other such organisations to exclude defaulters from their activities.

⁴⁶ She argued that although the MFIs claim not to hold collateral, in effect, their practice of forced savings and the forced contribution to the “disaster” fund amounts to demanding collateral. She argued that these forced contributions amount to an insurance fund for the Bank. As evidence of the displeasure of the borrowers with this system of forced contributions, and especially the fact that they were not able to

But while MFI practices such as holding borrowers' savings and insisting on contributions to the "disaster fund" may be considered somewhat paternalistic, MFI workers insisted that these funds serve the best interests of the members.⁴⁷ However these practices are interpreted, it is difficult to argue with the Bank's assertion that it has broken the link between prior ownership of assets as a pre-requisite for obtaining credit – enabling several million Bangladeshi women to gain access to credit where they would otherwise have found it impossible to do so.

Flexibility of the Contract

Another aspect of the microfinance model that accounts for its success is the flexibility of the informal – or implicit – contract. On the demand side, or from the perspective of borrowers, the malleable terms of the contract encourage more people to borrow. But, on the supply side as well, the trust-based system turns out to be greatly advantageous. While, in the context of a more binary formal system, the terms of the contract are largely fixed and changing them could be an expensive process involving high information and procedural costs, the flexibility of the informal system allows shocks to be internalised.⁴⁸

ii. Contract Enforcement

In enforcement terms, the microfinance model appears to be able to successfully ensure the repayment of loans without the security that either formal legal contracts or collateral are considered to provide in conventional banking.

recover these contributions voluntarily, she described a movement that her organisation, *Nijera Kori*, organised against the system. Personal interview at the headquarters of *Nijera Kori*, Dhaka, 24th April 2009.

⁴⁷ The practice of forced savings was argued to provide insurance for the borrower in times of need, and is the first port-of-call when a borrower is facing repayment difficulties. Moreover, the "disaster fund" has served the Bank and its workers well during the frequent periods of floods, when the Bank assumes responsibility for substantial reconstruction. Rafique Ahmad, personal interview, field trip to Tangail, 21st March 2009.

⁴⁸ This flexibility is demonstrated by the recovery of *Grameen* in the wake of its 1998 flood-induced repayment crisis, where the redrawing of repayment schedules allowed losses to be recovered to a significant extent. This is quite impressive when compared with a financial crisis in the formal system that, typically, results in losses being written off completely. As an ongoing feature, *Grameen* retains the flexi-loans that allow individual borrowers to renegotiate their repayment schedules if they find it difficult to meet their original targets.

Credibility of the Threat of Punishment

The relative credibility of the threat of punishment – albeit informal – within the microfinance model is critical to its success – especially given the weakness of the State legal system in the context of a country like Bangladesh.⁴⁹ As lawyer Manzoor Hasan, Director of the Institute of Governance at BRAC University, explained:

“The threat of social and financial sanction on which microfinance organisations operate is far more real than the formal sanction of law courts. Even in the absence of an explicit contract, local forces are used to make sure that people comply. A lot of contractual relations in Bangladesh don’t work because the threat of being taken to court is meaningless. The sense of impunity is quite high and there is very little sense of redress.”⁵⁰

Peer monitoring and Information

The formal economic literature has tended to explain the high repayment rates of MFIs in terms of peer monitoring. Field research, however, indicates that this analysis misunderstands the reality on the ground. As Syed Hashemi, Director of the BRAC Institute of Development Studies and a leading economist studying microfinance, put it:

“The economic literature has never got the modalities of repayment right. Loans were always given individually, and the function of the group has always been limited to building social capital and reducing transaction costs. Peer monitoring is something that has been confined within textbooks and journals.”⁵¹

⁴⁹ This factor is anticipated in the theoretical literature by Stiglitz (1990), as well as Besley and Coate (1995). It was stressed by several interviewees in the field, but was emphasised, in particular, by Manzoor Hasan (personal interview, Office of the Institute of Governance Studies, Dhaka, 24th March 2009). There is some debate, however, with regard to the precise nature of this threat of punishment, or the reasons for compliance: the spectrum of explanations range all the way from successful “social capital” building efforts and the internalisation of positive social norms by members, to a process of rational decision-making on the part of members to comply – based primarily on economic interests, to the less benign explanations of the threats of social sanction and loss of reputation, and, worse still, to the use of coercive force by the Bank to ensure repayment.

⁵⁰ Personal interview, BRAC Institute of Governance office, Dhaka, 24th March 2009.

⁵¹ Personal interview at the office of the BRAC Institute of Development Studies, Dhaka, 17th April 2009.

Indeed, there is extensive evidence to suggest that even when “group liability” operated in theory, the group worked more as a monitoring, motivational and support device rather than via the strict enforcement of joint-liability.⁵²

Despite the inadequacies of this model, it does identify an extremely important aspect that contributes to its success – the economies that it affords in the information costs of monitoring. Since the mutual enforcement model – or informal law – requires that breaches be observable but not necessarily publicly verifiable, the information costs associated with it are inherently lower. Thus, Stiglitz (1990) establishes that this model has significant informational advantages over formal regulation since the community is far better poised than formal institutions to monitor the actions of borrowers – enabling it to better overcome the problems of “moral hazard”⁵³ and “adverse selection”.⁵⁴ These informational advantages are critical in allowing the flexibility of design discussed above, and allowing speculative defaults (i.e. an attempt at evading repayment) to be relatively easily distinguished from genuine ones (i.e. due to some unforeseeable circumstance such as a natural disaster or sickness in the family). Not only does this imply that these contracts have an in-built mechanism of insuring against risk – but they allow the lender to give loans to those considered riskier borrowers as well, making the system inherently more inclusive.⁵⁵ In addition, there are certain structural features specific to *Grameen*, such as regular repayment schedules that contribute to better monitoring.⁵⁶

⁵² Hashemi identified three “disciplining” conditions that explain why the poor pay loans back: first, the economic incentives (in particular, the fact that borrowers are not permitted to obtain subsequent loans without repaying); second, the “social capital” aspect of belonging to a group and an organisation; third, the social condition of power and hierarchy. Several other key interviewees stressed each of these as explanatory factors for the high repayment rates. See, for example, Jain (1996).

⁵³ This is a technical term used in the economic literature to describe the difference in behaviour between a person insulated from risk and another fully exposed to risk in a particular situation. On the advantages of the microfinance model in avoiding this problem, see Arnott and Stiglitz (1991)

⁵⁴ This is an economic term that refers to “bad” results in market processes that arise from buyers and sellers having asymmetric information. On the benefits of the microfinance model in dealing with this problem, see Ghatak (1999).

⁵⁵ Wydick (1999) finds evidence of this insurance dimension of group lending.

⁵⁶ See Armendariz de Aghion and Morduch (2000). A recent paper by Field and Pande (2008), however, finds, that a less stringent repayment schedule does not adversely affect repayment rates.

Economic Rationale of the Individual

Another reason, identified by interviewees, for why borrowers pay back is that it appeals to their individual economic rationality to do so. For instance, the threat of not refinancing borrowers who default further heightens the efficacy of the enforcement mechanism. Thus, despite the fact that no legal punishment is attached to default, borrowers have an incentive to repay in order to be able to obtain subsequent loans.⁵⁷

Mujeri stressed this factor:

“The MFIs are a great boon to the poor in their struggle for survival. They realise that if they don’t repay their access will be cut off. In addition, the group plays a role in creating peer pressure, as well as mutual support if someone is on the verge of defaulting. Finally, there is intensive supervision.”⁵⁸

Moreover, an increasingly important feature contributing to the desire for borrowers to maintain a positive reputation is the increasing inter-linking of markets, or, the expansion of *Grameen* into other markets that impact borrowers, thereby increasing the stakes in the relationship between bank and borrower.⁵⁹ *Grameen* has now diversified into areas as varied as electricity generation, information technology, education, telecommunications and textiles. These enterprises are designed to permeate the lives of borrowers in a

⁵⁷ See Stiglitz (1990) and Besley (1995).

⁵⁸ Personal interview, BIDS office, Dhaka, 18th April 2009.

⁵⁹ The argument is made by Hoff and Stiglitz (1990). Some of the *Grameen* enterprises include *Grameen Shakti* (energy), *Grameen Phone*, *Grameen Telecom*, *Grameen Cybernet*, *Grameen Communications*, *Grameen Solutions Ltd.*, *Grameen IT Park*, *Grameen Information Highways Ltd.*, *Grameen Trust*, *Grameen Fund*, *Grameen Shikkha* (education), *Grameen Star Education Ltd.*, *Grameen Knitwear*, *Gonoshastaya Grameen Textile Mills Ltd*, *Grameen Bitek Ltd*, *Grameen Uddog* (Enterprise), *Grameen Shamogree* (Products), *Grameen Capital Management Ltd*, *Grameen Byabosa Bikash* (Business Promotion), *Grameen Health Care Trust*, *Grameen Healthcare Services Ltd*, *Grameen Veolia Water Ltd*. and, the world’s first “social-business enterprise,” *Grameen Danone Food Ltd*. It is notable that *Grameen Bank* does not own any share in these companies. They are independent companies registered under the Companies Act and bound by all the tax and other obligations of any other company in the country. The only exceptions to this are the *Grameen Krishi* (Agricultural) Foundation and *Grameen Motsho* (Fisheries) Foundation, which were started by the *Grameen Bank* as separate legal entities. In addition, *Grameen Bank* stood guarantor for *Grameen Shakti* and *Grameen Motsho* (Fisheries) Foundation when they took loans from the government and other financial bodies.

See, further, Yunus (2007).

variety of different ways.⁶⁰ Other factors that add to the incentives of borrowers to maintain a good reputation include the attractiveness of the support services provided by the *Grameen* “bicycle bankers”.⁶¹

Social Capital and Norm Creation

Another set of interviewees analysed the efficacy of the microfinance model in terms of the institutional innovation of the “group mechanism”, successful attempts at social capital building and establishment of positive norms that are internalised by members. Hasan emphasised the aspects of the group mechanism that promote loan repayment:

“The fact that groups are homogenised and lending is mostly to poor women is important. In the early 1970s, with non-homogenous groups, the system didn’t work. Mixed groups of men and women were highly ineffective. Money entered the picture much later, when members of the group already knew each other. The social function of the selection of women as borrowers is crucial since the sense of responsibility of women, their commitment to the household and children and their traditional role as custodians of ‘family honour’ lend themselves well to the functioning of the mechanism.”⁶²

Sociologist-economist and cabinet minister in the “caretaker government”⁶³, Hossain Zillur Rahman highlighted another factor – the building of social capital:

“One of the key reasons for the success of the borrower-lender relationship within the microcredit paradigm is the mobilisation of social capital and the ability to tap into it. The second reason for its success is its organisational specificities: the ritual surrounding the formation of the

⁶⁰ The omnipresence of *Grameen* and some other leading Bangladeshi NGOs has led to speculation about their having become para-governmental organisations. See *The Economist*, 2001: “NGOs in Bangladesh: Helping or Interfering?”, September 13.

⁶¹ See Edgcomb and Barton (1998).

⁶² Personal interview, BRAC Institute of Governance, Dhaka, 24th March 2009.

⁶³ Mustafizur Rahman rather poetically described the era of the “caretaker government” in Bangladesh as the “rule of a few good men for a few years” (personal interview, Centre for Policy Dialogue Office, Dhaka, 27th March 2009). Although the government came into power supported by the military, popular consensus among interviewees appeared to be that its rule was far more “benign” than that of many supposedly democratically elected governments. For a very brief introduction to the “caretaker government” see Section III.A.2. above.

group, the idea of the weekly meetings and so on, help to create a strong group identity over and above the economic rationale of microcredit...The wider impact of the *Grameen* is not in the economic arena but in the psychological, socio-cultural domain. The real change is occurring in the domain of ideas.”⁶⁴

Hashemi suggested an interesting means of testing the relative importance of the “economic” and “social” rationales: “The real test is whether members pay back when they feel that an MFI is going bust.” Applying this test, he argued, that the fact that there were no mass defaults when the *Grameen* appeared to be “going under” in the 1980s provides evidence for the proposition that it is, indeed, creating norms amongst members.⁶⁵ This point was reiterated by Chairman of the *Palli Karma Shohayok Foundation* (PKSF), as well as of the Institute of Microfinance, Wahiddudin Mahmud:

“The crucial thing to note is that microcredit is habit forming. It becomes a norm that MFI loans are repaid, just as it is a norm that government agricultural loans are not repaid. In Bangladesh, it has now become a social norm to repay MFIs. The theoretical literature, variously attributing repayment to group liability, peer pressure and so on, is therefore irrelevant.”⁶⁶

Thus, the “social capital” explanation of the high repayment rates reported by the *Grameen* is attributable to not just the exercise of economic rationality by members (although this is why members may have started out paying loans back), but rather because it is a norm that they internalise, or, more simply – it becomes a habit. More importantly, if this account of the reasons that underlie repayment success is true, then critical to the success of the microfinance enforcement mechanism is its essentially participatory character that allows the problem of apathy of agents towards the system to be overcome and enforcement to be achieved through *internal legitimacy* rather than third-party enforcement.

⁶⁴ Personal interview, Power and Participation Research Centre (PPRC) Office, Dhaka, 29th March 2009. See, for an elaboration of this point, Zillur Rahman (2007).

⁶⁵ Personal interview at the office of the BRAC Institute of Development Studies, Dhaka, 17th April 2009.

⁶⁶ Personal interview at his Motijheel residence, 1st April 2009. PKSF will be discussed below.

Coercion

There is an increasing perception that the MFIs are now just “the new money-lenders” – rampantly employing coercion of various kinds in ensuring loan recovery.⁶⁷ Reports have emerged of a variety of acts of coercion by MFI workers, including refusing to let the dead body of a member be removed till debts were cleared⁶⁸; pulling down tin roofs of the huts of villagers⁶⁹; threatening mothers about the safety of their daughters and even driving women into prostitution in order to pay back debts.⁷⁰

According to Kabir the use of force – both violent and in the form of psychological pressure – is the norm rather than the exception: “These are situations in which the MFI is forcing people to repay who can’t. For the ground staff, everything – from their salary to their prospects of promotion – depends on their being able to collect repayment”.⁷¹ Professor Q. K. Ahmad, a well-known economist in Bangladesh, formerly at Dhaka University, who has now founded his own think tank, reiterated this point: “The purpose of the MFIs is to collect money; they will use any means available.”⁷²

Lawyers and human rights activists, in particular, expressed concerns about the lack of procedural propriety in MFI lending activities. They emphasised the importance of a “rights-based” approach to lending so that borrowers should not feel as though the loan provider “owns” them⁷³ – preferring the confiscation of collateral to the use of force as a means to recover loans. Tawfique Nawaz, a senior advocate at the Supreme Court and veteran politician, was especially emphatic, arguing that the mode of recovery adopted by

⁶⁷ Rahman (1999) and Mallick (2002) have argued that the use of coercion of various types by Bank workers is widespread in ensuring the recovery of loans; this was echoed in several field interviews.

⁶⁸ Samsul Bari, Personal interview at his Gulshan residence, Dhaka, 3rd April 2009.

⁶⁹ Q. K. Ahmad, Personal interview, Bangladesh *Unnayan Parishad* Office, 27th April 2009.

⁷⁰ Tawfique Nawaz, Personal interview, Sonar Bangla Hotel, Dhaka, 3rd April.

⁷¹ Personal interview, *Nijera Kori* Office, 24th April 2009. In response to the defence provided by many champions of microfinance, that there would be a “revolution” if there were widespread use of force, Kabir commented: “There should have been revolutions about many things.” She does, however, provide evidence of people organising against the microfinance organisations, see *Nijera Kori* Annual Report 2003-4, Table 22.

⁷² Q. K. Ahmad, Personal interview, Bangladesh *Unnayan Parishad* Office, 27th April 2009. See, for an elaboration of this point, *Unnayan Parishad* (2007), in Appendix C.

⁷³ For example Khushi Kabir, Personal interview, *Nijera Kori* Office, 24th April 2009.

the *Grameen* amounted to legal “molestation”.⁷⁴ Barkat, a Dhaka University Professor emphasised that internal coercion can be very problematic as well:

“Since 90 per cent of the time the person using the credit is the husband, and the person repaying the loan is the wife, the women spend many sleepless nights. In fact, polygamy is re-emerging as a function of microfinance since the more wives a man has, the more credit he can access. This, combined with the fact that there are many different MFIs providing loans means that there is a lot of credit in circulation, leading to borrowers being caught in a debt-trap. This makes ensuring repayment even harder for the MFIs and leads to the further use of force, higher interest rates and so on. It also results in greater domestic violence and heightened social unrest.”⁷⁵

Representatives of the MFIs and sympathetic observers, however, denied that the use of coercion is widespread. Yunus put it as follows: “Even if we could use force in Bangladesh, could we do that in New York, or in the many other countries in which we operate? It is not true that our borrowers have no ‘voice’. Even if they are not educated, their children are. Do you think that they would stay silent?”⁷⁶ According to Manzoor Hasan, the use of coercion is sporadic rather than a trend: “If pressure, extortion and intimidation were the norm, the whole scheme would have failed. To what extent can you intimidate, and how would the NGOs have achieved this?” He reiterated that without co-operation at a very high level, the scheme would not have worked, and that lapses are very much the exception or aberration to a scheme supported by a very high measure of consensus. Hasan emphasised that maintaining discipline is essential, training borrowers to understand, observe and enforce rules, but that some NGO workers may “miss the wood for the trees” and take things too literally. This, according to Hasan, is the main

⁷⁴ Tawfique Nawaz, Personal interview, Sonar Bangla Hotel, Dhaka, 3rd April. Despite the fact that the functioning of the Bank is authorised by the Grameen Bank Ordinance Act 1983, Nawaz argued that its operations were “unlawful”. He pointed out that under The Usurious Loans Act (1918), The Money Lenders Act (1933) and The Money Lenders Act (1940) two features emerged – the regulation of the quantum of interest and the modalities of recovery – by which the *Grameen* ought to be bound. Under this body of law, the creditor has certain facilities for pursuing the debtor. For instance, the loan officer has the powers to act as a certificate officer and is allowed to make a determination, in writing, as to whether there was a failure to pay. Further, since 1940, if recovery was not elicited through written notice, this would be called “molestation”. Not only does the *Grameen Bank* never issue written notice, but all the devices they use would, according to Nawaz, fall into the category of “molestation”.

⁷⁵ Telephone interview, 2nd May 2009.

⁷⁶ Personal interview, Grameen Bank Headquarters, 20th April 2009.

source of the lapses. In addition, microfinance projects tend to be very labour intensive, and for them to be sustainable, it is important that a business-like perspective be adopted, especially since a large majority of MFIs are now striving to be self-sustaining.⁷⁷

Imran Matin, a Vice-President at BRAC and long-time microfinance researcher, provided a different explanation, attributing the problem of the use of coercion to the growing competition in the microfinance sector in Bangladesh and to what he calls “management failure”:

“The average loan size for an MFI is very small, Tk. 5000-6000. Therefore there has not been much growth in the size of loans. The problem of 'overlapping'⁷⁸ is occurring because MFIs are being risk averse in not increasing the size of loans, and the current size of individual loans does not satisfy demand. As a result of 'overlapping', however, the 'weakest lender' gets paid off last. This is the main inducement to use force. The increase in coercion is essentially a function of the fact that there are too many players. The smaller MFIs are the biggest problem...There are bound to be some lapses, especially since credit officers are under pressure to both disburse and collect loans, as is necessary for MFIs to run. But in most cases, the use of coercion is a function of management failure. For instance, there are many instances of one group member taking loans from everyone else in the group. But a good manager would have formed the groups better. The manager is cheating and trying to make his life easier by allowing members with a greater credit absorption capacity into the group.”⁷⁹

In reality, the success of the enforcement mechanisms adopted by the microfinance model probably lie in a combination of the elements discussed above. Although there does appear to be evidence of the sporadic use of force, it appears unlikely, on balance, that the membership base of *Grameen* – and other MFIs – could have reached millions if this were the dominant mode of enforcing repayment.

⁷⁷ Personal interview, BRAC Institute of Governance Headquarters, 24th March 2009.

⁷⁸ This refers to the growing phenomenon in Bangladesh whereby borrowers take loans from more than one MFI. This is discussed at length below.

⁷⁹ Personal interview, BRAC Centre, 29th April 2009. He did add, however, that the use of force by bank workers is taken very seriously by BRAC, recounting a 2008-incident involving a long-term defaulter who was physically abused by BRAC branch officers, loan collectors and other group members. The legal aid branch of BRAC took legal action against BRAC, compensation was paid to the family and the amount was deducted from the employee's salary.

2. In “Equity” Terms

a. The Model of “Equity”

In this section, the equity aspects of the two schemes are compared in terms of both economic outcome variables such as income, investment, employment and property ownership of essentially instrumental normative interest, as well as welfare indices of inherent value such as gender equity, access to education, access to healthcare and nutritional status.⁸⁰

b. Overview of Empirical Evidence

The land-titling programme does not directly address welfare indices of inherent value, but rather, attempts to address them tangentially via economic variables of instrumental normative value. Nonetheless, this section considers whether, in the first place, the economic variables targeted by the programme are effectively impacted and then, whether these variables in turn give rise to improved welfare indices. On the other hand, although *Grameen* started out as a credit access programme, its agenda quickly evolved to become far more broad-based – adopting what policy-makers in Bangladesh are calling a “microfinance plus” approach.⁸¹ *Grameen* targets economic variables mainly through an attempt to increase income through access to credit, but also facilitates property ownership (both through funding the acquisition of “business assets” and the provision of housing loans), engages in employment generating activities and provides direct avenues and instruments of investment and insurance. It is also increasingly pro-active in its approach to welfare indices of inherent value. Its focus, so far, has most explicitly been on education — it provides education loans and scholarships, as well as funding for

⁸⁰ The concepts of “welfare” or “equity” are notoriously difficult to measure, but the lead of “human-development” type approaches is followed to look at a list of basic dimensions that are widely accepted to impact “welfare”. To reiterate a point that has already been made, this section neither claims to provide an entirely satisfactory definition of welfare, nor an exhaustive account of the welfare impacts of the programmes. Data from a variety of sources is considered, rather, to provide some indicative evidence on programme performance.

⁸¹ Mustafizur Rahman was one of many interviewees to use this phrase (Personal interview, CPD office, 27th March 2009).

schools. In addition, it has started to address nutritional concerns through the production of high-nutrient, low-cost food products and clean, low-cost drinking water.⁸² It is currently working actively to extend its reach to the healthcare sector.⁸³ Its commitment to gender empowerment is explicit — lending almost exclusively to women.⁸⁴ However, given the prominence that the microfinance experiment has achieved, there is surprisingly little objective – and recent – data on its performance.⁸⁵ In the discussion that follows, the available data is used to provide a very general account of programme performance.

c. Land-titling: Detailed Empirical Evidence and Analysis

i. Economic Variables

Looking first at the economic variables that the land-titling programme targets, the evidence is mixed. There are certainly some advantages associated with the programme. Indeed, the ILD claims a total of \$18.4 billion in net benefits from the programme in Peru between 1992 and 2007.⁸⁶ It claims that 11 million Peruvians below the poverty line now legally own their urban and rural real estate assets as a result of 1.8 million rural real estate assets and 1.7 million urban real estate assets having been formalised in this period, including 382,100 businesses belonging mainly to the poor. It asserts, further, that the net value of the urban real estate assets titled has increased by \$2.9 billion owing to the

⁸² This refers to the collaboration between *Grameen* and the French yogurt manufacturing company, Danone, to produce low-cost yogurt high in nutrients aimed specifically at overcoming some of the nutritional deficits of Bangladeshi children. See Yunus (2007). *Grameen* has also recently entered into collaboration with the French company, Veolia, to establish *Grameen Veolia Ltd*, to supply low-cost, safe drinking water in Bangladeshi villages. This is particularly crucial because of the presence of arsenic in Bangladeshi water.

⁸³ Initiatives involving healthcare are mainly *Grameen Healthcare Trust* and *Grameen Kalyan*. See further, Yunus (2008).

⁸⁴ Aspersions have been cast on the motivations of the *Grameen* for lending to women. Mallick (2002) argues that this choice is prudential rather than ideological, since women borrowers are easier to administer than men. This accusation is reiterated by some NGOs in Bangladesh like *Nijera Kori*. Whatever the initial impetus for lending to women, it does not detract from the social impact of the choice.

⁸⁵ There was a surge in studies of microfinance in Bangladesh in the early and mid 1990s. But there are few recent studies not produced by the MFIs themselves. The most recent comprehensive study referred to repeatedly by interviewees was Khandker (1998) – now over a decade old. Further, any “impact studies” on microfinance are mired in the methodological controversies of the “Pitt-Murdoch debate”. See Pitt and Khandker (1998), Murdoch (1998) and Murdoch (1999).

⁸⁶ ILD (2008), Appendix C.

programme. Moreover, according to the ILD, formalised urban owners have saved \$196 million in red tape costs.⁸⁷

How can these claims be evaluated? It has, undoubtedly, increased formal property ownership of the poor, with several million legal titles having been distributed in Peru alone. Indeed, irrespective of the legal effectiveness – or lack thereof – of titling, the granting of official deed to previously landless squatters or poor farmers may in itself have political and self-esteem effects that are important. Thus, there is some evidence to indicate that titling may have not only the economic impacts traditionally predicted by theory, but may also lead to greater political assertiveness.⁸⁸

Moreover, the programme has achieved great economies in the cost and time involved in the titling process.⁸⁹ Even commentators who were generally sceptical of the titling scheme – like Trivelli – agreed that the actual implementation of the programme is considered to have been quite efficient, especially in Lima. She pointed out, however, that the titling process has proved to be far more complex than initially anticipated: in the highlands, Andean valley and jungle, for instance, the issues are much more complex than in the outskirts of Lima. There are issues of communal land rather than individual land, and no good records exist. Documentation is further complicated, she pointed out, by many factors such as landowners wanting to underestimate the size of the plot in order to save on service bills.⁹⁰ Further, as Eduardo Zegarra of GRADE pointed out, there are situations in which complex – and politically charged – conflicts of property rights exist between the mining companies and villagers.⁹¹

Moreover, Javier Escobal, also of GRADE, expressed concerns about a reversion to informality. He estimated that as many as 20 to 30 per cent of titled families may have reverted to informality. Moreover, titling is limited to granting of formal rights over

⁸⁷ *ibid.*

⁸⁸ The Rural Development Institute finds evidence of these effects in the case of China, see for example Prosterman (2001) and Prosterman and Hanstad (2006).

⁸⁹ The cost is estimated to have dropped from around \$2,000 to \$50 and the time taken from 15 years to 6 weeks. See Panaritis (2001), p.22.

⁹⁰ Personal interview, IEP office, Lima, 20th August 2008.

⁹¹ Personal interview, GRADE office, Lima, 19th July 2008.

property that they already, in effect, control (i.e. that it is a land-*titling* rather than land-*reform* programme, not involving redistribution), the value of the programme amounts to any gains that may accrue from the change from *de facto* to *de jure* ownership. The phenomenon of squatting has a long tradition in Peru, Escobal commented, and informal rights are very well entrenched.⁹²

However, there is evidence of some other economic benefits. First, titling may lead to increased household investment.⁹³ Indeed, it stands to reason that greater security of land rights – even if notional rather than real – would stimulate investment. But whether overall investment actually increases, given that credit supply does not increase, has been questioned.⁹⁴ Second, some studies find that titling leads to increased labour force participation rates. This is hypothesised to be due to the fact that titled families need to spend less time defending their property, leaving them more time to devote to productive activities.⁹⁵ However, the validity of this now well-known finding by Field (2007) – cited widely by advocates of the programme – has been brought into question, especially by Mitchell (2005).⁹⁶ Indeed, many other local commentators observed that the foundations for security of occupation may be diverse, and that titling may only have made an appreciable difference in newer, more insecure communities.⁹⁷ At the same time, titling may have certain positive social effects associated with increased security of ownership and the creation of relatively settled communities.

⁹² Personal interview, *Jose Antonio* Restaurant, 21st August 2008.

⁹³ Galliani and Schargrodsky (2005). Prosterman and Hanstad (2006) also find evidence of security of land rights leading to increased investment. Despite this function of titling having been emphasised greatly in the theoretical literature (see for instance, Demstet, 1967), it is not clear from the empirical evidence that it is essential for investment. A number of studies show that perceived security of tenure is more important than exact legal status. See for instance, Payne (1989), Razzaz (1993), Varley (1987).

⁹⁴ See Carter and Olinto (2000).

⁹⁵ See Field (2007) and Galliani and Schargrodsky (2005).

⁹⁶ He attacks Field's findings on a number of counts. First, he argues that she does not make the case that lack of title gives rise to a particular need to defend the property, especially in a context where legitimacy can have varied bases. Second, he contends that she fails to account for the new jobs that titled families were absorbed into in a period of economic downturn. Finally, and most crucially, he argues that the very basis for making the comparison—the fact that the sequence of titling was random—is false. In particular, he points out that a third of the data for non-titled families is drawn from the Huancayo region—the birthplace of the “Shining Path” and the epicentre of political conflict in Peru and that this data is, consequently, not representative. See p. 309.

⁹⁷ This point was stressed by Valdivia (personal interview, GRADE office, Lima, 19th July 2008) and Trivelli (personal interview, IEP office, 1st August 2008)

However, the land-titling programme grants apparently more secure rights of ownership to the poor while, simultaneously, making rights of ownership far more easily alienable. Indeed, the social impacts of the potential loss of land by the poor may be highly undesirable. The titling programme adopts an “all or nothing” strategy of inducing the poor to put at stake their major asset or resource — their land. As their only means of insurance, the impact of its loss would likely be disproportionately severe, and may result in landlessness. The strategy is rendered even more risky because it is proposed in the absence of any public welfare schemes — such as healthcare or food subsidies, training or assistance programmes with regard to the use of resources — increasing the likelihood of distress sales of land. An alternative, less risky approach would be to offer a part of the produce of the land as collateral instead of the land itself.

In addition, the titling programme throws up the problem of inequities of initial access: Current occupation of land by squatter families may not be an equitable way of distributing land. Indeed, inherent in the titling scheme is that the completely landless — the most destitute in a community — are left out of its ambit altogether. Further, it is those who were most successful in breaking the law before the reform that are not only rewarded by it, but also expected to become “law-abiding citizens” overnight.

ii. *Welfare Variables*

Turning now to the welfare impacts of the titling programme, it is clear that it does not directly address issues of health, education, nutritional status and so on. In fact, the titling scheme is not attached to any explicit social agenda. The starting point of the programme is the existing power allocation. It is not concerned with existing inequities, but rather, attempts merely to leverage existing power allocations to achieve a more efficient outcome. Its primary concern is with the economic losses that are associated with “dead capital” as a result of untitled land in the developing world. In that sense, both the positive and negative social effects of this programme are incidental. Nor have titling programmes, with their focus on achieving social change through efficiency

enhancement, diversified organically into different social sectors in the way that the microfinance movement has.

Some studies show evidence of a tangential impact on school attendance of children of titled families,⁹⁸ but no direct evidence of the other indices improving as a result of participation in the programme, except through any increases in income that may result from increased labour force participation.⁹⁹ Research in the field did, however, reveal that there are certain social benefits associated with the titling programme. One of the crucial ancillary benefits, that Calle stressed, is that it facilitates access to municipal social services, such as water and electricity, in Peru's shantytowns: "There is a town close to Lima that has been without water and electricity for 20 years, for instance, but it is impossible to provide these facilities without blueprints."¹⁰⁰ COFOPRI has been trying to play an increasingly active role in attempting to provide the information that will enable these facilities, according to him, and an attempt is now being made to set-up these services at the same time that titling takes place.¹⁰¹

Titling has also been found to have a positive effect on some indices of gender equity.¹⁰² In cases of joint titling, in particular, a positive impact has been found on the woman's position in the household.¹⁰³ In addition, titling has been found to be associated with decreased household size. Again, this is attributed to a reduction in the need to maintain large families for reasons of security¹⁰⁴ and to increased contraception use and decision-making power on the part of women.¹⁰⁵

⁹⁸ See Field (2007); and also Galliani and Schargrodsky (2005). The ILD uses Field's result to calculate that "child labour has been reduced by 28 per cent among formalised urban property owners", see ILD (2008) in Appendix C. The basis of this calculation is not made clear in the report.

⁹⁹ Galliani and Schargrodsky (2005), however, do not find evidence of increased labour income as a result of titling.

¹⁰⁰ Personal interview, COFOPRI Headquarters, Lima, 7th August 2008.

¹⁰¹ *ibid.*

¹⁰² See COFOPRI (2002) and Fort (2008) in Appendix C.

¹⁰³ Field (2003). Datta (2006) puts forward similar findings in the context of India.

¹⁰⁴ Galliani and Schargrodsky (2005).

¹⁰⁵ Field (2003).

However, the gender-effects titling need to be seen in perspective. Indeed, titling is frequently associated with the loss of the customary rights of the most vulnerable. Since, due to the complexity and nuance of customary rights, it is impossible for registration merely to recognise and record accurately existing rights, it invariably involves some *de facto* reallocation of rights.¹⁰⁶ Further, since the sections likely to have the most significant interface with the formal system are the most-privileged, this reallocation will presumably be at the cost of the most vulnerable leading, inevitably, to a legitimacy-deficit in the reforms. In this way, customary rights and insurance mechanisms are likely to be destroyed by the registration process. Platteau (2000) and Andre and Platteau (1998) find compelling evidence of this in the context of Rwanda. Cousins *et al.* (2005) reiterate this in the context of South Africa. Specifically, several studies find that titling has an adverse impact on women's rights where it formalises already-existing inequities of power,¹⁰⁷ or erodes systems of customary justice.¹⁰⁸ Further, although some empirical studies find that the social justice problem can be overcome by explicitly registering land in the name of women, it is particularly difficult for them to access the formal justice system to vindicate their rights.¹⁰⁹ Indeed, even targeted programmes in general tend to benefit those who are best off within the class they target.¹¹⁰

Finally, titling may be extremely vulnerable to the appropriation of rights by the powerful. While formal registration losing the nuance of customary rights may be prevalent within the process, registration may be — worse still — vulnerable to intentional manipulation by the elite. Indeed, the more unequal a society, the higher the likelihood of such exploitation of vulnerable categories by officials and others. Widespread evidence of this can be found in Thailand¹¹¹, India¹¹², Latin America and the

¹⁰⁶ Barrows and Roth (1989), p. 21.

¹⁰⁷ Lastarria-Cornheil (1997).

¹⁰⁸ Ensminger (1997), Kevane and Gray (1999), Hare, Yang and Englander (2007).

¹⁰⁹ Lastarria-Cornheil, Agurto, Brown and Elisa Rosales (2003) and Fenrich and Higgins (2001). A recent article by Joireman (2008) emphasises both customary law and women's rights as serious factors that the land-titling programme will need to contend with.

¹¹⁰ For instance, the Indian system of reservation for the Scheduled Castes and Scheduled Tribes tends to benefit the socio-economic class within the caste that least needs the reforms, frequently called the "creamy layer". Thus, despite titling targeting squatters, it may fail to impact the neediest among them. See further, Agrawal and Gonsalves (2005).

¹¹¹ Thomson *et al.* (1986) and Feeny (1988).

¹¹² Wadhwa (1989) and Viswanath (1977).

Caribbean¹¹³, Uganda¹¹⁴ Nigeria¹¹⁵ and South Africa¹¹⁶. Given the particularities of property rights conflicts in Peru, i.e. the muddy nature of property rights in the Andes and the Amazon, and the highly politicised issues of land ownership by foreign mining companies, these risks are likely to be substantial.

c. Microfinance: Detailed Empirical Evidence and Analysis

i. Economic Variables

The impact of *Grameen* on economic variables of interest is considered first. To begin with, *Grameen* reports that average household income is 50 per cent higher for members in *Grameen* villages than residents of non-*Grameen* villages. These estimates of increased income are backed by some objective third-party assessments.¹¹⁷ Despite its contribution to poverty reduction, however, *Grameen* has been criticised for the high interest rates that it charges.¹¹⁸

Moreover, participation in the *Grameen* programme is claimed to be associated with a decrease in poverty. The *Grameen* Bank has developed a list of ten indicators that it uses to assess whether members have moved out of poverty. These pertain to housing, access to clean drinking water, school enrolment, size of loan, sanitary facilities, access to clothing and mosquito nets, ownership of assets, savings, access to adequate nutrition, and access to healthcare.¹¹⁹ On the basis of these indicators, the Bank claims that of

¹¹³ Stanfield (1990).

¹¹⁴ Doornbos (1975).

¹¹⁵ Zubair (1987).

¹¹⁶ Cousins *et al.* (2005).

¹¹⁷ These studies include Khandker (1998) and Hossain (1988).

¹¹⁸ See, for instance, Ahmad (2007), Ch. 5.

¹¹⁹ The specific criteria are as follows: First, it asks if the family lives in a house worth at least Tk. 25,000 or a house with a tin roof, and each member of the family is able to sleep on a bed instead of the floor. Second, it asks if family members drink pure water out of tube-wells, boiled water or purified water. Third, it asks if all the children in the family over six are going to school or have finished primary school. Fourth, it considers, if the minimum weekly loan instalment of the borrower is Tk. 2000 or more. Fifth, it looks at whether the family uses a sanitary latrine. Sixth, it examines whether family members have adequate clothing for everyday use, warm clothing for winter and mosquito nets. Seventh, it assesses if the family has access to additional sources of income like vegetable gardens, fruit-bearing trees and the like to fall back on. Eighth, it considers if the borrower maintains an average annual balance of Tk. 5000 in her

approximately the eight million current borrowers, 64 per cent are already over the poverty line.¹²⁰ *Grameen* workers do admit, however, that there are approximately ten million poor people in Bangladesh still untouched by the Bank.¹²¹ Further, *Grameen* reports that a significantly smaller proportion of *Grameen* members live in poverty (20 per cent) compared with non-*Grameen* members (56 per cent).¹²² Several independent studies also find evidence of reduced poverty indices in *Grameen* households¹²³ and improved socio-economic status.¹²⁴

The positive impact of participation in a microfinance programme at the household level was confirmed by several interviewees. Mustafizur Rahman, the Executive Director at a leading Bangladeshi think tank, Centre for Policy Dialogue (CPD), asserted that MFIs have had “a *fundamental* impact on poverty”.¹²⁵ As he put it: “Given the failure of the government to provide for the basic needs of the people, the household level support provided by microfinance has made a fundamental difference to the prospects of survival of the poor. In a country like Bangladesh Tk. 5000 can make the difference between a family – particularly the women of the family – eating or not.”¹²⁶

Baqi Khaliliy, Executive Director of the Institute of Microfinance and well-established microfinance researcher made a similar point:

“That microcredit has a positive impact, in some sense, is fairly trivial. If you decrease the liquidity-constraint of a household, welfare is increased. The overall effect will vary depending on what you do with the finances. Microfinance is working in the short run. The real issue is that, in the long run, unless enough of a surplus is generated, the short run impacts will be

savings account. Ninth, it asks if the family faces any difficulty in having three square meals a day, i.e. if any member of the family goes hungry at any time of the year. Finally, it considers whether, the family can take steps to seek adequate healthcare if a family-member falls ill.

¹²⁰ Yunus (2008)

¹²¹ This figure was provided by Rafique Ahmad (Personal interview, field trip to Tangail, 21st March 2009).

¹²² *Grameen Bank* website.

¹²³ Hossain (1988).

¹²⁴ Wahid (1994). Some studies, for instance Ebdon (1995), argue that the pressures of scaling up and a pre-occupation with performance indicators lead to a reluctance on the part of the Bank to make risky loans, even if this means leaving out the most disenfranchised. *Grameen II*, however, attempts to address these issues through its “beggar programme”.

¹²⁵ Personal interview, CPD office, Dhaka, 27th March 2009.

¹²⁶ *ibid.*

wiped out. At the moment, no comprehensive longitudinal study exists, although there is some evidence of positive welfare impacts...The contribution of MFIs has to be seen more holistically. Given that the government has failed to provide a safety net for the poor, the MFIs have, at least, contained poverty and prevented its increase. The financial services that the MFIs provide significantly aid the survival of the poor. In this sense, MFIs greatly ease the burden on the government. The contribution of the MFIs to poverty reduction is, consequently, three fold – the direct contribution, the contribution towards containment of poverty and the reduced pressure on the government.”¹²⁷

Salehuddin commented that although it is difficult to estimate the contribution of the *Grameen Bank* to GDP, it has made a substantial contribution to the SME and informal sectors: “Overall the impact has been very positive. Poverty in Bangladesh would have been much worse without the contribution of the MFIs.”¹²⁸

These claims are not, however, undisputed. Lawyer and founder of Dhaka-based think tank, Research Initiatives Bangladesh (RIB), Samsul Bari reported that the “findings on the impact of microfinance are totally negative”.¹²⁹ Further, serious concerns were raised about the failure of microfinance to have a decisive impact on poverty at the macro level in Bangladesh, as well as the ability of the microfinance model to pave the way to a more broad-based economic transformation”. As former Dhaka University professor Q. K. Ahmed put it: “If the claims of the MFIs are true, why is 50 per cent of Bangladesh still poor? It is not in the interests of the MFI to allow members to ‘graduate’. It only leads to a decrease in their numbers.”

Moreover, Barkat pointed out that microfinance has not been able to reach the ultra-poor but has, at best, reached the lower echelons of the middle classes and the upper echelons of the absolute poor. He also stressed that loans tended to be used mostly for consumption rather than productive purposes: “There is a problem with the idea that the poor can use microcredit to build assets and that borrowers need to start repaying within weeks of receiving the loan. For instance, if a person takes credit to buy a cow, the cow

¹²⁷ Personal interview, Institute of Microfinance Office, Dhaka, 19th April 2009.

¹²⁸ Personal interview at his Baridhara residence, Dhaka, 21st April 2009.

¹²⁹ Personal interview at his Gulshan residence, Dhaka, 3rd April 2009. On the findings of the institute, see <http://www.rib-bangladesh.org/>. This assertion is supported by Ahmad (2007).

can only be sold in one year. In the meanwhile, how can she repay the weekly instalments?”¹³⁰ Finally, the problem with the “scale” of economic activities supported by MFIs was highlighted. According to Mujeri: “The NGOs are aware of the scale problem. Most NGOs are involved in quite low-tech, traditional ventures, and without increasing the capital intensity of these ventures, the surpluses generated will always be very small...It is crucially important to establish linkages with the wider market.”¹³¹

In addition, the failure of microfinance organisations to address structural issues was a recurring theme in interviews.¹³² To quote Q. K. Ahmad: “Without looking at the wider power structure of the village, you cannot achieve a transformation. Empowerment can only be achieved through health, education and so on. It is time for microcredit plus.”¹³³

ii. *Welfare Variables*

The direct impact of *Grameen* on welfare indices is considered next. Several commentators attributed credit for Bangladesh’s surprisingly good performance on social indicators, such as the Millennium Development Goals, to the microfinance movement. As Mahmud emphasised, “The key contribution of the *Grameen* is its social impact. You cannot prove directly that this is because of microcredit, but developments like a demand for contraception and a shift from ‘quantity’ to ‘quality’ of children have occurred at a lower level of income than expected, and it can be hypothesised that MFIs have played a significant part in this.”¹³⁴

As discussed above, obtaining membership to the *Grameen* requires internalising a number of different types of prudential practices like memorising the “sixteen decisions”. In addition, although there is little substantive interference with how the loans are used, members are provided with ongoing assistance in the form of encouragement and trouble-

¹³⁰ Personal interview, Dhaka University campus, Dhaka, 2nd May 2009.

¹³¹ “Muri” is puffed rice snack consumed all over Bengal. Personal interview, BIDS office, 18th April 2009.

¹³² This point was stressed by Kabir of *Nijera Kori* (personal interview, *Nijera Kori* office, Dhaka, 24th April 2009) as well as Mujeri (personal interview, BIDS office, Dhaka, 18th April 2009).

¹³³ Personal interview, *Unnayan Porishad* office, Dhaka, 27th April 2009.

¹³⁴ Personal interview at his Motijheel residence, Dhaka, 1st April 2009.

shooting advice in the face of financial difficulties. There is evidence of these non-credit, participatory aspects having a positive effect on self-employment profits.¹³⁵ Indeed, the agency-empowerment dimension of the scheme is one of its key assets. Moreover, *Grameen* is found to have specific welfare impacts. In particular, various studies have found positive effects on contraception use by women.¹³⁶

Moreover, the *Grameen Bank* is considered to have made a significant contribution to gender equity, particularly in the context of Bangladesh. The fact that 97 per cent of *Grameen* borrowers are women is an achievement in its own right, especially in a country where a stigma is attached to women undertaking activities outside the home.¹³⁷ In addition, studies have found a positive impact on decision-making capacity within the household and a number of other empowerment indices.¹³⁸ This is unsurprising given the explicitly redistributive agenda of the *Grameen* with regard to women—transferring resources and power to a section of society deprived of it.¹³⁹ For instance, to consolidate the woman's position in the household, mortgages given out by the Bank are always made in the name of the woman as a disincentive against her husband divorcing her. Moreover, although there is some evidence of increased domestic violence in the short run,¹⁴⁰ other studies find that the *Grameen* mechanism paves the way to greater assertiveness on the part of women and reduced domestic violence, particularly over time.¹⁴¹ In addition, positive impacts have been found on specific welfare indices such as women's health.¹⁴² Further, as is now widely documented, targeting women is associated with normatively desirable distributional impacts. Pitt and Khandker (1998) find that

¹³⁵ McKernan (2002).

¹³⁶ Schuler and Hashemi (1994), Amin, Li and Ahmed (1996), Schuler, Hashemi and Riley (1997).

¹³⁷ Accusations have, however, been levelled against the *Grameen* with regard to the appropriation of funds by husbands. Indeed, Rahman (1999) estimates that men, in effect, control as much as 60 per cent of *Grameen*. However, on a relative estimate, women still have greater access to resources than under the conventional system of loans being made directly to the men in the family. In fact, studies by Van Tassel (2004) and Ligon (2000) find that, given the degree of male dominance in Bangladeshi society, the involvement of the husband in the loan venture might even be financially prudent.

¹³⁸ Schuler and Hashemi (1994), Hashemi, Schuler, and Riley (1996), Osmani (1998) and Pitt, Khandker and Cartwright (2003).

¹³⁹ Hasan stressed the importance of this change in “power dynamic” (personal interview, Institute of Governance at BRAC University, Dhaka, 24th March 2009).

¹⁴⁰ Rahman (1999).

¹⁴¹ Schuler, Hashemi, Riley and Akhtar (1996) and Schuler, Hashemi and Huda Badal (1998).

¹⁴² Nanda (1999) in a study on microfinance in India.

annual household consumption expenditure increases by Tk. 18 for every additional Taka borrowed by women from these credit programmes, compared with Tk. 11 for men. Mujeri at BIDS, summed up the position well:

“One of the windfall gains of the MFI experience has been women’s empowerment. This was not motivated by idealism, but rather by prudential considerations – it is easier to lend to and recover loans from women. But the access to income has transformed these women fundamentally – both psychologically and socially.”¹⁴³

Finally, microfinance makes a significant contribution to releasing the untapped economic potential of the female labour supply in Bangladesh. Emran, Morshed and Stiglitz (2007) explain that microfinance works essentially due to imperfections in the capital and labour markets. Where even one of these markets functions perfectly, capital and labour move seamlessly to each other, but in the more realistic context of imperfect markets, microfinance harnesses the untapped labour power of unemployed women in the home, thereby evening out capital-labour ratios. In this way, a productive section of the population, women, left out of the labour market due to market imperfections, are brought into it. Zillur Rahman pointed out the importance of this factor in accounting for the success of the microfinance movement.¹⁴⁴

B. ANALYSIS OF INSTITUTIONAL LEARNING

In this section, the institutional learning from the land-titling and microfinance programmes will be considered. Both programmes attempt to put forward solutions to the collective action problem – one through primarily formal means and the other through principally informal devices. The implications of the institutional performance of the programmes for broader issues of legal design are discussed.

¹⁴³ Personal interview, BIDS office, Dhaka, 18th April 2009.

¹⁴⁴ Personal interview, Power and Participation Research Centre (PPRC) Office, Dhaka, 29th March 2009.

1. Land-titling: Realisation of Limitations and Emphasis on Informal Aspects

The consensus amongst both field interviewees and in the academic literature appears to be near-ubiquitous that the land-titling programme has failed, in some significant sense, failed to achieve its avowed purposes. This pronouncement on the overall performance of the programme was delivered not only by impartial third-parties to the programme such as researchers at Lima-based think tanks involved in studying the programme, but was acknowledged by some of the most senior officials at the main agencies responsible for the implementation of the programmes, i.e. at ILD, COFOPRI, SUNARP and, even, the World Bank.¹⁴⁵ Interestingly, however, this has not led to a move towards the abandonment of the programme, but instead led to quite significant institutional “learning effects”. As Valdivia at GRADE put it, “It is now widely recognised that at least the credit effects of the titling programme have failed; policy-makers are looking to usher in a new wave of the initiative looking beyond just credit.”¹⁴⁶

The ILD, itself, now recognises the limitations of the titling programme. Victor Endo, Vice President, International Affairs admitted: “Titling is a necessary but not a sufficient condition for credit.”¹⁴⁷ While attempting to dismiss the findings that titling did not lead to increased access to credit by arguing that the “drying up” of credit was the function of an international crisis and that credit was not even available to the rich, he explicitly added that “soft” expertise of the MFI-type could be crucial to the future success of the scheme. In particular, he emphasised that information is extremely important. Thus, for instance, it is vital to set-up databases to track credit scores.¹⁴⁸ He also stressed that greater flexibility with regard to the definition of property than had been displayed in the past was in order, stating that there was no “off the shelf” definition. He emphasised, however, the need for harmonisation. Thus, while more complex property rights systems

¹⁴⁵ Interestingly – and perhaps significantly – field interviews revealed that of the agencies listed, the approach adopted by the World Bank was the least critical. Rodorigo Palacios of the World Bank, for instance, refused to admit that the programme has failed to have the predicted credit-effects (personal interview, World Bank office, Lima, 15th August 2008).

¹⁴⁶ Personal interview, GRADE office, Lima, 19th July 2008.

¹⁴⁷ Personal interview, ILD Head Office, Lima, 25th July 2008.

¹⁴⁸ *ibid.*

such as communal holdings or forest lands, may call for greater flexibility in how they are allocated, he maintained that formalisation is essential.¹⁴⁹

According to Rafael Arribas, International Affairs Officer, also at ILD, a prime example of this spirit of innovation is provided by ILD's initiatives in Tanzania.¹⁵⁰ As Arribas described it, the country had no public registry for land or contracts, but only the equivalent of "primitive notaries". While the "best practice" would be a nationwide integrated computerised system of the type established in Peru, the existing system was more along the lines of a "one man army" – with the same person responsible for taking pictures, interviewing witnesses, and, indeed, performing all the necessary functions for registration. The operation of these "notaries" was "extralegal" in the classical sense of ILD's definition of the term, but it was clear that the introduction of computers would be too expensive for the government. Thus, the ILD opted to give these pre-existing agents the power to act as "official notaries" while incorporating some changes to practice. For instance, these "notaries" were instructed not to burn all their documents, and to maintain some records so that the information gathered did not die with the agent.¹⁵¹

Interviews at COFOPRI also provided evidence of "institutional change." According to Calle of COFOPRI, while the Peruvian programme was "just a titling programme" until three years ago, in its current phase – or, more specifically, since January 2007 – the programme has started to undergo significant changes.¹⁵² In particular, it has started to focus explicitly on the "cultural" aspects of implementing the programme – that were, until now, ignored. As Calle put it: "What can they do with their titles if they don't know *how* to use it?"¹⁵³ Calle described the features of the new programme, now engaged not just with titling but, rather, with the promotion of what he called "a culture of formalisation".¹⁵⁴ As he explained, "*Campasinos*"¹⁵⁵ have been migrating to the cities in

¹⁴⁹ *ibid.*

¹⁵⁰ Personal interview, *Rosa Nautica* Restaurant, Lima, 27th July 2008.

¹⁵¹ *ibid.*

¹⁵² Personal interview, COFOPRI Headquarters, Lima, 7th August 2008. On COFOPRI's strategy for future reforms see COFOPRI (2007a) in Appendix C.

¹⁵³ *ibid.*

¹⁵⁴ *ibid.*

¹⁵⁵ Spanish for "country dwellers".

large numbers for the last 30 years. The houses they live in have not changed, but their families have grown.”¹⁵⁶ The programme, according to Calle, will try to emphasise the importance of individual space as an important economic motivational device. In addition, Calle added, several migrants who left to come to the cities just abandoned their original land. It is important, he argued, to formalise this abandoned land. Finally, the programme will start to focus directly on trying to teach beneficiaries how to use title, for example, by going to the bank, improving houses and using credit to improve houses. Calle pointed out that as people have children, a section of the family often has to live on the roof. But once these families are titled, it is hoped that they will have the motivation to build on the property.¹⁵⁷ These cultural factors will be addressed through the medium of advertisements, as well as personalised visits to, and meetings with, beneficiary households. As Calle summed up the rationale behind the changes: “It is hard to formalise without changing mind-sets.”¹⁵⁸

When asked about the motivations behind the changes in the thrust of the programme, Calle cited various factors.¹⁵⁹ Politically, the new President coming into power was an impetus for a fresh direction – the Garcia government promised 800,000 new titles when it came into power. He claimed that at the time of the interview nearly half of these had already been distributed. The second reason behind the shift, he argued, was the declining interest in the titling programme, and the realisation that one of the reasons that the titling program was declining was the neglect of the cultural aspects of the programme, or, as he put it, “it became clear that the attitudes of people needed to change.” Finally, according to him, this shift is part of a broader socio-economic transition: “Forty-four per cent of Peru is poor and by 2011 the President wants to bring it down to ten per cent. In fact, the rate of poverty has already gone down. It was 49 per cent when he entered office.” Calle explained that the Garcia government has adopted a twelve-point socio-economic programme to address the problems of poverty, with a particular focus on a more equal distribution of the benefits of growth, and COFOPRI is one of the key programmes. The new government is committed, in Calle’s opinion, to a bottom-up approach to poverty

¹⁵⁶ *ibid.*

¹⁵⁷ *ibid.*

¹⁵⁸ *ibid.*

¹⁵⁹ *ibid.*

alleviation: “Of the 1800 districts, 800 are poor with poverty levels of 80 to 90 per cent. A majority of COFOPRI programs will be based in these areas.”

Calle concluded that the problems of development – and poverty – in Peru could not, ultimately, be solved through the medium of just formal law: “The problem with the law is the difference between the ‘official’ and the ‘real’. Twenty-eight thousand laws exist in Peru, but they are very ineffective. Law in Peru has been turned into an instrument of control rather than development. The problem of development is ultimately cultural.”

Along these lines, Lucia Fort, Gender Development Specialist at the Gender and Development Unit of the World Bank, currently working on a “business training” programme for titled women, argued the following:

“A lot of women have been titled, but there’s not too much evidence of them doing too much with their titles. It is now clear that titling does not increase access to credit, since financial institutions are not ready to provide credit on the basis of title and people with title do not want mortgages. In addition, crucially, people did not know what to do with their titles. The question that prompted this program is – what can be done to improve the efficacy of the titling program for women? This programme will attempt to change the institutional context, so that women have better access to labour markets, financial markets, product markets and land-titling.”¹⁶⁰

However, the critical aspect of the World Bank’s new “business training” programme is the insight that supplementary support mechanisms are essential – land-titling by itself will not bring about the outcomes initially envisaged by De Soto and the agencies involved in implementing the programmes.

2. Microfinance: Decline in Productivity and Movement Towards Formalisation

Despite the generally positive reports on the performance of the microfinance sector in Bangladesh, the reality on the ground is even more complex than reported by the

¹⁶⁰ Personal interview at her Miraflores residence, Lima, 3rd August 2008.

academic literature. In particular, field interviewees expressed serious concerns about its declining productivity. One of the root causes of the problems facing the microfinance sector was identified as the excessive number of MFIs operating in Bangladesh. Mujeri of BIDS emphasised this point:

“We do not know how many NGOs are operating in Bangladesh, but typically, there will be more than one NGO operating in a village in any given sector. A recent survey reveals that each household is part of three to five NGOs on average. However, the Law of Diminishing Returns has kicked in with the microfinance industry. The sector was very productive initially, but now the productivity is diminishing. This is a function of several MFIs operating within the same space and funding the same kinds of activities. If the repayment rates are kept artificially high, the whole edifice may collapse. The NGO sector used to be very cohesive, but now there is a great deal of infighting... There is a need for a second-generation revolution to build on and consolidate the transformations of the first generation. For instance, even the innovation in microfinance – the ‘sister companies’ – are fractured initiatives, rather than an integrated package. This makes it difficult to exploit synergies. What is in order is a set of integrated, well-designed and well sequenced reforms, implemented with a great deal of positive energy.”¹⁶¹

Some commentators implied that the reason for the “boom” in the microfinance sector was the lure of profits, or its transition from being a means to an end to being an end in itself, i.e. that the sector is now largely motivated by the goal of sustaining itself rather than alleviating poverty. Indeed, Bari described microfinance in Bangladesh as a phenomenon of “*elish maccher tel diye elish maach bhaja*” – or, metaphorically, describing the industry as “fish frying in its own fat”.¹⁶² As Bari asked, “Why does Bangladesh have thousands of MFIs? Because they want to do good, or because they want to do good business?”¹⁶³ In particular, this is argued to have led to several undesirable features of the microfinance model including very high interest rates, an excessive drive to expand subscription, a tremendous pressure to recover loans, and a

¹⁶¹ Personal interview, BIDS office, Dhaka, 18th April 2009.

¹⁶² “Elish” or Hilsa is a bony fish that is considered a great delicacy in Bengal. Personal interview, 3rd April 2009.

¹⁶³ *ibid*

degree of mechanisation accompanying expansion. Q.K. Ahmad reiterated this point asking, “The MFIs are self-sufficient and self-sustaining, but are its borrowers?”¹⁶⁴

One of the most pernicious impacts of the operation of several MFIs in the same village is the problem of “overlapping” – or borrowers taking loans simultaneously from more than one MFI. Borrowers often resort, as Kabir of *Nijera Kori* pointed out, to borrowing from one MFI to pay back a loan to another, resulting in their getting caught in a debt-trap.¹⁶⁵ Even Yunus admits that overlapping is a problem.¹⁶⁶

Another outcome of the continued informal operation of the microfinance sector, particularly in its presently over-crowded state, is increasing incidents of fraud. The most prominent example of this was the case of JUBOK¹⁶⁷ but this is certainly not an isolated phenomenon. The problem of the threat of fraudulent activities on the part of MFIs is exacerbated given their attempts to obtain permission to hold savings from their depositors.

The response of the microfinance sector to the criticisms raised is a move towards formally regulating the sector. These developments were described by Zillur Rahman.¹⁶⁸ Until recently, microfinance in Bangladesh was not regulated. MFIs were typically registered under The Societies Act or, alternatively, as trusts. Thus, while the microfinance provider had a legal status, the activity was not itself subject to legal regulation. One of the main motives behind this, he elaborated, was to avoid the stifling effect of over regulation by the Co-operatives Act. The *Palli Karma Shohayok Foundation* (PKSF) was established by the government in 1990, but is now largely self-

¹⁶⁴ Personal interview, *Unnayan Parishad* office, Dhaka, 27th April 2009.

¹⁶⁵ Personal interview, *Nijera Kori* office, Dhaka, 24th April 2009.

¹⁶⁶ “Overlapping does happen. Often one woman will be a member of more than one microcredit organisation and will provide each different organisation with a different name. When asked why she does this, she will say that each of those different names are really her name – that she was called by one of those names as a child, that she’s been called by a different name since getting married and so on. By allowing overlapping, the microcredit organisations are offsetting each other. They need to stop this phenomenon just to look out for themselves.” ADD REFERENCE

¹⁶⁷ Jubo Karmasangsthan Society (JUBOK) was a non-governmental organisation involved in microfinance, but also running several other businesses. On the JUBOK scandal, see further ‘Jubok asked to return money to depositors’ in *The Daily Star*, July 7th 2006

¹⁶⁸ Personal interview, Power and Participation Research Centre (PPRC) Office, Dhaka, 29th March 2009.

driven- working as a credit “wholesaler” to establish standards, streamline procedures and provide funding to start-up NGOs.¹⁶⁹ Given the recent developments, however, Zillur Rahman reported that preparations for the establishment of the new Microcredit Regulatory Authority (MRA) are underway that will establish entry barriers, but will also have the ability to raise capital through the share market and deposits.¹⁷⁰ The *Grameen Bank*, of course, will not be under this organisation since it was set up according to specific legislation – the Grameen Bank Ordinance Act 1983.

Mahmud elaborated on the clauses of the Act that would establish the MRA:

“The clauses of the Act are relatively relaxed. With regard to repayment by borrowers, it remains completely voluntary. At a secondary level, however, it introduces formal legal regulation. Via the Public Demands Recovery Act, 1913 mechanism, PKSf can now seize the assets of NGOs. If an MFI goes bust, the first claim on assets lies with borrowers whose savings were held by the MFI, and the second claim lies with PKSf. However, both the borrower-MFI and the MFI-PKSf repayment rates have been very high at 99 per cent so it is hoped that this eventuality will arise relatively rarely.”

Many observers in Bangladesh see this move towards formalisation as inevitable. As Atiur Rahman, the Governor of Bangladesh Bank put it, “Trust-based regulation works very well in the context of a small organisation. But as an organisation grows, you need a wider regulatory framework. Microfinance in Bangladesh is suffering the pangs of these ‘transition issues’.”¹⁷¹ He emphasised, however, that MFIs should not be treated as ordinary banks, and that innovation must be exercised in developing a regulatory framework for microfinance. Rahman expressed particular concern on this point since, he argued, the central bank has a tendency to be quite “heavy-handed”. He was sensitive to the fact, however, that the “culture” of microcredit must be understood and, in particular, that the “participatory style of MFIs should not be stifled”. With reference to microfinance, he saw his key challenge as the new Bangladesh Bank Governor one of mediating the tensions between regulating the sector while maintaining its flexibility.

¹⁶⁹ See further, http://www.pksf-bd.org/about_pksf.html

¹⁷⁰ See further, <http://www.mra.gov.bd/>

¹⁷¹ Personal interview, Dhaka University Campus, Dhaka, 7th May 2009.

Salehuddin agreed with this point: “The government monitors the activities of *Grameen Bank* via the Board: *Grameen* reports to the Board and the Board reports to the government. Bangladesh Bank does not, however, monitor *Grameen* like it monitors other banks, nor do I think it should. It would have a stifling effect.”¹⁷² Under the new system, Salehuddin explained, the Bangladesh Bank Governor will be the ex-officio Chairman of the MRA, and regulation will be exercised through this. As Salehuddin argued, “Bangladesh Bank should not run microfinance, it does not understand it well enough.”¹⁷³

IV. ANALYTICS

The empirical analysis of the two credit-access programmes in the previous section looked, first, at “programme outcomes” (providing an overview of performance outcomes at a “given” moment in time) and, second, at “institutional learning effects” (attempting to trace their trajectories of institutional evolution). The analysis of performance outcomes of the programmes will, thus, be discussed as the “static” analysis and of institutional learning effects as the “dynamic” analysis.

A. STATIC ANALYSIS: IMPLICATIONS OF PERFORMANCE OUTCOMES

The case studies illustrate the limits of the formalist model. Indeed, contrary to the predictions of the current orthodoxy, the informal model performed better than the formalist model in terms of performance outcomes.¹⁷⁴ This section attempts to analyse the reasons for this.

¹⁷² Personal interview at his Baridhara residence, Dhaka, 21st April 2009.

¹⁷³ *ibid*

¹⁷⁴ This finding does not claim to be entirely novel. Indeed, there exists a rich literature on both legal and economic informality generally. Moreover, empirical studies have been available for some years now that establish the substantial failure of the Peruvian land-titling programme to increase access to credit, and for even longer chronicling and attempting to analyse the successes of the microfinance movement in Bangladesh. In that sense, the results of the original qualitative interviews conducted in this study confirm what was already known.

The essential difference between the approaches taken by the land-titling and the microfinance programmes respectively is that while the former adopts a *linear* model of development, the latter adopts a *systemic* one. Linear models of development, of which the Washington Consensus approach is typical, assume that there are certain critical variables in the “development equation” that can be identified, with predictably direct impacts on the development process. Indeed, it is this perspective that informs the essential premise of the land-titling programme that stimulating growth – and thereby reducing poverty – in the developing world is a question of implementing a single strategic intervention, land-titling to bring “dead capital” alive. The problem with this position is its failure to capture iterative and feedback effects, and to recognise crucial linkages between economic systems, legal systems and social systems. It is this pitfall that the microfinance model avoids with its more integrated approach.

The position adopted by the land-titling programme rests on a set of interrelated assumptions about economic, legal and social systems. To begin with, the land-titling programme is premised on the assumption that the main factor – or transaction cost – impeding the proper functioning of markets is the absence of formal rights. It assumes further that the *procedure* of titling will, by itself, lead to increased credit access – without a deeper engagement with the enforcement mechanisms that would enable this. Thus, the process of titling land is assumed to correct for market failures, and agents are assumed to be able to transact more or less costlessly. This theoretical reflects the popular, if inaccurate, interpretation of the Coase Theorem that argues that in the absence of transaction costs, economic efficiency is not concerned with how property rights are assigned as long as they are clearly assigned. While the microfinance model is also founded, essentially, on an acknowledgment of the dynamism of the market mechanism, it recognises the inherent imperfections in the functioning of markets, and the pervasiveness of barriers to access within markets. Thus, the solution that it presents to the problem of access to credit by the poor is more *substantive* – providing loans directly and without formal procedural requirements. In the light of the insights of Stiglitz and others into the imperfections that developing world markets are riddled with – ranging

from externalities to information asymmetries – it can be argued that the characterisation of markets on which the microfinance model is based is far more realistic.

Further, the exclusive focus on economic variables of *instrumental* interest, rather than welfare variables of inherent interest, that characterises the land-titling programme stems also from the broad assumption of perfectly functioning markets, since welfare indices are assumed to be best-served by targeting economic variables. Again, this idea can be traced at least as far back as Hayek. The microfinance programme, however, has always had an explicit focus directly on welfare variables of *inherent* normative interest as a result of both a lack of faith in the market mechanisms to provide them spontaneously, as well as in deference to their importance for the success of the market process. This position is premised on the characterisation of markets as advanced, for instance, by Polanyi, and on the rejection of what Stiglitz has called the “neoclassical dichotomy” – or the separation of the economic and political.

The most important factor that accounts for the relative success of the microfinance model over the land-titling model is its use of a more effective enforcement mechanism. But this, again, is rooted in the relative engagement of the microfinance model with social, economic and legal realities.

The land-titling scheme hinges on further assumptions about the functionality of other parts of the system that are also over-simplistic. For instance, the working of the titling mechanism assumes a well-functioning legal system but here, again, the approach of the land-titling programme is “top-down”. It assumes not only the superiority of State-enforced law over more community-based regulatory devices, but also the feasibility of replicating Western legal models in the developing world context. This perspective assumes a view of the law that is excessively *formalistic*, vesting paramount faith in law as written down in statutory form. This, however, is to assume that by merely writing laws down, their effect can be achieved. It assumes, further, that once laws are written down, they can be interpreted and applied completely objectively, eliminating any role for norms. This is infeasible for any legal system. Finally, in both its approach to markets

and to legal systems, the land-titling programme fails to account adequately for social context. It ignores, for example, the argument that the capacity of economic agents to reap the benefits of the market system may be premised on access to certain basic social services. But most critically, it neglects the evidence that the best way of implementing the law is not through *external imposition* but rather through drawing agents into the system through a process of building internal legitimacy. This set of assumptions was seen to be quite standard within the paradigm of the rule of law orthodoxy.

The microfinance model, on the other hand, focuses not on a written code but rather adopts an *informal* view of the law as lived practice. While legal informality continues to be inadequately theorised, this approach to enforcement is anticipated by, for instance, Ostrom. Finally, and most crucially, the microfinance model works because it is able to effectively solicit the participation of agents in the enforcement of the system by drawing them into it through building up *internal* legitimacy. It is this final point that accounts for its relative success in overcoming the collective action problem in the context of the developing world.¹⁷⁵ Again – while an adequate theory to explain this phenomenon is lacking – the concept of social capital helps to explain the relative efficacy of the *Grameen* model.

B. DYNAMIC ANALYSIS: INSTITUTIONAL LEARNING EFFECTS

The case studies demonstrate the inadequacies of the formality-informality dichotomy in the theoretical literature. Thus, although the microfinance model has worked extremely well for several decades and across a network of several million borrowers not only in Bangladesh but abroad as well, it is now organically evolving towards formalisation or codification of its learning. Similarly, the land-titling programme in Peru in its second and third waves is incorporating the lessons from their own learning, i.e. without the

¹⁷⁵ If anything, the *Grameen* model is being criticised, particularly within Bangladesh, for not adopting an even more all-encompassing approach. The Bangladeshi NGO *Nijera Kori*, for instance, argues that even the “microfinance plus” model is overly simplistic in thinking that these interventions will alter the fundamental power dynamics within Bangladeshi villages without engaging more closely with structural issues at the community level. See <http://www.nijerakori.org/>. This objection is further articulated in Barkat (2008). This point is also made by Ahmad (2007).

appropriate informal aspects of the programme – whether described in terms of establishing a “legal culture” or creating the right “cognitive” framework – formal reform efforts can have, at best, a limited impact. This section, thus, turns to the dynamic analysis, or a consideration of the institutional learning effects of the two models.¹⁷⁶

In embarking on this discussion it is helpful to keep in mind Rodrik’s distinction between “tacit” or “specific” models of the microfinance-type (that are inherently local and rooted) and “general purpose” models or “blueprints” like land-titling (that lend themselves, at least in theory, to replication). These distinctions are not absolute – thus there are elements of the “general” in the more “specific” models and elements of the “specific” in the “general” – and may be thought of as points along the institutional spectrum. But this nomenclature does help to identify an institutional conundrum that is otherwise ignored by the theoretical literature, but is amply illustrated by the case studies: the problem that the microfinance model may be confronting is that it is not general enough while the weakness that the land-titling model almost certainly faces is that it is not specific enough.

1. Evolution of the Land-titling Model

Despite the focus of the land-titling model on legal formalisation, it does not completely ignore elements of informality – or what De Soto and the ILD call the “extralegal”. Indeed, De Soto advocates “listening to the barking dogs” – or taking account of the realities of the informal economy and integrating elements of this into the formal code. In addition, both De Soto’s writing and the work of the ILD are based on extensive empirical research on the informal economy in Peru. To that extent, both the intuitions and the empirical foundations on which the land-titling programme is based are sound. The problem lies in the conclusions that are drawn.

¹⁷⁶ These dynamics are often studied using a game theoretical approach. See for instance, Aoki (2001) and Greif (2006). While insights from game theory go a long way in helping us understand these institutional mechanisms, in the present situation it provides only a partial explanation. Game theory explains cooperative action largely as a strategy adopted based on calculated payoffs from repeated games. This does not explain, however, why some *Grameen* members continued to repay loans even when the threat of *Grameen* sinking seemed very real in the wake of the 1998 flood-induced crisis. The explanation of this phenomenon may lie in the fact that the *Grameen* may have succeeded in fostering a positive, long-term habit. On norm-creation and “tipping points”, see Granovetter (1978).

As Upham (2002) argues, the empirical evidence that De Soto uses to make the case for formality could more easily be used to make the case for informality.¹⁷⁷ But despite the initial sensitivity of the research on which the land-titling scheme was based to issues of informality, it was ultimately due to its neglect of these issues – and indeed, the alternative lessons that it could have learnt from its empirical base – that it failed to perform better. It is to these issues of context to which the programme is forced to return to in the current period. Indeed, key representatives of all the major stakeholders in the programme – the ILD, COFOPRI, SUNARP and the World Bank – have admitted that the programme has failed to have the predicted effects and that it is crucial in the next “wave” of the programme to turn to the “cultural” aspects of reform that were, until now, ignored. Thus, the ILD is adapting its own practice to incorporate a more flexible approach in the advice that it provides to developing countries; COFOPRI is shifting its focus from the titling programme in the narrow sense to the promotion of a “culture of formalisation”; the World Bank is introducing elements of informal diversification into the programme, such as business training for women.

The phenomenon of “top down” Western-style legal reforms that fail to “take root” in the context of the developing world is by no means a new one. This is the problem of “transplantation” that, in some sense, applies to all of the developing world vis-à-vis the formal Western-style legal structures that were inherited in the colonial period. Since then, transplantation was attempted by the first law and development movement, and, then, in the context of the transition economies. Each of these attempts has, largely, resulted in failure. A significant part of the explanation for this may be the attempt to introduce laws ahistorically and out of context – failing to account for pre-existing

¹⁷⁷ Evidence is provided of the vitality and dynamism of the informal sector in Peru compared to the stagnating formal economy. As Upham puts it: “The phenomena that de Soto describes provide powerful evidence of the possibility of sustained and complex economic activity, at least on an individually small scale, without structure or protection provided by a formal legal system. The lesson more commonly drawn from de Soto’s work, however, is that the isolation of poor Peruvians from law has seriously limited their economic opportunities and, in turn, the general economic growth of Peru. Instead of weakening their faith in the need for formal law, de Soto and those influenced by him call for the official recognition of the informal economy and its inclusion within a dramatically restructured formal legal system. They argue that legalization of the rights of those in the informal sector under this new regime would give them greater access to credit and legal protection for large-scale investment.” Upham (2002), p. 11

structures. Given this rather overwhelming body of historical evidence, however, the prospects of success of the current rule of law orthodoxy will depend on its ability to distinguish its attempts at formalisation from these rather substantial attempts at social engineering of the past. So far – and from the evidence that the land-titling programme provides as an illustrative example – it appears to have failed to do so. Nonetheless, it may be true that formal law can sometimes be used to “seed” norms. Indeed, in the well-functioning legal systems of the developed world, it may be argued that this is the principal mechanism of law enforcement. To the extent that this aspect of the formal legal systems of the West can be replicated in the developing world, formal law may have some positive effects, but obeying the law is, itself, a norm that, like all other norms, must evolve out of the context.

2. Evolution of the Microfinance Model

Although it is accurate to classify the *Grameen Bank* as substantially informal in its relationship with borrowers – especially since there exists no formal contract between Bank and borrower, and default on the part of the borrower is not regulated by formal legal sanction – the Grameen itself is not an entirely “informal” institution. As described above, it started as a series of experiments in various Bangladeshi villages – but consolidating those experiments into what is now the *Grameen Bank* required formal law, i.e. the Grameen Bank Ordinance Act 1983. Thus, despite the fact that the *Grameen* is able to maintain contractual relations with so many million borrowers without needing to resort to formal law – the institution operates within the framework of a more formal legal system in Bangladesh.

Similarly, the mounting pressure for change to the microfinance model that is observed in the current period is also the result of an attempt at “scaling up”. In particular, although microfinance in Bangladesh was seen to have a positive impact on welfare at the household level, it is widely acknowledged that its impact on aggregate poverty has been

negligible.¹⁷⁸ It would, thus, appear that the prospects of shifting its impact from the micro to the macro level depend on it either extending its reach¹⁷⁹ as well as, critically, increasing the scale of the ventures that poor families are able to tap into, thereby allowing them to access larger surpluses and thus be lifted out of poverty more effectively.¹⁸⁰ Both developments are currently underway in Bangladesh.

To begin with, there has, in recent years, been a considerable increase in the number of MFIs operating in Bangladesh – although data on the exact scale of the phenomenon are not available.¹⁸¹ The proliferation in the number of MFIs has, however, led to the problem of “overlapping” – or borrowers taking loans simultaneously from more than one MFI. Indeed, borrowers are reported to resort to borrowing from one MFI to pay back another, thereby getting caught in a “debt trap”.¹⁸² The expansion of the sector has also been associated with an increase in the incidence of fraudulent activity.¹⁸³ Another form that the expansion of the sector is taking is the increasing diversification into “social businesses” – or higher scale business ventures that poor families would be unable to establish in their own right that either provide crucial social services to the poor at subsidised rates or allocate part of their surpluses to the poor.¹⁸⁴

It is significant that this “scaling up” of operations is accompanied by an increasing move towards formal regulation. The microfinance sector as a whole – and particularly the entry of new organisations into the sector – is, progressively, more formally regulated. This phenomenon started with the *Palli Karma Shohayok Foundation* (PKSF) and has

¹⁷⁸ To reiterate what was already stated in the last chapter, Khandker (1998) estimates that the annual impact of microfinance on poverty is as little as one per cent.

¹⁷⁹ Reliable data are not available for the current coverage of the microfinance sector in Bangladesh. Some interviewees claimed that coverage was now universal while others claimed otherwise – a senior *Grameen* Bank worker reported, for instance, that there were at least ten million poor people in Bangladesh excluded from the programme.

¹⁸⁰ The importance of this factor was stressed by Mustafizur Rahman (personal interview, CPD office, Dhaka, 27th March 2009).

¹⁸¹ Khalily estimated, in a personal interview, that there are over 1000 MFIs operating in Bangladesh in total.

¹⁸² Kabir

¹⁸³ For instance JUBOK, discussed above.

¹⁸⁴ This is the “microfinance plus” model referred to above. The bigger MFIs – *Grameen* and BRAC – are particularly active in this process of diversification. Matin estimated, however, that 95 per cent of MFIs do not exclusive provide microfinance, but are involved in other activities as well (personal interview, BRAC Centre, Dhaka, 29th April 2009). On the “social business” model, see further Yunus (2007).

now been extended to the Microcredit Regulatory Authority (MRA). Moreover, the “social businesses” which are increasingly the focus of established MFIs are, for the most part, regulated like any other business enterprise – by formal law.¹⁸⁵ These developments indicate that while a trust-based system seems to work effectively in regulating small transactions between the microfinance organisation and a network of up to several million individuals, as the size of transactions get bigger and the unit of regulation becomes larger (i.e. organisations rather than individuals), formal law becomes more necessary.¹⁸⁶

These empirical developments accord with the predictions of theory. Dixit (2004) has stressed that the expansion of the market may demand a more generalised form of trust that will allow anonymous actors to transact with each other on a wider scale on the basis of a mutual trust in the institutions of the economy rather than a network in which, as Dasgupta (2003) puts it, “names” and “faces” matter. This is somewhat analogous to the move from the barter to the money economy, facilitating exchange on a wider scale.¹⁸⁷ Stiglitz (2000) argues that the pressures of economic growth may, itself, limit the scope of informal regulation.¹⁸⁸ Thus, while the microfinance sector in Bangladesh was small – dominated by a few key players – entry into the sector did not need formal regulation, but as the number of players increased and incidents of fraud began to occur, there arose a need to regulate the sector.¹⁸⁹

¹⁸⁵ See further, <http://www.pksf-bd.org/> and <http://www.mra.gov.bd/>

¹⁸⁶ It is well known, of course, how important non-formal aspects of business, even between very large organisations, are. See, for instance Macaulay (1963).

¹⁸⁷ For instance, a *Grameen Phone* subscriber purchases a subscription not on the basis of a personal trust in the service provider, but rather, as a more impersonal market transaction. *Grameen Phone* is both one of the earliest and most successful of *Grameen's* “social businesses”. It is a joint venture between *Grameen Bank* and the Norwegian telecommunications company, Telenor. It is now the largest telecommunications service provider in Bangladesh. The reputation of the *Grameen Bank* is, however, a crucial factor behind the success of the venture.

¹⁸⁸ It was thought that as markets get stronger and communities less close-knit—or at any rate more mobile—the settled communities on which *Grameen* relies may be destroyed. The experience of *Grameen America*, the new *Grameen Bank* branch in Jackson Heights, New York – belies this intuition. Despite operating in the US and in an urban context, repayment rates have been around 99 per cent. See <http://www.grameenamerica.com/>

¹⁸⁹ A recent incident of fraud underscoring the need for regulation was JUBOK. See, for instance, *The Daily Star*, May 25, 2006. The over-supply of microcredit in the absence of regulation is leading to the problem of overlapping – or borrowers taking loans from one microfinance organisation to repay loans to another. Concern about this development was expressed repeatedly in personal interviews.

V. TOWARDS A THEORY OF INSTITUTIONAL EVOLUTION

This section attempts to draw out the implications of the “static” and “dynamic” analyses presented above. Two overarching themes emerge. First, from the static analysis, it would appear that there are important lessons to be learnt about the sequencing of institutional reforms. Namely, that better-rooted, context-specific informal institutional interventions may be more likely to succeed than formalisation programmes. Nonetheless, barring a few exceptions, legal informality remains substantially undertheorised. Second, despite the strength of the earlier assertion, it would appear from the dynamic analysis that over the course of institutional evolution, a variety of transition issues (including a potential push towards formalisation) will have to be dealt with. Thus, on this analysis, the relationship between formal and informal institutions is far more complex than initially posited. This relationship is even more substantially undertheorised than legal informality.

A. Issues of Sequencing

The problem confronted by the land-titling approach is that the transaction costs associated with dealing with small property owners proves to be too high to allow the scheme to be feasible. On the other hand, the microfinance model, through a process of social capital building, is able to reduce many transaction costs by building a process of trust-creation into the scheme and requiring borrowers to compulsorily participate in this process. Moreover, since no payment is attached to participation in the process of creating trust, the costs of enforcement are kept sufficiently low for the scheme to be viable. There are important lessons that it may be possible to learn from this experience about the role of social capital and trust in reducing transaction costs.

Indeed, the key strength of *Grameen* as an institution is its capacity to make the shift to a co-operative institutional equilibrium by fostering social capital and trust, i.e. by bringing

about a change *within* the agents in a system.¹⁹⁰ In the framework of the Hoff and Stiglitz (2008) model, the individual's expectations with respect to the prospects for establishing the rule of law will determine whether the individual supports it. The *Grameen* mechanism can be seen to be producing a public good by altering these expectations.¹⁹¹

Dowla (2006) provides a roster of ways in which the *Grameen* is engaged in social capital creation – by “forming horizontal and vertical networks, establishing new norms and fostering a new level of social trust to solve the collective action problems of poor people's access to capital”. Social capital theory predicts that co-operation will beget further cooperation (Hirschman, 1984; Putnam, 1993; Seabright, 1997), and, in the instance of the *Grameen*, this is seen to be the case – both within and outside the context of the specific programme.¹⁹² There are several concrete examples of the “spillovers” of *Grameen* operations. One instance is the election of *Grameen* members to local government bodies: In the 2003 local government election (the *Union Porishad*), 7442 *Grameen* members contested the reserved seats for women and 3059 members got elected – this accounts for 24 per cent of the total women's reserved seats.¹⁹³ The *Grameen* has also had an impact on conventional banks that have, for instance, started to ask for repayment of loans in instalments or give loans without collateral – for instance *Islamia Bank* and *Sonalia Bank*.¹⁹⁴

Ostrom emphasises the importance of “aggregated learning” – and evidence of this is seen in the case of the *Grameen*.¹⁹⁵ What is crucial, however, is that the social capital building initiatives of the early stages of institutional development of the *Grameen* paved the way for the current developments. Both the new microfinance organisations that

¹⁹⁰ On the relationship between trust and co-operation, see Arrow (1972), Coleman (1990) and Dasgupta (2003).

¹⁹¹ As Dasgupta (2003) puts it, the generation of trust is “riddled with positive externalities”.

¹⁹² Putnam (1993, p. 90) contends that “‘taking part in a choral society or a bird-watching club can teach self-discipline and an appreciation for the joys of successful collaboration.’” Hirschman (1984) describes trust as a “moral good”, growing with use and decaying with disuse. Seabright (1997) presents empirical evidence of cooperation begetting further cooperation. In addition, Dixit (2004), Ch. 3 stresses the continuing importance of civic associations.

¹⁹³ Yunus (2008), p. 16

¹⁹⁴ Kaiser Amin, Ex-Vice President BRAC Bank, Sonarbangla Hotel, Dhaka, 5th April 2009.

¹⁹⁵ Ostrom (1990). Ostrom's views on “learning” were described at some length above.

entered the fray after the *Grameen Bank* and other key players (like another now-major MFI, Association for Social Advancement or ASA), as well as the “social businesses” run by the bigger microfinance organisations, operate out of the membership base created by the “first generation” microfinance experiment.

But the success of the informal *Grameen* mechanism is not an isolated phenomenon. A host of alternative dispute resolution mechanisms, operating outside the ambit of formal courts, have been attempted in various parts of the developing world, while an emergent voice within the academic literature is starting to call for more innovative, if less ambitious, regulatory solutions.¹⁹⁶ The most recent example of this gradual shift in theoretical consensus is the recognition of Ostrom’s work establishing that non-conventional modes of regulating the commons may be more efficient than initially envisaged. Setting aside the accepted wisdom that the “rule of law” regime is the proverbial institutional “cake”, there is a pressing need to focus instead on what Galanter (2004) calls the legal “bread for the poor.”

On this basis, it is argued that a strong case can be made for the *sequencing* of institutional reforms. On the basis of the evidence provided in this section that there is a compelling case to be made for more informal, norm-based methods of solving collective action or coordination problems, at least as the starting point for institutional reform in the developing world context. These mechanisms being more rooted in social context and inherently more participatory, are much more likely to be seen as legitimate and, hence, be more effective than the impersonal structures of conventional formal law in the context of the developing world. This is true *at least* in – although not necessarily limited

¹⁹⁶ Experiments with “alternative dispute resolution mechanisms” range from the post-apartheid Truth and Reconciliation Commission in South Africa to the *Lok Adalat* (people’s court) system in India. In academic writing, Dixit (2004) stresses the importance of the role of alternative regulation mechanisms; Sage, Adler and Woolcock (2007) make a strong case for what they call “interim institutions” based on their in-depth engagement and incremental transformations of their political-economic contexts, citing successful examples of regulatory innovation in Cambodia and Indonesia; Rodrik (2008) argues for what he calls “second-best” institutions—which work within the constraints of deep-rooted government and market failure and cannot be removed in the short run—emphasising that these may be far removed from “best-practice institutions.”

to – the earlier stages of economic development of a country.¹⁹⁷ Nor is the relevance of informal structures exclusive to the developing world. In the developed world, informal norms and conventions have continuing importance – whether in the context of ensuring the efficacy of legislative interventions or of supplementing, or even substituting, formal contracts in business. Indeed, the success of most successful Western legal systems is attributable, in large part, to the mutually re-enforcing interactive dynamics between formal law and informal norms.¹⁹⁸ Following on from this, the next section turns to the issue of the interactive dynamics between formal law and informal norms.

B. The Relationship Between Formality and Informality

The “dynamic” developments discussed are the product of what will be called “the institutional conundrum” – the fundamental tension between the dual objectives of flexibility and replicability that confront the evolution of any institution. The idea of law as a “cognitive institution” helps to explain this tension. Institutions are theorized, on the one hand, as emergent and localised reactions to coordination problems, with those that are most cognitively decipherable and appealing to agents being the most effective; but, on the other, the growth of most originally localised solution will, at some point in its evolution, have to confront the problem of generalisation. Within this perspective, law and legal systems are seen as a means of capturing, systematizing and encoding knowledge or learning about successful strategies that emerge at the local level for solving collective action problems, in a durable form that lends itself to replication.¹⁹⁹ Thus, formal institutions can be seen as a mechanism for embedding informal structures. But, at the same time, the formalisation of the legal system is likely to introduce new rigidities. There is an unavoidable trade-off between the advantages of formalisation, in terms of the diffusion and replication of knowledge, and a loss or responsiveness of the formal elements of the system to societal change.

¹⁹⁷ The Chinese case is a difficult one to interpret authoritatively, it has certainly surpassed the “early” stages of economic development and has done so – and continues to – without the importation of Western institutional models, and in the absence of the rule of law as defined by the orthodoxy. See on interpretations of the Chinese case Upham (2009) and Qian (2003).

¹⁹⁸ The most important of these norms may be the “meta-norm” that law is to be obeyed.

¹⁹⁹ For different, but complementary expressions of this idea, see Deakin and Carvalho (2009) and Aoki (2010).

The cases of the land-titling and microfinance programmes demonstrate this tension. Thus, the land-titling programme began with a formal – albeit theoretically replicable – model, but this model failed to “take root” as a result of being inadequately grounded in both the social context, and the cognitive frameworks of agents. Conversely, the evolution of the *Grameen* model began as a completely localised programme rooted in the realities of both the social context and economic agents. However, it was its success at the local level that led to its expansion, but that process appears to have reached its limits – and its further expansion demands alteration to the model, and potential formalisation (which may entail all the problems with formalisation already discussed).

The limitations of the “technological” or “technocratic” view of the law – seeing it as a body of formal rules detached from its context and therefore capable of being transplanted – have been explored at length. But it would appear from the microfinance case study that there are also limits to the other point of view – advocating informal regulatory solutions without situating these solutions against the backdrop of the wider institutional framework against which it operates. This view takes insufficient account of the ability to generalise the solutions that it advocates. It is also this idea that underlies Ostrom's assertion that the informal regulatory mechanisms that she advocates are, by their very nature, designed to work on a relatively small scale.²⁰⁰ Indeed, the limit of Ostrom's models is that the “learning effects” or the possibility of “embedding” and “replicating” are inherently limited.

However, what is crucial is not whether the mode of regulation is formal or informal, but rather whether it is capable of influencing the actions of agents.²⁰¹ Without a transmission mechanism that will allow formal law to acquire traction in a host society by altering actions and norms, legal formalisation will have little or no effect. The characteristic of the successful legal systems in the developed world, that the developing world is being advised to mimic, is that formal law and social norms work in tandem. In particular, formal legislation, if it is to be successful, must have the capacity to shape norms and

²⁰⁰ This is exemplified by the fact that her case studies were limited to Common Pool Resources (CPRs) of fewer than 15,000 agents. See Ostrom (2000).

²⁰¹ This is increasingly emphasised in the literature by, for instance, Aoki (2001) and Greif (2006).

influence action. Thus, while there may exist a short-term policy choice between emphasising formal or informal institutions as a means of legal reform, in the longer term the critical issue is not that of choosing between the two, but rather the matter of making the shift from a negative to a positive equilibrium by facilitating co-operative action, and allowing the economic benefits of this to be realised. Observing the example of the successful legal systems of the West, this would, typically, be achieved through a combination of the formal and informal.

VI. CONCLUSION

This paper began by identifying the key questions currently confronting institutional theory – examining if the comparative case studies on the microfinance and land titling programmes shed any light on them. The question of the role of the law in the process of development remains open. The answer to this question depends, critically, on the definition of development adopted, and the characterisation of markets adhered to. It would appear, however, on the basis of both the evidence and the arguments presented that the current orthodoxy on the rule of law does not provide an adequate account of the role of law in the development process. Thus, for instance, the excessive emphasis placed by the orthodoxy on both property rights and formalism as a pre-requisite for economic growth appears unjustified. Moreover, on both normative and functional grounds, it would appear that there is a strong case to be made both for other types of substantive rights to support the market economy (like some welfare provisions) and for more informal means of achieving cooperation. Yet, the case for legal informality remains under-theorised.

The relationship between formal law and informal norms, however, turns out to be much more complex than it initially appeared. While much of the literature deals in false dichotomies of formal *or* informal law and characterises them as substitutes, evidence suggests that the most successful solutions to collective action problems arise when mechanisms are established to strengthen the complementarities between the two. Thus, in contrast to the narrow focus of the orthodox rule of law position on formal,

transplanted law, the existence of these complementarities necessitate the adoption of a theoretical approach open to understanding the value of the plurality of sources from which law may be derived – both “global” and “local”, as well as formal and informal.

This paper problematised some of the long-held assumptions of institutional theory, but it throws up a range of fundamental questions that will be critical going forward: The case studies suggest that informal systems may be a better point of intervention than formal law, but is this always the case? What is the role of formal law in seeding norms? Must informal systems inevitably mutate into formal ones at some stage of the ‘scaling up’ process? If this process of transition is inevitable, how can it best be essayed? How can the relationship between the formal and informal be understood at an analytic level? Will a formalised system lose the characteristics of local rootedness and responsiveness of the informal? Or will its evolution out of informal norms allow it to retain effectiveness? Is formalization a one-way street or will an excessively formal system suffer pathologies? These questions form the basis for a rich future research agenda.

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