Formal Enforcement Mechanisms and Informal Transactions

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Abstract
Operators of informal transactions developed certain interest in the relaxed nature of the business as compared to formal transaction because of its controversial laid down procedures and probably, the cost involved. However, due to the relaxed nature of informal transactions, it could be envisaged that, the environment would develop faster since its not strictly regulated. This paper critically examines the legal process of enforcing financial transactions in Ghana and, in particular, how appropriate and applicable such enforcement mechanisms are to informal financial transactions. It also explores the interplay between formal and informal financial transactions. The main aim of this paper is to outline the legal implications of formal and informal enforcement mechanisms regarding exchanges within and between informal financial entities.

Keywords: informal finance, financial transactions, enforcement.

1. Introduction
The absence of a defined, simple and low cost formal enforcement mechanism at the micro level and amongst informal practitioners has imposed an unavoidable burden in informal economies, leading to high transaction costs, delays and losses. The high costs of accessing formal enforcement mechanism coupled with the cumbersome laid down procedures, more often than not, excludes or prevents informal agents and participants from benefitting from the formal system.
Informal economies being the unregulated sector of the financial economy has within its unstructured system contractual relationships ungoverned by any set of rules or regulations (Portes, Castells and Benton, 1989)
Consequently, all transactional negotiations through to completion of agreements and its subsequent enforcement in the event of a breach are unregulated by the institutions of society where similar activities are regulated and monitored by governmental institutions. It is therefore hypothesized that informal economies thrive best within an unregulated environment and the absence of an effective legal system or the denial of access to such legal enforcement mechanisms has no fatal impact on the growth of informal economies.

Formal transactions are most often than not very complex in nature. In view of the fact that they are enshrined in legal language and form, formal financial transactions often constitute legally binding contracts. Consequently, such contracts can be legally enforced by contracting parties using the coercive powers of the state. It is this coercive power of the state that is appropriated through the legal system to compel the compliance of contractual terms. The rules providing for the use of the state’s coercive power therefore constitute the law of contract. To this end, the state can be described as an enforcement machine possessing matchless powers of compulsion (Kronman, 1958). In Ghana, the Contracts Act of 1960, together with the relevant financial laws, form the basis of enforcing financial contracts. The ultimate controlling power in any society is vested in the state, whose power of control is evidenced through its monopoly of the legitimate use of physical force. The use of this force by other individuals or institutions is however limited to the extent to which the state permits it (Weber, 1958).
The state usually serves as the sole source and controller of rights, obligations and entitlements, creating order and social control in any given society. Therefore, without governmental rules and powers of enforcement, society will be uncontrollable (Coase, 1960; Hobbes, 1909).
Even though coercive power similar to that of the state exists in many other human institutions which are not states, the mere existence of such power in these human institutions does not qualify them as states and therefore cannot be appropriated for the purpose of contract enforcement. Thus, the feature that distinguishes a state from any other human institution does not lie in the existence of coercive power but the outward existence of the concentration of power in the hands of a separate class of people (Lenin, 1895). Consequently, it is this distinctive and superior power of coercion and suppression concentrated in the hands of a certain group of people that can be appealed to by contracting parties to compel the compliance of contractual terms.
The concentration of the powers of enforcement in the state as well as its monopoly of the use of legitimate force is evidenced in both the spirit and letter of the constitutions and legal regimes of most countries. For instance, under the 1992 Constitution of Ghana, the judiciary is vested with the power to administer justice in Ghana and shall, by virtue of that power, have jurisdiction in all matters both civil and criminal. Pursuant to this power, the
judiciary may issue such orders and directions as may be necessary to ensure the enforcement of any judgment, decree or order of the courts (Constitution of Ghana, 1992: Articles 125(1) & (5), and 126(4)). Legal enforcement proceedings are therefore initiated in the courts and are governed by the Courts Act, 1993 (Act 459) as amended, the High Court (Civil Procedure) Rules, 2004 (C.I. 47), the Courts of Appeal Rules, 1997 (C.I. 19) as amended, and the Supreme Court Rules, 1996 (C.I. 16) as amended. Disputing parties are however encouraged to submit to arbitration under Courts Act, the Arbitration Act, 1961, and the Civil Procedure Rules, whereby parties are enjoined, in certain circumstances, to resort to negotiation and settlement processes to resolve certain matters amicably.

Various rules of court have in Ghana been enacted to govern the institution of an action in court. Under these rules, an action to enforce a contract is usually commenced by a plaintiff through the issue and service on a defendant of a writ of summons and a statement of claim. A defendant has eight days to enter appearance and 14 days to file a defence to an action. Where a defendant fails to enter appearance or file a defence within the stipulated time frame, a plaintiff may apply for judgment in default of appearance or defence. Judgments granted on grounds of default of appearance or defence are usually not final and the courts are often disposed to set them aside upon an application to do so (C.I. 47; Kom, 1971).

However where the writ is for a liquidated sum or damages, an application for summary judgment may be filed by the plaintiff, after a pre-trial conference has failed to resolve the matter, on grounds that the defendant has no reasonable defence to his claim. An application for summary judgment may be filed after the defendant enters appearance and the court may enter final judgment in favour of the plaintiff. In cases where the defendant files an affidavit in opposition to the plaintiff’s summons, or files a statement of defence in addition thereto, the court may determine the matter on its merit. The court may only enter such final judgment if the statement of defence discloses no reasonable defence to the action. In the event of a failure to obtain summary judgment, the parties may then go through the whole proceedings by filing pleadings through to taking summons for directions and then hearing by oral and documentary evidence (C.I. 47.). In practice, it could take about 37 proceedings from the issue of a writ through to hearing, submissions, writing, delivery and enforcement of judgment (The World Bank Group, 2009). Proceedings in the lower courts in Ghana take about 487 days to go through commencement to obtaining and judgment debts (The World Bank Group. 2009). This is in sharp contrast to what pertains in the United States, where it takes about 54 days to enforce a contract, and, surprisingly, about 1,000 days to do the same in Poland (Djankov et al., 2002). This is a clear demonstration of the fact that the time and cost of enforcing contracts in courts are not measured by or linked to the state of a nation’s economic development, but are measured by the efficiency of the legal system. An efficient legal system therefore results in a shorter time as well as lower cost of contracts enforcement (Beckmann and Boger, 2002). Adjudication through the courts comes with some element of cost which tends to be expensive. This cost element arise from the payment of filing fees, service fees and fees for execution, in addition to legal and consultation fees where the services of a lawyer are engaged (The World Bank Group. 2009). In sum, the cost of formal contract enforcement proceedings has been assessed at approximately 23.0% of the claim (The World Bank Group. 2009).

### 2.1 Usefulness or Otherwise of Legal Procedures in Contract Enforcement

In spite of the noted high costs associated with legal proceedings, resort to the legal enforcement mechanism in the resolution of disputes often yields good results. This is because effective rules of procedure are applied by the courts in an informed and sophisticated manner. Furthermore, disputes settled in accordance with legal proceedings are conducted in a forum independent of the social environment within which the dispute arose. Determination and settlement of contractual claims are also provided by experts empowered and backed by the state (Williamson, 1975; Galanter, 1981). According to Epstein, the availability of a legal system reduces the pressure on society and the parties from having to look for alternative cost effective means of settling disputes. This is especially true where the dispute is between parties of unequal power and strength. Recourse to informal and private dispute settlement mechanisms therefore seems less likely and less attractive to parties who have the option of a legal mechanism.

Anecdotal evidence suggests that the rule of law contributes to a nation’s wealth and determines its rate of economic growth. Studies also suggest that a well functioning legal system underlies a country’s prosperity (Posner, 1980; Barro, 1991; Scully, 1988). Where the rule of law does not exist or is weak, the resolution of disputes often depends on other enforcement substitutes. These substitutes include the use of threats, violence, arbitration - with or without legal enforcement of the arbitrator’s award - and retaliation including blacklisting of contract defaulters (McGirory, 1995; Intriligator, 1994). Even though these substitutes may provide alternative dispute settlement processes, they may be costly in cases where legally enforceable rights exist. The hidden cost associated with alternative informal dispute settlement processes is such that these processes favour simple contractual exchanges and not complex transactions. Whilst legal reforms are quite expensive, the cost of enforcing contracts outside the law in a modern society may well be colossal (Posner, 1980; Hendley et al., 1997; Posner, 1996).
Recourse to law also grants some level of satisfaction and leverage to parties with stronger and more powerful opponents, as the availability and neutrality of law gives them some hope of a remedy. Similarly, such powerful opponents may also take advantage of the law, using it as a legitimate camouflage to hide their real intention of pursuing weaker parties (Nonet, 1969). When considered in light of the above, it appears that the law encourages litigiousness in societies where both the weak and strong have access to this formal, legal dispute resolution mechanism. Even though the legal dispute resolution process may bring an end to disputes, it may not resolve disputes to the total satisfaction of all parties. To this end, the law only produces an illusory resolution and not a real dispute resolution, thereby creating a fertile ground for future and unavoidable conflicts (Sachs, 1973).

Notwithstanding the usefulness of law in settling disputes, protecting the rights of the weak and discouraging the use of more radical and dangerous means of fighting opponents, the party with the highest access to the available legal resources can exploit such access to increase his edge over the weaker party. Thus, a weaker party may sometimes be deliberately or inadvertently excluded from accessing the legal resources and even ultimately prevented from asserting his legal claims or rights or defending any entitlements. A classical example was seen in South Africa where in 1910, and upon the formation of the in-egalitarian South African nation, non-whites had their legal status in South Africa erased and even lost their voting rights guaranteed by entrenched clauses in the law (May, 1955).

The use of law in dispute resolution may also heighten existing tensions making them more difficult to resolve. This is because even though the nature of law is such that it creates social structures, roles, responsibilities and obligations purposely to resolve or prevent conflict, unfortunately, this purpose is often thwarted by the very nature of the law. In creating social structures and establishing roles, rights and obligations, existing social problems and conflicts are brought to light and this, more often than not, increases existing tension (Turk, 1976). Dispute resolution through the legal system appears to be more injurious to the resolution process, as disputing parties often see one another as adversaries, especially where they each insist on the legitimacy of their claim. In contrast, an informal dispute resolution process is usually conducted in a friendly manner. Parties to an informal dispute resolution process are therefore more likely to resolve issues amicably.

Contrary to informal proceedings, the legal environment is constituted of formalities and strict procedure and these often make dispute resolution difficult. Further, communication, which is an essential part of dispute resolution, may be precluded in a legal environment since the whole process may be at risk of the disclosure of injurious but relevant facts (Macaulay, 1963). In addition to the above, parties who obtain judgment at the end of a long trial may also be faced with inefficiencies in the enforcement process and may be unable to enjoy the benefits of the judgment (The World Bank, 2005). It appears the above may provide a reason why businessmen and petty traders in both developing and developed countries feel reluctant to resort to strict legal procedures and/or use no legal processes at all in their business transactions. Even in a litigious society like the United States, it appears most contractual and property disputes are resolved outside the legal system, often due to the cost of legal proceedings (Clark, 2002; Posner, 1980; Macaulay, 1963).

In spite of the difficulties encountered in accessing formal enforcement mechanisms, anecdotal evidence suggests that where the procedures adopted are minimal, formal proceedings produce fast, fair and affordable results. In their studies on contract enforcement in Ghana and doing business in 2004, the World Bank found that a lower number of procedures often produce fairness, impartiality, more honesty, consistency and promote public confidence in the legal system. Their observation in Ghana established that there are about 37 procedures in contract enforcement proceedings, making Ghana one of the countries with the lowest procedural complexities. They concluded that the existence of legal complexities and numerous processes create a fertile ground for bribery and corruption, leading to inefficiencies and public mistrust in the legal system (The World Bank Group, 2009; The World Bank, 2004).

Law, as a dispute resolution mechanism, becomes an important tool in societal control and the enforcement of rights, but only where legal resources or systems are available. Where legal resources are unavailable or where the legal system is inefficient, disputing parties have no choice but to rely on the use of non-legal power to deal with disputes. Law, in such circumstances, becomes irrelevant save the general recognition of the right to self-help (Hoebel, 1954). The use of law in resolving disputes in developing economies where there are imperfect legal systems may be evasive, especially where their legal enforcement system is inefficient. Therefore, contract enforcement in these economies may not be achieved through the legal system. Education, not law, is said to be responsible for achieving and maintaining the basic order in these societies, especially where self-control and informal control systems are heavily relied on (Llewellyn, 1951).

The legal system has not been an important part of the daily economic lives of developing societies. As a developing country, Ghana is no different, especially where majority of the population live in rural communities and often depend on the informal sector (Ghana Statistical Service. 2004; Ghana Government 1999-2000; Aryeeetey et al, 1997). Ehrlich in his study of the fundamental principles of the sociology of law, observed that law is relatively unimportant and that social forces tend to produce the same norms in all human societies.
can therefore conclude that social forces are compelling enough to induce normative values in man, making him a social animal and resulting in his compliance with acceptable societal norms without the influence of law. After all, contract enforcement mechanisms, which comprise of economic activity coordination and optimization processes, predate the state and legal institutions (Posner, 1998). This trend was evidenced in Ellickson’s study of Shasta County where neighbours in the county were strongly inclined to cooperate in the face of disputes. They achieved such cooperation not by bargaining and arguing out legally entrenched rights and entitlements, but by **adopting social control measures and enforcing adaptive norms that trump legal entitlements**. This informal system of resolving disputes was found to have achieved mutual advantage without any supervision or control by the state.

The adoption of an enforcement mechanism in any given situation depends on the nature of the dispute in question and the availability of a legal system. So that where the dispute is one arising out of a technical transaction or evidenced in writing and witnessed by a third party and the legal system is available and efficient, then a resort to formal enforcement mechanism will be more appropriate. Evidently, in such situations, the formal dispute resolution process will be less costly and more efficient. It goes without saying that where the legal system is ineffective or unavailable, disputing parties have no option but to rely on mechanisms beyond the law (McMillan and Woodruff, 1999). However, where the dispute arose out of an oral and informal arrangement, it may be difficult to enforce through the legal system as problems of verifiability arise causing delays and increasing the cost of enforcement (Beckmann and Boger, 2002). In such circumstances the powers of enforcement emanating from the state could be ineffective and rendered useless.

### 3.0 Conclusion

Despite the need for a well-defined informal enforcement mechanism in situations where the legal system is weak or unavailable, or where the dispute arose out of informal arrangement with no basis in law, the importance of the legal system cannot be overlooked if the overall social order is to be maintained. However, more often than not, the cost of accessing the legal enforcement mechanism coupled with cumbersome laid down procedures exclude users of the informal sector from accessing the legal system. Furthermore, the reliance on complex formalities and the nature of informal disputes make legal enforcement processes unsuitable for enforcing disputes arising out of informal financial transactions. Law and legal enforcement processes may, however, have some relevance for disputes arising between institutional agents and savers as the contractual relationship between them are often governed by regulations. Generally, law, including its regulatory and dispute resolution mechanism, may be, in substance and procedure inappropriate for informal financial transactions.

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