USAID Policy Paper

Institutional Development

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

I. Introduction: The Concept of Institutional Development

II. Institutional Development Priorities for the 1980s
- A. Analysis and Reform of the Policy Environment
- B. Consideration and Introduction of Organizational Alternatives
- C. Development of Institutional Learning Capacity
- D. Transfer of Knowledge and Technology
- E. Analyses and Improvement of Institutional Linkages/Coordination
- F. Improvement of Management Systems
- G. Provision of Skills and Training
- H. Capitalizing upon Local Capacities and Participation
- I. The Role of Institutions in the Development of Supporting Infrastructure

III. Conclusions
- A. Institutional Analysis
- B. Time Horizons and Financing
- C. Private and Non-Governmental Institutions

Executive Summary

It is USAID policy to help countries establish and strengthen public and private institutions in support of mutually agreed, priority development objectives. This is because effective institutions:

-- enhance a country's ability to marshall its own human and financial resources for development;

-- expand people's opportunities to undertake successful development by providing increased incentives for investment;

-- provide individuals with opportunities to acquire the skills, resources, and services needed to increase their productivity, income, and well-being; and

-- increase the likelihood that USAID and host country resources will foster development that can be sustained after external assistance is withdrawn. That is, USAID's investment should stimulate a process of investment and reinvestment by beneficiaries themselves that continues after the termination of donor involvement.

In undertaking institutional development efforts, USAID will adhere to the following principles:

1. Institutional development should be addressed as an issue in all projects, and should not be seen as a special activity of its own. This does not preclude support to particular institutions (e.g., regional management training entities) where the prime focus is in fact institutional development. Although analysis of institutional issues is required in all projects, no special institutional development effort is required where concerned institutions are demonstrably strong.

2. Institutional development must address weaknesses in complementary institutions,' since institutional deficiencies elsewhere in a sector (e.g., extension) may well inhibit the effectiveness of particular institutional interventions (e.g., in research).

3. Institutional development must encourage institutions that are flexible and which can adapt to changing local and national needs. This entails building effective Information- ' handling systems, strong analytic capacities, and close linkages to client or user groups. Well-functioning markets will support this goal as well.

4. Institutional development must provide for the active participation of clientele in the assessment of their needs, and in the design, implementation, and evaluation of field pro-grams. This helps to ensure that USAID- supported institutions will meet their own im presentation goals, be relevant to local needs, and become self-sustaining. Where possible, these methods and objectives should be realized through development of private sector institutions.

5. Institutional development must be aimed at providing people increased ability to acquire essential resources, and greater opportunity to apply these resources in rewarding ways. This can often be achieved by reducing the role of government and expanding the role of the private sector in development.

6. **We conclude that private sector options for institutional development must be considered carefully**. Experience has indicated that with the exception of such areas as basic public administration, major transportation infrastructure, and certain aspects of agricultural research, public preventive health measures, and basic schooling, private sector options are both less costly and more responsive to clientele, and at the same time more innovative, dynamic, and efficient, than public enterprise. **Thus, where there is a choice, USAID should encourage and**

support institutional development options in the private sector and should avoid activities that explicitly or implicitly preempt private sector options.

I. Introduction: The Concept of Institutional Development

This paper outlines USAID policy on institutional development. It begins with a short discussion of the concept of institutional development, and proceeds to a review of institutional development priorities in the 1980s. Here a number of important policy goals are set forth, and suggestions are made regarding various interventions likely to achieve these goals. The paper closes with recommendations for how the Agency can prepare itself to deal with institutional development needs in the coming years.

Effective public and private institutions are essential for providing a country the self-sustaining capacity to solve critical development problems. Furthermore, they: enhance a country's ability to marshall its own human and financial resources for development;

-- expand people's opportunities to undertake successful development by providing increased incentives for investment;

-- provide individuals with increased opportunities to acquire the skills, resources and services needed to increase their productivity, income, and well-being; and

-- increase the likelihood that USAID and host country resources will foster development that can be sustained after external assistance is withdrawn, through a process of indigenous investment and reinvestment.

It is therefore USAID policy to help recipient countries establish and strengthen public and private institutions in support of mutually agreed, priority development objectives, by drawing upon support from Title XII universities, the US cooperative movement, US and LDC institutes of management, PVOs, and other organizations with appropriate capacities.

By "institutions" we mean specific organizations (a commercial bank, a ministry of health), but we also mean institutions in the broader and more fundamental sense, such as financial and commodity markets, systems of land tenure, and legal institutions.[1] A nation's economic, political, legal, and social institutions determine the basic framework of incentives and opportunities within which development efforts take place. Even the best of organizations can accomplish little when this broader institutional framework is antithetical to development goals. However, because institutions become tangible only through the policies and actions of particular organization, much of USAID's institutional development effort will be focused on improving the policies and procedures of key organizations.

USAID has viewed institutional development as an important element of its development assistance program for many years, but, although the experience has been long, few universally valid approaches seem to have emerged. Rather, the clearest lesson is that nearly any type of initiative will be well suited to some situations and will fail in others; similarly, nearly all projects with significant institutional development components experience substantial implementation difficulties.[2] USAID's experience in this regard is mirrored by that of the World Bank; a staff paper on the topic has concluded that "the lack of clearly superior approaches in this field calls for considerable experimentation," while a Bank audit review of

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[1]See Ken McDermott, "Institutions in Agriculture and Rural Development," TPCA Occasional Paper No. 2, 15 January 1981.

[2]"Effective Institution building," USAID Program Evaluation Discussion Paper No. 11, March 1982.

recent projects and their institution building components shows that most methods (e.g., training, expatriate consultants, forming a new agency or unit, etc.) achieve only partial success under most circumstances.[3] This suggests that we have much to learn about how donors can assist in building effective LDC institutions. Thus, this paper makes few prescriptive statements about the relative utility of various institutional development models, of short or long term technical assistance, the role of various types of training, and so forth. At the same time, it is possible to point to some of the issues and lessons, which seem consistently to emerge in discussions of institutional development and to highlight the implications for programming and development
strategies. This is done in Section H below.

II. Institutional Development Priorities in the 1980s.

The most critical areas of concern in institutional development today relate to:

-- the host country policy environment;

-- the potential of various alternative forms of organization;

-- the importance of institutional learning capacity;

-- the problem of transferring knowledge and technology;

-- improvement of coordination and linkages among institutions;

-- improvement of management systems;

-- provision of training;

-- the role of local initiative and participation; and

-- the role of institutions in undertaking the development of physical infrastructure.

Each of these areas of concern is discussed in detail below.

A. Analysis and Reform f the Policy Environment. There is a strong interaction between a country's policies and the effectiveness of its institutions. Unfavorable policies can seriously inhibit institutional development. For example, many donor supported community development efforts in the 1950s failed because they ignored the need for complementary policies to encourage investment in the agricultural sector. Domestic private enterprise can be impeded or supported by the nature of enabling legislation, regulatory codes, and licensing procedures, as well as economic policies.

On the other hand, successful institutional development can also mitigate the impact of unfavorable policies. In India, for instance, cotton marketing associations permitted farmers to capture some of the value added from processing cotton even though prices for cotton were maintained at low levels. Because policies are always imperfect, full of conflicts, biased against some, and characterized by lags,

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[3]"The World Bank and Institutional Development: Experience and Directions for Future Work", report prepared by Projects Advisory Staff, 12 May 1980, and "Eighth Annual Review of Project Performance Audit Results," Operations Evaluation Department, September 9, 1982.

organizations will frequently seek to compensate for policy deficiencies. Often, however, organizational solutions to policy problems will simply shift the cost of poor policy to some other group in society. USAID may support organizational solutions of this sort on a short-term basis, when the clear intent is to gain leverage for policy dialogue, but USAID's long-term emphasis must remain on reform of poor policy.

Finally, effective organizations may serve to bring steady influence to bear on governments for needed policy changes. Popular organizations, national business associations, and planning units within ministries have proven effective in encouraging policy change. Thus, missions should undertake an ongoing assessment of host country policies, legislation, and regulatory procedures which facilitate or impede private and public institutional growth and effectiveness, and should develop within their overall programs a dialogue with host country government and assistance activities aimed at improving the content of host country policies.

B. Consideration and Introduction of Organizational Alternatives. Very often USAID's approach to development issues is to focus on increasing resources or opportunities to acquire resources, typically by introducing or strengthening an implementing organization. Thus, for instance, lack of credit is often identified as a problem in the agricultural sector, and the response is to build credit dispensing institutions. But the reasons why resources are lacking often have nothing to do with the capacities of particular organizations; rather, the problems may stem from poor policies (in the case of credit, artificially depressed interest rates) or weak national level institutions (e.g., poorly articulated financial markets). Hence missions that are considering organization type interventions to increase the availability of development resources should direct close attention to the broader institutional and policy environment, and the associated framework of incentives and opportunities. If these are fundamentally flawed, it is unlikely that an organizational intervention will be more than minimally effective.

If an organizational intervention is justified, then a number of other considerations come into play. For organizations to be effective, both their structure and their procedures must be suited to their socioeconomic environment, the nation's administrative and political traditions, and the technology around which they are organized.

Organizational theory has long recognized that the nature of an organization's environment profoundly affects its structure. An, agriculture department designed for a small homogeneous group of farmers with the security afforded by a well-established irrigation system, for example, would be quite different from one serving large numbers of small farmers, diverse in their conditions, and subject to the vagaries of natural rainfall. In the development of human resources, the organization required for training in technical skills related to employment is quite different from that required to manage a uniform system of primary schools. Similarly, although administrative traditions in much of the Third World are characterized by highly centralized, control-oriented management systems, environmental diversity and the technology of production militate in favor of decentralized, flexible structures. Hence, missions should explicit consider the implications that an institution's proposed function may have for the form it should take; and missions should ensure that the institutional structure is appropriate to the function. USAID should therefore see the task of institutional development not simply as institutional transfer, but rather as institutional invention and/or adaptation. Because of the uncertainty involved, it may sometimes be appropriate to encourage institutional diversity and Perhaps even organizational competition, although unproductive organizational conflict must be minimized.[4]

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[4] Institutional diversity can be either helpful or wasteful depending on the context. Offering farmers the opportunity to sell their grain to institutions other than a monopsonistic national marketing board is likely to be beneficial both to farmers and to the economy as a whole, but encouraging a nation to support a number of different agricultural research institutions may hinder scientific advanced and the utilization of findings.

In examining organizational alternatives particular attention should be given to the complementary roles of the public and private sectors. Where high returns redound to the economy but not to the individual investor, public sector institutions are likely to be required. This situation tends to prevail where fixed costs are extremely high but returns are very risky or low in the short-run, or because it is not feasible to charge a price to each consumer that will cover total costs (e.g., in the case of transportation infrastructure and some types of agricultural research). Nevertheless, investments in national public institutions must be balanced both by the establishment of decentralized institutions at regional and local levels, and by encouragement to the private sector. Balanced assistance of this sort is essential if excessive centralized control is not to inhibit individual and local initiative. Private institutional development can be promoted by assisting local business organizations (firms or associations) in management, technology assessment, accounting systems, and so forth; by providing funding for financial intermediaries; or by undertaking other activities as discussed in USAID's Policy Paper on Private Enterprise Development.

C. Development of Institutional Learning Capacity. Institutions must have the ability to learn from and adapt to the environment in which they work. Such learning capacity enables organizations to adjust development programs to their environment. For example, technology developed by agricultural researchers must be reconciled with the local knowledge, capacities, and goals of the farmers for whom such technology is intended, if the technology is to be generally useful and widely adopted. -This concept has gained currency in the management field, where learning and adapt ability are non-defined as requirements of successful organizations. This requirement is particularly critical for development institutions, because many urban-based managers and professionals are unfamiliar with the diversity of conditions found in rural areas, and with the speed and extent of the changes taking place.

Private sector institutions depend directly on market forces and thus generally face strong incentives for learning from their environment and for adapting to changes in the needs of their clientele. In the public sector, however, the incentive structure tends to be weaker, and so special efforts to create such incentives must be made, for instance by instituting performance- or impact-based employee reward structures, or by providing formal links between institutions and user or clientele groups. This may also help to ensure that public institutions phase down or alter their program content when the need they were originally formulated to address has been met.

D. Transfer of Knowledge and Technology. Key institutions in the development process are those that generate, adapt, and disseminate knowledge and technology at international, national, and local levels. Technology transfer is accomplished most effectively by those countries, which have a scientific establishment capable of evaluating and adapting knowledge and technologies to local conditions. The establishment of local institutions that have the capacity to tap and contribute to the world knowledge supply must therefore be a high USAID priority.

USAID's considerable experience in building such key institutions in the past, however, indicates that it is not possible simply to "transfer" institutional models to developing countries. They must be adapted to their environment. Of course, they must have qualified staff and adequate facilities to produce quality products; the best management systems and most responsive institutional structures fail when they have nothing to deliver to their clientele. But we have also learned that national knowledge and technology-producing organizations must be linked institutionally to the people who are expected to apply the knowledge and technology. Without such institutionalized interaction with user groups, the national institutions will remain isolated and ineffective. Where this requirement has been ignored, it has been common to hear that LDC researchers are more responsive to the research agendas of the developed world and the disciplinary interests of international associations than to the problems of their own farmers. We must learn from the successes of the past to structure institutions and incentives so as to combine technical excellence with accountability to the user. One way this may be done is to forge ties between new or developing organizations and established organizations with demonstrated records of success in the relevant field.

E. Analyses and Improvement of Institutional Linkages/Coordination. Many developmental efforts involve more than one organization in the planning and implementation process, and so an oft-encountered problem concerns the development of mechanisms, which link these organizations into a unified, effective whole. Donor agencies and host country governments have experimented with a wide array of organizational structures and processes in seeking to achieve more coordinated development efforts. Improvements in information systems which permit and encourage feedback .are a first step. In addition, basic changes in budgetary and planning procedures are required to achieve horizontal links among development departments or ministries, and to place expenditure authority in the hands of those directly responsible for implementation, rather than retaining these powers in central offices.

Integrated rural development projects provide an example of the linkage problem. Donor funded projects within defined geographical areas may be well integrated so that activities take place in a systematic and mutually supportive manner. However, these projects are often developed in isolation from normal organizations and administrative procedures, an isolation, which is usually reinforced by direct donor involvement in project management. Typically, therefore, the model proves to be non-replicable, and has no enduring impact. Hence, USAID should rely less on special project units of this type and strive instead to improve coordination among existing organizations.

Institutional coordination in the private sector can be improved by such measures as expanding and improving transportation and communications infrastructure, by fostering the development of local and national business associations, and by improving the efficiency of formal and informal financial and commodity markets, especially in rural areas where access to markets may be particularly limited, or where markets may be fragmented.

F. Improvement of Management Systems. To assure organizational effectiveness, key organizational systems, (e.g., decision-making and resource allocation information processing, budgeting, personnel, and logistics) must be strong. These basic components of organizational action allow policies and programs to be translated into concrete accomplishments. But an institutional development perspective must also focus on the informal aspects of organizations, i.e., how employee behavior is influenced by the structuring of authority, incentives, and information within organizations. Ultimately, it is these patterns of employee behavior, which are molded by the internal organizational environment, which determine whether an organization will be responsive to the external environment. A variety of techniques to create such systems are available and have been demonstrated to be effective in LDC settings, Thus, management improvement activities should include not only traditional emphases on financial management, training, and planning, but a new emphasis on assessing and restructuring patterns of behavior within institutions so that overall effectiveness can be improved.

G. Provision of Skills and Training. Successful institutional development depends upon persons trained in appropriate technical and managerial skills. In both skill areas a broad range of people need to be considered for training, e.g., private artisans and business people as well as government technicians, paraprofessionals as well as professionals, and local level administrators as well as central ministry personnel. To carry out this training a range of possible mechanisms is available, including traditional long-term degree programs, short-term seminars, action training workshops, non-formal education, and individual consultation/instruction. A general presumption exists in favor of in-country training. Various considerations, including the topical specialization required, costs and budget, and the best setting for training, will influence the decision on venue: on-site, elsewhere in-country, in another LDC, or in the U.S. Training programs intended to benefit private sector employees, managers, or entrepreneurs should involve private sector representatives in design, implementation, and financing to the greatest possible extent. However necessary these training programs may be, we should not lose sight of the fact that the need for project-related skill training is directly related to inadequacies within existing education and

training systems. It is the latter which must ultimately be made adequate and self-sustaining, or else there will be a perpetual need for project-related training.

H. Capitalizing upon Local Capacities and Participation. The first step in a broadly based development strategy which fully mobilizes available human resources is to assure that people have the opportunity to acquire resources (e.g., land, water, technology, and knowledge), as well as the incentives and opportunities to utilize the resources productively. Where political, economic, social, or geographical factors deny individuals a secure opportunity to obtain essential resources, or where there are strong disincentives for individual initiative and investment, the removal of these constraints must have priority in USAID's country strategies.

The development experience of the past two decades also indicates clearly that the impact and sustainability of public sector investments can be significantly improved if local citizens assume a role in needs assessment, project design, and implementation. Local participation (in both urban and rural areas) is essential in adapting development priorities, designs, and implementation strategies to particular contexts, and in communicating to planners local needs, constraints, and priorities. Participation of this sort ensures that public policies and programs are consonant with and supportive of existing private patterns of production and investment. For example, farmers or farmer organizations can provide agricultural planners valuable information about local production patterns, market conditions, and investment constraints, without which such planning tends to become irrelevant.

Local involvement in the development process also enables communities to provide a range of private resources (labor, materials, money, leadership) that can facilitate and guide both government financed and private sector projects. Equally important, community-level involvement may contribute to the management and maintenance of new programs, which can help defray recurrent costs. Finally, beneficiaries themselves must invest their own time and resources in development efforts to begin the process of indigenous investment and re-investment which marks the beginning of a successful development initiative and makes possible the termination of donor support. Operational guidance on encouraging popular participation is contained in Hand-book Three as an appendix to Chapter Two on PID preparation.

I. The Role of Institutions in the Development of Supporting Infrastructure. Many organizations require physical infrastructure in the form of buildings and equipment. USAID will consider provision of capital assistance to meet these needs where resource availabilities permit, and where such assistance is integrated with sound planning to strengthen the organizational, managerial, and technical aspects of institutional capacity. Conversely, it is often essential to *add* an institutional and human resource development component to projects (roads, water supply) which have in the past been approached strict, in terms of physical infrastructure needs.

These areas of emphasis are for most part complementary, and should all to addressed in a comprehensive program of institutional development. However, depending upon program size, the current activities of USAID and other donors, the political environment, and absorptive capacity, mission institutional development efforts may address a strategic subset of the areas outlined above. At one extreme, USAID's institutional development program may be limited to portions of a specific project or projects; at the other extreme, it may be a separate project to improve performance across several sectors-e.g., by analyzing and improving interest rate policy, or by increasing the effectiveness of local and national revenue generation efforts.

III. Conclusions

Implementing this policy implies some changes in the way USAID has approached institutional development in the past. These implications are summarized below.

A. Institutional Analysis.

Implicit in this paper is the assumption that missions will incorporate into their country development strategies, sector assessments, and project analyses a more complete analysis of host country institutional performance. Clearly, most missions will have, at least initially, neither the data nor the technical skills required. Over time, USAID should increase its in-house capacity to address development issues that are institutional in nature, and should simultaneously build LDC capacity to do so. This should take the form of supporting or creating national or regional private sector centers of business management and/or public administration, because it is only through the sustained involvement of such local institutions that long-lasting and self supporting institutional development can be expected to occur.

B. Time Horizons and Financing.

Institutional development takes time-time to build capacity, time to develop effective working relationships with local populations, time to adapt *a priori* models of institutional development to on-the-ground circumstances. Thus, USAID must be in a position to make longer term commitments to institutions (both public and private), and must be prepared to support a wide range of institutional development requirements. There are two implications: First, projects clearly dependent upon sustained institutional development will normally be designed and approved for a period of five to ten years, including provision for timely evaluation and redesign. Some projects may require two or more phases, lasting, in total, more than ten years. Second, USAID will approve recurrent cost and capital cost funding, but only when the national policy and manpower frameworks ensure effective utilization and when the government is doing as much as possible to mobilize domestic resources. Further details are presented in USAID's Policy Paper on Recurrent Costs.

Long term commitments and comprehensive recurrent and capital cost support are among the most powerful tools available to missions to accomplish needed policy and institutional changes. At the same time, financing too large a share, of an institution's growth can lead to dependency and a diminution of indigenous capacity. Thus missions should link such support to a definite schedule according to what local resources will be increasingly used to meet the needs of the institutions concerned, particularly with regard to recurrent expenditure.

C. Private and Non-Governmental Institutions.

Public sector resources for development, in terms of money, manpower, and capacity for innovative and efficient action, are usually meager in comparison to the private sector. Hence, USAID should devote greater attention to the identification of alternative private and non-governmental organizations to perform important development functions, and should explore how our development assistance can support these institutions. One approach is to ensure that USAID support to the public sector is (a) aimed at developing public services to private entities, such as technical institutes, credit facilities, trade and marketing associations, and vocational education programs; and (b) meant to improve the effectiveness of market institutions, for instance through increasing the opportunity to acquire technical information and to enter markets, through encouragement of private entrepreneurship, and through improved management in private sector enterprises. Another valuable approach is to support private organizations that can strengthen the capacity of government institutions to plan and implement programs. Private and voluntary organizations, Title XII universities, the US cooperative movement, and other organizations can be helpful in this regard.