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USAID and Economic Growth: Elevating Institutional Development

by Ken Lanza, April 9, 2015

Development professionals have long recognized that broad-based, sustainable development (BBSD) is underpinned by economic growth and is sustained by a robust, engaged and thriving private sector. Five decades of development experience, observation and research has demonstrated that economic growth is foundational for development across all sectors.

What is seemingly less understood is that a country's ***institutions***, which includes the policies that govern them, the legal contexts in which they operate, and the capacity of the professionals that administer them, are the keys to unlocking economic growth which alone can ensure that societies' gains endure. Institutions—social, political, judicial and economic—are the bedrocks of a cohesive and well-functioning society. Institutions—public and private—connect the array of macro-economic policies that impact all sectors, and as sector policies, with the myriad micro-transactions that implement them and the businesses and organizations that must adhere to them. Yet, even with this well-established knowledge, over time, USAID's programs have moved away from systemic economic growth programs which focused on developing strong, functioning institutions towards "transactional" projects, or those activities that could be done comparatively easily and quickly. Broadly defined, "transactional" projects, within an economic growth continuum, are characterized as those that support micro-level transactional activities—think, DCA, microenterprise, trade matching activities, public-private partnerships, and "deal" making, *inter alia.*

This project shift in economic growth priorities was first noticeable during the Carter Administration when the mandate for Basic Human Needs (BHN) essentially re-directed USAID's long-standing emphases on systemic institutional reform as a core development priority. BHN policies reduced project resources available for institutional support, mandated working with "...the poorest of the poor…" and re-prioritized projects around politically expedient imperatives that consisted mainly of transactional activities at the expensive of the far more difficult institutional ones[1]. Historically, USAID and its predecessor organizations provided transactional support as pilot projects, or to demonstrate effectiveness. Yet there was recognition

[1] While USAID does not disaggregate its budgets along "institutional" versus "transactional" types of programs, current data categorized under "economic growth" within the Foreign Affairs Database suggests a 1:3 budget ratio, respectively.

that these types of contributions while clearly helping to alleviate poverty were largely unsustainable in the absence of an environment with capable, functioning institutions. Still, they are attractive to political leaders (both in the US and the host-country) because inputs and intermediate results are more easily quantifiable (how many loans, how many new jobs, how much new investment, etc.) and are often easier to design and can typically deliver outcomes within politically acceptable timeframes.

The fallacy of course, is that for transactional development approaches to usefully contribute to the ultimate goal of BBSD—rather than just alleviating poverty temporarily—the surrounding institutional environment of appropriate policies, laws, incentives, and organizations must be in place to encourage and support private sector investment. Transactions ensue as a result of a competitive, conducive, and enabling business environment, but they are rarely the cause of it. [2]

Private sector growth is the most effective way to ensure that "business deals" are ultimately struck and that successive deals actually take place. An attractive business environment will naturally encourage more transactions but demands functioning institutions. Creating an enabling business environment and the institutions that make it work is where USAID's resources are most effectively invested.

Taking on the hard slog of institutional development is where USAID has significant comparative advantages relative to many other development organizations, especially NGO's and foundations. Through its access to host government policy-makers, business leaders, its power of the purse, and its long-term, in-country presence—all of which are necessary to overcome the many formidable challenges that institutional development presents—USAID is positioned to do what others cannot. Yet, over the last few decades, USAID has seemingly set aside these comparative advantages as the largest and most influential bilateral development agency, turning from a leading sponsor and advocate for policy and institutional reform—a role which few others can effectively play— to an agency that provides many of the same services that development foundations can, and do, provide. In short, USAID has traded it ability as a USG entity to take on the difficult, long-term tasks required for institutional reforms for the more easily achieved, measureable, and less time-constrained projects that many development foundations, NGOs, and PVOs can just as easily achieve.

Part of the reason USAID has lessened its historic role and focus on supporting institutional development may be because institutional reform programs tend to be

[2] The case of Intel's investment in Costa Rica is one of the more notable exceptions to this sequence. Intel's transaction was the cause of significant institutional change throughout the country, impacting policies, laws and regulations from such issues as construction standards all the way to university standards and curricula. It was one of few exceptions to the rule. (See World Bank IFC on Intel's Costa Rica Investment.)

highly complex. They often require a decade or more of commitments, and do not easily lend themselves to evidenced-based, quantitative measurements. They also are difficult to design and very difficult to implement. To complicate matters, they are often mired in political sensitivity, and require a long term, sustained commitment by USAID and host country governments. Institutional development projects must be able to persevere through the natural ebb and flow of shifting political landscapes (in the US and in host-countries) and the capacity to endure with an unwavering dedication to a shared vision of the long-term outcome. Naturally, these are commitments and risks that many politically appointed leaders prefer to avoid. Their short-term tenures are at odds with project timeframes that usually exceed the terms of their appointment.

Over the decades, and prompted by many factors, USAID programs have shifted away from an institution-centric priorities toward shorter-term transactional engagements. Frustration with the inevitably long and politically sensitive engagements typically needed to achieve results was likely part of the underlying cause of the transition. In the 60's, 70's and even 80's, many USAID projects were designed for 10 years, in some instances even longer, in recognition that institutional development depended upon long-term commitments and consistency to succeed. Now, USAID's average in-country projects are typically designed for three years. Combined with a broad lack of understanding, and more expedient, shorter-term political imperatives, the Agency's effectiveness in sponsoring institutional development as core to BBSD is becoming increasingly limited to the detriment of our development assistance objectives and the US stated "3D" policy goals.

Still there are ways to engage in the process of institution-centric development that can demonstrate early returns to USAID's investment. For example, a first step towards establishing functioning institutions is to put into place appropriate policies through which institutions are empowered to carry out their mandates. Stroke-of-the-pen policy adoption is comparatively easier, and usually faster, than other aspects of institutional development. Yet once policies have been adopted, implementing them successfully depends on a set of public and private institutions that are up to the tasks of oversight, intermediation, and implementation. These include the well-known institutions of government such as Ministries, Agencies, etc., but also depend equally upon private sector organizations such as banking and investment institutions, educational institutions, trade associations, industry organizations, business associations, and professional certification associations. Critical development programs are those that strengthen and empower those institutions, ensuring that they have the legal authority, adequate resources, and mandates that are aligned appropriately with their responsibilities. Continuous staff training and education programs further build institutional capacity.

The chart below highlights some, but certainly not all, of the major themes along an economic growth continuum and categorizes the project and program activities that fall within those themes. The areas considered "micro" are transactional efforts.

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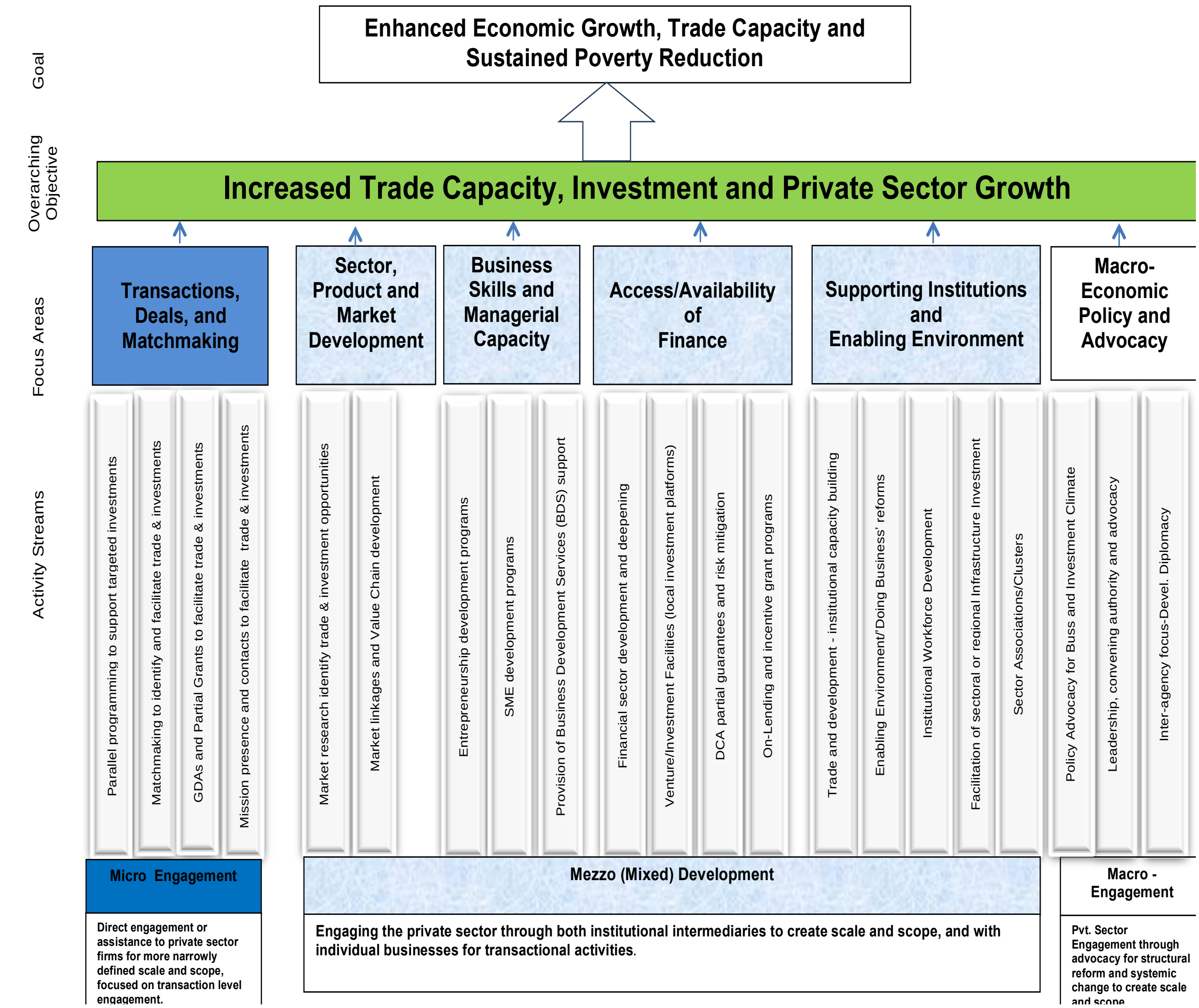
Those listed under “mezzo” are interventions that are most critical for connecting the micro-transactional efforts with the larger policy ones, focused essentially on institution-centric and an enabling environment. The “macro” themes highlight macro-economic policy engagements and support for policy advocacy.



USAID should make institutional reform its key development priority. Adopting the best policies without the institutions—public and private— with the capacity to manage, coordinate, and implement them are just empty suggestions. And the best transactions –or “deals”— in the absence of an overall business environment conducive to growth, become just individual deals lacking in scale, with minimal economic impacts, and only small chances for replication.