Supporting the Development of Institutions – Formal and Informal Rules

An Evaluation Theme
Basic Concepts

Gun Eriksson Skoog
Foreword

Institutions – formal and informal rules within which humans and organisations interact and perform – play a crucial role for sustainable development. However, existing institutional set-ups in many countries prevent development from taking place, just as they may render development co-operation ineffective. Donors recognise this. Hence, supporting institutional development is a strategic issue – increasingly so, not least in light of the Paris Declaration and current trends towards programme support and capacity development at system level. Institutional development is not easy, however, and experience-based knowledge about how to successfully support such processes is limited. Still, it is increasingly recognised that donors need to both consider and affect the broader institutional and political context. The importance of informal rules is also underscored.

In 2004, Sida’s Department for Evaluation and Internal Audit (utv) launched an evaluation theme on support for the development of formal and informal rules. The primary purpose is to learn lessons from Sida’s experience from supporting institutional development in partner countries. This theme is also to contribute to an increased understanding of institutions and institutional development, and of the implications for development co-operation more broadly. It is to perform a learning function for Sida staff at all levels and therefore adopts a process-oriented and participatory approach. As a first step, an orientation and overview phase was conducted in close co-operation with Sida’s operative departments and embassies to set the stage for evaluation. This phase was completed in 2005 and a series of reports and other documents were produced.

This utv Working Paper presents two of the documents. The first one – the Thematic Paper – introduces and motivates the evaluation theme, and presents the central ideas behind it. The second document – the Conceptual Paper – introduces the basic concepts and a perspective on institutions and institutional development. Both documents set the stage for the evaluation theme. They also serve as a point of reference for reflection and dialogue, on issues concerning support for the development of institutions among Sida staff and its partners, as well as for subsequent evaluations.

Gun Eriksson Skoog
Evaluation officer
Sida/utv
# Table of Contents

Supporting the Development of Institutions – Formal and Informal Rules:  
An Evaluation Theme ................................................................. 5

1 Points of Departure ................................................................... 5

2 Purpose and Overall Evaluation Questions............................... 8

3 Initial Phase and Present Paper ............................................... 9

4 What an Institutional Perspective May Offer .............................. 10

5 Potential Evaluation Issues and Topics ..................................... 12
   5.1 Overall Issues of Special Interest ......................................... 12
   5.2 Possible Evaluation Topics .................................................. 13

References .................................................................................. 15

Institutions as Formal and Informal Rules, Institutional Development and  
Processes of Change: Basic Concepts ......................................... 19

1 Institutions – Formal and Informal Rules ................................. 19
   1.1 What Are Institutions and What do they Do? ......................... 19
   1.2 What Kinds of Institutions are there? .................................. 21
   1.3 How are Institutions Related? ............................................. 23

2 Institutional Development and Processes of Change ................. 25
   2.1 How are Institutions and Actors Related? ............................. 25
   2.2 What is Institutional Change and Development? .................... 25
   2.3 What are the Types of Institutional Change? ......................... 26
   2.4 What are the Causes of Institutional Change? ....................... 26
   2.5 What are the Processes of Institutional Change? .................... 28
      2.5.1 Emergence and Change of Informal Rules ...................... 28
      2.5.2 Effective Change in Formal Rules ................................. 29
   2.6 What are the Characteristics of Institutional Change? ............. 30

3 Institutional Development and Development Co-operation ........... 33

References .................................................................................. 34
Supporting the Development of Institutions – Formal and Informal Rules: An Evaluation Theme

Institutions are formal and informal behavioural rules. They structure human interaction in social, political and economic life. Rules influence the way actors behave and societies perform and are a key to sustainable development. Donors recognise this and support the development of economic, political and social institutions. However, changing formal and informal rules is difficult. The process of change is complex and embedded in a country’s history and culture. What role is there for donors? How can they successfully support processes of institutional development in partner countries? These issues are at the centre of the present evaluation theme.

1 Points of Departure

It was for long assumed that poverty and underdevelopment was caused by lack of resources. Now there is a broad consensus that institutions play a critical role for sustainable economic and social development. The demise of the socialist system in Eastern Europe and the former Soviet Union has increased our awareness of the role of institutions and institutional development for sustainable development and poverty reduction. Institutional change in terms of political and economic reform has also been on the agenda since the late 1980s in many developing and transition countries – not least Sida partner countries. Institutions – in terms of formal and informal behavioural rules and norms – provide a framework for social interaction by defining the ‘rules of the game’. Thereby, they crucially impact on the way individuals and organisations behave and interact as well as on how societies perform and develop socially, politically and economically. The character, causes and consequences of institutions is studied within an expanding and broad field of research cutting across a number of social-science disciplines. This field is often referred to as the New Institutional Economics, inspired for instance – but not only – by the Nobel-prize winner and economic historian Douglass C. North.1 There is a rapidly growing body of knowledge about the role of institutions for development.

The importance of supporting institutional development is recognised within the international donor community, and increasingly so, as reflected for instance in the 2002 World Development Report, ‘Building Institutions for Markets’.2 According to the Swedish Policy for Global Development, contributing to increased knowledge and to building sustainable institutions is at the centre of development co-operation.3 And in Sida’s Policy for Capacity Development, institutional development is defined as a key component of capacity development.4 Supporting institutional development is becoming increasingly topical for donors in the light of current trends. The tendency towards programme support (budget support and sector-wide approaches) and

---

1 Some of the central works by North include North (1990) and his earlier work with Robert P. Thomas, North and Thomas (1973).
2 World Bank (2002)
4 Sida (2000)
capacity development at 'system level' highlights the role of well-functioning and development-conducive institutional frameworks. A rights-based and multi-dimensional approach to poverty reduction requires a thorough understanding of how existing institutional constraints and opportunities influence the power, choices and resources of the poor as well as ideas about how to deal with those institutions. Support for institutional development may thus be identified as a strategic issue of high policy relevance for donors in general and Sida in particular.

Developing appropriate and effective institutions is a difficult task, however, as witnessed by the experience of transition economies and reform attempts in many developing countries. One reason is the circumstance that institutional change is embedded in a country's specific historical and socio-cultural context, where social, political and economic institutions – formal as well as informal – are linked into complex systems. Institutions are thereby interrelated and institutional change is therefore contextual, complex and often long term and unpredictable. This circumstance has a number of implications for how to support institutional development, first of all, for what an external agency like Sida can do to promote inherently 'local' institutional change in partner countries. It also means that it may be difficult to promote change in individual rules, unless accompanying change in complementary rules or entire institutional systems are altered too. Moreover, it suggests that supporting institutional development is not only a matter of identifying the appropriate rules to be established or changed, but also – and perhaps more importantly – a question of tracing the very process of change, of 'how to get there'.

In spite of these difficulties, the international donor community, including Sida, has long experience of actually attempting to support processes of institutional change in both the East and the South. This involves, for instance, support for various types of public administration and political reform in relation to democratic governance, deregulation and privatisation as part of market-oriented reform, change in laws and regulations in connection with sector programmes and in norms and practices within organisations in relation to capacity development. There is no doubt vast experience, but what do we actually know about how to successfully support processes of institutional development? Very little, it would at first appear. Or rather, the knowledge that exists appears to be largely tacit, whereas explicit knowledge is missing. To date, no overall evaluation of Sida's support for institutional development has been conducted. Even an overview of the support itself is lacking, in spite of the fact that this support is likely to have become significant over the years. Similarly, there appears to be a lack of systematically accumulated and explicit knowledge within the donor community at large. Nonetheless, given the vast experience, we believe there is a lot of knowledge among Sida staff, consultants and counterparts – tacit knowledge that could be made explicit and used.

Besides, it is sometimes unclear what support is actually referred to as support for institutional development, institution building and related terms and what this implies in actual practice. In other instances, activities are not identified as support for institutional development but actually are that. Preliminary observations suggest that these concepts are vague and that there is conceptual confusion about them within Sida⁵ – and perhaps within the donor community at large. In fact, Sida appears to lack clearly developed concepts and other tools for analysing, understanding, supporting and evaluating institutional development. Sida's policy for capacity development highlights the role of institutions, but the related methodological work has focused on the knowledge and organisational aspects of capacity development – identified as the other two elements, besides institutions, of the concept capacity.⁶ Without clear concepts and basic analytical tools it is indeed difficult get a clear picture of the support, to analyse and

---

⁵ Eriksson Skoog (2002)
⁶ Certain efforts to develop concepts and tools has been made by Sida’s Capacity Development Project (see, in particular, Gustafsson, 2004), but they are not sufficiently elaborated to be useful for the analysis of institutions. Another attempt is reflected in a study commissioned by utv, Ostrom et al. (2002).
evaluate it and not least learn lessons from experience so as to develop the support further. Moreover, the knowledge that does exist about institutions and institutional change within research, in particular within the New Institutional Economics, does not appear to be made use of within Sida. Sida thereby runs the risk of missing important developments in social-science research and a potentially useful perspective. Given the increasingly strategic character of support for institutional development combined with the difficulty of the task, getting access to and making use of knowledge about how to successfully support such processes of change is critical.
2 Purpose and Overall Evaluation Questions

Against this background, and according to Sida’s Evaluation Plan 2004, in the second half of the year, launched an evaluation theme on supporting institutional development. The major purpose of evaluating Sida support for institutional development is to extract knowledge and draw lessons from Sida’s experience from supporting institutional development in partner countries. The preliminary overall evaluation question is: to what extent, how and why has Sida as an external agency managed to effectively support institutional development, particularly processes of institutional change in order to promote sustainable development and poverty reduction in partner countries, given the embedded and complex character of such change? By highlighting the role of institutions and introducing an institutional perspective, a second purpose is to contribute to an increased understanding of a) the role of institutions for poverty reduction and sustainable development and thereby for all Sida-supported activities, and b) the character of processes of institutional change and the roles that donors play in promoting these. Hence, a second preliminary overall evaluation question is: to what extent, how and why has the outcome of Swedish support been affected by the extent to which and how institutional factors have been understood, considered and addressed?

Both purposes serve the overall aim of contributing to making Swedish development co-operation more effective in promoting sustainable development and poverty reduction. The evaluation theme aspires to perform a learning function, first of all for Sida staff at all levels, but also for any partners involved. It hopes to contribute to individual learning, through reflection, dialogue and increasing understanding, but also to organisational learning, by transforming individual insights into the development of methodological tools, policy and practice of Sida support for institutional development. The evaluation process shall be designed to promote this end.

---

7 Sida (2004)
3 Initial Phase and Present Paper

Before the overall evaluation questions can be addressed, we need to orient ourselves about the theory and practice of support for institutional development. What do we, for instance, mean by institutions and institutional development? And what does Sida’s support for institutional development actually look like? What do we already know from past experience of support for institutional development and processes of institutional change? And what specific questions and areas of support would be most interesting to explore?

As a first step, an orientation and overview (o&o) phase was initiated in 2004. Its purpose is to a) introduce institutional concepts and perspectives to Sida staff, b) paint a picture of Sida’s existing support for institutional development, c) summarise already documented lessons based on Sida’s experience from such support, d) initiate reflection and dialogue around the evaluation theme and e) identify knowledge needs and central evaluation issues. The o&o phase serves both as a pre-study phase, preparing a more solid ground for the future evaluations within the theme, and as a learning phase with merits of its own. It will be completed in 2005 and is conducted in close co-operation with Sida’s operative departments and the embassies. A number of potential evaluation ideas will be identified towards the end of the phase and a first evaluation initiated in late 2005.

The activities during the o&o phase are outlined in a separate project plan, and include the production of a number of documents. The so-called Conceptual Paper, the second paper in the present publication, introduces basic concepts and elements of a conceptual framework and serves as a point of reference for the o&o phase as well as for subsequent evaluations. The present so-called Thematic Paper motivates and introduces the evaluation theme and serves as a starting point for dialogue with and among Sida staff and others on issues related to supporting institutional development. In its two final sections, it therefore first suggests different ways in which an institutional perspective may be useful for donors, and thereafter puts forward some tentative evaluation issues and topics.

---

8 See the Brief Revised Orientation & Overview Phase Plan.
4 What an Institutional Perspective May Offer

Apart from highlighting the role of institutions and offering a framework for the analysis of development problems and donor support for institutional development, an institutional perspective may prove useful for donors in a number of other ways.

Institutions unpack the context. An institutional perspective makes the hidden explicit and clear. It provides concepts and categories for grasping much of what is often perceived as vague, tacit, behind-the-scenes and difficult to articulate, but which many hold as important determinants of what we observe, do and can achieve but still often fail to address. It helps us to put the informal – rules and organisations, structures and relationships – on the table, to be observed, analysed, discussed, taken into consideration and possibly even dealt with. Power relationships, formal as well as informal, are also openly displayed by institutions, since relationships and distribution of power are largely defined and determined by the formal and informal rules of the game – whether social, political or economic.

An institutional approach is truly contextual. It stresses the importance of the context – in terms of the specific local circumstances – for the phenomena donors observe and support, and hence the importance of analysing, understanding and taking this context into account by adjusting to, making use of or trying to influence and change it. Institutions account for the framework within which actors operate and interact in pursuit of their aims and which conditions much of their behaviour, and thereby help us identify those conditions. An institutional approach stresses the importance of incentives created by the institutional context for the behaviour of actors. It interprets the resulting activities and performance largely (although not exclusively) as a consequence of these contextual circumstances and the incentives they give rise to. In other words, it attempts to understand the logic of the situation. This is the (inner) logic of why actors do what they are actually doing, given the specific situation and larger context in which they find themselves. It is an attempt at understanding why what they are doing makes sense to them – is rational – from their own point of view. Not only the institutional context but also the way that actors perceive their own situation is important for the way they act. Since formal and informal rules embody values and beliefs which influence actors’ perceptions, they also help us consider values and beliefs and the role they play more explicitly. The contextual character of the institutional approach enables a more genuine understanding of the behaviour, activities, performance and developments we observe and why, for instance, things don’t always turn out the way we expect.

Institutions offer a systemic approach. This implies, on the one hand, that it draws our attention to the interrelationships between the parts of the system – between rules and actors, but also between different rules, such as economic, political and social rules, between rules at different levels and, not least, between formal and informal rules. Secondly, it implies a holistic perspective, where a number of interrelated factors of various kinds and at various levels can be considered. (It offers a broad and all-encompassing perspective, for instance, on capacity development.) The institutional approach is multidimensional. It enables the integration and combined analysis of economic, political and social factors as well as the interaction between them. It cuts across and links social-science disciplines. Given that donors operate in virtually all social sectors, institutional analysis may prove useful for a broader understanding of the social systems in which they operate.

However, since donors’ ambition is to promote institutional change and development, just understanding institutions is not enough, we must also understand processes of change – how institutions come about.

Cf. the argument of Chabal and Daloz (1999), implying that ‘Africa Works’ – according to its own logic.
and change over time. An institutional approach facilitates our analysis and understanding of social change, more specifically about institutional change. In particular, it helps us to understand processes of institutional change by unfolding that process, as discussed above. Processes of change are largely path-dependent and thus influenced by historical developments. Institutional analysis highlights the importance of history – past experience and the institutional and ideological heritage, social, economic and political – for actors’ behaviour, processes of institutional change and the development of societies.

Institutional analysis provides concepts, categories and other analytical tools that facilitate systematic description and analysis of the issues discussed here. Today, many of these are perceived as unclear; there is need for increased – or at least explicit and systematically accumulated – knowledge and improved understanding. It also offers a potential for methodological development within Sida, which may prove useful for a broad variety of development co-operation activities, not least in the area of capacity development. Finally, it implies a partly new perspective, and thereby comes with new potential opportunities while reducing the risk for lock-in to old, taken-for-granted ways of thinking.
5  Potential Evaluation Issues and Topics

Here we suggest some issues of particular interest and potential evaluation themes.

5.1  Overall Issues of Special Interest

The following overall issues would appear be among those that stand out as central and thus need to somehow be dealt with in any evaluation.

 Processes of Institutional Change
As clarified above, supporting institutional development is not only a matter of identifying the relevant rules to be established or altered, but also – and perhaps more importantly – of understanding and promoting the process of how to get there, that is the dynamic process of change. Hence a central issue would seem to be to increase our understanding of how institutional change actually takes place and how such processes can be supported. As suggested above, there is some knowledge to be found in the research literature on institutions, but it is also likely that substantial knowledge based on practical experience is vested among the actors involved in international development co-operation. What are the components and phases of processes of institutional change, and who are the actors? What factors contribute to facilitating such processes of change – for instance how can formal change be effectively implemented?

 Role of Donors
And what is the role of donors in all this – donors are actors but what role shall they play? In particular, given the contextual and complex character of institutional change – embedded in the specific historical, social, political and economic context where institutions interact with actors, other rules as well as beliefs and values – what can an external agency like Sida do to successfully promote inherently internal processes of institutional development in partner countries? As discussed in the introduction, this would seem to be an important question to be addressed. Besides, Sida is not the only donor active in partner countries, but only one of several in a large donor community. This means the role of other donors must be taken into consideration, as well as recent but strong tendencies towards increased donor co-ordination of support and harmonisation of procedures. So one question is what Sida can do in the light of what other actors do and increased donor co-ordination.

 Role of Informal Rules
As stressed in this paper, institutional development is not only a matter of formal rules, but also informal rules and the relationship between the formal and the informal ones. A set of questions is related to informal rules. Apart from the general questions as to the relationships between formal and informal rules, in particular during processes of institutional change, there is the issue of how donors relate to informal rules. To what extent are donors aware of informal rules and their importance and role, and to what extent and in what way are they taken into consideration? And what are the consequences of not considering them? Are, for instance, informal rules targeted and in what way? Are they targeted directly or indirectly, for instance through efforts to influence societal norms of behaviour, such as towards the application of human rights, gender equality and environmental considerations? And to what extent and how are informal rules taken into consideration and possibly adapted to development co-operation activities whether these directly aim at institutional development or not? How do informal rules influence the outcome of the activities supported? And how does the adaptation to or lack of consideration of informal rules influence the success of the support?


Role of Informal Power

In particular, are donors aware of informal (or formal, for that matter) political rules and power relationships and their role in the functioning of the formal political system and the entire public administration, including the judicial system, for instance? How are these relationships dealt with — adapted to, taken into account? Or are efforts made to influence them? Are donors aware of the consequences of such informal political rules for the effectiveness and impact of support for formal processes of democratisation as well as for support for public sector and governance reform, such as decentralisation?

Role of Socio-Cultural Rules

The importance of understanding and recognising the socio-cultural institutional context in which international development co-operation takes place has been stressed here, and gives rise to similar questions as those above. To what extent are they understood, taken into consideration and adapted to or otherwise made use of? Is their role for the functioning of the economic and political systems recognised, for instance in efforts to promote rural and private sector development as well as good governance and public sector reform? The perhaps most intriguing question concerns the extent to which change in formal rules is adjusted to existing traditional or indigenous rules, in order to ensure consistency between them and increase the chances that the formal rules gain legitimacy in the eyes of the population and become effectively applied? And when socio-cultural rules are ignored what are the consequences for the success of donor efforts to support formal reform?

Institutional Inter-Relatedness

The questions about the roles of socio-cultural and informal rules and power relationships discussed above, are all variations on the theme of institutional inter-relatedness. An institutional perspective involves taking the relationships between various types of rules into account — between formal and informal, socio-cultural, political and economic rules as well as between rules as various levels. It is partly this inter-relatedness that accounts for the complexity of change in rules, and central questions of course concern how donors manage to deal with that inter-relatedness in development co-operation. Given the current tendencies towards programme support at central government and sector level, and stress now placed on capacity development, dealing with complexities becomes all the more pertinent. However, recognising the inter-relatedness between rules is important at all levels, ranging from the constitutional to the organisational.

5.2 Possible Evaluation Topics

The following evaluation topics are just preliminary ideas of possible areas on which specific evaluations might focus — to be discussed, considered, questioned and complemented or even substituted. Nothing has been decided yet, the purpose is just to get the discussion started and get some feedback on already existing ideas. New ideas are more than welcome, and the evaluations subsequently undertaken may turn out to be in entirely different areas.

Property Rights

Support for the definition, security, development and change of property rights might be an interesting area to examine, not least in the light of the fact that property rights are found to be one of the most important institutional factors for economic growth. By property rights we refer to a bundle of rights related to property, including ownership, user and tenure/heritage rights. Property may include land, real estate, urban squats etc. as well as collective and common property. There are various options here: one is to look at property rights broadly; another is to focus on land rights specifically. It is also possible to consider ownership rights in general, but focus on women’s property rights in particular — as a special case. Regardless of which option is chosen, considering both formal and informal/traditional rights and
the linkages between them would be particularly important. Support for development of property rights would seem to be an area of emerging interest at Sida where a network for women’s property rights was recently established. It would seem then, that a formative/learning evaluation could extract knowledge and contribute to the development of policy and practice.

**Local/Decentralised Institution Building**

Issues of institutional development concerning collective action within civil society, partnerships with public and private actors, polycentric governance, governance of common pool resources, natural resources and common property etc. might be an area to explore further.

**Rule of Law**

The rule of law is another institutional ‘factor’ – or consequence, rather – that is found to be of central importance for economic growth. The concept may be more or less broadly defined, but in its simplest sense, it means that formal rules are valid, which means they are mostly adhered to and enforced. The fact that the law (and other formal rules) actually rules – instead of discretion – reduces uncertainty and increases predictability. This creates stability, which is beneficial – not least to investors. The establishment and development of the rule of law has been the subject of donor support – and not only for economic development. It is an important element in Sida’s support for democratic governance and considered central for poverty reduction from a rights perspective. It might be another area where there is substantial scope for a formative evaluation to contribute to development of policy and practice. Whereas the focus might be on support for the judicial system, broader socio-cultural aspects, beliefs and values as well as the interaction between the formal system and traditional law and enforcement could be incorporated.

**Democratisation**

Support for democratisation and related formal political institutional change is an important part of Sida’s work for democratic governance, increasingly stressed in the new Swedish policy for global development and one of the most central issues in several Swedish government country strategies. One possible evaluation topic would be support for democratisation, with a specific focus on the extent to which informal political rules and relationships have been taken into account, and the implications for support and its outcome in terms of actual democratisation and change and/or reinforcement of political powers. Possible points of departure for African case studies might be offered by Chabal (2003), in the case of Kenya, and Sarah Vaughan and Kjetil Tronvoll (2003), for Ethiopia. However, other country cases may be equally or more relevant.

**Corruption**

Preventing and combating corruption is one of Sida’s three strategic priorities for 2005–2007. What does Sida (and other donors) do in order to counter corruption in partner countries – not only in terms of dealing with the symptoms, by securing their own procedures, but also in terms of addressing the causes of corruption through various kinds of support? Corruption is a truly institutional phenomenon – informal in character, but which in turn may be influenced by incentives shaped by other formal and informal political, economic and socio-cultural rules, as well as by such factors as resource availability. Research on the causes and mechanisms of corruption would appear to be substantial, which might motivate a literature survey as the first step. More specifically, questions might concern what donors know about the causes of corruption – how is it analysed and understood? How do donors try and manage to influence the prevalence and causes of corruption, in terms of both intended and unintended effects? A point of departure might be Sida’s rules and guidelines to anti-corruption work. Other potential questions concern whether donors in fact may contribute to corruption themselves, and if so: how, to what extent and why?
References


North, Douglass C. (1993):


Institutions as Formal and Informal Rules, Institutional Development and Processes of Change: Basic Concepts

This paper introduces some basic concepts and a perspective on institutions and institutional development. This is one of the two first points of departure for the initial orientation and overview phase of the overall evaluation theme on support for institutional development, launched by the Department for Evaluation and Internal Audit (utv) of the Swedish International Development Cooperation Agency (Sida).¹

The purpose of the paper is thereby to serve as a point of reference for, firstly, reflection and dialogue on the evaluation theme among Sida staff and other stakeholders, and secondly, as a conceptual framework for the subsequent studies and evaluations.

What are we actually talking about when we refer to institutions, institutional development and processes of institutional change? And what role do institutions play – hence how and why do they matter? This paper provides brief answers to these questions by accounting for some basic concepts and theory of the New Institutional Economics, as interpreted by the author. The New Institutional Economics is no homogenous school of thought² – and will not be accounted for here – but something like a common language is emerging. The presentation here partly draws on the previous work of the author,³ and adopts an institutional perspective that is adapted to the study of processes of change in rules.

1 Institutions – Formal and Informal Rules

1.1 What Are Institutions and What do they Do?

In daily parlance, the term institution is used to mean different things, which also appears to be the case within Sida. By institutions people sometimes mean organisations, or perhaps more commonly, public organisations. Sometimes they seem to refer to a more vague phenomenon at a system level, including both rules and organisations – perhaps a major function performed by the public sector.⁴ The World Development Report 2002 refers to institutions as ‘rules, enforcement mechanisms and organizations’.⁵ Here, however, we make a sharp distinction between institutions and organisations.⁶ This is in line with Sida’s policy for capacity development and, as explained below, crucial for the understanding of institutional change.

Institutions are here defined as behavioural rules for social interaction. These prescribe behaviour for actors in recurrent situations of interaction with other actors – and thereby solve social interaction prob-

¹ The other starting point is the presentation of the evaluation theme in the so-called Thematic Paper, the first paper in the present publication.
² Just as the descriptions of New Institutional Economics may vary. For definitions and overviews, see for instance Eggertsson (1990), Langlois (1990c), Kasper and Streit (1998) and Knudsen (1995)
³ In particular, Eriksson Skoog (2000).
⁴ Eriksson Skoog (2002)
⁵ World Bank (2002), p. 6
⁶ Cf. North (1995), p. 15. Whereas the definition of institutions may vary also within institutional economics, this distinction is almost always made.
lems.’ They form ‘the rules of the game’ while the actors are the ‘players of the game’. The terms institutions, rules and rules of the game will here be used interchangeably. There are formal rules, such as constitutions, laws and regulations, and informal ones – behavioural norms, codes of conduct and routines. Institutions are social, as opposed to personal. They are shared among the members of the society or group within which they apply. Institutions are enforced, and thus become effective in terms of actually being applied and adhered to, by some sort of sanction. Institutions that are not enforced are ineffective and may be considered non-existent, in terms of their influence on human behaviour and social interaction. Laws, for instance, which are not adhered to are only nominally in place. Elinor Ostrom consequently stresses the concept rules-in-use rather than rules-in-form.

Actors, the players of the game, may be individuals or organisations. According to North, organisations ‘consist of groups of individuals bound together by some common objectives’, and he identifies economic, political as well as social organisations. Organisations may be formal or informal. Informal organisations may be illegal such as the Mafia, but may also include social networks as well as informal groupings – for example, those cutting across departmental boundaries within existing formal organisations.

Rules guide human action. When actors are confronted with recurrent interaction problems, rules facilitate their decision making and behaviour by shaping expectations about how to behave successfully in those situations, thus reducing their behavioural uncertainty. Rules thereby shape incentives for behaviour. They codify accumulated knowledge, based on the experience of others before us about the type of behaviour that proved successful in the past – just think of routines and traditions. Rules also communicate values, by containing social prescriptions for behaviour – telling us what we should do.

Sida’s policy and methodological guidelines ‘Perspectives on Poverty’ and ‘Sida at Work’ may serve as examples. These are (sets of) rules that partly express the lessons learnt by Sida and other donors from practical development co-operation experience of what works well and what does not. At they same time, they strongly communicate the current Sida (and donor) values on how we should view poverty reduction and Sida’s role in development co-operation. These rules shall guide the behaviour of Sida staff, not least in interaction with partner countries. The extent to which they are rules-in-use and not just rules-in-form remains an open question.

Institutions perform both individual and social functions. First of all, they facilitate decision making and behaviour for individual actors in recurrent interaction situations. Besides, our own following of the rules facilitates the behaviour of others, by shaping their expectations about how we will behave. ‘[S]ocial institutions’ thereby ‘reduce the social uncertainty in the system by making the actions of the agents more predictable’. They solve co-ordination problems between individuals and provide ‘standard solutions to recurring social interaction problems’. These are important social functions. Hence institutions correlate social activity over time, between actors and situations and thus bring structure and stability to society. They ‘facilitate order’.

---

8 Hargreaves Heap (1989), pp. 4 and 116–119
9 Ostrom (1999), p. 37
10 North (1995), p. 16
12 Sida (2002; 2005)
14 Knudsen (1993), p. 269
15 Vanberg (1993), p. 190
16 According to Kasper and Streit (1998), p. 30, this is the ‘key function’ of institutions.
1.2 What Kinds of Institutions are there?

Institutions prevail in all areas of social life, at all levels and can be categorised in a number of ways. One important distinction is the one already made between formal and informal rules. Formal rules are consciously designed by humans and often codified in written form – examples are constitutions, laws and regulations. They are also often enforced by some external authority. The police and the courts, for instance, enforce the rule of law. Enforcement requires enforcing organisations. Informal rules evolve spontaneously and unintentionally over time through human interaction, and take the form of unwritten conventions, routines, customs, codes of conduct and behavioural norms. Informal rules are often self-enforced, because all (or most) actors find it beneficial to adhere to them (as long as others do too), for instance to honour promises or speak Swedish in Sweden. Those who do not abide by the informal rules of society can expect the other actors to show their disapproval even to the extent of expelling them from the group.

Institutions can be categorised functionally, according to the types of activity that they regulate. Political rules regulate political activity and determine the characteristics of the political system (single or multi party system, for instance). They include rules for how political power shall be distributed and among whom, procedures for political decision-making and for the electoral process. They define, for instance, the relationship between government and parliament and – of crucial importance in several Sida partner countries – between the ruling party and state organs (party supremacy or ‘independent’ state, for example). Formal rules may be expressed in a constitution, but informal political rules may also apply – for instance those of the political culture and debate. Informal political rules may also imply that what appears to be free multi-party elections are not – at least not according to the logic of the ‘Western’ political system. The formal election rules may prove ineffective in practice, because actors – political candidates as well as the electorate – instead adhere to co-existing informal rules, such as those which Patrick Chabal refers to as the neo-patrimonial political system prevailing in ‘black’ Africa.

Economic institutions make up the economic system – the framework that regulates economic activity. They may be broadly grouped into two categories: those that define the forms of ownership of the means of production, and those that define the mechanisms for resource allocation and co-ordination of economic activity. A market economic system can then simply be described as one where private property rights and the market mechanism dominate, while a centrally planned or directed economic system is dominated by state or collective ownership and bureaucratic/administrative co-ordination. In the former socialist economic (and political) system of Tanzania, for example, central formal economic rules were the following; state ownership of the ‘commanding heights’ through parastatal monopoly in several economic sectors; centrally determined prices of many consumer and producer goods; severe regulation of

---


18 Kasper and Streit (1998), pp. 31 and 100, make a more refined categorisation of what is here referred to as formal and informal rules. They categorise institutions, firstly, according to the way they come about, and distinguish between external and internal rules. External rules, such as laws, are designed and imposed from above, and internal rules, such as customs, evolve gradually through human interaction. Secondly, they categorise institutions according to the way they are sanctioned, and now distinguish between formal and informal rules. Sanctions for non-compliance with formal rules rely on a formally organised mechanism, whereas non-compliance with informal rules is sanctioned through decentralised, spontaneous social feedback. Although the external-internal and formal-informal categories not always coincide, the authors note that external institutions often are enforced formally and internal institutions tend to be enforced informally.


domestic and external trade – such as bans on cross-regional food trade; bureaucratic intervention in the operational decisions of parastatal enterprises.\textsuperscript{21}

There are also informal economic rules; examples are: those that govern activities in informal markets, traditional ownership rules, user and inheritance rights to land, and customary land tenure in Africa.\textsuperscript{22} Another example is offered by the Tanzanian socialist system. During its establishment in the 1970s, an informal rule gradually emerged within the public sector through interaction between the parastatals and other state organs, referred to as the soft budget constraint.\textsuperscript{23} The soft budget constraint implied that in situations when parastatals faced financing gaps – which were constantly reproduced and had to be dealt with – parastatal managers turned to various state organs for bail-out finance, and those organs provided it in one way or another.\textsuperscript{24} It emerged as a logical consequence of the socialist institutional system requiring a solution to a recurrent problem created by that very system.

\textit{Social or socio-cultural} institutions regulate social and cultural interaction, and mostly include informal rules determining for instance mutual rights and obligations between society members. Reference, once again, may be made to Tanzania and what Göran Hydén has referred to as the ‘economy of affection’ which involves informal networks for social interaction. These networks are largely based on kinship and characterised by certain values and behavioural rules, reflected for instance in the two concepts \textit{ujamaa} and \textit{ujima}.\textsuperscript{25} The caste system in India is another obvious example of informal socio-cultural rules. It may be worth noting, as Kasper and Streit do, that “[i]nstitutions – and underlying values – which are widely shared by a community define that community.”\textsuperscript{26} Socio-cultural rules form part of the culture of a certain society, and thereby define group identities and social belonging. Hence institutions apply to the interaction among actors within a certain group or society.

A categorisation of rules can be made on the basis of their \textit{domain of applicability}, in terms of geographical area or level. There are global institutions (such as international conventions within the United Nations system), pluri-lateral rules (as within the European Union), bilateral rules (for instance, development cooperation agreements between two countries). Within countries, there are laws at national level, regional decrees, municipal regulations and by-laws, contracts between organisations and statutes and routines within an organisation etc. Institutions prevail at all levels. Hence, there is no reason to restrict the prevalence of rules to the external context of organisations, as implicitly implied by Sida’s policy for capacity development.\textsuperscript{27}

The way actors behave within an organisation and how the organisation performs will be determined partly by rules within the organisation, and partly by the rules of the external context. Among the rules that define the behavioural opportunities and constraints of public sector actors, for instance, there are rules that apply generally within public administration, concerning perhaps relationships between vari-

\textsuperscript{21} For an account of the elements and character of the socialist political and economic institutional system of Tanzania, see Eriksson Skoog (2000), Chapters III and IV.
\textsuperscript{22} See for instance Jean Ensminger (1997) for an overview of land rights and changes in these in Africa.
\textsuperscript{23} The term was coined by the Hungarian economist János Kornai (see, for instance, 1979) in his study of the socialist system.
\textsuperscript{24} Eriksson Skoog (2000) studies the emergence, persistence and logic of the soft budget constraint – an informal institution – during Tanzanian socialism. Chapter III analyses the emergence of this informal rule.
\textsuperscript{25} Hydén (1980)
\textsuperscript{26} Kasper and Streit (1998), p. 32
\textsuperscript{27} Sida (2000), p. 21. This restriction may seem to be implied by North’s definition of organisations, related above. However, North (1995, p. 18) recognises that institutions also may prevail within organisations and further clarifies his distinction between institutions and organisations through the following statement: ‘Modeling institutions is modeling the man-made constraints on human interaction that define the incentive structure of the society. Modeling organizations is theorizing about the structure, governance (including the constraints defining the incentive structure internal to the organization), and policies of purposive entities.’
ous levels, or for procurement and appointment. At the sectoral level, there are sector specific rules, stipulating for instance the tasks of various organisations and concerning the procedures to be applied when carrying out these tasks. Within individual organisations, there are more detailed rules of both substantial and administrative nature, such as policies, guidelines and routines etc.\footnote{28}{See, for instance, Gustafsson (2004).}

The existence of rules at various levels implies that rules may be structured \textit{hierarchically}. Ostrom, for instance, distinguishes between \textit{constitutional-choice} rules at the policy-making or constitutional level, \textit{collective-choice} rules that regulate interaction in collective-choice situations, and \textit{operational} rules that affect day-to-day decisions.\footnote{29}{Ostrom (1999), p. 58}

\subsection{1.3 How are Institutions Related?}

The hierarchical structuring of rules implies that there is a \textit{hierarchical relationship} between institutions. Higher level rules regulate rule setting at lower levels, in terms of who is eligible to decide those rules, and which procedures shall be followed when changing lower level rules. Hence, rules at the operational level are set within the frames of the collective-choice and constitutional rules. All rules are nested in another set of rules that define how the first set of rules can be changed.\footnote{30}{Hence, the term ‘institutional system’ stresses the inter-relatedness of institutions, whereas the term ‘institutional framework’ stresses the relationship between institutions and actors, to be discussed below.}

Institutions are \textit{functionally interrelated}. They fit with one another into a system of institutions.\footnote{31}{Hence, the term ‘institutional system’ stresses the inter-relatedness of institutions, whereas the term ‘institutional framework’ stresses the relationship between institutions and actors, to be discussed below.} The function of each rule is to govern behaviour not governed by other rules, so that one rule takes over where other institutions cease to apply. This is recognised by several scholars.\footnote{32}{See, for instance, Neale (1988) and Bush (1988).} Institutions complement one another if there is a good fit between them – which is not always the case. Hence Kasper and Streit note that ‘[r]ule systems work better in ordering human actions if they form a hierarchy running from general to specific rules.’ Such hierarchies make it easier for individuals to understand the rules, because they serve to create an order among different rules and maintain consistency over time.\footnote{33}{Kasper & Streit (1998), p. 137}

Also the relationship between formal and informal institutions is largely \textit{complementary}. Since it is neither possible nor desirable to design detailed formal rules for all possible and specific recurrent situations informal rules are needed to complement the formal ones. Informal rules emerge spontaneously to take care of recurrent interaction problems that are not regulated by the formal rules. These problems often occur as a result of the formal rules, so that informal rules become adaptations to the formal rules. This happens, for instance, when working routines and practices that enable us to perform our tasks according to internal policies and regulations in our work places evolve over time. The soft budget constraint in the Tanzanian parastatal sector, related above, is another example. Moreover, informal institutions are important for the effective enforcement of formal rules, which cannot rely on formal enforcement mechanisms alone. If the formal rules are not consistent with the informal socio-cultural rules of society, they will lack legitimacy in the eyes of the members of that society, and are likely to be ignored unless they are enforced by coercion. Formal rule adherence then partly relies on informal enforcement.\footnote{34}{Kasper & Streit (1998), p. 139}

Institutional inter-relatedness and complementarity implies that individual rules cannot be studied in isolation. A certain rule must be examined in relation to other complementary formal and informal rules at
multiple levels, and the ways in which they are ‘nested’ – to use the words of Ostrom. Inter-relatedness and complementarity also implies that rules are mutually reinforcing, which creates a certain amount of inherent consistency and stability to the institutional system. Herbert A. Simon refers to society as a ‘a whole system of interlocking roles’ or institutions. However, there is not always – if ever – a perfect inner coherence between the rules of a system. There may be a poor fit, and then some institutions will prove ineffective in guiding behaviour. Informal rules, for instance, may not yet have been adapted to new or altered formal rules, whereby inconsistencies and tensions between them arise. Or, formal economic or political rules are rendered ineffective because they have not been adjusted to already existing informal socio-cultural rules. And partial formal institutional reform may cause inconsistency between different formal rules. Institutional inconsistency creates behavioural uncertainty for actors – for instance, about which rules apply – and instability. Perhaps institutional systems are best described not as stable and coherent but as continuously undergoing gradual change and adjustment in formal and informal rules. Indeed, institutional systems may experience both relatively stable and unstable periods. Still, institutional change would appear to be an ongoing process. To this we now turn.

35 Simon (1982b), p. 390
2 Institutional Development and Processes of Change

2.1 How are Institutions and Actors Related?

The relationship between actors (or human behaviour) and institutions is two-sided. First of all, rules influence actors by constraining or promoting their behaviour. At any point in time, the existing institutional framework thereby shapes incentives for behaviour, which in turn influence human action and interaction, organisational activity and performance. This is the first relationship. However, and as discussed above, the institutional system would seem to undergo more or less constant change, and humans are the ones who change the rules. Hence, the second relationship implies that rules in their turn are created and altered by human behaviour – the actions of individuals and organisations.

Consequently, rules do not exist in isolation – nor do they ‘act’ themselves – but always in relation to actors (individuals and organisations). This means that they cannot be studied in isolation, but only through their relationship and ‘interaction’ with actors. Similarly, enforcement and implementation requires enforcing and implementing organisations and individuals, and adherence to rules implies certain behaviour. In fact, rules themselves cannot be observed; the documentation of formal rules can, but this says little about their actual use and effectiveness. Hence, one way to study institutions is to observe the behaviour or behavioural patterns that implementation, enforcement and adherence to them gives rise to, as well as the consequences of such individual and organisational activity.

The distinction between institutions and organisations is important, as mentioned earlier, because in order to understand institutional change we must study the interaction between institutions and actors. It is, in fact, ‘[t]he interaction between the two [that] shapes institutional change.’ The distinction is important also for effective policy and reform measures. There is a great difference between changing the rules of the game and changing the players of the game, and the consequences differ. It may be relatively easy to exchange the players, for instance by replacing individuals or establishing new organisations within a given institutional framework. Changing the rules may be more difficult, but the consequences are often greater. Hence, by keeping the concepts institutions and organisations apart, we obtain far more useful analytical categories.

2.2 What is Institutional Change and Development?

Institutional development here refers to institutional change in a direction that promotes sustainable economic, political and social development, aiming at poverty reduction. It thus has a positive value connotation. Institutional change, by contrast, is value neutral. It may involve change, modification or dismantling of already existing rules or the creation of altogether new rules, regardless of whether the change is

---


37 North (1995), p. 15

38 Such organisational change was common, for instance, within the parastatal structure of agricultural marketing organs (including co-operatives) in Tanzania during the 1970s and 1980s, but implied no fundamental change in the functioning of parastatals or agricultural markets. (Eriksson Skoog, 2000, Chapters III & IV, passim)

39 When Tanzania changed the rules of the game by deregulating trade in agricultural products (and other commodities) and thereby abolished buying monopoly power (so-called monopsony) in the mid-1980s – hence a clear change in the rules for agricultural trade by different economic actors, individual peasants as well as private enterprises and parastatal organisations – the functioning of not only parastatals but of the entire agricultural market changed. (Eriksson Skoog, 2000, Chapter V, passim)
‘good’ or not. Creating or building institutions ‘from scratch’ can mean different things. It may refer to the establishment of rules for activities that were not previously taking place (such as market exchange in a certain sector). Or it may imply the shift from a situation where interaction was governed by personal ‘rule’ and discretionary power to one where behaviour and activities become governed by rules. When donors talk about institution building they may refer to establishment of the rule of law.

Institutional development and change may be more or less comprehensive, involving more or less change in many or few rules within a single or several levels and areas. Whole-scale transition of the entire economic and political system of former socialist countries are among the most dramatic institutional changes experienced – as well as the ‘revolutions’ that preceded them. Small-scale institutional change and development takes place more frequently, for instance within organisations, as reflected in reformulation of working procedures and modification of routines.

When we talk about institutional development and change here, we refer to effective change. Hence, nominal change in formal rules does not count as effective change, unless the rule also is actually implemented, enforced and used. No rule effectively applies or is valid, and thus exists as a rule, unless it actually guides human behaviour and is adhered to by actors. Consequently, institutional change may occur in the form of change in the enforcement of a formal rule, whereby the rule may shift from only being nominally in place to eventually becoming effective.

2.3 What are the Types of Institutional Change?

Institutions are man-made rules. However, they may be created in different ways. It is common to distinguish between two major types of institutional change, which by and large are considered to apply to two types of institutions, as already suggested above. Formal rules are created as a result of plan and conscious design (or pragmatically). Change in formal rules normally requires some kind of collective action and decision making. It often involves change through the political system of decision making – a political process – whether within the state, a municipality or individual organisation. In other cases, formal change in rules takes place through the collective action outside established political structures but within a community, as a means to solve a common problem or reach a common goal. The building of institutions for governance of common pool resources studied by Ostrom and her colleagues provides a wealth of examples. In this context it is worth noting that change and creation of formal rules may happen at local community level and not only at central level. Informal rules, by contrast, tend to emerge organically, spontaneously, as the unintended outcome of individual behaviour and social interaction. Any economic and political system has come about through a combination of spontaneously evolved and intendedly designed institutions.

2.4 What are the Causes of Institutional Change?

According to North there are two basic sources of institutional change: changes in preferences and in relative prices. Change in people’s preferences may stem from new values, attitudes and ideas – perceptions of

---

10 Kaspar & Streit (1998), p. 395. Formal rules may be decided by a single individual – a dictator or supreme ruler – for instance through presidential decrees, but then rather resemble personal rule and discretion.
11 Alston (1996), p. 27
12 Ostrom (1990) is a standard reference.
13 The terminology used here is inspired by Menger (1963), Book 3, Chapters 1–2, pp. 129–159. He refers to two different but complementary approaches to understanding social phenomena – pragmatically versus organically. A parallel may also be drawn to the distinctions between planned versus spontaneous order. For a recent discussion, drawing on the works of Carl Menger and Friedrich Hayek among others, see Kaspar and Streit (1998), pp. 142–155.
14 North (1990), pp. 84–86
how the world is and how it should be. The role of ideology in shaping institutional change is perhaps most clear within the former socialist system. Changes in relative prices come from changes in the ratio of prices of production-factors (due to changes in ratio of land to labour, labour to capital or capital to land), in information costs and technology. Relative prices and costs reflect the relative scarcity of resources and alter power structures and the bargaining power of actors. And it is the continuous competition for scarce resources between economic and political actors (individuals and organisations) that is the key to institutional change, North argues.

Changes in African land rights may illustrate the role of price change. Jean Ensminger shows that in areas where there was demographic pressure, expanded commercial opportunities and new technologies, agricultural land became increasingly scarce and its value consequently increased. As a result of the increased price of land, demand for land privatisation arose and changes in property rights from customary land tenure towards individual and exclusive rights took place. Wolfgang Kaspar and Manfred E. Streit, in turn, exemplify how organisational competition may cause institutional change. Globalisation – in terms of intensified trade and greater factor mobility – has led governments to compete for market shares and mobile production factors by actively making institutional adjustments. Related causes of change may be challenge to political leaders from new potential leaders or external force or threat thereof.

Hence, institutional change can be set-off by events external or internal to society. The role of technological change is recognised by several authors. Bush, for instance, contends that the driving force behind institutional change is growth in the fund of human knowledge, “generated by the community-wide problem-solving processes”. This suggests that many – if not most – impulses for institutional change emanate from within the institutional system itself. For instance, economic decline or poor performance may cause institutional change. If the existing institutional system does not favour sustainable development, but creates incentives for non-productive behaviour, society’s economic performance is likely to decline over time, due to the self-reinforcing tendencies of the institutional system. At a certain point, relative pay-offs will have declined to the extent that rule-following behaviour no longer produces the benefits to actors that it used to, which may create incentives for and initiate a process of institutional change. Adherence to existing rules that proved to be successful in the past may no longer do so when the context changes. Hence a need to cope with changed circumstances may cause institutional change. An additional source of change inherent in the system may be change in another rule, which leads to institutional inconsistency. Change can thus be initiated as a response to a changing context where past behaviour no longer works well.

Institutional change may also be the result of a more active initiative. Some actors prefer to experiment with breaking the prevailing rules, and are willing to accept the risk of sanctions, because they believe the advantages may be greater. If they are successful, other actors may imitate their behaviour and if a critical mass of actors change behaviour a new rule replaces the old one. Kaspar and Streit argue that “institutional evolution is propelled by those “million little mutinies” and the evaluation of these “million little mutinies” by numerous other people.” Both formal and informal rules may be altered through such entrepreneurial behaviour. One source of change that is increasingly recognised is changes in beliefs, ideas and

---

45 For the case of Tanzania, see Eriksson Skoog (2000), Chapter III, passim.
46 North (1995), pp. 15–16
47 “[N]ew social norms and property rights emerge[d] to internalize the beneficial and harmful effects and adjust to the new cost-benefit position.” (Ensminger, 1997, p. 167)
48 Kaspar & Streit (1998), pp. 399–404
values: changing perceptions of how to interpret the world and how it works, as well as changing values of how the world should be.

2.5 What are the Processes of Institutional Change?

Institutional change takes place through a process in which actors and institutions interact. By *process* we do not just mean anything that goes on over time, but more precisely, a sequence of events in causal and chronological stages over time. One may distinguish between the processes of change in formal and informal rules, although they have a lot in common. In order to understand specific processes of institutional change, it is important to identify the actors: both those who promote (change agents) and those who resist change, their specific problem situation, their wider context – in particular the institutional structure and perceptual legacy – as well as the behavioural incentives this context gives rise to. It is also important to understand the behavioural uncertainties that actors face, as will be clarified below, the sequence of events and the causal relationship between them.

2.5.1 Emergence and Change of Informal Rules

An informal rule may emerge spontaneously and unintentionally as a solution to a recurrent problem in the following way. When confronted with a new problem and facing uncertainty about how to handle it, an actor is likely to rely on past experience and ‘thinking’ (subjective perceptions – ideas as well as values) to interpret the situation and experiment with behaviour to deal with the problem. The way she goes about will thus be influenced by the legacy of her past and the present institutional and ideological context in which she finds herself. By making trials, eliminating errors and repeating successful behaviour as the problem recurs, the actor will gradually learn how to handle it. Over time she will develop a behavioural rule that offers a solution to the recurrent problem. When her behaviour has been repeated sufficiently often to display a regularity, it becomes exactly what others will expect from her in similar situations. This is now a social rule for interaction – an institution.

Once established, informal rules are self-reinforced. There are several reinforcement and maintenance mechanisms. First of all, it is easier (and cheaper) to adhere to an already existing rule than to set up a new one, which is associated with considerable costs. The existing rule offers a ready solution to the recurrent problem in question. Secondly, over time, actors learn to better adhere to the rule and benefit from the opportunities it offers, whereby incentives to adhere to it increase. Thirdly, adherence to an existing rule is beneficial because others do so – it offers a standard practice that makes it easier to interact with other actors. Fourthly, the rule is reinforced by the fact that it is consistent with and functionally complements the other rules, so adherence to one rule reinforces the other ones and vice versa. Fifthly, a rule is reinforced by its very application, since every time it is adhered to, actors’ expectations of its validity are reconfirmed. Finally, at least in certain cases, a rule may contribute to the reproduction of the problem it actually helps to solve, by being an integral part of the institutional system that repeatedly produces the problem.

Now consider a change in the external context of the actor. She may at first not recognise that the situation has changed and requires an adjustment of behaviour. When she eventually does recognise the change, she will face uncertainty about how to behave successfully. In those situations humans tend to adhere to the old

---


54 North (1990), pp. 93–95, identifies self-reinforcing mechanisms of institutions, drawing largely on Arthur (1988). Eriksson Skoog (2000), Chapter IV, elaborates on and adds to these in the case of the soft budget constraint. The final mechanism mentioned here is identified by her.
rules even more strictly than in the past, which may be her initial response to change. North recognises that once people have adapted their behaviour to the institutional structure, they face incentives to maintain it intact. They have learnt to take advantage of the opportunities provided and depend on it for their well being. Or they may believe that they do, fearing that they would do worse in a new set-up, where their uncertainty about how to behave successfully would increase. Learning to adapt to and benefit from new rules takes time. Hence actors may face incentives to try to prevent change of rules from taking place or becoming effectively implemented. Besides, change in formal rules may be ambiguous, and so produce inconsistencies with other rules. This may create uncertainty about the validity of formal change, hence about which rules apply (old or new?) which will add to actors’ slow adaptation.

The institutional structure thus creates interest groups with a stake in its existence. They ‘will evolve an ideology that not only rationalizes the society’s structure but accounts for its poor performance’. Consequently, ideas and values may contribute to delaying the process of institutional change, by slowing learning, adaptation, adjustment and behavioural change. Hence, old rules and dysfunctional behaviour may persist for some time before the actor recognises this and before the outcome has deteriorated sufficiently to motivate a behavioural change. Eventually, when she believes she may do better by changing behaviour than by maintaining status quo, she will begin searching for new behaviour that is more appropriate to the new situation. She will innovate and eventually develop a new rule in the way suggested above.

The process of informal institutional change depicted here has a lot in common with the process of change in formal rules, to which we now turn.

2.5.2 Effective Change in Formal Rules

In the case of formal rules, we may distinguish between two sub-processes. There is, firstly, the process that results in the creation or change of a nominal formal rule and, secondly, the process that renders the nominal formal rule effective in practice.

As mentioned above, much formal institutional change takes place within the political system at different levels. Hence, Eggertsson notes that ‘to explain changes in formal rules it is necessary to understand the decision processes and structures of political organizations that produce formal rules’. However, it is important to remember that such change can take place at any level of the political system of the state and its organisations, as well as within other organisations – whether economic, political or social, public or private. As noted earlier, change or creation of formal rules may also take place through collective action outside existing formal organisations.

Lee J. Alston sees formal institutional change as a result of supply and demand forces in society and the bargaining between them. He identifies three different situations (which may be overlapping in practice). In the first situation, change is not pushed by the specific interest of either demanders or suppliers of change, but is nonetheless caused by forces within the system itself. In this case, the change in formal rules is merely an adaptation to a general consensus that has emerged in society, and thus codifies the preferences of the population. This means that new formal rules codify already existing informal rules, and thus bring consistency between them. In other situations, there are certain actors who would benefit from new formal rules, and thus face incentives for and demand change. To succeed, they must have
political power to influence the process of change in their favour. In the final and third situation, there are suppliers of change, usually government actors, who face incentives and have the power to change the formal rules from within the political system itself.

Again, it is important to identify the actors involved in the process of change, in this case the demanders and suppliers. Kaspar and Streit make an attempt. First of all, there are actors who use entrepreneurial creativity to either challenge the formal rules, by breaking or circumventing them, or to innovate, by changing lower level rules within their own domain of control – for example, property rights and work practices. Secondly, there are actors – individuals or organisations – who become involved in the political process by raising their ‘voice’ for change in formal rules, thus trying to influence political decision-makers. Thirdly, there are political agents or political entrepreneurs – which include politicians and bureaucrats as well as leaders of, for instance, industry organisations, labour unions or other interest groups – who lobby for change in pursuit of their own interests. A final group of change agents are those who challenge the positions of the existing political leadership, from either within or outside the country. Outside challengers may also become players in the internal political process, influencing formal rules within existing constitutional arrangements. Foreign donor agencies would seem to belong to this group.61

For altered formal rules to become effective rules-in-use they must be implemented, applied and enforced by the relevant actors and organisations. First of all, actors must become aware of the new formal rule in one way or another. They must also be certain of its validity, which may depend on its consistency with other rules and on the decision makers’ history of changing rules. Partial change in formal rules, rapid and frequent changes and forward and backward movements in reform creates uncertainty about the validity and permanence of change. Change in formal rules usually requires implementation by public sector organisations, which may require changes in tasks, relationships and routines of existing organisations. Hence, the staff of these organisations must change their behaviour, internally as well as in their interaction with the public. Perhaps they also need to adopt a new attitude towards the public. Change in formal rules may also require different behaviour from private actors. Deregulation in Tanzania, for instance, meant that parastatal enterprises had to start behaving according the rules of the market, while they were used to rules of the socialist system.62 Finally, if new formal rules are not adhered to, they must be enforced by relevant organisations and thus by people in those organisations. This means that the rule of law is crucial for both the validity and change of formal rules. Enforcement also relies on informal enforcement, as discussed above, which implies that to gain legitimacy, a new formal rule must be consistent with the informal rules of the society.

All this requires change in peoples’ behaviour. As we have seen, changing behaviour is neither quick nor easy for a number of reasons. It requires willingness to change (hence, incentives), ability (knowledge and capability, which takes time to acquire, through learning) and lack of constraints to change, for instance in terms of other rules which are inconsistent with the new rule. This last is important; as an illustration, a number of government attempts to formally privatise ownership rights to land in Africa failed, because the new formal rules were neither adapted to, nor did they take already existing customary land rights and other interrelated informal rules into consideration.63

2.6 What are the Characteristics of Institutional Change?

The processes of change in formal and informal rules reveals much of the characteristics of institutional change. As pointed out by North, in order to understand the character of the process of institutional

---

62 Eriksson Skoog (2000), Chapter V, passim
63 See Ensminger (1997).
change, it is important to understand the stability characteristics of institutions. The stability of rules and 
the mechanisms for their maintenance, as shown above, are traced partly to the interaction and ‘symbiotic relationship’ between rules and actors, as well as to the inter-relatedness and functional complementarity between rules. Hence, once rules become established, they may be difficult to change or get rid of – there is a ‘lock-in’ in the institutional system.54

Change of both formal and informal rules tends to be characterised by path dependence, lock-in and embeddedness in ideological and institutional heritage. Institutions are embedded in the specific historical context, and thus the existing set-up of formal and informal socio-cultural, political and economic rules. This means that the emergence and change of rules is path dependent in the sense that which particular rule comes into existence depends on the initial conditions of the context as well as on developments that occur during the process. In particular, path dependence implies that the emergence of any specific rule is determined by the already existing rule structure. Path dependency further implies that institutional change – which rules come about, the way in which they change – is influenced by inherited and existing values and beliefs. Hence, the institutional set-up and supporting values and belief systems of yesterday and today, constrain and shape our choices and institutions of tomorrow.

Embeddedness, path dependency and lock-in further imply that institutional change tends to be gradual and incremental in character. The stability of rules partly stems from the time it takes to change behaviour, related to actors’ ability to decipher the environment, their subjective models of the world and values of how it should be, and by the gradual process of learning through trial and error. People tend to modify behaviour at the margin, reluctantly and under uncertainty. Hence, processes of institutional change are often slow and time consuming. Another reason for slow change may of course be that actors who gain from status quo and resist change may be in a position to actually prevent effective change from taking place. Public bureaucrats may, for instance, be able to retard the implementation and enforcement of formal rules.65

Finally, given path dependency and the other related characteristics, the pace and direction of institutional change varies, may take unexpected turns, and is difficult to predict. These too, are largely determined by behavioural uncertainty and institutional inter-relatedness. The pace and direction is also influenced by the strength of the existing organisations – their interests in keeping or changing the existing order and their relative bargaining powers – and the belief system, as noted by North. In particular, when the competition between organisations (whether political or economic) is hampered, their competition for scarce resources and pressure for change to existing rules will be reduced.66 It follows that institutional change would seem to be quite difficult, considering path dependency as well as the complexity and interdependencies within the institutional system.

What facilitates change in rules? North holds that ‘[v]igorous organizational competition will accelerate the process of institutional change.’67 The fact that rules are ‘nested’ hierarchically implies that change in rules at one level occurs within the frames and according to rules at a higher level. Ostrom notes that changes in higher-level rules ‘usually are more difficult and more costly to accomplish’.68 Consequently lower-level rules are easier to change – as long as the higher level rules are taken for granted. According to Omar Azfar, Oliver Williamson holds that ‘social structure and human motivations… take centuries or millennia to evolve’, ‘political institutions… take decades to gel’, ‘legal institutions… that take years to be legislated’, and

---

54 North (1990), p. 7
55 Cf. Winiecki (1990), on resistance to reform of the socialist system.
56 North (1995), p. 17
57 North (1995), p. 16
58 Ostrom (1999), p. 59
‘the use of law by private parties… that can be established over much shorter periods’. Informal rules are often perceived to take longer to change than formal rules, but this is not always the case.

Kaspar and Streit agree that change within a hierarchy of rules is easier. They consider informal rules to emerge and change through a decentralised process, but still taking place within cultural values and higher-level – so-called meta rules. Meta rules keep the evolution of rules on a continuous path and so make it reasonably predictable. Certain meta rules, as well as common meta rules within a society, facilitate the emergence of informal rules and may foster a more flexible, adaptive and learning society. Tolerance of experimentation, the use of humour as a means of easing conflicts, the rule that arguments should be depersonalised and, in particular, commitment to free speech and expression of one’s ideas are considered important.

---

69 Omar Azfar (2002), p. 2
3 Institutional Development and Development Co-operation

The crucial importance of institutions for the performance and development of societies lies in its shaping incentives for behaviour. Institutions thereby influence the actions of individuals and performance of organisations, as reflected in economic, political and social development – or stagnation or even decline. North argues that institutions ‘are the underlying determinant of the long-run performance of economies’. Donors appear to have recognised this and consider the promotion of institutional development important for sustainable development and poverty reduction.

The ways that donors support institutional development and processes of change in formal and informal rules, as well as the effects of such support remain, largely unknown, but will be further explored within the present evaluation theme. In principle, donors may influence the creation and change of all kinds of institutions at all levels, at any stage in the process and through any actors. Donor support for institutional development and processes of change may directly aim at such change, for instance through support for capacity development and reform programmes, or less directly – or even bring it about ‘by accident’. The effects of support will be of different kinds. Apart from the intended effects there may be unintended effects. This means that donors may influence institutional change or delay or prevent such change from taking place whatever their intentions.

---

North (1990), p. 107
References


North, Douglass C. (1993):


UTV Working Papers

2001:2 Incentives for Ownership
True Schedvin, Gun Eriksson Skoog

2001:3 Contracted-financed Technical Assistance (KTS)
True Schedvin

Göran Schill

2001:5 Evaluating External Assistance to the Western Balkans – with Special Emphasis on Bosnia and Herzegovina: A Preparatory study
Bo Sedin

2002:1 Mainstreaming Gender Equality:
Sida’s support for promotion of gender equality in partner countries:
Inception Report
Britha Mikkelsen, Team leader, Ted Freeman, Bonnie Keller, et allis

2002:2 Approach to Private Sector Development in the EEOA Programme, Zambia
Stephen Goss, Roger Blech, Guy Scott, Christopher Mufwambi

2004:1 Evaluation of Integrated Area Programmes in Bosnia-Herzegovina – a Report from an Evaluation Workshop
Joakim Molander, Maria Elena Wulff, E. Anders Eriksson, Jonas Bergström, Katica Hajrulahovic, Tale Kvalvaag

2004:2 Integrating Gender Equality into Development Co-operation – Drawing Lessons from the Recent Evaluations by Sida and the European Commission:
Joint Seminar, Brussels, November 2003
Mary Braithwaite, Britha Mikkelsen, et allis

Lorena Acevedo Nares, Martin Christensen

2004:4 Effects of Budget Support – A Discussion of Early Evidences
Maria Nilsson

2005:1 The Impact of Aid for Reconstruction of Homes in Bosnia and Herzegovina
Dragan Bagić, Dejan Dedić

2005:2 Значај пomoći. Sociološko istraživanje životnih uvjeta i stavova prema obnovi u Bosne i Hercegovine
Dragan Bagić, Dejan Dedić