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Rethinking systemic change:
economic evolution and institutions

Technical paper

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Foreword: a new perspective on systemic change

Economic systems are constantly changing and evolving – in most cases without purposeful external development input. Some countries and regions have managed to reduce poverty and improve the wellbeing of their populations without using development instruments such as market systems development approaches or any form of external funding. ‘Systemic change’ as a development outcome by itself lacks meaning and is ambiguous. Too often in our work we see programmes claiming to work towards achieving systemic change while they are busy fixing narrowly defined problems guided by very specific objectives in very short time frames, while ignoring the broader systemic context. They then expect to be able to ‘scale-up’ the solution they have found and through that make it ‘systemic’. We instead advocate an approach to ‘systemic change’ that is based on a deeper understanding of how economic systems change naturally and how we can influence that change to give it a different spin or accelerate it where possible (although some things will take time). Inspired by scholars such as Gary Klein and David Snowden, we could call such an approach *naturalistic economic development*.

We have a deep sense of unease about the prevalence of neoclassical economic logic in market development practice despite these approaches seeing themselves as originating in thinking around new institutional economics. We are convinced that the neoclassical view of the economy falls short of capturing the true complexity of socio-economic systems and their inner workings, as well as the interdependence between various key elements in these systems. This includes, for instance, the fact that markets are deeply embedded in societies, and their effectiveness depends on the emergence of social infrastructure such as trust and property rights. Over the last two decades, publications revealing a new understanding of socio-economic systems that better reflect reality have become popularly available, for example in the fields of complexity science and evolutionary or behavioural economics. These bodies of knowledge allow us to question the models we have been using and the opaque ‘labels’ they depend on – such as ‘systemic change’.

This research builds on the bodies of knowledge of evolutionary economics, new institutional economics and complex adaptive systems, collectively often referred to as New Economic Thinking. It draws from these bodies an understanding of economic change that is relevant for and applicable by team leaders and their teams in market development programmes. This understanding is also relevant for programme designers, funders and policy advisers.

We are still in the beginning of a process of exploring all the consequences of the new and broader understanding of how economic reality works and how we can shape it. To date, most of the publications on New Economic Thinking have focused on policy makers, especially those in the financial and climate change areas. This report does not offer any final conclusions but rather gives a preliminary yet practically applicable synthesis.

In our view, development actors and countries have two options to approach so-called ‘*pro-poor* market development’.

One option is to invest in the long-term development of a healthy socio-economic system by helping it to adopt characteristics that have been linked to the broad-based development of industrial countries and societies and which have led to substantial wealth creation and poverty reduction. There is an emerging consensus among new institutional economists that for a country to create wealth and develop both economically and socially, it needs institutions that support open access to economic and political activities and that allow and encourage specialisation and innovation.

The other option is to implement activities that lead to short-term (within the lifetime of a project), easily measurable gains for the poor population in a country. This is what most development activities target. Even those who speak about achieving systemic change see it as a means to an end, namely to reach a high number of poor people and improve their immediate circumstances in the short term. We believe that the second option does not lead to 'real' development, which is a long-term, sustainable and resilient trend of wealth creation and inclusion. Rather it focuses on solving immediate problems that lead to measurable results, such as improved information flows to farmers within a selected value chain or improved use of quality seed in an agricultural sector. Projects then try to scale these solutions to a large number of people. While some of these solutions might reach more people, our experience tells us that they hardly ever have a significant impact on the institutional landscape – on the contrary, because they are able to scale-up in the existing institutional landscape they often reinforce the current institutional setup and slow down real development. Institutional change cannot be put in place by solving problems and scaling them up. Institutional change can only occur if the local actors who are part of the system become aware of their role in the system and have options to purposefully influence institutional evolution. An important heuristic from systems sciences is that a group that is targeted by an intervention is likely to become more marginalised, not less – a boundary is drawn around the people, and the group is given an often highly simplistic and idiosyncratic label, such as 'the poor'. Instead of labelling groups of people, the aim of market systems development should be to create opportunities for all people to engage in a functioning market economy.

We question the utility of the concept of systemic change in markets. It is not systemic change that development agents need to look for. Systems do continuously change also without external development actors. The aim of development must be to enhance the evolutionary process in an economy and create access to this process for all levels of the society, both politically and economically. Instead of systemic change, development agents need to go back to a fundamental understanding of economic change that is in line with the evolutionary nature of change. In this new understanding of economic change, the system actors are at the core and in the lead. The understanding focuses on creating adaptive capability among these actors and on creating opportunities for them that lead to evolution.

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December 2016

Glossary - translating the key concepts

This document introduces several concepts and terms from the selected literature. The glossary gives lists the key concepts in the order in which they are introduced in the text, with a section number reference to where the term is explained in more detail.

New Economic Thinking is the collective term that captures recent thinking into evolutionary economics and complexity thinking and its relevance for decision makers. See Section 1.3.2

Evolution is a general-purpose and extremely powerful recipe for finding innovative solutions to complex problems. At its core, evolution is an iterative process of creating variety and selecting designs that are fit for purpose, and then amplifying these by adapting resource flows. While in nature fitness is determined by the environment, in economies fitness can be intentionally influenced by human actors. See Section 2.2

Amplification occurs in economic systems as selected designs and business plans are rewarded with more resources and are widely copied by others. Central to this process are enterprises, but they do not act alone. They are supported by a rich environment of organisations, formal and non-formal institutions and a broader societal context. See Section 2.2.

Variety is needed for evolution to work. Evolution selects among a variety of different designs the ones that are the most fit for purpose. Variety is created in biological evolution through random mutations. In economies variety is created through a mix of deduction, coming up with new designs through knowledge and logic, and tinkering, trying new things. This is often referred to as deductive tinkering. See Section 2.2.

Selection is the evolutionary process by which designs that are fit for purpose are selected. Selection occurs based on a fitness function that is determined by various factors. In biological evolution the fitness function is determined by the environment and co-existing species. In economies there are two ways in which a fitness function is formed: it can be formed by a powerful person or elite, who actively select according to their preferences; alternatively, it can be formed by a market, which exposes the designs to consumer demands and preferences. See Section 2.2.

Physical technologies are methods and processes for transforming matter, energy and information from one state into another in pursuit of a goal or goals; they enable people to create products and services that are worth trading. It is not only the thing itself, it is both the design for the thing and the instructions and techniques to make it. See Section 2.2.

Social technologies are methods, designs and arrangements for organising people in pursuit of a goal or goals; they smooth the way for cooperation and trading products and services. Many transaction costs, search costs and cooperation costs are created or curtailed through social technologies. Even the arrangement that hierarchies such as companies can emerge and allocate resources to specialised functions and that can learn through tinkering and adjustment is a social technology. See Section 2.2

Business plans are made by enterprises and other private and public organisations that are competing for resources, acceptance and buy-in in the economic and political spaces. These business plans typically combine or fuse physical technologies with social technologies in novel combinations. The purpose of business plans is to discover what is profitable, efficient or even possible in a given economic context. See Section 2.2.

Institutions embody 'the rules of the game' both on the level of personal interactions and also