IS GOOD GOVERNANCE GOOD FOR DEVELOPMENT?

EDITED BY JOMO KWAME SUNDARAM AND ANIS CHOWDHURY

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Chapter 1
Introduction: Governance and development

Jomo Kwame Sundaram and Anis Chowdhury

The idea of governance began to influence policy debates during the period of liberalizing market reforms in the 1980s. Margaret Thatcher and Ronald Reagan, in the United Kingdom and United States, respectively, sought to reorganize society and government around the principles and values of markets and private property. It was generally presumed then that such reforms would end problems of economic inefficiency, corruption and arbitrary rule in developing countries. In this context, governance was advanced as an alternative conception of authority expressed through institutions that would insulate markets from rent-seeking 'distributional coalitions' (Olson 1982). Nobel Laureate Douglass North's (1981) discussion of the security of property rights from threats by the monarch or the state has also influenced the governance agenda.[1] This emphasizes the role of institutions in providing checks and balances on the power of various organs of the state to ensure a stable, predictable and non-arbitrary state – a fundamental condition for spurring economic growth and prosperity. Thus, governance became a major concern of the Washington Consensus on development. Good governance should address market failures and ensure institutional reforms capable of making markets work better.

The presumption of a benign, potentially developmental post-colonial state was replaced with the idea of a necessarily predatory government whose politicians and administrators pursue their self-interest, seeking rents and other privileges. In this context, the question of who would drive the reform process became a major issue, as neither the state nor the political processes could be counted upon. Thus, reform has to be led by enlightened leaders operating 'outside' politics, for example, from civil society to advance the general welfare interests of society against self-serving bureaucrats and other vested interests.

The notion of 'good governance' met this new expectation in two ways. Conceived as authority potentially beyond politics and the traditional scope of government administration, it claims autonomy for ostensibly *technocratic* authority from Olsonian distributional coalitions. Individuals can thus be drawn directly into market processes while bypassing competitive politics presumed to be rent-seeking.

After over a decade of growing influence, more recently, however, new thinking about governance seems to have become increasingly influential in policy circles, for example, in the Department for International Development (DFID) in the United Kingdom and French Development Agency (AFD) in France (see DFID 2003; Meisel and Ould-Aoudia 2007). In the evolution of the idea of governance, the first phase emphasized a narrow view of governance – such as technocratic measures to improve government effectiveness and to develop a legal framework for market-based development – in the early World Bank reports on governance.

Hout and Robison (2009) suggest that then World Bank President James Wolfensohn's Comprehensive Development Framework (CDF), the Poverty Reduction Strategy approach and the post-Washington Consensus (Stiglitz 1998; Jomo and Fine 2005) were all part of the second phase's broader concern with political organization, emphasizing civic participation and social inclusion.

A third phase seems to be emerging, characterized by increasing sensitivity of power, politics and social conflict in shaping development outcomes; these are difficult to address with existing institutional and governance programmes. For example, as Mungiu-Pippidi (2006) pointed out, the main result of many anti-corruption policies introduced in Romania with the assistance of the international 'good governance' programmes was the establishment of many new institutions (anti-corruption ombudsmen and special prosecutors, etc.). But the problem is that these new institutions were quickly taken over by existing corrupt political networks and other interests. The same was true of the former Soviet Republics, including Russia.

More recently, there has been a growing debate and willingness to consider the political economy of governance. It is now widely acknowledged that political factors are not only more important than previously thought, but also that neither politics nor power is easily addressed with 'good governance' reforms or by engineering institutional change. Such political economy understandings of governance may well rescue the relevance of governance to development. However, efforts to depoliticize development in favour of ostensibly technocratic solutions continue. The continuing tension

between these two approaches – the political economy of governance and technocratic institutional engineering – makes easy resolution improbable.

Governance and growth: Conceptual, methodological and measurement issues

Effective government or good governance matters, but it is not obvious or clear what that means. The World Bank's Worldwide Governance Indicators (WGIs) project has attempted to define the indicators as corresponding to what the authors consider to be 'fundamental governance concepts' (Kaufmann, Kraay and Zoido-Lobato 1999b: 1). Kaufmann *et al.* have published eight papers (Kaufmann, Kraay and Zoido-Lobato 1999a, 1999b, 2002; Kaufmann, Kraay and Mastruzzi 2004, 2005, 2006a, 2007, 2008); however, the definitions of the indicators have changed over time since the indicators were first introduced. For example, in 2006, the definition of the 'political stability and absence of violence' indicator was redefined to measure 'perceptions of the likelihood that the government will be destabilized', rather than the likelihood itself (Kaufmann *et al.* 2007), and in 2008, the remaining indicators were redefined as measures of perceptions, instead of measures of the phenomena themselves (Kaufmann *et al.* 2008). The most recent definitions of indicators are as follows (Kaufmann *et al.* 2008):

1. *Voice and accountability* (VA) – measuring perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association and media freedom.
2. *Political stability and absence of violence* (PS) – measuring perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including political violence and terrorism.
3. *Government effectiveness* (GE) – measuring the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
4. *Regulatory quality* (RQ) – measuring perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
5. *Rule of law* (RL) – measuring perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular, the

quality of contract enforcement, the police and the courts, as well as the likelihood of crime and violence.

6 *Control of corruption* (CC) – measuring perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as 'capture' of the state by elites and private interests.

The World Bank's widely used WGIs have come under severe criticisms from researchers on methodological and conceptual grounds. For example, Thomas (2010) is highly critical of the definitional changes which have taken place. As she points out, there is a substantial difference between measuring something and measuring perceptions of it. She argues that in the context of governance, perceptions of crime risk have been shown to be quite different than actual crime levels. Likewise, perceptions of corruption differ from actual corruption levels, and trust in government does not necessarily match administrative performance. Thomas notes that changed definitions should mean discontinuation of the previous series of governance indicators, but the new indicators confusingly bear the same names, with no discussion offered to justify the changes in definitions while implying continuity. Meanwhile, the WGIs' authors continue to interpret changes in their data as reflecting changes in governance itself, rather than as changes in perceptions of governance.

Thomas also points out that the WGIs' methodology assumes that its variables are noisy signals of unobserved governance, and questions why variables measuring perceptions should be interpreted as noisy signals of something else if it is perceptions which are being measured. Thomas (2010: 39) elaborates,

> The methodology raises several concerns. The first is that some of the constructs themselves are poorly defined and may be meaningless. The second is that the proposed measures depend on undefended and unlikely assumptions about the nature of governance. The last is that no evidence for construct validity has been presented; indeed, given the methodological choices, it is doubtful that it could be.

When direct measurement of observable variables is impractical, social scientists often use proxies instead. A proposed measure of a construct, such as an inherently abstract concept, like the 'rule of law', is like a proxy measure in that it is essentially a hypothesis about measurement, that is, that the proposed measure correctly measures the construct. Like proposed proxy measures, not all proposed measures of constructs are equally valid. Therefore, the hypothesis

must be tested, and evidence supplied of the validity of the measure, before the measure is used. But proposed measures of constructs cannot be validated by comparing them with observable variables, as constructs are inherently unobservable. Therefore, a measure of a construct is validated, first by showing that it correctly represents the theoretical definition of the construct ('content validity' or 'face validity'), and then by seeing whether the proposed measure has the same relationships with observable variables that the theory predicts the construct itself to have ('convergent and discriminant validity'). That is, construct validity requires content validity, convergent validity and discriminant validity. According to Thomas, the WGIs fail on all counts, and she questions whether the WGIs measure what they purport to measure.

Recent research at the World Bank has also raised similar doubts about the WGIs. Langbein and Knack (2008) have challenged the measurement validity of the WGIs. An indicator that purports to measure an abstract concept should systematically and reliably relate to that concept (and not to other, different, concepts), regardless of how convincing the measurement may appear logically or conceptually; that is, an indicator should measure the hypothesized abstract concept with minimal systematic (non-random) and random error. According to Langbein and Knack (2008: 3), 'there is little if any evidence on the concept validity of the six WGI indexes'. They tested whether the six governance indicators measure a broad underlying concept of 'effective governance' or whether they are separate, causally related concepts. Their results reveal that the indicators are consistent with both, that is, they are causally related, separate indexes, but represent a single underlying concept. That is, the six indicators seem to say the same thing, with different words, and hence, amount to tautology. Thus, Langbein and Knack (2008: 4) conclude that 'the six indexes do not discriminate usefully among different aspects of governance. Rather, each of the indexes – whatever its label – merely reflects perceptions of the quality of governance more broadly. An implication is that they may have limited use as guides for policymakers, and for academic studies of the causes and consequences of "good governance" as well'.

Andrews (2008) argues that the WGIs lack acceptable definition and are ahistorical. They are also 'context-neutral' in the sense that they do not take into account country-specific challenges and environments which could be different, not only among developing countries but also between them as a group and developed countries as a group. Essentially, the WGIs are a combination of many different measures drawn from many different underlying theories, normative perspectives and viewpoints. Thus, like Thomas (2010), he sees this mix as the result of 'personal ideas of governance' of those developing the indicators.

Andrews also notes that the authors of the WGIs identify the foundations of their good governance work as '[t]he norms of limited government that protect private property from predation by the state' (Kaufmann *et al.* 2007: 2). They also assert that limited government should only be responsible for producing key 'inputs' to growth and development – such as education, health care and transport infrastructure. However, their arguments have changed on how such inputs should be supplied, invoking both Weberian bureaucracy and new public management (NPM) elements.

Critiques of the WGIs have raised other issues, such as the limits and biases of perceptions-based subjective measures. For example, Kurtz and Schrank (2007a, 2007b) point out that such measurements typically utilize very different survey instruments for foreign investors, domestic firms and citizens. Questions seek to glean assessments of the national legal system, the degree of 'red tape', the speed of the approval process and the extent of corruption. Reliance on these sorts of surveys requires the additional assumption that the interests of investors (both foreign and domestic) and the interests of the nation are essentially the same.

But their notion of state capacity as well as their measurement narrowly depend on surveys of business leaders. They are likely to contain substantial biases, for example, that investor-friendly liberalization, deregulation or privatization will improve governance, even though they will downsize and weaken the effectiveness of governments. Thus, even though such governance reforms may seriously undermine state capacity and capabilities, and thus weaken governance, the tautological logic leads to the conclusion affirming the starting presumption.

In sum, for Kurtz and Schrank (2007a, 2007b), the measurement of governance developed by Kaufmann, Kraay and their various collaborators at the World Bank, and subsequently, is riddled with systematic biases due to selection problems, perception biases, as well as survey design and aggregation problems. This most widely used data set, and the conclusions derived from it on government effectiveness, are, at best, partial and, at worst, misleading because they often measure initial conditions and ostensible effects of governance reforms, rather than the direct consequences of governance reform efforts on growth rates.

Rothstein and Teorell (2008) criticize the recent literature on 'good governance' and quality of government (QoG) for inadequately addressing the issue of what constitutes QoG in the first place. They identify at least three problems with existing definitions: either they are extremely broad, or suffer from a functionalist slant (such as 'good governance' is 'good for economic development'), or they only deal with corruption. The problem with such

a broad definition is that if good governance or 'QoG is everything, then maybe it is nothing' (Rothstein and Teorell 2008: 168). It fails to distinguish between issues that concern access to power and those related to the exercise of power.

It also cannot distinguish between the content of specific policy programmes, on the one hand, and governing procedures, on the other. Those who have defined 'good governance' as what can be shown to be 'good for economic development' illustrate this problem with functionalist definitions of the QoG. First, many important non-economic attributes of good governance, such as trust and subjective measures of well-being, are left out by such a definition. Second, with a functionalist definition, one cannot define a country's QoG level without first measuring its effects.

Thus, the functionalist approach borders on tautology. As *The Economist* (4 June 2005) noted, defining 'good governance' as 'good for economic development' may generate tautological explanations and meaningless policy implications: 'What is required for growth? Good governance. And what counts as good governance? Whatever promotes growth. And what is required for growth?'

Huther and Shah (2005: 40) attempt to define governance as 'a multifaceted concept encompassing all aspects of the exercise of authority through formal and informal institutions in the management of the resource endowment of a state. The quality of governance is thus determined by the impact of this exercise of power on the quality of life enjoyed by its citizens'. However, as Rothstein and Teorell note, this seemingly different definition of 'quality of governance' also suffers from tautology. To paraphrase, 'What is required for the quality of life enjoyed by citizens? Quality of governance. What is quality of governance? That which promotes the quality of life' (Rothstein and Teorell 2008: 169).

The popular definition of QoG that focuses only on corruption or its absence presumes that government policy discretion and interventions necessarily lead to corruption and abuse. However, according to Rothstein and Teorell, there is no empirical support for this presumption. Small governments are not synonymous with the absence of corruption while countries with very low levels of corruption have relatively large governments, as in Scandinavia and the Netherlands. In any case, defining good governance simply in terms of the absence of corruption is not very useful (Rothstein and Teorell 2008). While considerable corruption is clearly antithetical to good governance, good governance implies much more than merely the absence of corruption or even clientelism, nepotism, cronyism, patronage, discrimination and regulatory or policy capture. Rothstein and

Teorell reject the view that the record of government failures implies that minimalist government is best for development.

Aron (2000) did an early survey of a range of influential studies in the varied literature on growth and institutions, which critically assesses the strong claims found in the studies causally linking growth to governance. The survey notes a number of methodological and measurement flaws that can result in overestimation of the impact of governance and institutions on growth. Methodologically, most cross-country econometric studies suffer from selection bias, as African countries – where institutions are generally weak and growth performance has been poor, especially since the 1980s – are over represented. Second, most cross-country regressions use reduced-form equations where some measures of institutional or governance quality are used along with other variables, such as investment assumed to directly affect growth. Such regressions can overestimate the impact of institutions on growth, if institutional or governance quality also affects the efficiency of investment. It is difficult to disentangle the direct effects on growth of institutional quality variables and their indirect effects through their impact on investment.

Measurement problems arise from the lack of consensus in the growth literature on the definition of economic, political and social institutions, how they change, and the likely channels of their influence on economic outcomes. Thus, a wide range of indicators – including institutional quality (enforcement of property rights), political instability (riots, coups, civil wars), characteristics of political regimes (elections, constitutions, executive powers), 'social capital' (civic activity, organizations) and social characteristics (income differences, ethnic, religious, cultural and historical background) – are used in empirical work, although each potentially has a different channel of impact on growth.

Moreover, many of the institutional indices used in empirical work are ordinal indices which rank countries without specifying the degree of difference among countries and associate a number with a ranking. However, to be used meaningfully in a growth regression, such an index needs to be transformed into a cardinal index, where the degree of difference matters, not just the order. There is no reason to assume that the transformation from an ordinal to a cardinal index will be one-for-one (linear). For instance, the quality of the judiciary in Country A may be twice as good as that in Country B, where the judiciary is three times better than in Country C. But ordinal ranking on a scale, say from 1 to 10, of countries will not necessarily reflect the intensity of institutional quality differences among them. The often arbitrary aggregation of different components of many of the indices

is another vexing issue. Typically, these components are simply added up or averaged with the same weights.

After reviewing some key conceptual issues involved in the complex dynamic relations between institutions and economic development, Chang (2005) concludes that definitional issues, the failure to distinguish between institutional forms and functions, excessive focus on property rights and the lack of a plausible, let alone a sophisticated, theory of institutional change are some major problems of the currently influential literature. While it is unlikely that we will soon have a comprehensive theory of institutions and economic development that will adequately address such theoretical and methodological issues, recognizing and addressing these problems is imperative. More careful and non-ideological development of key concepts as well as better knowledge of historical and contemporary experience are also necessary for such progress.

Is good governance necessary for development?

Nevertheless, it has to be acknowledged that the good governance agenda has defined policy reform goals for developing countries that are widely supported in many developing countries and, especially, internationally. These goals include strengthening protection of property rights, rooting out corruption, achieving accountable and democratic governments, and imposing the rule of law. However, the empirical evidence conclusively shows that countries have only improved governance with development, and that good governance is not a necessary precondition for development (Khan 2009, 2010). All developing countries do poorly on good governance indicators, although some perform much better than others in terms of economic development. This implies the urgent need to identify key governance capabilities that will help developing countries accelerate economic development and thus eventually improve governance more generally on a sustainable basis.

Meisel and Ould-Aoudia (2007) argue that no theories of economic development support the claims of 'good governance' advocates, which many donors have instrumentalized as key criteria for disbursing development aid. Implicitly, many 'good governance' proponents presume a binary world in which all countries have the same set of institutional characteristics, but poor countries score badly due to pathologies, such as corruption, lack of democracy, state failures, market failures and so on, that prevent them from 'catching up' with the wealthy countries. Improving

governance to overcome these pathologies – presumably by improving their scores on 'good governance' indicators – is thus supposed to enable them to catch up. They also presume that the same incentives, especially prices, will have similar effects everywhere, regardless of the level of development, for example.

But developing countries are not simply countries that would be 'wealthy if they were not ill'. Rather, they are structurally and systemically different in many ways, and it is therefore not analytically or practically useful to characterize development problems as 'pathologies'. According to Meisel and Ould-Aoudia, the universal 'good governance' prescription has actually had modest or even no impact on growth. The imposition of formal rules from wealthy countries on low-income countries has not worked. As governance reforms may destabilize existing social and political orders, they have engendered resistance which has often become insurmountable in the short to medium term. Hence, although 'good governance' is unobjectionable, if not desirable, reforms inspired by this approach have not been and cannot be successful for accelerating economic growth in such circumstances. This is why the relationship between 'good governance' and growth is so weak, and why programmes and other efforts to promote 'good governance' have been so ineffective in accelerating economic development.

Kurtz and Schrank (2007a) critically assessed the much-cited work of Kaufmann, Kraay and Mastruzzi on the positive causal link between good governance and growth. Besides citing the methodological flaws, discussed earlier, they note that there is little convincing evidence that improved or good governance accelerates growth. Instead, the ostensible evidence using their problematic measures actually suggests that growth and development improve governance, rather than vice versa. Kurtz and Schrank (2007a: 552) conclude that 'the oft-asserted connection between growth and governance lies on exceedingly shaky empirical pilings'. Like others, they note that a number of developing countries, especially in East and South-East Asia, have fallen short on the most widely used World Bank's good governance benchmarks, but yet have performed well in terms of growth, equity and structural transformation. The qualitative literature on the development experience of these countries emphasizes state capacity and 'market governance' as key predictors of their unusually high growth rates and their higher levels of education, social equality and investment rates despite their modest, compromised or corrupt administrative capacity. The claims of growth-enhancing governance improvements are largely based on evidence of short-term growth performance. Although Kaufmann *et al.* (2007) initially disagreed with Kurtz and Schrank's critique, they later

acknowledged that the empirical literature on institutions and growth is inconclusive.[2]

Kim and Jacho-Chávez (2009) re-examined the conventional wisdom that a positive relationship exists between governance and growth by using nonparametric methods and the World Bank's governance measures. They found that regulatory control, reduced corruption and government effectiveness were insignificant for growth, while the empirical relationship between voice, accountability as well as political stability, and growth was highly nonlinear. These effects reflecting heterogeneity across indicators, regions and time are consistent with the arguments of Khan, Rodrik and Fukuyama that specific, targeted reforms to improve governance rather than wholesale reform may be more effective in accelerating economic growth.

Reviewing the historical experiences of the United States, Republic of Korea (South Korea), Mauritius and Jamaica, Goldsmith (2005) argues that governance is not significant in the way good governance proponents claim. The extremely dire conditions typically associated with failed statehood or state failure probably preclude most economic or social progress, and can lead to declining productivity and output as well as falling living standards. However, not all good governance reforms are similarly feasible or beneficial, let alone necessary or desirable in all circumstances. The United States and the Republic of Korea did not improve governance significantly on many fronts until they had become quite affluent.

Good governance reform proposals rely on the Weberian presumption of the ostensible superiority of 'modern' governance institutions over supposedly inferior 'traditional' arrangements. In fact, institutions which do not conform to some (typically Western) view of modernity are deemed traditional atavisms when, in fact, they may well be recent in origin due to the nature and impact of colonialism, post-colonial state building, economic liberalization or even globalization, such as contemporary patron-client, patrimonial or clientelist networks invoking culture, custom or heritage (Goldsmith 2005).

Contrary to the usual exaggerated claims about how much 'institutions matter', Goldsmith's case studies imply that greater transparency, accountability and participation are often a consequence, rather than a direct cause, of faster development. They also show that 'closed institutions' may provide a satisfactory basis for rapid growth, provided such institutions change appropriately over time in response to new conditions. Policymakers need to better understand such processes before expecting governance reforms to accelerate economic development in most developing countries.

As Rodrik (2008) notes, the incontrovertible long-run association between good governance and high incomes provides very little guidance

for appropriate strategies to induce high growth. He emphasizes the absence of any strong econometric evidence that relates standard governance criteria to growth as all the ostensible evidence is actually about income levels. Rodrik cites the example of China, Vietnam and Cambodia that are all growing rapidly despite poor governance indicators. Many other cases show that large-scale institutional transformation of the type entailed by the good governance agenda is hardly ever a prerequisite for getting growth going. Rodrik notes that poor countries suffer from a multitude of constraints, and effective growth acceleration interventions are those that address the most binding among them. Poor governance in general may be the binding constraint in some countries but certainly not in countries growing rapidly despite poor governance. Thus, as a rule, broad good governance reform is neither necessary nor sufficient for growth. It is not necessary, as the examples of China, Vietnam and Ethiopia show, and also not sufficient as it is difficult to sustain governance improvements without accompanying growth.

According to Andrews (2010), countries with more effective governments grew at an average annual rate of less than 2 per cent between 2000 and 2006, whereas countries with 'ineffective' governments (scoring below zero) actually grew by an average rate of about 4 per cent annually, despite facing much more daunting challenges, such as higher population growth. More effective governments generally also have higher domestic revenue sources, are less dependent on international trade taxes and more dependent on direct domestic income taxes than less effective governments. More effective governments were also much bigger in size in terms of public expenditure/GDP ratios, which ranged from 37 to 73 per cent in the mid-1990s and stood at between 35 and 55 per cent in 2004.

Aron (2000) notes that the correlations between institutional variables and growth are not robust, and causality can run in both directions, from good institutions to growth or from growth to better institutions. She argues that a more plausible and hence credible interpretation of the effects of politics and institutions on economic growth would require a more coherent, consistent and persuasive approach.

Fukuyama (2008) acknowledges the likelihood of two-way relationships between various aspects of governance and economic development. According to him, there may be cases where economic growth not underpinned by a strong developmental state but by a state with 'just enough' development accelerating governance may become the basis for further political and social development, tantamount to governance improvements. He cites the example of Bangladesh, where although fixing the problems of corruption and lack of democratic accountability is still daunting, the

economy has been growing impressively since the early 1990s. In so far as governance can improve with growth, a country like Bangladesh may be better positioned to further improve its institutions as it continues to grow. Fukuyama thus disagrees with the good governance orthodoxy at the World Bank and other donor agencies, which hold that since good governance accelerates growth, comprehensive institutional reform is a prerequisite for development. During the period 2003–7, virtually every country and region in the world experienced higher growth, and hence, Fukuyama holds that growth accelerations can and have occurred under a wide variety of institutional and policy regimes, a view similar to Hausmann, Pritchett and Rodrik (2004).

Corruption and economic growth

If good governance indicators suffer from measurement problems, and if the causality from good governance to economic growth cannot be ascertained, then can there be any causal link between economic growth and at least one indicator, corruption? This is a relevant question, as the good governance agenda often focuses mostly on anti-corruption measures in practice.

Corruption conceivably adversely affects development in many different ways, especially if it diverts resources that would otherwise be invested productively and increases uncertainty for investors. However, the historical evidence does not show a significant role of anti-corruption measures in accelerating economic growth. Data for the 1980s or 1990s show that the large differences in growth rates between fast and slow-growing developing countries were not associated with significant differences in corruption indicators (Khan 2006). In fact, the median corruption indices for both fast- and slow-growing developing countries were similar in the 1980s and 1990s, although both groups scored significantly worse than the advanced countries.

There are many views on the causes of corruption in developing countries. First, the most common and influential view is that corruption is principally due to the greed of public officials who abuse their discretionary powers for their own self-interest, that is, self-seeking bureaucrats or politicians. From different perspectives, the strength (power) or weakness of central governments, in turn, encourage or allow predation in many developing countries. Anti-corruption strategies therefore require strengthening related government enforcement capacities, but depending on perspectives, may seek to undermine other state capacities deemed likely to enable corruption.

Second, corruption and rent-seeking associated with needed government interventions cannot be addressed simply by privatization or liberalization. The conventional criticism of rent-seeking presumes that rents created by governmental interventions will be completely dissipated by rent-seeking behaviour, causing rent-seeking to be completely wasteful. However, there is no theoretical or empirical support for this presumption, undermining this criticism of rents due to government interventions. Rents can provide important incentives for innovative behaviour, widely deemed essential for economic progress. In fact, the notion of 'profit maximization' presumes the possibility of capturing rents, often by securing 'competitive advantage'. The major policy challenge then is to limit wasteful and unnecessary rent-seeking to maximize the gains from such behaviour. State capacities can and should be strengthened to better motivate innovative and entrepreneurial behaviour, while improving regulations to reduce associated rent-seeking.

Third, weaknesses in enforcing legal rights, including property and contractual rights, result in higher costs for negotiating, enforcing and protecting contracts. Weakly protected property rights or poorly enforced contractual rights – and associated corruption – seem widespread in developing countries. However, with sustained high growth, as well as greater social and political stability, economic conditions and expectations also become more stable, helping to sustain investment and growth. In other words, corruption tends to decline with sustained economic development.

Fourth, clientelism, or patron-client relations, is often associated with 'political corruption' involving efforts by politicians or others to retain or gain power. Developing countries' governments, political parties, factions, movements, business interests and politicians may use such measures to maintain the political status quo, often because the underlying problems – factors that are conducive to or encourage clientelism – cannot be addressed by more conventional measures, for example, owing to fiscal constraints. Clientelism needs to be regulated to limit its most damaging consequences; meanwhile, the ability of governments to budget and spend according to their own priorities – rather than according to those imposed through aid or debt conditionalities – should be enhanced to achieve social and political stability through transparent fiscal transfers to the deserving.

While all corruption is damaging in some way, and is hence undesirable, some types of corruption are much more damaging than others. Claiming to fight corruption in developing countries generally (by implementing a laundry list of desired governance reforms) sounds impressive and deserving of support, but such efforts often ignore more feasible and targeted policies that can improve economic performance. As it is virtually impossible to

address all types of corruption simultaneously, good policy should focus on the types of corruption most damaging to development, such as corruption that wastes precious investment resources. Reform priorities should respond to actual challenges and circumstances. Otherwise, anti-corruption and other governance reform efforts can set unattainable targets, inadvertently causing eventual disillusionment and reform fatigue as failure becomes apparent.

Reform implications and priorities

The preceding discussion shows that current understandings and measures of governance, especially in relation to economic development, are not only imperfect but also problematic. However, these flawed governance quality indicators and policy presumptions are being imposed by international financial institutions and donor country policymakers to reshape national institutions, policies and programmes as conditions for receiving development aid. But until more is known about improving governance and its likely impacts on economic progress, such requirements and conditionalities may do more harm than good.

Policymakers have been relying on conventional wisdom or prejudice in claiming a strong relationship between institutional reforms and development outcomes as there is no robust empirical support for this view. Furthermore, no strong evidence exists for guiding and determining how to prioritize and sequence governance reforms.

The World Bank's World Development Report 1997 advised developing countries to pay attention to 45 aspects of good governance; by 2002, barely five years later, the list had grown to 116 items. Even allowing for considerable overlap among these items, it seems that countries needing to improve their governance must undertake a great deal more to do so, and the longer they wait, the more they will need to do.

Unfortunately, the long and lengthening agenda often means that a multitude of governance reforms need to be undertaken urgently, often with little thought to their sequencing, interdependence or relative contributions to the overall goal of reforming governments to be more efficient, effective and responsive, let alone more able and likely to alleviate poverty. Among the multitude of governance reforms deemed necessary for economic growth, development or poverty reduction, there is typically little guidance about what is considered essential and what is not, what should come first and what should follow, what can be achieved in the short term and what can only be achieved over the longer term, what is feasible and what is not (Grindle 2004).

The good governance agenda is particularly demanding on states that are poor, badly organized, politically unstable or lacking in legitimacy. But reluctance to pursue any particular prescribed reforms could result in poor scores on performance indicators for effort, which is likely to adversely affect financial and other support by donors (Grindle 2004).

In some cases, it may not be possible to make much progress in one dimension without prior or simultaneous progress in others. And if certain institutional and policy reforms matter more for development, these should probably receive the most support. Selectively concentrating resources would be better than spreading limited resources thinly across a whole range of ostensible good governance reforms, as foreign development agencies tend to do (Grindle 2004).

Developing country policymakers receive confusing signals as donor government policymakers condition aid allocations on such performance standards. Compliant governments of least developed countries are rewarded for good behaviour (efforts, if not outcomes) with more generous aid, while non-compliant governments are punished. But what constitutes good behaviour for donor governments, and if inappropriate, what should it be? What policies will improve governance effectiveness scores? And will such policies foster growth and development as well?

However, the answers are unclear, as are aid recipients rewarded for policies that are not coherent, if not potentially contradictory, including stabilizing their polities, deregulating their markets, lowering their tax rates, ensuring their citizens' health and well-being, maintaining macroeconomic stability, providing reliable infrastructure and guaranteeing their civil servants' capabilities and integrity. What, then, should aid recipient governments do? Raise taxes to enhance fiscal space and provide better health care and education? Risk social and political stability by cutting spending? Raise living costs by liberalizing prices and eliminating subsidies?

Almost every seeming solution aggravates another problem, just as many supposed good governance measures may also adversely affect economic development. Donor use of benchmarks often punishes poor countries for the governance consequences of their own poverty. After all, if they had achieved economic development and consequently improved their governance, they would not need foreign aid in the first place.

Instead, 'good enough governance' implies a more realistic, pragmatic, nuanced, better prioritized and sequenced understanding of the evolution of institutions and governance capabilities. Hence, 'good enough governance' may be more realistic for countries seeking to accelerate growth, development or poverty reduction. Such an approach necessarily recognizes priorities,

preconditions and trade-offs in a context in which all desirable things cannot be pursued simultaneously. This implies acting on knowledge of what is most important and achievable, rather than trying to fill all supposed governance shortfalls or gaps at the same time, and designing and implementing public policy reforms mindful of conditions and context (Grindle 2004). Similarly, Meisel and Ould-Aoudia recommend 'governance for development', a new, broader concept of governance including various institutional arrangements that inspire confidence and which, they suggest, vary with the country's income level and other factors.

After reviewing much of the relevant literature, Kim (2009) questions the wisdom of donor pressure on developing countries to adopt ostensible 'global (or international) standard' policies and institutions since there are no 'best practice' policies and institutions that everyone should adopt. Instead, for him, improvements in institutions should be encouraged, but this should not be understood as imposing a fixed set of ostensibly superior (typically Western) norms and institutions on all countries. He also suggests that reform priorities should be determined by the recipient countries, in place of the current, mainly donor-driven, supply-side initiatives, and insists that 'good governance' reform efforts need to take account of the local context and realities.

Current understanding of institutions and governance, including the costs and benefits of reforms, only provides vague guidance. For example, there is no consensus on norms, standards or yardsticks for identifying a 'governance break-even point', when the gains from ostensibly improved governance exceed the costs of overcoming waste associated with supposedly poor governance practices. Thus, imposing unrealistically high standards of governance and corresponding requirements for governance reform on low-income countries may have adverse consequences. Development gains may not be as significant and as rapid as expected (Goldsmith 2005).

Andrews (2010) argues that the good governance agenda inadvertently imposes an inappropriate model of government that effective governments today ostensibly emulated in order to develop; this misleading agenda effectively 'kicks away the ladder' for other governments aspiring to accelerate development. According to Andrews, the model's major problem is the lack of a convincing theoretical framework to better understand government roles and structures in development; such a framework is needed before one can measure government effectiveness or propose specific models of what government should look like. Given the evidence of multiple pathways to development, the idea of a one-best-way model is very problematic indeed.

Interestingly, the United Kingdom's Department for International Development (DFID 2003: 12) seems to have realized that 'if getting good government is a long-term endeavour predicated on economic and social development, a more useful question may be how to achieve economic growth and development in spite of weak governance'. Instead of pursuing comprehensive systemic reform in support of an ambitious comprehensive policy agenda, a more modest incremental approach involving a few important but feasible reforms – targeting several key constraints or bottlenecks – may be more pragmatic and likely to succeed (DFID 2003).

The DFID suggests that better understanding of context could help policymakers avoid making superficial judgements about development performance and its determinants which aid donors tend to make in allocating concessional finance. Donors need to avoid the tendency to become overly influenced by short-term trends or to equate 'good' performance with implementation of a specific policy priority favoured by international development agencies or 'poor' performance with the failure to do so.

As Khan (2010) notes, history provides a useful longer term perspective on good or poor government, and on ways to improve it. It also provides useful insights into processes of change, including the interconnections among the economic, social, political and institutional dimensions of development, as well as the bases for improving government. However, such insights do not lead to easy solutions or simple formulas for better government or economic development. But they nevertheless suggest small but important ways for enhancing the cumulative development effects of policy reform efforts.

Besides improving understanding of country context or the political economy of development, this implies a significant shift away from telling developing countries what they should do to eliminate poverty, to better supporting the change required for accelerating development. This would imply being less preoccupied with implementing a specific policy or institutional reform agenda while improving understanding of what seems to work in particular circumstances and why.

Pragmatism does not mean merely looking at mundane problems and their immediate causes. Deeper analysis requires taking greater account of the state–society relations underlying key institutions which shape the capacity, capabilities and incentives for accelerating economic development. This implies having a long-term vision of change which would transform the poor from clients dependent on patronage to citizens with rights, entitlements and responsibilities, as well as identifying measures to

support that process. Foreign development agencies should therefore try to strengthen the bases for improved government, especially for an effectively developmental role for the state.

Book organization

Based on key World Bank documents and African experiences, Rita Abrahamsen analyses the good governance discourse to expose its inconsistencies, evasions and silences in Chapter 2. She argues that the discourse narrates governance in a manner that blurs the distinction between democratization and the retreat of the state from the social and economic field. The main effect of the discourse is to portray structural adjustment as a force for democracy. Analysis of the good governance agenda goes around in circles, always leading back to one factor: economic liberalization. Governance is conceptually linked to economic liberalization, and civil society is regarded as emerging from the liberalization of the economy and reduction of the state. Thus, it constructs a new legitimacy for economic liberalism in the form of structural adjustment programmes.

'Empowerment of the people' is reduced to cost-sharing and becomes a tool in the hands of liberal economists. The bourgeoisie is regarded as both the source of economic growth and democracy, and cultural sensitivity only entails a commitment to build on traditions compatible with capitalism and modern state structures. In the African context, the good governance discourse has been portrayed as a force for democracy: the liberators of civil society from an oppressive state. The term 'empowerment' in this discourse is devoid of any radical connotations and merely signals that people should 'pull their weight' and make development projects more cost-efficient.

But it completely ignores the fact that the good governance agenda also caused the state to retreat, making it harder for the state to meet demand for more and better services; there is a limit to cost-efficiency. The reduction of state capacity and capabilities and the simultaneous rise in expectations through civil society empowerment are a sure recipe for state failure. This then legitimizes the presence of 'international' in domestic politics and economic policymaking. This is how many international interventions are sanctioned by the development discourse's representation of the Third World. Abrahamsen challenges the good governance discourse's claim to cultural sensitivity and argues instead that it is not significantly different from the modernization theories of the past in that it embodies an image of the good society largely constructed from Western values and experiences.

In Chapter 3, Brian van Arkadie argues that it is a tautology to identify good governance as a contributor to growth and poverty alleviation, insofar as 'good' is defined in terms of the effectiveness of governance in promoting those objectives. For him, the efficacy of governance practice in promoting growth and poverty alleviation cannot be adopted as axiomatic; it has to be established by analysis. Van Arkadie provides a brief historical account of the rise of the good governance paradigm in development discourse and discusses some concerns regarding the current widespread use by donors of good governance in their approaches to reform-mongering and to aid conditionality.

Good governance has become a trendy 'buzzword', often used with little discrimination to mean many different things, so that arguably, it has been leached of meaning. It is overused, sometimes in a rather imprecise and confusing fashion. In the development literature, it has even had a euphemistic function, providing an umbrella for discussion of delicate issues, such as corruption or the promotion of exotic models of democratic practice. While the model of the good society informing the good governance discourse is typically left implicit, it seems to involve a vision of a pluralistic society, with formal political processes that are democratic.

However, comparative study suggests that even if a democratic, pluralistic society is an attractive goal, it may not be very compatible with the requirements for fast growth. In other words, there is no necessary consistency between good political governance as a goal and good economic governance as a means of enhancing growth. The potential conflict becomes clear when, having encouraged the election of representative government bodies, donors – and particularly the Bretton Woods institutions – find the resulting decisions are not very consistent with 'good' economic policy, so that donors quickly find themselves trying to constrain and even bypass electoral institutions through mechanisms of donor conditionality. In the development discourse, governance has been heavily promoted by donors, not only as a response to perceived limitations in traditional approaches to economic policy but also as a vehicle for promoting a donor political agenda.

The donor community has become increasingly assertive in promoting their own social and political ideals as cross-cutting issues motivating their approaches to external assistance. They sometimes generate tasks which are, in practice, difficult to implement. The changing donor agenda places strong pressures on fragile political institutions. As countries struggle to make the institutions of multiparty electoral democracy work, a new donor rhetoric gains currency, advocating decentralization, local empowerment and the

engagement of 'civil society'. The proponents of the extended governance agenda do not justify their intervention on strategic or self-interest grounds, but as the assertion of values claimed to be universal both in the sense that the appropriate ultimate destination of all societies is defined in terms of the ideals of Western donors, and that these ideals can be applied to the current practices of developing countries.

Nonetheless, van Arkadie believes that governance has been employed more usefully to address aspects of the political process crucial to development, neglected earlier by mainstream economists. Its widespread contemporary use reflects a heightened concern for political and administrative aspects of development and the policy process. According to him, in many respects, this concern is appropriate and useful. Another critical factor propelling the intrusion of governance issues into the pure world of the economist has been the recognition of the importance of institutions for the effective operation of markets.

After summarizing the limits of the WGIs' perception-based measures, Marcus Kurtz and Andrew Schrank argue in Chapter 4 that the use of perceptions-based governance effectiveness indicators – by multilateral development banks, international financial institutions and individual donor governments – to condition aid allocations sends confusing signals to policymakers in developing countries. Policies such as deregulating markets, lowering tax rates, ensuring the health and well-being of citizens, maintaining macroeconomic stability, providing reliable infrastructure, guaranteeing the skill and integrity of civil servants and stabilizing polities – favoured by donors and international financial institutions – are almost certainly in tension with one another. For example, to provide health care and education and to maintain a balanced or surplus budget, taxes need to be raised. But raising taxes lowers a country's ranking to investors. Thus, policymakers are faced with tough choices between risking social and political stability by cutting social spending and risking cuts in aid on account of ostensibly investor-hostile reforms. Almost every potential solution aggravates another problem, and the good governance benchmarks thus effectively punish poor countries for the consequences of their poverty. After all, if they could solve their social and economic problems, they would not need foreign aid in the first place.

Kurtz and Schrank point to considerable variations in the quality of governance and level of development, even within single polities. They argue that it is not clear that smaller governments are better governments, at least in terms of citizens' well-being, as measured by the United Nations Development Programme's (UNDP) Human Development Index (HDI).

They report a reasonably high correlation between the HDI and the size of the public sector in Latin American countries. Thus, while they concede that there could be a 'small government' path to human development, as exemplified by Chile, it is decidedly uncommon. They further argue that while a large public sector is not a necessary prerequisite for a high HDI, it can be a 'sufficient condition'. Their Latin American data also show that a number of high 'human developers' have low governance scores.

Thus, they argue that there are, clearly, two different paths to human development: the 'small government' Chilean road and the 'big government' road taken by the other regional success stories. Those who argue for smaller government also typically ignore structural constraints, determined by distinct social structures and skill sets in different types of societies. And a 'small government' road may well demand more (or different) state capacity than most developing countries are able to muster. This does not mean that they should let their people suffer in silence. Instead, their chapter suggests that big government, though less efficient, provides a more common – if by no means easily attainable – path to improved human development. This model may not only be more accessible to public officials in most developing countries but also more acceptable to their citizens.

Much work on the good governance agenda has isomorphic influences on development, where governments are influenced to adopt a one-size-fits-all approach to get things done. In Chapter 5, Matt Andrews doubts whether such an approach is at all useful, and argues that the models of good governance actually do not hold, even for supposedly effective governments. Governments look different, even if they are considered models of good government. This proposition is examined through a study of public financial management practices in a set of Organization for Economic Co-operation and Development (OECD) and non-OECD countries. It shows that effective governments are not more likely to exhibit better practice characteristics implied in one-best-way models. Good public finance management means different things in different countries. Therefore, according to Andrews, the good governance picture of effective government is not only of limited use in development policy but also threatens to promote dangerous isomorphism, institutional dualism and 'failing states'.

The chapter ends by suggesting that conceptualizing governance constructs as menu items to be chosen, rather than as essential elements of a one-best-way model, is an important step to better understand why good government looks different in different settings. The development community could start addressing such questions as why the world's more effective governments exhibit different combinations of better practices;

what current cross-country characteristics and/or historical factors led to these menu choices; what internal factors lead governments to adopt different governing solutions. Guidance on such questions will be a much more helpful step for developing country governments in choosing from a menu of institutional reforms than asking them to undertake wholesale governance reforms as stipulated by the good governance agenda.

In Chapter 6, Arthur Goldsmith challenges the view of international development agencies that developing countries can boost rates of economic growth by introducing 'good governance' measures. He critiques the good governance agenda (i.e. transparent, accountable, participatory governance) of these agencies as static and ahistorical; they ignore the political and economic cost of governance reforms. By carefully analysing the history of economic development, especially specific governance reforms and economic turning points in the United States, Argentina, Mauritius and Jamaica, he argues that these agencies underestimate the time and political effort required to change governance, and overestimate the economic impact. These careful case studies imply that greater transparency, accountability and participation are often results, rather than direct causes, of faster development, contrary to optimistic claims of donors and international financial institutions about how much institutions matter.

Furthermore, these case studies show that seemingly deficient institutions may be a satisfactory platform for rapid growth, provided key growth-inhibiting institutions are reformed pragmatically over time. For example, patronage, as a means for building loyal political support, could, at times, make governance more credible in the eyes of private investors. Likewise, clientelism and the exchange of lucrative favours could have benefits for development as they may enhance political legitimacy and stability, and, therefore, help create a conducive business climate. Similarly, 'pork-barrel' spending in remote regions can help create an integrated national economy. These show that impaired governance sometimes supports rather than undermines development, provided the tendency of patronage to encourage lax administration or excessive corruption can be balanced or minimized. Therefore, policymakers need to understand these processes better before counting on wholesale 'big bang' governance reforms for rapid growth and poverty reduction in developing countries.

Goldsmith doubts the robustness of many econometric studies, claiming to find a strong causal relationship between governance reforms and economic growth. These results are mostly spurious due to the possibility of unseen joint effects. That is, instead of better governance accelerating development, both good governance and rapid growth may be consequences

of other underlying causes. The optimistic econometric results may also be due to extreme or outlying cases, such as failed states, which preclude almost any social or commercial progress. After excluding failed states, in most cases, governance has less predictable economic outcomes.

Overestimation may also result from reverse causation or endogeneity between growth and institutions. These methodological issues add to the complications caused by measurement errors, highlighted in previous chapters. Until and unless the empirical picture is clarified, policymakers will have to rely on guesswork regarding institutions and development strategy. One may never know how to calibrate institutional quality to a country's historical circumstances. There is no scientific basis for deciding what steps towards institutional improvement should come first or receive most support. Goldsmith concludes, 'Governance reform is a dynamic and socially embedded process, which … seems to move forward irregularly. Even after years, supposedly improved civic institutions may not produce perceptibly more efficient governance or many "development dividends".'

Rapid economic growth and transformational development in China and Vietnam pose a challenge for those who believe that 'good governance' is a prerequisite for accelerating economic growth. In Chapter 7, Martin Painter examines the cases of China and Vietnam, both of which have scored poorly on 'good governance' indices while experiencing dramatic economic growth and impressive levels of poverty reduction. He contends that the blueprint for governance reforms advocated by international donor agencies implies a dogmatic belief in an 'imagined western, liberal-democratic historical experience' which presumes a universal trajectory and common end-point for political and economic development in which acquiring the attributes of good governance is deemed essential or part of a necessary stage. Like Andrews and Goldsmith, Painter notes that this understanding of development denies the fact that such a trajectory was not universally part of the Western historical experience.

Painter describes key features of public sector reform programmes in China and Vietnam to show that good governance reform has not been, and need not be, the priority. Rather, the prevalence of 'low quality' or 'poor governance' in these countries is best understood as the consequence of pragmatic reform strategies adopted for coping with transition challenges and for achieving successful development. He identifies aggressive NPM-style commercialization of public service delivery mechanisms as one such home-grown strategy, rather than due to overzealous adoption of prescriptions ostensibly based on Western experience. Although foreign experiences with NPM, structural adjustment, privatization, public sector

and welfare reform were studied, both countries have prioritized 'crossing the river by feeling the stones'. Not surprisingly then, proponents of the 'good governance' agenda consider the public sector reform programmes of China and Vietnam plagued by 'poor sequencing'.

Painter concludes that if the development and reform experiences of China and Vietnam can be generalized, governance reforms may best be considered second-order measures to 'mop up' the adverse consequences of badly governed development. He suggests that governance will only improve after people appreciate, from bitter experience, the adverse consequences of badly governed markets, and then demand better quality public goods and services, as happened in the historical experience of the West. Painter sums up his conclusion by suggesting that 'good governance can come later'.

In Chapter 8, Mushtaq Khan argues that the emphasis in policy and analysis on 'good governance' capabilities is symptomatic of a deeper bias in contemporary economic policy and research. Supporters of the good governance reform agenda have failed to identify convincing case studies of countries that have actually made significant economic transformations from poverty to high standards of living by following the agenda they propose. Even if improvements in governance capabilities in developing countries could improve growth, it does not follow that such improvements will be sufficient to achieve a developmental transformation.

Although case studies and statistical evidence underscore the importance of governance, they suggest that a different set of governance capabilities are required. Countries that have achieved significant developmental transitions in the past half century now have strong governance capabilities, but none of them would have scored highly in terms of 'good governance' measures when their take-offs began or for a considerable period thereafter. Rather, they prioritized developing governance capabilities to address specific problems, such as overcoming constraints limiting technology acquisition, solving problems in allocating valuable resources such as land, and maintaining political stability within acceptable limits. Khan describes such government capabilities as developmental or growth-enhancing governance capabilities.

For Khan, the experiences of the East Asian developmental states, with their significant developmental capabilities, no longer provide many useful lessons or much guidance for setting immediate governance reform priorities. Their post-war 'political settlements' were unusual, allowing them to more effectively intervene to overcome development constraints on a scale not feasible in most developing countries anymore. Most developing countries will probably not be able to make enough progress on these capabilities to have a significant impact on their development prospects.

Thus, the only feasible and desirable governance agenda may be to incrementally improve developmental governance capabilities on a smaller scale, taking account of political and institutional initial conditions in each country. According to Khan, a better starting point for countries would be to look at the sectors and firms that have actually experienced sustained spurts of growth. How did they solve or overcome the market failures and other development constraints that affect learning, technology acquisition and land purchases? What other significant market failures did they have to overcome? A closer examination of such issues is likely to reveal country and sector-specific solutions that have worked or improved understanding of why they have not; this is a better starting point for identifying strategies that may work in similar sectors. Khan argues that this incremental approach to capability development has to involve experimentation and trials, not the replication and adoption of blueprints drawn from dissimilar contexts. Historical evidence suggests that it is the incremental development of growth-enhancing governance capabilities that has been critical for triggering and sustaining development.

This volume begins by summarizing the major conceptual, methodological and policy criticisms of the 'good governance' advocacy discourse that has become extremely influential in the economic development literature in recent decades. It revisits the governance conditions which have been conducive to and supportive of accelerations in economic development, suggesting that what may seem like 'poor governance' may actually reflect prioritized, pragmatic and possibly effective efforts to overcome developmental bottlenecks. The volume ends by pointing the way to a 'developmental governance' reform agenda which may be much more relevant to and suitable for developing countries seeking to accelerate economic growth and structural transformation.

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Chapter 2
The seductiveness of good governance[1]

Rita Abrahamsen

Conventional discussions of development tend to ignore the power of discourse and its role in the construction and maintenance of Western hegemony in the Third World. This chapter shows how development discourse has constructed the Third World as underdeveloped and thereby normalized and legitimized the right of the North to intervene in, control and develop the South. The focus is on the good governance agenda itself. The good governance discourse is merely the latest version of the 'dream of development', entitling the North to develop and democratize the South in its image. In this way, the chapter shows both how the international is always present in domestic politics and how many international interventions are sanctioned by development discourse's representation of the Third World. Development discourse thus emerges as crucial to an understanding of development in Africa.

Based on key World Bank documents, this chapter provides a theoretical and textual analysis of the good governance discourse and aims to expose its inconsistencies, evasions and silences. It argues that the discourse narrates governance in a manner that serves to blur the distinction between democratization and the retreat of the state from the social and economic field, and thereby constructs a new legitimacy for economic liberalism in the form of structural adjustment programmes. This relegitimation is achieved by invoking images of an 'alien' interventionist state versus an 'indigenous' African capitalism, and through reliance on a liberal conceptualization of power, state and civil society. The key effect of the good governance discourse has been the construction of structural adjustment, and the institutions and countries that promote it, as a force for democracy: the liberators of civil society from an oppressive state. A closer analysis of the agenda's claim to 'empower ordinary people', however, reveals that the discourse deprives

this term of its radical political connotations and instead gives it a highly instrumental meaning. Empowerment in the good governance parlance merely signals that people should ‘pull their weight’ and make development projects more cost-efficient; again, the near fusion of democracy and economic liberalism in the good governance discourse becomes apparent. The chapter also challenges the good governance discourse’s claim to cultural sensitivity and argues instead that it is not significantly different from the modernization theories of the past in that it embodies an image of the good society that is largely constructed from Western values and experiences.

The strength of development discourse, Gilbert Rist has written, comes from its power to seduce; ‘to charm, to please, to fascinate, to set dreaming, but also to abuse, to turn away from the truth, to deceive’ (Rist 1997: 1). The promise to eradicate poverty is so seductive that although the history of development is littered with failures, the *belief* in development survives. Past failures merely give rise to new theories, each claiming to have discovered the real solutions to the problems of development. The good governance agenda is simply the latest in a long series of such theories.

This chapter is not concerned with the implementation of the hotchpotch of policy recommendations contained within the good governance agenda, nor does it seek to rectify or to arrive at the ‘correct’ theory of development. Instead, the focus is on the discourse itself, the way in which it narrates development as an absence of good governance. It seeks to expose, not only the discourse’s conceptualization of democracy but also what the discourse silences and evades, the ways in which its seductive power is used to deceive. This, in turn, should enable us to show what effects these ideas about development have on larger social processes, what interventions and practices they legitimize, and also what actions and policies they delegitimize and exclude.

Almost any analysis of this nature runs the risk of representing discourse as monolithic, unchanging and unchallenged, of constructing consensus where diversity, discord and flexibility exist. While there are dissenting voices within development and no complete uniformity and agreement can be said to exist between various donor countries and aid organizations, it is nevertheless the case that development discourse today is more homogeneous than perhaps ever before. The so-called ‘Washington Consensus’ (Williamson 1993) is still accepted by the majority of multilateral and bilateral donors, and there is general agreement on the desirability of both economic liberalism and liberal democracy. Disagreement is confined to the more minor issues and details of what importance to assign to

the various aspects of 'good governance' and 'development', while the overarching tenets remain unchallenged. On this very basic level, then, it is legitimate to speak of the existence of a development discourse that donors and creditors in the North all subscribe to and advocate as the model to be followed by the South.

Alien state intervention, indigenous democratic capitalism

The concept of good governance was first introduced to development discourse by the World Bank's 1989 report *Sub-Saharan Africa: From Crisis to Sustainable Growth*. This document was a major statement of the institution's intellectual leadership of the donor community (Gibbon 1993), and ever since, the Bank has taken the lead in the articulation and ideological refinement of the new development doctrine. The 1989 report, together with the Bank's study *Governance and Development* (1992a), still represent the most rigorous and assertive official pronouncement of current development thinking, the *locus classicus* of the governance literature.[2] Accordingly, my analysis of the governance discourse centres on these two documents, but also draws on articles published by two senior members of the World Bank staff and the more summary Bank report entitled *Governance: The World Bank's Experience* (1994). By and large, bilateral donors have fallen to line with the views expressed in these documents, and although contemporary development discourse cannot be seen as monolithic and unchanging, there is nevertheless broad agreement on the fundamental elements of good governance as constructed by the World Bank.

The World Bank's construction of good governance starts from a rejection of the development models of the past. The 'postindependence development efforts failed', we are told, 'because the strategy was misconceived' (World Bank 1989: 3). According to the Bank, there is now 'a growing consensus' that these strategies 'pinned too much hope on rapid state-led industrialization' and mistakenly encouraged African governments to make 'a dash for "modernization", copying, but not adapting Western models' (World Bank 1989: 83, 3). Following independence, 'Africa's governments were grafted onto traditional societies and were often alien to the indigenous cultures' (World Bank 1989: 38).

The Bank's senior policy advisor makes the same point, asserting that 'state institutions based on Weberian bureaucratic principles … were not compatible with the beliefs and practices of African society' (Landell-Mills

1992: 543). The post-colonial state was, in short, ‘the perfect example of an alien system imposed from the top’, and because the underlying cultural premises of Western state institutions were foreign to the continent, these institutions ‘started to crumble the moment the colonial administrators left’ (Landell-Mills 1992: 545, 543). With hindsight, then, Africa’s ‘economic, political and social disaster’ can be blamed on ‘a fundamental flaw in the prevailing development paradigm’ (Landell-Mills 1992: 543).

The lesson has now been learned, however, and development theory has been amended accordingly. While previous state-led development efforts failed because they ‘did not build on the strengths of traditional societies’, the good governance agenda claims to be different (World Bank 1989: 60). Past development strategies made a rigid distinction between the modern and the traditional, discarded the traditional and made it abundantly clear that ‘[m]odern societies meant “progress” ’ (World Bank 1989: 60). The good governance agenda claims to have a greater degree of cultural awareness and appropriateness, as there are ‘close links between governance, cultural relevance and the components of civil society’ (Landell-Mills 1992: 567). The new development paradigm recognizes, in the words of the World Bank, that ‘far from impeding development, many indigenous African values and institutions can support it’ (World Bank 1989: 60). Good governance does not therefore advocate a ‘dash for modernization’, but understands instead the need to ‘progressively remodel its institutions to be more in tune with the traditions, beliefs, and structures of its component societies’ (Landell-Mills 1992: 545). Accordingly, ‘each country has to devise institutions which are consonant with its social values’ (World Bank 1989: 60). Change cannot be imposed from the outside by development agencies, but will be effective only if it is ‘rooted firmly in the societies concerned’, and World Bank programmes must therefore ‘reflect national characteristics and be consistent with a country’s cultural values’ (World Bank 1992a: 12; 1989: 193).

On the face of it, these suggestions are very seductive and almost commonsensical. The expressed desire to build on a society’s own values, rather than imported ones, would today be endorsed by both the political left and right. The recognition of the ‘alien’ nature of the modern state and its lack of roots in indigenous society also reflects recent debates.

The World Bank’s discourse, however, performs two important functions within the governance discourse. First, it serves to dissociate the good governance agenda and its proponents from the development failures of the past. Previous development strategies may have been misconceived, but these mistakes have now been rectified as donors have discovered the ‘real’ solution to Africa’s problems. In this way, the development apparatus and

the World Bank in particular remain untainted by previous mistakes and retain the moral right to continue the development effort.

Second, the representation not only serves to construct an image of the modern Weberian state as alien to Africa but also delegitimizes state-led development.[3] The state is constructed as a Western invention, a result of foreign ideologies and misguided development theory, imposed from above to modernize indigenous societies. Because the state is a foreign imposition, everything the state does is tainted and state intervention, whether the provision of welfare or the ownership of enterprises, is bound to fail as it is out of tune with local values and customs. In this representation, the prevailing developmental or interventionist state becomes the enemy of the people, the reason for Africa's underdevelopment and misery. The good governance agenda, however, emerges as the liberator that will allow not only for development but also for the release of society's true, indigenous values. At this point, the good governance discourse takes a rather astonishing twist. While the state and *state capitalism* are regarded as imported artefacts, *capitalism* is represented as an integral part of Africa's indigenous culture, perfectly attuned to local, traditional values.

The governance discourse portrays African societies as bursting with suppressed capitalist energy and entrepreneurial spirit. Under the headline 'Africa's market tradition' the World Bank reminds us that '[e]ntrepreneurship has a long history in sub-Saharan Africa. In parts of the continent long-distance trade on caravan routes dates back to the 11th century' (World Bank 1989: 136). We are further asked to recall that Great Zimbabwe mining activities were linked to Arab trading and export centres on the south-eastern coast, where a liberalized system of exchange operated and where mutual tolerance prevailed. In contemporary Africa, by contrast, state-led development has stifled private sector activities. In their misguided 'dash for modernization', governments 'greatly underestimated the depth and potential of African entrepreneurship' (World Bank 1989: 136). Massive resources were directed to public enterprises, and these policies 'have driven entrepreneurs into the informal sector' and 'crowded local firms out of access to markets and financial resources' (World Bank 1989: 136–7). But 'despite considerable hostility from central government, local entrepreneurs have shown remarkable vitality', and the Bank argues that in sharp contrast to the failure of public enterprises 'almost everywhere the informal sector has been a thriving success' (World Bank 1989: 59, 38).

Not only has African capitalism triumphed against the odds, but it has done so in a manner consistent with Africa's indigenous culture. According to the World Bank, enterprises in 'the informal sector are organized around

and supported by, local values and traditions' (World Bank 1989: 140). Traders and artisans carry out their activities 'according to long established customs and rules administered through grassroots institutions' (World Bank 1989: 136). Thus, the good governance discourse speaks of financing in the informal sector in terms of savings clubs, rotating funds and other informal arrangements where 'interpersonal loyalties' are more important than formal guarantees and profit (World Bank 1989: 140–1). There is no mention of moneylenders charging exorbitant interest rates. Instead, informal sector capitalism is given a caring and compassionate face, less concerned with profit because of its reliance on 'personal relationships' (World Bank 1989: 140).

In this way, the good governance discourse constructs a binary opposition between alien state intervention, which is associated with past development failures, and indigenous capitalism, which represents the basis for future development successes. While there is no denying the dismal performance of the African state, a clear consequence of this binary opposition is that it bestows legitimacy on the contraction of the state and its services in accordance with structural adjustment programmes. Because the state is an alien oppressor, the curtailment of state activities becomes a people-friendly, democratic venture, almost to the extent that state contraction or destatization is presented as synonymous with democratization. This conflation of destatization with democratization is an essential characteristic of the good governance discourse, and, as we shall see, it reverberates in various guises throughout the entire discourse.

The conflation of destatization and democratization has its roots in the perception of democracy and economic liberalism as the two sides of the same coin. Contemporary development thinking perceives of democratization and economic liberalization as interrelated and mutually reinforcing processes, an argument that can be synthesized as follows: economic liberalization is expected to decentralize decision-making away from the state and multiply the centres of power. This, in turn, is assumed to lead to the development of a civil society capable of limiting the power of the state and providing the basis for liberal democratic politics.

Democratic rights, however, are seen to safeguard property rights, which in turn create the security and incentives necessary for economic growth. A positive synergy is thus perceived to exist between economic liberalization and democracy, and the World Bank accordingly argues that 'political legitimacy' is a 'precondition for sustainable development' and growth, and that economic reform will be 'wasted if the political context is not favourable' (World Bank 1989: 60, 192). This view has been repeated by numerous other development organizations and bilateral donors.

Former British Foreign Secretary Douglas Hurd, for example, maintained that 'good government goes hand in hand with successful economic development. In the short term an authoritarian or corrupt government may achieve some economic progress. In the longer term, however, such governments prove inefficient, and are unable to deliver social goods as effectively as governments which are accountable' (Hurd 1990: 4–5). The same view also informed the later Labour government's foreign policy, with former Foreign Secretary Robin Cook stating that 'the past two decades have repeatedly demonstrated that political freedom and economic development are mutually reinforcing' (Cook 1998).

In the good governance discourse, democracy emerges as the necessary political framework for successful economic development, and within the discourse, democracy and economic liberalism are conceptually linked: bad governance equals state intervention, good governance equals democracy and economic liberalism. Or in the words of two senior World Bank officials, governance means competent and accountable government 'dedicated to liberal economic policies' (Landell-Mills and Serageldin 1991: 307). Because democracy and economic liberalism are conceptually linked in the one concept of 'governance', the possibility of conceiving of potential contradictions between the two is virtually impossible within the parameters of the discourse. To be in favour of democracy is simultaneously to be in favour of free-market economics and structural adjustment. The fact that the two may at times conflict, so that, for instance, economic inequalities generated by capitalist competition may undermine political equality and the functioning of democracy, is rendered inconceivable by the fusion of the concepts. It also follows from the above definition of governance that democracy will lead to good governance only if the electorate chooses governments that adhere to a free-market ideology. This is, of course, an inherently undemocratic stipulation, in that it attempts to restrict the scope of political choice. It entails, in short, an *a priori* determination of economic model and a relegation of constituents' preferences to second-order importance. The possibility that large sections of the electorate in poor countries may favour economic and political solutions that conflict with the good governance agenda's vision is passed over in silence by the discourse.

Instead, the good governance agenda claims to speak on behalf of the 'ordinary people' of Africa, and states that its primary aim is to 'empower' them and enable them to resist the alien and oppressive state (World Bank 1989: 54). In this way, an essential unity of purpose is constructed between the development apparatus and the 'ordinary people', in that they all oppose

the state and seek to reduce it. The good governance agenda's strategy for supporting the people against the state is to strengthen civil society, a strategy intimately bound up with economic liberalism.

Liberating civil society

In the good governance discourse, civil society emerges as the key link between economic liberalization and democratization; it is both the locus of economic growth and vitality, and the seedbed of democracy. The weakness of civil society on the African continent is blamed on the statism of past development strategies. The dominance of the state is seen to have prevented the growth of autonomous organizations, which in turn enabled state officials in many countries to serve 'their own interests without fear of being called to account' (World Bank 1989: 60). Civil society is regarded as a 'countervailing power' to the state, a way of curbing authoritarian practices and corruption; hence the concern for strengthening or nurturing civil society. The World Bank states that good governance 'requires a systematic effort to build a pluralistic institutional structure' (World Bank 1989: 61), and intermediary organizations are seen to have an especially important role to play. They 'can create links both upward and downward in society and voice local concerns more effectively than grassroots institutions. In doing this, they can bring a broader spectrum of ideas and values to bear on policy making' (World Bank 1989: 61). Intermediate organizations are also expected to exert pressure on public officials for better performance and greater accountability. In short, it is believed that by 'deliberately supporting the development of plural institutional structures, external agencies can help create an environment that will tend to constrain the abuse of political power' (Landell-Mills and Serageldin 1991: 313).

According to the good governance discourse, the best way to strengthen civil society is to reduce the role of the state and expand the scope of market forces as suggested by structural adjustment programmes. This is expected to decentralize decision-making away from the state and open up new spaces for grass-roots organizations and private initiatives. In this context, attention is drawn to the flourishing of informal, voluntary organizations such as credit unions, farming associations, women's groups and professional associations on the continent over the past decade (World Bank 1989: 61; 1992a: 25; Landell-Mills 1992). The growth of such voluntary associations is, in large part, a reflection of the state's curtailment of services in accordance with structural adjustment programmes. As the

African state has become unable or unwilling to deliver basic services and infrastructure to its citizens, more and more people have come to rely on private initiatives, frequently centred around traditional, ethnic associations, but also involving new, voluntary self-help groups. The vacuum left by the retreating state has thus been filled by private initiatives, and given the good governance discourse's representation of the state as an alien oppressor, this development is regarded as enhancing the prospects of democracy. In the words of Landell-Mills (1992: 563), the 'proliferation of associations at all levels' supports the trend towards 'more participatory politics, greater public accountability, and hence basic democracy'.[4]

While the mushrooming of associational life on the continent in recent years is indisputable, the good governance discourse's representation of this development as inherently democratic is far from unproblematic. This representation is intimately bound up with the conceptualization of civil society within the governance discourse. A notoriously vague and ambiguous concept, civil society is at no point defined in the World Bank discourse.[5] In fact, the two main documents under consideration do not use the concept at all, but refer instead to institutional pluralism as well as intermediate and grass-roots organizations. It is only in the 1994 report *Governance: The World Bank's Experience* that the concept emerges, but here, its meaning is taken as too obvious and familiar to require any definition or further discussion. This treatment of civil society as an unproblematic concept has become commonplace in much contemporary literature on development, where civil society is used as an all-encompassing term referring to a wide range of voluntary cultural, economic, social and political associations, institutions and relations outside the state. This is also the World Bank's usage and, in effect, the references to institutions and intermediate and grass-roots organizations in the two main documents are simultaneously the Bank's definition of civil society. In the governance discourse then, civil society equals associational life.

The agenda's conceptualization of civil society proceeds from a particular conception of state and society, where the state is associated with power and civil society belongs to the realm of freedom and liberty.[6] In this interpretation, power and exploitation become the exclusive property of the state and the public/formal sector, and any reduction of the state and its economic and social services can accordingly be represented as an expansion of democracy and freedom. Such a narrow sovereign conception of power gives rise to the rather romantic representation of civil society as implicitly democratic, and the mere existence of organizations outside the state is assumed to be sufficient to limit the power of the state and enforce a

transition to democracy. This representation is reductionist in the extreme. The emergence of various voluntary groups and associations cannot automatically be expected to constitute the basis of an active, well-informed, articulate civil society, nor can it be taken for granted that political activities with a strategic dimension will be generated by societal organizations and movements. Many associations in civil society do not involve any self-conscious political intention or action and do not seek to limit the reach of the state or influence its policies. Other groups, in turn, may espouse authoritarian ideologies and pursue undemocratic strategies and goals. Civil society cannot therefore be seen as either inherently democratic or undemocratic; rather, its character may vary across time and space.

Such observations are of particular relevance in many developing countries, where the blossoming of informal associations is largely a result of the inability of the state to deliver basic services. People have withdrawn from an increasingly oppressive and exploitative state, and turned instead to community networks for their social welfare. In the same way, the black or parallel market has provided an effective way of avoiding high taxes and the artificially low prices paid for farm products by state marketing boards. Such exit or coping strategies may well have weakened the state, but the ability to avoid the state should not be conflated with an ability to support democratization in any constructive and significant way as it does not necessarily imply any political alignment or relation to political parties or activities.[7] Instead, these strategies generally signal a deep distrust of the state and a perception of its institutions as irrelevant to everyday life and struggles. If anything, such attitudes may have negative implications for democratization, which requires the associations of civil society to engage with state institutions in order to achieve their aims and improve their conditions of existence.

The heterogeneous and segmented nature of civil society also cautions against definitions that treat it as inherently democratic. Civil society in Africa (as elsewhere) embodies a diverse set of traditional, ethnic, professional, class, local, regional and national interests. While heterogeneity does not in itself prevent voluntary associations from mobilizing for democracy, it increases the likelihood that some may become agents of ethnic or parochial interests, especially where state boundaries are still in dispute and nation-building an incomplete process. This is arguably the case in many developing countries, and such conflicts are sufficient reminders of the potential dangers in culturally heterogeneous societies. And while the vacuum created by the retreating state may well allow voluntary organizations to mobilize for democracy, it also raises the spectre of intensified particularism and fragmentation.[8]

While such interpretations may be too pessimistic, it seems equally clear that the good governance discourse's representation of civil society as inherently democratic is too romantic and optimistic. The mere existence (or absence) of civil society, important as it is, is not sufficient to explain the success or failure of democracy. Civil society and its relationship to democratization cannot be understood in abstract terms, but requires instead a specific analysis of the various groups and interests involved in these struggles. The point here, however, is not merely to note that the highly differentiated nature of African societies, both in terms of ethnicity and wealth, must be taken into account when considering the democratic potential contained in the emergence of their civil societies. Rather, the important question relates to the effects of an order of discourse that ignores such cautionary observations about the heterogeneous and potentially undemocratic qualities of civil society. What actions and practices are legitimized by this discourse, and what types of power does it underwrite? The short answer is that the good governance discourse serves to construct economic liberalism as a force for democracy. The equation is simple: coercive power is perceived to reside exclusively in the state and public institutions, and any reduction in the size or reach of the state is therefore regarded as conducive to democratization. Structural adjustment curtails state activity and is associated with the growth of voluntary groups and organizations, and hence, adjustment becomes a democratic enterprise for the liberation of civil society.

Empowerment through cost recovery

What, then, remains of the good governance discourse's claim to empower 'ordinary people', one may legitimately ask. The governance discourse has the effect of valorizing everything outside the institutions of the state and bestowing democratic legitimacy on all organizations and practices in civil society. Civil society emerges as undifferentiated and harmonious, and there are no classes, no races, no genders, ethnic groups or oppressors in the civil society of the good governance discourse. Instead, the various groups and associations of civil society are implicitly expected to further the cause of 'the people', that is, to serve the interests of all groups equally and democratically, and we are repeatedly reminded of 'rich traditions of community and group welfare and the 'widespread practice of sharing among people' (World Bank 1989: 60, 168).

Reality, unfortunately, is somewhat different. Structures of power and hierarchies of wealth and influence permeate all civil societies, and

developing countries are no exception. The governance discourse, however, builds on an essentially ahistorical notion of civil society, where tradition is regarded as part of human nature, unchanging and set apart from power and authority. Organizations are abstracted from the socio-economic structures in which they are embedded, and become instead part of the South's eternal tradition of sharing. Not only does this representation render inequalities of power between individuals, classes and groups invisible, but it also conceals the possibility that various traditional associations and practices may be hierarchically organized and form part of structures that privilege certain individuals and groups and enable them to serve their own particularistic economic and political ends. Accordingly, Landell-Mills discusses the Harambee movement in rural Kenya only in terms of cooperative effort and mutual benefit for all, neglecting alternative views that the self-help activities of the movement rely heavily on women's labour, and that 'some communities, some groups and some national elites benefit far more than others' (Thomas 1988: 23).

The good governance discourse not only obscures such relations of power and domination, but its declared intention to build on traditional, indigenous structures in the effort to improve governance implies a continuation of the forms of oppression entailed within primordial relationships. This position is, of course, not compatible with the new development paradigm's democratic message, but it is nevertheless the inescapable corollary of its rather romanticized conceptualization of tradition and civil society.

The conception of power that underpins the good governance discourse also has the effect of obscuring the coercive and oppressive relationships associated with capitalism. By locating power exclusively in the state, the marketplace becomes a realm of freedom and liberty. Such a conceptualization of civil society cannot take account of the possibility that economic liberalization may reinforce existing socio-economic inequalities, as it does not recognize the organizational and institutional structure of power in social relations in the first place. Similarly, there is no room for a critique of the threat that capitalist market forces may pose to systems of social solidarity and justice, and thus, to some structures of civil society itself, nor is it recognized that state action at times may be necessary or desirable to overcome or reduce inequalities in civil society.[9] Instead, the confinement of power to the state and the portrayal of the market as a place of liberty reinforce the image of structural adjustment as conducive to the expansion of democracy, and yet again, we see how democratization becomes almost synonymous with destatization.

The governance agenda's overall aim to 'release the energies of ordinary people' and to 'empower ordinary people to take charge of their own

lives, to make communities more responsible for their development, and to make governments listen to their people' is also intrinsically bound up with economic liberalism (World Bank 1989: 54). The seductive power of development is clearly demonstrated in the intention to empower; it draws on emotive and forceful imagery and appeals to notions of rights and justice. If taken literally, this call for empowerment has far-reaching political consequences, in that it implies a challenge to local as well as national power structures. If people were enabled to hold those in power more accountable, they might demand more services and a more just distribution of income, and thus put into question the whole gamut of existing socio-economic arrangements.[10] Needless to say, this is not the intention of the development apparatus, and when analysed within the overall context of the economic policies of the good governance agenda, empowerment takes on quite a different meaning.

One of the central tropes of the good governance discourse is *cost recovery*, which the World Bank introduces as one of a few 'watchwords for the future' (World Bank 1989: 7). The Bank advocates the introduction of user charges for secondary (possibly also primary) education and primary health care whereas full cost recovery is recommended for 'nonbasic services such as university education and nonessential health services' (World Bank 1989: 6–7, 86). Water supply and sanitation are other services for which 'much of the cost could be recovered through user charges' (World Bank 1989: 7). The World Bank maintains that '[w]hatever the merits of free social services, the reality in Africa is that it means inadequate provision or no provision at all to many people and particularly to the poorest and most vulnerable' (World Bank 1989: 86). It is in this context that the emphasis on empowerment, as well as the need to build on 'indigenous African values and institutions', emerges. The World Bank suggests that '[c]ommunal culture, the participation of women in the economy, respect for nature … can be used in constructive ways' (World Bank 1989: 60). By placing the management of basic social services in local hands, two purposes can be achieved: programmes become more responsive to users, who then in turn 'become more willing to contribute to their cost' (World Bank 1989: 7). There is, according to the World Bank, little or no resistance to user charges in Africa, and 'even very poor people willingly pay for health care if they demonstrably get value for their money' (World Bank 1989: 6). All in all, cost-sharing is a means of 'empowering the beneficiaries to demand improved services and of fostering a sense of individual and community responsibility for their delivery' (World Bank 1989: 86).

It is this form of consumer sovereignty that the World Bank tries to dress up as empowerment and, by implication, as democracy. The incorporation of words like 'empowerment', 'self-help' and 'participation' into the Bank's otherwise monetarist vocabulary serves primarily to justify the curtailment of state responsibility. Adjustment programmes necessarily mean fewer state services, especially to the poor, and as a result of the economic crisis in the past decade, the burden of caring for the sick, feeding the poor, and so on has been increasingly transferred from paid state officials to unpaid local labour (mostly women). There is absolutely nothing democratic or empowering about this. By contrast, local people, and women in particular, are expected to make up for the shortfall in public services by putting in more working hours to compensate for the withdrawal of state provisions. While this may register in national budgets and World Bank statistics as cost saving and a sign of increased efficiency, it entails increased burdens for many local people. Terms like 'empowerment' and 'community responsibility', however, serve to give this development an aura of democratic freedom. Within the good governance discourse, then, empowerment is deprived of its radical, political implications and becomes instead a highly instrumental term; the objective is to 'capitalize on the energies and resources of the local people', who should pull their weight and thereby make development projects more cost-efficient (World Bank 1989: 58). Only in this context does it make sense for Landell-Mills (1992: 567) to describe local, voluntary self-help groups as 'cost-sharing moves'. Local initiatives are expected to fill the gaps left by the retreating state, to provide social services like health care, water and sanitation. Self-help, participation and empowerment become an intrinsic part of the effort to liberalize the economy, efforts that can be tapped into and used to reduce the cost of public provisions. Community involvement and empowerment are intended to function within the framework of economic liberalism to challenge existing power structures or question adjustment programmes through 'excess' demands. This kind of participation and empowerment has nothing to do with democracy, but again, we see how the good governance discourse blurs the distinction between the retreat of the state and democratization.[11]

Good governance as modernization theory

The good governance discourse presents its intention to build on local grass-roots organizations as evidence of the cultural sensitivity of the new development paradigm. As we have seen, a sharp contrast is drawn between

the 'modernization' strategies of the past, which imposed alien systems on traditional societies, and the new strategy, which builds on the indigenous and listens to 'the people'. Grave concern is also expressed about the risk of 'ethnocentric and cultural bias', and it is acknowledged that development institutions must be 'very cautious in proposing specific solutions or advocating particular arrangements' and that 'there should be no question of imposing a particular democratic system on any country' (Landell-Mills and Serageldin 1991: 311). Unlike the misconceived policies of yesteryear, then, governance takes account of cultural differences and recognizes that African values and institutions can support development and be used in constructive ways (World Bank 1989: 60; 1992a: 8). The emphasis is on the need for 'home-grown solutions' (Landell-Mills and Serageldin 1991: 311), and it is argued that each country 'has to devise institutions that are consonant with its social values' (World Bank 1989: 60).

On closer inspection, however, this is actually a peculiar brand of 'pick and mix' cultural relativism, which recognizes that indigenous African traditions are not uniformly favourable to democracy and economic liberalism. In *Governance and Development*, the World Bank points out that the spread of political legal systems modelled on Western traditions may lead to the existence of two sets of norms and institutions: 'Western notions of the rule of law, private property rights, and contracts' may be superimposed on 'ideas such as "consensus", "communal property", and "reciprocity" ' (World Bank 1992b: 8). The question of whether these 'different ways of anchoring social rights and obligations … hamper the functioning of modern economic institutions' is raised, only to be left unanswered in the document. Landell-Mills (1992: 545), however, is more outspoken on these issues. He asserts that the 'challenge is to build on the elements [of African tradition] that are compatible with modernization and development, *rejecting those that are not* and, where necessary and appropriate, borrowing wittingly from foreign models, western or eastern' (italics added).[12] The turn of phrase is important: the good governance agenda may advocate institutions that are consonant with indigenous social values, but then proceeds to narrow those values down to compatibility with modernization.

One aspect of African tradition that must be discarded is the strong family and ethnic ties, which 'have no place in central government agencies, where staff must be selected on merit and where public and private monies must not be confused' (World Bank 1989: 60). In the context of seeking to establish honest, efficient and accountable administration, such statements make eminent sense, but they simultaneously reveal a deeper contradiction, within the good governance discourse. On the one hand, the World Bank

praises Africa's strong family and communal ties in relation to issues of empowerment and cost recovery, while on the other, it attacks these aspects of African culture and practices as detrimental to good governance. It seems that the World Bank wants to make use of communal bonds when they can serve to reduce the cost of basic state services and abandon them as archaic and hostile to the project of development in other contexts.

Rather than cultural sensitivity, such statements signal not only a degree of instrumentalism but also a simplistic understanding of cultural practices and traditions as existing independently of social structures and as something that can simply be abandoned at will. While the persistence of patrimonial practices in Africa may well be an affront to good governance, one should not disregard the fact that these practices have particular historical and cultural roots and that they may also serve particular political purposes. Abandoning patrimonial practices may accordingly prove far from easy, and may also have wide-ranging consequences for the construction of viable political authority and structures of governance.[13] Another custom that must give way to good governance is communal land ownership and land use rights, as the World Bank claims that agricultural modernization makes land titling necessary (World Bank 1989: 104). This issue is presented as entirely 'technical' in nature, and there is no discussion of the political and cultural significance of communal land ownership and networks of patronage. Thus, the fact that land titling would most likely exclude some people from access to land and make the survival of others highly precarious, while enriching a few, is passed over in silence.

The good governance discourse asserts that it seeks to create 'a modern sector that *supports* the traditional sector, rather than one that aims to *replace* it' (World Bank 1989: 60, italics in original). It is nevertheless difficult to see how the governance paradigm is qualitatively different from the 'modernization' strategies of the past. Development within the good governance discourse is still perceived to imply 'a profound change in social culture' and a 'long-term process of changing mentalities' (Landell-Mills 1992: 564, 565). As we have seen, good governance is conceptually linked to economic liberalism, and the effort to strengthen civil society concentrates primarily on nurturing the bourgeoisie and creating an enabling environment for business. Apart from the token references to the 'empowerment of ordinary people', which ultimately boils down to an issue of cost recovery, the civil society of the good governance discourse consists primarily of modern, professional and contractual organizations. The discourse embodies a liberal conception of civil society as the equivalent of market or bourgeois society. This is not only a conception that elevates

the right to private property over all other rights, but it also draws on notions of the universal liberal subject and the philosophy of possessive individualism (see Williams and Young 1994). Accordingly, the World Bank (1989: 59) can perceive of a 'common desire of individual Africans to be independent economic operators', and its development mission thus appears as the liberation of the liberal subject from the oppressive structures of the state.[14]

In order to assist Africans in their struggle to become 'independent economic operators', the good governance discourse pays particular attention to strengthening the business community. A free economy is perceived as absolutely vital to civil society, and the focus is on creating an 'enabling environment' that can release private energies and encourage initiatives at every level (World Bank 1989: 59). 'Private enterprises' are regarded as 'a crucial component of civil society, acting effectively as its life support' (Landell-Mills 1992: 563). Accordingly, 'measures taken to favour private-sector activities, including the widespread attempts to privatise state enterprises, serve to reinforce civil society' (Landell-Mills 1992: 564). The good governance agenda here employs arguments that are commonplace in many liberal accounts of the rise of democracy in the West, where the bourgeoisie is regarded as the engine not only of economic growth but also of democratization.

In the conventional manner of modernization theory, the good governance discourse can be seen to draw on the historical experience of the West in its construction of development. As Barrington Moore's famous dictum 'no bourgeois, no democracy' indicates, the emergence of civil society in the West is closely bound up with the pioneering role of this class in demanding and maintaining a sphere free from state intervention (Moore 1991: 418). The good governance discourse now expects the bourgeoisie to perform the same function. This view also holds strong support among contemporary liberal academics, and Diamond (1988a, 1988b), in particular, has been an eager proponent of the bourgeoisie as the agent of democracy. Diamond argues that the intimate link between political power and dominant class formation in Africa has stunted the growth of an autonomous, indigenous bourgeoisie and that this has 'meant the absence of that class that pressed for the expansion of democratic rights and limitation of state power during the early development of democracy in the industrialized West' (Diamond 1988a: 22). In Africa, the 'bourgeoisie that has developed … has been bureaucratic or political, non-productive, and even parasitic' (Diamond 1988a). He thus argues that the increasing movement away from statist economic policies and structures represents the 'most significant boosts to

the democratic prospects in Africa' (Diamond 1988a: 27), as it is expected to loosen the connection between state power and class formation.

It cannot, however, be categorically stated that the bourgeoisie in European history was always in opposition to the state, nor can the African bourgeoisie be trusted to act as the democratizers of their societies. In European history, this class has frequently formed vertical links and alliances with the state, especially when it feared challenges from below.[15] The bourgeoisie in parts of nineteenth- and twentieth-century Europe sought to overthrow political absolutism in order to safeguard the sphere of liberty and private property, but it did not seek to inaugurate the rule of the majority. In other words, the bourgeoisie had liberal goals associated with economic freedom, but not political democratic objectives. The bourgeoisie and democracy cannot therefore be regarded as logically or historically linked. Instead, democracy has, as Therborn argues, always and everywhere been established in struggles against the bourgeoisie and can be seen as 'grafted' onto liberal capitalism (Macpherson 1977; Therborn 1983: 271). In the same way as the European bourgeoisie resisted democratization, the emerging business classes in Africa may have much to fear from democracy and universal suffrage. To identify this class as an agent of democracy in the manner of the good governance discourse is therefore highly contentious. It is one thing to assume that the bourgeoisie is or can be the agent of liberal capitalism but quite another to expect it automatically to promote democracy. The support of this class for democracy and majority rights cannot be taken for granted, but requires instead concrete empirical investigation.

The good governance discourse also contains another related assumption that is equally problematic, namely that economic liberalization will lead to the development of an *autonomous* bourgeoisie (democratic or otherwise). This expectation entails a view of civil society as separate from the state, but no such clear demarcation line can be drawn between the two. Instead, the boundaries of state and society constantly overlap and intersect in complex ways, and this is especially the case in African countries. This feature of state–society relations is effectively captured in Jean-François Bayart's (1993: 218–27) image of 'the rhizome state', which is linked to society through a multiplicity of horizontal networks. While the World Bank and many liberal writers (like the prolific Larry Diamond) lament the near fusion of state elites and economic elites, they exaggerate the fragility of this relationship, expecting it to disintegrate once liberalization begins. However, clientelistic relations between the state and the various groups engaged in production and accumulation have evolved over time and may not be easily superseded by an ideal-type bourgeoisie capable of acting independently of the state.

First, groups closely associated with the state are most likely to benefit from liberalization measures, and clientelistic relationships may be continued and reinforced rather than severed by adjustment programmes. Government officials may use their positions of authority to gain a disproportionate share of privatized resources and income-earning opportunities; concerns by donors, including the World Bank, about the politicization of economic reforms lend further support to such arguments (see, for example, *Africa Confidential*, 39 (13), 1998).[16] Second, sections of the bourgeoisie may actively seek the continued protection of the state. The reaction of the Chinese business class during the pro-democracy protests in 1989 may serve as an illustration here. The nascent Chinese entrepreneurial class did not come out in favour of reform, as they were anxious not to jeopardize the stability of the political and bureaucratic support that provided profit and protection. They were particularly opposed to any crackdown on corruption, as this would target precisely the personal ties with state officials that business depended on. And as many firms were run by relatives of high-ranking government officials, the students' call for an end to nepotism fell on deaf ears (Wank 1995). Similarly, the Zambian business community, represented by the Zambia Confederation of Chambers of Commerce and Industries, argued against the government's economic liberalization programme. In the Confederation's argument that the programme 'kills domestic industries' (*Zambia Daily Mail*, 24 May 1993), an implicit preference for state protectionism and old-fashioned 'crony capitalism' can be detected.

In the good governance discourse, however, the bourgeoisie, by virtue of its place within civil society, is inherently and automatically democratic. It is also assumed to be willing to defend the rights of the 'ordinary people' against the alien and oppressive state. Such a representation is only possible by denying power and interests in civil society, so that all individuals and groups are perceived as equal and as sharing the same goals and motivations. Not only is this rather naive, but it also relies on a particular interpretation of the emergence of democracy in the West. In this respect, contemporary development discourse is not significantly different from the modernization theory it so eagerly disclaims. Like modernization theory, it theorizes about development on the basis of the historical experience of the West, and despite its claim to be 'culturally sensitive', it embodies a vision of the good society largely constructed from Western values. Prime among these are democracy and economic liberalism, which according to the good governance agenda are historically linked and constitute two sides of the same coin. The discourse then proposes to reconstruct or develop societies according to these values, to recreate the South in its own image.

Conclusion

The power of development to 'seduce' (Rist 1997) is clearly evident in the good governance discourse. Its language and imagery are forceful and emotive, and its claims to 'empower', 'democratize', 'release energies' and 'liberate civil society' are the stuff that dreams are made of. Analysis of the good governance agenda, however, seems to go around in circles, always leading back to one factor: economic liberalization. Governance is conceptually linked to economic liberalization, and civil society is regarded as emerging from the liberalization of the economy and reduction of the state. 'Empowerment of the people' is reduced to cost-sharing and becomes a tool in the hands of liberal economists. The bourgeoisie is regarded as both the source of economic growth and democracy, and cultural sensitivity only entails a commitment to build on traditions compatible with capitalism and modern state structures.

Despite the discourse's effort to distance itself from past development failures, its endless repetition and reification of its ostensible respect for indigenous traditions and cultures, the agenda's recommendations amount to little more than a new gloss on age-old prescriptions. The main effect of the discourse is to portray structural adjustment as a force for democracy. Although the discourse does not go all the way towards reducing democracy to economic liberalism, it is clear that 'good governance' is impossible without liberal economic policies. In this way the discourse legitimizes continued structural adjustment, and gives it a more democratic face, while simultaneously delegitimizing more interventionist and collectivist strategies, which by implication become examples of 'poor governance'.

Three decades on, the good governance agenda has been largely unsuccessful in promoting stable multiparty democracies. This, however, does not mean that the good governance discourse as such has been a failure. Success or failure should be judged by what development as a practice actually does, rather than by its stated aims and objectives. Seen from this perspective, the governance discourse has been eminently successful. The good governance discourse reproduces the hierarchies and unequal relationships that have characterized development ever since its inception, and seen as part of the exercise of power in global politics, it has helped legitimate the North's continued power and hegemony in the South. By constructing African countries as undemocratic and lacking in good governance, it reconfirms the right of the North to intervene, set conditions and define the policy choices of the South. In this way, the good governance discourse is an intrinsic part of the governance of the South

by the North and one of the ways in which contemporary international structures and relations of power are maintained and reproduced. By constructing democracy as relevant only within countries, the governance discourse shields international organizations and relations from democratic scrutiny and serves to bestow legitimacy on a world order that is essentially undemocratic.

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Chapter 3
Good governance and donors

Brian van Arkadie

This chapter discusses some concerns regarding the current widespread use by donors of good governance in their approaches to reform-mongering and to aid conditionality. These include reflections based on experience with policy work over the past 45 years in a wide range of developing and transitional countries. For the purposes of this discussion, governance will be taken to mean the practices guiding the formulation, implementation and oversight of the programmes, policies and activities of organizations, and in particular, governments, and the development of appropriate institutions for effective development.

Good governance as a development policy theme

The first question to be addressed is why does governance feature so prominently in contemporary discussions of economic policy? That was not the case 20 years ago – indeed, at that time, the term 'governance' was not in common usage in the economic development literature. It might be useful to explore why 'governance' has featured so prominently in the economic policy discourse in recent years.

At one level, a cynical view might be that it is largely a matter of fashion. Since the term became a trendy 'buzzword', it has been used with little discrimination to mean many things, so that arguably, it has been leached of meaning. It is overused – some times in a rather imprecise and confusing fashion. This is partly because of the holistic, ambitious nature of the concept, encompassing a wide range of aspects of State management and politics. But also, as a cliché, it is often used rather pompously as a synonym for 'government' and 'good government'.

Sometimes 'governance' seems to serve a cosmetic purpose, to dress up traditional subjects in a more attractive contemporary guise (e.g. the study of public administration, or politics) so that the "government" seems to have been replaced by "governance" throughout development literature. In the development literature, it has even had a euphemistic function, providing an umbrella for discussions of delicate issues, such as corruption or the promotion of exotic models of democratic practice.

More usefully, it has been used to address aspects of the political process crucial to development, which were earlier neglected by mainstream economists. Its widespread contemporary use reflects a heightened concern for political and administrative aspects of development and the policy process. Obviously, in many respects, this concern is appropriate and useful.

Another critical factor propelling the intrusion of governance issues into the pure world of the economist was the recognition of the importance of institutions for the effective operation of markets. Probably, many economists working in established market economies neglected the importance of institutions because they implicitly assumed the existence of the institutions conditioning markets in their own economies, without bothering to analyse their origins or functioning. In fact, it is not surprising that the scholarly impetus to study the role of economic institutions came from economic historians.[1]

The critical importance of institutions became clear in the context of the transitional economies. When planned economies began the transition to the market, the importance of many institutions became clearer because of their absence. In most developing economies, while the institutions required for effective markets may exist in principle (such as systems of commercial law, secure land tenure, etc.), they may not function adequately in practice.

While markets in economic models are abstractions, in reality, they are institutions, governed by rules and influenced by the behaviour of the various actors. And effective legal institutions are not only a matter of the enactment of laws but also of the administration of the law. The effectiveness of the State in setting up the rules of the game and ensuring their predictable and transparent application emerged as a key, but far from simple, issue. In this sense, effective governance – in the sense of the fashioning and implementation of the 'rules of the game' that provide the context for the market economy – is of crucial importance.

In transitional economies, there was an urgent need for company laws, commercial laws, bankruptcy laws, banking laws and so on. Land tenure arrangements were a crucial factor in rural development, and land

law reform a crucial step in the reform process. The legislative task was enormous. But even more challenging has been the development of all the other components that make legal systems work – the judiciary, the legal profession, a popular understanding of the law.

In transitional economies, a key issue for proponents of reform is the degree to which laws and other public institutions are biased in favour of the public sector – the standard metaphor is to argue for a 'level playing field' between private and public sectors. Even more important for the creditability of reform process was the manner in which property rights are created. Property is obviously a key institution in the market, and market reform resulted in and required new patterns of ownership. The way in which property is acquired effects not only efficiency but also the perceived fairness and legitimacy of a market system. It also affects politics; the appearance of crony capitalism and economic mafias often resulted from the use of political power to accumulate illicit wealth by those with political access, and in turn the use of that ill-gotten wealth to influence the political process, but also from the use of corporate resources to secure greater political influence, for example, through public relations, lobbying and so on.

In non-transitional economies, there was not the same need to create a formal institutional fabric from scratch, but similar issues take on crucial importance, particularly in relation to the way the rules of the game are administered. Uncertainty about legal processes, insecure property rights, capricious and arbitrary enforcement of regulations affecting business activities, unpredictable licensing arrangements, ineffective tax administration and corrupt politicians and other officials together create a negative environment for business activity.

In developing economies, governance emerged as a theme following recognition of the constraints on development that can arise from weak government capacity. A stylized (i.e. simplified) outline of the introduction of governance into the development discourse in developing economies implementing structural adjustment reforms could be described as follows. In the era of market-based reforms in the 1980s and early 1990s, the main focus of the economic debate centred around alternative ways market tools could be used to implement effective policies and to explore differing transitional routes from controlled to liberalized economies (e.g. the debates about 'big bangs' versus gradualism as transitional routes). The role of government was discussed largely in terms of appropriate economic policies in the sense of market liberalization and maintaining macroeconomic stability. This effectively meant minimizing the role of

government, both in terms of reducing government budgets and reducing government interventions in the economy.[2]

Economists most committed to market-based solutions saw their main tasks as the advocacy of the efficiency of the market and the promotion of the broadest extension of market solutions. Attention to the government as such largely focused on the need to reduce government expenditure and, in particular, to reduce the size of the 'bloated' public service. Within that context, the political agenda could be seen as very much a matter of limiting the role of government to what it could manage effectively and preventing the government from generating fiscal and monetary instability, and what economists described as 'economic distortions'.

One reason for the introduction of governance as a dimension of the economic reform debate was the increasing recognition that such an approach to policy was not enough. Some issues that required attention related to the political economy of policymaking – factors that determine government commitment to policies are as important as the substantive content of policies. An approach that saw policymaking as mainly being about identifying optimal economic solutions neglected a number of issues central to effective economic policy. This became evident when the initial acceptance of reforms and policy packages was not sustained, where there was no commitment to persist with reforms in the face of setbacks or no effective constituency supporting the reform process. This led to increasing attention being given to the political preconditions necessary for effective reform.

Another factor was that an economic agenda defined largely in terms of dismantling important parts of the State apparatus easily neglected consideration of areas where the role of the State continued to be crucial. Even those who thought that the main task of policy was to unleash the 'magic of the market' had to accept that effective market operations require the State to provide critical inputs needed for markets to be effective, including establishing an appropriate institutional environment and providing a range of services that would not be supplied effectively by the market.

At the early stages of structural adjustment, this was neglected. Fiscal austerity and removal of policies that protected State employees contributed to a severe deterioration in the capacity of governments to deliver even the most basic services. Structural adjustment in its early applications further demoralized the public service, as sharp devaluations and budget tightening drastically reduced the real value of public service salaries, at the same time as many perquisites of office derived from the State also disappeared.[3]

In a number of countries, an initial impetus to private investment following economic liberalization ran into constraints resulting from poor and deteriorating public services – roads, water and power – while deteriorating educational systems resulted in a decline in the quality of the workforce. In Africa, in particular, the introduction of reforms coincided with a sad decline in the capacity of governments to carry out required tasks. During the pre-reform period, government capacities had eroded as a result of the impact of such external shocks as the oil crises, from the effects of governments trying to do too much, taking on management tasks that overstretched bureaucratic capacity and, as a result of dysfunctional and failed control systems, creating opportunities for corruption that provided income opportunities to public servants, as their real incomes were eroding as a result of economic crisis.

Even if reforms involved a considerable retreat of the State, the State remained a crucial economic actor. Thus, from the late 1980s, there was increasing awareness of the negative consequences of the erosion of government capacity, which generated a range of 'capacity-building' initiatives, soon subsumed as activities under the broad rubric of promoting good governance. There is, of course, considerable debate over what the precise role of the State should be, but there is a wide consensus about the need for the State to provide certain critical services – economic infrastructure and investment in human resource development.

Efforts to restore the capacity of government institutions – to raise the efficiency and probity of the public service to effective levels – have been high on the African policy agenda for the past decade and a half. The crucial importance of government capacity for effective development is evident, but difficulties experienced in capacity building have demonstrated the difficulty in achieving progress.

In practice, it proved difficult to use external assistance as a vehicle for promoting government reform. This is, in part, because aid modalities had themselves been a source of erosion of coherent public administration. Faced with weakening administrative capacity, donors were unwilling to fund the public service in general but sought mechanisms to ensure the operation of those bits and pieces of the system that they took to be important or needed for implementing their programmes. This was done by such devices as project management units, special secretariats created to take on key tasks, the use of national consultants on more attractive terms than the civil service and so on. The result was that aid-supported activities became an important source of distortion in the public sector incentive structure and contributed to the demoralization of those officers

not benefiting from donor projects. In those many cases where aid became the major source of development finance, the dysfunctional impact became a serious source of capacity erosion. And aid-supported administrative reform projects have often incorporated precisely those modalities that have disrupted the smooth functioning of civil service incentive systems. Aid dependence became part of the problem, rather than the means to a solution.

At the theoretical level, a revival of belief in the central role of the State responded to increasing recognition of the potential for market failure, weakening the doctrinal foundations of support for the minimalist State. The renewed recognition of the importance of the role of the State was supported by the recognition that a key characteristic of the successful economies of East Asia was that a buoyant private economy was supported by coherent and effective State action, 'the developmental State'.

If government remained central to the development process, 'good governance' could be seen as having a crucial instrumental role in achieving economic development goals. In this respect, 'governance' reflected the concern that government should play its necessary economic role effectively. From that point of view, governance incorporates more traditional approaches to public administration and to the formulation of economic policy, while adding a political economy dimension which explores the political conditions that make for effective policy implementation.

In general, the focus on the many aspects of governance has been useful in deepening understanding of development processes. But it has also provided justification for dysfunctional efforts by donors to interfere in political practice in recipient countries.

Donor involvement in the political affairs of recipients

Many practical aspects of the involvement of donors in the pursuit of good governance are not, in principle, controversial, although they sometimes generate tasks which are, in practice, difficult to implement. Thus, the considerable attention given to the improvement of public financial management and public administration reform of recent years is sensible, although involving expensive and demanding efforts.

However, other components of the donor governance agenda are more controversial. Governance is more than a positivist, value-neutral, technocratic term, as its use typically incorporates strong normative views about expected behaviour and appropriate political institutions.

In the development context, for so-called 'like-minded' donors, it has tended to incorporate a vision of an honest and efficient State, which is both responsive to the public in general through democratic processes and also conscious of and able to implement the macroeconomic and microeconomic requirements for market-based growth. It spills over into specifically political agendas/objectives. In the development discourse, governance has been heavily promoted by donors, not only as a response to perceived limitations in traditional approaches to economic policy but also as a vehicle for promoting a donor political agenda. This provokes a number of questions.

What makes good governance potentially controversial is that in addition to effective government being seen as an *instrument* for the achievement of economic growth objectives, governance concerns are also promoted as *ends* in themselves. The donor community became increasingly assertive in promoting their own social and political ideals as cross-cutting issues motivating their approaches to external assistance.

The distinction was not clear-cut; gender awareness, participation of civil society, decentralization and multiparty democracy were promoted, both as desirable in themselves and as necessary components of a successful growth strategy. Thus, such key governance concerns as anti-corruption were promoted, because corrupt practices were perceived not only as socially objectionable as such but also as barriers to economic progress.

This assertion of goals that incorporate the prevailing values of donor communities is understandable enough, but has obvious dangers. International interventions to deal with conflict situations, prevent genocide, respond to serious civil conflicts and address issues of human rights are all allowed for within the articles governing UN practice, but none of these justify continuing intrusion into the internal political processes of countries as a routine and ongoing activity.

Similarly, the statutes of the Bretton Woods institutions clearly restrict any intervention in the political affairs of members. And as bilateral aid grew in the 1960s, many aid agencies saw their role in supporting development programmes as quite separate from political issues. Of course, in practice, aid portfolios have long been influenced by the strategic and political objectives of donors, particularly in the context of the Cold War, but many supporters of development aid found this invidious.

What seems to have happened in recent years is that proponents of the extended governance agenda do not justify their intervention on strategic or self-interest grounds but as the assertion of values which they claim to

be universal – both in the sense that the appropriate ultimate destination of all societies is defined in terms of the ideals of Western donors and that these ideals can be applied to the current practices of developing countries.

To put the issue bluntly, even if one personally shares these ideals, one can question whether wealthy States have the right to impose these values on poorer countries through development assistance, or whether this is not a form of neocolonialism, a resurrection of the white man's burden of imperial days.

The counter-argument is likely to be that even if the objectives of development aid are restricted to the support of economic growth and poverty alleviation, donor promotion of the broad governance agenda is justified as most governance objectives are portrayed as necessary *means* for achieving accelerated growth and poverty alleviation. How far is that argument evidence based?

Is good governance necessary for growth and poverty alleviation?

In a sense, the identification of good governance as a contributor to growth and poverty alleviation is tautological, insofar as 'good' is defined in terms of the effectiveness of governance in promoting those objectives. However, this leaves open the question of what sort of governance is likely to be effective and, more particularly, how far like-minded governance ideals are likely to coincide with effective governance in that sense.

While the model of the good society informing the good governance discourse is typically left implicit, it seems to involve a vision of a pluralistic society, with formal political processes that are democratic, a public service which operates effectively and honestly, subject to consultative processes engaging organizations representing the various legitimate interests in society and local communities.

Insofar as formal political institutions are concerned, although there is controversy, a coherent body of donor doctrine has emerged about what constitutes proper process – there should be more than one party and political power should be transferred through elections which are free and fair according to emerging international criteria. This is, of course, an attractive vision of the prerequisites for democratic process.

However, such an approach rules out any possible merits of one-party rule, although a number of the development successes of the 1970s, 1980s

and 1990s were implemented under *de jure* (China, Viet Nam) or *de facto* (Singapore, colonial Hong Kong, and until the 1990s, Republic of Korea, Taiwan Province of China and Japan) one-party regimes.

There would obviously be great difficulties with the incorporation of the political governance agenda, as described above, into approaches to development policy if comparative study were to suggest that even if a democratic, pluralistic society is an attractive goal, it may not be very compatible with the requirements for fast growth. In other words, there is no necessary consistency between good political governance as a goal and good economic governance as a means of enhancing growth. The efficacy of governance practice in promoting growth and poverty alleviation cannot be adopted as axiomatic; it has to be established by analysis.

The potential conflict becomes clear when, having encouraged the election of representative government bodies, donors – and particularly the Bretton Woods institutions – find the resulting decisions are not very consistent with 'good' economic policy, so that donors quickly find themselves trying to constrain and even bypass electoral institutions through mechanisms of donor conditionality.

The underlying difficulty is that donor political doctrines are more axiomatic than evidence based. Empirical evidence suggests that economic growth and poverty alleviations in poor countries are not very correlated with the degree of multiparty democracy – the distinction seems to be more between autocratic regimes which deliver economic growth and those that do not.

Moreover, if some good governance ideals have often been an outcome – rather than a cause – of economic growth, and if 'bad governance' contributes to accelerated growth, then it is logically possible that the eventual achievement of good governance may be furthered by the current 'bad governance' practices.

Can good governance be exported?

Some elements of the governance agenda are no more, nor less, transferable than other skills and techniques supplied through technical assistance. In general, technical assistance is not easy, and the record of performance in many areas has been weak, but the transfer of, say, accounting skills required for financial management is not more difficult than transferring medical or engineering skills. However, transferring political institutions brings in other considerations.

Donor fashions in social and political priorities respond to changes in 'public opinion', and the evolution of political thinking in donor countries, rather than specific conditions in recipient countries. Apart from any larger philosophical questions regarding the use of the aid relationship for the promotion of political values, at the very practical level, political ideas, whatever their intrinsic merits, are most likely to take root when they respond to the current needs and balance of forces in the society where they are being planted, rather than reflecting the factors conditioning thinking abroad. Even if goals such as political freedom and gender equality can be defended as universally applicable, their successful pursuit is more likely when initiatives have deep national roots.

Fashions also change, so that one powerful source of exogenous instability affecting policymaking in heavily aid-dependent countries is the unpredictable shifts in donor fashions. This is to be seen in the changing attitudes of donors to poverty programmes. In the early 1970s, propelled by the International Labour Organization's (ILO) World Employment Program and by work in the World Bank by economists such as Hollis Chenery, Mahbub ul Haq and Paul Streeten, 'basic needs' and poverty-focused development became the flavour of the period.

Then, with the oil shocks, economic crisis and the decisive political shifts in the United States and United Kingdom (Reagan and Thatcher), 'structural adjustment', the retreat of the State and belief in the market became the order of the day. During the 1990s, poverty alleviation again becomes the focus of aid agencies. For Third World officials, the changing views of donors are almost as powerful a source of uncertainty as fluctuations in international markets.

The changing donor agenda places strong pressures on fragile political institutions. As countries struggle to make the institutions of multiparty electoral democracy work, a new donor rhetoric gains currency, advocating decentralization, local empowerment and the engagement of 'civil society'.

Given the resources at the disposal of donors, it is also only too easy to create an apparent constituency for the donor reform agenda, for example, through the funding of nongovernmental organizations (NGOs) which are nongovernment only in the sense that they are independent of the national authorities but which, in many cases, are, in effect, donor organizations, the creatures of donor agencies responding to the powerful stimulus of donor funding.

There are also risks of confusion in the proliferation of objectives. Over the past two decades, mixed messages have emerged from the donor community. On the one hand, in the 1980s, recipient governments were

advised, in quite clear terms, that the capacity of government was severely limited, and that therefore, the extent of government intervention in the economy should be severely curtailed. But subsequently, they have been requested to incorporate a whole range of social engineering and political goals, carrying the implication that the State can 'fine-tune' its interventions to achieve quite sophisticated social objectives.

With the introduction of new approaches to governance, there are also instances of confusion of means and ends, even at the project level, so that the actual purpose of development interventions becomes unclear. If decentralization and consultation become ends in themselves, expenditures and interventions can be justified because they promote such activity irrespective of whether they contribute to an intended material outcome.

Insofar as the main objective of consultation is to draw on local knowledge in programme design, consultation has an instrumental role and is justified (or not) insofar as it contributes to the better adjustment of a programme to local conditions and preferences.[4] However, there seems to be a sense in which consultation is valued irrespective of any instrumental outcome. The emphasis on what, in an earlier age, would have been described as a 'community development' approach has some obvious merits; however, consultation is time consuming, involving real economic costs to participants. Those who participate may do so expecting a material return and may be unpersuaded of the intrinsic merits of meetings. Moreover, the proliferation of governance-related objectives in project design may obscure the appraisal and evaluation of the intended material outcomes.

In pushing for political change, donors sometimes base their advocacy on insufficient evidence and analysis. One donor axiom which seems to have gained widespread currency in recent years is that decentralized development will be more responsive to grass-root needs, and that therefore, political decentralization should be promoted. The merits of decentralization are seen to derive from the premise that local government, being closer to the people, will be more responsive to their needs.

However, difficulties arise from the anodyne vision of society implicit in approaches to decentralization and 'bottom-up' decision-making. Are the local communities presumed to be homogeneous? It is interesting that the donor vision of rural society seems to be of a village community based on equality and shared interest (rather similar to Julius Nyerere's vision of the Ujamaa village), a building block for a democratic participatory process.

An additional axiom of donor thinking seems to be that the more local (decentralized) the decision-making process, the more egalitarian,

participatory, fair and free from corruption it will be. Under some circumstances, this may be true, but there is not a universal or axiomatic case. In practice, local power groups may control local politics, and local government is no more immune to corrupt practice than national-level institutions. It can even be the case that decision-making processes and public resources can be captured by elites and vested interests at the local level even more readily than at the national level, and that local government is as likely to be captured by local interest groups (e.g. landowners, local business people, privileged castes, local party machines) as to reflect grass-roots concerns. The realities of economic inequalities, social differentiation and patron-client political networks seem to be ignored in the appeal to bottom-up, participatory processes.

As decentralization is demanding in the use of personnel and can be fiscally expensive, there needs to be a strong evidence-based case made that it is likely to deliver what is hoped of it in the particular circumstances in which it is being promoted.

In the Poverty Reduction Strategy process, there was a good deal of emphasis on consulting 'civil society' and the 'poor'. All to the good, but who is to define civil society, and who is to be invited to the table?

The desired nature of the consultative processes promoted by donors remains rather unclear. It has led to a shift in emphasis from consultation with elected representatives (making formal political institutions work) to subjecting policies to informal consultations with representatives of concerned groups. There are risks of such donor-sponsored consultative processes becoming a parallel and competing system to the established systems of political accountability through elected political bodies, perhaps problematic at a time when the critical importance of electoral processes is also being promoted.

Moreover, the criteria by which those to be consulted are selected is unclear, subsumed under the nebulous concept of 'civil society'.[5] Some donor initiatives even involve an effort to buy civil society, by specifically funding civil society organizations. This seems to miss the point that robust autonomous institutions (e.g. trade unions) emerge as a result of pioneers taking risks, not as a simple response to financial incentives.

In many countries, it is NGOs that are identified as representing civil society, but who are in fact representative, and by what processes do they establish their credentials? Many NGOs are largely made up of small groups of middle-class operators, often astute at assessing donor preferences. The truly poor are rarely organized or represented in policy discourse.

Parallel with the emphasis on consulting 'civil society' at the policymaking level, another buzzword was coined with the emphasis of consulting 'stakeholders' in project and programme preparation and implementation. 'Stakeholder' is another popular but ill-defined term in the good governance vocabulary. Project designs include references to procedures to ensure the participation of 'stakeholders' in decision-making, 'bottom-up' approaches, the 'empowerment' of farmers, engagement of civil society and the promotion of decentralization. However, it is surprising that rarely, if at all, is any effort made to identify who are the stakeholders in question.

In an agricultural project, who are the stakeholders? – the farmers, or landlords, or the consumers, or the traders or the processors? When differing stakeholders' interests conflict, how is conflict to be resolved? Insofar as the economic interests of these groups are in conflict, is consultation, rather than competitive market transactions, the appropriate means of resolution?

Insofar as it goes beyond a woolly verbiage, the emphasis on consultation of stakeholders seems to imply two things: that collective decision-making by various interest groups is usually a good thing, and that the interests of the various stakeholders can be reconciled through a consultative process.

Adam Smith, in *The Wealth of Nations*, pointed out how a gathering of interest groups (e.g. traders) was more likely to lead to collusion in favour of particular private interests, rather than promotion of the public good. And it is not difficult to think of instances where the 'stakeholders' are 'rent-seekers'.

Moreover, whereas some conflicts can be resolved through consultation (particularly where there is a positive sum game), economic decisions more typically involve choices between meeting competing interests, which either require resolution through a central allocative mechanism (e.g. the national budget) or through the market. Nevertheless, recognition that implementation of an effective economic policy regime is not solely, or even primarily, a matter of professional economic analysis and design, but also of political commitment, has been useful.

One arena in which that became evident was in relation to the promotion of market-based reforms by the World Bank and the donor community. It became evident, even to donors, that economic analysis, backed by aid conditionality, was not sufficient to ensure effective policy implementation. To carry a difficult package of reforms through, a high level of local commitment was required – there had to be a national constituency to support policies, which could back up the programme and sustain it in the face of opposition. All serious reforms threaten some vested interests, and

in some cases they are perceived to place burdens on the majority of the population. It was not enough to push the bitter medicine down the throats of unenthusiastic national authorities; there also had to be a national basis of support for policies to be effectively implemented and sustained. In the discussion, this was articulated by positing the need for 'national ownership' of policies.

How could national ownership of policies be achieved? This is an issue very much subject to continuing debate. Some have sought the solution in charismatic leadership – a man on a white horse – or, as in East Asia, authoritarian or quasi-authoritarian regimes. In other cases, support is sought from small technocratic elites.

But where political governance comes into its own is through the recognition that the most durable support comes from building a consensus among a sufficient group of interests within the political system. Within a democracy, this is likely to imply building support and understanding in the ruling party as well as among the public at large. However, building consensus in support of change can be equally important in a one-party state. In Viet Nam, a one-party Communist system, an aggressive programme of market reforms was carried through, supported by a consensus crafted by extended discussion, negotiation and careful consensus building within the one-party system.

If policies promote change, there will always be some groups whose interests are threatened. Compromises may be necessary to put together coalitions of interest that see change as consistent with their perceived interests. This is not primarily a matter of 'selling' policies but rather of crafting an effective political process whereby policies are developed. Support is more likely for a policy package that has emerged from a formulation process based in the national decision-making structure, in which the concerns of a potential constituency are addressed, and least likely if the policy package is crafted by external experts.

This has implications for the aid relationship. Over long periods of aid dependence, donors have become accustomed to taking the initiative in defining policies, not only through conditionality mechanisms but also by taking the initiative in identifying, preparing and appraising projects, producing reports defining sectoral policy options and in effect determining the development budget. This process shifts responsibility from national authorities, who can hardly feel responsible or be held accountable for programmes initiated and designed by others. In effect, it has been a process of infantilization, which has drained initiative and responsibility away from national governments.

It is not surprising if the result has been the lack of national ownership of the resulting programmes. Accountability, ownership and responsibility imply control. If programmes are not controlled by the national authorities and, in a fundamental sense, do not emerge from the national decision-making process, then national governance is a sham. And the reality will not be changed by a process of 'consultation', orchestrated and funded by donors, with outcomes largely predetermined by donor priorities.

In this regard, the shift made by donors to budgetary and programme support mechanisms and away from project support was initially intended to provide the basis for greater national control and real decision-making, necessary preconditions for more effective national allocation mechanisms. However, it has had the reverse effect where donors used the shift to programme aid as an occasion for introducing more general policy conditionality to replace the loss of control previously exercised at the project level. Budget support is most likely to contribute to the restoration of national control over development programmes if donors take the gamble of allowing national governments to control the disbursement of the 'pocket money'[6] they are allocated without the detailed controls incorporated in Performance Assessment Frameworks.

Good governance and equity

A particular sense in which 'good governance' is now seen as more than just an instrument for the achievement of economic policy goals, but even as an end in itself, is in relation to issues of distribution, equity and poverty reduction. A responsive and just system of government is seen as important, both as a social goal and for its instrumental role in promoting an equitable pattern of growth. In particular, it seems to be increasingly recognized that good governance implies a willingness of the State to promote economic equity, and that where necessary, the State should intervene to protect the weak and promote the interests of the poor.

In this, as in other areas of development policy discourse, shifts in conventional views are cyclical, rather than linear. In the 1970s, a good deal of emphasis was given to distributional issues, for example, in the development of the 'basic needs' approach to development policy. Basic needs fell by the wayside with the onset of the robust commitment to the market and the reduction in the role of the State in the era of structural adjustment.

This is not to say that market solutions are necessarily unresponsive to the needs of the poor. Indeed, where systems of intervention and control have

been used to bolster the interests of better off groups, liberalization may benefit the poor. Even much criticized structural adjustment programmes, with their associated devaluations and decontrols, initially shifted the terms of trade in favour of the peasantry in many countries.

The strong case that poverty alleviation and market-led economic growth can go hand in hand draws on the evidence of East Asia, where market-based, export-led strategies resulted in high rates of growth associated with remarkable reductions in poverty. This was true under a range of different political regimes, in Taiwan Province, Singapore and South Korea, as well as the People's Republic of China, and now Viet Nam. However, although that has happened in some cases, the consistency of growth and poverty alleviation may not be the general case, but may require special conditions (e.g. in some societies, the benefits of growth were spread widely following radical land reform and dramatic social change – as in China and Viet Nam).

Before celebrating the East Asian experience as demonstrating the absence of the market-equity dilemma, a number of points should be noted about the characteristics of the East Asian experience in addition to the commitment to market-based, export-led economic growth strategies.

The first relates to initial conditions. The successes generally started with a reasonable degree of rural equality in terms of access to land, whether as a result of communist revolution (China and Viet Nam) or US-sponsored post-war land reforms. Property relations were changed by forceful State action.

Second, all the East Asian successes involved a strong commitment to investment in the human resource development, not only through universal primary education but also through massive investments in higher education.

Third, although quite committed to market-led export growth, the range of tactics adopted in relation to State intervention has been broad and heterodox, ranging from Korean support for big business to Singapore's version of the welfare State, to the continuation of the leading role for a partially reformed State-owned sector in China and Viet Nam. Market yes, but with policies sensitively crafted to reflect national political and economic realities.

All this suggests that in East Asian experiences, there were a wide range of economic governance mechanisms, in the sense of State interventions in the economy. While they differed, they were all responsive to the needs of economic growth and adopted policies which ensured reasonable diffusion of benefits, particularly through education and access to land, throughout society.

There have been other experiences where growth has not been associated with such a broad diffusion of benefits, with negative social consequences, and also, arguably, where unequal patterns of growth have contributed to economic stalemate. This is one possible interpretation of the history of many Latin American countries and looms as an issue in the Indian subcontinent.

Concluding observation

One question that now needs to be addressed is whether models of governance now being promoted will make the State more responsive to the potential for broad-based development, or whether it will be another instance of donor rhetoric promoting approaches that fail to root in local realities. The fundamental difficulty for the outsider is to come to terms with political and social realities as they exist and to judge what is appropriate and what is possible given those realities, rather than promoting images of society largely based on an idealized interpretation (typically not very deep) of the experiences of Organisation for Economic Co-operation and Development (OECD) countries.

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Chapter 4
Perception and misperception in governance research: Evidence from Latin America

Marcus J. Kurtz and Andrew M. Schrank

This chapter identifies and takes issue with a potentially troubling development in the study of comparative politics. While political scientists have traditionally deployed *objective* indicators of 'political organization and administrative capacity' (Reynolds 1983: 976), including tax ratios (Organski and Kugler 1980; Benson and Kugler 1998), tax structures (Kling 1959; Krasner 1985), political participation (Przeworski and Sprague 1971), and the nature and extent of public service provision (Migdal 1988; Putnam 1993), they are beginning to import *subjective* indicators of 'governance' from economics (Sandholtz and Gray 2003; Fish 2005; Gerring and Thacker 2005; Blake and Martin 2006; Cameron, Blanaru and Burns 2006). The customary distinction between objective and subjective measurement is, by now, less salient than the various differences *among* the subjective or 'perceptions-based' alternatives (Kaufmann, Kraay and Mastruzzi 2005a). Whose perceptions do they capture? Of which institutions or issue areas? And to what effect?

We hold that the leading perceptions-based indicators are poorly explicated, give the perceptions and interests of businesspeople (and foreign businesspeople in particular) undue influence, are riddled with measurement error and all but impossible to interpret, and should therefore be either reconsidered or replaced by *improved* objective indicators that take public sector inputs as well as outputs into account.

We make the case for reconsideration and/or replacement in four principal sections. The first section offers an abbreviated introduction to the perceptions-based literature. The next section develops a critique of the conceptual and operational underpinnings of the leading perceptions-based indicators. The following section draws an important but frequently overlooked distinction between the quality of governance and the quantity of government. The concluding section discusses objective alternatives.

Intellectual context

Economists first brought perceptions-based indicators of corruption, property rights and the rule of law to bear in cross-national growth research in the mid-1990s. For instance, Paolo Mauro obtained national-level indicators of judicial integrity, corruption and bureaucratic quality from commercial risk rating agencies as early as 1995 (Mauro 1995). Arthur Goldsmith deployed an index of property rights developed by the Heritage Foundation more or less concurrently, and turned to the Corruption Perceptions Index developed by Transparency International for the first time a few years later (Goldsmith 1995, 1999). And Alberto Ades and Rafael DiTella introduced the corruption indicators found in the World Economic Forum's *Global Competitiveness Report* at approximately the same time (Ades and DiTella 1997).

By the end of the decade, however, Daniel Kaufmann and his colleagues at the World Bank Institute had come to believe that 'many of these indicators serve as imperfect proxies for one of a smaller number of more fundamental concepts of governance', including 'the rule of law, government effectiveness, and graft' (Kaufmann, Kraay and Zoido-Lobatón 1999a: 1–2), and had therefore decided to develop a series of 'aggregate governance indicators' designed to capture the fundamental concepts in a more transparent and accurate fashion. They aggregated data from a wide array of sources including – but by no means limited to – the aforementioned foundations, nongovernmental organizations (NGOs) and commercial risk rating agencies; developed an unobserved components model; and distilled the aggregate data into six different indicators: voice and accountability, political instability and violence, government effectiveness, regulatory burden, rule of law and control of corruption.

The so-called Worldwide Governance Indicators (WGIs) have gained rave reviews (Gervasoni 2006) and market share in political science, sociology, law, public policy and, of course, economics (see, for example, Apodaca 2004; Fish 2005; Rigobon and Rodrik 2005; Borrmann, Busse and Neuhaus 2006; Lee 2007) – in no small part due to the creativity and entrepreneurship of the authors. And the WGIs are by no means devoid of merit. They are available for more than 150 countries. They cover a ten-year period. They include standard errors as well as individual country scores. And their authors issue frequent and welcome caveats as to their various limitations (see, for example, Kaufmann, Kraay and Mastruzzi 2005b: 41).

In fact, the WGIs arguably provide the best possible case for the perceptions-based measurement of governance. They are, by all accounts,

among 'the most carefully constructed and widely used' (Arndt and Oman 2006: 49) indicators available. And they are, by now, more than a decade old. If they fail to convince, we argue, then the entire project of perceptions-based measurement demands reconsideration – if not abandonment.

The limits to perceptions-based indicators in prospect: From explication to operationalization

Do the WGIs convince? We are neither the first nor the only scholars to entertain doubts (Arndt and Oman 2006; Bhagwati 2007; Knack 2007; Thomas 2007). Our doubts begin, however, with the explication of the conceptual underpinnings of the measures themselves (see Kurtz and Schrank 2007a, 2007b). Rudolf Carnap famously defined the process of explication as 'the transformation of an inexact, prescientific concept, the *explicandum*, into a new exact concept, the *explicatum*' (Carnap 1962: 3), and offered a number of apposite examples including the self-conscious transformation of the *explicandum* of 'warmth' into the *explicatum* of 'temperature'. According to Carnap, the description of the *explicandum* is a necessary starting point in the process of measurement and comparison, and is therefore no less central to scientific progress than the eventual interpretation and assessment of the *explicatum*. 'Although the *explicandum* cannot be given in precise terms', he argued, 'it should be made as clear as possible by way of informal explanations and examples' (Carnap 1962: 3). Otherwise, parties to a scientific discussion or dispute would inevitably wind up talking past one another.[1]

Our discussion therefore starts with the *explicanda*. What are the prescientific concepts in question? While Kaufmann and his colleagues purport to be measuring institutions, and devote a good deal of time to their operationalization, they offer ad hoc and/or inconsistent definitions of their underlying concepts. Take, for example, their measure of the 'rule of law'. They initially define the rule of law as 'respect of citizens and the state for the rules which govern their interactions' (Kaufmann, Kraay and Zoido-Lobatón 1999b: 2). They subsequently abandon their original definition for 'the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence' (Kaufmann *et al.* 2005a: 4). And they eventually decide to deploy a more encompassing, if less discriminating, definition that includes the 'extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence' (Kaufmann, Kraay and Mastruzzi 2006: 4).

They offer neither Carnap's 'informal explanations and examples' nor, for that matter, a rationale for their definitional amendments – let alone a discussion of their implications. Are we to assume that their rule of law indicator (RL) assesses different concepts in different years? Or that the definitional changes have no effect on the indicator's interpretation? And, if the latter, why do they introduce the changes in the first place?

The implications are by no means trivial. Let us take a concrete example. Italy's rule of law score all but collapsed between 1996, when the Italians (1.05) outperformed the Czechs (0.941), Poles (0.867), South Koreans (0.846) and several other members of the Organization for Economic Co-operation and Development (OECD), and 2006, when it found itself relegated to an ignominious position (0.313) beneath Jordan (0.452), Botswana (0.611), Malaysia (0.564) and Uruguay (0.484) – not to mention a number of monarchies, dictatorships, emirates and tax havens (Kaufmann, Kraay and Mastruzzi 2008, Table C5). In fact, Italy's estimated RL scores have declined from their previous values in seven out of ten updates to the WGIs. Why? Have Italian politics and society really changed so dramatically and so consistently over the course of a single decade? Or did Kaufmann and his colleagues de-emphasize the informal relationships and institutions that loom large in the Italian political economy (Putnam 1993) in favour of formal institutions like the police and courts – that are less operative in much of Italy – when they abandoned their original definition of the rule of law? Our point is neither to whitewash Italy's very real governance dilemmas nor to rule out other explanations for the fall. We simply wish to underscore the fact that conceptual shifts – especially those that are neither explained nor justified by their authors – come with real interpretive costs.[2]

Our concerns are neither frivolous nor pedantic. After all, the rule of law's empirical referent is anything but obvious. Legal scholars like Thom Ringer have not only condemned the 'conceptual anarchy among development theorists, experts, and donor agencies surrounding the very meaning of the expression', but have gone on to wonder whether the 'problem with measuring the success of rule of law reform initiatives is that the parties assessing them may have something quite different in mind to those implementing them' (Ringer 2007: 182; see also Daniels and Trebilcock 2004). Nor are they alone. Political scientists and sociologists have expressed doubts about the concept as well (Stephenson 2000; Kurtz and Schrank 2007b). And Dani Rodrik has recently wondered whether he is 'the only economist guilty of using the term abundantly without having a good fix on what it really means' or simply 'the first one to confess to it' (Rodrik 2007).

Kaufmann and his colleagues appear to be sanguine by way of comparison. While they take comfort in the fact that the various aspects of governance they purport to measure 'tend to be quite highly correlated across countries' (Kaufmann, Kraay and Mastruzzi 2007a: 555), they are in fact assuming what needs to be proven – that is, that their correlated indicators are valid measures of governance in the first place. Otherwise the reported correlations are all but devoid of meaning (see also Knack 2007).[3]

Are the WGIs valid indicators of governance? We will address the question by focusing primarily upon the most recent iteration of their RL, for 'measurement validity is specifically concerned with whether operationalization and the scoring of cases adequately reflect the concept *the researcher* seeks to measure' (Adcock and Collier 2001: 529, italics added), and Kaufmann and his colleagues hold that RL in particular captures the 'norms of limited government' (Kaufmann *et al.* 2007a: 555) that are central to the literature on institutions and growth (Kaufmann *et al.* 2007a: 561; see also Kaufmann and Kraay 2002: 192).[4]

Table 4.1 recapitulates the definition of the rule of law that appears in the most recent iteration of the WGIs – that is, the concept that Kaufmann *et al.* purport to measure – and includes summary information on the sources, respondents and questions incorporated into the RL. The questions tend to fall into three principal subgroups: crime, property rights and judicial and security institutions. We evaluate RL's content validity by reflecting upon each subgroup and asking (i) whether key elements are omitted or (ii) inappropriate elements are included in the indicator's construction (Adcock and Collier 2001: 538).[5]

Crime

RL includes data on both crime in general and a number of specific offences (e.g. kidnapping) or categories of crime (e.g. organized crime). The underlying data sources include expert assessments of crime prevalence rates and trends, household survey data on victimization, and subjective assessments of the costs that criminals impose on business. And the rationale for their inclusion is more or less obvious: a society characterized by the rule of law is unlikely to be crime-ridden and vice versa.

Our concerns therefore derive not from the incorporation of crime data per se but from the manner in which they are incorporated. After all, the data summarized in Table 4.1 are unlikely to present an unbiased portrait of the level and distribution of crime in society. On the contrary, they are likely to give undue weight to crimes that affect business and elite interests.

Table 4.1:
Components of the WGI rule of law indicator

	Rule of law[a] *Source*	*Type*	*Respondents*	*Questions*
Representative	Global Insight Global Risk Service	Commercial information provider	Staff	Losses and costs of crime Kidnapping of foreigners Enforceability of government contracts Enforceability of private contracts
	Economist Intelligence Unit	Commercial information provider	Correspondents	Violent crime Organized crime Fairness of judicial process Enforceability of contracts Speediness of judicial process Confiscation/ expropriation
	Cerberus Intelligence Gray Area Dynamics	Commercial information provider	Staff	Nationalization/ expropriation
	World Economic Forum Global Competitiveness Survey	Nongovernmental organization (with business representation)	Firms (survey)	Common crime imposes costs on business Organ ized crime imposes costs on business Quality of police The judiciary is independent from political influences of members of government, citizens or firms Legal framework to challenge the legality of government actions is inefficient Intellectual property protection is weak Protection of financial assets is weak Tax evasion

Table 4.1 (cont'd)

	Rule of law[a]* *Source	***Type***	***Respondents***	***Questions***
	Gallup World Poll	Commercial polling firm	Households (survey)	Confidence in the police force Confidence in judicial system Have you been a victim of crime?
	Heritage Foundation Index of Economic Freedom	Nongovernmental organization (conservative)	Staff	Property rights
	Cingranelli & Richards Human Rights Database	Academics	Expert codings of US Department of State and Amnesty International reports	Judicial independence
	Institutional Profiles Database	French Ministry of the Economy, Finance, and Industry and Agence Francais de Developpement	Expert assessments	Respect for law in relations between citizens and the administration Security of persons and goods Organized criminal activity (drug trafficking, arms trafficking etc.) Importance of the informal economy Importance of tax evasion in the formal sector Importance of customs evasion (smuggling, underdeclaration etc.) Running of the justice system Security of traditional property rights Security of property rights: formal property rights Security of contracts between private agents

Table 4.1 (cont'd)

	Rule of law[a] *Source*	*Type*	*Respondents*	*Questions*
				Government respect for contracts Settlement of economic disputes: justice in commercial matters Intellectual property Arrangements for the protection of intellectual property Agricultural sector: Security of rights and property transactions.
	Political Risk Service International Country Risk Guide	Commercial information provider	Staff	Law and order: The law subcomponent is an assessment of the strength and impartiality of the legal system, while the order subcomponent is an assessment of popular observance of the law (assessed separately)
	Business Environment Risk Intelligence Financial Ethics Index	Commercial information provider	Panel of experts	Financial fraud Money laundering Organized crime
	US Department of State Trafficking in Persons Report	USDOS	Expert assessments	Human trafficking
	Global Insight Business Conditions and Risk Guide	Commercial information provider	Staff	Judicial independence: An assessment of how far the state and other outside actors can influence and distort the legal system. This will determine the level of legal impartiality investors can expect Crime: How much of a threat businesses face from crime such as kidnapping, extortion, street violence and burglary

Table 4.1 (cont'd)				
	Rule of law[a]* *Source	***Type***	***Respondents***	***Questions***
	African Development Bank Country Policy and Institutional Assessments	African Development Bank	Country economists	Property rights
Non-representative	Afrobarometer	University/NGO collaboration	Household survey	Based on your experiences, how easy or difficult is it to obtain help from the police when you need it? Over the past year, how often, if ever, have you or anyone in your family feared crime in your own home? Over the past year, how often, if ever, have you or anyone in your family had something stolen from your house? Over the past year, how often, if ever, have you or anyone in your family been physically attacked? Trust in courts
	Asian Development Bank Country Policy and Institutional Assessments	Asian Development Bank	Country economists	Rule of law
	Business Environment and Enterprise Performance Surveys	World Bank & European Bank for Reconstruction and Development	Survey (firms)	Fairness, honesty, enforceability and quickness of the court system How problematic is crime for the growth of your business How problematic is judiciary for the growth of your business
	Bertelsmann Transformation Index	Nongovernmental organization	Staff	Rule of law Private property

Table 4.1 (cont'd)

	Rule of law[a] ***Source***	***Type***	***Respondents***	***Questions***
	Freedom House Countries at the Crossroads	Nongovernmental organization	Staff and consultants	Rule of law
	World Bank Country Policy and Institutional Assessments	World Bank	Country economists	Property rights
	Freedom House	Nongovernmental organization	Staff and consultants	Judicial framework and independence
	Global Integrity Index	Nongovernmental organization	Local country experts and peer review	Executive accountability Judicial accountability Rule of law Law enforcement
	International Fund for Agricultural Development (IFAD) Rural Sector Performance Assessments Latinobarometer	IFAD Nongovernmental organization	Country economists Survey (household)	Access to land Access to agricultural water Trust in police and judiciary Crime victimization
	Institute for Management Development's World Competitiveness Yearbook	Education organization	Survey (business)	Tax evasion is a common practice in your country Justice is not fairly administered in society Personal security and private property are not adequately protected Parallel economy impairs economic development in your country Patent and copyright protection is not adequately enforced in your country
	Americas Barometer	Vanderbilt University	Survey (household)	Crime victimization Trust in police, courts and judiciary

a Measuring the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police and the courts, as well as the likelihood of crime and violence.

Source: Adapted from Kaufmann, Kraay and Mastruzzi 2009, especially Table B5. Representative sources are available for most countries and therefore weigh more heavily in the final indicators.

While the surveys undertaken by the World Bank and the World Economic Forum (WEF) are self-consciously designed to tap the costs crime imposes on business (see, for example, Kaufmann *et al.* 2008, Table B5), the household surveys undertaken by Gallup and the various regional barometers are likely to prioritize the interests of the elite for a less obvious reason. Respondents in crime victimization surveys are known to overreport property crimes that tend to affect the better off and underreport violent crimes that tend to affect their less fortunate compatriots (Bergman 2006: 221).

Thus, the crime data incorporated into RL are best portrayed neither as proxies for the rule of law writ large nor as random variables but as indicators of the elite's ability to insulate itself from what Alejandro Portes and Brian Roberts (2005: 67) have labelled the 'forced entrepreneurship' of the poor in the Latin American context. According to Portes and Roberts, the relentless onslaught of debt, austerity and free-market reform has provoked the unprecedented growth not only of poverty and inequality but also of anger and resentment in Latin American cities. 'Property crime may rise in these contexts', they maintain, 'as some members of the subordinate classes take matters into their own hands in order to redress both absolute and relative deprivation'.[6]

Our point is most assuredly neither to rationalize property crimes nor to deny their relationship to the rule of law but to underscore the fact that they are neither inclusive of the full array of crime in most societies nor random occurrences, and that RL therefore *omits* or *obscures* important elements of the rule of law (i.e. violent crime, sex crime, violations of labour and environmental law etc.) and in all likelihood *includes* – albeit indirectly – the various correlates of crime at the country level (e.g. poverty, inequality, the age distribution of the population, collective efficacy etc. (see, for example, Sampson *et al.* 1997)).

Property rights

RL includes data on property rights and threats to their sanctity (i.e. expropriation) as well as information on a number of specific categories of property rights (i.e. intellectual property). The property rights indicators are drawn from commercial risk rating agencies, firm-level surveys and inter- and nongovernmental organizations. But the rationale for their inclusion is unclear, for Kaufmann *et al.*'s definition of the rule of law neither made reference to property rights until 2008 (cf. Kaufmann *et al.* 2007b: 4, 2008: 7) nor militates against their compromise or transgression by *legal* means in any event.

Take, for example, eminent domain provisions in US property law. They give the government the authority to override legitimate property claims in a host of well-defined situations, and are therefore perfectly consistent with the rule of law, but nonetheless give rise to virulent opposition in practice, and are therefore likely to undercut the RL score if used too frequently.

Our objection is readily addressed, however, neither by asserting the infrequency of eminent domain nor by retroactively including a reference to property rights in the definition of RL, for the expropriation and confiscation of property are frequently deployed in the war *against* corruption and crime, and their use is therefore no less consistent with the growth than the absence of the rule of law. Park Chung Hee's campaign against the 'illicit accumulators' in South Korea offers a case in point (Schrank 2007), and more recent examples are readily available in Africa, Asia and Latin America (see, for example, *The Economist* 1981; Arnold 1999).

But one need not travel to the developing world to witness the confiscation and expropriation of assets deployed in defence, rather than contravention, of the rule of law. The Racketeer Influenced and Corrupt Organizations (RICO) Act offers a no less apposite North American example. After all, RICO gives US government prosecutors the right to seize the assets of allegedly corrupt or criminal organizations before they have attained a conviction – and thereby threatens the economic lifeblood of suspect enterprises. A number of observers have given RICO credit for the demise of the Mafia in the 1990s (Laurence 2004). And James Jacobs and Lauryn Gouldin (1999: 169) have therefore labelled the act 'the most important substantive anti-organized crime statute in history'.

The statute has not, however, been free of criticism. While law enforcement officials are justifiably fond of RICO, and favourably disposed towards asset forfeiture in particular, their critics decry 'policing for profit' (Blumenson and Nilson 1998) and worry that the law not only gives the government a 'license to steal' (Levy 1996) from legitimate businesses but also constitutes a 'nuclear deterrent to rational negotiations' (Arkin in *Newsweek* 1989). Is the cure of RICO worse than the disease of corruption and crime? The answer is anything but obvious, for the RICO experience suggests not only that the same institution can simultaneously militate in favour and against the rule of law but also that property claims themselves are, by their very nature, subjective and controversial – even in the advanced industrial countries.[7]

They are arguably more controversial in the developing world, however, and are therefore decidedly ill-equipped to play a meaningful role in perceptions-based indicators of the rule of law. 'A government that evicts squatters will in all likelihood be portrayed as a threat to private property

by the squatters and a bulwark against expropriation by the landlords', we have argued, 'and the problem is likely to be compounded by the fact that in much of the developing world this year's squatters are likely to be next year's landlords and vice versa' (Kurtz and Schrank 2007b).[8]

Nor are the examples of allegedly ill-gotten gains in the United States and squatters in the developing world unique. The problem of ambiguous property claims is widespread and will, in all likelihood, be aggravated by the growing salience of intangible or intellectual property in the future (see, for example, Evans 1997), for different states and societies have radically different conceptions of the appropriate length and scope of patent, copyright and trademark protection.

Judicial and security institutions

RL also includes questions on courts, contract enforcement and the police. The 'courts, cops and contracts' cluster, as we call it, incorporates data from firm and household surveys as well as expert assessments; tracks the government's ability and willingness to ensure the safety and security of the population; and plays an almost indisputable part in the assessment of the rule of law.

We nonetheless wonder why Kaufmann and his colleagues simultaneously omit or de-emphasize a series of regulatory agencies that are no less central to the security and well-being of the population, including, but by no means limited to, the tax, labour, food, drug, health and safety inspectorates; banking and financial overseers; and environmental monitors. Regulatory authorities are involved in *law enforcement*, after all, and their virtual exclusion from RL arguably says more about the types of laws valued by the indicator's authors and advocates than about their importance to the concept itself.[9]

In short, RL appears to suffer from a pronounced and systematic pro-business bias. The crimes covered, the institutions included and the interests served all point in the same direction – as do the interests, institutions and crimes overlooked. And the biases will arguably prove not only threatening but also fatal to content validity when aggravated by what, for lack of a better term, we will call sampling error. After all, the bulk of the data incorporated into the measure – approximately two-thirds of the 'representative' sources that are weighted most heavily in the final indicator (see Table 4.1) – are derived from either private investors or their commercial advisers.[10]

Kaufmann and his colleagues (2007a: 556) admit that pro-business biases are possible in theory but belittle their impact in practice. We have already

Table 4.2:
Do businesspeople and their neighbours perceive government in the same way?

Question	*Responses*	*Businessperson*
Trust in the judiciary	1 = much trust	Odds ratio = 1.15 ($p < .010$)
Trust in the police	2 = some trust	Odds ratio = 1.25 ($p < .001$)
	3 = little trust	
	4 = no trust	

Note: Self-identified businesspeople are coded 1, others are coded 0, country dummies are suppressed and odds ratios for businesspeople are presented next to their parenthesized *p* values. Non-responses and 'don't know' are dropped.

Source: The data are from Latinobarometer (2005); the more recent data available to Kaufmann, Kraay and Mastruzzi are not publicly available.

established that reported crime victimization varies by social class. Do business perceptions of other aspects of the rule of law differ substantially as well? Fortunately, the Latinobarometer data employed by Kaufmann and his colleagues invite a direct test.

Table 4.2 includes the results of two ordered logistic regression models. The dependent variables are the answers to the Latinobarometer questions about trust in the judiciary and police incorporated into the RL for the year 2005. They are coded from 1 (much trust) to 4 (no trust). They are regressed on an indicator variable that assumes the value of 1 whenever the respondent is a businessperson and a series of country dummies. And they underscore the differences among businesspersons who consistently evince less faith in police and judicial institutions than their compatriots.[11]

A defender of the WGIs might rebut charges of bias by portraying businesspersons and their advisers as particularly desirable data sources whose opinions should loom large in their indicators. Private investors not only have more experience with institutions like the police and courts than the average citizen, they might argue, but are also in the vanguard of the struggle for growth and development in market societies. But non-businesspersons are neither ignorant nor unimportant to the process of growth and development; on the contrary, they make countless individual decisions – about everything from personal savings and voting to the treatment and education of their children – that aggregate into important societal outcomes. Such decisions not only influence but are influenced by the broader sociopolitical context, however, and a governance indicator worthy of its name will therefore take the ideas and interests of non-businesspersons seriously.

In short, we have argued not only that the concept of rule of law is poorly explicated but that the RL itself is invalidated by skewed questions addressed towards a biased sample of respondents. The consequences are particularly acute when RL is incorporated into growth regressions as an exogenous variable, for a positive coefficient could reflect any combination of at least four different underlying processes: first, a positive relationship between *actual rule of law* (e.g. crime control, confidence in the courts) and growth; second, a positive relationship between *some but not all aspects of the rule of law* and growth; third, a positive relationship between the *underpinnings of the rule of law* (e.g. equity and opportunity) and growth; or fourth, *herd behaviour* on the part of investors who receive their advice from the same consultants and risk rating agencies and thereby animate growth regardless of the so-called fundamentals.

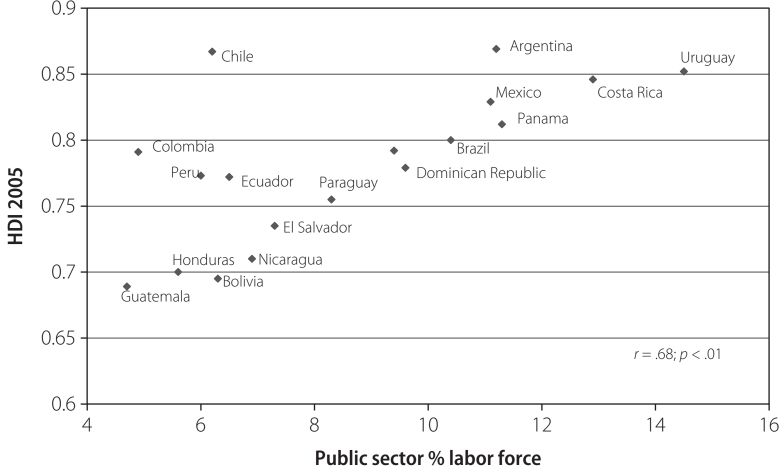
Limits to perceptions-based indicators in practice: Quality versus quantity

The WGIs are premised upon the liberal premise that 'he who governs best, governs least' (Kurtz and Schrank 2007a: 543). After all, Kaufmann and his colleagues explicitly reject the Weberian ideal of 'legal-rational' authority for a definition of administrative efficacy rooted in 'the norms of limited government that protect private property from predation by the state' (Kaufmann *et al.* 2007a: 555).[12] And consumers of their data tend to conclude that states in developing countries need to be 'not only smaller, but smarter' (Lora and Panizza 2003: 135).

In fact, the WGIs and their consumers tend to assume that there is an inverse relationship between the quality and the quantity of government. But the WGIs themselves make no effort to distinguish the quality of governance from the quantity (or size) of government, let alone to assign relative weights to each. Governance scores presumably rise with decreases in crime, corruption and their correlates, but whether those decreases are, in fact, the products of better (and presumably less) governance or more governance (whether 'better' or not) is by no means clear. Sometimes, governments really can make a difference by throwing more resources (e.g. police, teachers, judges) at a problem; often, they have no alternative.

Figure 4.1 is illustrative. It plots an admittedly crude indicator of national well-being – that is, the Human Development Index (HDI) constructed by the United Nations Development Programme (UNDP 2007) – against a similarly crude indicator of the size of government – that is, the share of the

Figure 4.1:
Human development by public employment (2005)



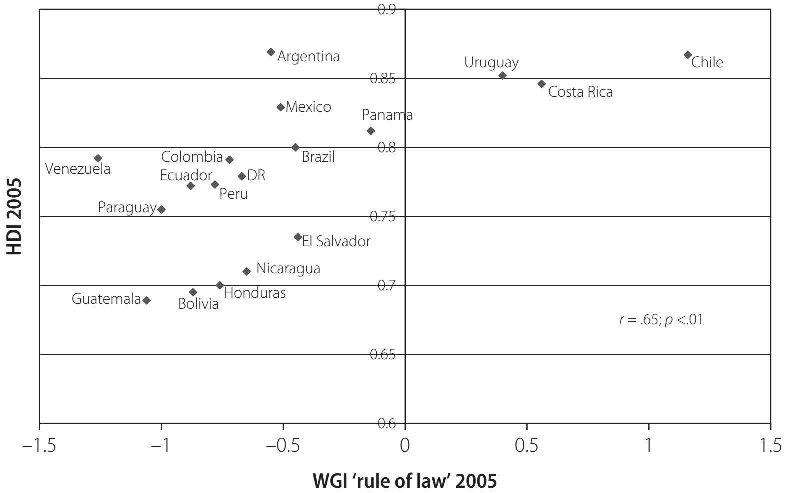
Source: UNDP (2007), Table 1; Carrizosa (2007), Table 1.

labour force in the public sector (Carrizosa 2007) – for 18 non-communist Latin American countries in 2005.

We draw three conclusions from the scatter plot. First, it is not clear that smaller governments are better governments – at least not if 'better' is associated with well-being. If anything, the opposite seems to be the case, for the bivariate correlation between the HDI and the size of the public sector is 0.68. Second, while there does seem to be a 'small government' path to human development, as exemplified by Chile, it is decidedly uncommon. Seven Latin American countries have HDIs of 0.8 or above. Six of those countries have the largest public sectors in the region. And, third, a large public sector has all the hallmarks of a 'sufficient condition' (Ragin 2000: Chapter 9) for high human development. While Chile is found in the north-western quadrant of the scatter plot, and thus suggests that a large public sector is not a necessary prerequisite for a high HDI, there are no countries in the south-eastern quadrant, suggesting that a Latin American country with a large public sector will invariably guarantee its citizens a reasonable degree of human development.

Of course, Kaufmann and his colleagues might respond to the first conclusion by questioning whether the countries in the north-eastern quadrant are, in fact, well governed. If their public sectors are approximately twice as large as the Chilean public sector, yet their human development performance is no better, after all, there is reason to believe that they are

Figure 4.2:
HDI by 'rule of law'



Source: UNDP (2007); Kaufmann *et al*. (2008).

getting less 'bang' for the proverbial 'buck' – and that their quality lags accordingly. But from a methodological and policy perspective, this is a bug and not a feature of the Kaufmann *et al*. approach, for both the difference between quality and quantity and the corresponding policy implications are obscured by their measure. Consider Figure 4.2, which plots the HDI against the WGI RL score for 2005.

One finds a similarly high (if decidedly less neat) correlation but a much murkier picture. Once again, Chile is in the north-eastern quadrant but it is suddenly joined by Uruguay and Costa Rica. Meanwhile, a number of high human developers have lower governance scores than El Salvador. How do we make sense of this picture? Ironically, the best way of doing so is returning to the objective data in Figure 4.1, where we can clearly discern two different paths to human development: the small government Chilean road and the big government road taken by the other regional success stories. While in Figure 4.2 Costa Rica and Uruguay appear to have much in common with Chile, Figure 4.1 reveals that they are actually much more comparable to Argentina and Mexico.

In fact, Figure 4.1 suggests that a large public sector is a sufficient cause of high human development and leads to an obvious hypothesis. The Chilean road entails limited extraction and efficient distribution; the big government alternative presupposes more aggressive extraction and less

efficient distribution; and the absence of cases in the south-eastern quadrant derives from the fact that any government willing and able to extract at that level is obliged to effectuate some measure of distribution (however inefficiently) as well.[13]

What, if anything, are the policy implications? While Kaufmann *et al.* would presumably hold out the Chilean path as the rational one to follow, they are largely blind to structural constraints. Efforts to extract and efforts to distribute require distinct social structures and skill sets and are thus differentially possible in different types of societies. And the Chilean road may well demand more (or different) state capacity than most developing countries are able to muster. Does this mean they should let their people suffer in silence (or worse)? Perhaps not, for the evidence in Figure 4.1 suggests that aggressive extraction with less efficient distribution provides a more common – if by no means easily attainable – path to improved human development and may not only be more accessible to public officials who are unwilling or unable to pursue the Chilean path but also more acceptable to their citizens than the status quo.

Conclusion: Bringing objectivity back in?

Where do we go from here? We begin to provide an answer by briefly reviewing the experience of one of the more successful subjective measures in the history of the social and medical sciences: self-reported health status. A quarter of a century has passed since Jana Mossey and Evelyn Shapiro first realized that self-reported health status provided a better predictor of seven-year survival rates among the Canadian elderly than either data drawn from medical records or self-reports of specific conditions (Mossey and Shapiro 1982), and much has been learned in that time. Subjective assessments of global health status are by now known to (i) be highly correlated with other indicators (or correlates) of health and well-being, (ii) add enormous explanatory power to multivariate models of mortality (Idler and Benyamini 1997) and (iii) suffer from conceptual limitations that sharply circumscribe their practical utility (Krause and Jay 1994).

Medical professionals know that individuals who label their own health 'poor' are likely to die sooner than people who consider themselves fit (Idler and Benyamini 1997), but they do not know why they do so and are therefore unable to act upon their knowledge. Some suspect that self-reports are more inclusive than objective data, tap undiagnosed diseases or capture the effects of co-morbidity. Others think they capture trajectories

rather than levels. Some point to underlying correlations with family history, socio-economic status or behavioural characteristics, and still others to self-fulfilling prophecies. But unless and until an actual causal mechanism is adduced, medical professionals will continue to act not upon subjective but upon objective data when choosing treatment.

Perceptions-based measures of governance have much in common with subjective assessments of health status. They are, after all, highly correlated with each other and with the presumed covariates of good governance (e.g. GDP per capita, school attainment). They, too, add explanatory power to multivariate models. And they also suffer conceptual shortcomings that undercut their practical utility. Take, for example, the rule of law. A positive RL coefficient in a cross-national growth regression is difficult to interpret, let alone act upon. It could reflect the influence of one or more of the actual inputs to RL (e.g. crime, courts, contracts), which are themselves endogenous and are therefore not readily altered by public policy. Or it could betray the impact of the direct effects of the social and economic conditions that influence those inputs (i.e. per capita income, social capital etc.), which are arguably even less susceptible to policy manipulation. It could be a product of pure measurement error of the sort admitted (but perhaps underestimated) by the indicator's authors. Or it could be the product of herd behaviour among investors who purchase their information from the indicator's underlying sources. Unless and until we have clear answers to these questions, however, the WGIs will be of limited practical utility.

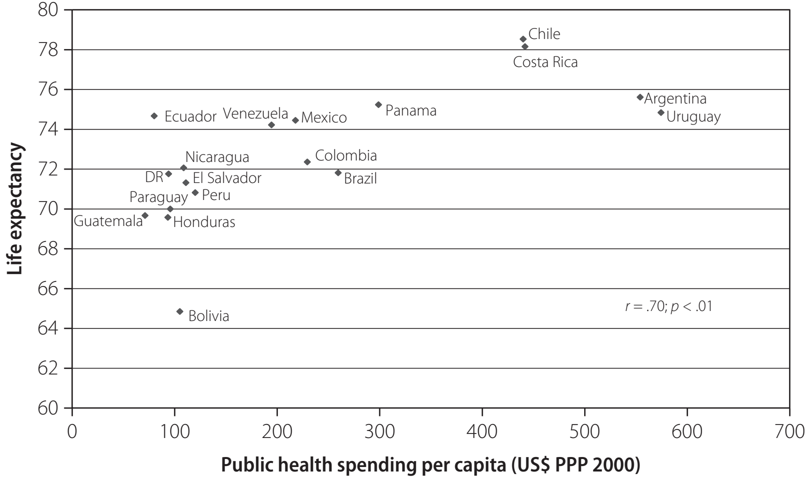
The problem is aggravated, we believe, by the implicitly contradictory targets embedded in the indicators and sub-indicators that go into the WGIs. After all, the sources employed by Kaufmann and his colleagues reward governments for policies that are almost certainly in tension with each other. What, then, should developing country policymakers who hope to improve their WGI scores *do*? Outlaw the expropriation of assets in order to maximize RL or adopt laws like RICO and use them to expropriate corrupt businesspeople and politicians so as to gain better scores on the control of corruption (CC) indicator? Extract and invest resources in schools and roads so as to bolster 'government effectiveness' (GE) or cut taxes in order to ensure 'regulatory quality' (RQ)? Clamp down on protest so as to ensure 'political stability' (PS) or give the protesters and the press a free pass in an effort to maximize 'voice and accountability' (VA)? Almost every potential solution aggravates another problem, and the WGIs therefore punish poor countries for their very poverty. After all, if poor countries could solve their social and economic problems, they would not be poor – let alone worried about their governance scores – in the first place.

What, then, is to be done? The medical professionals who collect and analyse self-reported health data ultimately turn to objective alternatives when diagnoses and treatments are necessary. Unfortunately, however, objective governance data are not readily available. The traditional proxies – for example, tax ratios and the like – have been largely discredited for one reason or another. And nobody has seen fit to invest in the creation of alternatives. We think such an effort is long past due, however, and would yield important pay-offs not only for social scientists and policymakers who are sceptical of perceptions-based measures but also, ironically, for their defenders, for the existing subjective indicators arguably cry out for the legitimating aura of an objective benchmark.

What would objective governance indicators look like? First, they would, of necessity, be issue-specific. While subjective health data are 'global' in nature, the objective data that guide diagnosis and treatment are necessarily circumscribed to particular health problems. Similar specification would be required for governance data, especially in light of the fact that governance is known to vary across issue areas and sectors within countries as well as among countries more generally (see, for example, Johnson 1982). Second, they would focus on issues with measurable outputs: education, health care provision and postal delivery come immediately to mind (see Putnam 1993). Third, they would incorporate data on *inputs* as well as outputs. One problematic feature of the WGIs is their almost complete inattention to the problem of opportunity cost. A government that bankrupted itself in a successful war against corruption would presumably see its corruption control score improve – at least in the short run. But it is not clear that it would have made a wise choice in doing so. And, finally, it would differentiate the efficacy of governance – that is, the enforcement of the rules of the game – from the quality of policymaking – that is, the creation of the rules of the game – as well as from the sociocultural context that underpins both the rules and their enforcement. It would thus demand independent data on inputs and outputs as well as policies and contextual factors that might affect both.

We can do no more than provide a brutally abbreviated example at present. Neither available data nor the space we have left would tolerate more. But we will try to illustrate the *sort* of approach we think desirable by examining the issue of health care provision in Latin America – which, at least in theory, meets the aforementioned criteria. It is not only narrow in scope, at least when compared to 'global' issues like the rule of law, but is widely regarded as a key product of state capacity (Caldwell 1986). In addition, measures of inputs as well as outputs are available for this

Figure 4.3:
Life expectancy by public health spending per capita c. 2005



Source: World Bank (2008); PAHO 2007 (Table 7).

indicator. We treat life expectancy at birth as an indicator of health output. We treat the level of public health care spending per capita as an indicator of the quantity of health inputs. And we assume that at least part of the unexplained variation in output is due to quality differences.

The data in Figure 4.3 suggest several interesting conclusions about governance. First, they fly directly in the face of the widespread notion that 'limited government', in Kaufmann *et al.*'s formulation, is necessarily the best government. While the cross-sectional data permit no causal claims, they are at least consistent with the idea that public health care spending promotes, rather than undercuts, life expectancy in Latin America. In fact, the absence of countries in the north-western quadrant raises the possibility that a high level of public health care spending is a *necessary* condition of very high levels of life expectancy. Second, they suggest that quality matters too. Spending alone accounts for only half of the variation in health care output. At least part of the residual may be a product of quality differentials. And finally, they suggest that objective governance indicators could, with a good deal of additional effort, provide a valuable complement or even alternative to the existing perceptions-based measures. One would not only need longitudinal as well as cross-sectional data from a larger number of countries but would also have to deal with questions of endogeneity and selection. But these issues arise with subjective data as well – and there they

are compounded by issues of conceptual ambiguity, systematic and random measurement error, and causal indeterminacy.

A thoroughgoing collective effort to aggregate and disseminate objective data would not only help researchers combat such problems but would also provide an alternative if such a campaign were to fail. Data on inputs and outputs are available across a wide array of issue areas in a large number of developing countries. It is high time that intergovernmental organizations began to aggregate them and make them available to policymakers, scholars and activists around the world.

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Chapter 5
Good governance scripts: Will compliance improve form or functionality?[1]

Matt Andrews

The past decades have witnessed the rise of a new development paradigm as academics and donors have embraced the idea that governance matters to social, political and economic development. Political and administrative reforms in many countries are directly shaped by the scripts informing good governance indicators. Countries apparently buy into the story that 'this is what good government looks like'.

Countries and organizations comply with scripts like these all the time, understanding that legitimacy and support are often conditional on such. This behaviour reflects a theory called isomorphism. It posits that organizations exist within fields – 'those organizations that, in aggregate, constitute a recognized area of institutional life' (DiMaggio and Powell 1983: 148) – and face pressure to conform to the externally defined 'belief systems and related practices that predominate' such fields (Scott 2001: 139). If organizations do not yield to these isomorphic pressures, they lose legitimacy and jeopardize their external support and survival.

Governance indicators constitute defined 'belief systems and related practices' in the development field. Isomorphic pressure to comply with the requirements of such indicators could lead countries to adopt governance reforms that help improve functionality and advance development. One can expect this where we have proof that the 'belief systems and related practices' embodied in governance indicators actually facilitate development. Isomorphic pressures could also foster compliance with forms that make countries look better but do not necessarily help them function better. This is likely where we cannot show that the 'belief systems and related practices' embodied in governance indicators actually facilitate development.

This chapter asks if isomorphic compliance with governance indicators will improve form or functionality in developing countries. Put another way, will countries that follow scripts informing indicators just look better or actually be better (facilitating development)?

The first section examines the development community's story of good governance and argues that we have cause for concern. Developed countries that score high points on governance indicators do not follow the good governance scripts in the same way. Put another way, functional states do not share the same governance forms. The second section analyses this issue in depth, asking whether fiscal rules, a common form expected in 'good governance' models, are uniformly in place in more functional governments. It finds that they are not. There is thus reason to believe that governments may adopt such forms without any improvement in functionality. We should question the functional contribution of good governance scripts to development.

The development community's story of good governance

At its most basic, 'governance' refers to 'the general exercise of authority' (Michalski, Miller and Stevens 2001: 9) or, as the World Governance Indicators (WGIs) developers put it, '[T]he traditions and institutions by which authority in a country is exercised' (Kaufmann, Kraay and Zoido-Lobaton 1999: 1). Built ostensibly on this general definition, the WGIs have emerged as, arguably, the most influential governance measure (Arndt and Oman 2006). They combine various stand-alone elements into aggregate indicators of six governance concepts, including 'rule of law' and 'government effectiveness'. These mix outcomes (like effective health care statistics) with processes and structure (like meritocratic hiring and the degree of decentralization) and policy choices (about the size of government, for example, and the extent to which a government exhibits a pro-business orientation). The various elements are aggregated into indicators that apparently reflect how well authority is exercised, by concept area, in a country (aka governance).

Most indicator sets spotlight structural characteristics of governments and associated outcomes considered important for development; for example, the WGIs name a measure 'Government Effectiveness' (Kaufmann *et al.* 1999; Kaufmann, Kraay and Mastruzzi 2007). The indicators (WGIs and others) arguably underlie strong isomorphic influences on

thinking about what effective government is (for discussion, see Arndt and Oman 2006 and Goldsmith 2007). Academic work, lending engagements and reform proposals gain legitimacy by identifying with the 'myth' or 'story' that formal structures reflected in the indicators provide a rational means to attain desirable ends – in this case development itself (Meyer and Rowan 1977: 346). The following description captures the contents of such myth:

> An effective government is small and limited in its engagement, formalized in mission and process and drawing limited revenues primarily from domestic sources. High-quality personnel devise and implement needed programs and deliver efficient and effective services via participatory processes and through formalized, disciplined, efficient and targeted financial management. Responsiveness to the citizenry's changing needs is high, effected through transparent, decentralized and politically neutral structures; consistently, even during political instability, without impeding (indeed supporting) the private sector.

The 'story': Developed countries are governed like this

Many might find this word picture appealing – the kind of government we would all imagine is 'good'. The message implied in these indicators is that these are the common characteristics of a good government that developing country governments should attempt to reproduce. The message is often presented like this: developed countries do it this way … you should copy them. Figure 5.1 provides some support for this message. The figure shows scores for 184 countries on the 'government effectiveness' element of the WGIs. These scores range from −2.5 to +2.5. Negative scores reflect less-good governance. Countries are organized to show the relationship between GDP per capita in 2005 and government effectiveness scores in 1998 and 2008. Note simply how positive the relationship is between these two pieces of data. If a country is more developed (with a higher GDP per capita), it also seems to have better governance (with a higher government effectiveness score). What the figure shows graphically is also evident in statistics, with a strong correlation existing between WGI dimension scores like 'effective government' and per capita income figures (0.76 in the 184 countries shown in Figure 5.1, significant at 0.00).

Figure 5.1:
WGI government effectiveness scores and GDP per capita

Such evidence also emerges if one looks at individual countries. Which 'examples' might lower and middle countries look up to as models of 'good governance' – where social authorizing structures have facilitated development? Many would agree with the following kind of country set: Denmark, Singapore, Canada, Sweden, Australia, the Netherlands, the United Kingdom, Hong Kong, the United States, Belgium and Germany. Coincidentally, these countries make up the 'top 10 per cent' in Figure 5.1's score for 184 countries (all scoring above 1.5 on the WGI effective government indicator). They are all developed countries and tend to have better outcomes, such as more sustained growth rates, stronger business environments and better social indicators.

The reality: Developed countries are governed differently

But evidence does not show that these countries reached this development nirvana by complying with the governance story embodied in the WGIs. Indeed, evidence shows that these kinds of countries do not comply with this story today.

The institutional characteristics of governments in these countries – the core of governance structures – vary a great deal among these countries.

While one may argue that all the governments exhibit formal bureaucratic systems with disciplined budgetary processes, for example, differences in the details of how these systems work are quite significant (Curristine 2005; Hallerberg, Strauch and von Hagen 2007; Joumard *et al.* 2003). For instance, the degree of political influence on appointments, promotions and performance assessments varies significantly across governments, as do basic civil service structures (see OECD 1999 for a dated comment, and for more recent discussion, Choi and Witford 2008 and Matheson *et al.* 2007). The use of arms-length agencies also varies, as does the degree to which these agencies are subject to formal rules governing the rest of government (Matheson *et al.* 2007).

There are even more prominent differences when one considers the limits and size of government and the degree to which it is engaged in the economy (Handler *et al.* 2005; OECD 1999). The good governance paradigm suggests the importance of limited governments, which it measures in terms of legal checks (rule of law) as well as institutionalized constraints on government scope and fiscal size.[2] While the rule of law is central to all the 'good governments', it is much more limiting in some than others. For example, an OECD survey of budgeting practices found that the United States legislates processes in all 11 areas considered, but the United Kingdom only legislates 4 of the 11, implying different levels of discretion in the latter.[3]

Furthermore, government revenue and spending as a percentage of GDP ranged in these governments from about 35 per cent to about 55 per cent in 2004 (Hauptmeier, Heipterz and Schuknecht 2007: 298).[4] A government like Sweden uses this money to fund extensive engagements across the economy, and plays a dominant role in financing and providing social services (also providing 'bakeries, gyms and garden centers' (Henrekson 2005)). The US government is more restrained in its social activities, and the private sector actually plays a bigger role in financing and providing key services like health care. Comparing the two reveals that the governments actually differ a lot, in size and scope, which are two variables organizational theorists find foster all sorts of other structural variations.

Literature shows that governance structures in the model countries differ in other areas as well. The governments exhibit different levels and types of decentralization, politically, administratively and fiscally (Mosca 2007; Stegarescu 2004). Also, while economic and administrative regulatory burdens tend to be lower than in other countries, they are still highly variable across the sample (Malyshev 2006; OECD 2005). Different regulatory mechanisms underpin different relationships between the government and the private sector, an important aspect of governance.

Commonly good governance functionality comes through different forms

Governance indicators thus identify governments that look commonly good in terms of the outcomes they produce – or functionality – but seem to vary in regard to other institutional characteristics – the forms they adopt. Perhaps we should not be surprised at this, given that the indicators generally reflect perceptions of governance and are not measures of actual institutional characteristics. The bottom line, however, is that the 'good governance' story presented in these indicators seems quite limited: good governments can look very different in terms of their forms but achieve similar functional results. Forcing them to look the same in terms of form may not yield improvements in functionality.

The following section provides a more rigorous argument for this proposition by examining the key characteristics of a particular aspect of good governance, that is, public financial management (PFM).

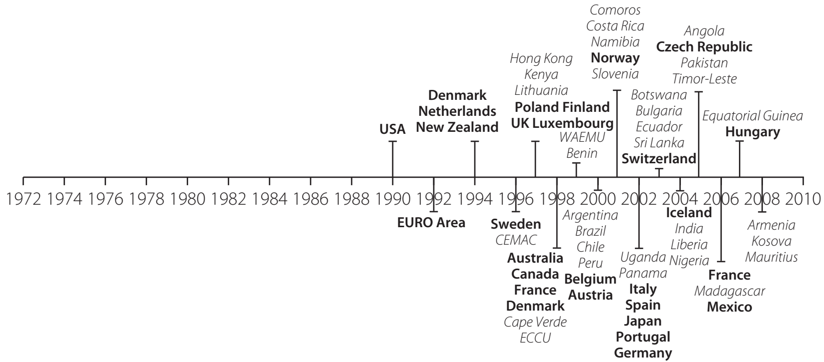
Form versus function in PFM systems

Critics might claim that the differences mentioned above are random, or that countries with good governments probably vary less on core 'best practice' characteristics than other countries. They might argue that relative convergence around good governance criteria is higher in countries with good governments than in countries with less-good governments, and that my observations fall short in providing rigorous evidence otherwise. I attempt to respond to these critics here, providing more rigorous evidence that governance functionality does not imply common forms.

I do this by analysing one small dimension of the 'good governance' script in development: the use of fiscal rules to ensure budgetary discipline. Development organizations frequently recommend fiscal rules as fundamental mechanisms to facilitate strong PFM. Strong PFM systems are important because, as Kettl (1992: 1) says, 'Nearly everything we want government to do requires money.' International organizations like the IMF and OECD identify institutional features of strong PFM systems, considered necessary 'to effectively control public expenditures'. Top-down, structured budgeting techniques like fiscal rules are one such feature.

Anyone reading work on fiscal rules in the mid-1990s would have believed that all leading governments had similar top-down mechanisms and that these rules offered a one-best-way solution to fiscal problems.

Figure 5.2:
When countries adopted fiscal rules, according to recent studies



Source: Data drawn primarily from CESifo (2007), IMF (2009) and Scartascini (2007). The data show initiatives after the 1970s, which means that earlier reforms in places like Germany and Japan are not included. Some countries shown above – including the United States – have also departed from using fiscal rules.

The fiscal rule concept was quickly picked up in Latin America and other regions as a best practice mechanism to facilitate expenditure control and management. It is now part of the dialogue in reform throughout the world, manifest in terms like 'deficit rule', 'expenditure rule' and even in the more operational 'budget limit'. Figure 5.2 shows detail from recent studies on a number of countries that have adopted these rules. It illustrates that fiscal rules are fairly new (note the adoptions began only after the 1980s in this list) and that a variety of countries have adopted them. Countries in bold are OECD countries and countries in italic are non-OECD countries that are largely developing or transitional.

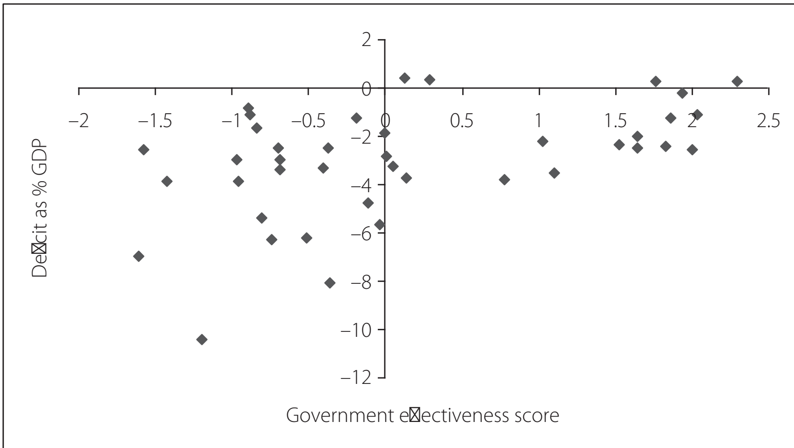
It should be interesting to note that the number of non-OECD developing countries shown in Figure 5.2 is at least as high as the number of OECD countries. The implication is that developing countries with less functional governance systems may be more likely to adopt the fiscal rule 'form' than more functional OECD countries. Figure 5.2 is not comprehensive, however, so we should be careful not to read too much into this. The study below goes beyond such data, however, to examine data from the 2007 OECD Budget Practices and Procedures Database about which countries do and do not have these forms in place. The database provides common quantitative data on 89 detailed questions about PFM systems in 38 countries.[5] A subset of these speak to the issue of fiscal rule adoption.

Good governments have commonly functional PFM systems

Deficits are the only PFM outcome measure commonly available across countries. These are also a vital PFM outcome measure given current struggles with economic downturns and fiscal management.[6] Figure 5.3 shows average deficits across the 38 countries included in the OECD database for 1990–2006. Governments considered more effective on the WGI indicators are at the right with deficit averages below 2.5 per cent of GDP over this period, compared with higher averages for many of the other governments. The figure thus suggests a convergence around lower average deficits for the more effective governments. In other words, good governments have similar outcomes, or are similarly functional in managing budgetary issues.

All the good governments were responding to higher, problematic deficits in the 1970s and 1980s. Economic and political pressure to control these deficits is credited as the dominant influence in favour of recent more disciplined financial management (Blondal 2003). Most of the nine governments actually recorded material decreases in expenditure in the mid-to-late 1990s as a result of such pressures. The pressure was not just for control and lower spending, but also for lower and better spending. Various authors suggest a high level of consistency in the way the more effective governments dealt with this pressure (see Blondal 2003; Joumard *et al.* 2003, for example). As noted, one argument is that they all introduced fiscal rules to achieve functionality.

Figure 5.3:
Average deficits for 1990–2006



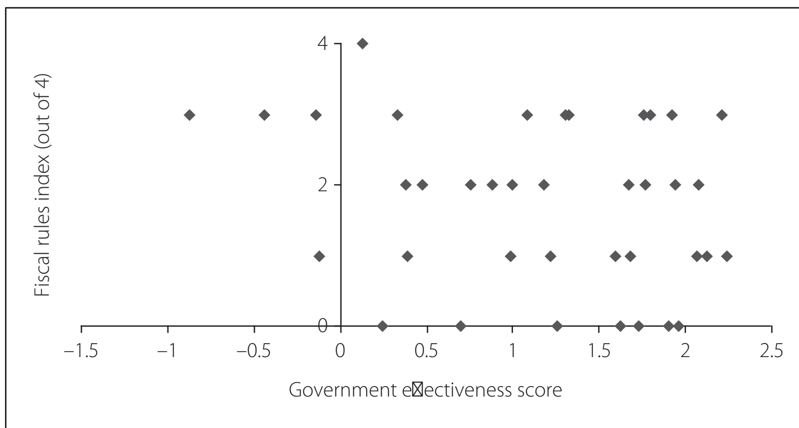
Source: World Development Indicators (accessed December 2007); OECD 2007.

Good governments were not more likely to adopt the fiscal rule 'form'

Evidence in the OECD database shows that this is not, however, the case. Scores on fiscal rule adoption here range from 0 to 4, indicating the number of different rule types a country has in place (including budget balance, debt, expenditure and revenue rules). The scores are graphically related to different WGI effectiveness scores (as in Figures 5.1 and 5.3). Figure 5.4 shows that higher fiscal rule adoption is not reserved for the more effective good government models to the right. Indeed, three of the four governments in the sample scoring below 0 on the WGI government effectiveness indicator (Venezuela, Peru and Argentina) have scores of 3 on the fiscal rule adoption measure. Only one of the five governments scoring above 2 on the WGI indicator has a fiscal rule adoption measure of 3 (the other four scoring below this level).

The ten countries scoring lowest on the government effectiveness indicator (all below 0.5) have the highest fiscal rule adoption measure average (2.2) as compared with the ten countries scoring between 0.5 and 1.5 on the WGI (averaging 1.9) and the 17 countries scoring between 1.5 and 2.5 on the WGI (with an average of 1.47). However, *t* tests indicate that none of these differences are significant, showing that good governments are not more likely to exhibit this good government characteristic than others.

Figure 5.4:
Fiscal rules and government effectiveness scores



Source: 2007 OECD Budget Practices and Procedures Database.

Good governments achieve functionality with different forms

Table 5.1 details the variation in fiscal rule adoption in the nine so-called good governments identified earlier in this chapter. This illustrates that these governments look very different in terms of the rules they adopt to facilitate budgetary discipline. The first column in Table 5.1 shows that two of the nine governments (Australia and the United States) do not actually have fiscal rules.[7] The other seven have different types and combinations of rules.

Table 5.1
Fiscal rules in the more effective governments

Country	***Fiscal rule***	***Expenditure rule***	***Limits for spending requests***
Australia	No rules		No
Belgium	Budget balance rule		For some types of expenditure at a chapter level
Canada	Expenditure, budget balance, debt rules	Targets nominal growth rate, covers central government only, dependent on political commitment of government	For all expenditure at chapter level
Denmark	Expenditure, revenue, budget balance rules	Targets real growth rate, covers entire government sector, dependent on political commitment of government	For some types of expenditure at organizational level
Germany	Debt rule		For all expenditure at line-item level
Netherlands	Expenditure, revenue, budget balance rules	Targets real expenditure ceiling, dependent on formal agreement of parties in government	For all expenditure at organizational level
Sweden	Expenditure, budget balance rules	Targets nominal expenditure ceiling, covers central government only, based in legislation	Other
United Kingdom	Budget balance, debt rule		No, but indicative limits
United States	No rules		No, but indicative limits

Source: 2007 OECD Budget Practices and Procedures Database.

Column two shows that the mix of expenditure rules looks quite different in the four countries that have them. In some cases, the rule targets expenditure levels, while in others, it targets growth rates, covering central government only in some cases and the entire government sector in others, and relying on political commitment for influence in some cases, agreement among ruling parties in others, and legislation in one country. The third column features information about whether governments provide limits for budgeting entities prior to these entities submitting spending requests (often called ceilings). These are not macro-fiscal rules, but certainly are budget rules and contribute to the top-down formal budget structure. Again, there is a range of experience, from no limits at all to indicative limits only, to limits on some kinds of expenditure, to limits for all expenditure types.

This range of experience creates problems for advocates of a model of the appropriate 'form' of good PFM. Some may disagree and argue that the general experience is to have rules. However, the institutional literature so readily referenced in good governance work emphasizes the importance of institutional detail, making even differences in the mix or the specifics of rules very important. These differences lead to different influences on behaviour. Consider, for example, the different ways offside rules impact behaviour across sporting codes like football, field hockey and rugby. In some instances, these rules prohibit an attacking player exceeding the last line of defence, but in others, they prohibit passing a certain point in the field, while in others, they constrain players to points behind the physical presence of the opposition. The different implications of such different rules on budgeting behaviour would be amusing to consider!

Different forms work differently in different contexts

Different fiscal rule influence is in evidence across the governments. For example, Sweden has found the rules (based in legislation) quite influential, and is one of the governments actually maintaining fiscal discipline in recent years (at least at the national level and when looking at expenditures in a strict sense).[8] However, economic challenges associated with unification and a prolonged recession made it very difficult for Germany to strictly adhere to rigid rules in the European Stability and Growth Pact.[9] The United States actually had fiscal rules from the late 1980s and formally still has some on the books, but these are not reflected in the OECD database, partly due to their perceived lack of presence and influence.[10] In both the

United States and Germany, social and economic challenges (the Iraq war, unification and economic pressures) were partly to blame for undermining the influence of rules.

Other governments in the effective government sample are also experiencing pressure in this regard as they face the challenges of other 'special costs' associated with aging populations and, more recently, the 2008 global economic downturn.[11] These costs contribute uncertainty to the PFM agenda and make rigid rules less appropriate devices for fiscal management. One could also argue that they redefine the role of fiscal deficit measures as PFM outcome indicators; in the face of spending challenges or economic downturns, some governments might find it less appropriate to rigidly control deficits in some years, rather allowing some slack to accommodate new policies or demands.[12]

Identifying how uncertainty influences the appropriateness of fiscal rules assists in understanding why different governments have different PFM forms. Hallerberg *et al.* (2007: 338) underscore the importance of this kind of understanding in their direct reference to unanswered questions about adopting fiscal rules themselves: 'While rules seem attractive and straightforward to contain the spending and borrowing bias of profligate governments, it is by no means clear what institutional design they need and how they should be embedded into the government budgeting process to be effective.' Hallerberg *et al.* (2007) suggest other political process influences on fiscal rule adoption, identifying two institutional approaches in countries attempting to enhance top-down budgetary influence – delegation and contracts. Delegation involves a minister of finance using rules to enforce his or her influence, while contracts involve actual contractual agreements about fiscal behaviour within the executive and between the executive and legislature. The authors argue that delegation is appropriate for single-party governments where ideological distance and political competition are small in the party, while contracts are appropriate for coalition governments and for single-party governments where ruling party ideological distance and political competition are significant.

The authors emphasize the significance of these differences: 'The European framework [of rigid rules] may be less effective in countries whose budget process is shaped by the delegation approach … [and] … the two are not easily interchangeable for a given country' (Hallerberg *et al.* 2007: 339). The story of PFM systems, related to fiscal rules, thus emphasizes context and the need to embrace contextual variation in thinking about governance forms. Different forms accommodate functionality differently in different contexts.

Concluding thoughts

This chapter asks if isomorphic compliance with governance indicators will improve form or functionality in developing countries. Do we have any reason to believe that countries following good governance scripts will look better or actually become better (facilitating development) as a result?

I tackle the question by looking for evidence that 'forms' implied in good governance indicators are linked to better functionality – do developed countries really have these forms in place? The first section raises doubts about such, providing secondary evidence that the more functional governments of this world actually look very different. They are different in size, for example, and have varying levels of decentralization and de-politicization.

The chapter then goes beyond secondary sources to examine a more discrete dataset showing which countries adopt fiscal rules – a staple 'form' in discussions about good PFM. The evidence suggests that while more functional governments commonly have better outcomes (lower deficits) they do not all have the good governance form (fiscal rules) and actually achieve their functionality in different ways that seem to be contingent on contextual factors.

This evidence causes me to question whether the 'forms' implicit in good governance – and good PFM scripts in particular – facilitate more functional government. It appears that countries exhibiting good outcomes – or functionality – can have very different governance structures – or forms. This evidence should challenge the current predilection for one-best-way models of PFM systems and government structures in general. These models are being foisted on developing countries with the implied promise of development but without evidence that the developed countries themselves uniformly adopt the model elements. Countries that come out reflecting 'good government' – according to the influential good governance indicators – actually look very different, varying on the very dimensions that indicators imply are central to good government.

Therefore, the development community should pay more attention to this variation. Such attention will require closer focus on the importance of context in shaping governments. Instead of building an ever-growing list of good governance characteristics we would like developing countries to adopt, researchers should focus on better understanding what structures governments actually do adopt and why.

It is important to note that elements of the good government picture painted by governance indicators are already fixtures in global public

sector reform programmes, and context appropriateness is not a strong point in most development engagements. A recent study of 31 African countries' PFM reforms finds governments commonly pursuing multiple 'best practice' constructs in the form of a model: like multi-year budgets (29 of the 31); programme, activity or performance budgets (25 of the 31); external audit and legislative reform (28 of the 31); and internal audit (25 of the 31) (Andrews 2010). One should note the cross-country variation in this sample: about half had Francophone histories (where external audit did not exist in the modern guise), 7 of the 31 countries had experienced serious social and political upheaval in the previous five years, 6 had not produced an annual budget in at least one of the previous three years, at least half had major discrepancies in the line-item classification scheme they used, and most had only 20 and 50 qualified accountants in the country (private and public sector, the numbers present in the United States in the 1880s). Surely, the variation in countries should have led to varying types of reform proposals, composed of different mixes of best practice constructs (and perhaps some constructs that are not best practice). Surely, the major differences between these contexts and those in which new ideas were hatched should raise red flags to those advocating replication.

The stories of replicated 'best practice' reform designs abound, as do tales of failed reforms. The latter are partly to blame (I believe) for the fact that effective government elements underlying reforms resemble the principles of administration Herbert Simon decried as problematic proverbs over 60 years ago – quotable and convenient constructs for rationalizing past behaviour or justifying future decisions, but defective in providing serious theoretical explanation or practical advice. Simon (1947: 53) argued that, as with all proverbs, the principles of administration of his day stood well when applied alone and in the right context, but poorly when considered in tandem with others: 'For every principle one can find an equally plausible and acceptable contradictory principle.'

The discussion of variation in 'good governance' structures suggests that leading world governments do not treat these sets of potentially conflicting principles (or proverbs) as elements of one strict model but rather as items in a menu. Put metaphorically, Sweden 'chose' to have a large but decentralized government system for providing its health care because it 'fit' the context.[13] The United States has a system dominated by the private sector perhaps because it 'fit' that context as well. The two governments and societies adopted different menu selections of different practices to achieve similar objectives (provide world-class health care). Interestingly, there is evidence of 'choice', even within governments and

over time. While authors like Wehner (2007) show that wealthier, more developed countries are also more transparent in their PFM systems, most wealthy governments 'choose' lower levels of transparency in certain sectors – like defence.

Conceptualizing governance forms as menu items to be chosen, rather than essential elements of a one-best-way model, is an important step to better understanding why good government looks different in different settings. However, it will be a helpful step for developing country governments, especially if linked to thoughts on how governments should 'choose' from the menu. The development community could start addressing this question by asking why the world's more effective governments exhibit different combinations of better practices. What current cross-country characteristics and/or historical factors led to these menu choices? What internal factors lead governments to adopt different governing solutions? How can function drive form in the governance domain, rather than form driving function?

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Chapter 6
Is governance reform a catalyst for development?[1]

Arthur A. Goldsmith

Governance is widely considered the lynchpin in current international development strategy. While social science has always maintained that governance (decision-making procedures and behavioural conventions in formal public organizations) has consequences for the developmental performance of nation states, the contemporary official tenet is that 'good' (i.e. transparent, accountable, participatory) governance should be established and expanded everywhere to boost the tempo of development. Open civic institutions are seen as a catalyst because they create an environment that rewards honesty, hard work and entrepreneurship. Civic institutions that lack transparency, accountability and participation generate perverse incentives that are said to hold down economic growth and perpetuate poverty.

I am hesitant to accept this doctrine in full. It seems static, ahistorical and to ignore the political and economic costs of governance reforms. Extremely adverse conditions of failed statehood probably preclude almost any social or commercial progress, but in-between cases of deficient governance have less predictable economic outcomes. My reconsideration of four such cases leads me to question empirical claims that certain upfront investments in civic institutions normally produce large 'development dividends'.

Institutions matter … but how much?

The international community's stress on governance dates from the late 1980s, as development agencies tried to come to grips with the economic breakdown of the former Soviet bloc and to understand why so many

structural adjustment programmes were failing to take hold, particularly in Africa. Corruption in the public arena and lack of the rule of law were identified as central problems. Thus, the United Nations Millennium Development Goals (MDGs) feature good governance as means for bringing about development and fighting poverty.

The idea that governance and institutions make a big difference in development has a long intellectual lineage going back to Adam Smith.[2] The underlying reasons why a national economy is stagnant and unproductive can be diverse, and may include scarcity of capital, backward technology, unequal trading relationships, harsh climate, lack of natural resources, remote location, anti-commercial cultures, overpopulation and low education levels. Superimposed on all these factors is the quality of a country's governance, which is said to determine how efficiently resources are employed and how creatively development challenges are managed. Being landlocked or located in the tropics are givens, whereas being poorly governed is something humans can alter if they set their minds to it.

Microeconomics is the prism policymakers today are likely to use to identify desirable configurations of governance. Taking a rational choice perspective, the central issue of governance is to design institutions that discourage people from using the state to distort private exchanges for their benefit. Achieving better governance is largely a matter of setting up and sticking with procedures that reduce transaction costs and increase the gains to trade. Optimal institutional constraints are based on arm's length principles. Personal relationships should play as small a role as possible in collective decisions. Better governance should reduce the risks of trade and investment by making legislation and court rulings more predictable, and by reassuring asset holders that the state will not arbitrarily revoke their property rights (the 'commitment problem').

Three particular precepts of sound governance stand out in the microeconomic literature on this subject:

- Given that optimal behaviour for rational decisions requires complete information (the problem of 'adverse selection'), transparency is a top concern. Citizens and businesses on the outside must see how civil and political institutions work on the inside. It should be clear to everyone who is responsible for what actions. There should be no doubt about the aim and content of public policies, lest asset holders be frightened into hoarding or fleeing with their capital.
- A second principle is accountability, which allows for the replacement or disciplining of leaders who do not listen or break their promises

(the 'agency' problem). No official should be able to hide from the consequences of poor job performance.

- Participation and empowerment are deemed important because a spectrum of people and interest groups need to reveal preferences, debate options and make trade-offs based on the information they have. If too few members of society are represented in government decisions, leaders have little inducement to produce the infrastructure and government services that are the foundation for sustained economic growth and social advancement (the 'public goods' problem).

A growing body of empirical research supports the pivotal role for institutions in development (e.g. Acemoglu, Johnson and Robinson 2001; Rodrik, Subramanian and Trebbi 2004). Making statistical observations across a large number of countries, these studies usually find non-transparent, unaccountable and restricted governance is detrimental to development and welfare, while the opposite tendency is advantageous. Specific good governance factors associated with strong long-term national economic performance include rational-legal public bureaucracies (Evans and Rauch 1999), judicial independence (Feld and Voigt 2003), protection of property rights (Gradstein 2003), a tradition of common law (Mahoney 2001) and democracy (Gerring, Bond, Barndt and Moreno 2005). The implication for public policy is hopeful: realistic improvements in governance could raise per capita incomes significantly over the long run, and often have positive effects even over relatively short periods (Kaufmann, Kraay and Mastruzzi 2005).

This sounds almost too good to be true. Not only is good governance normatively gratifying, but it also stands on solid experiential ground when it comes to encouraging development. Perhaps the argument is too good to be completely true. Academic critics have suggested several reasons why econometric studies might find 'institutions matter' more than they really do. Policymakers are apt to disregard these caveats, at least in official statements, although many must know in their heart of hearts that the praises they sing about governance go beyond what scholarship can justify.[3]

There is the possibility of unseen joint effects: rather than better governance accelerating development, both plausibly may be the product of other underlying causes. For example, early colonizers in temperate climates brought with them European institutions that emphasized property rights and checks against government, but these settlers also brought skills acquired in the home country. Development and good governance in these European settlements could thus both be outcomes of improvements in human resources (Glaeser, La Porta, Lopez-de-Silanes and Shleifer 2004).

Another methodological problem is endogeneity or reverse causation. For instance, a meritocratic bureaucracy could be a crucially significant antecedent factor in industrialization, but politicians in industrializing countries probably also feel less pressure to support their relatives and friends by finding them bureaucratic jobs. Thus, industrialization could actually be the antecedent of meritocracy in the public sector. To control for endogeneity the more sophisticated empirical studies introduce instrumental variables, but it is hard to find indicators that correlate with institutional quality but not with economic growth (Jütting 2003). If institutions are endogenous, that also makes it very difficult to assess counterfactuals or the forecasted course of events that would have taken place in the absence of a particular institutional framework (Przeworski 2004). Adding to these methodological challenges is measurement error (Aron 2000; Andrews 2008). Many variables that try to capture aspects of governance could be inaccurate.

Case studies in institutional development

The comparative case method is a supplementary approach to large-*n* designs for illuminating the links between governance and development. Descriptive data generated from case studies are generally useful for clarification and interpretation – and for warning observers not to gloss over complexities when studying social or natural phenomena. Consider the United States, Argentina, Mauritius and Jamaica. These four cases represent two 'most similar' pairs of 'most different' cases, deliberately chosen to look for parallel processes and outcomes in diverse settings.

The United States and Argentina are examples of 'early development', where the state stayed more in the background. The United States is particularly important because it is the prototype for many good governance measures and characteristics. Are observers making the teleological fallacy of projecting present-day institutions onto the past, when the United States was still a developing country? Argentina bears many obvious parallels to the United States, with a rich natural resource endowment, large internal markets, temperate climate and heavy immigration among other similar traits, but with worse institutions and less successful industrialization today. Were its institutions always far below US levels?

The remaining two cases illustrate 'late development', where the state typically plays a more substantial role regulating business and providing social safety nets. Mauritius is considered a marquee case of development

through good governance, which is frequently cited as an object lesson for other developing countries. Perhaps its institutions have been portrayed too favourably. Jamaica is a seemingly controlled 'natural experiment' in which most civic institutions and many socio-economic factors are analogous to those in Mauritius, but where development has not gone nearly as far.

The independent variable for consideration is any of several conscious efforts to make civic institutions more transparent, accountable and participatory. Table 6.1 lists several specific problems of governance that many citizens are familiar with: patronage hiring, corrupt campaign finance and electoral malfeasance, personalized or clientelistic lawmaking and law enforcement, investor fraud. Practical alternatives exist for each bad practice. The standard answer to patronage in public services is to introduce a merit system of bureaucratic recruitment; the usual way to improve a politicized or corrupt legal framework is through judicial independence,

Table 6.1:
Some common governance failures

Deficient institutional pattern	***Typical reforms***
Public administration: Government workers are recruited and promoted for partisan connections (patronage)	Competitive entrance and advancement, job tenure for civil servants
Judiciary: People with close ties to government get preferential treatment in court (no rule of law)	Lifetime tenure for judges, merit plan for nomination
Issue advocacy: Established families and big businesses get special consideration in legislation (rent-seeking)	Registration of lobbyists; 'revolving door' rules for ex-officials
Campaign finance: Election campaigns are paid for by large, secret donations from wealthy interests (political capture phenomenon)	Disclosure of donors, donation caps, public funding
Elections: Voting is marked by bribery, intimidation and deception to obtain predetermined outcome (rigged balloting)	Secret ballot procedures, election commission
Legislative process: Lawmakers provide targeted individual or group favours to maintain local popularity, and they neglect production of public goods (clientelism)	Expand the franchise; emphasize non-selective government programmes that benefit broad categories of people based on objective criteria
Investor rights: Managers misappropriate corporate assets, mistreat small shareholders (inefficient capital markets)	Accounting disclosure requirements, minority shareholder rights, curbs on insider trading

the corrective for voting fraud is to establish a secret ballot and systematic voter registration system, and so on. These good governance reforms are quantifiable, though *de jure* changes are less ambiguous than are actual changes in how officials and citizens behave. We can establish when a country promulgates a new statute affecting governance and, with more difficulty, how long it takes to implement the statute.

The dependent variable is an upturn in the national rate of development marked by the onset of a period of 'growth acceleration'. These are defined as any eight years a country has annual growth of per capita gross domestic product (GDP) of 3.5 per cent or more, which is at least 2 percentage points above the previous eight-year rate and which takes the level of income higher than before the acceleration. The United States (1877), Argentina (1902) and Mauritius (1971) each experienced a growth acceleration when per capita GDP was under US$3,000 (see Table 6.2). Jamaica did not have one, so for the sake of argument, I use 1962, the year of Jamaica's national independence, as the turning point. Per capita GDP was similar to the other countries' at the beginning of their economic speed-up periods. My research design calls for working backward from these turning points to see if particular governance reforms played an identifiable role leading up to the transition from slow to rapid growth. The case method also provides opportunities to observe how governance evolved after these decisive moments.[4]

Figure 6.1 shows each nation's respective income growth over the 30 years following the speed-up. Those trend lines go well beyond the initial eight-year episodes used to mark a growth acceleration. I present the longer time frame to cover the possibility that decades may be needed to see the link between governance and development in a nation state. The four cases represent a spectrum of long-term outcomes. Mauritius had by far the most rapid rate of growth, compounded over 30 years. The United States was next. Growth in Argentina and Jamaica, however, petered out over the course of 30 years.

Table 6.2 reports when the four countries started to acquire selected 'high-quality' institutions, such as a civil service commission to ensure a merit-based bureaucracy. The dates refer mainly to *de jure* changes, not to actual changes in behaviour. New rules that look transparent, accountable or participatory on paper may not be the dividing lines they appear to be. Still, as is immediately clear from Table 6.2, many major formal additions and improvements to governance took place well after the growth acceleration point for both the United States and Argentina. Assuming real change took additional time, the order and placement of those reforms seem inconsistent with the view that 'institutions matter' a great deal as a

Table 6.2:
Milestones of growth and good governance

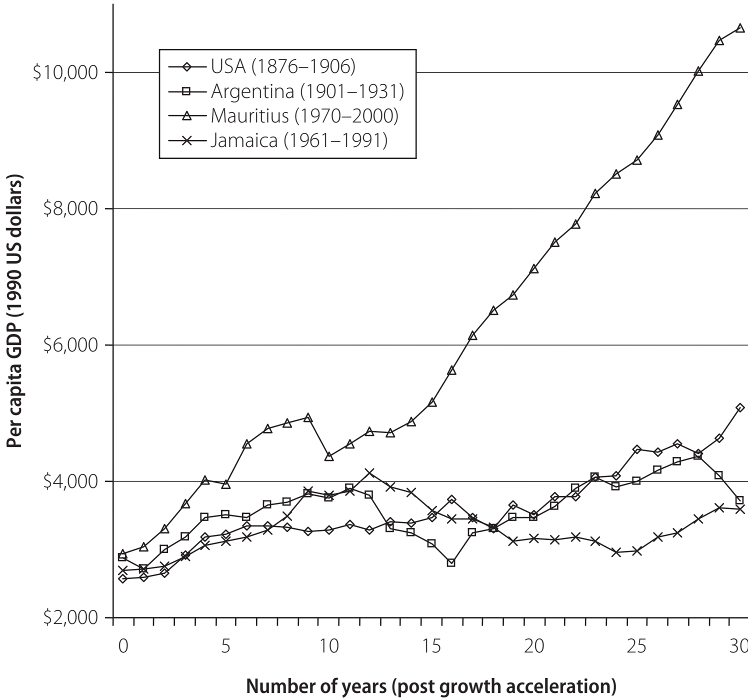
Country	*Growth acceleration**	*Income trends†*	*Signs of reform*
United States	1877	Initial per capita GDP: US$2,570 8-year growth rate: 3.8% per year 30-year growth rate: 2.4% per year	Civil service commissions: 1883–1940 (federal and state) Judicial independence (state level): 1913 (first state merit plan) Campaign finance: 1890s (first state mandatory disclosure laws) Fair elections: 1888–1910 (most state secret ballot laws) Investors' rights: 1911–31 (state 'blue sky' laws)
Argentina	1902	Initial per capita GDP: US$2,717 8-year growth rate: 3.6% per year 30-year growth rate: 1.1% per year	Civil service reforms: 1980s Judicial independence: 1853 (nominal) Campaign finance: 1990s (disclosure rules and spending caps) Fair elections: 1912 (secret ballot law) Investors' rights: 1990s
Mauritius	1971	Initial per capita GDP: US$2,945 8-year growth rate: 7.2% per year 30-year growth rate: 4.5% per year	Public Service Commission: 1953 Judicial independence: 1800s Campaign finance: No disclosure or spending caps for parties Fair elections: 1947 (secret ballot law) Investors' rights: 2004 (Financial Reporting Council set up)
Jamaica	None (independence in 1962)	Initial per capita GDP: US$2,702 8-year growth rate: 2.8% 30-year growth rate: 1.0%	Public Service Commission: 1951 Judicial independence: 1800s Campaign finance: No disclosure or spending caps for parties Fair elections: 1944 (secret ballot law) Investors' rights: 2001 (Financial Services Commission set up)

* A growth acceleration is an increase in per capita growth of 2 percentage points or more that is sustained for at least eight years. The post-acceleration growth rate has to be at least 3.5 per cent per year, and post-acceleration output must exceed the pre-episode peak level of income (Hausmann, Pritchett and Rodrik 2005).

† Per capita GDP is in 1990 dollars.

Source: Column 2: Mauritius and Jamaica: (Hausmann *et al.* 2005), United States and Argentina are author's estimates, based on Maddison (2003); Column 3: Author's estimates (from Maddison 2003); Column 4: See text.

Figure 6.1:
Four countries, four economic turning points



Source: Maddison (2003).
Note: See text for definition of a growth accleration.

springboard for development (though the timing is not inconsistent with the notion that institutions need continuous improvement if development is to be sustained). By contrast, good governance institutions were more of a pre-existing condition in Mauritius and Jamaica. Of course, precedence does not make something a cause of something else. We risk making a post hoc fallacy if we fail to consider alternative causal mechanisms for the onset (or stillbirth) of rapid growth.

In the next section, I briefly explore the history of these countries to ascertain which specific institutional reforms were accelerants for development (as opposed to development being an accelerant for the reforms). I also consider whether unreformed governance was itself an accelerating factor (or at least not a decelerant that stopped faster development in its tracks).[5] In different ways, each of the cases suggests a path of development difficult to square with the good governance perspective.

United States

The abusive governance of America's Gilded Age (1866–1900) is half forgotten today. Public institutions from that time look secretive, personalistic and arbitrary when measured by today's standards – yet the latter part of the nineteenth century was an era of unprecedented technological improvement and industrialization for the United States. Reformers of the time were mocked as 'goo-gooers' due to their fixation on good governance as a cure for the nation's problems. They underestimated the difficulty of meaningful reform.

Start with public administration. Good governance theory rejects the spoils system of bureaucratic recruitment as an impediment to development. Patronage leads to unpredictable and inefficient delivery of critical government services, and should therefore be replaced with a modern, professional personnel process. The 1860s were the zenith of federal patronage, with nine out of ten executive branch civil service positions redistributed. Federal employees, in return, were required to kick back part of their salaries to their political parties. The federal spoils system slowly retreated over the next several decades in a process that was clearly more the outcome of economic growth than its source. To this day, patronage remains deeply embedded in many sub-national administrative and political units.

The judicial branch was also problematic in nineteenth-century America. Good governance doctrine holds that it is critical to have an independent judiciary free from direct partisan influence, which permits the courts to uphold property rights and make unpopular, but economically necessary, decisions. Conditions were quite different during the Gilded Age. Turnover among state and local judges was high and many parlayed their experience on the bench into moneymaking opportunities in the private sector. By the early twentieth century, most states used partisan judicial elections, turning jurists into office-seekers and further compromising their neutrality.

America's elected state judges were not especially consistent about protecting property rights. Acting in the name of progress, they were prone to reinterpret common law with respect to property and contracts. State appellate courts granted states widespread authority to use their power of eminent domain to expropriate assets and assist private companies. The heyday of these subsidies was from 1870 to 1910 (Nedelsky 1990: 226). Many judges were also complicit in illicitly transferring millions of acres of public land to large cattle, timber, mining and railroad companies during that period.

Unfair elections are another oft-mentioned feature of misgovernance. During the Gilded Age, political parties printed their own ballots, making it easy to monitor how people voted and intimidate those who refused to go along. District captains at the polling stations would pay voters and follow them to the ballot box to verify that they cast their votes correctly. The first state only enacted a secret ballot law in 1888, which provided for official ballots to be distributed by non-partisan election officers and made detailed arrangements for privacy in the voting booth. By 1910, all but two states had passed similar statutes. Bribery of voters became a criminal offence in all states by the 1920s. A number of states also began to require disclosure of campaign receipts and expenditures. Landmark federal legislation in 1907 barred corporations from giving money to candidates for national office. Its effect was diluted, however, because it failed to put restrictions on the individuals who owned or managed the companies. America's first lobbying disclosure law was passed in 1890. Even today, several states do not prohibit elected officials from using their position to secure contracts. Many still allow the receipt of gifts by legislators and permit legislators to represent private interests before government bodies (Hedge 1998: 119).

Business practices took a while to become more transparent. Between 1911 and 1931, all states but one adopted securities laws, setting minimum standards for corporate disclosure (Mahoney 2003). Only in 1933 did the federal government step in and require companies to present registration statements with new public offerings of stocks and bonds, and to make 'full and fair' disclosure of financial information. A year later, corporate officers and directors were forbidden to buy and sell stock based on nonpublic information. Small shareholders won other rights, such as being treated equitably in dividend policies and in access to new security issues by the firm, being able to sue directors for neglecting their fiduciary responsibilities, and being allowed to file shareholder resolutions to defend their interests.

Putting the evidence together regarding US public administration, judicial independence, voting practices, campaign finance and corporate governance, there is little to show that good governance reforms catalysed economic modernization in the late 1800s, as opposed to being auxiliary or complementary factors in the process. In some instances, the economic upturn itself may have generated additional poor governance by creating new opportunities for opportunistic, self-seeking and deceptive behaviour. Civic institutions were gradually improved over time, but those improvements came during or after the major expansion of trade and industry, not before. To this day, acute governance problems remain in the United States, as shown by ongoing campaign finance scandals and corporate accounting fraud.

Argentina

In contrast to the United States, Argentina is often seen as an exemplar of substandard governance holding down development. The Latin American nation is notorious for political instability and military intervention despite attaining one of the world's highest living standards during its Golden Age (1880–1914). Common perceptions aside, it is ambiguous whether most of the applicable Argentine institutions of the time were so different from American institutions in the equivalent historical era. For example, both countries traditionally based their civil service on patronage. Like the United States, Argentina had no central personnel agency and no central control over employment, promotion, discipline or dismissal of public servants. Virtually everyone who worked in the government service was chosen for political reasons. The noticeable difference between the cases is that Argentina took even longer to carry out modernizing civil service reforms.

Concerning the rule of law, the judicial branch had *de jure* independence under the country's 1853 Constitution, which was modelled after the US Constitution. But in practice, the executive branch exerted more pressure over the judiciary than it did in the United States. The courts were initially disposed to protect the property rights of big farmers and ranchers. Later, especially during the Juan Perón era, the courts proved flexible and stood aside to allow enactment of populist policies that restricted landowners' property rights and favoured the working classes (Alston and Gallo 2010).

Argentine elections were marked by intimidation and electoral fraud in the early 1900s, which resonates with American experience at the time. The Radical party successfully pushed for a secret ballot, instituted in 1912. While aspects of the law violated voter confidentiality, elections did become much more competitive. As was true in the United States, electoral competition was associated with widespread purchase of votes, with many voters expecting small personal rewards in exchange for their support. However, the practice proved harder to suppress in the Latin American country.

Campaign finance reform has been an issue in Argentina at least since 1931, when the first decree to provide public funding was issued in an effort to level the playing field for all political organizations and to promote legislators' independence from powerful lobbies. As in the United States, efforts to regulate and illuminate private political donations were often stymied.

Argentine corporate governance has been opaque, though this did not prevent the emergence of an active local stock market in the early twentieth century. More than in the United States, Argentina's biggest domestic companies were personal or family-owned. Firms relied on bank loans, mainly through the state-owned banks or private funding through main stockholders. Investable funds were increasingly concentrated in a single institution, the Banco de la Nación Argentina, creating a lopsided financial structure vulnerable to rent-seeking (Nakamura and Zarazaga 2001). Later, the severe economic crisis of 1989–91 generated pressure to open the financial system. Wanting to attract foreign investors, the government passed a series of laws to bring its corporate governance into line with international norms (Apreda 2001).

In sum, Argentina reinforces reservations, also raised by the American case, about direct causal links between improved governance and a speed-up in development. Pervasive patronage, clientelism and pork-barrel politics in Argentina did not block rapid income growth during the Golden Age (though they may have been contributing factors in the growth reversal towards the middle of the 30-year period shown in Figure 6.1). For a time, its people were among the best-off nationalities on earth measured by average income, though they later lost that lofty status. The most striking difference between the Argentine and American cases is the fact that reform stalled and took longer to implement in Argentina, but that was after the period of growth acceleration.

Mauritius

Mauritius is often presented as a poster child for how high-quality institutions bolster development. At independence in 1968, it had one of the world's densest and most heterogeneous populations, with 700,000 people who hailed from three continents, spoke several languages and practised four major religions. Few observers held out much prospect for this small, isolated, resource-poor new nation.

Two surprising things happened after independence that confounded the pessimists and made Mauritius stand out among developing countries. First, was stellar economic performance (look at the growth curve in Figure 6.1). Before 1971, Mauritius was a stagnant monocrop economy, dependent on the declining world sugar market. Today, it is a thriving manufacturing exporter, financial services centre and tourist destination. It has achieved middle-income status and scores very well on most measures of human

development. The second outstanding fact about Mauritius is its democratic stability. The country adopted a Westminster-Whitehall style political and administrative structure marked by regular competitive elections, gracious losing and loyal opposition.

Most accounts of the country's political history emphasize how the system of governance evolved during a prolonged period of colonial tutelage, which allowed local people to acquire experience with self-rule incrementally. Mauritius had a large public sector, with government employees representing over 1 per cent of the colony's population in 1900 (Lange 2003: 404). Mauritians held over 90 per cent of these posts, including most high-level positions by the end of the colonial period. Recruitment was supposedly based on talent, not on connections, as enforced by the Public Service Commission (established in 1953). Legislative elections with a very limited franchise took place from 1886. As of 1947, there was near universal adult suffrage (with a few literacy restrictions) with secret ballot. Responding to rising demand for independence, Britain introduced the ministerial system to Mauritius in 1957, followed by internal self-government in 1965, and formal decolonization three years later. Because Mauritian law was an amalgam of British and French law, local magistrates always played a key role in interpreting and enforcing the law. British colonialists were not sufficiently familiar with French codes to administer the law by themselves. Judicial independence was sacrosanct and the final court of appeals is still located outside Mauritius in the Judicial Committee of the Privy Council in the United Kingdom.

We should be careful not to commit the fallacy of wishful thinking about this case, however. While governance was clearly superior to what many other ex-colonial countries had, it is easy to filter out details that do not fit the positive image. Though political parties in Mauritius were not supposed to use the civil service for patronage purposes, they did. Two critical official reports on the civil service system in the run-up to independence called attention to the problem of family, communal and ethnic favouritism among civil servants (Minogue 1976: 162–3). Even now the bureuacracy is far from a pure meritocracy. According to the government's own summing up, industrial development occurred despite, not because, of the bureaucracy (McCourt and Ramgutty-Wong 2003).

The political process was not quite as consensual or above board as in the simplified historical account, either. Accusations of corruption were common in the post-independence era, and several high-elected officials were caught red-handed smuggling drugs in 1985, under cover of diplomatic

immunity. An official investigation noted the country's economic boom had increased contact between business people and politicians, creating a climate for bribery and extortion (Bowman 1991: 89).

Corporate governance was also lacking during the 'miracle' years. A small group of family-owned holding companies control a large part of Mauritius' economy, and shareholders cannot easily unlock the value in these firms, according to the World Bank (2002). The country fails fully to meet OECD guidelines for disclosure and equitable treatment of shareholders.

Despite flaws, Mauritius' institutions were still much better than average for developing countries. While that quality differential might have produced a large 'development dividend', I am leery of causal oversimplification. Alternative explanations for Mauritius' strong performance favour additional factors. Of particular importance may be geography, which enabled the country to capitalize on ethnic organizational links to the Indian homeland. Given personal connections and Mauritius' proximity, Indian entrepreneurs found the island a convenient offshore export platform to enter the European Union and US markets, using trade preferences available to Mauritius but not to India. Indian businesses also used Mauritius as a tax haven by setting up holding companies to avoid tax liability in India. Multinational companies continue to take advantage of other special Indo-Mauritian arrangements, and up to a third of the foreign investment in India comes through Mauritius. There are similar personal and commercial ties between the less numerous Sino-Mauritian population and the diaspora Chinese business community, which have also benefited the economy.

Jamaica

Jamaica reinforces the idea that participatory governance and accountable institutions may have been secondary conditions in Mauritius' development take-off. There are many parallels between the two cases. Jamaica is also a small island nation with a history of plantation agriculture. Jamaica also emulates Britain's Whitehall-Westminster model, with neutral, non-partisan civil servants advising elected government ministers. Decolonization was similarly gradual, culminating in full independence a few years ahead of Mauritius. The country had some material advantages over Mauritius, including the discovery of rich bauxite reserves in the 1940s. The big difference between the two cases is that economic growth stalled in Jamaica.

Because Jamaica's institutional endowment approximates that of Mauritius, it is hard to blame standard governance factors for the absence

of a growth acceleration. Britain's colonial administration began to recruit significant numbers of qualified local people for responsible positions in the 1940s. At independence, the size of Jamaica's public sector workforce was comparable to what Mauritius had. The two countries' Public Service Commissions came into being at about the same time to regularize personnel procedures and oversee training of staff. There were complaints that Jamaica's civil service was insufficiently oriented to development and incapable of hiring the most talented graduates, but few doubted its political neutrality. The tradition of non-partisanship did erode in the 1970s, with the growth of statutory bodies and public corporations outside the civil service system and the government's increasing reliance upon politically reliable special advisers to develop policy (Mills 1997: 19), although that seems more a result than a cause of poor economic performance.

The integrity and independence of the judicial branch measure up to Mauritian standards. Individuals must meet high educational and experience standards to sit on the bench. There are special constitutional provisions to protect higher court judges in Jamaica, but these have never had to be tested because no higher court judge has ever been threatened with removal from office (Munroe 2003: 24). As with Mauritius, the Privy Council in London is the final court of appeal. Citizens have the right to sue the state and frequently win judgments against government bodies.

Jamaica has a robust two-party system, with each party exchanging office roughly once a decade from the 1950s through to the 1980s. A secret ballot with universal adult suffrage dates from 1944. The Electoral Office of Jamaica was established to guarantee the integrity of the electoral process. Like Mauritius, Jamaica has no campaign finance law requiring parties to disclose income or to limit their expenditures, so that factor cannot be blamed for economic differences between the countries.

Jamaican corporate governance falls below contemporary standards for transparency and shareholder empowerment – but not noticeably below practices in Mauritius. The local corporate sector is dominated by clans with large block holdings and cross-membership on the boards of firms. There is limited disclosure of ownership or voting agreements among shareholders, and financial information is not readily available to the public. The situation is in flux. Jamaica's Financial Services Commission came into existence in 2001 to bolster compliance with international standards of financial accounting and investor protection. That was a few years ahead of when Mauritius set up comparable institutions.

Why did the economy languish in the late 1960s? Nongovernance factors were important. Jamaica did not have the global business linkages

that benefited Mauritius. Bauxite, Jamaica's principal export, fell in price after independence. Other Caribbean nations developed competing tourist facilities. Some of Jamaica's superficially good governance institutions and practices also played an unexpectedly negative part in this story. The highly regarded participatory political process did not lead to production of public goods in the way it should have in theory. Citizens, especially those in the lower classes, bound themselves to one political party or the other to obtain individual benefits, such as temporary jobs or small public works contracts (Edie 1990). Clientelism became ingrained as opportunities in the private sector failed to materialize, polarizing the electorate and fostering a zero-sum mentality that bred violence among activists. Some electoral districts have evolved into politically homogenous 'garrison communities', dominated by gangsters with partisan affiliations (Figueroa and Sives 2002). Pervasive criminality deters tourism and investment, thus closing the circle of slow growth.

Concluding points

Four cases can never be definitive, but they do provide anecdotal confirmation for four provocative hypotheses about governance:

- Meritocratic bureaucracies, independent judiciaries and honest elections are worthy goals in their own right, but setting them up need not give a perceptible jolt to development.
- Provided other conditions are favourable, objectionable public institutions may be adequate for an upsurge in production and income.
- Good governance reforms are more effect than cause of sped-up development, though over time they seem to become a more important factor in sustaining development.
- When the rate of development picks up, so may graft and extortion, though often any escalation in corruption prompts countervailing political demand for anti-corruption measures to be enacted.

Why would these out-of-favour propositions be true? The reason governance reform may not give a noticeable jolt to development (the first hypothesis) probably has to do with the time lags of implementation. Inefficient institutions are sticky due to resistance from select groups that gain under non-transparent or unaccountable arrangements. Elite resisters will usually have success stalling and even reversing governance reforms. Even if they see advantages in switching sides and getting behind changes

in civic institutions, that is still likely to distort the effects on a nation's total wealth and the distribution of income.

Several explanations exist for hypothesis number two (impaired governance sometimes supporting rather than smothering development). For instance, patronage is a means for building loyal political support, which could at times make governance more credible in the eyes of private investors, balancing if not completely making up for the tendency of patronage to encourage lax administration. Clientelism and the exchange of lucrative favours could also have benefits for development if they add to political legitimacy and stability and, therefore, to a positive business climate. Take pork-barrel spending, which goes to certain regional constituencies but may help integrate them into a cohesive nation, while also acting as a stimulus to domestic firms which receive the contracts (though it might also have polarizing effects if the political pork is not distributed evenhandedly among regions and firms). Governance is always a gradient from bad to good, and workable institutions vary according to national contexts and level of economic development (Brinkerhoff and Goldsmith 2005; Andrews 2010).

The idea that good governance follows growth (hypothesis number three) is partly explainable by the possibility that open and participatory institutions take more human and financial capital to run successfully. Also, political demand for clean governance is often a middle-class phenomenon, and a larger and better educated middle class is one of the likely long-run outcomes of a faster growing economy. As the economy becomes more complex, in due course, business lobbies and other economic interest groups may also agree that neutral but competent civic institutions would better serve their needs.

Hypothesis number four (rapid development may initially bring about worse governance, which, in turn, may stimulate reform) is a corollary of number three. Stronger economic growth, in the absence of legitimate limitations on the behaviour of politicians and business people, allows greed to flourish. When extensive wrongdoing becomes known, that may give civil society organizations the political momentum to create greater choice and accountability in governance. This leads to a tug of war with entrenched elites and their entourages, who push back on the new rules and look for ways around them. With luck, some institutional innovations stick, and those that come undone induce additional reformism in the future.

The cases obviously raise questions about using stock governance reforms as a general treatment for slow growth or non-development, regardless of the national setting. Institutions function like an ecosystem with a heavy

measure of interdependence. That may mean the complementarities among institutions are more important than the performance of any single institution in encouraging development. Perhaps 'institutions matter' most when a critical mass of open, rule-based institutions exists. Reforms themselves may have life cycles. Certain institutions may gather human and technical resources gradually before breaking through to have an impact; other institutions may have 'shock value' at first, but grow less effective as political actors adjust to new rules and figure ways to accomplish their previous objectives within the new institutional framework.

Until and unless the empirical picture is clarified, policymakers will have to rely on guesswork regarding institutions and development strategy. We may never know how to calibrate institutional quality to a country's historical circumstances. No scientific basis exists for deciding what steps towards institutional improvement should come first or receive most support: is it civil service reform? Electoral reform? Corporate governance reform? If a system of open and rule-based institutions is crucial, a comprehensive approach to institution building might seem advisable. It may not be possible to make much progress on one dimension of the system without progress on the others. Then again, if certain individual institutions matter the most, focusing resources would make more sense than a scattershot of governance reforms, as the international development agencies often mandate (Grindle 2007). But if selectivity is the appropriate strategy for development assistance, what institutions are the right entry points? Should donors work opportunistically with williing partners? Or should they be less random in choosing which institutions to support? The answers to these questions probably vary among countries because attitudes and experiences are never the same.

Then there is a dilemma about how far and how fast to push Weberian institutional logic at the cost of disrupting informal clientelistic networks. No standards exist for how to identify the 'governance break-even point' in a country, where the cost of fighting cronyism and other unwritten practices equals the social and economic gains from open governance. Our current understanding of institutions provides only a vague outline for making this trade-off. The costs and benefits, moreover, are constantly changing. What works well enough in one period may prove maladaptive in another period, when expectations are different. In any case, getting the reforms through is not a technocratic enterprise that can take place above the turmoil of domestic politics.

Given that good governance has many dimensions that go beyond the narrowly economic, Western donors will continue to encourage aid recipients to set up transparent, accountable and participatory institutions.

They should be wary, however, of fixating on a one-dimensional view of development and holding out unrealistic expectations for institutional change, economic growth and poverty reduction. Governance reform is a dynamic and socially embedded process, which, the four cases remind us, seems to move forward irregularly. Even after years, supposedly improved civic institutions may not produce perceptibly more efficient governance or many 'development dividends'.

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Chapter 7
'Poor governance' for development in China and Vietnam

Martin Painter

China and Vietnam are both transition economies ruled by Communist Parties. Both governments score poorly on 'good governance' indices while experiencing rapid economic development. While administrative reform has been high on the agenda in both countries, the motives are unclear and the results mixed. Progress on issues such as anti-corruption, creation of a merit-based civil service and development of a service culture is disappointing.

The main argument of this chapter is that the incidence and persistence of poor governance are best seen as pragmatic responses to the problems of transition and development. Home-grown commercialization of public services is a good example of this strategy. Contemporary China and Vietnam have strong development records although good governance reform has not been the top priority. This is not the same as saying that good governance in itself is not a desirable objective as it is, nor is it to deny that some reformers in China and Vietnam share this view (at least as a long-run strategy). However, governance reforms are best seen as measures to mitigate the adverse consequences of successful development, not as a precursor to such development.

Good governance and development

This section reviews the literature on the ambiguous connections between good governance and development. Governance has been defined broadly as 'the traditions and institutions by which authority in a country is exercised' (Kaufmann, Kraay and Zoido-Lobaton 1999: 1). For the Asian

Development Bank (1998: 16), governance is 'the manner in which power is exercised in the management of a country's social and economic resources for development'. In the 'quality of government' (QoG) discourse, it is associated with some key institutions; for example, 'Good governance is epitomized by predictable, open and enlightened policymaking (that is, transparent processes); a bureaucracy imbued with professional ethos; an executive arm of government accountable for its actions; a strong civil society participating in public affairs; and all behaving under the rule of law' (World Bank 1994). For Rothstein and Teorell (2008: 165), 'the impartiality of institutions that exercise government authority' is central.

Enthusiasm for governance reform has both ideological and empirical foundations. It can be seen as a doctrinal distillation of an imagined, ostensibly common, Western, liberal democratic historical experience (Painter 2002). It often presumes a universal trajectory and common objective of development in which acquiring good governance is necessary. In practice, however, such a trajectory was not a universal part of the Western historical experience, while good and bad governance institutions and practices still coexist in developed countries today (Brinkerhoff and Goldsmith 2005).

Measures to specify testable QoG features and their correlations with development have been developed. The indices include 'voice and accountability', 'rule of law', 'control of corruption', 'regulatory quality' and the like. Various cross-national studies imply such attributes are associated with high growth, high income and well-being. But even where the data are objective (many studies of the correlations with developmental outcomes rely on country data drawn from subjective perception surveys), most such studies suffer from the possibility of 'unseen joint effects' and 'endogeneity or reverse causation' (Goldsmith 2007: 167). They also ignore the exceptions and anomalies.

Some measures – for example, the World Bank's Government Effectiveness and Rule of Law Indices and Transparency International's Corruptions Perception Index – are highly inter-correlated and 'have positive but surprisingly weak correlations with economic growth, while the correlation with GDP per capita is very strong', implying that 'the causality between economic growth and QoG is more like a "virtuous circle"' (Holmberg, Rothstein and Nasiritousi 2008: 19).

No clear lessons can be drawn about causation or sequencing though the institutional and developmental trajectories appear intertwined. These findings provide no firm basis for any set of good governance reforms as a prerequisite for development. Grouping a range of good governance

attributes and positive correlations with various desirable outcomes does not identify 'what is essential and what's not, what should come first and what should follow' (Grindle 2004: 526).

Nevertheless, the search for temporal as well as logical relationships between good governance and development is a strong feature of discussions about reform strategies in the international public administration and development community, where there is often a concern for 'what should come first'. Here, the possible detrimental effects of overzealous adoption of some new public management (NPM) ideas provide a good example. Allen Schick's (1998) 'correct sequencing' argument holds that developing countries need a neutral, professional, centralized, rule-bound Weberian-style bureaucracy and basic public sector budgeting and accounting procedures before introducing more decentralized, market-like models of public service delivery. The World Bank (2004: 194) has also advised 'choosing and sequencing public sector reforms carefully, in line with initial capacities, to create firmer ground for further reform'. In general, '[f]irst stage reforms' should try to achieve or strengthen 'formality, discipline and compliance with the rules', while second-stage reforms – after a 'formality threshold' has been reached – should 'strengthen flexibility, discretion and a focus on results'. For example, for civil service reform, 'first-stage reform' requires 'creat[ing] a legally defined cadre with common terms and conditions', after which 'second-stage' reforms – such as 'devolve[ing] and diversify[ing] pay arrangements to provide flexibility to employers' – can be introduced (World Bank 2004: 194–6).

Reforms in China and Vietnam

This section looks at the public administration reforms in China and Vietnam in the context of global governance reform prescriptions. It is clear from this analysis that, with some qualifications, the trajectory of change has been due to imperatives and priorities for which good governance models are of limited relevance. This section offers a case study of public service delivery reform suggestive of NPM. A 'transition-specific' reform logic and agenda to use the market to accelerate growth, not to improve governance, have emerged, resulting in a decline in some governance standards. China began its 'reforms' from the late 1970s, some years before Vietnam, which launched its *doi moi* 'renovation' programme in 1986. Both countries have embarked on marketization of their economies. The scope of state sector reforms has been far-reaching – dismantling the command economy and

restructuring administration by creating new organizations, legal reforms and market regulations.

The basic challenge has been how to construct new state capacity while pursuing marketization. Despite some differences in emphasis and implementation between the two countries, there are strong similarities in prioritization and sequencing of public sector reforms. A concise stylized account follows:

1 *Administrative downsizing and reorganization* were early priorities to dismantle the command economy. Departmental reorganizing and restructuring have been a continuing process, particularly in China. In both countries, bureaucratic politics have been associated with gaining or losing status in the administrative and political hierarchy. Creation of 'super-departments' and new regulatory organs have appeared, while existing ministries and departments have been forced to focus on regulation and coordination, instead of direct economic micromanagement (Dong, Christensen and Painter 2010; Luo 2003; Ngok and Chan 2003; Ngok and Zhu 2007; Painter 2003a; Yang 2004).
2 *State-owned enterprises* (SOEs) have been restructured to act more or less autonomously in the market as commercial entities. A growing number have been gradually 'equitized', 'socialized' or 'privatized'. Other significant changes include freeing enterprises from the bureaucratic controls of state management. Subsidies have been reduced, although many SOEs still have privileged access to loans, land and administrative approvals. Regulation and coordination are now done by other, more indirect means (Broadman 2001; Fforde 2005; Li 2004; OECD 2005; Painter 2003b; Yang 2004).
3 *Marketization of public services*, requiring enterprises and service delivery units to charge user fees and compete for customers, has been introduced in both countries alongside SOE reforms. Education and health in China and, to a lesser extent, in Vietnam are increasingly commercialized, managed and provided by lightly regulated quasi-state, quasi-private entities, and funded by fees and charges, rather than by budget allocations. Much of this process has not been carefully designed, although reformers have paid lip service to NPM and other reform fads (Gu and Zhang 2006; London 2006; Mok and Painter 2007).
4 *Decentralization* has allowed sub-national levels of government to acquire new resources. Effectively, local governments now 'look to the market' for revenue, rather than rely on central budgets or taxes, as a result of which (if successful), they have gained autonomy (Duckett 2001; Lu 2000; Mountfield and Wong 2005; Painter 2008).

5 *Budgeting* has become more transparent, and *financial management* more oriented to delivery. World Bank and OECD 'best practices' have become more influential. But budget opacity and data unreliability remain major problems. Tax administration reform remains a major priority in China and Vietnam. Financial management devolution has been driven by shifting the administrative and financial burden to local units, and thus (via fees and charges) to the client or customer. Periods of 'turning a blind eye' to informal off-budget activities are interspersed by clampdowns to check abuses (Lu 2000; Wedeman 2000; World Bank 2005b).

6 *Personnel management reform* aimed at creating a more professional, rule-regarding and output-focused body of public officials has involved new regulations to formalize public employment. Meanwhile, the ruling Communist Party remains in control of the appointment and promotion of all public officials in both China and Vietnam. 'Expertise' is valued, especially at senior levels, with upgraded qualification requirements and criteria for promotion that increasingly combine technical with political qualifications. But patronage and underemployment persist, with bloated payrolls including staff not clear about their public service duties or obligations. Salary reform has 'monetized' remuneration, but reward may not be well linked to performance (Burns 1993, 2001; Chan 2004; Lam and Chan 1996; OECD 2005; Painter 2003a, 2006).

7 *Rule by law* has required new laws, ordinances, circulars and other legal documents to regulate a growing non-state sector. Such legal reform tries to build administrative and state capacity on the basis of legality. Political mobilization through Party-state rule is insufficient, as citizens have greater autonomy in a market economy. Due process and legality are also meant for more reliable administrative controls *within* the state under Party leadership – for example, between levels of government. New laws seek to check the ability of local bosses to arbitrarily 'govern by decree'. *Judicial reform* has resulted in growing professionalization of the judiciary. However, the Party in both China and Vietnam has not significantly loosened its grip on legislators or judicial officers. 'Rule by law' does not coincide with Western notions of 'rule of law' (Gillespie 2005, 2006; Gillespie and Nicholson 2005; Peerenboom 2004).

8 *Regulatory* or legal and institutional reform steps have reduced unnecessary controls on the private sector associated with the old 'permissions' culture. Administrative procedures remain burdensome and are only being reformed slowly. Even if rendered irrelevant, they reappear in another form as administrative units seek to retain control.

'Service culture' has improved with more 'customer-friendly' forms of access and delivery, such as 'one-stop shops'.

9. *Anti-corruption* campaigns have used existing inspection and enforcement machinery (including Soviet-style inspectorates) along with citizen complaints mechanisms. Such campaigns target Party officials and may result in heavy punishment. While posing a real challenge to Party-state legitimacy, systemic corruption within the Party remains unresolved. Such corruption is largely associated with the participation of officials in private businesses based on the privatization of state assets or abuses of state powers. The Party will not accept external oversight, and continues to manage and control anti-corruption campaigns, including new anti-corruption bodies (Gillespie 2002; Gong 2006, 2008).
10. Steps for *grass-roots accountability* have sought to make local officials more accountable to their citizens and to promote transparency. Serious protests against abuse of state power by corrupt officials prompted 'grass-roots democracy' measures that encouraged citizens' participation in local administration and direct elections. These measures have been implemented and managed by 'people's organizations' directly associated with the Party (Foster 2005; Levy 2003; Li 2002; Oi and Rozelle 2000; Pastor and Tan 2000; Zingerli 2004).

Although not exhaustive, this list encompasses the most significant areas of reform and change. The reform agenda is comprehensive and given high priority, with frequent new measures by the top leadership.

There appear to be many similarities between the issues prominent in China and Vietnam, and those significant in other countries. The reform discourse reflects NPM reform themes such as privatization, deregulation, devolution and transparency. But the combination of items on the local reform agenda and the manner in which they are conceived, rationalized and implemented follow their own logic. From a good governance perspective, there are contradictions: for example, politicization continues to trump impartiality and legality at many crucial points; 'grass-roots democracy' is strictly limited by Party controls; considerations of service quality, accountability and access are swamped by reliance on badly regulated markets; and so on.

Indeed, the outcomes do not show steady or significant improvement in key good governance practices. Implementation gaps and shortfalls are greatest where deficiencies are most glaring – for example, failures in the anti-corruption field and in regulatory reform, the realization that behind

the 'rule by law' remains the hand of the Party in controlling the state and managing the judiciary, and the continuing absence, for the most part, of a service culture in a professional, merit-based civil service.

None of this is particularly surprising. For example, dismantling the command economy gives 'downsizing' a different meaning in China and Vietnam; likewise, while 'deregulation' and 'reregulation' are familiar themes in the West, there is no parallel with the regulatory task confronting governments in China and Vietnam seeking to create governed markets, rather than just 'tweaking' existing ones. Similarly, taken-for-granted building blocks of administrative capacity, the subject of reform in the West (e.g. to make them more 'customer-friendly'), may be absent to begin with.

In this context, the reforms described above have their own logic when viewed in context and in combination. The events set in train by the decision to hasten the creation of markets produced circumstances, including unintended consequences, that have shaped what has been feasible. Where convenient and appropriate, reformers have called on external models, such as NPM, to support the changes, but just as often, they have found their own 'home-grown' rationales.

Devolution and local power

The rest of this chapter considers the privatization of public service delivery as one such field of reform, where a mix of local circumstances, overseas models and home-grown solutions has driven the agenda. This section sets out the context of the changing role of the state during the transition before analysing service delivery reforms. The state has devolved in two senses: first, many state entities have been 'pushed into the market'; second, this has led to growing dispersal of power within the state. Rocca (2003: 14–15) refers to the 'societalization' of the unified, centralized socialist state.

Instead of transforming society from 'above' or 'outside', the state has become involved in dealing with the societal consequences of marketization, including new legitimacy challenges. One consequence has been more opportunistic behaviour by public officials as market actors. First acting from *within* the state, many public officials have new economic and political roles *beyond* the state as they participate and benefit in the market economy. Informal, illicit and illegal uses of state power and resources to facilitate economic accumulation have typically taken advantage of official state restructuring initiatives. State capacity in regulating society and market has

been weakened by these moves as administrative reforms have sought to strengthen it. 'Reform' has often been captured by local leaders for their own purposes, creating new challenges for the central government, both to control local development and to respond to widespread public discontent over corruption and abuses of power.

Devolution has also entailed increased powers for sub-national government. There has been a trend in both countries towards a greater sub-national share of service delivery and expenditure. First, state enterprises and collectives shifted the burden of welfare provision to local government, and with rising incomes and aspirations, the demand for public services has also risen. With the growing weakness of the centre in regulating local government behaviour, regulation and management of local economic development has also largely become the responsibility of local government. In China, sub-national expenditures rose following the economic reforms of the 1980s, stimulating rapid growth of local bureaucracies.

As the tax capacity of local governments has not kept up, local governments are increasingly relying on 'extra-budgetary' sources. New fees, charges, levies and fines were imposed, many of dubious legality (Bernstein and Lu 2003: 107–9), resulting in the rise of extra-budget and illicit off-budget revenues and expenditures (Mountfield and Wong 2005: 98). Such revenues were tapped through discretionary local powers, often used to reward local officials with jobs, bonuses and other benefits (Bernstein and Lu 2003: 84–6; Gong 2006; Wedeman 2000). The boundaries between 'legal' and 'illegal' fees were blurred, with more discretion, weak regulation and system abuse (Bernstein and Lu 2003) as local audit and tax offices overlooked irregularities (Oi 1999: 153–9), and clampdowns by the centre did not always achieve the intended results.

Increased off-budget activity has been directly associated with the autonomization of existing and new service delivery, creating new opportunities for employment, enterprise and profit without having to rely on state budgets. Many new social organizations under state sponsorship and regulation perform 'state-like' functions. Thus, the state has created a variety of new 'hybrids', mainly for profit (Duckett 1998; Benewick, Tong and Howell 2004). Thus, public service delivery has shifted almost entirely to this 'quasi-state' sector.

The nature of the administrative and structural arrangements has shaped new administrative forms emerging with the informalization of quasi-public local finances. Reshaping public administration organization in both China and Vietnam has had three components: (1) administrative agencies involved in 'state management' (ministries and departments), (2) service

delivery units (e.g. public hospitals) and (3) enterprises. Here, we focus mainly on the second category.

State reform has involved a mix of informal, bottom-up, local initiatives with top-down encouragement (World Bank 2005a). Bottom-up pressures came from employees, particularly technical and professional personnel seeking more secure jobs and higher incomes. In both countries, official remuneration for public employees was widely seen as inadequate, to be supplemented by other income (Painter 2006). Even before the new regulations requiring greater self-reliance, local service delivery units had to find their own resources to top up official salaries with supplementary charges on consumers of services or by running businesses on the side (Lam and Perry 2001: 26–7; Painter 2006). Professional employees in China have been permitted to provide fee-paying services to clients while retaining their official positions. In many ways, autonomization simply formalized what was already happening 'off budget' (Painter 2006).

Governance and service delivery

For Schick (1998) and others, with service delivery marketization and flexible reward arrangements, NPM has trumped good governance. This argument might go as follows: reward and incentive schemes for public sector workers and professionals are not just remuneration packages but also instil and reinforce norms and standards. They can be important for capacity building for governance reform. For the Weberian bureaucratic ideal type, provision of a standardized package of rewards to office-holders and functionaries is based on objective qualifications of merit, separating the office from the person, and aligning individual job and career incentives with organizational and service objectives, including public norms and practices.

In the situations that have evolved in the public service delivery sector in China and Vietnam, pay, tenure and other conditions of service are dependent on both market incomes and budgetary funding. Remuneration has come to depend less on efficient performance of official duties and more on available income-generating activities. Local-level patrimonialism, based on access to and control of organizational resources, has developed, involving highly fragmented, localized employment arrangements, rather than a unified system. This situation has also created great potential for various forms of private appropriation of the public sector employee, that is, corruption.

It should be remembered how the Chinese and Vietnamese governments got to this situation. In Vietnam and China, the public discourse about development in a 'market economy with socialist characteristics' has legitimized the indiscriminate quasi-privatization of public services at the local level. With the transition, a new conception of the state emerged as one of manager/funder, that is, no longer provider/producer. The distinction between state management on the one hand and production on the other emerged, with the former role akin to 'control and steering' as provision or production became seen as purely commercial or technical. The distinction has had the same meaning and consequences for autonomization of both SOEs and service delivery agencies, both viewed as production units (GSC 2000c: 8). Unlike old-style 'begging and giving' (or state subsidy), party leaders urged enterprises to rely, for their survival and expansion, on profits, while public service delivery agencies should mobilize 'people's resources' (GSC 2000a: 15).

'Socialization' is the term used for co-financing and co-production of public services, instead of the worldwide term 'privatization', and in fact, the denial is deliberate.

> The stance and viewpoint of Vietnam is that socialization of some activities in the public sector, as well as equitization of a proportion of SOEs, *can be by no means considered as privatization*. Socialization will be conducted under the principle that 'the work is shared between the State and the people', and the State will take the principal role, exercising State management functions. (GSC 2000b: 18, italics added)

Significantly, the 'people's resources' have been defined individually as well as collectively. Particularly at the local (commune or ward) level, there was a tradition of in-kind provision of household labour and other resources for public works. By extension, the expectation developed that each household would contribute a portion of its income in the form of fees to fund public services. The application of a 'user pays' logic also flowed directly from the 'salarization' of in-kind benefits under post-socialist salary reforms: once this occurred, in principle, households had the means to pay for previously free benefits (Painter 2006). To sum up, the quasi-marketization of service production and delivery was not only a matter of pragmatic convenience but also a logical extension of the wider market reform agenda. Much of it was spontaneous.

Paradoxically, emergent home-grown doctrines of socialist reform and renovation were more important as sources of ideas to rationalize these changes than neoliberal NPM-style, foreign models of privatization. Key to the reform process was that the issue of public services was defined first and foremost in production rather than consumption terms. Access and equity questions, of the kind inherent in considering 'public goods', were sidelined, as were basic 'consumer protection' provisions of the kind competitive market reform might include. Expanding production would, thus, involve new forms of self-sufficiency in a market context and more flexible management arrangements within a lightly regulated environment which would not restrain local initiative and enterprise.

Conclusion

In both countries, a commonly expressed metaphor to describe the reform approach in the transition era is 'crossing the river by feeling the stones'. Public service delivery reforms were about pragmatically addressing dilemmas of the transition from the command economy. An emerging 'middle class' demanded access to higher quality public services. To meet this demand, autonomization and commercialization were encouraged, as public finances were inadequate for the task, and this also solved the problem of paying wages and meeting other service costs. These developments suited local elites, giving new opportunities for patronage and profit. A distinctive transition vocabulary – 'socialization' and 'self-sufficiency' – was used to legitimize the reforms as well as 'imported foreign' policy reforms such as NPM. The 'poor governance' implications have been viewed, by and large, as unavoidable for economic development.

This is not to say that foreign experiences of privatization and welfare reform were not studied, but it is clear that many lessons from such experiences were ignored. Most Western commentators on the Chinese and Vietnamese reforms have invoked similar criticisms of 'poor sequencing' (echoing Schick's critique): devolution, autonomization and commercialization were encouraged before basic regulation and policy coordination were in place; personnel management was deregulated before new public employment laws and regulations were adopted; reformed public financial management was approved without adequate accounting controls and auditing; regulation and coordination of service

access, affordability and quality were deferred, leading inexorably to service deficiencies; and so on.

Remedial measures by the Chinese and Vietnamese governments have been of three types: first, to deal with accountability at the 'grass-roots' level; second, to address some 'market failures' of privatized systems through regulatory and financial reforms; and third, to redefine the respective roles of central and local governments. These responses reflected the need to sustain Party legitimacy in the face of citizen dissatisfaction. In both Vietnam and China, pre-existing citizen complaint mechanisms have been strengthened, providing mechanisms for monitoring and checking abuses by local officials, while giving local victims safety valves for their grievances. Elected representatives are closely monitored and integrated into existing administrative hierarchies.

To directly address service delivery market failures and to improve funding for local governments, the central government in China has articulated principles about the 'welfare' role of government in ensuring certain basic minimum standards and redressing inequalities. This has involved new rhetoric about inclusive growth and building a 'harmonious society', which deliberately echoes paternalistic Confucian doctrines. More financial support for infrastructure has been provided to rural local governments and to the western provinces together with tougher regulation of fees and charges and curbs on some forms of privatization. The pace of privatization may be slowed, while the state's role – as basic provider, regulator and guarantor – is being reassessed (Mok and Painter 2007).

Broader capacity-building processes – such as civil service reform, strengthening legality and developing a service culture – proceed more slowly, constrained by circumstances. The adverse consequences of the rush to unregulated marketization have offered important lessons. Other reform agendas may now gain more urgent attention, as they are interconnected. As markets in health and education to stimulate supply have developed, the harmful effects have generated greater interest in better regulation and more effective public accountability. Market forces may thus stimulate demand for good governance. Angry purchasers of expensive fake drugs and dubious college degrees have demanded measures to enforce standards, while higher quality suppliers want to restore public confidence in the industry. Better governance may thus emerge once people appreciate, from bitter experience, the adverse consequences of badly governed markets for the quality of public goods – as in the West. In sum, good governance can come later.

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Chapter 8
Beyond good governance: An agenda for developmental governance

Mushtaq H. Khan

The limitations of the good governance agenda are well reviewed in the rest of this book. The empirical relationship between improvements in the governance capabilities identified in the good governance agenda and the achievement of accelerated economic growth has not been established. There is a weak relationship identified in some regression exercises, but the strength of the relationship is weak at best. The arithmetic results suggest that the additional growth achievable through feasible improvements in good governance is limited. Deriving important policy conclusions from the results of weak multi-country regression results is also problematic for other reasons. For one thing, given the two-way causality that exists between good governance capabilities and economic growth, econometric tests are imperfect in identifying the strength of the relationship in one direction. More significantly, supporters of the good governance reform agenda have failed to identify convincing case studies of countries that actually made a significant economic transformation (from poverty to high standards of living), primarily by following the agenda that they propose. Even if we accept that achievable improvements in good governance capabilities in developing countries could result in *some* improvements in growth and development, this does not establish that these improvements will be sufficient for achieving a developmental transformation. The case study and statistical evidence actually supports the importance of governance, but suggests that a different set of governance capabilities were important. Countries that achieved significant developmental transitions in the past 50 years had strong governance capabilities, but none of them would have scored highly in terms of 'good governance' when their take-offs began or for a considerable period thereafter. Rather, they had governance capabilities

for addressing specific problems, such as overcoming constraints limiting technology acquisition, solving problems in allocating valuable resources such as land and maintaining political stability within tolerable limits. We describe these capabilities as developmental or growth-enhancing governance capabilities.

The exclusive emphasis in policy and analysis on 'good governance' capabilities is symptomatic of a deeper bias in contemporary economic policy and research. Economists agree that there are many reasons why private contracting cannot solve many important economic problems. These reasons explain a range of market failures constraining growth and development. It would be inappropriate to suggest that institutional and policy interventions could achieve *all* the beneficial outcomes that private contracting failed to achieve. But the opposing position, which dominates in contemporary research and policy, is also inappropriate. This position is that the role of policy should be to focus solely on improving market efficiency so that private contracting could solve these problems. Governance reforms of the 'good governance' variety are essentially attempts to build state capabilities for enforcing the rule of law and property rights so that private contracting can take over and market failures will then disappear by definition. One danger of this approach is that it assumes that significant improvements in contracting efficiency are possible in developing countries. All the evidence suggests that such significant improvements are not achievable for structural reasons. This is why successful development has depended on critical public agencies with capabilities to assist in the solution of a small number of critical market failures. The contemporary approach to governance ignores the importance of these developmental governance capabilities that have been critical for triggering and sustaining growth in developing countries.

The types of market failures that may constrain growth can be identified by looking at the policies that have been important for sustaining growth in developing countries. The Growth Report of the Commission on Growth and Development (2008) summarizes the state of knowledge in this area. The Growth Report takes care to point out that growth is a complex process involving experimentation and the ability to respond to evolving problems. It rightly points out that there is no blueprint of necessary and sufficient conditions that can be identified, and responses that are appropriate at one stage of development may become a problem if continued for too long. Nevertheless, the report identifies five broad areas where *policy* appears to have been important for achieving sustained high growth in the post-war period. These policies were not only about enabling markets to address

particular problems but also correcting market failures when private contracting on its own was insufficient.

A first broad group of policies were important for supporting high levels of accumulation. A second group of policies promoted innovation and imitation, and accelerated or sustained the technological catching up that development involves. A third group of policies achieved macroeconomic stabilization. A fourth set of policies ensured the effective allocation of land, labour and capital. And finally, there were policies that ensured social inclusion and were important not only for achieving developmental goals but also for maintaining the political sustainability of the growth regime (Commission on Growth and Development 2008: 34). The report makes clear that countries used different policies and instruments to achieve these goals, and all countries did not perform equally strongly on all these fronts all the time. Nevertheless, sustained growth over long periods of time required policies that achieved a significant level of success on all these fronts.

These interconnected areas are broadly defined and cover the main issues relevant for understanding the growth process in developing countries. The debates over macroeconomic management have a separate literature and will not be examined further here. However, aspects of investment, technology acquisition, factor allocation and political stabilization are strongly interconnected with one another and with the institutional and political governance capabilities that are our focus. We argue that governance capabilities that support appropriate policies in these areas are critical for sustaining growth in developing countries. But as the Growth Commission report also sets out, there is considerable debate and empirical variation observed in the policies that achieved the outcomes that contributed to sustainable growth across countries. Successful countries addressed these problems in different ways, using different institutions and policies, but success required addressing a common set of problems.

Economic policy has been important for addressing a range of serious and sustained market failures that constrained performance in each of these areas. The market failures are broadly recognized, but the best way to respond to them seriously divides economists and policymakers. In recent years, the response to these market failures has been to focus on a narrow set of governance reforms that are aimed at enhancing the efficiency of markets and thereby reducing their extent and severity. These 'good governance' reforms are now well known, focusing on improving the enforcement of property rights, the rule of law, reducing corruption and improving the accountability of public officials. These governance reforms aim to achieve *market-enhancing* changes in the institutional environment rather than to

directly tackle the market failures that constrain accumulation, technology acquisition and other constraints on growth in developing countries (Khan 2007b, 2008a). If a market-enhancing governance strategy could actually make markets more efficient, private contracting would achieve all these goals and further policy attention would not be required.

While progress on market-enhancing governance capabilities is certainly desirable, the historical evidence suggests that progress along these directions is unlikely to be rapid or extensive in most developing countries for a number of structural reasons (Khan 2008a). As a result, sustaining growth in poor countries also requires governance capabilities and policies that directly address specific market failures. If particular solutions cannot be found to raise accumulation, accelerate technology acquisition and address other constraints in ways that are effective for that country, it is unlikely that growth will be sustained. These specific governance capabilities may be described as *growth-enhancing* or *developmental* governance capabilities to distinguish them from general market-enhancing governance capabilities. Our hypothesis is that by accident or design, successful countries had a number of governance characteristics that enabled them to implement policies to overcome critical market failures constraining growth given their specific initial conditions.

The developmental governance capabilities that drove growth in the high-growth East Asian countries have been known for some time. But it is perhaps unfortunate that the discussion of developmental governance has been dominated by the experience of industrial policy regimes in North-East Asia (e.g. Amsden 1989; Wade 1990). While these regimes were indeed developmental, the problem paradoxically was that their developmental governance capabilities were very strong, making it less likely that they could serve as credible role models for other countries whose internal political organization and initial conditions made it less likely that they would be able to follow these strategies. The more recent growth experiences in South and South-East Asia and in Africa appear to be driven to a much greater extent by 'market forces'. In fact, the North-East Asian countries were also market economies which grew by taking advantage of global market opportunities. The greater role of 'market forces' in the growth experiences of South and South-East Asian countries in the 1980s and beyond implies that there appear to have been less significant government interventions in these countries.

In reality, the picture is, of course, more complex. The role of the state has been less direct in South and South-East Asia, and technological progress in the 1980s and beyond has indeed been driven by private sector

firms relying on market contracts to a greater extent. But their existing capabilities were themselves very often the result of past capability-building programmes where governments were closely involved. Also, the strategies of private sector firms in driving capability development in critical growth sectors depended on business–government relationships that enabled the leading firms to address particular market failures. The emergence of the automobile and pharmaceutical sectors in India or the garments industry in Bangladesh are examples (Khan 2009b). It is important not to misread this history as one of purely market-driven growth. The critical sectors that drove growth in these countries would not have developed if important market failures had not been addressed through very specific solutions. It is important for developing countries to continue to ask themselves where further capabilities and globally competitive firms may be coming from to spread growth to new sectors and regions.

Fortuitous global conditions and business–government relationships may have allowed the development of critical new technological capabilities in a few sectors in a few countries. Behind the scenes, their growth strategies worked because the appropriate developmental governance capabilities effectively existed. But to drive growth into new sectors and to sustain growth, an analysis of the governance capabilities that were responsible for driving growth in these sectors is necessary so that these examples of success can be replicated across other sectors and regions within these countries. The challenge of developing growth-enhancing governance capabilities is therefore not about attempting to replicate the institutional and policy experience of North-East Asian countries but rather to better understand the drivers of growth in certain developing countries so that their own developmental governance capabilities can be identified, built up and strengthened to sustain growth. In particular, where accidental business–government relationships drove growth, it is especially important to identify how particular government failures were addressed, so that more formal and directed policies and capabilities can be developed for other sectors.

The next section examines the roots of the 'market-enhancing' good governance agenda. The following section summarizes the evidence that casts doubt on the relevance of this policy agenda for developing countries. The section after that looks at the alternative developmental or 'growth-enhancing' governance agenda, and explains the importance of understanding the experience of growth in particular countries through this lens. The example of the Bangladeshi garment industry is used as an illustration to show how an alternative reading of history can suggest a different set of governance challenges for developing countries.

The emergence of the market-enhancing governance agenda

Developing countries have long known about market failures and why opening up to markets is desirable but does not guarantee the achievement of competitiveness. The distinction between competition and competitiveness lies at the heart of many of the policy challenges facing developing countries. The ability to compete in global markets is an essential condition for sustaining growth. And for this, access to global markets and eventually openness to market competition are also essential. However, while competitiveness is indeed critical, opening up domestic markets and exposing domestic producers to the discipline of global markets will not necessarily achieve competitiveness unless domestic producers are already close to the global competitiveness frontier. Nor will access to markets necessarily allow domestic producers to make the relevant contracts to ensure that their productivity is improved to globally competitive levels. This is because markets in developing countries are likely to suffer from significant transaction costs which, in turn, are observed as market failures. The adoption of free markets *in the presence of market failures* will not ensure that currently backward domestic producers can contract to achieve competitiveness in global markets. Under these conditions, low wages are no guarantee of inward capital flows or investments by domestic investors in ways that achieve competitiveness in critical sectors that can lift up average standards of living in the country. Indeed, the historical experience has been that the adoption of free-market strategies in the presence of market failures can lead to a collapse of domestic productive capacity rather than its rapid improvement, particularly when domestic producers are distant from the global technology frontier.

Far from achieving convergence with more advanced countries, the colonial history of most developing countries was one of growing divergence between themselves and advanced countries after colonial trade policies were imposed on them. For instance, from 1873 to 1947, Indian per capita income declined from around 25 per cent to under 10 per cent of the US level (Clark and Wolcott 2002). This happened during a period of virtual free trade as average tariffs were under 5 per cent of trade values during most of this period. This was also a period of relatively strong protection of the rights of foreign (British) investors and virtually no restrictions on the repatriation of capital and profit. The proximate cause of this relative decline was simply that it was not profitable to invest in modern manufacturing or agriculture in India. The productivity of Indian workers was so low that low

wages did not give India a competitive advantage in almost any industry. This problem remains today for most sectors in most developing countries.

The persistence of low productivity is a puzzle because this problem should be solved by long-term private investments in upskilling and training of workers and managers. Given the wage differentials, the promise of significant future profits should induce private investors to invest in capability development in developing countries. But the puzzle disappears when we look at the significant market failures in capital, land and labour markets that prevent productivity-raising contracts being credible (Khan 2009b). Without any corrective strategies to overcome these market failures, the only areas that are likely to grow in poor free-market economies are sectors that have already achieved international competitiveness. These are typically low technology sectors where the productivity gap with more advanced competitors is likely to be low and the wage differential can more than compensate for this. But these sectors are also typically only capable of adding limited value to the domestic economy. Moreover, the pathways up the value chain from these low technology sectors may also be blocked if the market failures constraining capability development are not addressed.

The challenge of development is that in most developing countries, there are very few sectors that have already achieved or are close to levels of international competitiveness. The rapid growth that some developing countries have experienced in recent years can be traced to their achievement of global competitiveness in a few sectors like garments and textiles, cut flowers, toy and shoe manufacturing or food processing and packaging. A few other developing countries like India have achieved global competitiveness in a small number of high technology sectors like software, pharmaceuticals, iron and steel and automobiles. When we look at these success stories, we find that in each case, global capabilities were built up through very specific processes that overcame critical market failures. In many cases, initial capabilities were developed under earlier policies that may not have been very successful across the board but did develop capabilities in pockets. Many of these high capability sectors then led growth during the 1980s and beyond. Nevertheless the challenge of replication and spread remains for most of the economy, even in relatively successful developing countries.

The market-enhancing approach in addressing market failures has to be understood in the historical context of previous attempts to address these issues in developing countries. At the end of colonial rule, the initial response in many developing countries was to address market failures constraining technology acquisition using a variety of direct interventions

that sought to build capabilities by protecting infant industries. These policies included import protection, the promotion of public sector industries in new technologically advanced sectors, licensing the use of foreign exchange to reduce the cost of investments in new sectors and so on. In general, these policies provided subsidies to investors in new sectors to compensate for temporary backwardness and the high costs of organizing investments, given market failures in capital, land and other markets. Such interventions were common in the 1950s and 1960s as developing countries attempted to reverse their performance under colonialism by developing infant industries in new higher technology sectors.

Early strategies of promoting infant industries were disappointing in many developing countries. One problem was that given their capabilities, the scope of policy was too broadly defined. Even to effectively address a narrower range of issues, governance capabilities would have to be developed in many cases to manage these interventions and prevent policy-induced rents being captured by unproductive firms and entrepreneurs. In most developing countries, these capabilities were not remotely sufficient to enforce the requirements for success. While there were some attempts to improve these governance capabilities, their importance was not sufficiently recognized at the time. In their absence, interventions to correct market failures often resulted in poor outcomes. Infant industries refused to grow up, subsidies were captured by powerful groups, and public sector enterprises underperformed with rents dissipated in over-employment and other forms of inefficiency. Clearly, providing implicit subsidies was not enough without incentives and compulsions, based on appropriate institutional design and governance capabilities, to enforce rules to ensure that interventions to correct market failures had a positive net effect.

The response to this experience should have been to conclude that perhaps the range of interventions needed to be scaled back to only target critical market failures, and that appropriate governance capabilities needed to be developed to ensure the success of these interventions. Instead, the response from the late 1970s onwards was to abandon corrective strategies in their entirety. The perception was that the 'government failures' that had resulted from these interventions were worse than the market failures they had set out to correct (Krueger 1990). Liberalization to get rid of these failing interventions began to gain currency, particularly because in many developing countries, state interventions were indeed very inefficient and often resulted in net reductions of welfare. But it soon became clear that liberalization itself required governance capabilities. Markets required not an absence of government, but actually required very strong and effective

governance to enforce property rights, maintain a rule of law and create other regulatory conditions that would allow private contracting to work effectively. And so, governance entered mainstream policy discussions as part of a strategy of promoting markets and creating the 'level playing field' for private contracting based on comparative advantage.

In theory, if the state could enforce these institutional rules, market transaction costs across the board would be low enough for market failures to disappear. This was the genesis of the theoretical economic case for good governance. All of the key capabilities within the good governance agenda were essentially about enforcing property rights and the rule of law effectively to make markets more efficient (Khan 2004, 2005a, 2008a). Other parts of the agenda, such as reducing corruption and making governments more accountable directly, fed into the goal of ensuring a rule of law and stable property rights. But in addition to the theoretical economic arguments, the good governance agenda became politically robust because, obviously, citizens in developing countries wanted these conditions as *ends in themselves*. After all, who wants to live in a society with high levels of corruption or poor rule of law? But for international agencies and analytical economists, the good governance capabilities were *means to an end*: the achievement of efficient markets in developing countries. The convergence of civil society demands and the analytical policy support of mainstream economists and policymakers contributed to make the good governance agenda unassailable for a long time.

The problem from the perspective of economic development was that the new strategy was, if anything, even more ambitious than the old one. For a developing country to do significantly better on good governance capabilities than its per capita income warrants appears to be quite difficult. There are obviously differences in good governance capabilities between developing countries, even at the same level of per capita incomes, but these differences are relatively small, particularly when we consider the standard errors inherent in numerical measures of governance capabilities. But governments can only ignore market failure and focus on good governance capabilities if they are assured of making significant progress on these capabilities. Indeed, they would have to make very significant progress in enforcing property rights and the rule of law if market failures are to effectively disappear. This is not only an ambitious expectation in developing countries, but it goes against all the historical evidence of what is possible and ignores important structural conditions that are likely to make these goals unachievable in any realistic timescale (Khan 2007a).

The most obvious structural constraint in the path of transforming poor countries in line with good governance expectations is that the protection and enforcement of property rights are expensive. When the majority of assets in a country are of low productivity, they are unlikely to have the collective capacity to pay for effective enforcement of property rights as a public good. The same goes for the enforcement of the rule of law. The historical evidence is that the enforcement of property rights and the rule of law are closely correlated with the average productivity of assets since it is the income generated by assets that ultimately has to pay for the enforcement of formal institutions. Clearly, differences among countries, for instance, in terms of how political groups are organized and how intensely the ownership of assets is contested, may affect the enforceability of rights and rule of law. Clearly too, the causality between the enforcement of rights and the productivity of assets goes in both directions, so slightly better enforcement of formal institutions can give a developing country an advantage. But it is unlikely for a poor country to achieve enforcement of the rule of law or of property rights that is significantly beyond its ability to pay for these public goods. Therefore, it is unlikely that a feasible improvement in the enforcement of property rights and the rule of law in a developing country will make it unnecessary to identify and respond to particular market failures.

For similar reasons, it is also unlikely that a developing country will be able to sustain a level of corruption that is significantly lower than other countries at a similar level of per capita income though there may be some differences due to country-specific differences in the organization of their politics (Khan 2001, 2002, 2006a, 2006b). It is not surprising that after much effort on anti-corruption campaigns, there has been little reduction in corruption on a sustained basis in developing countries. There are a number of reasons for this dismal performance, which should make us not more tolerant of corruption but certainly more careful in identifying priorities in anti-corruption strategies. The term 'corruption' describes a wide range of processes where public officials transgress formal rules of conduct for personal benefit. Like property rights and the rule of law, a large part of corruption is due to limited resource availability for enforcement. In addition, it is structurally difficult to legalize many rents in developing countries because the emerging capitalists who are the beneficiaries of these rents still lack legitimacy. In contrast, advanced countries also have significant rents, but these rents are largely legal and take the form of subsidies and transfers. As a result, the rent-seeking around these rents can also be legalized and regulated. If many rents cannot be legalized, the associated rent-seeking will

remain grey or illegal, making a significant part of rent-seeking structurally corrupt in developing countries. Over time, as the capitalist sector becomes established and legitimate, some corruption will disappear automatically as a greater proportion of rents become legitimate and legalized.

Most significantly, political corruption plays a structural role in developing countries, and it is important to understand the nature of and variations in these processes. Political stability in any country requires significant redistributive strategies. In advanced countries, a large part of national income is taxed and redistributed legally through formal fiscal processes as part of the political process of stabilization. As much as 40 per cent of national income is typically taxed and redistributed in these countries. The creation and allocation of these significant rents clearly results in significant amounts of rent-seeking, but this rent-seeking is legal and regulated, and part of the formal political process. In developing countries, political stability is not and cannot be achieved through formal redistribution in this way, largely for structural reasons. The number of taxpayers is too small, the tax take is therefore a much smaller percentage of national income, the demands for redistribution from different quarters is significantly in excess of the resources available and powerful groups are organized by elites who want redistribution to themselves and their groups. The general result is that politics in a typical developing country is personalized, based on constructing coalitions of the powerful who are given access to rents on a privileged basis to achieve a more or less sustainable ruling coalition (Khan 2005b, 2010). While there are significant differences among developing countries, and successful developing countries are gradually becoming rule-following democracies, the typical developing country violates rule-following norms in the very processes through which its ruling coalition is constructed. A significant improvement in capabilities to fight corruption is therefore unlikely until a social order can be constructed in rule-following ways; the development of a broad-based productive society is a necessary precondition for this.

These observations suggest that while progress in the direction of good governance is highly desirable, it is unlikely that developing countries can address their developmental problems solely by focusing on good governance. Indeed, the historical evidence does *not* support the argument that poor countries grew fast by first achieving significant improvements in their good governance capabilities (Khan 2007a, 2007b, 2008a). This is the basis of our distinction between two broadly defined governance reform strategies: the 'market-enhancing governance' (good governance) strategy that focuses on improving general market efficiency and contract

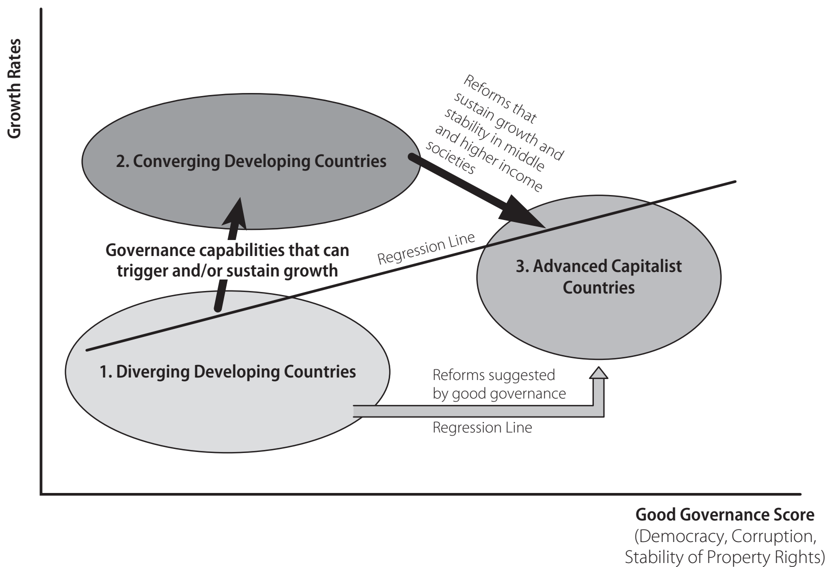
enforcement, and the *growth-enhancing* or *developmental governance* capabilities that allow specific market failures to be addressed (Khan 2007b). In one sense, the latter is less demanding because it requires a more limited set of capabilities in developing countries. But in another sense, building developmental governance capabilities is more demanding because there are no blueprints that are likely to be appropriate for every country. The market failures that are most important are different across developing countries depending on their initial conditions. But moreover, strategies that will work in some countries may not work in others because their initial political and institutional conditions are different and this matters for understanding the type of institutional solutions that are more likely to be effectively enforced. This is why we observe that successful countries used many different strategies for correcting market failures, and strategies that worked in one country often failed in another (Khan 2008a). This makes it particularly important for developing countries to understand these challenges and design programmes that can experiment with different solutions to identify approaches to critical market failures that are more likely to work in their specific conditions.

The evidence

It is clear that developing country economies score poorly on every aspect of good governance. Some of these countries do well and others do not, and the challenge is to test whether these very significant differences in performance can be attributed to the relatively small differences in their good governance scores. One problem of testing good governance strategies is that the data available are weak and only available from the 1990s (Arndt and Oman 2006).

However, on the basis of this weak data (based largely on aggregating subjective perceptions indicators) and the limited time over which the data are available, supporters of the good governance agenda have attempted to derive hard support for the good governance strategy using econometric approaches. The econometrics occasionally shows a weak positive relationship between good governance capabilities and growth. But these results are problematic on a number of grounds (Khan 2007b, 2008c). In particular, as Figure 8.1 shows, when we look at the data in a disaggregated way, high-growth (converging) developing countries appear to have the same mean governance scores and the same dispersion in these scores as slower growing (diverging) developing countries. This is consistent with extensive

Figure 8.1:
Good governance versus growth-enhancing governance



Source: Khan 2007a.

case study evidence of institutional and political conditions in East Asia and elsewhere, which suggests that high-growth countries did not *first* achieve improvements in good governance as a precondition for beginning their growth take-offs.

The positively sloped regression line ignores these significant patterns hidden in the data. Looking solely at the regression result appears to suggest that slow-growing developing countries should focus on good governance reforms to improve their growth rate. But even a snapshot look at the data suggests that the big differences among developing countries are not in their performance along good governance capabilities. They are likely to have significant differences in their governance capabilities, but these are clearly not along the dimensions measured by good governance capabilities. In any case, even if we accept (as we do) that other things being equal, a higher score on good governance is likely to have a positive effect on growth, the strength of the relationship is weak overall. Most regression analysis shows that the additional growth that *feasible* improvements in good governance can offer is limited (Kurtz and Schrank 2007). An additional one or two percentage points on the growth rate that feasible improvements in good governance could *theoretically* achieve do not promise a slow-growing

country a developmental future. And this is ignoring the fact that there is very likely a two-way causality between good governance scores and economic growth, and it is difficult to identify the true strength of the relationship in one direction using available econometric techniques. Deriving important policy conclusions from the results of this methodologically and empirically weak multi-country regression analysis is therefore problematic.

Given the limited support that cross-section data can provide, supporters of good governance policies (for instance, Kaufmann, Kraay and Mastruzzi 2007) have sought support in long-term econometric exercises using instrumental variables, for example, Acemoglu, Johnson and Robinson (2001, 2002). In their approach, instrumental variables correlated with settler colonialism are found to correlate with contemporary per capita incomes. The argument is that settler colonialism established stable property rights, and this explains the subsequent prosperity of these regions. But it is by no means clear that the instrumental variable approach proves that stable property rights were important for growth. Other factors were also correlated with the onset of settler colonialism, such as the higher levels of human capital that settlers had, compared to indigenous populations in non-settler societies (Glaeser *et al.* 2004). But far more significantly, a reading of history suggests that the period of economic transformation in settler colonies was one of significant and violent property rights disruptions (Khan 2009a). The economic transformation of settler colonies involved very significant transfers of assets from indigenous populations to new settlers. History tells us that settler colonialism did not *first* establish stable property rights that allowed efficient markets to achieve significant asset transfers from indigenous populations to more efficient users of their assets. Rather, settler colonialisms followed particularly violent paths of resolving property rights issues and, paradoxically, this allowed them to achieve property right transformations rapidly, though at very high human cost. Far from the examples that Acemoglu, Johnson and Robinson rely on to establish the importance of stable property rights, their examples are actually of countries that used significant violence to achieve transformations rapidly.

The econometrics of instrumental variables diverts attention from this far less attractive historical evidence that tells us that settler colonialism achieved very rapid success in transforming traditional societies because resistance from losers was violently and rapidly overcome (Khan 2009a). Successful productive transformations subsequently allowed the stabilization and protection of the new property rights of settlers over time. No one disputes the long-run relationship between productivity and property rights because

once assets become more productive, they can begin to pay for their effective protection and property rights are likely to be better protected. Nor can it be disputed that everything else being the same, if property rights can be better defined, there will be positive effects on time horizons, investments and contracts. The question is really about governance priorities during this difficult period of *transformation* that developing countries are going through when asset use and social organization are changing dramatically from traditional economies to modern productive ones.

We are concerned about the governance conditions that ensure a rapid and successful *process* of transformation, not the governance that emerges as an *outcome* at the end of the process. Acemoglu, Johnson and Robinson were attempting to demonstrate the governance conditions during or prior to this transition, not the property rights that emerge as a result of a successful transformation. But the historical facts show that they too confuse process with outcomes by relying on econometrics without asking historical questions. History tells us that settler colonial countries did not use efficient markets and contracts (and therefore good governance) to achieve this transformation. Rather, they used extreme force and violence and a disregard of the rights of indigenous populations to achieve rapid changes in resource allocation towards more productive uses. As models for contemporary developing countries, these are exactly the wrong models for politically acceptable developmental transformations. Thus, neither the cross-section econometrics using contemporary governance indicators nor the instrumental variable regressions provide convincing evidence that countries actually made a significant transition from poverty to prosperity by *first* achieving good governance capabilities as a precondition for the effective developmental transformations of their societies.

The contemporary data summarized in Figure 8.1, as well as case study data, suggest that converging developing countries did not achieve their high rates of growth by first achieving good governance capabilities (Khan 2007a, 2008a). However, we know that Group 2 countries in the figure include many different types of growth stories, some more sustainable than others. Some converging economies had significant growth-enhancing governance capabilities that allowed them to address important market failures across the economy. This allowed them not only to grow fast for a while but also to sustain this growth and spread it across the economy and make a sustained transition to prosperity. The North-East Asian countries were examples of countries with such governance capabilities. But other countries in the converging group are there because they have some sectors or regions or minerals which produce globally competitive products and

where business–government relationships have either consciously or accidentally developed to solve particular problems constraining growth.

This means that in many Group 2 countries, the governance capabilities that triggered and sustained growth were often based on very specific political and institutional arrangements that varied across countries, but nevertheless deliberately or accidentally addressed specific market failures. Despite differences across countries, institutional arrangements and governance capabilities worked only if they successfully addressed important market failures. In particular, there were broad types of problems that needed to be addressed, even if the solutions differed somewhat across countries. The viability of the growth process for converging developing countries depended on the effectiveness of these solutions and their sustainability given the political settlements within their societies. These countries face significant challenges in sustaining their growth by replicating their success across new sectors. A starting point is to analyse the factors that allowed growth in some sectors to be able to replicate and extend this growth across the economy. For the diverging countries, there is an even more difficult challenge of experimentation and effort in devising effective responses to the most important market failures constraining their growth.

Developmental governance: An analytical framework

Markets provide access to trading opportunities, and therefore a growing economy must have reasonably well-working markets. But history as well as economic theory tell us that market access may not be of much use for a developing country if it does not have the competence and capability to produce goods and services of the right quality and price for the global marketplace or domestic markets. At the heart of development, therefore, is the challenge of developing broad-based productive capabilities in a society. The inputs required for enhancing productive capability, namely machines and equipment and a workforce with the appropriate formal qualifications, have often been the focus of economic theory and policy. But history is replete with examples of investments that fail and workers with formal education who remain unemployed. And in fact, the fear that investments will fail to become productive is usually what constrains investment, not the absolute scarcity of productive factors. Indeed, many developing countries suffer from capital flight and the outmigration of skilled workers, suggesting that what is missing is the knowledge about how to put together productive factors to produce competitive products.

At the heart of this missing knowledge is a set of missing technological and entrepreneurial capabilities to use machines and workforces effectively to produce competitive products. Hirschman (1958) had pointed out the critical absence of entrepreneurial capabilities in developing countries a long time ago. Hirschman's entrepreneurial capabilities were a shorthand description of capabilities that involve a type of knowledge that has subsequently been described as *tacit knowledge* that owners, managers and workers can only achieve through learning-by-doing and by putting in high levels of effort over time (Nelson and Winter 1982; Stiglitz 1987; Lall 1992, 2000a, 2000b; Lall and Teubal 1998). The obverse of tacit knowledge is the codified knowledge that can be learnt in classrooms, textbooks and instruction manuals. In contrast, tacit knowledge can only be acquired by learning-by-doing, though of course, depending on the technology, some initial level of formal codified knowledge is necessary. The point is that developing countries are often unable to even produce things for which they *have* the formal codified knowledge because what is missing is the relevant tacit knowledge. Consequently, an increase in investment in new productive capacity and in formal education is necessary, but not sufficient for achieving growth or sustaining it. It is also necessary and even more important to acquire the technological and entrepreneurial capabilities so that the country can make profitable use of new investments and keep acquiring new technologies that are appropriate for using the formal skills that they already have. A further problem in many developing countries is that new enterprises find it difficult to acquire land that is contiguous given the weak definition of property rights and the fragmentation of landholdings. This can also significantly raise the transaction costs of setting up new enterprises. Sustaining growth requires institutional solutions that can address these and other problems.

Most developing countries make relatively slow progress in 'learning to learn' these critical capabilities on an ongoing basis (Stiglitz 1987). This is often a critical problem slowing down their growth and can easily result in a spurt of growth driven by high levels of investment, eventually becoming unsustainable in a competitive global economy. Indeed, in the absence of rapid development of these capabilities, the rate of investment will also slow down since new production facilities will not be profitable. In other words, the rate of investment is dependent on the success of a country in acquiring new entrepreneurial and technological capabilities. While investment can assist in developing the capabilities to learn and to create the institutions and governance capabilities for sustaining learning, high levels of aggregate

investment are not, in themselves, sufficient to ensure this. Since attaining these capabilities is hugely beneficial for society collectively, and should potentially be profitable for the firms investing in learning-by-doing, it is useful to ask why many developing countries find it so difficult to make sustained progress here.

In general, when economies fail to achieve socially beneficial outcomes, we can classify the possible reasons for the failure in terms of different types of 'market failures'. We use the notion of market failure as an organizational tool to classify different types of problems and not to imply that markets are potentially self-regulating if the causes of failures are removed. There are broadly two types of approaches to market failures. The first, and less useful approach, is to compare actual market outcomes with a theoretical benchmark of a perfectly competitive market. Deviations from that benchmark are identified as market failures. This approach is typically not useful because it is now well known that a perfectly competitive market is not a realistically achievable benchmark and does not help us to identify feasible missed opportunities in a context of social transformation (Stiglitz 1996). However, the approach continues to be influential because the dominant good governance approach of developing market-enhancing governance capabilities is implicitly derived from this perspective. The strategy of making markets more efficient across the board by reducing transaction costs assumes that significant progress towards the theoretical optimal market outcome can be achieved in this way.

The second and more pragmatic approach to the analysis of market failure is to identify *incremental* changes in institutional arrangements that can *improve* economic outcomes. The incremental or partial equilibrium approach does not make any presumption that a theoretical perfect market exists that would maximize global welfare. Indeed, it argues that such a benchmark is based on implausible assumptions that hinder, rather than help, the construction of policy. Instead, this approach is to ask whether it is possible to solve particular problems that can raise value added or welfare in the economy. The *growth-enhancing approach to governance* is in this tradition, and argues that the primary task of governance reform is to enhance the governance capabilities of states so that they are better able to address specific problems in developing countries that private contracting is failing to solve.

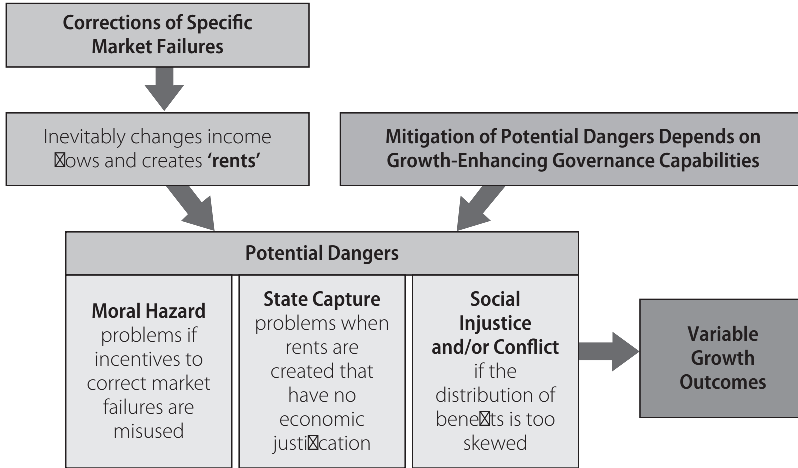
The incremental approach asks if there are economic activities which would enhance social output or welfare, and if there are, why individual contracting is not resulting in these activities being implemented. If an activity (like investment in a new sector) can potentially raise net social

output, in theory, it should be possible for investors, workers and others to privately contract to set up the production and collectively benefit. If they do not, then it is likely that there are specific transaction costs (including information costs and the costs of enforcing contracts) that are preventing private contracting, and these are the sources of the specific contracting failures that we identify as the relevant market failures in this context. If specific institutional changes and policies can be identified that could allow some or all of these activities to take place, then the market failure can be addressed. But the success of these strategies is likely to require the simultaneous development of specific governance capabilities to ensure that policies and institutions are adequately enforced. These are the relevant growth-enhancing or developmental governance capabilities in this context.

Indeed, even in very rich societies that can spend significant amounts on market-enhancing governance, specific market failures always need to be addressed. Given the greater inefficiency of markets in developing countries, it is puzzling why the importance of developing these specific capabilities is underplayed in developing countries. The work of Stiglitz (1996) and others has shown that market failures can be widespread due to information asymmetries and other reasons. These asymmetric information problems alone mean that market societies require extensive rents to operate reasonably efficiently. Rents create incentives to improve on market outcomes in the presence of asymmetric information and other market failures. Some of these rents, such as reputation rents or efficiency wages, can appear spontaneously through private institutional arrangements in advanced economies. However, many significant market failures are not addressed spontaneously, particularly in developing countries, and here, government action is required. At the same time, the correction of specific market failures does indeed face problems of rent-seeking and moral hazard that the liberal critique identifies. The major problems are summarized in Figure 8.2.

Policy and institutional responses that address specific market failures will inevitably change income flows and, by definition, create 'rents' defined as income flows that would not otherwise have existed in the absence of these policies or institutional responses (Khan 2000a, 2000b). The emergence of rents does not always imply the reduction of welfare or growth prospects. Indeed, some rents are associated with the implementation of growth and welfare-enhancing policies addressing market failures. The problem is that there are strong incentives to engage in rent-seeking activities of different types to influence the type and allocation of rents in society. The management of rents is therefore important because rents are

Figure 8.2:
Governance capabilities for addressing market failures



likely to induce rent-seeking. Rent-seeking is the expenditure of resources by potential beneficiaries to influence state policies in particular ways. State policies, even potentially beneficial ones, can create rents, and thus induce rent-seeking. Sometimes, the rent-seeking is damaging because it influences or distorts state policies in damaging ways, allows powerful groups to capture rents or otherwise subverts policy. At other times, the rent-seeking may have a cost, but does not prevent the implementation of policy. In the most benign case, rent-seeking is simply the mechanism through which conflicting interests formulate socially beneficial policies (Khan 2000a). Thus, like rents, rent-seeking as such is not necessarily a problem, and in any case, it cannot be eliminated entirely. The important point, from the perspective of governance reform, is that while the creation of some rents (like monopoly rents) lowers social welfare, other rents (like some government expenditures) may be a response to existing market failures, and if properly managed, can raise social welfare. The critical determinant of outcomes is therefore governance capabilities of the agencies implementing the relevant policies.

As Figure 8.2 summarizes, policies to correct specific market failures can result in a number of problems. First, there is a problem of moral hazard where policy creates benefits for some market participants but fails to achieve the desired policy goal. For instance, subsidies to assist training or making credit lines available to new start-up companies to overcome

capital market failures may be wasted without achieving the desired result. For this not to happen, governance capabilities of oversight and withdrawal are required so that the rents are not permanent and may be withdrawn if results are not achieved. The more narrowly defined the policy is, the more plausible it may be to develop the governance capability to administer the policy reasonably effectively. A second problem is that policymaking agencies of government may get captured by rent-seekers who may engineer solutions to market failures that do not really exist, simply to benefit from the rents created as a result. Limiting these possibilities requires governance capabilities and oversight by stakeholders to ensure that state capture cannot reach damaging proportions.

Finally, policy responses to market failures may be politically controversial because solutions to market failures may benefit particular constituencies or groups. The same market failure can be addressed by many different policy approaches with different distributions of benefits. For instance, a negative externality can be addressed by taxing the emitter of the externality, by subsidizing the emitter not to emit, by regulatory limits on emission, or by creating property rights on the externality-generating activity. Each solution has different transaction costs and therefore chances of success, but more significantly, each also has different distributions of benefits, even if the net social benefit is the same in all solutions. What this suggests is that if the distribution of net benefits is excessively adverse for powerful or significant groups in society, or if they have significantly adverse welfare implications on marginal groups, then even if the policy enhances growth overall, there may be resistance and opposition that, in turn, will have social costs in the form of conflict. We describe the distribution of power among organized groups in society as its 'political settlement' (Khan 2010). Success in solving specific market failures therefore also requires governance capabilities to ensure that policies do not have excessively damaging political consequences.

To develop reform strategies that are likely to be both implementable and effective, policymakers would be helped by an understanding of the governance arrangements that have worked in their own countries in the past. In developing new institutional arrangements that can address important market failures, governance capabilities need to develop in parallel so that policy does not fail because of a failure of management and implementation. An examination of the ways in which responses to market failures worked in second-tier countries is therefore a useful way for policymakers to understand and learn from their own success. An important caveat should, however, be kept in mind. Because countries have

very different political settlements, their capacity to enforce and manage different types of corrections to market failures is also likely to be very different. Therefore, we would expect feasible and effective strategies of incremental reform to be different across countries, depending on their political settlements and other initial conditions. For particular countries, an incremental approach to reform could build on strategies and institutional arrangements that worked in the past. This should be the foundation for developing a consensus on national development strategies (Khan 2008b). For more general lessons across developing countries, we can identify patterns and types of responses across broad types of political settlements which may simplify research into subsequent groups of countries.

Learning and technology acquisition

An important set of market failures constraining development affects the acquisition of tacit knowledge and technological capabilities. If learning-by-doing is required to acquire tacit knowledge, production will involve initial periods of loss-making that need to be financed. The private contracting problem is that financiers and those putting in learning effort within firms are unable to write enforceable contracts that are acceptable to all sides. Learning-by-doing can fail if key stakeholders within the firm fail to put in high levels of effort in experimentation and learning, and the problem for financiers is to ensure that there are enforceable contracts that allow them to withdraw financing, change management or take other steps if progress is unsatisfactory. These are obviously contracts that are difficult to enforce effectively in a developing country. Not surprisingly, financing learning is limited to investments that can be financed by the owners of firms themselves, using their own resources in situations where they have significant control over the effort put into learning. This clearly limits the pace of learning. This important area of contracting failures can be addressed by financing loss-making periods in start-up companies, provided governance capabilities exist to ensure that finance is not wasted as a result of moral hazard problems (Khan 2000b, 2009b).

In the literature on technology acquisition, it is recognized that responding to this market failure involves the management of what have variously been referred to as *learning rents* (Khan 2000b), *contingent rents* (Aoki, Kim and Okuno-Fujiwara 1997: 14–18) or *performance-indexed rewards* (World Bank 1993). The financing of learning inevitably creates new income flows for enterprises, managers and workers. These are, by definition, rents, and

the creation of rents induces further activity in the form of rent-seeking that can subvert the potential correction of market failure. We define rents in this context as policy-induced income flows that would not exist in the absence of that policy. In general, these and many other types of policy-induced rents can be potentially value and welfare enhancing for society (if they are associated with policies targeting market failures) or the reverse (if they are captured by powerful groups without generating the desired results) (Khan 2000b, 2007a). Whether the potentially beneficial effects of some rents can be realized depends therefore on how the rents are managed by the agencies charged with managing them.

When we look at how developing countries achieved international competitiveness in important sectors that drove their growth, we see a variety of institutional methods of financing the learning-by-doing and a variety of agencies and institutional conditions that had sufficient enforcement capability to ensure high levels of effort. These experiences have important implications for the design of institutions and agencies to promote technology acquisition in developing countries, and they indicate the governance capabilities that have to be present to make success more likely. The problem is that the enforcement of institutional rules to ensure that financing is not wasted, in turn, depends on the 'political settlement' in the developing country, which defines the relative power of different groups affected by the institution. The enforcement of similar institutions can therefore vary significantly across developing countries. Financing strategies that work in one may fail to have the same effect in another. Nevertheless, strategies that worked in particular countries not only tell us something about their political settlements; they also tell us the likely design of financial instruments for assisting learning that is most likely to work in these contexts (Khan 2009b).

A classic example of capability building is provided by the garments industry in Bangladesh. Low wages and a hard-working, largely female, workforce were important for the success of this industry, but were certainly not sufficient to ensure the emergence of the sector as a globally competitive industry driving exports and employment growth in Bangladesh since the mid-1980s. The acquisition of competitiveness in the sector required the financing of learning-by-doing, and this was based on a number of institutional and political arrangements that sufficed to ensure high levels of effort (Khan 2009b). One component of this financing was provided by the Multi-Fibre Arrangement (MFA) introduced in 1974 to protect the US garments and textile industry. It gave a number of least developed countries like Bangladesh quota-free access to US markets, but these countries had

no garments industry that could take advantage of this access, and most of these countries failed to acquire these capabilities. Bangladesh was lucky, because while the MFA gave the country 'quota rents' (the ability to sell at a higher cost of production than the most competitive exporting countries which had become quota constrained), this was not sufficient to ensure that a competitive industry would emerge. That required the investment of further resources in learning-by-doing, and this emerged through a very specific financing arrangement between a start-up Bangladeshi company called Desh Garments and the South Korean Daewoo which had an interest in transferring garments know-how to Bangladesh, given that they also had a textile business that needed to sell fabrics to a competitive garment-producing company.

The financing arrangement involved Desh sending around 150 critical personnel to Daewoo's garment production plant in Pusan in 1979, with Daewoo meeting the cost of hosting and providing production-line training. All other costs were borne by Desh. Daewoo would be repaid for its training by a 3 per cent royalty on eventual sales by Desh and another 5 per cent for marketing, given its knowledge of global marketing chains. In addition, credibility for the project was provided by high-level support from the political leader of Bangladesh at that time, Ziaur Rahman, who wanted the new sector to emerge. This support made credible the promise that critical institutional innovations required for the project, like back-to-back LCs and bonded warehouses that reduced the cost of financing imports of fabric required as inputs, would be forthcoming. Thus, a combination of targeted institutional arrangements, backed by sufficient enforcement capabilities to ensure high levels of effort in the learning effort, was essential for the eventual success of the project. The way in which the training and learning-by-doing was financed ensured that Daewoo had strong incentives for ensuring that tacit knowledge was rapidly transferred. After all, Daewoo would not be paid until Desh technicians returned home and started exporting. The Desh technicians also knew that an easy life in Pusan was not assured for long, and they too had every incentive to acquire the knowledge and return. Both Desh and Daewoo were confident that assistance would also be provided by the political leadership in Bangladesh to implement a limited number of specific institutional arrangements required for the new sector. Given a full description of the mechanisms of financing and the institutional and governance capabilities backing these conditions, it is not at all surprising why high levels of effort were in fact forthcoming.

In fact, the learning happened at an explosive rate. The initial understanding between Desh and Daewoo was for the collaboration to continue for five years, but so successful was the learning effort that Desh cancelled the collaboration after one and a half years. Indeed, the dramatic growth of garments exports from Bangladesh, first from Desh and then from a growing number of imitators, led the United States to impose quotas on Bangladesh in 1985. So, in the end, the learning opportunities created by the MFA and the additional financing arrangements that allowed the learning-by-doing to happen only needed to last for a very short time. This is partly because of the relatively simple nature of the technology, but also because the mechanisms and governance capabilities were appropriate for ensuring high levels of effort in learning. In a different way, very specific financing instruments, governance arrangements and an appropriate political settlement were behind other success stories, like the Indian automobile industry and its pharmaceutical industry take-offs in the 1980s. In each case, market failures that were otherwise constraining learning were overcome by specific financing arrangements backed by institutional and governance structures that ensured high levels of effort in acquiring the relevant tacit knowledge required for global competitiveness (Khan 2009b).

There are lessons to be learnt from these experiences. First, success, even in relatively low technology sectors like garments, was not based simply on opening up markets and waiting for comparative advantage to do the rest. There were significant missing capabilities, and acquiring them was more difficult than acquiring the machines or organizing the workforce. Second, the complex 'contracting' that was required to achieve success in learning-by-doing did not have to await the achievement of generalized good governance conditions that would allow purely private initiatives to solve these problems. The generally high levels of transaction costs in these markets would have prevented private contracting in the absence of any additional assistance. But relatively limited assistance was often sufficient. For instance, in the case of the garments industry in Bangladesh, the limited support coming from the MFA and a very specific set of institutional promises from the political executive in Bangladesh were sufficient to create both the incentives for private players to invest in learning as well as compulsions for all sides to put in high levels of effort. Third, the solution of these problems did not require national-level industrial policy as in the North-East Asian countries. Indeed, many of the developing countries that succeeded in accelerating their growth rates after the 1980s did not have the governance capabilities to have attempted learning strategies

on that scale. At the same time, these were not simply successes driven by already existing comparative advantage that did not require learning strategies: even relatively simple technologies like garments production required learning strategies to become competitive.

Fourth, in each case of success, the design of the financing instrument was critical. The critical financing 'instruments' (like the Desh–Daewoo agreement) had to be credible in terms of protecting the interests of the different parties, while creating strong incentives for high levels of effort. As the overall governance environment was typically far away from the benchmark of 'good governance', what was required was that the enforcement of critical elements of these agreements was credible, given the overall political settlement in the country. Thus, it is by placing specific arrangements within the broader context of institutions and the political settlement within a country that we can understand why particular financing arrangements worked effectively when others did not. In cases of success, such as the Bangladeshi garment industry, the enforcement capabilities and interests of the political leadership were appropriate for the enforcement of particular arrangements and the provision of specific institutional support that was limited in scope and not opposed by powerful interests within the political settlement. It follows, finally, that the replication of success into new sectors and regions within these countries requires an appropriate set of strategies for financing learning while making sure that the institutional and governance conditions are appropriate for ensuring high levels of effort. This can be based on replicating the design of particular financial instruments that worked in successful sectors in that country in the past. But different sectors and technologies have somewhat different requirements, and more complex technologies may require longer periods of support. In the general case, it may also be necessary to strengthen governance capabilities around a limited number of agencies and institutions in ways that are feasible given the overall political settlement so that successively more complex financing arrangements become credibly enforceable. The *developmental governance* agenda for promoting technology acquisition can be structured around such a set of insights.

Market failures in land markets

Another serious constraint in many developing countries is that investors can find it almost impossible to buy contiguous plots of land close to

infrastructural amenities. This is ultimately because of structurally high transaction costs in land markets, traceable to poorly defined land rights, multiple claims on land, poor contracting institutions and often very fragmented land ownership. These are common problems faced by many developing countries though the specific problems can depend on particular historical circumstances. Transaction costs in land markets can frequently preclude the setting up of new economic activities or the expansion of existing ones except at very high cost. This, in turn, slows down economic transitions by making it difficult to set up firms producing new products and services and constraining the rapid expansion of successful activities to capture changing market opportunities.

Transaction costs in land markets should not be confused with the price of land, though for the purchasers, the difference may not be very obvious. The net effect is that the price of buying a piece of land effectively becomes so high that potential investors are put off. Potential investors find that to acquire a substantial piece of contiguous land through the market, they have to deal with perhaps dozens of potential sellers, many of them with competing or overlapping claims, and it takes a long time to settle these conflicting claims. The presence of many smallholders also raises transaction costs because some can hold out for better prices when the deal is almost done. In some cases, there may be no formal rights at all; the land may formally belong to the state or to a community with no clearly defined rules for its use or transfer (Khan 2009a).

The cost of establishing well-defined property rights over land, in the good governance sense, is typically unrealistic in the short to medium term in most developing countries. In reality, investors in developing countries have to fall back on a variety of non-market processes to acquire land, and these can be interpreted as more or less successful responses to the underlying market failure. These strategies can range from state regulation in the form of compulsory purchase orders to acquire land for industrial development, and the involvement of political actors or even mafias who acquire land using their political power for onwards selling to actual investors, to business–government relationships that are used to deploy political power to acquire land for particular investors. The particular mechanisms and their efficacy can vary significantly across countries, as can the implications for social justice, sustainability and economic growth.

The importance of government responses to market failures in land markets is not limited to developing countries. Even in advanced countries,

where land has well-defined property rights, transaction costs can sometimes be large enough to justify some form of public purchasing policy for land. This would be the case, for example, if many contiguous plots of land have to be acquired, for instance, for making a highway. In these cases, transaction costs can become very high if prices have to be negotiated and agreed with each owner separately. In addition, subsequent owners can hold out for higher and higher prices, knowing that the purchaser has already pre-committed to purchase plots in this area. As a result, we typically see compulsory purchase orders of different types as a way of addressing this problem. The acquisition of land for major infrastructure projects like roads begins with a public enquiry where alternative routes and fair compensation rates are discussed, followed by compulsory purchase orders to acquire land for the project.

In developing countries, the much higher transaction costs in land markets mean that a wider range of projects may require public land use legislation and assisted purchases if projects are to go forward (Khan 2009a). These public interventions are often necessary policy responses to high transaction costs that cannot be significantly reduced over the short to medium term by market-enhancing governance reforms like stabilizing property rights or improving the rule of law. At the same time, the absence of governance capabilities for managing these processes can result in significant social injustice and, eventually, political confrontations. High-growth developing countries have managed to solve the land problem, at least in pockets using a variety of agencies and arrangements. Implementing any particular strategy of solving land access problems requires governance capabilities, such as the ability to identify critical land use requirements, carrying out land acquisition fairly, given the constraints set by the political settlement and with acceptable levels of compensation for existing users, while ensuring that land becomes available at the lowest transaction costs for growth sectors. In the absence of these growth-enhancing governance capabilities, non-market land allocations are subject to serious risks. The possibility of political capture of agencies by powerful groups, or direct land grabbing by unproductive speculative interests, can not only inflict social injustice on vulnerable groups; these activities may significantly slow down growth and direct investible resources into unproductive speculative activities. The institutional and political capacity to overcome these market failures is an important growth-enhancing governance capability for developing countries.

Conclusions

For most developing countries, the East Asian developmental states with their significant developmental capabilities have not been very useful for identifying or setting immediate reform priorities. The post-colonial political settlements in these East Asian countries were very unusual and allowed their states to intervene effectively in solving market failures on a scale that is unfeasible in most developing countries. But the agenda set by the good governance approach is also unfeasible for typical developing countries since it is even less likely that they will be able to make enough progress on these capabilities to make a significant impact on their development prospects. The only feasible governance agenda may be to incrementally improve developmental governance capabilities on a smaller scale, taking account of the political and institutional initial conditions in each country. A good starting point for particular countries would be to look at the sectors and firms that actually drove spurts of growth in certain sectors. How did they solve or overcome the market failures that affect learning, technology acquisition and land purchases? What other significant market failures did they have to overcome? A closer examination of these questions is likely to reveal country and sector-specific solutions that worked, and this is an important starting point for identifying strategies that may work in similar sectors or for achieving further technology upgrading in existing sectors.

This incremental 'Hirschmanian' approach to capability development has to be based on experimentation and trials, not on the adoption of blueprints from other contexts. If development and capacity building is seen as a process of trials, which it is, developing countries are more likely to incrementally and pragmatically develop specific governance capabilities that allow them to address the most significant market failures constraining growth sectors. This would be a radical departure from the comforting certainties of the good governance approach to governance reform. It would mean experimenting with strategies of financing technology acquisition and identifying the agencies and financing instruments that would need to be governed effectively for high levels of effort to be forthcoming. It would mean experimenting with strategies of land acquisition that were politically feasible in that country and building the governance capabilities for operating critical agencies that were required for making these strategies effective. It would mean identifying other critical market failures that are specific to the country and its stage of development and identifying agencies and governance capabilities that could address these problems.

International agencies do not like to admit that this type of country-specific experimentation drives development because this does not allow a consistent and general set of policy advice to be provided to all countries. But the historical evidence suggests that it is the incremental development of growth-enhancing governance capabilities that is critical for triggering and sustaining development.

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Notes

Chapter 1 Introduction: Governance and development

1 In *The Rise and Decline of Nations*, Mancur Olson (1982) regarded rent-seeking by distributional coalitions as undermining economic development and contributing to economic decline. He saw society as a constant struggle between creative and productive agents, whose hard work helps to enrich an economy, and organized groups of lobbyists, special interests, brigands and tax collectors whose rent-seeking activities reduce the overall size of the pie and could well turn economic growth into stagnation and even regression. In *Structure and Change in Economic History*, Douglass North (1981) focused on securing property rights from the threat of appropriation by the Monarch. While for North, security and constraints on the executive were paramount, for Olson, the nature and origins of property rights were just as important.

2 See Kurtz and Schrank (2007a, 2007b) and Kaufmann *et al.* (2007) for rejoinders and replies.

Chapter 2 The seductiveness of good governance

1 Adapted from Abrahamsen (2000): Introduction and Chapter 3. A revised and updated version of *Disciplining Democracy* is forthcoming.

2 Both these documents represent major research efforts by the World Bank. *Governance and Development* (World Bank 1992a) is the product of 22 members of staff, while the 1989 long-term perspective study was partly a response to critiques of structural adjustment programmes and consulted numerous scholars outside the Bank.

3 A similar point is made by Beckman (1992).

4 This view of associational life as more or less automatically supporting democratization also finds widespread support in academic writing (see, for example, Bratton 1989; Chazan 1982, 1988a, 1988b, 1993; Diamond 1988a, 1988b).

5 Useful explorations of the concept of civil society can be found in Cohen and Arato (1992), Calhoun (1993), Keane (1988), Taylor (1990), and Walzer (1991). The conception has only more recently been introduced to the analysis of African politics; notable contributions include Bayart (1986), Fatton (1995), Harbeson, Rothchild and Chazan (1994) and White (1994, 1995).

6 A similar observation is made by Bangura and Gibbon (1992).

7 Ekeh argues that civil society in Africa is highly apolitical and is 'largely indifferent, to the affairs of the civil public realm over which the state presides' (Ekeh 1992: 197). While this may be a rather heavy-handed generalization, it nevertheless serves as a useful corrective to the uncritical interpretation of civil society as an automatic check on the powers of the state.

8 The ambiguity of civil society's relationship to democratization has, for example, been noted by Lucy Davis (1995) in a case study of the popular organization Mboscuda among the Mbororo in north-west Cameroon. Davis is doubtful whether the organization will become an effective participant in a national democratic movement, or whether it will instead develop into a vehicle for ethnic chauvinism.
9 Whitehead (1993) has convincingly argued that the maintenance of social communal values to curb unbridled individualism was a major concern of some early theorists of civil society. Such concerns seem all too easily forgotten in contemporary debates that associate democracy with capitalism and state minimalism.
10 A similar point is made by Beckman (1992).
11 The good governance discourse's appeal to grass-roots and self-help organizations is perhaps analogous to the neoconservative call for a return to family values, tradition and religion in the West, as part of the attempt to revive self-restraint and unburden the state.
12 This brief reference to Eastern models appears to be nothing more than a token gesture, as the experience of Japan and the East Asian Tigers is conspicuously absent from discussions of good governance. This is the argument of Moore's (1993) article 'Declining to Learn from the East?', which maintains that if Eastern development models had been considered, good governance would have appeared very different and accorded a much greater role to selective state intervention.
13 In relation to the decline of patrimonial politics and the maintenance of political authority and social order, see for example, Reno's book on the emergence of warlord politics (1998) and Zartman (1995) on state collapse.
14 It is interesting to note here how culture can be used to defend almost any argument. For a long time, many leaders promoting the idea of an African socialism rooted their ideas in precisely the opposite interpretation of African culture. The late President Julius Nyerere, for example, argued that 'whenever we try to help Africans become capitalist shopkeepers, capitalist farmers, industrialists, etc., we find that most of them fail because they cannot adopt the capitalist practices which are essential to commercial success … Capitalism demands certain attributes among its practitioners which the majority of our people have never been forced to acquire' (Nyerere 1968: 18).
15 Marx argued that the French bourgeoisie in the mid-nineteenth century sacrificed the autonomy of civil society to protect their interests from the masses. The 'French bourgeoisie', he wrote, 'was compelled by its class position to annihilate … the vital conditions of all parliamentary power and to render irresistible … the executive power hostile to it' (Marx 1963: 63).
16 See also Gibbon (1992), Galli (1990), Hibou (1999) and Zack-Williams (1990).

Chapter 3 Good governance and donors

1 Most notably in recent years, Douglass North, who received the Nobel Prize for his work on the role of institutions, but also other leading economic historians, such as Alexander Gerschenkron.
2 In the African context, that was the approach of the World Bank report on the economic crisis in Africa, *Accelerated Development in Sub-Saharan Africa: An Agenda for Action* (World Bank 1981) – often referred to as the Berg report – which set the stage for the World Bank's promotion of structural adjustment in Africa in subsequent decades.

3 Writing on structural adjustment in the early years (1983), I commented that many African governments had made the mistake of assuming in the 1970s that if you did not pay farmers, they would nevertheless produce – they did not. An equally dangerous error was being made – not paying civil servants and assuming they would continue to work. This created the civil servant's response: 'the government pretends to pay us and we pretend to work.' 'Some Realities of Adjustment: An Introduction'. Editorial introduction to *External Finance and Policy Adjustment in Africa*: special issue of *Development and Change*, 17 (3), July 1986.
4 The strength of the case made over the years by Robert Chambers for 'bottom-up' programming derived particularly from the evidence that the local community and peasant farmers had access to knowledge critical for the success of agricultural projects.
5 Recently, in participating in an evaluation of the Poverty Reduction Strategy Paper (PRSP) process in Tanzania, it was made quite clear that one evaluation criterion should be the effectiveness of government consultations with 'civil society'. However, there was an astonishing lack of clarity among representatives of the donor community regarding what that term meant in practice.
6 The use of this term not only emphasizes the infantilism involved in the process but also refers to a comment by then Lord (Harold) Macmillan, in a speech in the United Kingdom's House of Lords, referring to when he had to receive an International Monetary Fund (IMF) delegation while he was Chancellor; it went something like this: 'then I had to receive some gentlemen from Washington, I did know who they were, but it reminded me of when I was at prep school – a lot of jaw-jaw but not much pocket money.'

Chapter 4 Perception and misperception in governance research: Evidence from Latin America

1 Dumont and Wilson import Carnap's approach to explication into the social sciences (1967). Przeworski and Sprague (1971: 217) embrace Hempel's extension of Carnap's approach. And Wesley Salmon underscores the continued relevance – if by no means, immutability – of the broader realist programme to which Carnap and Hempel contributed (1999).
2 A third possibility is that perceptions of Italy's institutions were tainted by knowledge of the country's lacklustre growth performance over the period in question (Kurtz and Schrank 2007a).
3 In fact, Kaufmann and his colleagues are, at least implicitly, adopting the by now discredited 'operationist' approach to measurement in which meanings are produced by measures and not vice versa. While they explicitly claim to derive the definitions of the six aspects of governance covered by the WGIs from 'existing definitions or understandings of the concepts' (Kaufmann, Kraay and Mastruzzi 2007c: 24), they occasionally admit that their indicators actually drive their definitions – and that the meaning is therefore in the measure. 'That is', they write, 'we have just one implicit definition of corruption, which comes from the aggregation of these many data sources across many countries' (Kaufmann *et al.* 2007c: 7). The limits to operationism are by now well known. According to Henry Byerly, the 'strict application of the more extreme operationist doctrine would lead to as many notions of a quantity such as mass as there are different operational procedures for measuring mass' (Byerly 1972: 376). Less strict applications are untenable, however, for efforts to

justify – rather than simply invoke – particular operational definitions inevitably appeal to meanings that are independent of the measures themselves. See Hempel (1956) for a seminal critique of operationism.

4 Adcock and Collier worry that scholars who fail to put their conceptual differences aside for the purposes of measurement validation will find themselves paralyzed by intractable disputes over concepts (2001: 538–9). We therefore follow their advice and take Kaufmann *et al.*'s definition of the rule of law as a given for the purpose of the discussion of validity – despite our scepticism about their conceptualization more generally. We should note briefly that we find the conceptualization – but not the operationalization – lying behind their 'government effectiveness' measure to more adequately capture the classical Weberian notion of good governance. See Kurtz and Schrank (2007a, 2007b) for a discussion.

5 An alternative approach would assess convergent and discriminant validity by asking whether RL is (i) strongly correlated with different measures of the rule of law and (ii) weakly correlated with indicators of distinct but related governance concepts. While Kaufmann and his colleagues tend to *incorporate* available indicators of rule of law into their own metaindicator, and thereby render RL more or less immune to convergent validation, they boast that RL is *strongly* correlated with their other governance indicators (Kaufmann *et al.* 2007a: 555) – and thereby raise serious doubts about their discriminant validity.

6 Our own admittedly crude data analysis confirms their sense that Latin America's current crime wave betrays a pattern of 'entrepreneurial rationality' (Portes and Roberts 2005: 75). We regressed crime victimization data from Latinobarometer (1 = victim within the past year) on a 7-point scale designed to capture the respondent's level of education – an admittedly crude proxy for social class – and found an enormous positive effect (odds ratio = 1.21; $p < .0001$) net of country characteristics. Car ownership provides an alternate proxy for social class and yields a broadly similar result (odds ratio = 1.45; $p < .0001$). Results are available from the authors upon request.

7 Nor is RICO exceptional. The Forest Service has provoked hostility in the western United States by confiscating the cattle of ranchers who violate federal grazing rules (see, for example, Dorsey 2001).

8 Our example is by no means farfetched. Latinobarometer asked respondents in 18 Latin American countries how well they thought property rights were guaranteed in 2007: completely (1), somewhat (2), not very (3) or not at all (4). An ordered logistic regression of the numerical responses on education – our proxy for class status – yields a proportional odds ratio of 0.98 ($p = .005$) net of country fixed effects and thereby suggests that better off respondents perceive their property rights to be more secure. Alternate proxies yield similar or more dramatic outcomes. Complete results available from the authors upon request.

9 A brief review of the WGI 'regulatory quality' (RQ) indicator does little to assuage our concerns. RQ addresses the degree to which tax, labour and environmental laws compromise business competitiveness, for example, but fails to ask to what degree they protect workers or the environment (Kaufmann *et al.* 2007, Table B4).

10 Another comes from an NGO that the authors themselves describe as 'conservative' (Kaufmann *et al.* 2009: 56). And only one source includes any citizen surveys at all.

11 Kaufmann, Kraay and Mastruzzi (2007d: 570) appear to believe that systematic differences between business and non-business perceptions can only contaminate their estimates if they alter the rank order of countries. We can neither confirm

nor rule out alterations in rank order given the complete absence of citizen surveys for most of their indicators, but we are not convinced that they are necessary to introduce bias into RL – which is, after all, an interval measure. Furthermore, the Afrobarometer data reported in Kurtz and Schrank (2007b: 566, Table 1) suggest that businesspeople themselves offer inconsistent evidence on the quality of governance. While they actually report better access to public services than their compatriots, they nonetheless hold the government in lower esteem.

12 Kaufmann *et al.* (2007a: 555) go on to note that 'this concept is much more closely related to our measures of Rule of Law and Control of Corruption, as well as several other indicators of these concepts'.

13 Of course, this suggests that a large public sector may be as much a symptom as a cause of human development, at least if 'cause' is defined *senso stricto.*

Chapter 5 Good governance scripts: Will compliance improve form or functionality?

1 The chapter builds on Andrews (2008).

2 The WGI 'Regulatory Burden' element has as one of its core sources scores on the Heritage Foundation/Wall Street Journal Index for government intervention in the economy, which is measured in terms of the following: government consumption as a percentage of the economy, government ownership of businesses and industries, share of government revenues from state-owned enterprises and government ownership of property, economic output produced by the government.

3 The numbers draw from my own assessment of Question 4, a to k, in the 2007 OECD Budget Practices and Procedures Database, which asks about the legal basis of the following: the form and structure of the annual budget and related legislation, the timing of the annual budget process, roles and responsibilities of different parts of the executive in budget formulation and execution, roles and responsibilities of the legislature and the executive in the budget process, provisions on what happens when the budget is not approved by the beginning of the fiscal year, requirement for legislative authorization of spending, requirement for legislative authorization of taxes, rules for the use of contingency or reserve funds, requirement for audit of government accounts by the supreme audit institution, requirements for internal audit structures in line ministries, management and reporting relating to off-budget expenditures.

4 The entire group of governments was in fiscal trouble in the early to mid-1990s, the tail of a fiscal expansion period that led to some significant adjustments in the past 15 years.

5 Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Costa Rica, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Peru, Poland, Portugal, Slovak Republic, Slovenia, Korea, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States and Venezuela.

6 Anderson (2006: 2) noted that deficits were re-entering the agenda in 2006, stating that '[f]iscal deficits have reclaimed their place as a pressing public policy issue around the world'.

7 See OECD (2002) for more detailed analysis of fiscal rules that confirms the information in the table. One (Australia) has had surpluses in the past few years while the other (United States) has recorded deficits.

8 Anderson (2006: 31) argues that the rigid rules have not stemmed expenditures at the local level (not covered by rules) and have led to increased use of tax expenditures 'to introduce new policies without breaching the ceiling or requiring balancing measures'.
9 Posen (2005: 5) writes that 'Germany, along with other Eurozone members France, Portugal, and more recently Italy, has been in repeated violation of these rules.' Posen argues that this is partly because 'Germany has of course suffered from a prolonged recession and historically high unemployment since 2001, which has put significant pressure on fiscal policy.'
10 The US experience is well discussed in Anderson (2006) and in Schick (2005), who discusses the situation as such: 'The Gramm-Rudman-Hollings laws (GRH) enacted in 1985 and 1987 purported to limit annual budget deficits; the 1990 Budget Enforcement Act (BEA) capped annual appropriations and required that any legislation increasing the deficit – or decreasing the surplus – be offset. BEA expired at the end of fiscal 2002, but some of its rules have been re-imposed in congressional budget resolutions. These have not been effective.'
11 Interestingly, a country like Sweden may face less pressure from such costs because of the historical role government has played in providing social welfare (something criticized in the deficit years of the early 1990s). This established role decreases uncertainty about future demands.
12 In some instances, this will be reflected in structural deficit measures, which should account for economic cycles, but these measures do not reflect potential social challenges that may be demographically induced or other challenges governments may face. Counter-cyclical budget management approaches are increasingly being introduced to facilitate policy continuity and guide spending.
13 I am aware that the choice of words here will create problems for many readers. The idea that a country actively chooses one form over another is obviously controversial and requires greater analysis. I do not propose to do this here, but believe the issue is how, along paths of development, countries do adopt highly varying government structures.

Chapter 6 Is governance reform a catalyst for development?

1 This is a revised version of a paper that appeared in the April 2007 issue of *Governance*.
2 Institutions have two overlapping meanings in the literature. One definition covers formal or informal rules that induce people to do what they would otherwise avoid (or dissuade them from doing what they would otherwise prefer). Another definition emphasizes the public and private organizations in which these rules are embedded. My focus in this article is on the latter. Governance concerns the mechanisms and processes through which political actors pursue their interests. The governance reforms of interest to me are conscious changes in formal rules intended to allow citizens, politicians and bureaucrats to interact in fair, responsive and encompassing modes of conduct.
3 On the donor side, interest in good governance is as a proviso for disbursing development assistance, the terms of which can be made more politically correct by linking governance to development and poverty reduction. On the aid recipient side, policymakers find it prudent to echo the donors' rhetoric so as to have continued access to aid. These interests create a divide between political speech at the United

Nations or World Bank, and the carefully parsed words of scholars about governance and institutions.

4 Many additional arguments exist for good governance, besides wishing to increase per capita GDP: good governance fosters non-violent conflict resolution, protects the rights of citizens, promotes equality and so forth. I am focusing on GDP growth because the data are more readily available and because higher national incomes are central to many other developmental outcomes.

5 Though provocative for today's beliefs, the idea of unreformed governance accelerating development would have been in line with conventional wisdom in the 1950s and 1960s. The widely held functionalist view of corruption saw poor governance as a price that at times must be paid for economic development at low to medium levels of national income. Skimming from infrastructural and private industrial investments was believed tolerable and perhaps even desirable, as long as elites did not impede growth and allowed ample benefits to trickle down to the ethnic, regional or family communities that supported the regime. This argument was not inconsistent with the Marxian notion of 'primitive accumulation' of capital, as an oppressive but ultimately beneficial step in development. Both Marxian theory and the prevailing modernization school of the Cold War era posited that industrialization and prosperity caused countries to adopt democratic, rational and legalistic modes of rule, rather than the other way around. It was considered pointless and perhaps counterproductive to try to tackle governance problems prematurely.

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