Chapter 8: Improving Public Sector Governance: The Grand Challenge?

That many states are failing to deliver on their most basic functions is a harsh reality. Generalizations are dangerous given the wide diversity of developing countries. But the typical developing country state today is faced with rising expectations, an increasing and disparate population, and a rapidly changing international environment that are outstripping its ability to deliver public goods and services. States have responded with varying degrees of competence to these challenges and cover the whole spectrum. At one end, are the failed states, where governments barely exist, and when they do, hardly provide any services. At the other extreme are a handful of countries where leadership and bureaucracies are relatively competent and governments are doing well by the people. In between are a wide spectrum: weak or predatory states which “consume the surplus they extract, encourage private actors to shift from productive activities to unproductive rent seeking and fail to provide collective goods” (Evans, 1995:24); young democracies struggling with a difficult political transition, managing simultaneous political and economic liberalization with weak bureaucracies and few checks and balances; more mature democracies where governments are doing the best they can, but face the same difficulties as the advanced countries when it comes to political corruption and abuse of office. Then there are the large continental size polities like India and Brazil which are difficult to categorize, because within their national boundaries can be found the entire range of governance configurations. There is as little in common between Peru and Pakistan as there is between China and Chad. But all countries now face a common challenge: how to get governance “right.”

Though there had been extensive research earlier into the causes and impact of poor governance, and in particular of corruption,\(^1\) it was not till the mid 1990s, with improvements in data and econometric techniques, that large, cross-country analyses of the impact of governance institutions on investment and growth emerged. This research has shown that corruption, which is both a symptom and cause of bad governance, discourages private investment and, more generally, that the quality of governance institutions has a significant, if not predominant, impact on economic growth (Maoro, 1996; Keefer and Knack, 1996; Wei, 1996, 1997; World Bank, 1997; Kaufman et al, 2000 and 2002; Rodrik et al 2002). Furthermore, it has provided empirical evidence of what analytical studies have long argued and case studies have suggested: corruption distorts the allocation of resources in ways that hamper poverty alleviation, i.e. corruption hurts the poor (Maoro, 1998; Davoodi and Tanzi, 1998; Gupta, S. et al, 2002).\(^2\)

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\(^1\) See for instance Susan Rose Ackerman (2004) and Robert Klitgaard (1988) among others. Much of the work on rent-seeking that punctuated the literature from the mid 70s to the 80s, e.g. Krueger (1976), Bhagwati (1978), essentially tackled conceptual issues.

\(^2\) The causality can work both ways, with growth also perhaps inducing better governance. There have been some recent attempts to address this (see Rodrik and Subramanian, 2003; Subramanian and Roy, 2001)
Combined with the extensive public awareness efforts of international organizations, such as Transparency International and the World Bank, the empirical research has helped stimulate governance reforms in developing countries. The 1990s witnessed a mushrooming of efforts to improve governance of the public sector, from very focused, technical reforms of budgetary and civil service systems to more encompassing efforts such as decentralization and the overhaul of the legal and judicial system. This chapter reviews these efforts. It begins with an introduction of key terms – governance, corruption, institutions – and, building on a simple framework that is adapted from the WDR 2004, presents a brief discussion of why governance reforms are particularly challenging. It then reviews the varied efforts of countries to improve governance, focusing on a few key areas, and draws emerging lessons from this experience. Recognizing that one size does not fit all, the chapter then presents a heuristic approach to identifying possible avenues for reforms depending on broad country characteristics and concludes by examining the obstacles reformers face in improving governance and what potential routes one might take to address them.

The wide variety of reform efforts spread across many areas makes it difficult to capture the richness of the lessons in a succinct way. Context matters and thus diversity in approach and implementation is to be expected. But, a general undertone does permeate most, if not all, of these reforms: the reforms reflected attempts to find a balance between the discretion of politicians and bureaucrats over policymaking and policy implementation and their accountability for resulting decisions and actions. From mega to micro level reforms, the thrust was to find a workable balance.

- The spread of democratic processes, particularly with the fall of the Berlin Wall, set limits on previously wide discretion of then authoritarian governments, with elections, however imperfect, introducing accountability of politicians for outcomes (see chapter 9). Complementing this was a recognizable trend of encouraging (or at least allowing) more active participation of civil society organizations in public decision making processes, giving rise to innovative forms of public accountability.
- Legal and judicial reforms were pursued to provide checks on the government’s potential for abuse, particularly in between election periods, and, more generally, provide the underpinnings for the rule of law.
- Legislative reforms were also explored to strengthen the capacity of the Legislature to oversee the Executive’s management and use of resources and in some cases to create space for opposition parties to restrain potentially harmful majority party initiatives.

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3 The “Cancer of Corruption” speech given by World Bank President James Wolfensohn at the 1996 IMF/World Bank Annual Meetings is considered to be a watershed in the Bank in the fight against corruption and the push for reforms of governance institutions in developing countries. The publication of Transparency International’s Corruption Perception Index made governments and their constituent publics more aware of problems of corruption and helped trigger the development of cross country empirical studies and survey based diagnostic work on corruption (see for instance, Kaufman 1999, Reinikka and Svensson 2003)

4 Perhaps the most encompassing reform has been the introduction of electoral institutions, which is the subject of Chapter 9.
Decentralization sought to give local governments more autonomy and flexibility in order to improve the delivery of basic services to the citizenry. At the same time, new forms of accountability, including local elections, had to be established in order to keep local officials faithful to their mandates.

Reforms in budget formulation sought to give spending agencies more control over the temporal allocation of resources but within newly established hard aggregate and sectoral budget constraints set by oversight agencies. Parallel reforms in budget execution attempted to give spending agencies more flexibility and control over the allocation of their respective budgets in exchange for greater accountability for outputs and outcomes.

Reforms in public administration, punctuated with the adoption of fast evolving information and communications technology, moved towards radical changes promoted under the so-called “New Public Management,” involving privatization of commercially viable state run activities, creation of semi-autonomous agencies, contracting out management of select services, outsourcing, and performance management. The basic thrust was to give agencies more space to manage – a la private sector firms – and to create new ways of monitoring performance. Towards the end of the decade, the pendulum seemed to swing back towards more basic forms of management and accountability.

The 1990s indeed witnessed a flowering of public sector governance reforms. But, as the chapter argues, the emerging results have generally been mixed, if not disappointing, suggesting that institutional reforms are far more challenging and will take time to mature.

A. UNDERSTANDING THE GOVERNANCE CONUNDRUM

Economic performance – growth, investment, and poverty reduction -- depends in part on governance. In turn governance is shaped by underlying institutions. Public sector governance refers to the manner in which the State acquires and exercises the authority to provide and manage public goods and services. Corruption, which refers to the use of public office for private gain, is the mirror image of governance: bad governance invariably leads to corruption; but corruption can likewise perpetrate bad governance.

The quality of governance (and thus nature and extent of corruption) depends fundamentally on institutions, defined broadly as the “rules of the game” that shape the behavior of organizations and individuals in a society (North, 1990:3). Institutions can be formal rules, such as a country’s constitution, its laws and regulations, contracts and internal procedures. Or they can be informal rules such as the values and norms that drive bureaucratic behavior. Though scholarly research and concern with institutions is not new, a strong interest in it reemerged in the 1990s primarily as a result of the slow progress in development and poverty reduction despite stronger macro-economic policies.

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5 Formal organizations, e.g. The Central Bank, are also often times referred to as institutions. In the abstract, an organization is a collectivity functioning within a predetermined set of formal rules. That is, it is an agglomeration of rules that affect the behavior a given set of individuals.
in the 1980s. Interest moved from “getting the policies right” to “getting the institutions right” and had a particular focus -- the rules of the game upon which governance of the public sector is grounded.

Fundamentally, public sector governance is about the nature and quality of three principal relationships: between citizens and politicians, between politicians as policymakers and the bureaucracy (those responsible for providing public goods and services), and between the bureaucracy as delivery agents and the citizenry as clients. Figure 8.1a below illustrates this triad of relationships and highlights the peculiarities of the first.

A.1. Citizens and Politicians: The Heart of Governance

In an ideal world, citizens are able to hold politicians accountable for their actions and for policy outcomes -- political accountability. This comes about through two channels. First, which we might call the “direct” channel, is through elections and the second, which we might call the indirect channel, is through checks and balances on the abuse of power. Periodic elections provide the basic means through which citizens can hold politicians “to the fire”. Restraints in the form of legislative oversight of Executive or ruling party decisions and actions foster accountability in between elections. Moreover, court adjudication of disputes among contracting parties, especially between government and the citizenry, provides the foundation upon which politicians and, more generally, the public sector can be held accountable for delivering public goods and services. In well functioning democracies, these latter features are embodied in the Constitution and promote the “rule of law”, i.e. everyone, politicians included, behave in accordance with agreed upon rules as embodied in laws and regulations and no one, even the highest elected or appointed public official, is “above the law.”

But reality departs significantly from theory. First, many countries are not democracies. Some are purely authoritarian and others, while exhibiting the formal trappings of a democracy, do not have a truly independent parliament or judiciary. And, second, as chapter 9 aptly discusses, even in countries where there are regular competitive elections among multiple political parties or candidates, i.e. ostensibly, seemingly working democracies, elections often do not have the desired effect so that politicians can easily shirk from their campaign promises and responsibilities. In either case, weak institutions typically govern the relationship between citizens and

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6 The World Development Report 2004 characterizes the bilateral relationships as one of accountability (of agents to principals). But the relationship can also be affected by other factors, in particular, capacity issues. If the agent does not have the ability or the resources to perform his task then no matter how strong the accountability link, he or she will be unable to deliver on his or her mandate. If, for instance, bureaucrats have a poor financial management information system to work with, they cannot produce adequate information upon which to judge their performance.

7 There is in fact a third channel which is through so-called citizen “voice” which involves mechanisms that citizens can use to inform politicians of problems, needs, and preferences. This is discussed as part of the third leg of the relationship triad – citizen power.

8 In fact, the Judiciary itself provides a public service to the citizenry.

9 See also chapter 5, WDR 2004.
politicians. The legislature rubber stamps narrowly focused special interest initiatives of the executive; high ranking officials abuse their authority for private gain; enforcement agencies prey on the citizenry, courts are easily swayed by pressure from influential politicians; etc.. In other words, the rule of law is weak. And when rule of law is weak, a particularly aggressive form of corruption can easily emerge -- state capture. Worse, when state capture occurs, rule of law could be weakened further or attempts to improve it stymied.

Figure 8.1a: Citizens and Politicians

State Capture

Policy Makers

Delegation & Voice

Political Accountability

Citizens

Client Power

Providers

Public Goods / Service Provision

Bureaucratic Capacity

Internal Acc

State capture “refers to actions of individuals, groups, or firms either in the public and/or private sectors to influence the formation of laws, regulations, decrees and other government policies to their advantage through the illicit and non-transparent provision of private benefits to politicians and/or civil servants (World Bank, 2000).” As Kaufmann (2003) argues, it is a serious problem in many developing countries. When pervasive, it becomes the principal stumbling block for efforts to reform governance

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10 For clarity, this refers to two general types of institutions. The first are political institutions – rules or arrangements that define, govern, and influence how leaders and other politicians are selected and replaced. The second are institutions of restraint – rules or arrangements that establish checks and balances on the abuse of power and authority.

11 More specifically, the possibility of obtaining rents drives influential groups and/or individuals to bribe politicians or high-ranking civil servants. In turn, the latter introduce and maintain bad laws, policies, or regulations in order to perpetrate their illicit earnings. Note that in this context, corruption causes bad governance.
institutions: why should the powers to be change the “rules of the game” when they benefit immensely from it?

A.2. Politicians/Policymakers and the Bureaucracy: The Core Principal Agent Problem

Politicians are the primary policymakers of a country and as such are responsible to the citizenry for the policies that eventually get promulgated and implemented. However, they do not implement policy. Rather they delegate this responsibility to an army of bureaucrats; hence the need for the so-called civil service, i.e. the bureaucracy.\textsuperscript{12} In delegating, politicians establish the rules and regulations, i.e. the institutions, which govern the operations of the Civil Service. This would include for example formal institutions such as a Civil Service Code, the budgeting system, or reporting systems and informal institutions such as the practice of “amakudari” in Japan.\textsuperscript{13} These institutions establish the parameters within which civil servants implement public policies and deliver public goods and services.

Delegation almost always gives rise to what economists call the principal agent problem. The principal delegates the implementation of a task to an agent but in so doing faces the problem of insuring that the agent indeed completes it as he (the principal) has envisioned. The agent will most certainly know whether he has accomplished the task as mandated or not. But the principal, being at least one step removed from the process, will have to establish tractable means of monitoring the agent in order to confirm exactly what has been accomplished. In other words, delegation results in an information asymmetry between the principal and the agent in which the former is disadvantaged and therefore must incorporate efficient means of monitoring the latter.

In delegating the task of implementation, policymakers establish a compact with bureaucrats. This compact has two major features. First, it provides the means through which the bureaucracy can develop and enhance its capacity to implement policies and deliver public goods and services. After all, if bureaucrats do not have adequate capacity then they cannot be expected to deliver effectively on their mandates no matter how hard they try. Capacity in this context refers to (i) the skills bureaucrats need to deliver on various mandates, (ii) the resources (capital and financial) to support the needed efforts, and (iii) the processes and systems, e.g. the budgeting system and the procedures for using it, that enable large numbers of individuals to function as a well oiled machine. Second, the compact also establishes means through which bureaucrats can be held accountable to policymakers for performing their tasks. Accountability in this context, which for clarity will be referred to as internal accountability, means that bureaucrats are responsible to policymakers for the accomplishment of certain tasks and are prepared to

\textsuperscript{12} In practice, the bureaucracy can also delegate some responsibilities to non-government organizations, e.g. contracting out to private providers.

\textsuperscript{13} Amakudari (meaning literally descent from heaven) refers to the long standing (but unofficial) practice in Japan of rewarding successful high ranking career civil servants with a high paying, prestigious job in the private sector for a fixed period, e.g. five years, upon retirement. See Chalmers Johnson (1983) MITI and the Japanese Miracle.
explain and face the consequences of any corresponding deficiencies or failures. Accountability mechanisms typically involve internal checks and balances (internal to government agencies), e.g. internal audit, ex-post program evaluations, ex-post reporting, as well as external (to government agencies) restraints, e.g. the ombudsman, supreme audit institutions, anti-corruption commissions.

Note that adequate capacity is necessary for accountability to work. Information is needed for auditing, performance evaluation, reporting, investigations, and prosecution. And processes, skills, and resources are needed to provide the infrastructure and create the incentives to produce the right information. In the same vein, more effective accountability helps strengthen capacity as policymakers are more willing to grant greater flexibility and resources make the bureaucracy even more effective. Figure 10.2b highlights the salient features of the compact.

**Figure 8.1b: Politicians/Policymakers and the Bureaucracy**

The quantity and quality of services and the outcomes of policies depend crucially on the nature of the compact. When the compact is defective, either because of weak capacity and/or poor accountability, administrative (or bureaucratic) corruption typically emerges. *Administrative corruption* “refers to the intentional imposition of distortions in the prescribed implementation of laws, rules, and regulations to provide advantages to individuals resulting from illicit private gains to public officials (World Bank, 2000).”
Weak capacity and/or accountability translate into numerous opportunities for soliciting or extracting bribes and other illicit side payments. Indeed a number of empirical studies have shown that deficiencies in civil service processes and procedures tend to lead to increased administrative corruption (Van Rickeghem and Weder, 2001; Evans and Rausch, 2000; World Bank, 1997) and have confirmed what numerous case studies have found (see for instance Rose-Ackerman, 1978; Wade, 1982; Klitgaard, 1988 and 1990).  

Though administrative corruption differs fundamentally from state capture and thus may exist even in the absence of the latter, the two are linked. Politicians are at the heart of state capture, either as perpetrators or as willing respondents to the captors. But bureaucrats are the ones who will implement the distorted policies that result from capture. Hence, politicians need the acquiescence, if not the active participation, of at least some segments of the bureaucracy. In practice what this implies is that politicians constrain the capacity of the bureaucrats or weaken their accountability. For instance, in many of developing countries, the annual budgets allocated to the Ombudsman or to the supreme audit institution are far smaller than what is necessary for them to perform their tasks adequately and the personnel appointed to key posts are rarely the most qualified (Heilbrun, 2003). Moreover, as chapter 9 points out, politicians will prefer to sustain clientilistic practices within the bureaucracy rather than introduce formal, transparent merit based recruitment processes. That is, the compact is itself partly conditioned by the extent of state capture.  

A.3. Bureaucrats and the Citizenry: Where the Rubber Hits the Road  

For most citizens, the immediate contact with the State is through the bureaucracy. From obtaining a drivers license to enrolling children in the community public school to arguing with a traffic policeman, citizens have much more frequent and regular dealings with the bureaucracy than with politicians. Ideally, citizens should be able to hold civil servants directly accountable for the poor implementation of policies and programs. But in reality they have to go a longer and sometimes circuitous route: from citizens to politicians/policymakers and then from the latter to bureaucrats through the compact. They can complain to their congressman or their mayor about the poor quality or inadequacy of some service and hope the latter intercede with or pressure the bureaucracy on their behalf. And if they have generally been unhappy with the response they can vote the latter out of office. But they cannot penalize or punish bureaucrats directly or officially. 

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14 There is controversy surrounding the relation between public sector pay and corruption. It is commonly presumed that the lower public sector compensation the greater administrative corruption. Various empirical studies suggest that there are clearly other factors at play that confounds this relationship. See World Bank, Administrative and Civil Service Reform website, http://www1.worldbank.org/publicsector/civilservice/ineffectivemon.htm#4.  
16 See the World Development Report 2004 for a thorough explanation of the long route of accountability.  
17 At the community level, citizens can use “shame tactics” to pressure local level civil servants who themselves must also live within the same community.
But citizens do have some leverage over the bureaucracy if they can organize themselves into NGOs, parent associations, religious organizations, etc. and use the organizations to provide politicians information about what is going on the ground thus exerting pressure on them to get the bureaucracy to work more efficiently or, more directly, to participate in the actual provision of some services. Ultimately, the capacity to organize gives citizens so-called “voice” -- the ability to monitor the performance of the bureaucracy, generate valuable information, and pressure politicians for action -- and “client power” -- the ability to engage directly with service providers in the provision of services -- that strengthen the compact between politicians and the bureaucracy and thus helps improve the delivery of public goods and services.

Figure 10.2c highlights the role of voice and client power in the triad.

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18 Social development specialists refer to these as forms of social accountability (see Ackerman ,2004). While these are generally accepted, if not encouraged, in democracies, they are often presumed to be restricted in authoritarian regimes. In practice, however, authoritarian regimes do care about the satisfaction of the citizenry with basic public goods and services, for their legitimacy depends partly on this. For a good example, see Pomfret, John. 2003, “SARS Reported in Rural China,” available on line at [http://stacks.msnbc.com/news/904928.asp?cp1=1](http://stacks.msnbc.com/news/904928.asp?cp1=1), and Pomfret, John. 2003, “China to Open Field in Local Elections,” Washington Post (June 12).

19 It should be noted that “client power” also includes the ability of citizens to choose among different providers of the same service. This however does not require collective action on their part; rather it requires policy decisions to promote some form of competition among service providers. On the latter, voice (and thus organization) however can play a role in getting politicians to promulgate those policies.
Citizens generally find it difficult to organize. Collective action is costly and so does not always emerge naturally. Hence, citizens are often left to fend for themselves. In situations where the link between them and the politicians is weak, e.g. flawed electoral processes, this can exacerbate the problem of administrative corruption. In desperation (and frustration) to get some service, citizens may ultimately opt to offer bribes or to give in to bureaucratic demands for bribes. The inability to organize can thus worsen an already defective compact. In short, one way or another, citizens can indirectly influence the delivery of public goods and services.

B. PUBLIC SECTOR GOVERNANCE REFORMS IN THE 1990s

The previous section laid out a simple framework within which to present a cogent discussion of the myriad of governance reforms that occurred throughout the 1990s and that have continued well into the current decade. This section attempts to identify some potential lessons from these reforms using the framework as a guide to the analysis. Given the enormity of the issues involved and the long term nature of these reforms, one can of course only offer a glimpse of what concrete lessons appear to be emerging.

B.1. Politicians/Policymakers and the Citizenry: Enhancing Political Accountability

Chapter 9 discusses the dilemmas faced by democracies, particularly nascent ones, in promoting genuine political competition, and thus in establishing political accountability. When the citizenry is unable to clearly attribute responsibility over poor outcomes to politicians, elections, which are to start with already blunt accountability instruments, become distorted and this enables non-performing or poor performing politicians to remain in power.\textsuperscript{20} The direct channel thus remains weak.

Perhaps partly because of the immense difficulty of addressing problems in political institutions, countries and donors turned to an “indirect channel” of political accountability where “technical solutions” could presumably be more readily applied – legal and judicial reforms.\textsuperscript{21} These reforms of course had a broader objective, which is to promote the rule of law. But, as discussed above, a primary by-product of improved rule of law is enhanced accountability of politicians: state capture, which is a symptom of weak political accountability, thrives when rule of law is weak.

\textit{Legal and Judicial Reforms Cannot be “Technical” Short Cuts to the “Rule of Law”}

Despite problems in the political arena, serious efforts at reforming legal and judicial systems emerged in developing countries during the 1990s. As noted in chapter 5, in Eastern Europe and the former Soviet Union, both the fiscal crunch and regime

\textsuperscript{20} Political accountability during elections can be enhanced by independent Electoral Commissions. However, such institutions may themselves also be subject to capture.

\textsuperscript{21} This is not to say that no work on reforming political institutions has taken place. There in fact have been some efforts such as attempted reforms in political campaign finance. But these efforts have been far fewer than those devoted to legal, judicial, and legislative reforms.
collapse led to massive privatizations. In Latin America, the weight of the 1980s debt crisis forced governments to sell of large state owned enterprises whose inefficiencies and massive loans accounted for significant portions of the budget deficit and public debt. Moreover, fiscal crises brought to the fore the realization that governments could no longer go it alone in promoting development and that private investments. Particularly for large infrastructure projects, private investment had to be attracted and nurtured to help in the long term development effort. Thus private sector development became a primary objective both of developing country governments and donor agencies. Both these trends -- the privatization thrust and the new emphasis on private sector development – helped make legal and judicial reform an imperative in many developing countries.\textsuperscript{22} Law and development activities skyrocketed during the 1990s, with the IFIs and key donors stepping up loans and grants to support legal and judicial reform.\textsuperscript{23}

Pragmatic approaches to legal reform have been more effective and are more likely to succeed.

Most private sector law reforms were supported through short-term technical assistance involving one or more foreign law professors or practitioners expert in a particular area or sub-area (Kovacic 1995; deLisle 1999). Foreign experts typically brought the text of their own country’s law, either as a basis for drafting a country-specific statute or simply for adoption wholesale. For example, in the early 1990s the Ukrainian legislature was asked to enact a verbatim translation of the Uniform Commercial Code, an lengthy American statute governing sales, leasing, and related transactions, and advisors to the Mongolian government suggested that to create a stock market it simply copy U.S. securities laws.

The ease and low cost with which law reform assistance could be supplied produced a rash of activity. The pace was particularly frantic in the transition countries where business-related laws were either out-of-date or, in the case of states of the former Soviet Union, never in existence in the first place. For instance, in the three Baltic states

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\item It should be noted that the heightened concern with improving legal and judicial systems in the 90s was predated by similar concerns and reform efforts in the 1960s. And, there is some indication that the latter reforms are only now beginning to bear fruit. Moreover, there are other factors that have made governments in both developing and developed countries much more concerned with legal and judicial reforms in the 1990s. These include globalization and trade, drug trafficking, human rights, immigration, the protection of intellectual property, the suppression of terrorism, and the consolidation of emerging democracies. See Messick, R. “ Lessons form the Law and Development Movement of the 1990s,” unpublished manuscript, PRMPS, The World Bank, December 2003.
\item The World Bank’s first significant effort was a 1990 adjustment loan to Bangladesh followed two years later with support to Tanzania for the training of judges, the upgrading of legal libraries, and the publication of court decisions. In 1992 the Bank also extended a $30 million loan to Venezuela solely for judicial reform. This was the first of 11 investment loans totaling close to $200 million that the Bank extended principally for judicial reform during the 1990s. Data from other organizations show a similar increase in judicial reform activities. Starting from scratch in the 1990s, the Inter-American Development Bank had made 18 loans totaling $418 million by June 2001 and entered into 65 technical cooperation agreements comprising another $43 million to support reform of judicial institutions (Biebesheimer and Payne 2001, 12). Likewise, the U.S. Agency for International Development, which had a small court reform program in the mid-1980s, had provided $__ million in grants to judiciaries throughout the developing world by ____.
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of Latvia, Lithuania, and Estonia “hundreds of law were passed . . . in the early 1990s, and when government regulations are added, the number grows into the thousands” (Klavins 2000, 4).

Despite the surge in the number of new laws however, many have had little or no effect on behavior. Several nations of the former Soviet Union have statutes that on paper provide corporate shareholders more protection than they enjoy under French or German law, but as capital flows attest, investor rights in France and Germany are much more secure (Pistor, Raiser and Gelfer 2000, 65). In Albania and Romania, statutes governing the posting of collateral for a loan and the regulation of banks and securities markets have been enacted, but businesses report they are ineffective (Gupta, Kleinfeld, and Salinas 2002, 13-14). And although new laws in Bangladesh, Pakistan, and Benin require bank debtors to repay immediately their outstanding loans, most debts remain unpaid (Messick, 2004).

A number of lessons have emerged from these experiences. First, a new law must reflect the realities of the institutional environment within which it is to be inserted, including in particular the state of the institutions that will enforce it – Judiciary, Ministry of Justice, the police, regulatory agencies. When the agencies that will enforce a new law are corrupt, technically incompetent, or insufficiently independent of political authorities, the law must compensate for these deficiencies.

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**Box 8.1: Bright Line Rules vs. Standards**

An early lesson law reformers learned was the importance of substituting bright lines rules for standards wherever possible. A bright line rule specifies the exact conduct expected, an example being a law establishing 45 mph speed limit, whereas a standard leaves the question of violation to the enforcement agency, such as a law making a “reasonable speed” the limit. Bright line rules put less of a burden on enforcers than standards. The determination of whether was exceeding 45 mph is straightforward whereas deciding whether a speed was reasonable requires investigation into such factors was the time of day, weather conditions, and the presence of pedestrians and other traffic. Bright lines rules also leave enforcers with little or no discretion and so reduce opportunities for bribery. The enforcement of bright line rules is far easier to monitor too, which can provide openings for self-help and other means of enforcing the law without resort to the authorities (Hay and Shliefer 1998).

Second, simplification of legal procedures can go a long way to improving the efficiency of implementation and, by implication, reduce opportunities for corruption, particularly in countries with weak complementary institutions. In fact, in countries with diverse legal traditions, switching from written to oral hearings have improved efficiency and access. (World Bank, 2002).

Third, implementation can be made easier if custom is incorporated into the law. Because customs are norms citizens are already observing, where custom is consistent with the larger public interest, its absorption into state law runs little risk of creating an enforcement gap. Hernando de Soto (1988) for instance spearheaded several law reforms in Peru that incorporated the norms and practices of street vendors, urban transit operators, and small land holders into law. Peru’s new land law, granting urban squatters
property rights to their land relies on customary methods of showing possession to establish these rights.

And fourth, reflective of the political nature of legal reform, a transparent and inclusive reform process reduces opposition to a new law and enhances compliance. Reflecting on the EBRD’s experience during the 1990s, its counsel for law reform asserted that “the most important lesson for the sustainability of effective legal reform over the long term is the need to develop and nurture a transparent and inclusive legal reform process” (Bernstein 2002, 9). In its projects, the EBRD has included not only representatives of various government ministries, regulators, judges, and legislators but also businesses and other civil society groups.

Poor incentives rather than weak capacity has been the root cause of poor judicial performance

The concern with improving the implementation of laws and in particular the enforcement of contracts -- between businesses, between lenders and borrowers, and between consumers and vendors -- gave rise to parallel reforms of the judiciary. Part of the impetus arose from some of the seminal work on institutions and economic growth. In an influential piece that appeared at the start of the decade, Douglass North asserted that the poor enforcement of contracts was the principal reason why some countries remained poor. North contended that the absence of low-cost means of enforcing contracts was “the most important source of both historical stagnation and contemporary underdevelopment in the Third World” (1990, 54). In the context of privatizations and private investment, a well functioning judiciary meant that contracts could be affordably enforced and that the government could not therefore easily expropriate private property, either directly (thru confiscation) or indirectly (thru onerous taxation) without due cause. Because government has the power to coerce, it has the power to confiscate as well and thus the potential to discourage private sector activity (Weingast, 1995). The judiciary would restrain politicians (and bureaucrats) from making whimsical, self-serving decisions that violate the rights of firms and individuals.

Elaborating on this thesis at mid-decade, Oliver Williamson (1995) argued that when the judiciary is unable to enforce contractual obligations, one of two things happen. Either a disproportionately large number of transactions occur in the spot market, where there is less opportunity for contract breach, or firms circumvent the judicial system altogether by purchasing their suppliers or customers, turning arms-length transaction into intra-firm ones. But in either case, he argued, the results were higher transaction costs and hence a “low-performance economy.” In short, judicial reform should be of paramount concern to developing countries.

As the decade unfolded, a broader rationale for judicial reform had replaced the narrow emphasis on contract enforcement. With increasing frequency a better functioning judiciary was linked to, if not equated with, the “rule of law.” Although this Anglo-Saxon concept -- and related ones in use in Europe, Latin America, Asia, and Africa -- can mean many different things (Stephenson 1999), in the parlance of the development community “rule of law” became synonymous with a state where laws
effectively restrained rulers from opportunistically seizing private property while promoting welfare-enhancing cooperation among the citizenry. This broader emphasis coincided with the growing recognition in the international community that a well-performing judiciary was part of the solution to many problems of development. By the decade’s close, judicial reform had, in the words of one practitioner, become “the big tent for social, economic, and political change generally” (Jensen 2003, 347). Perhaps somewhat unfortunately, it became the entry point to a problem that was fundamentally political in nature because it lent itself more readily to “technical” solutions.

This growth in objectives was matched by significant changes in judicial reform programming among donors, particularly the IFIs. World Bank judicial reform projects to create commercial courts and support similarly focused interventions rapidly gave way to far more ambitious undertakings. Projects included support for new institutions to assume responsibility for governing the judicial branch, revising rules on the selection and promotion of judges, overhauling management of the judiciary’s human and physical resources, rooting out corruption, constructing new court houses, and equipping them with modern communications and computer technology, training for lawyers and judges, programs to reach out to women and the poor, and the establishment of administrative courts.

Reforming courts and related institutions has proven to be a far greater challenge than originally thought. At the start of the decade, judiciaries in virtually every developing and transition nation confronted a host of similar problems: decrepit buildings, inadequate equipment, poorly-trained and underpaid judges and support personnel, cumbersome procedures, and poor management of personnel and physical resources. Not surprisingly, early projects aimed directly at curing these ills – building capacity. But, in common with the experience with reforms to other public sector institutions during the 1990s (World Bank 2000), most of these interventions produced little change (Burki and Perry 1998; Carothers 1996; Blair and Hansen 1994; GAO 1993). Figure 10.2 below is indicative of the inertia. In 1996, the business community in various countries around the world perceived their respective judiciaries to be unreliable and as a consequence have contributed to corruption.

Figure 8.2: Judiciary and Corruption
As experience with judicial reform grew, it became clear that the roots of poorly performing courts lay much less in a lack of resources and skills, i.e. weak capacity, and much more in the behavior of judges, clerks, lawyers, and litigants. As the World Development Report 2002 argues, “the success of judicial reforms depends on increasing the accountability of judges (and lawyers), that is providing them with incentives to perform effectively (p. 132).”

Domestic-inspired and supported reforms to the courts in India offer a well-documented example. There, an enormous number of tribunals have been created to handle civil service, tax, land, and consumer cases to reduce the burden on the regular civil courts and to speed up the disposition of cases. But as several studies document, these reforms have had little effect (Moog 1997). The reason is that lawyers, clerks, and many litigants have an interest in court delay and thus continue to frustrate reform efforts. That is, state capture has compromised the proper functioning of formal institutions.

**Development of complementary institutions is essential for reform**

Another emerging lesson from the experience of the 90s, one which in fact the WDR 2002 had highlighted, is that the absence of parallel institutional reforms will tend to negate any progress in judicial reform. For example, as Box 8.2 illustrates, reform of the police and the public prosecutor offices are key complementary reforms, which if left unattended will constrain efforts to improve the judiciary.

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**Box 8.2: Integrated Justice Sector Reforms: The Jamaican Case**

The Justice sector plays a critical role in enforcing the rule of law, protecting property rights and protecting the rights of citizens. Safeguarding the accountability mechanisms that underpin the justice sector requires an effective collaboration between the courts and the police. Using an economic model of crime, successful violence reduction programs substantially increase the cost of crime by combining a high probability of capture (by the police) with a high probability of conviction (by the judicial system).

Investment climate surveys show that property crime is a growing world wide problem that adversely affects investor confidence. The Jamaican judicial system which is fairly well developed has been criticized because of dramatic increases in political and criminal violence. An effective crime prevention strategy in Jamaica would need to improve police capabilities to match judicial effectiveness. An increase in police accountability and improvements in police-

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24 For a more extensive discussion, see Islam (2002).
community relations are necessary to compliment the probability of conviction by the judicial system in order to deter crime in Jamaica.


While most efforts focused on improving the court system, some reforms dealt with alternative dispute resolution mechanisms. These projects both under- and over-estimated the role of institutions in resolving disputes among contracting parties. Arbitration, mediation, and other forms of alternative dispute resolution methods were offered as a way of channeling disputes away from the courts to private fora. At the same time, projects largely ignored that many disputes can be avoided altogether if more information were available on the creditworthiness and reliability of potential contracting parties.

Unlike state-sponsored courts, private, alternative dispute resolution fora can neither induce the parties to appear nor to comply with the resulting decision (Landes and Posner 19xx). For private methods to be an effective substitute for resolution by the courts, the parties must have some incentive to submit their dispute and be bound by the outcome. In the commercial world, maintaining a good reputation often supplies that incentive.

The importance of reputation helps explain why many bargains are kept despite the inability of courts to enforce them. It is clearest in firm-to-firm transactions, where, as in the case of the construction industry, a small, close knit group of companies interact on a regular basis. It is also evident in the efforts of private agencies to provide data on consumers’ repayment history. Where consumers know that the failure to meet an obligation to one merchant may result in the denial of credit by all merchants, the incentive to avoid default is considerably stronger. The importance of credit bureaus and other devices for sharing information is beginning to be recognized. For instance, recent research has shown its significance for deepening credit markets (World Bank 2003, 101-103).

Addressing contract enforcement problems through information and reputation is a relatively apolitical approach to improving the rule of law. But, while important, it can only be part of the resolution to credible commitment problems inherent in contracting among private parties. The question that arises then is what else can a country do to the make investment environment more predictable while waiting over the long haul for courts based rule of law to emerge? Goodpaster (2003) argues that relationships of genuine trust, based on kinship relations can potentially provide reasonably effective alternatives that build on current political realities. The critical ingredient, he contends, is that whoever gives the assurance of contract fulfillment can indeed guarantee that the

25 In a related argument, Goodpaster (2003) contends that social capital and trust based relationships can serve as a robust alternative to the Courts in the enforcement of contracts. His analysis is very much consistent with the empirical findings of Wei (1996) on kinship networks in China. Wei finds that emergence of informal kinship networks helps explain the huge inflows of capital into China despite the foreign investors’ perception of high levels of corruption.
implicit trust will not be abused or that any abuse will be effectively remedied. Campos et al (2001) analyze and describe real world examples of alternative credible commitment mechanisms -- from Indonesia under Suharto to present day China -- and provide some empirical evidence in support of this thesis.

Reforms of and within the Legislature deserve greater attention from donors

While reforms to the legal and judicial system as well as corresponding technical assistance expanded during the 1990s, there was distinctively much less activity on legislative reforms.\(^{26}\) This is due to the lack of experience among donors with this type of reforms, the more political and controversial nature of these reforms, and the nascent state of many legislatures.\(^{27}\) Nevertheless, the spread of democracy created the space for legislatures to evolve into independent political institutions that could oversee the Executive and, with or without foreign assistance; the legislatures have ventured slowly to build their oversight capacity.

In most countries, the legislature is the constitutionally mandated institution through which governments, with the Executive as head, are held to account to the electorate. In doing so, the legislature can use several means, including approval of budgets, the questioning of senior government officials, the review and confirmation of executive appointments, impeachment and/or the power to dismiss the government, question period, the establishment of parliamentary committees and the formation of commissions of inquiry.

A fundamental and critical role of the legislature in most countries is to scrutinize and authorize revenues and expenditures and to ensure that the national budget is properly implemented. Yet while legislatures around the world have the constitutional power to consider national budgets and authorize governments to raise revenues and carry out expenditures, there has been a wide variation in the actual exercise in this power.

Schick (2002) has noted the long-term decline in the influence of national legislatures on budget policy in industrialized countries, due to a combination of devolution of spending to state and local governments and, to a lesser extent, of revenues and the expansion of both entitlement spending and national debt service. This budgetary decline is perhaps most evident in Britain, where Parliament has long ceased to influence budget measures proposed by the executive (Davey, 2000).\(^{28}\)

By contrast, in developing and transition countries, the 1990s witnessed a trend towards legislative budget activism, reflecting the process of democratization and the opening up of possibilities for legislative involvement in what was previously closed budgetary systems. In Brazil, for example, Congress had historically played no

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\(^{26}\) Manning and Stapenhurst (2002)

\(^{27}\) Lippman and Emmert (1997).

\(^{28}\) Towards the end of the decade, a number of legislatures responded to this weakened position with a burst of budget activism. A recent OECD study (1998) found that more than half of the legislatures were playing a larger role in budget development than they were ten years ago, suggesting that they have maintained their oversight role and simply shifted emphasis.
significant role in the budget process; now, constitutional changes have given Congress powers to modify the budget (Blöndal, J. R., C. Goretti & J. K. Kristensen, 2003). In Africa, too, changes are occurring. For example, South Africa and Uganda have passed Financial Administration or Budget Acts which give more influence to the legislature during the budget formulation and approval processes.

But the experience to date suggests that developing country legislatures have a long way to go in being able to adequately perform their oversight functions, especially over the national budget. Building oversight capacity involves, inter alia, strengthening the “money committees”, establishment of dedicated research staff, enhancement of complementary institutions such as the national audit offices, and the encouragement of public input at the various stages of the budget cycle. Through the 90s, numerous organizations, including bilateral donors, multinational organizations and international financial institutions have supported efforts to enhance the oversight capacity of legislatures. Such assistance has ranged from supplying office and other equipment to helping establish legislative budget offices and strengthening committees. However, results have been mixed.

Indeed, Carothers (1999) notes that in the area of democracy assistance, it is support to the legislatures that most often falls short of its goals, and argues that legislative strengthening efforts should be seen as complements to related governance improvements. “Treating legislatures as self-contained entities that can be fixed by repairing internal mechanisms is unlikely to get very far. Rather,…it is more useful to think in terms of helping a society develop the capacity to enact laws that incorporate citizens’ interests…[this means] working with many people and groups outside the legislature, including political parties, citizens groups, the media, officials from the executive branch, jurists and others (Carothers, 1999, p.98).” In the case of money committees, this means dovetailing reform activities with broader efforts to enhance government accountability and strengthen public financial oversight and ensuring that training activities include participants from other stakeholder organizations, such as the Ministry of Finance, the Auditor General’s Office and representatives from civil society.

B.2. Policymakers and the Bureaucracy: Strengthening the Compact

For more than two decades now, public sector management reforms have focused heavily on improving the so-called compact between politicians as policymakers and civil servants as implementers of policy and service delivery. Indeed, the now well documented and extensively studied reforms in New Zealand, Australia, and the United Kingdom that graced the reform landscape in the 1980s almost exclusively dealt with this compact. From the large scale, big bang privatizations and radical changes in financial management in New Zealand, to the forward looking budget reforms in Australia, and to the proliferation of Next Steps agencies in the U.K, all aimed at altering the fundamental relations between politicians/policymakers and bureaucrats in order to improve the delivery of public goods and services.

With the fiscal crunch arising from the debt crisis of the 1980s, a similar trend occurred in the developing world in the 1990s. Efforts to prune and rationalize the role of the state led to privatization of state owned enterprises. Similarly, budget and financial
management reforms were initiated and even the more challenging and controversial new public management reforms of the U.K. and New Zealand variety were initiated in a great number of developing countries\textsuperscript{29}.

These reforms essentially had two thrusts. The first was to build the capacity of the public sector – personnel skills, systems, and processes – to formulate and implement policies. The second, which became more of the emphasis during the decade, was to infuse clearer and more binding accountabilities of civil servants to policymakers and politicians. Underpinning both these trends was the move towards greater democratization of politics that sought to strengthen political accountability and as a consequence the compact. This often took the form of a major decentralization of financial and functional authority to local governments with a view to bringing governments closer to the people.

\textit{Some Emerging Lessons}

The public sector management reform efforts pursued in the 1990s have produced mixed results. Given the slow pace at which institutions change, and the fact that most of these reform efforts are rather recent in origin, it is far too early to reach any definitive conclusions about successes or failures. Moreover, there has been very little systematic research evaluating results and outcomes, partly because of the stop-go nature of many reforms. Even when reforms appear to be successful, it is often too early to judge whether such success is sustainable. Given that reforms imply changes in formal and informal rules, both of which are rooted heavily in a country or organization’s culture and history, it is also not obvious that successful reform efforts in one organization can be easily transplanted into another organization in the same country, let alone across a country’s borders. What follows in the following discussion is an attempt to cull some preliminary conclusions from the experience to date. These must by their very nature be tentative and subject to revision as we learn more about what drives public sector governance reforms.

What then are the promising lessons? Based on a review of reforms in public expenditure management, tax administration, administrative and civil service reform, E-government, anti-corruption, and decentralization, we have identified nine avenues worth exploring.

\textbf{Fiscal Management}

\textit{Governments faced with populist pressures can strengthen fiscal discipline by tying their own hands.}

Through the 1990s, governments have attempted to improve fiscal discipline in a number of ways\textsuperscript{30}. The most high profile efforts, as discussed elsewhere in this report,

\textsuperscript{29} There are differing interpretations of the composition of New Public Management reforms. But there is a general agreement that the key components include deregulation of line management, conversion of civil service departments into free-standing agencies.; performance-based accountability, particularly through contracts; and competitive mechanisms such as contracting-out and internal markets. Various authors also include privatization and downsizing as a part of the package (Polidano, 1999).

\textsuperscript{30} Fiscal discipline was critical to maintaining macroeconomic stability which in turn was essential to stimulating growth (see chapter 3)
have been to make Central Banks independent as a means of clarifying the direct responsibility of the Central Bank over controlling inflation and granting it the flexibility to meet this mandate. While many countries have indeed adopted this approach, recent research suggests that its effectiveness depends in large part on the nature and efficacy of checks and balances in the larger environment. “Delegation is more likely to enhance credibility and political replacements of central bank governors are less likely in the presence of multiple” political checks and balances (Keefer and Stasavage, 2003: 407).

On the public expenditure side, the experience of the 1990’s led to a recognition of the importance and impact of fiscal institutions, with a number of studies suggesting that institutions define and constrain the nature of the political bargaining that affect fiscal outcomes. Evidence from empirical studies of fiscal institutions and budgetary outcomes suggests that well-defined anti-deficit rules, especially when coupled with credible limits on government borrowing, induce smaller deficits and more rapid adjustment of taxes and spending to unexpected fiscal shortfalls. In part, these institutions are meant to contain interest group pressures on the budget.

In recent years, a number of countries and sub-national governments in developing countries have passed Fiscal Responsibility Acts to strengthen fiscal management, e.g. Brazil. These laws require the Executive to present to the legislature, prior to the presentation of the proposed budget, the policies and parameters to which it intends to adopt and bind government over the medium term and to explain to the legislature ex-post any deviations from the budget during the fiscal year. They enhance transparency as well as accountability (of the Executive to the Legislature and of both the Executive and the Legislature to the citizenry) by stimulating discussion both within the legislature and the public/media of fiscal policies and their implications before and after budget deliberations. Though there are no studies to date assessing the effects of such legislation, the expectation is that such legislation will strengthen fiscal discipline.

**Hidden contingent liabilities destroy the fabric of fiscal discipline**

The Asian financial crisis highlighted the importance of budget transparency: the budget should not only reflect the actual expenditures to be made during the fiscal year but also include the budgetary implications of all fiscal risks, e.g. contingent liabilities arising from loans made by state owned banks that could become real liabilities in the medium term. A higher level of budget transparency matters since it provides a basis for informed debate about budgetary policy among the public, the Legislature, and within the Executive. By increasing the chances that fiscal risks will be identified and policy responses put in place, fiscal transparency was seen to be essential to maintaining fiscal discipline. But again, as box 8.3 suggests, progress has been slow partly because of capacity constraints and partly because of political considerations.

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32 Alesina and Perotti (1996) discuss institutions in terms of the degree of centralization of authority in the budget process and the degree of transparency. Von Hagen (1992) provides summary information on the budget process in European Community nations. Von Hagen and Harden (1995) use indices of budget process that reflect to estimate simple cross-sectional regression models relating budget structure to fiscal outcomes such as the debt/GDP and deficit/GDP ratio. The results suggest that tighter budget rules are associated with lower budget deficits and reduced levels of government borrowing.
Box 8.3: Fiscal Transparency and Developing Countries

The fiscal transparency code was introduced in 1998 as a response to the financial crises of the late 1990s when potential vulnerability was seen to have been hidden by the lack of relevant fiscal information. The fiscal Report on the observance of Standards and Codes (ROSC), which is a voluntary diagnostic, assesses the availability and quality of fiscal data but goes further to also evaluate the fiscal management framework, including relations between levels of government, and accountability for fiscal activities outside the budget. 33

The fiscal ROSC applies a uniform approach to countries, assessing systems relative to “good” practice while avoiding a pass/fail judgment. As of end-2003, ROSCs had been completed in 63 countries, of which 58 are posted on the IMF website. Countries in which the fiscal ROSC has been undertaken include industrial economies, emerging market economies, transition economies and developing economies. Application of the fiscal ROSC has met with some challenges in ensuring even-handed treatment of countries at different levels of development and revisions to the guidelines have sought to address these differences appropriately.

Countries electing to have a fiscal ROSC reflect an element of reform self-selection and are often already engaged in fiscal management reforms. Nevertheless, in developing economies, the fiscal ROSCs have identified pervasive problems of data quality (un-reconciled accounts, lack of clarity in accounting policies, weak external audit), excessive discretion in tax administration and poor enforcement, unrealistic budgeting, weak internal controls, significant payment arrears, and lack of clarity in defining responsibilities of various levels of government. In a number of developing economies, the scope and extent of off-budget activities (including quasi-fiscal activities) is an issue to be addressed. Other than a few industrial countries, most countries also do not quantify tax expenditures.

Source: Fiscal Affairs Department, IMF.

An MTEF, while technically attractive, will work only if politicians embrace it

Medium-Term Expenditure Frameworks (MTEFs) gained currency as an important reform during the 1990’s, with many countries adopting them as a way to increase the transparency of budgeting and enhance the predictability of agency budgets. Because public sector projects all have fiscal implications beyond the fiscal year, governments had come to realize the importance of managing expenditures (and thus deficits) not just over the typical one year period but over the medium term. This eventually gave rise to the Medium Term Expenditure Framework (MTEF). Its primary function is to infuse a multi-year perspective into budgeting, enabling policymakers to recognize the implications of current budgetary decisions for government finances in the future and creating a more disciplined, sequenced budget process that clarifies deliverables and accountabilities of both central and line ministries.

In the OECD, most countries pursued a partial implementation of an MTEF. Either by choice or circumstance, they have not adopted the full plethora of features 34. The adoption of multi-year features evolved gradually over time, usually as technical improvements to the budget process rather than big-bang reforms: unbundling the key features of an MTEF, and pursuing them individually, appears to be a more effective

33 For a more extensive discussion of assessment instruments in the area of public financial management, see Allen, Schiavo-Campo, and Garrity (2004)
34 About 73 percent have multi-year expenditure estimates incorporated into their budgets and 67 percent have a medium-term fiscal framework with ceilings for expenditures, deficits and revenues over multiple years as part of their budget (see World Bank/OECD Survey on Budget Practices and Procedures, 2003). Available at: http://ecde.dyndns.org. As of December 2003, 27 (of 30 total) OECD and 17 developing countries are included in the database. For the features of an MTEF, see World Bank, Public Expenditure Management Handbook, 1998.
approach than wholesale adoption of the full gamut of features. This suggests that an MTEF may be better used as a conceptual framework for thinking how elements of budget reform fit together rather than a reform in and of itself and implies that diversity in implementation is more the rule. Yet, in developing countries, it has been introduced (largely through donor initiatives) as a technically superior “one size fits all” process to annual budgeting.

In Africa, the implementation process has been slow. Of the nineteen countries with MTEFs at some stage of implementation, as of 2002, only five MTEFs were integrated in a meaningful way into the budget process. In most cases, MTEFs have operated in parallel to the general budget process. More significantly, only four countries submitted MTEFs to both cabinet and parliament and, in some cases, the MTEF has remained strictly a Ministry of Finance technical document. Not surprisingly, the MTEF has not produced the results expected of it.

An MTEF’s value comes from the multi-year information that it can generate and from the ensuing discussion, debate and agreement among different parties engaged in the budget process, in particular the Legislature, about the trade-offs among programs, activities, and projects that need to be made. Hence, for an MTEF to be effective, it needs to be integrated into the budget process and budget documents. Quite clearly, just like the budget, an MTEF is fundamentally political. So its effectiveness depends in large part on the willingness of politicians to embrace it as a reformed budget process and accept the discipline it brings. Hence, not surprisingly, progress in many developing countries has been muted.

Organizational and Human Resource Management

Capacity constraints are binding: Strategic incrementalism may be the only option for many developing countries.

The World Development Report of 1997 argued that the State should match its role to its capacity. Taking on too much stretches the State’s capabilities and thus makes it less effective. This was certainly evident with the various reforms pursued in public expenditure management. But it is perhaps most salient in the attempts of many developing countries to adopt new public management approaches.

New Public Management reforms are a challenge even in countries with strong capacity.

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35 An MTEF has seven key features: (i) a top down process for establishing hard budget constraints at the aggregate and sectoral level, (ii) a bottom up process in which line ministries prepare forward estimates of expenditures over a three or four year period, (iii) a system for reconciling the forward estimates and the hard budget constraints which would included processes for making intersectoral reallocations, (iv) transparent system for incorporating changes to the forward estimates during roll overs to the following year, and (v) a tractable system for undertaking program evaluation.

36 Benin, Burkina Faso, Chad, Ethiopia, Gabon, Gambia, Ghana, Guinea, Kenya, Lesotho, Malawi, Mali, Mozambique, Namibia, Rwanda, South Africa, Tanzania, Uganda and Zambia.


A big story in the 1990s was the proliferation of New Public Management (NPM) reforms -- with organizations set up at arms length from the parent ministry and having a contractual arrangement with it -- and a budding love affair with performance measurement. But these reforms basically put the cart before the horse. Manning and Parison (2003) argue that NPM types of reform efforts are difficult to successfully implement in both developing and developed countries, and nearly impossible in countries lacking institutionalized “organizational discipline”, i.e., where the basic civil service management systems do not function as intended. A recent study shows that in environments in which the basics are very weak, resort to New Public Management style performance management techniques is associated with poorer performance, as measured by increases in administrative corruption (Anderson, Reid and Ryterman, 2003). In this study, the authors found that the most fundamental and significant factor contributing to better performing public organizations is the creation of merit-based personnel management practices: putting recruitment and selection systems, performance evaluation procedures, promotions procedures, salary setting rules and procedures, wage bill controls, and due process protections in place and functioning as planned. The implication is that these core systems and practices are preconditions for effective performance management practices.

Performance-based budgeting, emerged as a corollary reform under the NPM, emanating primarily from the experiences of the U.K. and New Zealand in dealing with their respective fiscal problems. In the past twenty years, OECD member countries have gradually shifted the focus of public sector budgeting and management from inputs to outputs in an attempt to clarify, both internally within government and externally to the general public, what agencies should be providing, i.e. improving the quality and usefulness of information to strengthen internal accountability. This development has arguably enhanced the quality of public sector management and increased the government’s effectiveness and efficiency.

But, as with the multi-year framework, this process has taken many years to evolve and mature and the experience has debunked the earlier belief that performance measurement can often be an effective catalyst for organizational change. More important for developing countries though is the fact that

39 Privatization of State owned enterprises has been a key element of the NPM. Typically, state run commercially viable entities are spun out of the State sector and into the private sector as part of an overall program of “trimming the State.” See chapter 5 for a discussion of the experience with these efforts in the 1990s.
40 A point that Schick (1998) makes more generally.
41 Their finding is very much consistent with earlier related work by Evans and Rausch (1997). There is also research at the sector level that supports these findings. Gunnarsson et al (2004) find strong empirical evidence indicating that the granting of autonomy to local district school principals (akin to delegation under the NPM) results in improvement in student performance only if the principal and the school staff have adequate capacity to take advantage of the increased autonomy.
42 For a discussion of the limitations of outcome oriented management and budgeting see OECD (2001).
43 See Schick 2003, Getting Performance Measures to measure up. Schick cites the Britain’s Next Steps initiative which government established new agencies by separating service delivery from the policymaking functions of ministries. Then it set performance targets. More than 100 agencies were created, and each was given operating independence and a charter (called a framework document) that spelled out its responsibilities and the manner in which it is to be held accountable. Each negotiates annual performance targets with the parent ministry to which it is responsible, and each compares results to these targets. The Next Steps reforms are generally regarded as among the most effective innovations in British
OECD countries had already very much established well functioning basic personnel management systems, many in the Weberian tradition, before launching into performance management and budgeting.

*Capacity constraints and political imperatives can severely impede Civil Service reform*

In many developing countries, establishing basic (core) systems requires overhauling the civil service. This poses two major problems. First, opposition will be much more widespread and thus more politically challenging to address. And second, the limited capacity of many developing country governments will be taxed heavily as it will need to manage this “whole of government” process.

The impact of politics is especially acute in the context of civil service reforms. A key part of the difficulty is, unavoidably, the fact that such efforts must transfer some authority from the political echelons, e.g., legislators, ministers, and their political appointees, to a cadre of de-politicized officials (civil servants). In many developing countries, the political history and environment make this a gargantuan task.

A malfunctioning civil service system creates disillusionment among the populace since public services will tend to suffer. One would thus expect that politicians would be interested in improving the internal incentive mechanisms that govern the civil service. A de-politicized, reasonably well compensated and skilled civil service can in fact serve as a credible commitment mechanism to foster better service. Politicians could thus promise better primary health care or greater access to and better quality of primary education and be credible to the citizenry. However for many developing countries, reforms were attempted under conditions where clientelist politics of one form or another had already been deeply entrenched. Hence, opposition to reforms has been formidable and, not surprisingly, the experience with such reforms has been quite discouraging.

A World Bank study on the experience with civil service reforms in Africa reflects very much the reality of political constraints. As the study concludes, “For each of the reform areas considered, there exists a well-understood set of mechanisms which have the potential to align the administrative system to support developmental goals. Each of the chapters takes these normative ‘best practices’ as the starting point, and examines the degree to which they have been realized in practice. In all but a few cases, the results so far have fallen far short of the normative model. For example, comprehensive efforts at administrative reform achieved some success only in 3 of 7 sample countries where they were attempted and have achieved little in the remaining four countries where political constraints short-circuited ambitious programs. What plausibly underlies this implementation shortfall is the ‘politicians dilemma’ . . . the need to balance the technocratic logic which shapes many proposals for reform with the political imperatives of building and sustaining alliances with powerful patrons, of avoiding conflict with powerful social groups, and of maintaining electoral support.

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44 See Stevens and Teggemann (2003) and Manning and Parison (2003). For a case study on reversibility, see World Bank on Albania CSR (need exact reference).
45 See Shepherd (2003) for a discussion of this point.
46 For instance, World Bank, 2000, Institutional Governance Review: Bolivia
Depending on the severity of the political constraints, even well-intentioned leaders are thus limited in how ambitious a reform agenda they can take on. A key lesson is that it can be counterproductive to ignore these constraints, and bulldoze along with an agenda (Levy and Kpundeh, 2004: 12, 16).

*With appropriate design and sufficient political commitment, “enclaving” can potentially be a path to sustained reforms of the Civil Service*

The challenge of politics and capacity constraints have led some countries to experiment with enclave approaches to civil service reform – spinning off select government entities from the central government ministries – essentially as a means of matching capacity with the demands of managing the political process. Among the more visible of these reforms was the thrust towards increasing the autonomy of the revenue collection agencies, driven in large part by declining tax collection efforts, i.e. tax to GDP ratios, (with serious budgetary implications). This became a key feature of governance reforms in Latin America in the early 1990s, starting with Peru in 1991, and followed by Venezuela, Mexico, Bolivia, Guatemala, Argentina, and Colombia. This reform also became popular in Africa in the late 1990s, with 12 countries experimenting with Revenue Boards or semi-autonomous agencies. In Asia, by contrast, only Malaysia and Singapore have given greater autonomy to their tax administrations, although other countries in the region are beginning to discuss and consider this as well.

In general, an ARA has more flexibility in managing personnel and finances and more control over corporate governance relative to the typical government agency. At the same time, it also has clearer and more transparent accountabilities. Like the independent central bank in the case of monetary policy, it was designed to resolve a credible commitment problem: if properly functioning, an ARA signals taxpayers that tax policies and regulations will now be credibly and fairly enforced. In theory, it implies that firms that comply faithfully with the rules would no longer be at a competitive disadvantage to firms which do not. For the general taxpayer, it means that everyone will pay his “fair” share of financing public goods and services. And, it also means that compliance will be easier because the transactions costs of paying taxes would be reduced. The overall implication thus was that collections would increase and service would be more taxpayer friendly.

In practice, the performance record of ARAs has been mixed: some countries have improved performance dramatically across a number of indicators, while others have had difficulty attaining the expected results or sustaining initial progress. Problems

47 The establishment of Large Taxpayers Units (LTUs) was a related reform that many countries explored to improve tax compliance of the largest taxpayers and to pilot new organizational structures, systems, and procedures. More than 40 developing and transition countries have set up special large taxpayer units. Again, this reform was first implemented in Latin America and followed by a number of African countries and transition economies, while only 5 Asian countries (Bangladesh, Cambodia, Lao PDR, Philippines, and Sri Lanka) have developed special large taxpayer structures so far. The percentage of total taxes revenue collected by LTUs ranges from 28% in Sri Lanka to more than 80% in Benin, Burkina Faso, Togo, Mexico and Uruguay.

48 For a particularly strong critique, see Fjelstad, (2002). For a more general country survey and balanced assessment, see Taliercio (2003) and for a good theoretical argument, Taliercio (2004).
in performance have resulted primarily from the lack of political support, tensions between the ARA and the ministry of finance, and poor organizational design, including among others weaknesses in the new accountability regime. Nonetheless, on the whole the record suggests that, with enough political push and proper design, ARAs can improve tax administration and be sustainable (see Box 8.4 below).\(^49\)

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**Box 8.4: SUNAT – A Modest Success**

In the late 1980s, Peru decided to set up a semi-autonomous revenue authority (SUNAT), as tax administration was riddled with corruption and on the verge of collapse, with revenue collections dropping to a record low of 9 percent in 1988. A comprehensive staff screening and replacement program was initiated, and less than one third of the original tax administration staff was rehired by the new organization. A modern human resource management system was introduced and SUNAT was allowed to operate under private sector labor laws. Salaries were adjusted to private sector levels. A new financing mechanism provided financial stability and the agency was able to operate without undue political interference. By 1997 tax revenues had recovered to 14 percent of GDP. However, SUNAT, after its successful start, suffered from decreasing political support for efficient revenue collection, a decline in the quality of the tax policy framework, which made the task to collect taxes fairly and efficiently more difficult, and increased interference by the Ministry of Finance in its autonomy. SUNAT as a consequence has suffered a loss of standing in public opinion. Despite these problems, however, the creation of SUNAT has permitted the launch of far-reaching efficiency and integrity-enhancing reforms, which have had an ongoing impact on revenue performance. Revenue collection, at 12% of GDP in 2001, remains far above the pre-reform level.

Given the immense difficulty, both politically and in terms of capacity, of overhauling the “whole of government”, for many developing countries, enclaves may be the only game in town. Comprehensive reform approaches strain limited institutional capacity, generate more than the tractable level of opposition, and thus almost always stall and crumble midway through, if not early in, the process. The important lesson to keep in mind is that enclaving must be strategic.\(^50\) Otherwise, it runs the risk of constraining and/or distorting the capacity building efforts of government (see Box 10.5). Part of the reason why ARAs have been modestly successful in some countries is that revenue collections dictate the budget envelopes in most developing countries so that much of what government does depends heavily on the performance of its tax collection agencies.\(^51\) Moreover many of these countries faced serious budgetary problems. That is, reforming the tax administration apparatus was strategically important because the control of the budget deficit and thus the performance of government as a whole depended crucially on it.

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**Box 8.5: The Enclave Conundrum in Uganda**

The Government in Uganda now has to decide the fate of more than 70 enclaved units – mainly outgrown project implementation units and semi-autonomous organizations called secretariats. These were set up at the behest, or with support, of donors because of their doubts about line ministries’ inadequate capacity and their dissatisfaction with ministries’ procurement practices. Weak civil service or one-off nature of the unit’s activity justified the creation of

\(^{49}\) While the same political support might perhaps have achieved the same results without the move to an ARA, in some instances introducing an ARA has served to energize and crystallize support for more wide ranging administrative and civil service reform that might not otherwise have been mobilized.

\(^{50}\) At the sector level, see Harding, April (2003) for an extensive comparative review and analysis of different approaches to health care provision – direct provision by the public sector, through non-profit providers, through for profit providers, and through informal providers. The lessons suggest possibilities for focused strategic interventions in the health sector.

\(^{51}\) Again, see Taliercio (2003).
such units as a *purely temporary* measure. These enclaved units organizations were allowed to set their own wage rates, above ministry levels based on the premise that necessary skills would not be available at the public service’s low salary levels.

Ironically, with these higher salaries, the enclaved units have recruited substantial numbers of skilled personnel from within the public service and have drawn staff from their parent ministries by offering higher salaries, further depleting their limited capacity of ministries, and demoralizing competent ministry staffs. These units thus have undermined the process of building the much-needed capacity within related core line ministry functions. This in turn has reinforced donors’ perceptions of limited capacity within the ministries.

Enclaving has also undermined the budget process. First, although accounted in the budget under development expenditures, two-third (71 percent) of enclaved units’ expenditure is of a recurrent nature. These recurring expenditures come from the government’s 10% contribution to donor funded projects. While this may seem a nominal proportion of any project’s total budget, the total constitutes nearly one-third (28%) of government’s own generated funds. This significant part of government’s own generated resources is spent without the rigor that is associated with allocating other government expenditures.

In fact, a study by Levy and Engberg-Pedersen (2004) on the African experience suggests that more narrowly focused, strategic interventions may indeed be more successful over the long run. Moreover, they found that, among the more narrowly-focused reforms, the capacity building initiatives focused on improving expenditure accountability were considerably more successful than those focused on human resource management. They conclude that the more technical nature of expenditure accountability reforms may have been less threatening to vested interests than the more politically sensitive administrative reforms, and perhaps more importantly, that these reforms produce more readily observable results that generate needed support from the general public (to counter vested interests).

**While controls and compliance are key, values, commitment, and pride in public service may be important as well for sustained performance**

Judith Tendler argues, with some merit, that mainstream development advice has paid little attention to worker commitment “except to argue that government workers are doomed by their self interest to be uncommitted.” The New Public Management Reforms were in fact based partly on this premise and thus driven by a desire to introduce stronger market based incentives as a means of reforming government bureaucracies. Emulating the experiences in developed countries such as New Zealand and the U.K, developing country governments attempted to adopt performance management techniques that grew out of reforms in the private corporate sector. These reforms are aimed at enhancing the autonomy of public sector managers and staff while at the same time increasing their accountability. While they have arguably led to improved service and performance in developed countries, they have not had much success in developing countries.

Tendler contends that the experience in the industrial countries with industrial performance and workplace transformation has shown that worker dedication to the job is

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52 Draft World Bank report: “Affording Uganda’s Public Administration Sector” which is currently being reviewed by the Government of Uganda, December 2003

53 Based on evaluations of the Banks Operations Evaluation Department (OED), 8 of the 9 expenditure accountability projects were rated successful; in contrast, only 2 of the 8 projects on human resource management were rated successful.
an important explanation for improvements in performance. Recognition of this has caused well performing firms to pay close attention to “innovative practices that increased worker dedication. “Almost all these innovations involve greater worker discretion and autonomy, greater cooperation between labor and management, and greater trust between workers and managers (Tendler, 1997:4-5).” She contrasts this with the development literature which has been “riveted by the absence of worker commitment”, and the suspicion that “civil servants are self-interested, rent-seeking and venal, unless proven otherwise”. Tendler cites as evidence the preoccupation with downsizing in civil service reforms without corresponding efforts to reorganize work “in ways that increase worker commitment”. Her own research on public bureaucracies at work under an innovative state government in Ceará, Brazil shows how important the infusion of a sense of calling and dedication was to successful outcomes.

Box 8.6: Building a sense of calling and commitment in public service delivery: Ceará, Brazil

High performance and significant developmental impact in various programs in Ceará, Brazil, has provided a new interpretation for factors motivating the State, civil society, and civil service. Ceará saw substantial improvements in preventive health indicators such as infant mortality and vaccination coverage. Agriculture programs saw a significant measurable increase in output and productivity. Spillover effects from procurement reform programs resulted in local economic development, in addition to increasing output and productivity for small-firm suppliers. Public works construction created more jobs in the economy than usual, resulting in a greater share of public expenditure being allocated to labor.

Four closely intertwined explanations can be offered for this improved performance:

• First, civil servants in these programs showed high dedication to their jobs. They were either dedicated entrants into civil service and work conditions perpetuated that dedication or, circumstances of the jobs elicited commitment from them.
• Second, the Government repeatedly and publicly demonstrated admiration and respect for the civil servants by regularly announcing successes and openly rewarding good performance building a sense of calling and pride around workers and creating a sense of chosen elite in the public service. Publicity also increased citizen awareness and public monitoring of civil servants and local governments; and created a new constituency that would help leaders and agencies overcome political opposition.
• Third, innovative organization of tasks for workers in the public programs, resulted in often voluntary ownership of varied and multiple tasks. These multiple tasks often coalesced into client-centric, problem-solving approaches to service-delivery.
• Finally, repeated messages from the Government and re-organization of tasks kept rent-seeking behavior under control by creating a sense of pride, ownership and recognition around public service in the eyes of society and civil servants alike.

This case challenges the mainstream developmental belief that poor performance of public programs is due to the inherent self-interest of civil servants. It demonstrates that the creation of a sense of calling and ownership around public service by a committed leadership, a dedicated work force, and an informed and engaged civil society can increase acceptance to reform and improve service delivery.

(Source: Judith Tendler, pp. 135-165)

54 At its core, this is the basic assumption of the principal – agent model. The NPM reforms have been driven by principal-agent concerns.
55 There are other case studies that are consistent with and support Tendler’s thesis. See for instance, Osborne and Gaebler (1992), and Levine (1995).
The effectiveness of ICT is preconditioned on the reengineering of underlying processes and the proactive use of change management

In a quest to improve the delivery of front line services, many countries began adopting information and communications technologies (ICT) in such varied areas as tax collection, customs valuation, procurement, treasury and cash management, issuance of licenses, land registration and titling, passport issuance, and many other focused front line public services. This 1990s trend, which has come to be known as “E-government,” involved significant experimentation with the application of ICT to various internal processes to increase transparency and efficiency.

E-Government applications have normally evolved through a four-stage process. The first stage includes the publication of information on a website for citizens to seek knowledge about procedures governing the delivery of different services. The second stage allows for interactivity online. Clients can download applications for receiving services. The third stage involves electronic delivery of documents. The fourth stage results in electronic delivery of services where more than one department may be involved in processing a service request or service.

Box 8.7: Mexico’s E-SAT Program – Striving for Greater Efficiency in Tax Administration

Inspired by the early successes experienced by Argentina, Brazil, and Chile in terms of using ICT for the purpose of improving the delivery of government services, the Mexican government, as part of its OECD based program of regulatory and administrative reform, began the process of moving government information and services online. Within this framework, Mexico’s Federal Tax Administration, (the Servicio de Administración Tributaria SAT) embarked on E-SAT, a program to offer tax services online. The e-SAT initiative does not constitute one discrete project but, rather, a continuously evolving, administration transcending series of “works in process.” Measured from its 1995 starting point, the initiative has led to the development and implementation of tax administration efficiency enhancing features and services. By 1998, SAT succeeded in establishing an interactive web page that (i) contained basic information pertaining to Mexico’s tax laws and procedures and (ii) permitted obligated taxpayers to electronically file their annual declarations. The primary beneficiaries of the first phase of this new system were the large corporations.

In 2000-2003, SAT expanded the nucleus of online tax services and provided for the electronic realization of the following tax transactions: (i) obtainment of a personal form of electronic identification, (ii) obtaining a corporate tax ID for new entities via the Internet, (iii) submission of a tax declaration and other relevant forms, iv) the realization of an inquiry into the status of a taxpayer account and,(v) the scheduling of an appointment with a SAT tax counselor. In August 2002, the SAT promulgated a new regulation requiring the electronic submission of most individual and corporate taxpayer declarations (through the SAT’s portal) and payments (through the portal of the taxpayer’s bank). The SAT is currently working to develop and make operational online systems for the receipt and processing of credit card payments and the realization of tax refunds. E-SAT has greatly reduce the amount of paperwork previously managed by Mexico’s tax registry, declaration, and collection units.

E-Government has been a powerful enabling tool that has aided governments in enhancing the efficiency and effectiveness with which they deliver services. Table 8.1 illustrates examples where efficiency gains have been made.

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56 Kossick (2003)
57 It can also enhance transparency. For instance, the use of electronic bulletin boards in government procurement has made information on government contracts much more widely available (see Bhatnagar and Deane, 2003).
Table 8.1: Examples of Efficiency Gains from ICT

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of Government Application</th>
<th>Number of days to process before application</th>
<th>Number of days to process after application</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Registration of documents</td>
<td>Several days</td>
<td>20-30 minutes per document, one day for business licenses</td>
</tr>
<tr>
<td>Chile</td>
<td>Taxes online</td>
<td>25 days</td>
<td>12 hours</td>
</tr>
<tr>
<td>China</td>
<td>Online application for 32 business services</td>
<td>2-3 months for business license</td>
<td>10-15 days for business license</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Several visits to multiple offices for filings</td>
<td>Several seconds for routine filing for companies</td>
</tr>
<tr>
<td>India, Andhra Pradesh</td>
<td>Valuation of Property</td>
<td>Few days</td>
<td>10 minutes</td>
</tr>
<tr>
<td>India, Andhra Pradesh</td>
<td>Land Registration</td>
<td>7-15 days</td>
<td>5 minutes</td>
</tr>
<tr>
<td>India, Karnataka</td>
<td>Updating Land Registration</td>
<td>1-2 years</td>
<td>30 days for approval, request completed on demand</td>
</tr>
<tr>
<td>India, Karnataka</td>
<td>Obtaining Land Title Certificate</td>
<td>3-30 days</td>
<td>5-30 minutes</td>
</tr>
<tr>
<td>India, Gujarat</td>
<td>Interstate Check Posts for Trucks</td>
<td>30 minutes</td>
<td>2 minutes</td>
</tr>
<tr>
<td>India, Andhra Pradesh</td>
<td>Statutory Certificates on caste</td>
<td>20-30 days</td>
<td>15 minutes</td>
</tr>
<tr>
<td>Jamaica</td>
<td>Customs Online</td>
<td>2-3 day for brokers to process entry</td>
<td>3-4 hours</td>
</tr>
<tr>
<td>Philippines</td>
<td>Customs Online</td>
<td>8 days to release cargo</td>
<td>4 hours – 2 days to release cargo</td>
</tr>
<tr>
<td>Singapore</td>
<td>Issue of Tax Assessments</td>
<td>12-18 months</td>
<td>3-5 months</td>
</tr>
</tbody>
</table>

Source: Bhatnagar, Subash and Arsala Deane (2003).

Despite this, experience so far suggests that E-government is not a panacea for basic problems. Reengineering of fundamental processes needs to precede attempts to adopt ICT: for real gains to be made, processes need to be simplified and automated in a way that reduce discretion of government officials. For example, the implementation of Tunisie TradeNet (TTN) system, an electronic system connecting all actors involved in external trade operations to facilitate import and export procedures in Tunisia, has involved re-engineering of trade related processes of nine public and private entities. While the ongoing reengineering of processes and change management has led to some delay in realizing some expected efficiencies and cost savings, TTN has had an impact on users, reducing the average time to perform import operations from 10 days to 2 – 3 days.  

Second, most e-government projects have faced substantial resistance from internal staff. Public servants view E-Government projects as a threat to their jobs. Publication and easier access to information dilutes their control and diminishes their

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58 A study on the effectiveness by Dorotinsky and Floyd (2004) of efforts to introduce computerized integrated financial management systems (IFMIS) in Africa concludes that “technology can only add value in the context of an underlying commitment to disciplined decision-making, and internal management systems geared to monitoring compliance.”

responsibility as information broker. Hence, reform projects can stall unless adequate change management processes are likewise adopted.  

And third, political support from top leadership is critical. Leadership and support from the top levels of government have facilitated buy-in from other government departments and have helped “sell” the project to a larger internal audience and the general public. In Andhra Pradesh, India, for example, top leadership publicly pushed for E-Government and allocated resources accordingly for an ambitious program. Several services are now delivered online and the State Secretariat is moving to a paperless office and electronic workflow. In Korea as well, the success of the OPEN project has been largely due to the support from the Mayor of Seoul who took a multi-pronged approach (including setting up an online tracking of permits and license applications) to curb corruption. In Gujarat, with strong support from leadership, the computerized check posts trebled the fines collected from overloaded trucks. But when this support waned, the verve to reduce corruption weakened, with new forms of extortion hampering the overall effectiveness of the program.

External Restraints

**To combat corruption, prevention may be more effective than investigation and prosecution**

Complementing the more prevalent, macro based judicial reforms were a scattering of efforts throughout the developing world to establish institutions of restraint that focused primarily on enhancing internal accountability. With the spiraling concern over corruption in the public sector, countries began to look to supreme audit agencies, the ombudsman, and anticorruption agencies to help telescope efforts to curtail corruption. Among these, the establishment of anti-corruption agencies (ACA) gained most currency, with countries from Latin America to Africa hoping to fast track anti-corruption efforts.

Anti corruption agencies emerged in the 1990s as a means of introducing independent checks on abuse of office by public officials. The basic logic put forth is that a single agency (as opposed to the more typical multiple agency) approach makes it easier to overcome coordination, information, and leadership constraints. The widely known success of Singapore’s CPIB and Hongkong’s ICAC (though quite different in approach) have been largely the stimulus for these efforts.

The limited assessments of various single agency reforms have been very mixed. Resource constraints, weaknesses in complementary institutions, e.g. the judiciary and the police, and multiple goals have tended to impede ACAs from adequately meeting their mandates (Meagher, 2002). In some cases, ACAs have been set up ostensibly to satisfy a political need, e.g. outcry from a corruption scandal or a loan conditionality, but are not given adequate resources or political backing to actually do their work. In these instances, they have served as instruments to at least temporarily deflect demands for action against corruption while authorities do not undertake any real, concrete steps to

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60 It is estimated that roughly 40% of an e-government project’s cost must be allocated to managing the change process (Bhatnagar and Deane, 2003).

Box 8.8: What it Takes to Create a Successful Anticorruption Agency

A recent study of comparative experience with anti-corruption agencies prepared for the World Bank noted the following factors that drive success of anti-corruption commissions:

- **Establishment**: The success of an ACA depends on its being carefully situated from the start within a set of well-defined supports. These would include a comprehensive anti-corruption strategy, careful planning and performance measurement, realistic expectations and strong enough political backing (across class/party) to make it effective regardless of (political and personal consequences). The agencies that seem to score highest on these measures are those in Hong Kong, Singapore, Malaysia, Uganda and Australia/NSW....

- **Focus**: The ACA needs to be strategic in defining its focus in a way that will maximize its effectiveness. For example, an agency could focus on prevention and monitoring government implementation of anti-corruption policy (foregoing a comprehensive mandate, as in Korea); its jurisdiction could be mainly prospective (only limited concern with past cases, as in Hong Kong); it could choose cases selectively, based on clear standards (as in Argentina and NSW); or it could deal only with the probity and reputation of the public service (as in the US and India)....It appears that clarity of focus is indeed consistently associated with success – except where massive resources are available.

- **Accountability**: This comprises such things as the application of legal standards, the availability of judicial review, systems of public complaints and oversight, a requirement that the agency answer to all branches of government and the public, and precise and comprehensive expenditure accountability. Some commentators also suggest keeping the agency’s size, as well as the “free” support given by aid donors to a minimum....Overall, accountability is not uniformly associated with success in terms of ACA goals- indeed it is frequently a hindrance, stopping or delaying agencies from taking desired actions. Still, many of the successful ACAs are strongly accountable, but this is probably an outgrowth of the rule of law, which seems to be more consistently associated with success (see below)

- **Independence**: This in some cases arises simply from outside accountability, sometimes from the agency’s placement and line of responsibility, the appointment and removal procedures for top officials or some forms of fiscal autonomy. The most important sign of independence is the absence of political intrusion into the agency’s operations.... De facto autonomy, on the other hand, enables ACAs to operate on a consistent and professional basis with relatively little partisan intrusion – and in most environments, this mode of operation is important to success.

- **Powers**: Observers have suggested that a successful ACA will have strong research and prevention capabilities, along with the authority to do the following: access documents and witnesses, freeze assets and seize passports, protect informants, monitor income and assets, propose administrative and legislative reforms and exercise jurisdiction over the chief of state. ...(many) agencies have most or all of these powers on paper but frequently cannot put them into effect due to lack of coordination, weak capacity in cooperating institutions, and political factors.

- **Resources**: Agencies in this field, as in others, depend on well-trained personnel – including sufficient numbers with highly specialized skills. Staff should also be well-compensated, subject to integrity reviews and quick removal and endowed with strong ethic of professionalism, integrity and high morale...(also important are) sufficient funds, adequate facilities and assets and high level information sharing and coordination with other government bodies.

- **Complementary institutions**: The stated criteria here include adequate laws and procedures, basic features of the rule of law including functioning courts, free and active media, an active community of NGOs, and public interest groups, and other capable institutions such as supreme audit and central bank....ACAs are not successful in the absence of (the basic features of the rule of law). On the other hand, civic factors such as free media and capable non-governmental watchdogs are not as clearly associated with ACA success.


During the 1990s, supreme audit agencies were also established or restructured in many developing countries. The effectiveness of these agencies, which are crucial for
enforcing financial accountability of the government, has been highly variable (Heilbrun, 2003). In many countries, the independence of the Auditor General is often compromised by an Executive that seeks to prevent the opposition from learning of possible cases of illicit enrichment. For instance, in one particular country, reports from the Auditor General are submitted to the president who then makes a determination of when and how to release the information. Unfortunately, all too often, the information is never released.

A major objective of these institutions of restraint is to control corruption in the public sector. Efforts to reform these institutions were thus in large part due to the need to address the problem of corruption. This approach however concentrates on cures rather than prevention. And because it requires a considerable degree of coordination among equally difficult complementary reforms, it rarely works in developing country contexts, at least not in the short to medium term. As the decade ended, it became clear that the gestation period for these reforms would be much longer than expected and that, over the medium term, focusing on preventive (ex ante) measures (as opposed to ex post “curative” measures grounded on prosecution) would potentially yield better, long lasting results.

Anti-corruption efforts pay off when they focus on preventive measures that reduce opportunities for corruption. These include among others:

- **Reduce the likely benefits from corruption.** Promoting competition in the private sector through lower barriers to entry, regulatory reform where there are natural monopolies, all serve to reduce rents and rent seeking. Ensuring competition in procurement through nationwide advertising and efforts to prevent collusion can also greatly reduce corruption. More radical measures include calling for a referendum for the public to approve large projects and the tax and expenditure allocation choices these imply.
- **Reduce the number of transactions that create opportunities for graft.** Import liberalization, removal of price controls, removal of industrial and trade licensing requirements or making such licensing automatic, When India liberalized industrial licenses in the early 1990s, a large industry aimed at obtaining licenses disappeared and the corruption associated with it. Similarly when Indonesia liberalized its trade regime in the 1980s it radically reduced corruption in import licensing. Streamlining bureaucracy, reducing the number of approvals required for particular transactions and reducing bureaucratic instructions, simplifying rules, improving service standards and decentralizing services all have this effect.
- **Increase information, transparency and public oversight.** Corruption often occurs because of lack of information. Governments lack information on what their agents are doing on the ground. Consumers of government services are not aware of the rules or the charges that are legitimate. Clarification of rules and increasing transparency helps reduce opportunities for corruption. Involvement of beneficiaries in the oversight of government programs also reduces opportunities for corruption. The World Bank’s Kecamatan Development Program in Indonesia is a particularly good example of this.63

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63 World Bank (2003b)
But prevention can also be enhanced by establishing time tested, basic systems of personnel management. Evans and Rausch (1997) show empirically that merit based recruitment systems and long-term career path arrangements, essential attributes of a Weberian system, have a significant positive impact on reducing bureaucratic corruption. In related work, Von Rijkeghem and Weder (2001) provide empirical evidence supporting the thesis that smaller pay differentials between the public and the private sector lead to lower levels of bureaucratic corruption.64

Much of current thinking about fighting corruption is influenced by the principal agent problem. This problem arises because of a divergence of interests between the principal and the agent, an asymmetry of information between the two, and the agents incentive to hide information and shirk. The above approaches assume that the “principal” (the politician or the head of a government agency) is himself not corrupt, and that he has an interest in ensuring that his “agents” are not corrupt. In other words, “it presumes that (the principal) can act with monopoly and discretion to structure the incentives for (the agent), without it then following that (the principal) will act corruptly.” (Philip, 2003). Indeed, upward accountability to the principal may increase his monopoly and discretion.

This principal agency model only works when the State is able to pursue the common good of the people in an unfettered manner. But most principals, i.e. politicians, even if they themselves are honest, need money to stay in power, fight elections or buy off opposition. Those who contribute such money can then influence the way power is exercised. If politicians are beholden to special interests or are captured by various interest groups, fighting corruption becomes rather difficult (see section C for reform strategies under State Capture).

### B.3 The Citizenry and the Bureaucracy: Nurturing Client Power

By the mid 90s, due in part to the rising trend towards greater democratization, there was a clear recognition of the important role civil society organizations, e.g. NGOs, religious organizations, could play in inducing better performance from government. While strengthening the compact was key to better performance, reform politicians had to be supported in their efforts and the more traditional politicos had to be cajoled into supporting reforms. In many developing countries, elections opened up the gateway for citizens to hold politicians accountable for the performance of the public sector, e.g. better service. By themselves, however, they have proven to be insufficient and blunt in their impact.65

*Strengthening client power can often lead to a more effective compact: service delivery problems are a potent foundation to build on*

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64 There continues to be a debate about the impact of pay on corruption largely because other management aspects are likewise weak. See earlier discussion, section B.2.

65 See chapter 9 on political institutions, for reasons why this is so.
With elections came an environment better suited for experimentation, particularly at the sub national level. Many innovative (and effective) home grown experiments with citizen and media advocacy, community monitoring of government performance, or NGO involvement in policymaking and implementation sprouted throughout the developing world as a means of pressuring and/or encouraging both politicians and bureaucrats to improve the delivery of public goods and services.\textsuperscript{66} For example,

- The Report Card Surveys, which originated in Bangalore, India (see Box \_\_ below) have spread to other parts of India and is now being tried in other developing countries e.g. the Philippines, Peru. This instrument has served to coalesce the collective voice of citizens seeking better public services.\textsuperscript{67}

- Different forms of “participatory budgeting” have emerged in parts of the developing world, e.g. Brazil, South Africa. At its core, “participatory budgeting” engages citizens of a community and their elected representatives, e.g. the mayor or governor, in a partnership to determine the priorities for the community and what projects will be funded from the local budget during the coming fiscal year. Typically, this process has been launched by forward looking local politicians as a means of locking in future politicians to a transparent budget process for which they can be held accountable.

- NGO advocacy for greater transparency and fairness in public procurement and monitoring of procurement processes have become more common as well. So-called integrity pacts developed by the international NGO, Transparency International (TI), have now been used in several countries as part of huge procurement contracts, e.g. Colombia, Mexico.\textsuperscript{68}  

A major implication of the above experiments is that active civil society participation in reform efforts can potentially lead to much needed improvements in the compact. The ten years experience of the Public Affairs Center in Bangalore, India illustrates the potential of using client surveys as a lever to induce long overdue upstream public management reforms and to an improvement in service delivery (Box 8.10).

\textsuperscript{66} The World Development Report 2004, Making Services Work for the Poor, provides many examples and indicates the extensiveness of citizen based mechanisms for raising the demand for better governance.  
\textsuperscript{67} Citizen Report Cards are on the one hand a voice mechanism but on the other also an empowerment tool and thus strengthen “client power.” Such surveys help resolve collective action dilemmas among the citizenry and enable them as a group to pressure bureaucrats and politicians to improve the delivery of services.  
\textsuperscript{68} An integrity pact actually embodies a transparent process of procurement which all participating bidders agree to bind themselves to. A civil society organization, e.g. local chapter of TI, monitors the process step by step to assure all bidders that each has kept to the joint commitment.
Box 8.10: The Report Card Survey in Bangalore, India – Stimulating Administrative Reforms

In 1994, an erstwhile NGO, The Public Affairs Center (PAC), was born in Bangalore, India, with the goal of improving the quality of public sector governance in India. Its primary focus and strength lay in assisting citizen groups in "using knowledge as a basis for collective action." To undertake this task, it developed the now well known Report Card Survey. In 1994, the PAC conducted its very first survey, effectively an opinion poll, of citizens in Bangalore on their perceptions of various aspects of the quality of services provided by eight key government organizations – the City Municipal Corporation, The Electric Authority, The Water & Sanitation Board, Bangalore Development Authority, Telecom, City Transport company, and the City Police. The results of the survey were published in a leading newspaper thus raising the visibility of the survey’s implications – citizens were generally dissatisfied with delivery of public services, with some agencies perceived to be doing extremely poorly. This led public officials in a number of the agencies to discuss their agencies’ problems with the PAC and citizens group. The PAC offered to help these agencies in addressing some of the problems. In 1999 and again in 2003, the Report Card was once again undertaken to evaluate whether progress agencies have been able to improve their delivery of services. As the chart below indicates, over ten years, there have indeed been significant improvements in public satisfaction with the service delivery across all eight agencies (similar results obtain for the “poor”). The lesson: demand pressures can lead to needed public sector reforms.

The Bangalore experience suggests a further implication for engaging CSOs: interventions to improve service delivery may provide a potentially viable and sound entry point for governance reforms. Demand driven reforms have generally focused on the delivery of public services, from local communities seeking better schools for the children to private firms demanding quicker processing of license applications. Why? Service delivery is where the state meets the average citizen. Changes in judicial processes, civil service reforms and decentralization may not mean very much to the average citizen but changes in the quality, quantity and access to services mean something in their everyday lives and thus makes them more amenable to supporting, if not seeking, reforms in governance.

The example below from West Bank and Gaza (Box 10.11) illustrates the huge potential for this approach. In the Middle East and North Africa (MENA), many countries are non-democracies ranging from monarchies to purely authoritarian regimes. So political accountability is relatively weak. In fact, as the World Bank (2003) reports, the governance gap in MENA is significantly wider than those in other developing country regions and the primary factor that explains this wider gap are weaknesses in public accountability. Thus, in these countries, there appears to be much less governance reform activity. But when looking below the grand national scene, particularly at community level, CSO efforts to address poor service delivery appear to be sprouting.

### Box 8.11 Service Delivery and Civil Society in West Bank and Gaza

A 1998 service delivery in the West Bank Gaza asked a representative sample of beneficiaries about the provision of health and education services by NGOs, the private sector, and the Palestinian Authority. To evaluate the quality of the equipment and service, specialists also carried out institutional reviews of education and health facilities. The findings show that beneficiaries often select a particular provider because of easy access to the service or because of the providers’ quality – areas where NGOs and the private providers ranked higher than the government. The findings were presented at dissemination workshops that were attended by ministers, senior civil servants, and senior representatives from NGOs and private organizations. How did the ministers of health and education react? They used the findings to improve the quality of health and education services across the board and to improve coordination among the government, the NGOs and the private sector.


This phenomenon is not inconsistent with the regimes. All regimes care about their legitimacy. One way that non-democratic regimes can maintain, if not enhance, their legitimacy is by providing adequate public services. But to do this, they need information about the existence, nature, and location (i.e. which agencies) of service delivery problems. CSO efforts such as report card surveys provide such information which leadership can then use to introduce needed reforms to the compact.

**To be effective, civil society efforts require an adequate supply response**

The known experience with “demand” raising efforts in developing countries is still rather thin, partly because many occur at the local government level and thus rarely go on print, or if they do, they are in the local vernacular and thus of limited reach. But it is fair to say that such efforts can be and have been effective in taking both politicians and bureaucrats to task for poor performance. The “People Power” episode in the Philippines that led to the resignation of a duly elected but highly corrupt president is an

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70 See in particular figures 1.4, 1.5, and 1.8, World Bank (2003c). In this report, public accountability “measures the openness of political institutions and participation, respect for civil rights, transparency of government, and freedom of the press.” It is more or less an index that reflects a combination of the quality of political accountability and client power.

71 While dictatorial tactics have certainly kept the Castro regime in power for almost 4 decades, there is something to be said about the high quality of health services in the country, which is among the best in the developing world, as a factor that has contained citizen dissent.
extreme example of what the engagement of civil society groups can do (despite difficult collective action problems).

But for demand raising efforts to be effective, there must be an adequate “supply response.” In practice, what this means is that there must be some public officials (career or appointed) who are willing to work closely with concerned civil society groups on a given issue and at the same time the latter must be willing to engage constructively with the former. Often times, public officials see CSOs as a threat to their authority. Advocacy focused CSOs on the other hand tend to view public officials with disdain. But, to be able to move things along, CSOs need partners inside the public sector since they have the knowledge and understanding necessary to move a reform agenda within the government. Likewise, reform minded politicians and civil servants need CSOs to galvanize public support. The collaboration of these two groups appears to be essential to success. Box 8.12 below illustrates one such effort.

**Box 8.12: Procurement Watch – Working with the “Enemy”**

In 1998, the Government of the Philippines, through the initiatives of the Department of Budget and Management (DBM), launched a program to reform the public procurement system. With assistance from the USAID, the DBM conducted an in-depth study of the country’s procurement system and identified many serious problems which could not be addressed adequately without legislation that could bring the many disparate laws and regulations impinging on procurement under a single, clearly written law. Getting such a law passed was a daunting task since the law would fundamentally affect age old arrangements between politicians and contractors. And for a year the reform program stalled.

But in 1999, the mood of the polity began to turn sour on government and, as survey after survey indicated, the focal point of its disenchantment was corruption. Moreover, of the activities that the citizenry considered seriously plagued by corruption, procurement was among the very top, second only to revenue collection. Around this time, the World Bank had just completed a corruption diagnostic study “Combating Corruption in the Philippines” which raised citizen awareness of the problems by several decibels. And again procurement stood out as a major problem area. These developments provided an opportunity to move forward once again on the reform program. The challenge however was to focus the citizen’s anger and frustration on corruption in procurement to create sufficient political incentives for well meaning and/or strategically well placed legislators to lead an effort to pass a procurement reform bill and to stymie efforts of politicians who, under less focused and visible circumstances, would block any such bill.

Procurement Watch Inc (PWI) was born in part out of the need to harness the collective anger and frustration of the citizenry towards corruption in government procurement. It was organized as a non-profit institution with encouragement from the DBM and seed funding from the World Bank through its ASEM Grant facility and private contributions by (then) recently retired government officials, academics working on corruption issues, and private citizens with long standing concerns for problems in government procurement.

In order to establish its credibility and gain the respect of citizen groups and legislators, PWI quickly developed technical expertise in the area of procurement. With well trained and experienced staff and an active board of directors, it managed to draw attention from the media on the need for a procurement reform bill, to secure advocacy support from different citizen groups throughout the country, to be invited to participate actively in the three technical working groups formed to formulate the law – one in the Executive, another in the House of Representatives, and the third in the Senate — and to be sought after for advice by proponents of the bill in both the House and the Senate.

With technical assistance from donors* and advocacy support coordinated and managed by PWI, the DBM finally secured the passage of a landmark bill “The Government Procurement Reform Act of 2002” by both Houses of Congress. The President signed the bill into law on January 10, 2003, almost four years from the time the effort was initiated.

* USAID provided the bulk of donor assistance with complementary support from the World Bank, CIDA, the Asia Foundation, and the Asian Development Bank.
Information and media help build citizen power

Media can be a potentially powerful instrument through which citizen action can be galvanized. A free press raises popular awareness of inappropriate actions on the part of elected and appointed officials. When people are aware of corrupt officials or networks, their reaction may include voting against incumbents, protest and manifestations of unrest, or disengagement from the formal economy.\textsuperscript{72} Widespread press coverage was indeed notable in the resignation of former Brazilian president Collor in the early 1990s, which brought citizens to the streets to protest. It was also instrumental in building the people power movement in the Philippines to depose then President Estrada in 2001 and widespread protests in Ecuador to oust then president Bucharam in the late 90s.

Media pressure (more precisely, from progressive elements) could just as well create the impetus for reform. Just as brave reporting brought down the Nixon Whitehouse in the United States, so also can it shake the foundations of corruption in developing countries. Box 8.13 below is illustrative.

\textsuperscript{72} For an outstanding study that analyzes the effect of type of electoral system on policy outcome see. Myerson (1999); . See also Persson, Tabellini, and Trebbi:(2000) for an assessment of the impact of corruption and voting in different electoral systems (e.g. majoritarian or proportional representation).
In 2003, over an intense period of six months, a team of researchers from the Philippines Center for Investigative Journalism (PCIJ) conducted a lifestyle check on personnel from the Bureau of Internal Revenue (BIR) and published their findings in a three part Report “BIR Officials Amass Unexplained Wealth” which later was picked up by the daily newspapers. Throughout the years, survey after survey has indicated that the Bureau is one, if not the most, corrupt government agencies.

The research produced a wealth of information on the lavish lifestyles of BIR officials and employees -- ranging from grand houses in highly exclusive neighborhoods to expensive luxury vehicles – despite modest incomes. The research covered 25 officials at various levels and found that many of them could not explain how they acquired their assets, including shares in businesses and companies. As the Report states “One regional director, for example, lives in a big house in posh Ayala Alabang, yet he earns less than P300,000 (approximately $5,400) a year. Parked in his garage on the day PCIJ visited were a Ford Expedition, a Toyota Land Cruiser, and a brand new BMW.”

The Report also uncovered interesting schemes such as BIR officials petitioning the Civil Service Commission to change their birth records so that they can delay retirement. From 1989 to 2001, the PCIJ team discovered that 24 applications from the BIR for such change were made. As the team discovered, the rationale for this was to hang on to lucrative postings.

Since the publication of the Report, one senior official has resigned and several have been suspended pending investigation by the Ombudsman. But, more important, after seeing the potential of life style checks, the newly appointed Ombudsman has launched a life style check program and has made it a high priority for his Office. It remains to be seen whether any of the officials under investigation will be indicted and convicted of corruption, as many challenges still confront the legal and judicial system. Nevertheless, life style checks have been added to the arsenal of the anti corruption agencies making it more difficult for public officials to enjoy any illicit wealth.

Source: Bacalla (May 2003), Porcalla (May 2004); and Nocum (May 2004).

As Box 8.13 highlights, the power of good research that feeds into the media should not be underestimated. One of the most successful experiments in the use of information to engage community action was the introduction of a public expenditure tracking survey (PETS) in Uganda in 1996. There the Ministry of Finance launched the first PETS, through research assistance from the World Bank, to monitor the flow of funds from the budget for education per capita grants to local school districts. The survey indicated that, in 1994, the local districts received on average only 13 percent of the funds due them. Alarmed by this huge leakage, the Ministry launched a nationwide awareness program that informed local communities of the funds that were due their respective districts and as result communities were able to monitor the flow of funds. The results have been more than astounding, with the leakage falling to less than 20 percent of the budgeted funds (from a high of 80 plus percent in 1994).73

The Uganda experiment indicates the power information can have in galvanizing civic action. It also suggests the potential influence that right to information laws may have in empowering NGOs, business organizations, and civil society more generally. For example, a grassroots campaign in Rajasthan, India led by a local NGO, the MKSS, used information gleaned from government files to expose and then combat massive corruption at the local level, showing how public officials skimmed money off the wages of workers paid friendly contractors for work never done. A recently passed freedom of

73 For an extensive discussion, see Reinnika, Ritva and Jakob Svennson (2003 and 2004).
information law made it possible for the MKSS to conduct this vigorous and successful campaign.74

B.4. Decentralization: “Compressing” the Triad

Despite troublesome measurement difficulties, especially the extent to which local governments have real autonomy in decision making, it is fair to conclude that many developing countries embarked on wide-ranging decentralization efforts in the 1990s (WDR 2000; Litvack, Bird and Ahmad, 1998; Burki, Perry, and Dillinger, 1999; Wetzel, 2001, Ebel and Yilmaz, 2002). Although some of these efforts may have been indirectly stimulated by fiscal crisis, e.g. Indonesia, these efforts were inspired largely by significant changes in the political landscape: the collapse of long standing highly centralized regimes and the emergence of strong global pressures towards democratization. In many countries, the pent up distaste among the citizenry for tight, unchecked central control and a greater desire for holding political leaders and the bureaucracy more accountable provided the impetus towards decentralizing government functions and services, e.g. Thailand. Decentralization was seen as a way to “shorten” the link between citizens and politicians, to alleviate the principal agent problems of the compact, and to create an environment that would help empower the citizenry in its quest for better services.

In line with the break-up of the former Soviet Union, transition countries showed a significant increase in the number of countries reporting sub-national expenditure data. More generally, among developing countries, the share of sub-national governments in total government spending increased on average by 20% from the 80s to the 1990s.75

Decentralization is fundamentally a political choice (rather than a technocratic solution) whose design and implementation may not lead to better service delivery. If it is designed well, decentralization can move decision making closer to the people, enhance the efficiency and responsiveness of service delivery (Faguet, 1997; Kahkonen and Lanyi, 2000; Bardhan and Mukherjee, 2002), support economic growth, and offer a potentially powerful tool for alleviating poverty. If designed inappropriately or when introduced without strong local participation and accountability (of local officials to local citizens), it can lead to macroeconomic instability (Prudhomme 1999), declining service levels (Martinez-Vazquez, 2001), heightened regional disparities or conflicts (Smoke, 2001), and increased corruption (Brueckner (1999).

Absent hard budget constraints, local governments can worsen the fiscal situation. Throughout the 1990s, intergovernmental fiscal reforms featured prominently in decentralization efforts. Laws, regulations, and processes were changed to provide a basis for systematically transferring responsibility for delivering services, as well as nationally collected revenues (either through intergovernmental fiscal transfers or devolved revenue sources), to local governments. Though the experience across countries has varied widely, one lesson that has emerged is the importance of imposing credible, hard budget constraints on local governments (Rodden et al., 2002). Absent such constraints, local governments could become reckless with borrowing to fund local initiatives or find other

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74 For more on lessons on freedom of information laws, see World Bank, Prem Note (forthcoming).
75 Based on IMF Government Financial Statistics.
mechanisms to transfer liabilities and potentially expose the national government to unwanted fiscal risks.

**Box 8.9: Hard Budget Constraints: The Challenge of Fiscal Decentralization in Argentina**

The Argentine experience highlights the challenges in the design and evolution of a good intergovernmental fiscal system. Provinces in Argentina depend on federal transfers for the bulk of their fiscal resources. Revenue sharing (coparticipaciones) was introduced in the 1930s to compensate provinces for the introduction of national income and sales taxes. In 2000, 56 percent of provincial resources came from this common pool. Roughly 60 percent of the provinces financed less than 30 percent of their spending from own resources (Tommasi 2002).

The system has evolved in such a way that it has been fraught by an unfortunate combination complexity, discretion, and rigidity (Eaton 2003), which in turn has weakened the hard budget constraint of provinces and arguably circumscribed the federal government’s capacity for macro-economic management. The complexity of this system has led some observers to refer to the system as a labyrinth (Saiegh and Tommasi 1999). The presence of politically powerful governors, multiple political parties, politically motivated transfers, informal rules for borrowing, lack of transparency, the inability of the federal government to commit to having provinces bear the “pain” of their own actions, poor incentives for own revenue mobilization, and discretionary bailouts have all worked to create soft budget constraints and a common pool problem.

The sources of Argentina’s most recent economic and political crisis are complex (Perry and Servén 2002), and include poor fiscal management on the part of both the central government and the provinces during the 1990s. Somewhat paradoxically, some of the institutional innovations of the early 1990s such as the currently board later conspired in the severity of the crisis, as subsequent needs for further reforms and adjustment were not carried through. While Argentina made some progress in imposing a hard budget constraint on provincial fiscal behavior in the 1990s (Webb 2002), the sum of individual provinces – along with federal government behavior -- have tended to unsustainable spending and borrowing. The introduction of a minimum revenue floor (piso minimo) in the early 1990s, for example, introduced unanticipated rigidities and poor incentives for many provinces later in the decade (Eaton 2003). The failure of effective federal-provincial coordination in the mid-1990s may have set part of the seeds for the subsequent troubles (Tommasi 2002).

The challenge of ensuring hard budget constraints under fiscal decentralization are invariably contingent on the social, cultural, and institutional features of each country. The experience in countries such as Argentina, and Brazil, underscores that a mix of central commitment problems and limitations for effective regulation can conspire to weaken sub-national hard-budget constraints (Rodden, Eskeland et al. 2003). Strong efforts on the part of central government to regulate can deepen problems, for example when sub-national governments circumvent the spirit of regulations through recourse to affiliated state owned enterprises, including regional banks. The Argentine experience underscores that there are no quick fixes for these type of problems, but that they require the evolution of credible policies – and political will – buttressed by effective institutional arrangements, be they predominantly of market based (e.g., as they have effectively evolved over time a few cases such as the United States) or hierarchical mechanisms dependent on central oversight.


For many countries, decentralization was seen as a means to bring government closer to the people and thus to improve the delivery of basic services, i.e. to shorten the so-called long route of accountability. In principle, decentralized participatory local governments were better informed about the needs of the local poor. Locally elected officials may be held more accountable by local citizens and may be more responsive to the needs of the poor.

But, as the 1990s experience suggests, the allocative benefits of decentralization cannot be achieved without strengthening accountability at the local level. Traditionally, accountability was assumed through political representation (i.e., local democratic governance), with some recognition of the importance of local revenue mobilization. But political representation appears to be insufficient, reflecting concerns about elite capture,
and the weaknesses of local political processes (Crook and Manor, 1998; Conning and Kevane, 2001).

Accountability at the local government level is a multi-faceted phenomenon. Because the ultimate objective of devolved arrangements is to provide the public services needed by local residents in an equitable and technically efficient manner, the most critical concern is the political accountability of locally elected officials to local residents. However, local government accountability also extends vertically from the local government to “higher” levels of government. Likewise, since the local bureaucracy constitutes the group with the most direct impact on services ultimately obtained by local residents, they too must be considered a part of the mix since even if local officials are strongly committed to responding to local needs, without appropriate inputs by the bureaucracy, the intended services may not be forthcoming (Schroeder, 2002; Schleifer and Vishny).

Accountability concerning the use of funds transferred to a local government should be as important as accountability of how it uses funds collected directly from local revenue payers. Likewise since centrally imposed rules over local government actions are, at least in principle, often made to encourage accountability to local residents, ensuring that those rules are followed should be of concern to the higher level of government. While instruments for ensuring financial accountability are commonly in place, implementation of those instruments is often poor. Long delays in financial audits of local account, for example, have been common in many developing countries, and as a result, they have not become effective instruments of accountability.

The administrative aspects of decentralization are as important as the fiscal aspects

While much emphasis has been placed on the financial aspects of decentralization, much less attention has been paid to implementation arrangements, the details of which ultimately determine outcomes: (i) redefining the role of central government away from directly providing most services to facilitating and monitoring local service provision, (ii) transferring civil servants and assets to local governments, (iii) defining an effective structure of local governments, and (iv) developing personnel, budgeting and reporting systems. The challenges that have emerged fall into three categories: (a) adoption of a more systematic view of decentralization (Bahl, 1999); (b) balancing of responsibility with resources, capacity and accountability; and (c) creating incentives for implementation to match formal decentralization arrangements. One potential way to address these challenges is to develop a pragmatic strategy for implementing decentralization (Litvack, Ahmad and Bird, 1998; Bahl, 2000; Nielson, 2001; Bahl and Smoke, 2003). While such a strategy would be unique to each country undergoing decentralization, it should include a general vision and framework for reform, mechanisms for coordination and resolving conflicts, a prioritization of reforms and plan for sequencing them, information to monitor outcomes and adjust the reform program, and incentives to change central and local behavior.
C. STRATEGY AND IMPLEMENTATION: THE REAL CHALLENGE TO GOVERNANCE REFORMS

The 1990s has provided a plethora of emerging lessons for governance reforms. What seems to be working? What appears not to have worked and why? These are some of the key questions that the previous section has attempted to explore. Given the long time it takes for such reforms to mature, these lessons can at best be tentative. Nevertheless, as discussed above, there have been many which developing countries can at least begin to reflect on in contemplating and mapping out their future programs and actions. Box 8.10 below summarizes the emerging lessons.

Box 8.10: The Emerging Lessons: A Summary

Politicians and Citizens: Enhancing Political Accountability

(1) Inherent complexities of enhancing political accountability through elections led to a greater focus among donors on related reforms that are ostensibly more technocratic in nature but, in reality equally political and complex. As the experience shows, legal and judicial reforms cannot be technical short cuts to the rule of law.
- Pragmatic approaches to legal reform have been more effective and are more likely to succeed
- Poor incentives rather than weak capacity has been the root cause of poor judicial performance
- Development of complementary institutions is essential for judicial reform.

(2) The spread of democracy has raised the importance of the oversight capacity of the Legislature and consequently the need for greater donor support for legislative reforms.

Politicians/Policymakers and the Bureaucracy: Strengthening the compact

Lessons on the Compact can be divided into three general areas: fiscal management, personnel and organizational management, and external institutional restraints:

Fiscal Management:

(1) Governments faced with populist pressures can strengthen (aggregate) fiscal discipline by tying their own hands.
(2) Hidden contingent liabilities destroy the fabric of fiscal discipline
(3) An MTEF, while technically attractive as a mechanism to facilitate allocative efficiency, will work only if politicians embrace it

Personnel and Organizational Management

(4) Binding capacity constraints suggest that strategic incrementalism may be the only viable path for sustained civil service reforms in many developing countries
- New Public Management reforms are a challenge even in countries with strong capacity.
- Capacity constraints and political imperatives can severely impede Civil Service reform
- With appropriate design and sufficient political commitment, “enclaving” can potentially be a path to sustained reforms of the Civil Service
(5) While controls and compliance are key, values, commitment, and pride in public service may be important as well for sustained performance
(6) The effectiveness of ICT is preconditioned on the reengineering of underlying processes and the proactive use of change management

External restraints

(7) To combat corruption, prevention may be more effective than investigation and prosecution

The Bureaucracy and the Citizenry: Nurturing Client Power

(8) Strengthening client power can often lead to a more effective compact: service delivery problems are a potent foundation to build on
(9) To be effective, civil society efforts require an adequate supply response
(10) Information and media help build citizen power

Decentralization: Compressing the Triad

(11) Decentralization is fundamentally a political choice (rather than a technocratic solution) whose design and implementation may not lead to better service delivery
(12) The administrative aspects of decentralization are as important as the fiscal aspects
The decade also offered insights into reform strategies, which typically fell into two broad categories: the big bang, shot gun approach or ad hoc incrementalism. The former was largely inconsistent with capacity constraints and political realities and the latter were isolated efforts not linked to a longer term, overall game plan.

“Big bang” approaches were bound to fail as they often overstrained limited implementation capacity. In Hirschman’s words, countries with the wherewithal to carry out a coordinated big push “would not be underdeveloped in the first place” (Ellerman, 2000). The main results from such vanguard approaches to governance reforms have been a major change in the formal rules: new or amended constitutions, new legislation, ostensibly independent courts and audit institutions, etc. These are not unimportant. Formal rules should matter in shaping behavior. But they rarely do unless there is an equal commitment to better aligning informal rules to improve the incentives facing politicians, bureaucrats, and citizens. Changing the formal rules does not change day-to-day practices. The old informal rules dominate, with strong vested interests and networks ensuring that they do. Such informality, which is reflected in the dissonance between actual behavior and formal rules, often overrides formal rules and threatens potential reform: in effect it undermines the rule of law (World Bank, 1998:128).

Ad hoc incrementalism, on the other hand, has also been problematic. With few exceptions, these reforms were often symbolic in nature, intended to preserve the old rules and informality while pretending to reform. In some cases they represented attempts of individual or small groups of reformers whose efforts are well motivated, but, for lack of support, were ultimately undermined by jealousy, intrigue, or fatigue. More important, they tended to be unrelated to a more coherent reform strategy and thus over time many lost their steam.

Thus, big bang approaches are unlikely to work in most settings, nor will ad hoc uncoordinated interventions without an overall game plan relevant to the conditions facing the country. What is needed instead perhaps are highly focused, pragmatic interventions, that are linked (even loosely) to an overarching long term strategy. These interventions, which may be termed “strategic incrementalism”, may be opportunistic because they exploit the willingness to reform, but which are better grounded in the political realities and consistent with the capacity constraints of the country concerned. Knowing what is appropriate in which country situation is often half the battle.

Providing a detailed road map to guide strategy is beyond the scope of this chapter and is a task requiring fundamentally new research and analysis. But we can offer a glimpse of what is possible. While empirical evaluation and assessment of public sector reform is still in its infancy, an analysis of past developmental experiences suggests a possible approach to governance reform strategies in developing countries.

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76 For an excellent example, see World Bank (2003b).
77 There is “often a vicious circle whereby the failure of the state breeds more corrective rules which both reformer and opportunist applaud -- the reformer under mistaken formalistic notions about how to reform and the opportunist in the knowledge that reform will be frustrated and his opportunism can continue” (World Bank, 1998:128). This is not to imply that in developed country settings there are no informal rules. These never disappear. But they tend to be better aligned with formal institutions rather than being inconsistent with them. (North, 2002).
A recent survey of firms conducted by the World Bank in the Eastern Europe and Central Asia (ECA) region provided information that could be used to situate countries in the region along a two dimensional matrix, administrative corruption on one dimension and state capture in the other. Recall (from section B) that administrative corruption reflects the quality of the compact and state capture the strength or weakness of political accountability. So the quality or state of governance in a country can be broadly characterized along these two dimensions. Figure 8.3 reproduces the matrix, situating countries in the region along these dimensions.

The matrix suggests a classification of countries into four possible types: Capable, Weak, Captured, and Restrained. And for each type, possible potential entry points for strategic interventions can be identified.

**Capable:** In these States, administrative corruption tends to be low and state capture not heavily entrenched. Examples of such states are South Korea, Chile, and Hungary. To a lesser extent, Botswana and Andhra Pradesh and Karnataka in India may fall into this category as well. In these states, the challenge is usually to increase the quality and efficiency of public services, in order to best utilize limited public

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78 This is the Business Environment and Enterprise Performance Survey (BEEPS) conducted first in 1999 and most recently in 2003. The findings in the 1999 survey were analyzed and published in 2000 in a World Bank Report *Anticorruption in Transition*.

79 Note that client power influences and is influenced by both state capture and administrative corruption.
resources. Episodic scandals, reported by vigilant media or civil society organizations, usually result in public dialogue and ultimately in a set of actions to reduce opportunities for corruption in the future. In these countries it is often possible to undertake difficult systemic reforms using more or less a technocratic approach, providing there is leadership and support that coalesces around the reform objective.

**Weak:** Many of these countries have only recently emerged from conflict or attained statehood, and are missing many of the basic structures needed to manage the public sector. Thus, both bureaucratic capacity and accountability are weak, i.e. administrative corruption is high. Often weak states have relatively low levels of state capture from business interests – not because of effective mechanisms of accountability, but precisely because the state is insufficiently developed to be captured. In fact, as these basic structures are established, opportunities for capture quickly increase and the country becomes at risk for becoming a captured state. Examples of such states are Albania (in 1999) and Armenia (in 1999) within ECA. Nepal and Tanzania may be examples outside ECA, as well as many of the states in the LICUS category.\(^\text{80}\) In these states, the primary challenge is to ensure that taxes are collected, key services are delivered, and budget execution is sufficiently controlled. Given limited bureaucratic capacity, it is especially important that reform efforts are targeted and that international support for these reforms is highly coordinated.

**Captured:** These states have serious problems of administrative corruption nested in an environment highly subject to capture. There is often an urgent need to build capacity in the public sector. However, investments in capacity are unlikely to produce sustainable improvements, because of political corruption (grounded on rents) that permeates the system at all levels. Examples of such states include Azerbaijan (in 1999), Russia (in 1999), and Kyrgyz. States that are “weak” but resource rich or dominated by a few valuable industries can fall easily into this category. The challenge in these states is to break the stranglehold of the special interests, for example by breaking up powerful monopolies, if capture is by private interests, or reducing military expenditures, if capture is by the military. Not surprisingly, these types of reforms are the least likely to be adopted while the vested interests remain strong.

**Restrained states:** The bureaucracy in these states tend to have sufficient capacity and accountability so that administrative corruption is relatively mild. Political accountability is likely the “weakest link in the chain” resulting in high levels of state capture. Examples of such states are Croatia (in 1999), Serbia and Montenegro (in 1999), and Latvia. Argentina, the Philippines, and some States in India may be examples of a restrained state outside of ECA. Options are limited while the existing

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\(^\text{80}\) World Bank data suggests that 25 to 30 qualify as LICUS. In these countries, securing law and order and ensuring the delivery of very basic public services remain the primary governance tasks. Beyond this, the evidence suggests that comprehensive and/or more technically demanding governance reforms are unlikely to be feasible. The LICUS Task Force Report (*reference*) suggests starting with narrow, manageable "zero-generation reforms" – institutional or socio-economic changes that are politically-feasible and socio-economically non-divisive – are likely to provide quick pay-offs (so-called low hanging fruit) and have some potential to catalyze further change.
leadership is well entrenched. When genuine change in leadership occurs, as in Croatia, Serbia and Montenegro, Slovakia, and Latvia, and where civil society is relatively robust and can play an important role in stimulating demand for change, reforms can emerge fairly fast and can potentially be sustained.

Table 8.2 summarizes the discussion and highlights the potential entry points for strategic interventions in each of the four types of States. Each type faces different challenges and different opportunities for reform. Among the four, “breaking through” a captured state presents perhaps one of the most difficult strategic challenges in governance reform.

Table 8.2
States and Entry Points for Strategic Interventions: A Governance Typology

<table>
<thead>
<tr>
<th>Type of State</th>
<th>Governance Profile</th>
</tr>
</thead>
</table>
| Capable state | • low to modest administrative corruption  
|               | • mild state capture |
| Weak state    | • high levels of administrative corruption  
|               | • mild state capture |
| Captured state| • high levels of administrative corruption  
|               | • high state capture |
| Restrained state| • low to modest administrative corruption  
|                | • high state capture |

<table>
<thead>
<tr>
<th>Main Implications for the Triad</th>
<th>Key Challenge</th>
<th>Possible Entry Point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Some gaps in bureaucratic capacity and internal accountability</td>
<td>Increasing efficiency of public service delivery</td>
<td>Technocratic reforms in public administration, as needed; comprehensive reform strategy may be feasible</td>
</tr>
<tr>
<td>Very weak bureaucratic capacity and/or internal accountability</td>
<td>Ensuring delivery of basic public goods</td>
<td>Highly targeted reforms in key sectors only, supplemented by limited reforms in budget execution to ensure financial accountability</td>
</tr>
<tr>
<td>Very weak political and internal accountability; possibly weak bureaucratic capacity</td>
<td>Breaking hold of vested interests on the process of policy and institutional reform</td>
<td>Build demand for reforms; possibly explore opportunities at sub-national level</td>
</tr>
<tr>
<td>Very weak political accountability</td>
<td>Increasing “voice” and client power</td>
<td>Build demand for reform; await change in leadership due to crisis related to corruption, after which technocratic reforms to increase political accountability may be possible</td>
</tr>
</tbody>
</table>

Public sector governance has been in many ways the grand challenge facing developing countries. A crisis of governance of varying intensities pervades much of the developing world, with the poor paying the heaviest price for this. Rising to this challenge invariably must begin with a deeper understanding of the political dimensions of reform, and in particular, how can it be used to identify and build reform constituencies capable of sustaining the reform momentum. This requires fundamental changes in our methods of analysis. In this context, a focus on ‘drivers of change’ could be a potentially promising avenue.\(^{81}\) While the particular drivers will naturally vary from

\(^{81}\) Duncan (2003).
country to country, the common thread of this approach is a focus on solving specific, highly salient problems facing individual communities – for example in healthcare, sanitation, or business regulation. These are problems around which constituencies for reform both inside and outside of government may be easier to build and maintain than, say, upstream reforms in civil service reform or financial management.

In many countries, the drivers of change may be a group of young, perhaps inexperienced leaders, in need to training and support. Almost all successful reform efforts have been shepherded through by dynamic leaders: “Such leaders seize opportunities as they appear, but they also create them, by identifying and reaching out to potential beneficiaries, reshaping institutions and articulating a compelling and achievable vision of the future.” (World Bank, 1997:154). The challenge in this instance is how to create and nurture an environment that can encourage dynamic, forward looking individuals to take up the cudgels of pushing much needed reforms. In some cases, this may well be through political decentralization and economic liberalization, where the former gives local public officials autonomy over their localities and the latter creates pressures for competition among the localities.

In other cases, the pressure for reform may emanate from the outside. Civil society groups, media, business associations, and/or religious organizations are fertile sources of change. While collective action problems often plague these groups, experience shows that they are fully capable of overcoming these. The challenge for them is one of sustainability, a problem that donors and private foundations can address through technical assistance and funding. The latter is particularly significant since better governance is a public good and thus groups working on governance reforms will generally find it more difficult to solicit contributions from the general public.

Whether this focus on problem solving and results oriented “drivers of change” will help countries navigate the difficult terrain of governance reform in the next decade remains to be seen. What is certain is that governance reform will retain a high place on the reform agenda.

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