Governance and Poverty Reduction

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Technical Note 1: Governance and Poverty
1. Definitions

Governance refers broadly to how power is exercised through a country’s economic, social, and political institutions. This broad definition covers a multitude of related concerns.

Problems of poverty and governance are inextricably linked. Weak governance of public institutions imposes particular costs on the poor. Institutional dysfunction deters governments from undertaking actions that benefit the poor. For instance, the failure of municipal governments to recognize and protect the property rights of the urban poor undermines communities and weakens family networks.

Box 1: Global perspectives on governance:

**United Nations Development Programme (UNDP)**
Governance is the exercise of economic, political, and administrative authority to manage a country's affairs at all levels. It comprises mechanisms, processes, and institutions, through which citizens and groups articulate their interests, exercise their legal rights, meet their legal obligations, and mediate their differences. ([http://magnet.undp.org/policy/default.htm](http://magnet.undp.org/policy/default.htm))

**Organisation for Economic Cooperation and Development**
Governance denotes the use of political authority and exercise of control in a society in relation to the management of its resources for social and economic development. This broad definition encompasses the role of public authorities in establishing the environment in which economic operators function and in determining the distribution of benefits as well as the relationship between the ruler and the ruled. ([http://www.oecd.org/dac/](http://www.oecd.org/dac/))

**Commission on Global Governance**
Governance is the sum of the many ways individuals and institutions, public and private, manage their common affairs. It is a continuing process through which conflicting or diverse interests may be accommodated and cooperative action may be taken. It includes formal instructions and regimes empowered to enforce compliance, as well as informal arrangements that people and institutions either have agreed to or perceive to be in their interest. ([http://www.cgg.ch/welcome.html](http://www.cgg.ch/welcome.html))

**World Bank**
As described in the 1994 report Governance: The World Bank’s Experience, “Good Governance is epitomized by predictable, open and enlightened policy making (that is, transparent processes); a bureaucracy imbued with a professional ethos; an executive arm of government accountable for its actions; and a strong civil society participating in public affairs; and all behaving under the rule of law.” ([http://www.worldbank.org/publicsector/overview.htm](http://www.worldbank.org/publicsector/overview.htm))
When the reach of legitimate political authority is limited and public administration is rife with patronage, collective action of any kind—especially that which is pro-poor—becomes impossible. The recent literature on poverty gives voice to these governance concerns and is increasingly focused on identifying institutional arrangements that are most likely to produce results favorable to the poor. (See the Annex.)

2. Focusing on key concerns

Governance is a broad topic and can reasonably include consideration of areas ranging from human rights—through democracy and participation—to military spending. To offer a practical connection between broad concerns about how power is exercised through economic, social, and political institutions and the specific steps that can be taken to improve institutional arrangements, this chapter draws on the four key elements of the poverty framework set out in the introduction to this sourcebook. The governance question is what can be done to reform institutions to achieve improvements in these areas:

- Empowering the poor
- Improving capability of the poor by improving basic services
- Providing economic opportunities by increasing access to markets
- Providing security from economic shocks and from corruption, crime, and violence
Table 1 summarizes the relationship between key governance issues and these poverty concerns.

**Table 1. Poverty Concerns and Governance Issues**

<table>
<thead>
<tr>
<th>Poverty concerns</th>
<th>Governance issues</th>
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| 1) Empowering the poor | Rules for seeking and holding public office
- Fair, transparent national electoral processes
- Power-sharing arrangements to ensure stability in heterogeneous societies
Oversight by political principals
- Parliamentary oversight with supreme audit institutions
- Budget that is credible signal of government policy intentions
- Pro-poor policies from government
- Sound institutions for local representation |

2) Improving reach, efficiency, and sustainability of basic services
- Adequate, predictable resources for sectors, local authorities
- Pro-poor budget priorities for service provision
- Stable intergovernmental transfers with hard budget constraints
- Hierarchical and transparent budgeting processes
Demarcation of responsibilities for delivery
- Assignment of responsibilities according to subsidiarity principle
- Capable, motivated civil servants
- Merit-based recruitment and competitive pay
- Hiring to fill real needs, within a hard budget constraint
- Public service that earns respect
Accountability downwards
- Publication of accounts for local-level activities
- Dissemination of basic data on performance
- Mechanisms for client feedback, including report cards and other types of client surveys
Flexible delivery
- Involvement of civic, private partners
Development of local capacity
- Incentives to deploy staff to poor, remote areas
- Appropriate autonomy in deploying staff |

3) Increasing access to markets
- Legal and regulatory framework
- Enforcement of antidiscrimination legislation
- Incentives for deepening of credit and land markets
Methods for reducing exclusion
- Enforcement of legislation against barriers to movement
- Provision of information on labor and credit markets |

4) Providing security
   a) from economic shocks
- Rules for sound economic management
- Hard budget constraint for aggregate fiscal discipline
- Efficient administration of tax and customs
- Independent central bank to carry out monetary policy
Safeguards against economic vulnerability
- Recognition of property rights over physical assets
- Access to social insurance and other service through hub-and-spoke arrangements |

   b) from corruption, crime, and violence
- Enforcement mechanisms
- Independent, adequately funded court system
- Access to speedy recourse and redress
Efficient courts with competent judiciary and legal personnel
- Alternative mechanisms for dispute resolution |
2.1 Empowering the poor

Promoting participation is a foundational principle of reducing poverty. Only by participating in formal political and administrative processes can the poor influence broad policy directives, budget priorities, and program design specifications. To be sustainable, participation has to be embedded in and supported by formal structures at the national and subnational level.

Two governance arrangements promote and sustain participatory processes. The first arrangement comprises electoral rules that mandate regular and fair competition between seekers of political office. The second includes power-sharing arrangements between ethnic or regional factions—for example, informal elite pacts, bicameralism, federalism, or even confederacy—that ensure greater stability than winner-take-all ones. Equally important are parliamentary oversight mechanisms—for example, regular reporting by supreme audit institutions—that help political principals ensure that public administrators meet their fiduciary and operational responsibilities.

Often, participation by the poor is conditioned by their proximity to decentralized political institutions, also governed by appropriate electoral rules, and local planning bodies that make allocative and operational decisions. While they alone do not guarantee empowerment, these local governance arrangements give the poor a chance to articulate and mobilize around their most immediate concerns.

2.2 Improving capability of the poor by improving basic services

One of the most complex problems for public administration is improving the performance—that is, reach, cost efficiency, and quality—of social, rural, and infrastructural services, particularly at local or district levels where states so often fail the poor. Broadly, improved service delivery requires that governments allocate adequate resources to ‘pro-poor’ priorities and ensure predictable flow of resources—through hierarchical and transparent budget processes—to sectoral and subnational authorities. Functions are ideally assigned to different tiers of government and reinforced by a legal framework for resolving interjurisdictional disputes. Supporting these structural arrangements should be a capable, motivated staff, recruited on the basis of merit and paid a competitive wage. Civil service rules that establish these conditions of service should be enforced with establishments controlled within a hard budget constraint.

Decentralized responsibility for delivery is necessary but not sufficient for improving service delivery. Sustainability and efficiency are both enhanced by actively involving beneficiaries and by actively encouraging other producers through, for example, creating credit unions and community development associations. Processes that involve the poor, elicit their feedback, and disseminate information on resource management and performance also strengthen accountability.

2.3 Providing economic opportunities by increasing access to markets

The state plays a central role in defining and enforcing the rules governing access to private markets. Social exclusion and discrimination keep the poor out of markets for land, labor, and credit, as buyers or as sellers. Removing these barriers requires far-
reaching national and local antidiscrimination efforts to expand the freedom of poor individuals to participate in mainstream institutions.

Also, government should enact legal and regulatory reforms necessary for deepening markets and actively disseminate information to the poor on opportunities for employment and asset ownership.

2.4 Providing security from economic shocks and from corruption, crime, and violence

Microeconomic shocks such as job loss or periodic violation of property rights are a frequent occurrence in the lives of the poor. When the property rights of poor citizens are not protected, or even recognized, the resulting uncertainty generates strong disincentives for asset accumulation. Arrangements that provide social insurance as well as other essential services such as primary health care or vocational training reduce vulnerability on multiple fronts.

Poor macroeconomic performance affects all economic players, but is especially costly to the poor as evidenced by the regressive tax imposed by inflation. The best safeguard against poor macroeconomic performance is sound management of fiscal and monetary policy.

Vulnerability to crime, violence, and corruption is a major deterrent to the poor participating in the mainstream of society. Governments can act to check these forms of arbitrary action with two arrangements that "open the doors" of the justice system. They can authorize alternative dispute resolution bodies--or formalize existing informal institutions--that are less expensive and speedier than the traditional court system. Governments can also introduce methods by which the poor can report--anonymously or publicly—on the behavior of public officials such as the police.

3. Using this Chapter

This chapter is intended for use during the PRS process as input into a broad-based dialogue on governance. It is intended to provide guidance on a collaborative approach as the second of three key steps. The chapter assumes that an initial poverty analysis has been undertaken. It is designed to lead to a subsequent operational strategy for government and key partners on how to improve poor citizens’ involvement in the mainstream of economic and social life.

**Step 1 - Developing a more comprehensive understanding of poverty.**

The initial stages of the PRSP process will entail analytical work on analyzing the various dimensions of poverty. This poverty analysis—which would ideally include an overview of governance concerns— will provide a substantive basis for PRSP consultations.

**Step 2 - Defining a strategy for achieving pro-poor governance**

Diagnosing the quality of governance arrangements is crucial to determine critical reform pathways for achieving pro-poor governance. This chapter is intended to do exactly that, by suggesting reform options that are not only technically sound but also legitimate.
in the eyes of the poor. More detailed diagnostics can be applied when time and resources allow.  

Step 3 - Linking country strategy to donor operations

As the participatory process winds down, government will be faced with the challenge of engaging donors and other partners in supporting the country strategy.

The chapter is designed to offer assistance to government in step 2. It is intended to be used as a diagnostic aid by a working team comprising government and civil society representatives. It provides four sets of questions on feasible institutional reforms that can be addressed independently and can assist in:

- Empowering the poor
- Improving the capability of the poor by improving basic services
- Providing economic opportunities by increasing access to markets
- Providing security
  - from economic shocks and
  - from corruption, crime, and violence.

4. Empowering the poor

Holding government—the executive—accountable rests on two foundations. First, there must be some bodies or groups to which the executive answers. Second, the executive must be required to change course in certain circumstances. If the answers that it provides are not seen to be satisfactory then, in some situations, alternative behavior should be enforced.

With those dimensions in mind, horizontal accountability concerns relationships between the executive and those players of more or less equal power, while vertical accountability refers to relationships where power is predominantly on one side. Both of these relationships can, of course, lie along a spectrum according to the frequency with which accountability is exercised. The figure below maps these relationships.

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1 Particular World Bank products that may help include: Diagnostic toolkits that are available on the Institutional Analysis and Assessment toolkits Web site at http://lnts012.worldbank.org/prem/ps/iaamarketplace.nsf
- Surveys of public officials and households that can be organized in collaboration with the World Bank Institute http://www.worldbank.org/wbi/gac/programs.htm
- More formal reports including: Institutional and Governance Reviews:

2 This mapping of accountability relationships owes significantly to Schedler, Diamond and Plattner (The Self-Restraining State: Power and Accountability in New Democracies. Edited by Andreas Schedler, Larry Diamond, and Marc Plattner. Boulder: Lynne Rienner Publishers Inc., 1999). See the World Bank Public Expenditure Review for Guyana (Reorienting Public Expenditures to Serve the Poor, April 2000) for a practical example of applying this framework. See also World Bank PREM notes: Using an Ombudsman to Oversee Public Officials and Fostering Institutions to Contain Corruption for recent World Bank experiences.
There is every reason to assume that the architecture of the state—including the relationships between the executive, legislature, and judiciary—and other institutional arrangements for the transfer of power between governments, including voting arrangements and electoral laws, affect the performance of the public sector in responding to poverty.

**Is government office contestable in practice?**

Regular, free, and fair elections that result in changes of government, coupled with freedom of expression, assembly and organization, and the right to stand for election, are fundamental to empowering the poor. Key questions include whether there really is freedom of expression and opinion unrestricted by media or self-censorship, and what difficulties some groups face in obtaining permission to hold a demonstration or to form civic associations.

The rules for seeking and holding public office should be fair and transparent, with power-sharing arrangements that ensure stability in heterogeneous societies. Elections should be competitive, and an electoral law should provide for setting up an independent electoral commission and electoral boundaries by a neutral or representative body. The law should also credibly prohibit vote buying while encouraging election monitoring by independent groups from civil society. Key points are how much government and opposition candidates have equal access to state resources during political campaigns, and whether the voters’ register is updated before elections and is not controversial.

One key area for examination is how political parties are encouraged to function transparently and without undue hindrance. For example, are government and opposition parties free to hold public meetings and rallies, and is the framework transparent for state and public financial and nonfinancial support of political parties? Is the governing party financed through off-budget resources? Can opposition parties openly obtain adequate resources to participate in competitive politics? Financial and nonfinancial contributions to political parties should be disclosed to the public, and the parties’ financial accounts should be audited regularly and the results made public.
Is the government held accountable by the legislature for its policy actions?

Lengthy delays in audit reports to the legislature are a particular warning sign that the government is not held accountable by the legislature for its actions. Key questions in ensuring that the government is held accountable for budget execution and transparency include:

- Does the executive reconcile and justify to the parliament deviations between forward estimates and budget estimates and between budget estimates and actual spending?
- Do ministries and agencies provide annual reports to the parliament in which performance is explained?
- Are audited financial statements submitted to the parliament in a timely way?
- Are they debated in the parliament?
- Does the executive take any notice of audit findings and any related parliamentary reports?
- Are there any public interest groups analyzing the budget, including from the perspective of its poverty focus?
- What percentage of the budget is earmarked, formally and informally?
- Are there clear criteria for when earmarking is legitimate?

Parliament should include a functioning finance committee and the equivalent of a public accounts committee. Parliamentary committees should be supported by professional staff and adequately resourced. Individual parliamentarians should have enough staff and enough financial resources to perform their duties.

Is the budget a credible signal of government’s policy intentions?

Requiring the government to state its policy and spending intentions clearly is a vital precondition to holding it accountable. The central government budget is a distinctive statement of government policy intentions, although not all policies have budgetary implications. How robust are the links between planning, policymaking, and the budget? Are policy priorities articulated and reflected in budget allocations? Does actual spending match allocations?

Policy volatility and deviation from functional appropriations are two particularly useful measures. Policy volatility tests the assertion that radical variations year to year in the budget indicate that there is no coherent set of policy priorities and that officials charged


4 The World Bank Institute provides training programs and seminars to assist in developing Public Accounts Committees (http://www.worldbank.org/wbi/governance/india1_new.htm).

5 The Inter-Parliamentary Union (IPU) (http://www.ipu.org/) and the Commonwealth Parliamentary Association (http://www.comparlhq.org.uk/) can provide valuable guidance on these issues. See also the list of other parliamentary sites maintained by the IPU (http://www.ipu.org/english/otherweb.htm).

6 Comparative cross-country data is available from Public Sector Group of the Poverty Reduction and Economic Management network, World Bank. (Link to governance data Web site is forthcoming).
with implementation will not take policy statements seriously because they are likely to change. Deviation from functional appropriations tests the view that the government should be held accountable by the legislature for its policy actions. High deviation indicates poor quality of planning or implementation, and lessened credibility in the budget.

In identifying institutional problems it is useful to consider the budget timeframe. Is the budget exclusively annual? If not, does a medium-term perspective mean that when policy decisions are made, the outer-year costs and impacts are considered?

In identifying remedies, delivering credible policies that are sustained, effective, and adequately financed goes to the heart of the political process:

- Does the cabinet, or equivalent, have clearly articulated policy priorities?
- Are there sectoral strategies for key sectors?
- Are they public documents?
- Are the domestic stakeholders—civil society, business community, public interest groups, labor unions, farmers’ associations, and other interest groups—consulted on policy?
- Are agreed-upon sectoral priorities and goals subject to arbitrary change by the head of government?
- Are major policy proposals referred to the cabinet for decision?
- Are policy proposals required to specify their intended outcome, associated outputs, and costs over the medium term—on and off budget?

5. Improving capability of the poor by improving basic services

The sector toolkits provide detailed guidance on alternatives for providing education, health, and other crucial services to the poor. However, there may be general constraints to service delivery that may indicate cross-cutting problems of governance and public management.

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7 Policy volatility is calculated as the median of the year-to-year policy changes (absolute values) in each functional classification over the preceding four years, where policy changes are defined as the difference between the percentage share in the budget from year \( n \) to year \( n+1 \), calculated as a proportion of the year \( n \) figure.

8 It is calculated as the sum of all (absolute values of) deviations between approved and implemented budgets by functional classification.

9 A more detailed diagnostic is available in the Public Expenditure Institutional Assessment toolkit available on the World Bank Institutional Analysis and Assessment toolkits Web site at [http://lnts012.worldbank.org/prem/ps/iaamarketplace.nsf](http://lnts012.worldbank.org/prem/ps/iaamarketplace.nsf). This assessment of budgetary institutions includes models for assessing formal public spending institutional arrangements and for assessing the capability of cabinet arrangements for social and sectoral policy-making. The toolkit has been piloted extensively, but is now being extended to assess the fit between budgetary institutions and the particular executive and legislature configurations. The toolkit has been piloted in Thailand, Indonesia, Uganda, Malawi, Ghana, Australia, New Zealand, Colombia, and Benin. More general information on public spending issues can be found at [http://www.worldbank.org/publicsector/pe/index.htm](http://www.worldbank.org/publicsector/pe/index.htm).
Identifying specific shortcomings in the delivery of public services is challenging, as there are few international standards against which to benchmark service levels. Survey tools can be used to benchmark access and unit cost for different services (for example, enrollment rates and cost per pupil in education) at the appropriate point of delivery (for example, the school or district-level hospital). More information on relevant guidelines can be found in the **Outcome Monitoring and Evaluation** chapter.

More generally, service delivery can be benchmarked by looking at:

- The access of particular groups and stakeholders to services
- Service use rates
- Operational efficiency, including the cost per given output
- Timeliness
- Levels of perceived corruption.

The key point is that service provision is good or bad in relative terms. Identifying districts or agencies that, in providing a service, perform particularly well or badly in relation to others—or in relation to their own past performance—can help highlight poor service delivery, or outstanding best practice.

Research indicates that effective and sustainable service provision rests on three foundations. Attempts to expand the reach of services as well as the quality of services should be based on predictable and adequate resource flows. Second, the credibility of policy—the degree to which officials understand and are committed to the strategies that they are asked to implement—can significantly influence service performance. The credibility of policy directives from higher levels of government is improved when policies are consistent and not opposed by district officials, and when planning processes are participatory and inclusive and staff are not subjected to micromanagement or political interference.

Third, the quality of the civil service is crucial, and the degrees to which basic civil service rules ensure staff discipline is a key driver of performance in service delivery. Assessing the civil service requires an examination of the formal legislation and rules, and consideration of how these rules are enforced in practice.

The degree and nature of agency autonomy is a significant design question. Service delivery agencies are usually restricted in the ways they can use inputs—human, financial, and technological resources—to achieve policy goals. Input restraints can limit opportunities for corruption. However, these restraints can prevent local staff from putting resources to their most efficient use in providing services. There is a balance to be achieved, as experience from around the world demonstrates that policymakers are less successful when they prescribe the means by which services should be delivered at the local level. Flexibility over the means of delivering services, subject to minimum standards, is a preferred approach to ensuring efficient service delivery.

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10 As a very rough proxy, the waiting time for telephone lines (Source: International Telecommunication Union, 1998. *World Telecommunication Development Report*. Geneva, [http://www.itu.int/](http://www.itu.int/)) can provide some idea of the quality of government services relative to other countries. Telephone service is provided by government in almost all developing countries, and the waiting time for a telephone line is an indicator of administrative capacity and responsiveness. This indicator is negatively correlated with an index of meritocracy in the civil service. Some data is provided by the World Bank on [http://www.worldbank.org/data/WDI/PDF/tab5_10.pdf](http://www.worldbank.org/data/WDI/PDF/tab5_10.pdf).
The level of service provision is also significant. Subsidiarity—the principal of providing services at the lowest practicable level of government—has been shown to improve service delivery in many situations.

**Are the policies of government explicitly pro-poor in design or implementation?**

Public spending to alleviate poverty can be broadly targeted through public services or more narrowly targeted to certain types of people. Concentrating public spending in areas that are relatively more important to the poor, such as primary health care or primary education, is an example of broad targeting. Governments also design antipoverty programs that try to identify the poor and channel income or in-kind payments to them alone. (See the chapters on *Social Protection and Public Spending* and Technical Note 2).

**Are services provided at the lowest practicable level of government?**

Several different forms of decentralization can exist within a country and can characterize sectors within a country:

1. *Deconcentration*—the mildest form of decentralization occurs when the central government disperses responsibilities for certain services to its regional branch offices.

2. *Delegation* refers to a situation in which a central government transfers responsibilities for decisionmaking and administration of public functions to local governments or semi-autonomous organizations that are not wholly controlled by the central government but are accountable.

3. *Devolution* is a more extensive form of decentralization. Here, the central government transfers authority for decisionmaking, finance, and management to local governments that have clear and legally recognized jurisdictions over which they exercise authority, within which they perform public functions, and to whose constituents they are accountable.

In general, decentralization is neither good nor bad. If it is designed well, it can move decisionmaking closer to people and improve governance, including the efficiency of service delivery. However, design is complicated, since it involves political, fiscal, and administrative policies and institutions that individually and interactively affect outcomes. If decentralization is not designed well, or introduced in certain types of environments, it can have negative impacts. The key challenge is to balance responsibilities with accountability and resources.

In practice, there is often a big difference between formal arrangements for decentralization and what is actually happening in the country. An essential element of decentralization is the need for a clear division of responsibilities and a clear system of accountability. There is no perfect set of intergovernmental arrangements that will remain intact indefinitely—central and local officials must be accountable to their constituents to ensure effective governance. Important questions include whether spending and revenue are clearly assigned to different levels of government. Are spending and revenue matched to enable financing of services, and are transfers predictable and transparent? How often are rules for transfers changed?
Are local governments held accountable for responding to citizens' preferences in delivering public goods and services?

Subnational government should be held accountable for the services for which it is responsible. This requires a clear assignment of responsibilities between levels of government. Hard budget constraints are necessary, but insufficient. Credible subnational elections, the publication of full accounts, and the involvement of civic and private partners in service delivery enforce accountability. The active use of incentives to deploy staff to poor, remote areas is a particular indication that subnational government is responding to pressures for performance.

Key questions about local political institutions include whether elections provide constraints on subnational fiscal decisions. Voters will face greater incentives to punish deficits if the tax-benefit link is strong—in other words, if it has a low level of vertical imbalance. Local voters are more likely to hold their elected representatives accountable for local decisionmaking if decisions affect the allocation of their own resources rather than those sent from the central government. The presence of elections does not necessarily translate into strong accountability. 11

Can spending units or entities predict their aggregate funding and their cash flow in-year?

The necessary budgetary arrangements should be in place for effective service delivery. All spending units in government should know in advance what their budget funding will be as a prerequisite for operational efficiency and managerial accountability. Looking at the average proportional deviation between budgeted allocations for nonpersonnel costs, such as operations and maintenance, and other recurrent costs and actual spending under these appropriations for budget-funded organizations can be very telling. Predictability of funding for organizations in the key sectors of health, education, roads, and agriculture is particularly important if essential services are to be provided to the poor. 12

Is government a responsible employer, restraining employment costs while ensuring that remuneration arrangements do not establish perverse incentives?

The civil service should be rewarded appropriately. The numbers of civil and public servants should be in line with international practice, with the fiscal weight—public-sector wage bill as a percentage of gross domestic product (GDP)—not excessive. The key measures are the government wage bill as a percentage of GDP and as a percentage of

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11 See the World Bank Assessing Constraints on Service Delivery toolkit at the World Bank Institutional Analysis and Assessment toolkits Web site at (http://lnts012.worldbank.org/prem/ps/iaamarketplace.nsf). This toolkit is designed to assess constraints on front-line service delivery. It helps locate where the constraints are—identifying the degree to which they arise from problems within the service-providing agencies, or from difficulties at other provincial or national levels. It diagnoses the nature of the constraints external to the service provider, including the degree to which poor performance is rooted in weak provincial and national arrangements for policymaking, for ensuring resource flows, and for ensuring accountability. The toolkit is being piloted in Ethiopia, Benin, and Argentina.

government spending, and the cost of goods and services as a proportion of government expenditure.

Levels of pay should be sufficiently competitive to recruit, retain, and motivate qualified staff at all levels, with particular attention paid to the ratio of civil service to private-sector pay, the ratio of highest to lowest salary in the civil service—or the vertical compression ratio—and the ratio of highest to lowest salary within the same civil service job classification—or the horizontal compression ratio. It is important to have an understanding of the competitiveness of salaries for public posts in relation to private-sector equivalents, including any government targets and underlying rationale such as job security.

Are there processes for ensuring that total compensation levels continue to retain and attract needed skills? What are the turnover rates? Is remuneration at senior levels appropriate to skills, as indicated by compression ratios? Is the value of compensation undermined by the discretionary component? Are pay scales clearly and consistently linked to rank? Overall, is the compensation system simple, monetized, transparent, and fair? Also, is the pension system affordable, effective, and fair?

Is government unable to implement legitimate policies because of resistance from or limited capacity in the civil service?

Resistance to implementing key government policies from vested interests within the civil service is a frequent obstacle to providing vital services to the poor. Distributing basic data on performance and methods for client feedback, including report cards and other types of client surveys, can help. It is important that the number of political appointees in the civil service is limited. A useful guide is that in the United States, the proportion of political appointees is around 1:400; in Sweden, it is around 1:2000. Estimated percentage of budget-funded public-sector staff in core ministries in central government that were changed in the last 2 elections can be informative. The frequency of transfer or reassignment of civil servants before end of term in position can be a symptom of political involvement in the civil service.

Vertical decompression outside the range 1:7 to 1:20 can undermine incentives for public officials to pursue a career and take disciplinary threats seriously. Average central government wages as a proportion of average private-sector manufacturing wages below 0.5 provide inadequate attraction for skilled staff, or above 1.5 may indicate "capture" of pay policy by existing personnel. Horizontal decompression—discretionary allowances over and above base pay—in excess of 1:1.2 can provide opportunities for excessive managerial discretion, facilitating organized corruption and rent-seeking. See the World Bank Civil Service Institutional Assessment toolkit on http://www.worldbank.org/publicsector/test/prempak or on the World Bank Institutional Analysis and Assessment toolkits Web site at http://lns012.worldbank.org/prem/ps/iaamarketplace.nsf for further details.

The toolkit assesses formal and informal institutional arrangements for public-sector employment, including the impact of pay policy and the relations between national and subnational civil services. It examines the coherence and compliance with formal rules in relation to civil service policy and strategy, legislation and regulations, structure and career management, pay and employment, and performance management. The toolkit has been piloted in a range of European Union (EU) accession countries, Bolivia, Indonesia, Jordan, Mozambique, Romania, and Albania. It is currently being developed into a PREMPak, which will allow multiple users to question others’ assessments, facilitating dialogue and consensus among Bank staff, consultants, and country counterparts.
Several questions can be helpful in assessing the quality of the civil service. It is important to remember that the civil service proper may be found only in the central ministries. Access to civil service positions and responsibilities of civil servants should be legally defined. Key questions include the quality of the legislation that defines the scope of the civil service, and the subsidiary regulations describing procedures. The nature of the code of conduct or equivalent framework that governs the behavior of civil servants is also significant. Overall, is the civil service politically neutral, with rules for political activity for career civil servants set by the civil service legislation and explicit political activity prohibited by law?

Other questions concern merit-based recruitment. Is there an overall statement on the civil service operating on the basis of merit? Are job descriptions prepared and used? Does the civil service legislation require that appointments and promotions to career positions be made through merit-based competition? Even if recruitment policy is decentralized, does the principle of merit govern practices across the civil service? Is a process defined for top-level appointments that ensures consideration of candidates on at least a civil-service-wide basis, not excluding lateral entry by non- civil servants? Does the civil service legislation prohibit patronage and nepotism in career appointments and promotions?

Also, staff responsibilities, promotion prospects, and career paths and development should be credibly defined. There should be a clearly defined organizational structure and civil servant career classification system. The organizational structure of the civil service, including levels, units, and reporting relationships, should also be well-defined and consistently applied across management units. Rank and position classification systems should combine effectively to produce clear and adequate incentives to advancement while avoiding undue complexity. Key questions include whether the position classification system is effective in identifying families of jobs with distinct skills and requiring distinctive career management. Are there satisfactory equal employment policies and practices that mitigate gender, regional, and other discriminatory biases?

Do government employees earn respect from firms and from the general public?

The civil service should earn respect from the public and from businesses. However, surveys consistently show public frustration with civil service performance, and the high burden that corruption places on the poor. Have there been surveys of public perceptions of service quality in this country? If so, what were the results? What are public perceptions of corruption in the civil service?

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6. Providing economic opportunities by increasing access to markets

Is government structured to provide access to markets for the poor? The problems of restricted access take many forms. Corruption and red tape can make it unnecessarily costly to start a small-business enterprise, and reduce the proportion of businesses operating in the formal sector. “Unofficial payments” likely have the strongest deterrent effect, among would-be entrepreneurs, on the poor, and on others trying to establish a small business.

Credit may be unavailable to the poor because of inadequate contract enforcement. A legal system that effectively enforces contracts between banks and depositors, and between banks and borrowers, is required for a well-developed financial system. The poor and small businesses may be especially dependent on credit, if larger firms are more often able to finance investment from retained earnings. Credit may be unavailable to the poor because of insecure rights to land and other property. Lack of clear rights to land and other property restricts collateral available to the poor.

Unpredictable business regulation can deter investment in small businesses. Unpredictable policies may have particularly adverse impacts on the poor and small business. Wealthier investors and larger firms may have greater influence over policymaking, and can more easily diversify their income and assets across different areas of economic activity, so that sudden policy changes affecting one occupation or industry will have less influence on their well-being.

Weak antimonopoly rules and enforcement can harm small businesses, and consequently, poor workers and consumers. Small businesses can be harmed by the monopoly power of the firms with which they compete, or sell to, or buy from. Poor consumers pay higher prices to firms with market power. Although some government-created monopoly can be justified—mainly as temporary patent protection—much market power in developing countries is granted for political reasons or is the product of weak rules and enforcement capacity.

Labor laws can unduly limit job opportunities for the poor, by raising costs of labor to producers, inducing them to substitute into capital. Potential employers of the poor sometimes confront significant public-sector barriers to expanding employment, such as state-protected monopoly behavior by existing businesses, arbitrary and capricious regulatory activities or confiscatory taxes and corruption. The poor may confront mobility restrictions, such as the inability to sell assets to finance relocations to areas in which jobs are more plentiful.

Are property rights and contracts respected?

State institutions should facilitate voluntary exchanges. The noncash proportion of the money supply is a telling measure of where government is an effective third-party enforcer of contracts, and whether it can be trusted not to expropriate financial assets, firms and individuals will find it more advantageous to deposit financial assets in banks rather than holding them as cash. Thus, better governance will be associated in general
with higher contract-intensive money (CIM) ratios. The percentage of private land that is formally titled is also significant.16

**Are vulnerable groups particularly excluded?**

Social exclusion and discrimination keep the poor out of markets for land, labor, and credit, as buyers or as sellers. The poor fare particularly badly when credit is unavailable. In some cases, customary obligations can also limit the activities that the poor can undertake. Removing these barriers requires far-reaching national and local anti-discrimination efforts to expand the freedom of poor individuals to participate in mainstream institutions. Also, government should enact the legal and regulatory reforms needed to deepen markets and actively inform the poor of opportunities for employment and asset ownership.

**Does red tape and corruption prevent the poor from starting businesses?**

Corruption and red tape can make it unnecessarily costly to start a small-business enterprise, and can reduce the number of businesses operating in the formal sector. Unofficial payments likely have the strongest deterrent effect, among would-be entrepreneurs, on the poor and on others trying to establish small businesses. Corruption and excessive regulation are two sides of the same coin. It is important to consider the costs in time and money needed to obtain business-operating permits.

Unpredictable business regulation can also deter investment and may have particularly impacts on the poor and small business. Wealthier investors and larger firms may have greater influence over policymaking, and can more easily diversify their income and assets across different areas of economic activity, so that sudden policy changes affecting one occupation or industry will have less influence on their well-being.

7. **Providing security from economic shocks**

Inadequacies in aggregate fiscal discipline can adversely affect the poor in two ways: by inflation and by unstable funding of poverty-related programs and services. (See also the chapters on *Macroeconomic Framework* and *Public Spending* for further guidance on these questions.)

Unstable spending may be attributed to external shocks—that is, factors “beyond our control”—or they may be self-induced, reflecting the incentives of decisionmakers. Overly optimistic revenue estimates, for example, are more likely to result from efforts to escape the need to make tough spending tradeoffs—or to meet deficit targets—than any technical or policy problems.

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16 Comparative cross-country data is available from PRMPS, World Bank. (Link to governance data Web site is forthcoming). See the World Bank *Legal and Judicial Institutional Review* toolkit for a more detailed assessment of system performance in deterring wrongful conduct, facilitating voluntary transactions, resolving private disputes, and redressing governmental abuses of power. It will also assess how well the key institutions of the judicial system—the courts, the private bar, and the public prosecutors—are working. The toolkit is available on the World Bank Institutional Analysis and Assessment toolkits Web site at (http://lnts012.worldbank.org/prem/ps/iaamarketplace.nsf).
Persistent problems in any of these areas point to institutional difficulties. For example, the greater the share of fiscal activities conducted off budget, the more likely it is that institutional weakness is a serious cause for concern.

*Have a significant group of the fiscal outcome ratios deteriorated over the last five years—particularly, Expenditure/Gross National Product (GNP); Revenue/GNP; Budget Deficit/GNP; Public Sector Borrowing Requirement/GNP; Public Debt/GNP; Guarantees/GNP; Inflation; and Growth?*

An increasing share of the budget deficit funded by international financial institutions, or a significant increase in the ratios of mandatory and earmarked expenditures to discretionary expenditures, is a warning sign that fiscal policy may be presenting risks to the poor.

*Is tax policy—effective? What is the divergence between potential revenue as sanctioned by tax legislation and actual revenue?*

Revenue predictability is crucial to prevent future economic shocks, and unplanned revenue shortfalls reflect low administrative capacity or deliberate overestimates to avoid difficult spending reductions. Revenue predictability is the difference between actual central government revenues and those projected in the budget adopted by parliament at the beginning of the fiscal year. Simple and easy-to-administer tax laws, with relatively small numbers of taxes and other nondebt sources of revenue for government, and special categories of taxpayers and tax exemptions, are important to prevent disappointing revenue collection. Any sign that revenue varies dramatically from one year to the next, with government unable to predict current revenue collections in advance, is a warning of possible economic shocks for the poor in the future.

*Is tax policy efficient in practice—with a low total cost to society of collection compared with revenue raised?*

The social cost of collection includes direct administrative outlays, taxpayer compliance costs, and economic efficiency and equity costs due to tax administration. An inefficient tax system will be an unproductive one—leading to revenue shortfalls and economic shocks for the poor. The cost efficiency of revenue administration, including overall resource allocation and its exploitation of economies of scale and the costs of compliance to taxpayers, is determined by 1) the economic neutrality of the tax system, 2) any obstacles that it places in the way of the efficient functioning of markets, and 3) the degree to which it discriminates against foreign direct investment flows. Tax system equity—ensuring that the revenue burden, excluding user charges and fees, falls equally on equally placed citizens with minimal discrimination among different groups of equal taxpayers—is fundamental to minimizing taxpayer resistance.

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17 See the World Bank *Diagnostic Framework for Revenue Administration* on the World Bank Institutional Analysis and Assessment toolkits Web site at [http://lnts012.worldbank.org/prem/ps/iaamarketplace.nsf](http://lnts012.worldbank.org/prem/ps/iaamarketplace.nsf) for further details. The toolkit provides a comprehensive diagnostic framework for revenue administration, including an array of environmental factors that impinge on the Revenue Administration (RA); the effect of the history of the RA on its current and future functioning; organizational strategy; organization and management functions; and informal culture. The toolkit combines a preliminary examination of the symptoms of RA weaknesses with a detailed diagnosis based on the congruence model. The toolkit has been piloted in Colombia.
Is a hard budget constraint between tiers of government maintained through the intergovernmental system and the financial system?

All levels of government should be disciplined to provide best-value services for the poor. Spending and revenues should be clearly assigned to different levels of government—and matched to enable financing of services. Transfers are often unpredictable and nontransparent, and rules for transfers are frequently changed. If local voice is to be an effective means of holding local leaders accountable for meeting local needs and preferences, then local government must be certain of its funding and in its responsibilities. A hard budget constraint on subnational government is a clear signal that it is to be held accountable for service quality. Soft budget constraints can lead to a cycle of moral hazard and an expectation by subnational governments that the national government will “bail them out” of any financial difficulty. This can lead to subnational governments being fiscally irresponsible—by overspending, undertaxing, or overborrowing—to national bailout, and to central burden financed by money creation or overborrowing.

Does central government have the authority to control subnational government borrowing? Is this restriction enforced? Do subnational governments have access to capital markets? Where they do, is there an implicit or explicit central government guarantee? The issue of subnational borrowing is a controversial one. On one hand, lumpy local investments are most efficiently and equitably financed through borrowing. On the other hand, if a hard budget constraint does not exist between levels, governments might borrow beyond their means to repay and rely on central government bailouts—through the banking system, leading to inflation, or fiscal systems, leading to greater fiscal deficits. The most notable case of this is Brazil central bank. It continually rolled over the debt of subnational banks when they were unable to pay. This led to a moral hazard problem, where the states expected central bailouts and continued to borrow beyond their means to repay. The ultimate result was a major fiscal burden for the central government.

In the ideal world, local governments borrow in competitive markets, and they are disciplined by the competition for capital. They do not borrow from the central government or from locally owned public-sector enterprises or banks. In practice, arrangements vary widely between countries. If local governments have any reason to suspect that opportunistic fiscal decisions will be rewarded in the future, however, the central government may need to mitigate this moral hazard problem by regulating subnational borrowing. There are many ways for the central government to do this. The most direct is to simply ban all autonomous subnational borrowing and allocate all credit through a centralized process. More subtly, it may limit only certain kinds of borrowing, place numerical restrictions on borrowing, or specify that borrowing be used only for investment.18

18 See the Inter-governmental Relations Institutional Review available on http://www.worldbank.org/publicsector/pe/index.htm. This toolkit, under development with Bank wide testing planned, assesses arrangements for fiscal decentralization, including expenditure and tax assignment by function and level of government, intergovernmental transfers, and subnational borrowing. It also assesses institutional arrangements for administrative decentralization and key dimensions of political decentralization. More general information on decentralization can be found on http://www.worldbank.org/publicsector/ decentralization/index.htm. See also Decentralizing Borrowing Powers for recent World Bank experiences.
Is the revenue administration corrupt?

Tax and customs administrations often figure among the most corrupt government agencies in developing countries. Sufficient organizational autonomy of the revenue administration, combined with performance linked budgets, is often advocated as a way of achieving efficiency. Competitive base pay and transparent and nonarbitrary reward procedures are also widely recommended. Key questions are whether salary costs provide realistic incentives for officials without placing an excessive burden on the budget, and whether positive incentives are leading to overzealous harassment of taxpayers.

Tax simplification is perhaps the most important method of limiting opportunity for corruption. Making tax obligations transparent and trimming the compliance costs of honest taxpayers can be helpful in reducing the corruption of revenue authorities. Is there presumptive taxation of small businesses that may not keep extensive books and records to reduce the discretionary power of tax inspectors and make tax calculations simpler and clearer? Are responsibilities clearly divided along functional lines, and are procedures transparent and written? Are the institutional safeguards outside the revenue administration in place, including include an independent and effective judiciary, independent external audits, and taxpayer associations that strengthen citizens’ voice? Is excessive contact between taxpayers and tax officials avoided?

8. Providing security from corruption, crime, and violence

The quality of a legal system depends on how well it is performing four key functions: the deterrence of wrongful conduct, the facilitation of voluntary transactions, the resolution of private disputes, and the redress of governmental abuses of power.

To assess these dimensions, it is important to open dialogue with nongovernment organizations (NGOs) and other representative groups of civil society, and with target professional groups, including government officials, lawyers, and judges. Assessing the strengths and weaknesses of the key institutions of the judicial system—the courts, the private bar, and the public prosecutors—require nuanced judgements from informed observers. The extent to which information about the law is reasonably available to all citizens can best be assessed by a small group of officials and NGOs. However, to obtain a detailed breakdown of the caseload of the first-instance courts of general jurisdiction, for example, it might be necessary to survey court administrators, judges, and attorneys.

A population that fears crime, and has little confidence in the state’s ability to protect citizens from crime, and which reports that crime and theft are significant obstacles to

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19 More information can be found in the World Bank PREM note, An Anticorruption Strategy for Revenue Administration.

20 See the World Bank Legal and Judicial Institutional Review on the World Bank Institutional Analysis and Assessment toolkits Web site at (http://lnts012.worldbank.org/prem/ps/iaamarketplace.nsf). Web site for further details. This toolkit is under development and will assess system performance in deterring wrongful conduct, facilitating voluntary transactions, resolving private disputes, and redressing governmental abuses of power. It will also assess how well the key institutions of the judicial system—the courts, the private bar, and the public prosecutors—are working. Also see World Bank PREM notes on The Law and Economics of Judicial Systems and Reducing Court Delays: Five Lessons From the United States for recent World Bank experiences.
conducting business, suggests weak governance. Key indicators include the proportion
of the population willing to report crime to authorities, and the number of homicides per
100,000 per year. Surveys can provide evidence of the views of firms and households
on corruption in government.

**Are the courts independent and held accountable for the quality of their judgements?**

Is the judiciary independent of the other branches of government? It is instructive to
consider whether there has been any media story or other credible report in the past five
years stating that this independence has in fact not been honored. Are there special
courts to hear complaints involving the police, the military, or other security forces that
are not a part of the judicial branch?

In considering whether judges are able to decide cases free of outside pressures, it is
important to consider whether they are tenured and for how long. If a high proportion
of judges is in office under an exception to the normal tenure rules, or if a large number can
be transferred without their consent, independence may be weakened.

What are the mechanisms by which the judiciary is held accountable and to whom? Are
judges immune from the criminal or civil law?

**Is the competence of the judiciary and key legal personnel reasonable?**

Pay is a significant driver of quality, although certainly not sufficient. How does the
compensation of judges and other court personnel compare with similarly situated
individuals in the private sector?

**How are judges selected, promoted, and disciplined?**

Is the market for legal services, including private attorneys and notaries, competitive?
Overarching these concerns, the ways in which lawyers and notaries are held
accountable for their performance, including ethical rules governing the practice of law,
are significant.

What checks exist on decisions made by public prosecutors? Is the decision to charge
recognized as discretionary? Where it is, are there guidelines for how this discretion is to
be exercised? Are these guidelines public? Do lawyers, judges, and executive branch
personnel believe the decision to charge or prosecute is more or less influenced by
politics than it was five years ago?

**Are the courts efficient?**

Are the courts able to enforce debt contracts at a reasonable cost?

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21 The World Bank Institute can assist with such surveys. See
World Bank experiences are available in relation to Corruption and Development, New
Frontiers in Diagnosing and Combating Corruption, and Using Surveys for Public
Sector Reform. The World Business Environment Survey 1997 provides a useful benchmark
Can the courts complement the work of the police and the prosecution?

Is the population willing to turn to the courts for resolving private disputes?

State institutions should assist in resolving private disputes. The willingness of the population to submit private disputes to the court system and the percentage expressing satisfaction with how disputes are handled, including the timeliness and cost of resolution, are important considerations.

The proportion of the population that has submitted dispute to some form of alternative dispute resolution (ADR) method in the past five years and that has expressed satisfaction with ADR is also significant.

The proportion of the population that has litigated against government entities, including the police, in the past five years can be a useful indicator of citizen confidence that they can effectively redress abuses of power. Other key measures include the number of people indicating satisfaction with how cases were handled, and with cases being resolved on a timely basis and at reasonable cost. Parliamentarians’ perceptions of court effectiveness in redressing executive abuses of power—seeking views from government and nongovernment party members—can provide useful insights.

9. A governance checklist

This chapter has posed some broad questions about governance arrangements and their impact on the poor. Table 2 summarizes these against the poverty concerns presented in the introduction.

It is one thing to identify governance reforms that will help the poor; it is another to ensure their implementation. There are three preconditions to effective institutional and policy reform: political commitment, political feasibility, and sustainability. The benefits of reform must outweigh the costs. Meeting all three conditions does not guarantee that a reform will succeed, but it does indicate a higher probability of success. The following points are offered as a guide to teams that are seeking to review their proposed governance reform agenda against the tests of practicability and sustainability.

Who gains and who loses from the proposed governance changes?

To the extent that important elements of the government's support base are negatively affected, political leaders' commitment to reform is reduced. However, to the extent that key groups supporting the government are expected to benefit from the proposed reform, political commitment will be strengthened. Which gain, and which are likely to

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22 See the World Bank Commitment to Reform Diagnostic on the World Bank Institutional Analysis and Assessment toolkits Web site at http://lnst012.worldbank.org/prem/ps/iaamarketplace.nsf for further details. This toolkit assesses the political desirability of proposed reforms, the political feasibility—including opposition to this project or to broader reforms inside or outside of the government—and the sustainability of reform, including potential changes in key stakeholders.

Also see the World Bank PREM note Assessing Political Commitment to Fighting Corruption for a discussion of particular experiences in institutional reform. The World Bank Anti-Corruption Center provides a broader discussion and other examples (http://www.worldbank.org/publicsector/anticorrupt/index.htm)
lose from the proposed reforms? Are any of these groups in the government’s current support base? Are any of the groups that stand to win or lose swing groups—groups that are critical to the government’s ability to remain in power and that can credibly threaten to shift their support to the opposition? Within the past 30 years, has there been any attempt at reform in this sector by this government or by a government with substantially the same support base?

**Are these changes politically feasible?**

Even if the governance reforms are politically desirable, they may not be politically feasible. To bring about institutional change, government decisionmakers must be able to ensure the support and cooperation of other parts of government, which are critical to approving and implementing the reform project—for example, legislature, bureaucracy, and judiciary, etc. Assessing the strength of opposition to reform is important. It entails identifying the critical “veto gates,” or institutional junctures, at which particular players can block the government’s reform initiative. Who within the government needs to approve the proposed reform for its enactment? Who might be opposed to the reform project, and why? What change in the design of the reform might win their support? Which groups outside of government are known to be opposed to the reform?

In particular, which organizations or groups—for example, tax officials, law enforcement agents, government regulators, and clerks—will have to perform tasks to implement the reform?

**Are these changes sustainable?**

The issue of sustainability is particularly important for institutional reforms. They have longer gestation periods than policy changes, which can be achieved at the stroke of a pen. The sustainability of governance reform is dependent on whether the current government can expect to be in power, with a reform-friendly support base, long enough to ensure implementation. If a government comes to power that opposes reforms, the key question is whether the new government would wish to enforce the reform. If the reform can generate groups of beneficiaries, these groups may be able to pressure government to prevent reform reversals or enforcement failures. Which players in-country are expected to monitor the reform project and hold the central government accountable for its results?
### Table 2. A checklist of the key governance questions

<table>
<thead>
<tr>
<th>Poverty concerns</th>
<th>Governance issues</th>
<th>Key questions</th>
</tr>
</thead>
</table>
| 1) Empowering the poor | - Rules for seeking and holding public office  
- Oversight by political principals | • Is government office contestable in practice?  
• Is the government held accountable by the legislature for its policy actions?  
• Is the budget a credible signal of government’s policy intentions? |
| 2) Improving capability by improving reach, efficiency, sustainability of basic services | - Adequate, predictable resources for sectors, local authorities  
- Demarcation of responsibilities for delivery  
- Capable, motivated staff  
- Accountability downward  
- Flexible delivery  
- Development of local capacity | • Are the policies of government explicitly pro-poor in design or implementation?  
• Are services provided at the lowest practicable level of government?  
• Are local governments held accountable for responding to citizens’ preferences in delivering public goods and services?  
• Can spending units and entities predict their aggregate funding and their cash flow in-year?  
• Is government a responsible employer, restraining employment costs while ensuring that remuneration arrangements do not establish perverse incentives?  
• Is government unable to implement legitimate policies because of resistance from or limited capacity in the civil service?  
• Do government employees earn respect from firms and from the general public? |
| 3) Providing economic opportunities by increasing access to markets | - Legal and regulatory framework  
- Mechanisms to reduce exclusion | • Are property rights and contracts respected?  
• Are vulnerable groups particularly excluded?  
• Does red tape and corruption prevent the poor from starting businesses? |
| 4) Providing security  
  a) from economic shocks | - Rules for sound economic management  
- Safeguards against economic vulnerability | • Have a significant group of the fiscal outcome ratios deteriorated over the last five years?  
• Is tax policy effective?  
• Is tax policy efficient in practice—with a low total cost to society of collection compared to revenue raised?  
• Is a hard budget constraint between tiers of government maintained through the intergovernmental system and the financial system?  
• Is the revenue administration corrupt? |
|  
  b) from corruption, crime, and violence | - Enforcement mechanisms  
- Access to speedy recourse and redress | • Are the courts independent and held accountable for the quality of their judgements?  
• Is the competence of the judiciary and key legal personnel reasonable?  
• Are the courts efficient?  
• Is the population willing to turn to the courts for resolution of private disputes? |
Governance Technical Notes

Technical Note 1. Governance and Poverty—Recent Research

THE EVIDENCE

“Good governance” in the form of public institutions and policies that enforce property rights and contracts, while restraining corruption, is now widely viewed to be a necessary condition for long-term economic growth. Douglass North24 and many others have generated a growing body of work that combines rational choice theory, information economics, game theory, law, and organization theory to focus on the incentives that shape decisionmaking by public and private players. The recent empirical work corroborates these theoretical arguments, quantifying the costs of over-regulation, corruption, and other manifestations of bad government in terms of foregone investments and growth.25 Because increases in per capita income are usually, although not always, accompanied by reductions in poverty rates, there is a strong presumption that good governance—through its impact on growth—alleviates poverty. Knack and Anderson27 provide a more direct analysis of the governance-poverty link. Examining growth in incomes for the poorest quintiles of income earners, they find that good governance is progressive in that it is associated with larger growth rates in incomes for the poor than for the population overall. Gupta, Davoodi and Alonso-Terme find a large and statistically significant positive association between corruption and poverty rates.28

There is strong evidence linking higher per capita incomes to improved health and education outcomes, for example, reductions in infant mortality and in illiteracy. Because of the demonstrated effects of good governance on income growth, there exists a strong presumption that good governance improves health. Kauffman, Kraay and Zoido-Lobaton provide some evidence of direct links between governance and health and education outcomes. They show that countries scoring higher on their indexes of such areas as rule of law, graft, and voice and accountability tend to have lower infant mortality and higher literacy rates, as well as higher per capita incomes. Norton finds that countries scoring higher on indexes that rank the security of property rights also fare better on a human poverty index, constructed from longevity, literacy, child nutrition, and access to health services and safe water.

There is some evidence that democratic institutions have a positive impact on poverty, as measured by infant mortality rates, literacy rates, and other objectively measurable outcome indicators. Amartya Sen argues that democracy can make a positive contribution to development by creating political incentives for rulers to respond positively to the needs and demands of their citizens. There is reason to assume that the architecture of the state, including the relationships between the executive, legislative, and judiciary branches and other institutional arrangements for the transfer of power between governments, including voting arrangements and electoral laws, affect the performance of the public sector in responding to poverty. Dreze and Sen assert that the openness and accountability of democratic societies explain why India but not China has managed to avoid large-scale famines. Kaufmann et al. find that an index of “voice and accountability” is associated with lower infant mortality and illiteracy across countries. There is also some evidence that participating in local and national

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33 Dr. Johann Graf Lambsdorff (senior research adviser to Transparency International and assistant professor at Göttingen University) notes that the empirical evidence that democracy reduces corruption is weak. He cites two unpublished studies by M. Paldam (“The Big Pattern of Corruption: Economics, Culture and the Seesaw Dynamics”, Aarhus University, Denmark, June.1999) and D. Treisman (“The Causes of Corruption: A Cross-National Study,” University of California, Los Angeles, June.1999) that investigate this relationship while controlling for the level of development as depicted by GDP per capita. In such multivariate regressions, democracy does not significantly affect levels of corruption (as measured by the Transparency International index). The two authors therefore argue that the effect of democracy is ambiguous. There appears only a small but significant influence when testing for countries that have been democracies without interruption since 1950. The only tentative conclusion possible is that while the current degree of democracy is not significant, a long period of exposure to democracy is associated with less corruption. Lijphart provides further evidence from a 36-country study in Patterns of Democracy: Government Forms and Performance in Thirty-six Countries. New Haven: Yale University Press, 1998.
35 Kaufmann, Kraay, and Zoido-Lobaton, “Governance Matters.”
decisions helps to improve the quality of projects and the welfare of vulnerable groups such as women and their children.

MEASURING GOVERNANCE

In recent years, the number and type of governance indicators has increased dramatically. However, this period has seen little agreement about their use and there are few examples of governance indicators having a substantial impact on the policy actions of governments or on specific reforms proposed by donors and IFIs. Most of the growing array of governance indicators has become available only in the last few years, and the limited coverage over time makes it more difficult to convincingly demonstrate causal relationships between governance and measures of well-being. Studies using these indicators confirm that development has occurred where there is now good governance—but it does not necessarily follow that they reliably point to where development will occur in the future.

Governance indicators have been widely used in research, testing links between good governance and economic outcomes. The range of governance indicators now available is impressive (see Table 3), and the literature associated with them demonstrating their linkages to development outcomes is extensive. However, the only conclusions arising from most of this research is that the “black box” of governance in some way affects public-sector performance, which in turn affects poverty or other outcomes. This is an important achievement that has helped to dramatically alter our perspectives on the process of development, but it does not offer us any firm prescriptions about what should be done. We have no firm grounds on which to assert, for example, that decentralization or improved budgetary arrangements will improve some particular aspect of public-sector performance.

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38 One exception is the use of indicators to identify countries where a governance discount in International Development Association allocations should apply.


40 A particularly comprehensive list of recent research evidence demonstrating that measurements of governance do indeed correlate with measurements of development is provided in Burki, Shahid Javed, and Guillermo Perry, 1998. Beyond the Washington Consensus: Institutions Matter. World Bank, Washington, DC, and other sources.
Table 3 An Incomplete List of Sources of Governance Indicators

("Single" means that the dataset contains just one indicator, “multiple” that the dataset includes many individual variables)

### I. Indicators of institutional arrangements

<table>
<thead>
<tr>
<th>Sources</th>
<th>Data Sets</th>
<th>Concept Measured</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Policy and public spending management</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Bank (as calculated from Government Financial Statistics)</td>
<td>Policy volatility (single)</td>
<td>Calculated as the median percentage difference from year to year in government spending, by functional classification, over the last four years</td>
</tr>
<tr>
<td>U.S. State Department</td>
<td>Compliance with auditing standards for military spending</td>
<td>Compliance with new U.S. legislation on transparency in budgeting</td>
</tr>
<tr>
<td><strong>Public employment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Bank (1997 Schiavo-Campo, de Tommaso and Mukherjee)</td>
<td>Aggregate wage bill totals and employment totals of civil and public servants (multiple)</td>
<td>Public officials are categorized to allow for cross-country comparability</td>
</tr>
<tr>
<td>&quot;</td>
<td>Civil service pay relative to private-sector pay</td>
<td>Average salary for civil service divided by average worker income</td>
</tr>
</tbody>
</table>

### II. Indicators of government performance

<table>
<thead>
<tr>
<th>Sources</th>
<th>Datasets</th>
<th>concept measured</th>
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</thead>
<tbody>
<tr>
<td><strong>Business Environment Risk Intelligence</strong></td>
<td>Political Risk Index (multiple)</td>
<td>Socio-political conditions</td>
</tr>
<tr>
<td>&quot;</td>
<td>Operation Risk Index (multiple)</td>
<td>Bottlenecks for business development</td>
</tr>
<tr>
<td>Wall Street Journal</td>
<td>Annual survey of business analysts (multiple)</td>
<td>Attractiveness of the business environment</td>
</tr>
<tr>
<td>Standard and Poor</td>
<td>Country Risk Review (multiple)</td>
<td>Risk to the profitability of investments</td>
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<tr>
<td>European Bank for Reconstructi on and Development</td>
<td>Transition indicators (multiple)</td>
<td>Progress toward a market economy</td>
</tr>
<tr>
<td>&quot;</td>
<td>Legal reform survey (multiple)</td>
<td>Effectiveness of the legal framework</td>
</tr>
<tr>
<td>Economist Intelligence Unit</td>
<td>Country Risk Service (multiple)</td>
<td>Risk ratings for investors</td>
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<tr>
<td>&quot;</td>
<td>Country forecasts (multiple)</td>
<td>Attractiveness of the business environment</td>
</tr>
<tr>
<td><strong>Freedom House</strong></td>
<td>Freedom in the World (multiple)</td>
<td>Political rights and civil liberties</td>
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<tr>
<td>&quot;</td>
<td>Nations in Transit (multiple)</td>
<td>Progress toward democracy and a market economy</td>
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<tr>
<td>World Economic Forum</td>
<td>Global Competitiveness Survey (multiple)</td>
<td>Business environment</td>
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<td>Heritage Foundation</td>
<td>Index of Economic Freedom</td>
<td>Prospects for growth</td>
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<td>International Country Risk Guide (multiple)</td>
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<td>quality of the legal system</td>
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<tr>
<td>&quot; Transparency in Asia (multiple)</td>
<td>Business environment</td>
<td></td>
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<tr>
<td>&quot; Quality of the media (multiple)</td>
<td>Censorship and access to foreign media</td>
<td></td>
</tr>
<tr>
<td>Institute for Management Development</td>
<td>World Competitiveness Yearbook (multiple)</td>
<td>Business environment</td>
</tr>
<tr>
<td>Transparency International</td>
<td>Corruption Perceptions Index, aggregation of many indicators (single)</td>
<td>Corruption perceptions</td>
</tr>
<tr>
<td>International Telecommunications Union</td>
<td>Waiting time for telephone line (single)</td>
<td>Wait for key service generally provided through government</td>
</tr>
<tr>
<td>Private-sector credit (from IFS data)</td>
<td>Private-sector credit/GDP, from International Financial Statistics</td>
<td>Financial sector development</td>
</tr>
</tbody>
</table>

Note: This list draws, among others, from Kaufmann, Kraay and Zobato-Lobaton 1999.

This illustrative list could, of course, have been considerably larger. It is not clear where to draw the line between governance indicators and the growing number of political economy indicators that illuminate aspects of the checks and balances on government. Lijphart’s recent work in developing measures of the degree to which power is tightly held by the executive branch, and the degree to which power is dispersed among different levels and organizations of government, is a case in point.42