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Foreword

Good governance is an essential complement to sound economic policies. Efficient and accountable management by the public sector and a predictable and transparent policy framework are critical to the efficiency of markets and governments, and hence to economic development. The World Bank's increasing attention to issues of governance is an important part of our efforts to promote equitable and sustainable development.

This booklet, based on the work of a 1991 Bank task force, addresses the issues of governance that fall within the Bank's mandate. I endorse the main messages of the booklet and encourage wider discussion and debate of the important issues it raises.

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President
The World Bank
April 1992

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The booklet also draws on work by Samuel Paul on accountability and by Hans Jürgen Gruss and Andres Rigo on the rule of law. Deborah Brautigam, assistant professor of public policy and development, Columbia University, undertook a review of the literature on governance and commented extensively on a draft. Contributions from the Bank's regional staff were coordinated by Mamadou Dia (Africa Region), Daniel Ritchie (Asia Region), Stephen Heyneman and Anthony J. Pellegrini (Europe and Central Asia, and Middle East and North Africa regions), and Shahid Chaudhry (Latin America and Caribbean Region). Numerous other Bank staff contributed ideas and experiences and commented on the ongoing work. Secretarial support was provided by Lynette Alemar, Sonia Benavides, Maria Estrella, Marjorie Pavia, and Amelito Velasco. The booklet was edited by Alfred Imhoff.

Introduction and Summary

In this booklet, governance is defined as the manner in which power is exercised in the management of a country's economic and social resources for development. Good governance, for the World Bank, is synonymous with sound development management. The Bank's experience has shown that the programs and projects it helps finance may be technically sound, but fail to deliver anticipated results for reasons connected to the quality of government action. Legal reforms, however urgent, may come to naught if the new laws are not enforced consistently or there are severe delays in implementation. Efforts to develop privatized production and encourage market-led growth may not succeed unless investors face clear rules and institutions that reduce uncertainty about future government action. Vital reforms of public expenditure may flounder if accounting systems are so weak that budgetary policies cannot be implemented or monitored, or if poor procurement systems encourage corruption and distort public investment priorities. Failure to involve beneficiaries and others affected in the design and implementation of projects can substantially erode their sustainability.

These examples illustrate a broader point: good governance is central to creating and sustaining an environment which fosters strong and equitable development, and it is an essential complement to sound economic policies. Governments play a key role in the provision of public goods. They establish the rules that make markets work efficiently and, more problematically, they correct for market failure. In order to play this role, they need revenues, and agents to collect revenues and produce the public goods. This in turn requires systems of accountability, adequate and reliable information, and efficiency in resource management and the delivery of public services.

Yet there is no certainty that institutional frameworks conducive to growth and poverty alleviation will evolve on their own. The emergence of such frameworks needs incentives, and adequate institutional capacity to create and sustain them. The World Bank, along with other external aid and finance agencies, is involved in assisting developing countries build these incentives and develop such capacity. Thus, for example, in public sector management, the Bank's work has broadened from assisting in improving the management of project-related agencies to addressing such systematic constraints on sound management as weaknesses in the civil service, in wage structures, and in the central economic agencies that are responsible for policy formulation. This broader approach is also under way in other areas of governance, such as action to clarify accountability and strengthen the legal framework.

This booklet identifies four areas of governance that are consistent with the Bank's mandate: public sector management, accountability, the legal framework for development, and information and transparency. It focuses on the last three areas, analyzes issues of relevance to the Bank, and cites examples of Bank experience and best practice in each area.

The Bank's work on governance is selective, given the legal and resource constraints it faces, and given the limitations facing any external agency working in areas for which national decisions and government commitment are the fundamental determinants. This in turn implies concentrating Bank efforts in countries where they are most likely to succeed, and where there is a shared perception of need. Success will also depend on the extent to which this work reflects the country's institutional needs, its history, its political economy, and the nature of its society. When government commitment to sound development management is in doubt, the Bank's encouragement of an intensive dialogue on the overall development program can be an important precursor to change. When that dialogue is not fruitful, it inevitably affects the Bank's analysis of the country's overall development management and performance, and in turn the nature and extent of Bank support for the country. Thus the Bank's work related to governance must both be informed by a long-term perspective on the country's development strategy and prospects and aim at sustainable results.

The World Bank's interest in governance arises from its concern for the effectiveness of the development efforts it supports. A general definition of governance is the "exercise of authority, control, management, power of government." A more relevant definition for Bank purposes is "the manner in which power is exercised in the management of a country's economic and social resources for development."[1] The Bank's concern with sound development management thus extends beyond building the capacity of public sector management to encouraging the formation of the rules and institutions which provide a predictable and transparent framework for the conduct of public and private business and to promoting accountability for economic and financial performance.

Public sector capacity issues are discussed in detail in *The Reform of Public Sector Management: Lessons of Experience* (World Bank 1991c), and will be referred to only briefly in this booklet. The main focus here is on the overall management of resources for development—with a special emphasis on accountability, the legal framework for development, and information and transparency.

In his legal memorandum, the Bank's general counsel set out "a legal framework for the Bank's dealing with this issue as a prelude to any future analysis of the manner in which the Bank may take it on operationally" (Shihata 1991). Given the limited nature of the Bank's direct operational experience with governance, except for public sector management, this initial review defines basic concepts and surveys Bank experience to date. The booklet also cites best practice and highlights issues that have emerged as the Bank addresses a wider range of concerns related to governance.

Issues of governance are not new to the World Bank. As a development institution, the Bank has grappled with these issues from its inception. However, the relatively good growth performance of developing countries between 1965 and 1980 helped conceal the deep-seated problems of governance which affected their efficient use of resources and retarded their efforts to adjust in response to a changing external environment. By the beginning of the 1980s, as growth decelerated sharply and the developing world was adversely affected by a severe worsening in the terms of trade, the emergence of a climate of relative scarcity began to expose issues of governance in many countries. At the same time, it was becoming increasingly clear that investment lending could not achieve its objectives in the absence of an appropriate policy framework.

Structural adjustment lending and related reforms of public sector management aimed to create an enabling environment for growth. They sought to reduce government intervention in incentive policies, promote the more efficient use of public resources, and cut fiscal deficits—thereby indirectly addressing those issues of governance which affected the management of resources. Despite some encouraging success with adjustment lending and public sector reforms, the enabling environment is still deficient in many cases. More effective Bank-supported investments and policy reforms thus depend, in such cases, on further improvements in the institutional framework for development management.

For some Bank borrowers, the effectiveness of both adjustment and investment operations is impeded by factors which contribute to poor development management. These include weak institutions, lack of an adequate legal framework, weak financial accounting and auditing systems, damaging discretionary interventions, uncertain and variable policy frameworks, and closed decisionmaking, which increases risks of corruption and waste. In countries where corruption has adversely affected development, pervasive patronage in government has led to public investment choices being used to finance white elephants, usually by contracting excessive foreign debt. Monopolies were sanctioned and allocated to friends of those in power, at great economic cost to the nation. In some countries, progress toward policy reforms has been offset by uncertainties in the investment climate. In other countries which have moved toward realistic relative prices, the expected private sector response has been inhibited by inconsistent behavior toward business by some government agencies, by inconsistencies between new government policies and the established legal framework, or by discrimination against certain ethnic groups with strong business communities. In Eastern Europe, the lack of a legal system conducive to private sector development is a severe impediment to privatization and new investment. In some Latin American countries, rapid decentralization has outstripped systems of accountability and civil service institutions at the provincial or state and local government levels, which has in turn increased already unsustainable fiscal deficits.

The Bank staff concerned with Africa were the first to articulate the Bank's concerns in the book *Sub-Saharan Africa: From Crisis to Sustainable Growth: A Long-Term Perspective Study* (World Bank 1989) in a frank discussion of the "crisis of governance."[2] This book proved a stimulus to the debate now under way in both developing and industrial countries on issues of governance in general, and in the Bank, as it relates to economic development. Another stimulus has been the rapid political changes in Eastern Europe, Latin America, and parts of Asia and Africa. These changes have been accompanied by changes in the role of the state to reflect a greater preoccupation with the creation of an enabling environment for development, larger responsibilities for the private sector, a reduction in direct government involvement in production and commercial activity, and the devolution of power from the center to lower levels of government. These changes have usually been associated with difficult economic reforms and macroeconomic adjustment. To nurture a political consensus in support of these reforms, governments require considerable skill. By its function, the Bank is intimately involved in this broad reform process, and governments are turning to it more and more to assist them in addressing a broader range of economic management issues, including the legal framework and systems of procurement and financial accountability.

Bilateral lending and aid agencies have become increasingly sensitive to public criticism of concessional aid flows to governments which lack democracy, have a poor human rights record, or are seen to be corrupt. These agencies have been pursuing a broader agenda regarding governance through political channels.

The World Bank's mandate, as laid down in its Articles of Agreement and as applied in practice, is to promote sustainable economic and social development. Its concern for governance must be driven by that mandate. The General Counsel's memorandum identified five aspects of governance that are beyond the Bank's mandate: the Bank cannot be influenced by the political character of a member; it cannot interfere in the partisan politics of the member; it must not act on behalf of industrial member countries to influence a borrowing member's political orientation or behavior; it cannot be influenced in its decisions by political factors that do not have a preponderant economic effect; and its staff must not build their judgments on the possible reactions of a particular Bank member or members. This memorandum then suggested that governance may, however, be relevant to the Bank's work if it is addressed in terms of having good order and discipline in the management of a country's resources. Thus, there could well be a need for the Bank to encourage, for example, civil service reform, legal reform, and accountability for public funds and budget discipline (Shihata 1991).

The next section of this booklet describes the nature of the problem of governance from the Bank's perspective. Following sections analyze the four key dimensions of governance and the Bank's experience with each: public sector management, accountability, the legal framework for development, and information and transparency. The last sections discuss the role of the Bank and implications for Bank practice, and outline next steps.

The Nature of the Problem

The Role of Governments

Even in societies that are highly market-oriented, only governments can provide two sorts of public goods: rules to make markets work efficiently and corrective interventions where there are market failures (McLean 1987: 19–21). With respect to rules, without the institutions and supportive framework of the state to create and enforce the rules, to establish law and order, and to ensure property rights, production and investment will be deterred and development hindered (Eggertson 1990). This is because high "transaction costs" (that is, the cost of arranging, monitoring, and enforcing contracts) will inhibit such activities. Compensation for market failure is more problematic. Governments in the 1970s relied on this rationale to rush into unwise policies and investments, although their own policy interventions often were responsible for market failures, and the investments did not yield adequate returns. Governments now increasingly recognize the need for more restraint and for taking "market-friendly" steps to deal with problems. In addition, the state must play a key role in providing services such as education, health, and essential infrastructure, particularly when such services are directed at the poor and are not forthcoming from the private sector. A well-educated labor force and adequate infrastructure are fundamental to the quality of private investment.

To finance such expenditures, however, the state needs revenues. The state also needs "agents" who will collect taxes from the public and produce and deliver essential services (such as education and health, and a legal framework).[3] This, in turn, requires systems of accountability—both within the government and from the government to those it serves. For the system to work, an adequate and reliable flow of information is essential. Without it, the rules are not known, accountability is low, and uncertainties are excessive. Thus, accountability, publicly known rules, information, and transparency are all elements of sound development management. Moreover, the institutional framework needed to provide these public goods must be managed efficiently.

Productive institutional arrangements will vary between countries on the basis of their cultural traditions and historic relationships. And they will continue to evolve as the economy grows and becomes more complex and more integrated with international markets. Mature institutional frameworks take a great deal of time to develop, but there is no guarantee that arrangements which are supportive of economic growth and poverty alleviation will, in fact, emerge. The state may behave in a predatory manner or pursue strategies that hinder property rights. Its agents may behave in an opportunistic manner and indulge in "rent-seeking." Why do some states behave differently from others? What are the conditions that permit success? The historical evidence is far from clear. Yet institutional economists, such as Douglass North, argue that institutions, defined as "the rules of the game in a society" (North 1990: 3),[4] determine the performance of economies. Efficient institutions emerge when there are built-in incentives to create and enforce property rights, defined in the broadest sense. The example most often cited is that of the contrasting paths pursued by England and Spain in the seventeenth century, when both countries faced severe fiscal crises. The path pursued by England led to a burst of innovative activity; that of Spain led to a decline of such activity.

> In England, Parliament created the Bank of England and a fiscal system in which expenditures were tied to tax revenues. The consequent financial revolution not only finally put the government on a sound financial basis, but laid the ground for the development of the private capital market. More secure property rights, the decline of mercantilist restrictions, and the escape of textile firms from urban guild restrictions combined to provide expanding opportunities for firms in domestic and international markets. Both the growing markets and the patent law encouraged the growth of innovative activity . . .
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> In Spain, repeated bankruptcies between 1557 and 1647 were coupled with desperate measures to stave off disaster. War, the church, and administering the complex bureaucratic system provided the major organizational opportunities in Spain and in consequence the military, priesthood, and the judiciary were rewarding occupations. The expulsion of the Moors and Jews, rent ceilings on land and price ceilings on wheat, confiscations of

> silver remittances to merchants in Seville (who were compensated with relatively worthless bonds called juros) were symptomatic of the disincentives to productive activity. [North 1990: 114–15]

Such historical contrasts illustrate the importance to development of the "underlying institutional characteristics" of societies. Institutional economists point out that in order to understand better why these characteristics are different in different societies, we need to know more about the interaction between culture and formal rules and institutions.

Scholars differ on the role of culture in shaping institutions and rules. Some argue that the importance of cultural divergences diminishes as the market economy progressively transforms society. Others, citing Japan, stress that norms and values of consensus and reciprocity may soften the impersonal nature of the market, and that national cultures impart a long-term, culturally specific shape to the legal and other institutions that support the functioning of the market. These two views are not necessarily inconsistent; the issue is one of degree.

The current debate on governance, therefore, needs to take account of cultural differences.[5] The concepts that are discussed in this booklet mean different things to different cultures. For example, the concept of "contract," which is at the heart of accountability and the rule of law, implicitly carries the notion that rights and obligations incurred at a given point in time through an abstract legal device—the contract—will be honored at a later point in time by all parties concerned. Some cultures may have different conceptions of the relative importance of contractual agreements in relation to other rights and obligations. These may include, for example, strong and binding ethnic or kinship ties. Social norms may affect, for example, attitudes toward evading taxes or what constitutes conflict of interest.

The spread of political and legal systems modeled on Western traditions may lead to the simultaneous existence of two sets of norms and institutions for dealing with broadly defined rights and obligations, with Western notions of the rule of law, private property rights, and contracts superimposed on ideas such as "consensus," "communal property," and "reciprocity," which have evolved over long periods of time in many non-Western cultural settings. Although these different ways of anchoring social rights and obligations may or may not hamper the functioning of modern economic institutions, such as the market, it is important to be aware of them when pursuing policy reforms and institution building.

When Governance Fails

The institutional characteristics for managing development thus vary widely among countries and do not permit easy generalization. Nor is it practical to attempt a taxonomy, classifying states, say, by different characteristics of governance. This complexity arises from the unique imprint of history, geography, and culture on each country's institutions and rules, and the multidimensional nature of governance as a concept. Thus each country is at a different level of political, economic, and social development reflecting a wide array of historical, geographic, and cultural factors. A number of the World Bank's borrowers have been relatively successful in creating the institutions and rules that promote broadly based economic development. Some others are on their way to doing so, whereas yet others still labor under severe political, institutional, and economic constraints on better government performance. What is said in this booklet about government performance must be applied to individual countries in their context.

But poor governance is readily recognizable. Some of its main symptoms are:

- Failure to make a clear separation between what is public and what is private, hence, a tendency to divert public resources for private gain
- Failure to establish a predictable framework of law and government behavior conducive to development, or arbitrariness in the application of rules and laws
- Excessive rules, regulations, licensing requirements, and so forth, which impede the functioning of markets and encourage rent-seeking
- Priorities inconsistent with development, resulting in a misallocation of resources
- Excessively narrowly based or nontransparent decisionmaking.

Such "problems" may be due to lack of capacity or to volition, or both, and may be of varying severity. It is when they are sufficiently severe and occur together, however, that they create an environment hostile to development. In such circumstances, the authority of governments over their peoples tends to be progressively eroded. This reduces compliance with decisions and regulations. Governments then tend to respond through populist measures or, as in some authoritarian regimes, they resort to coercion. Either way, the economic cost can be high, including a diversion of resources to internal security and escalating corruption. Poor development performance can in turn contribute to poor governance by further eroding the confidence of citizens in their governments and causing governments to behave insecurely.

The absence of good governance has proved to be particularly damaging to the "corrective intervention" role of government. Programs for poverty alleviation and environmental protection, for example, can be totally undermined by a lack of public accountability, corruption, and the "capture" of public services by elites. Funds intended for the poor may be directed to the benefit of special interest groups, and the poor may have inadequate access to legal remedies. Similarly, the enforcement of environmental standards, which benefit the population as a whole but which may be costly to powerful industrial and commercial groups, can be emasculated by poor governance. Industrial emissions standards, forest protection policies, and guidelines for the incorporation of environmental concerns into public expenditure decisions may be worth little more than the paper they are written on unless rules are clear, information is available to the public, and government officials are accountable. In the case of the environment, problems are magnified by difficulties of monitoring and enforcement, which enable official government policies to be ignored.

Among the underlying causes of poor development management is the level of economic, human, and institutional development. Lack of an educated and trained work force and weak institutions can substantially reduce the capacity of countries to provide sound development management. Poverty and illiteracy make poor governance more likely. This is not, though, to suggest that development automatically brings good governance; nor to imply that sound economic management is not possible in poor countries. There are a number of Asian counter-examples, both authoritarian and democratic. It is simply that poverty, illiteracy, and weak institutions make the task of good development management much more complicated and problematic.

Pervasive corruption is particularly damaging to development. Corruption occurs in all countries and in many different forms. It tends to thrive when resources are scarce, and governments, rather than markets, allocate them; when civil servants are underpaid; when rules are unreasonable or unclear; when controls are pervasive and regulations are excessive; and when disclosure and punishment are unlikely. Although there have been isolated instances of governments being both corrupt and successful at promoting development, in general, corruption weakens the ability of governments to carry out their functions efficiently. "Bribery, nepotism, and venality," notes *World Development Report 1991*, "can cripple administration and dilute equity from the provision of government services—and thus also undermine social cohesiveness" (World Bank 1991d: 131). Graft on a large scale is not possible without collusion with private companies or foreign suppliers, with officials of foreign governments sometimes turning a blind eye—a problem of international governance.

Other causes of poor development management are a high degree of concentration of political power and the colonial inheritance. On the positive side, many former colonies inherited systems of financial accountability, an independent civil service, and a legal framework. Because these were imported from outside, however, they have not always taken root. Colonial rule implied accountability to the colonial power, rather than to citizens; it thus sometimes destroyed indigenous systems of accountability.

Colonial rule has sometimes bequeathed standing armies and thus diverted resources away from development and made fragile civilian governments prone to military coups and related political instability. *World Development Report 1991* estimates that since 1948, there has, on average, been one coup attempt per developing country every five years (World Bank 1991d: 128). Colonially imposed frontiers have sometimes led to border disputes and ethnic strife. During the Cold War, such strife was, on occasion, fueled by arms exports to the rival factions or states.

These symptoms and causes of poor governance are not unique to any particular form of government. *World Development Report 1991* examined the evidence on the relative performance records of democracies and authoritarian regimes and noted that the democratic-authoritarian distinction itself "fails to explain adequately whether or not countries initiate reform, implement it effectively, or survive its political fallout" (World Bank 1991d: 134). Authoritarian regimes were just as likely to yield to the interests of narrow constituencies. The Report also noted that some studies suggest that for a given level of income, "improvements in social indicators are associated with freedom and liberty" (p. 134).

In sum, governance is a continuum, and not necessarily unidirectional: it does not automatically improve over time. It is a plant that needs constant tending. Citizens need to demand good governance. Their ability to do so is enhanced by literacy, education, and employment opportunities. Governments need to prove responsive to those demands. Neither of these can be taken for granted. Change occurs sometimes in response to external or internal threats. It also occurs through pressures from different interest groups, some of which may be in the form of populist demands. Although lenders and aid agencies and other outsiders can contribute resources and ideas to improve governance, for change to be effective, it must be rooted firmly in the societies concerned and cannot be imposed from outside.

As indicated in the foregoing discussion, four main dimensions of governance are relevant to the World Bank's work: capacity and efficiency issues in public sector management, accountability, predictability and the legal framework for development, and information. These are now discussed in turn.

Improving Public Sector Management

When the capacity of the public sector to manage the economy and deliver public services is weak, the prospects for development are poor. The public sector in many developing countries has been characterized by uneven revenue collection, poor expenditure control and management, a bloated and underpaid civil service, a large parastatal sector that provides poor returns on the scarce public funds invested in it, and weaknesses in the capacity of core economic agencies to design and implement policies that would address these problems. Not only does this state of affairs contribute to large fiscal deficits requiring adjustment measures, but it also progressively erodes the capacity of the state to provide economic and social services.

The World Bank's involvement in this area, until the 1980s, was overwhelmingly in the institutional development of the agencies implementing Bank-financed projects. With the introduction of adjustment lending, the Bank began to focus on improvements in overall public sector management, and the improvement of sectorwide institutions and service delivery. Within this dimension, three areas received primary attention in the 1980s: public expenditure management, civil service reform, and parastatal reform. Within public expenditure management, the emphasis was on assisting borrowers improve public investment programming and the budget process. Efforts to improve the execution and monitoring of public expenditure programs were less intensive. Under civil service reform, in the short term, the emphasis was on cost-containment measures; in the medium term, it was on strengthening personnel management and the effectiveness and efficiency of public agencies. In the management of public enterprises, the Bank assisted borrowers rationalize the size of the public enterprise sector; privatize, restructure, or liquidate public companies, as appropriate; improve the competitiveness of the policy environment; and clarify the relationship between the central government and public enterprises with a view to increasing the returns on the government's investment in the sector. The core agencies for key sectors and for national economic management have been assisted in strengthening management of these reform programs and in giving greater priority to and increasing the efficiency of the delivery of social services. Decentralization and tax reform are other areas where the Bank has supported government efforts to improve public sector efficiency (as noted in World Bank 1991c).

A recent World Bank report on public sector management (World Bank 1991c) provides a review of selected issues and concludes that initial results have been positive, often in trying circumstances. The effort has been long and arduous, reflecting obstacles of a sociopolitical nature. In public expenditure management, imperfect accountability has gone hand in hand with weak institutional capacity. In civil service reform, there is a shift in emphasis to improved personnel management. In all cases, the need for strong political commitment is noted. It is particularly difficult to ensure commitment to reforms over time. Tensions between economic benefits and political costs are typical of reforms in this area.

Accountability

> [Accountability] is found where rulers readily delegate authority, where subordinates confidently exercise their discretion, where the abuse of power is given its proper name, and is properly punished under a rule of law which stands above political faction.
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> —John Lonsdale (1986: 135)

The Nature and Scope of Accountability

Accountability, at its simplest, means holding public officials responsible for their actions. Political leaders are ultimately responsible to their populations for government actions, and this means that there has to be accountability within government. How this happens varies widely in different countries, depending upon cultural characteristics, history, political institutions, administrative capacities, and the public's access to and use of information. At a broad level, the economic objectives of public accountability include ensuring congruence between public policy and actual implementation, and the efficient allocation and use of public resources. This not only requires systems of financial accountability, but also the capacity and willingness of governments to monitor their overall economic performance. At the micro level, the primary concern is similar efficiency in investment and in the production and delivery of goods and services in the public sector.

Accountability is important throughout the economic system, not just within government. Governments also have an important role to play in ensuring accountability in the private sector, through company and securities legislation, competitive policy, and regulatory oversight. As the state sheds many productive investments in developing countries, this function becomes particularly important.

Public accountability involves three interrelated groups: (a) the general public and particularly recipients of public services, who are interested in service providers being accountable to them; (b) political leaders and supervisors of service providers, who would like the service providers to be accountable to them for a mixture of public policy and private and parochial interests; and (c) the service providers themselves, whose objectives and interests often differ from those of the first two.

The phenomenon of "capture" of public services and resources by relatively narrow special interests is an ever-present problem in all countries. It is made worse by monopoly, and also by the limited capacity of the public to demand *and* monitor good performance, especially because it is often hard to measure the benefits of public services. These factors make improvements in public accountability an especially complex and difficult undertaking.

The historical evolution of accountability reveals three features. First, micro-level accountability has become more important as the role of the state has expanded and made it impossible to apply broad political accountability to all the myriad actions of modern government. Second, the focus in public accountability tends to be on inputs, especially public expenditure, rather than on outputs or effects, which are often diverse and complex to measure. Third, except for legal accountability for government action in some countries, accountability has mostly been by internal administrative controls by political leaders, government agencies, and bureaucrats acting as proxies for the public. But hierarchical control is often ineffective, especially when collusion between supervisory and subordinate personnel is likely. Micro-level accountability remains critical, especially in ensuring government responsiveness to the views and needs of the "publics" for which services are intended.

Macro-Level Accountability

Two main aspects of macro-level accountability are particularly relevant to the Bank's work: financial accountability, and accountability for overall economic performance.

Financial accountability involves:

- A properly functioning government accounting system for effective expenditure control and cash management
- An external audit system which reinforces expenditure control by exposure and sanctions against misspending and corruption
- Mechanisms to review and act on the results of audits and to ensure that follow-up action is taken to remedy problems identified.

Without a well-functioning system of financial accountability, government efficiency is poor, and the probability of corruption increases greatly. Corruption is clearly an issue of concern not only because of potential misuse of external resources (including the Bank's) but also because it generally reduces the efficiency of resource use (box 1).

The World Bank has historically focused on financial accountability, especially in the context of investment projects. As is the experience of other external financing agencies, compliance with accounting and auditing covenants has been uneven. The problems encountered in these areas are not project specific but are symptomatic of weaknesses in countrywide financial accountability. The need for improved financial accountability at the national level is of particular relevance in countries where the Bank is undertaking adjustment lending and is, in effect, providing substantial resources directly to government budgets.

To address this issue, the Bank is pursuing in selected countries a three-pronged strategy. First, it is trying to *improve borrower performance* through stricter enforcement and the introduction of penalties for noncompliance. The penalties include not extending closing dates, making further processing of loans conditional on compliance with requirements on past loans, and suspending disbursements.

Second, it is trying to *encourage more systematic review of auditing and accounting capacities and needs during project preparation*, and encouraging greater contracting out for project accounting and audit services.

Third, it is helping to *strengthen borrower capacity* through countrywide reviews of auditing and accounting systems, and following up with assistance. In Ghana and Madagascar, economic management support projects aim to remedy deficiencies in public financial man-

Box 1. Reflections on Corruption

Corruption is the misuse of power for personal gain. Many people, anywhere, can be tempted to misuse power for personal gain, if permitted to do so at no cost or risk to themselves. Thus, corruption occurs in all countries in many different forms. It tends to emerge and increase in any country when inequalities are acute, resources are scarce, rules are unclear, disclosure and punishment are unlikely, and upward mobility is restricted. Efforts to reduce its incidence need first to identify the *kind* of corruption (graft, bribery, theft, conflict of interest, nepotism, bias, or favoritism), its *frequency* (pervasive, occasional, or intermittent), and its *perpetrators* (contractors, public officials, political elites, businessmen, and foreign suppliers).

The causes of corruption relate to political and economic conditions within the society and their linkages to problems in the world economy (Theobald 1990: 10–11, 161–69). As such, its causes are as complex as the types of corruption are varied. While distinguishing between symptoms and causes is important, sometimes symptomatic relief provides opportunities for needed social and economic change that will lead to more lasting "cures." For example, the bribery of public officials who allocate essential licenses can be mitigated by clear rules, disclosure, and effective enforcement. Further, the amount of licensing can be reduced with clear rules. In the long term, civil service reform will give more complete relief. Only over time, and with major policy reform, can improved economic performance increase economic opportunities and thereby provide the environment and context for diminished corruption. Yet every generation has to make its own struggle against its resurgence.

Competition, clear rules, and disclosure are important first steps. Many countries have sophisticated and strict laws addressing corruption. Yet the existence of legislation alone is insufficient. The problem may lie with a lack of dependable enforcement. At the same time that legislation is enacted, the strength and independence of the judiciary must be secured.

Many political leaders in countries with serious poverty have amassed extraordinary fortunes. Foreign exchange reserves have been transferred to foreign bank accounts. Such abuse, needless to say, adversely effects economic development. It unleashes cynicism, which corrodes public trust—and signals to others to do likewise. Private wealth accumulated through abuse of power amid public squalor undermines legitimacy. Yet graft on this large scale is not possible without collusion between major private corporations and public agencies. Often the "commissions" are paid by foreigners—foreign contractors, companies, or consultants. Sometimes such activity is associated with foreign aid. Foreign companies argue that bribery is but one of the costs of doing business in a country. Financing necessarily flows through different agencies; a percentage "take" off the top is considered a fee by some, a kickback by others.

What, if anything, can external lending and aid agencies do in these circumstances? In part, the recommendation for countries is also true for these agencies: reduce the number of unnecessary regulations, and rely more on market forces; ensure that the laws of the country are observed; insist upon meeting procurement and contracting standards; upon meeting audit requirements, study audit reports; and pay attention to the manner in which disbursements are handled.

Even with these safeguards, the problems are daunting. Aid coordination meetings provide another venue for flagging the importance of supervision, audits, and attention to disbursement processes. Audits may be required, and not always performed, or where performed, they may not be read. Project supervision is difficult to maintain in the best of circumstances; when donor agencies are pressed to do more with fewer people, supervision suffers.

Corruption is a two-way street. External lending and aid agencies have a responsibility to ensure that commercial considerations do not undermine good economic management in developing countries. Encouraging governments to develop sound public investment programs and respecting the priorities established is an important contribution external agencies can make. In this regard, the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), in consultation with the World Bank, has prepared a document entitled "Good Procurement Practice for Official Development Assistance" (OECD 1986). More recently, through an OECD/DAC Working Party on Financial Aspects of Development Assistance, a greater effort is also being made to ensure that competition for contracts under projects financed by external agencies is not a source of corruption and does not contribute to distorted investment priorities. The intention is to ensure greater transparency and fair trade practices through a common band of concessionality levels, more open procurement procedures for large projects, an upper income limit for tied aid, more transparency in large projects (for example, through international competitive bidding procedures and mandatory consultation), and so forth. Project preparation through joint appraisals and cofinancing with multilateral development banks including the World Bank is seen as one way to ensure sound investments. When such cofinancing is not possible, the DAC has proposed that external agencies look to the Bank for advice on the appropriateness of proposed bilaterally financed large projects in the particular country situation. A consensus has yet to be reached on these proposals.

Some observers have also suggested that one of the next steps may be to have external agencies more fully exchange information with one another about companies, contractors, or consulting groups which have been identified as having participated in graft, bribery, or other corrupt behavior. This "blacklisting" of corrupt companies or contractors by these agencies would provide a useful disincentive for these practices.

agement in those countries. The projects would clear the backlog of government accounts and introduce new accounting methods and software to improve the accuracy and timeliness of financial data. Similarly, a development management project in Mauritania helped to establish the office of auditor-general. Audit systems in the banking sector are being reformed in Poland and Algeria, and Poland has also requested technical advice on audits and evaluations of government programs and accounts. In January 1990, the World Bank's Africa Region set itself a target of twelve projects or project components aimed at strengthening financial management capabilities of borrowers through fiscal 1992. The Bank's Asia Region established a task force on auditing which also suggested the need for a more comprehensive approach to the problem. In Indonesia, the Bank is supporting a comprehensive accountancy development project (box 2).

Box 2. *The Indonesian Accountancy Development Project*

Indonesia's government accounting practice had changed little since the 1864 Dutch Financial Administration Act. Because the government found that it could not cope with the increasing complexity of government financial transactions, it requested World Bank support for an accountancy project. Budget reports and financial statements did not provide a comprehensive view of the financial situation and were often delayed. It took three years before government expenditures for a given period were reported to the Parliament.

In the private sector, the accounting system had fallen behind other skills required in industry and commerce. The shortage of trained accountants and managers who could produce and use accounting information was severe. The professional body of accountants—the Indonesian Institute of Accountants—was relatively young and lacked detailed accounting and auditing standards, a code of ethics, and disciplinary procedures.

The Bank-financed accountancy development project will address all these areas. It will improve accounting practices in the public sector by supporting the introduction of modernized government accounting. It will improve accounting practices in the private sector by supporting the development of technical standards and a code of ethics for the accountancy profession; by supporting the government's program to raise the quality of accounting faculties; by preparing for the future expansion of accountancy education and training; and by improving the legislation on accounting, auditing, and disclosure requirements.

The modernization of government accounting is being carried out with the use of local and foreign specialists who are assisting in the design of a uniform chart of accounts and a clear and specific classification of expenditures. Similar changes in accounting practices will be adopted by public enterprises and by lower levels of government.

With regard to private sector accounting, the World Bank will support the Indonesian Institute of Accountants to continue the certified accountant's professional education. Accounting principles and auditing standards will be formulated for more consistent financial reporting by commercial and industrial businesses, and a code of ethics will be developed.

In accounting education, the Bank will finance programs for personnel development, procurement of teaching equipment and materials, research, fellowships to train accounting teachers, and loan programs for institutions and students. The improved quality of accounting programs in universities and institutions will permit expansion of accountancy enrollments and increase the supply of accounting professionals.

The proposed project will be implemented over five and a half years. Its total cost is US$162.5 million, of which the Bank loan will finance US$112.0 million.

These country-level reviews will focus on coverage, timeliness, and the quality of financial control of projects and public expenditures, but also will take account of legislative or other review of government policies and programs and of public access to information.

Accountability for economic performance. The Bank has also addressed issues of economic accountability. As described in the paper on public sector management (World Bank 1991c), public expenditure reviews have focused on the efficiency of resource use in public investment programs, in the parastatals sector, in the social sectors, and more recently, in employment and wage issues in civil services. This has led frequently to the identification of reforms—including the removal of white elephants from public investment programs, privatization, restructuring and closure of some state enterprises, reallocation of resources in favor of primary health and primary education, and the removal of "ghost workers" and rationalization of employment levels in the public sector. Increasing attention is being given to strengthening the capacity of governments to monitor and evaluate their own economic performance, including resource use.

Governments could do more to strengthen their overall monitoring and evaluation function, currently largely mandated by external financing agencies and project-specific. Yet in many countries, departments are required by legislation to prepare annual reports on their activities. Some countries have performance monitoring ministries. The World Bank's Operations Evaluation Department has tried to encourage these activities, and more work under public sector management projects is under way. This process will be gradual, given the competing claims on resources.

In some industrial countries (and a few developing ones), a current wave of public sector management reforms seeks to raise the efficiency with which public resources are used by giving public managers greater freedom to run their operations but substantially increasing their accountability through objectives, specific targets, and performance monitoring. There has also been an attempt to link such efficiency concerns to broader notions of performance in implementing government policy objectives. This accountability is sometimes reflected in contracts, programs, or memorandums of understanding. A number of developing countries have adopted the use of such memorandums in the context of parastatal reforms, which are then negotiated by heads of government departments and chief executives of public enterprises. These have had mixed results, particularly when undertaken with inadequate preparation or discussion. This is accompanied by a movement away from a single-year to a medium-term budgetary framework that provides managers with a stable resource stream. Alongside this, accounting systems and internal auditing are being strengthened, with increased emphasis on cash management and, in some cases, accrual accounting. The audit function is now being widened to include not only financial probity but also "value for money" audits.

The applicability of these innovations to developing countries will vary. Some of the Bank's borrowers are probably ready for reforms along these lines. In most countries, however, there are no basic accounting and auditing systems. Greater autonomy to managers must be linked to improvements in financial information systems. Similarly, only when financial audit systems are functioning well can value for money auditing be considered.

Box 3. Decentralization in Poland and Romania

As Poland and Romania pursue political liberalization and macroeconomic adjustment, they are also embarked on a significant decentralization of the public sector. The three issues are closely linked.

Strengthening local government is widely viewed as essential to ensuring greater responsiveness and accountability for many kinds of infrastructure and services whose delivery and financing have been dominated by the center. It is important that both political and institutional means be developed to hold local government authorities accountable to their constituents because much of the justification for public sector decentralization is based on the premise that infrastructure and services can be provided more efficiently at the local level. At this level, beneficiaries can better express their needs, control costs, and hold local authorities accountable for their actions.

Decentralization of the public sector requires fundamental reforms in the expenditure and financing responsibilities of local governments in Poland and Romania. Fiscal chaos could ensue if local revenue capacity is not enhanced and intergovernmental fiscal transfers are not controlled. A collapse of local infrastructure and services is likely if local expenditure assignment is not matched with revenue authority and local institutional capacity. Local government reforms must include, therefore, fiscal reforms at the national and local levels and the strengthening of local government institutions. These reforms also will be crucial to stimulating increased private sector productivity, not only through improved delivery of public infrastructure and services and a prudent regulatory framework, but also because local governments will be key to implementing an effective policy of property rights through legal cadastres that provide security for the transfer of property.

Decentralization: The Macro-Micro Linkage

Decentralization is an increasingly common phenomenon in Latin America, Asia, and Eastern Europe. In theory, it can lead to significant improvements in efficiency and effectiveness by reducing overloading of central government functions and improving access to decisionmaking and participation at lower levels of government, for example, by improved service design, user financing targeting, and delivery (box 3).

If not carefully managed, however, decentralization can lead to a deterioration in the use and control of resources, especially in the short term. National goals can be seriously distorted by local governments, and scarce resources can be diverted to poor uses. Moreover, radical decentralization can seriously weaken the capacity of the central government to manage the economy through fiscal and mon-

Local governments will be key implementing institutions for the Bank's pipeline of proposed projects in both countries, primarily in the areas of infrastructure, the social sectors, environment, rural development, and poverty alleviation. Before these decentralizing countries may absorb effectively lending operations, however, local governments must be strengthened to discharge their new and growing responsibilities. Key areas for institutional strengthening include local taxation policy and administration (and consistency with national taxation policies); management of local enterprises (for example, privatization or regulation in areas such as water supply and sanitation, transport, solid waste, and housing); budgeting, accounting and audits; maintenance programming and implementation; investment planning and evaluation; and procurement practices.

Because decentralization in these countries comes after decades of tight central control, the pace and scope of the decentralization process are issues of concern for the countries and for the Bank, and all recognize that there is no broadly recognized "road map" for public sector decentralization. Therefore, the Bank's strategy for assistance to the decentralization process is broad and country-specific, but the short-term strategy is evolving in four key areas: (a) policy dialogue and possible inclusion of measures to strengthen local government as part of the program to be supported by adjustment lending; (b) country and regional sector work on local government reform (for example, regional work in fiscal 1991 and local government reform in Poland for fiscal 1992); (c) targeting technical assistance on local government reform (for example, a local government component of an infrastructure technical assistance loan to Romania); and (d) highly selective project support through lending operations in areas critical to overall adjustment and reform (for example, a proposed housing project loan to Poland).

etary means. In the late 1980s, Argentina's provincial governments were responsible for the largest and fastest-growing portion of the public sector deficit. Apart from the potential damage done to macroeconomic stability and expenditure efficiency, resources are arguably more open to capture by elite groups at the local level than at national levels.

Perhaps the most serious problem is weak administrative capacity at local levels, leading to waste and corruption. The poorest local authorities, whose constituents stand to gain the most from improved delivery and targeting of social services, are precisely those least able to manage increased responsibilities.

The Bank's present approach to decentralization and local government development relies heavily on financial tools to ensure efficiency, including cost recovery for municipal services. An upcoming study on decentralization in Latin America and Caribbean countries suggests the need for a more comprehensive strategy, with greater attention to mechanisms, such as hearings or surveys, which allow local preferences to be ascertained. In Mauritania, a project helped to establish the institutional framework for the creation of municipalities. In this instance, local elections followed, providing the public with one accountability mechanism. In Indonesia, an upcoming project provides assistance for (a) strengthening the institutional and human resource capabilities of local governments by increasing the efficiency and effectiveness of previously fragmented training programs, and (b) strengthening the institutions and coordinating capacities of local government and administration. Other initiatives could focus on strengthening the oversight function of national government. Venezuela has successfully used an executive council to marshal ideas, try out policies and legislation, and develop guidelines and administrative models. Future World Bank efforts, such as its municipal development program in Africa, could build on these experiences.

Micro-Level Accountability

Micro-level accountability can reinforce macro-level accountability when there is competition or participation. Competition—or scope for the public to "exit" when dissatisfied with a service—can have a salutary effect on the agency concerned by reducing its revenues and thereby making the careers or pay of its staff less secure. Participation enables the public to influence the quality or volume of a service through some form of articulation of preferences or demand. If such

Box 4. The Philippine Communal Irrigation Program

In May 1982, the World Bank approved a US$72 million loan to the Philippines for a program to develop communal irrigation systems that would involve the participation of farmer beneficiaries in all phases of planning, designing, and building each system. The project would involve the construction or rehabilitation of 144 communal irrigation projects covering about 33,500 hectares in 35 provinces of 11 regions. After the completion of a system, the farmers would assume full control of its operation and maintenance.

The project was remarkable in two ways: first, it was one of the most participatory projects ever to involve the Bank. Second, the initiative for the participatory approach came from a government agency, the National Irrigation Administration (NIA), which had been developing and testing the participatory approach for five years.

Before the participatory approach was introduced, nearly all of the NIA's professional field staff in charge of communal projects were trained exclusively in technical subjects such as construction, design, and survey. The participatory approach, however, required the addition of staff oriented toward people and trained in building the problem-solving capacities of local people. Consequently, the NIA hired community organizers who could work with farmers to develop irrigation associations.

The NIA hired six community organizers for its first participatory project in 1976. By early 1983, the number had expanded to 401. Of these, 295 worked on communal projects and 106 on national projects. The gradual approach to expanding the program allowed the organizers to accumulate learning. Organizers who worked on initial projects became the trainers and supervisors for later arrivals.

Evaluations in 1989 concluded that "participation produced consistently positive results. The canals and structures were viewed by the farmers as more functional and the system was more productive, with greater increases in rice yields and in irrigated area in the dry season. The irrigation associations were more likely to use water distribution methods that assured greater equity of water access to the members and were more likely to use sound financial management practices. They contributed more to construction costs at the time of construction and subsequently paid a greater percentage of their loans due. The costs of achieving the wide range of benefits demonstrated for the participatory projects was only 3% of the total cost of construction."

This program, widely studied around the world as a model of the possibilities of increasing effectiveness and sustainability, is still under way. A new Bank loan in 1988 for the operation and maintenance of the national system (which is distinct from the communal system) provided funds for community organizers and farmer training. Work has begun on a follow-up loan for the communal program.

"voice" makes the public agency more responsive, accountability is increased.[6] For example, in the National Irrigation Administration in the Philippines, the exercise of voice resulted in a greatly improved irrigation system (box 4). Often, however, competitive provision is more efficient except where national monopolies or market failure are predominant—and it is undesirable to regard participation mechanisms as a substitute for (rather than an adjunct to) the availability of alternative providers. In any case, there are inherent problems (free riding, elite dominance, and resource diversion) in collective action: the costs and benefits of various ways of providing voice need to be evaluated case by case (Olson 1965, 1982).

There are invariably numerous barriers to exit and voice. Legal and policy-induced barriers are more easily dealt with; natural barriers, such as spatial limitations (for example, an isolated village can afford only one school) are more difficult to remove. Services that the poor (weak voice) require and for which alternative sources of supply are difficult to find (low exit) will be the most difficult to deal with.

Exit mechanisms. There are several possible exit mechanisms, notably deregulation, contracting out of services to multiple private providers, and public-private or public-public competition. The key element is contestability: when incumbents are made to bid for contracts along with outside competitors, they will be more careful about their performance and their terms. Similarly, when regulations favor new entrants, the knowledge of potential entry can mitigate monopolistic behavior on the part of incumbents (Baumol and Lee 1991). New technologies can be used, if they are cost-effective, to broaden choice and access (for example, mobile courts, mobile schools, mobile health clinics, and the use of videocassette recorders or television for education).

Voice mechanisms. Dissemination of information about services can aid the public in demanding greater accountability from service providers. Periodic evaluation of services can exert pressure. For example, a poll of beneficiaries' views on the service or the gathering of data from both beneficiaries and service providers can sometimes be an effective alternative to elaborate participation arrangements. Procedures for making complaints and institutional mechanisms such as having an ombudsman are ways of providing voice when there is no need or incentive for collective action. "Hotlines" can be established to help prod response to unsatisfactory services. These mechanisms are used in some countries, and their effectiveness varies widely: in particular, elites tend to make the most use of these services. Consequently, they are most useful to the poor when the service is "nonexcludable," like drinking water, roads, or public facilities.

Participation of public representatives in decisionmaking or regulatory bodies is one way of enhancing voice. Users' representatives, for example, can be appointed to the board of directors of utilities or hold equity shares in them. If direct participation of users in decisionmaking is difficult or inappropriate, a consultation process can be instituted through public hearings, advisory panels, and so forth. Legal action by consumer action groups is also a possibility, though it is not common in developing countries.

Governments and nongovernmental organizations. Some developing countries have witnessed a mushrooming of private voluntary organizations (for example, Bangladesh, Chile, Colombia, India, Kenya, Mexico, the Philippines, Senegal, and Zimbabwe), whereas some other countries clearly have not (for example, Central African Republic or Malaysia) and depend much more heavily on governmental organizations and initiatives. Various factors contribute to the emergence of a strong voluntary sector, among them culture, level of development, and the stimulus provided by the influx of external nongovernmental organizations (NGOs) after a natural disaster. A powerful factor clearly is government hostility or encouragement.

Government policies determine the enabling environment for NGOs and the roles that they assume. Governments determine in the first instance through the extent to which they allow such rights as freedom of association or of speech whether NGOs can function effectively. Regulatory policies—and fiscal policy—also affect the environment within which NGOs operate. Precisely because NGOs may be a channel to the poor, or may be advocates for the poor, NGOs can be used by governments and aid and lending agencies to reach people who are otherwise difficult to involve in the flow of project benefits. They can also be called upon to assume roles in the provision of benefits or in communicating between different constituencies. But some governments are suspicious of NGOs precisely because of their advocacy for the poor. There are, thus, pressures to coopt NGOs and make them extensions of the state.

Direct funding by external aid and lending agencies can be an important means of supporting NGO activities. But it carries with it a number of attendant risks, which include possibly shifting NGO accountability from their natural constituents to these agencies, and making NGOs vulnerable to subtle pressures from governments that must approve direct funding of them (Fowler 1991). The literature (mostly written with support from bilateral agencies) shows that NGOs tend to be effective at reaching low-income groups, especially in remote areas, and at working in a relatively participatory way. They tend to be weak in planning and administration. NGOs' most important contribution may not be to deliver services but to initiate new approaches which are sometimes replicated on a larger scale. There can be, as a result, synergies between governments and NGOs; governments learn more about the needs of widely dispersed publics while NGOs acquire more effective management skills. The rapidly changing relationship between the state and NGOs needs further research and reflection.

The World Bank's role in promoting exit and voice. The World Bank is active in promoting deregulation and improving the working of markets in structural adjustment loans, in parastatal reforms, and in much of its sector lending. The Bank has, in recent years, also worked to expand participation and the involvement of NGOs in Bank-financed projects. In fiscal 1991, NGOs were significantly involved in 89 of the 289 projects the Bank's Executive Directors approved. In some sectors, most notably agriculture and population, NGOs are contributing significantly to effective project implementation. Criticisms by NGOs, although they are sometimes unduly harsh, have nevertheless contributed to the redesign or improved implementation of a number of projects.

Voice can also be increased through *popular participation* in the design and implementation of projects. The Bank's experience suggests that participation can be important to project success and sustainability. It is especially useful for activities focused on particular communities and dependent on their active cooperation, but it is also relevant to large-scale infrastructure projects. Participatory approaches in Bank projects have been tested successfully in a variety of sectors (notably, irrigation, forestry, livestock and agricultural credit, urban development and rural water supply, health and nutrition, the environment, and social investment funds). The Bank has recently embarked on an effort to learn better how to foster participation in Bank-supported activities (box 5).

Attention to ways of increasing exit and voice at the design stage of relevant service delivery projects will complement the strengthening of internal control systems. The use of such mechanisms, however, will improve accountability only when this leads to a change in the behavior of the service provider—its efficiency, access, and quality of service, not just its compliance with internal rules. This must be reinforced with incentives that reward responsiveness to users and the wider public.

Accountability at the micro level will, in turn, be sustained only when the government and society at large are committed to doing so. Comparative information on how effectively various countries deliver key public services can be a powerful tool to generate national

Box 5. Participatory Development and the World Bank

> We affirm . . . that the economic crisis cannot be resolved . . . without the full and effective contribution, creativity and popular enthusiasm of the vast majority of the people.
>
> —"African Charter for Popular Participation in Development and Transformation" (ECA 1990)

Participatory development is the process by which people, especially disadvantaged people, influence decisions that affect them. The disadvantaged are not only the absolute poor, but also those who are handicapped by a lack of wealth or education or because of their ethnicity or gender. "Participation" means influence on development decisions, not simply involvement in the implementation or benefits of a development activity, although those types of involvement are important and are often encouraged by opportunities for influence.

The World Bank has learned from its experience that participation is important for the success of projects economically, environmentally, and socially. The most important lesson has been that participation is a question of efficiency, as well as being desirable in its own right. In one study, the Bank evaluated twenty-five projects five to ten years after completion. Strong beneficiary organizations (an instrument of facilitating participation) proved to be a key factor in determining project sustainability (World Bank 1985). Another study of sixty-eight Bank-financed projects found that the economic rate of return was twice as high for projects which had been sensitive to local social and cultural realities (Kottak 1985).

The Bank's experience with participatory projects is limited, but growing. Participatory approaches have most often been adopted in projects designed to help particular communities in certain sectors: agriculture, especially irrigation, forestry, and livestock; urban development and rural water supply; and population, health, and nutrition. Social investment funds are a promising way for governments to support community-initiated small-scale projects. A recent review reveals that in virtually every participatory project the Bank has financed, participation has contributed to project effectiveness (World Bank 1990b). Individuals, households, groups, and communities are more likely to have a stake in, contribute to, and maintain projects that respond to their needs, knowledge, and initiative.

But participation is also valuable for bigger projects. The Bank's experience with environmental issues and adjustment loans indicates that public consultation and information sharing can improve the design and build public support for large-scale investments and policy decisions. This approach is working, for instance, in Mexico's hydroelectric project, India's Upper Krishna River dam project, and Ghana's private investment and sustained development promotion credit.

The Bank's operations and research staffs are pursuing a modest program of action and learning, supported by Swedish International Development Authority trust-fund resources, designed to strengthen the Bank's support for participatory development where this would contribute to the development effectiveness of Bank-related operations. Learning is being stressed because there are relatively few large-scale participatory development projects in the developing world. It is important to learn in what situations participation is worth the effort, and, in those cases, how the Bank and borrowing governments can effectively promote participation more widely. To date, Bank-supported participatory projects have been the exception rather than the rule, sometimes stemming from the personal commitment of individual task managers.

In most situations, the constraints on participation are external to the Bank (the intrinsic difficulties of engaging low-income people in project decisions, for example, and reluctance on the part of some governments). But improvements in income and education, together with increased interest among borrowing member governments, are relaxing external constraints in some situations. While grappling with the problems of making government implementing agencies more people-centered, the learning process is focusing especially on ways the Bank's own operational practices could be more supportive of participatory approaches.

and international interest in this area. The World Bank is researching and devising performance indicators for these services from as many countries as possible and will disseminate them widely so that governments, scholars, the media, and the public can see where each country stands with respect to the level and quality of its services (box 6).

The Legal Framework for Development

> The Rule of Law is not a Western idea, nor is it linked up with any economic or social system . . . As soon as you accept that man is governed by law, and not by whims of men, it is the Rule of Law.
>
> —Adetokunbo A. Ademola, chief justice of Nigeria (1961)

The rule of law is a wide—some would say all-embracing—concept. Its salience to the World Bank is more limited, but important. Some elements of the rule of law are needed to create a sufficient stable setting for economic actors—entrepreneurs, farmers, and workers—to assess economic opportunities and risks, to make investments of capital and labor, to transact business with each offer, and to have reasonable assurance or recourse against arbitrary interference or expropriation. This connection of the rule of law with efficient use of resources and productive investment, which must be understood and dealt with in highly specific and differentiated cultural and political settings, is the aspect most important to economic development, and hence to World Bank assistance.

Box 6. Improving Accountability for Environmental Projects

The deteriorating quality of air, water, and land resources in many developing countries is linked to problems of accountability and capacity. Government decisionmakers in charge of natural resource management often contribute to environmental deterioration through poor management decisions. Poor decisions are a function both of inadequate incentives, and of an inability to project the actual effects of well-meant decisions or to evaluate alternative uses of scarce government funds.

Environmental resource management is further complicated by the multi-sectoral nature of many decisions. Water resources, for example, are affected by solid waste systems, storm water drainage, the demands of commercial, household, and recreational users, and the requirements of ecological habitats.

Research currently under way in the World Bank addresses this problem. The Service Level Indicators for Capital (SLIC) research sponsored by the International Economics Department is seeking service level indicators for public facilities (sewerage, water, and so forth) and for natural resources, based on measures of quantity, quality, and reliability for both users and decisionmakers. Included in this research effort is a framework for applying SLICs through benefit-cost analysis. This extends the usefulness of these measures into investment decisions. SLICs create a bottom-up measure of resource performance, provide an information base which allows users and managers to view how decisions are made and the effects they have, and establish a transparent accounting framework for government service and natural resource decisions based on the level of services they provide to users. SLICs are currently being formulated in a number of different urban development projects in Indonesia.

Service indicators for water resources can be related to the specific uses described above for water resources. Indicator sets for each purpose would be specified by aggregating relevant measures. Service levels for industrial or agricultural water supply users could be based on physical measures; for household water users or recreational users, service levels might be based on total health risk; for ecological habitat, service levels could be tied to the number of viable ecosystems exposed to risk in the river stretch or habitat area.

By identifying and monitoring the specific environmental quality measures identified as important by decisionmakers and users, SLICs will improve the effectiveness of infrastructure and natural resource management decisions, and help establish operations and maintenance priorities for public infrastructure. In addition, by measuring these factors over time, SLICs should be able to establish trends in environmental resource quality, which will improve natural resource accounting, and define more precisely the relationship between natural resources and economic development. As SLICs enable line managers to make better decisions, the public availability of these indicators will also enable users to hold service providers accountable for the level and quality of the services they receive, both from government facilities and from other providers.

From among various definitions of the rule of law, two main dimensions emerge: the instrumental, which concentrates on the formal elements necessary for a system of law to exist; and the substantive, which refers to the content of the law and concepts such as justice (for example, due process), fairness (the principles of equality), and liberty (civil and political rights). In the view of many, the formal dimension needs to be complemented by substantive principles of the rule of law to create a "fair" legal system. For the World Bank's work, a "fair" legal system is, in a general sense, conducive to balanced development—that is, for example, one which facilitates growth and responds to the needs of the poor. For present purposes, however, the focus is on a more basic level: the processes of formulating and applying rules (Shihata 1991). Five critical elements are considered: (a) there is a set of rules known in advance, (b) the rules are actually in force, (c) there are mechanisms ensuring application of the rules, (d) conflicts are resolved through binding decisions of an independent judicial body, and (e) there are procedures for amending the rules when they no longer serve their purpose.

A Set of Rules Known in Advance

A set of rules known in advance implies three elements: the existence of a coherent set of rules, their communication with accuracy, clarity, and effectiveness, and the application *only* of rules known in advance (nonretroactivity of laws). Communication and coherence are two elements with which the Bank has been concerned. Many developing countries that were once colonies inherited rules for the communication of laws similar to those of the colonial power, under which governments' obligations to disseminate a new law were frequently limited to publishing it in gazettes; this left citizens with the burden of acquainting themselves with it.

Publication of official gazettes has ceased in many countries. The World Bank has assisted several countries to restart at least publication of the gazette (box 7), and it is also assisting in making the law more accessible and better known within government itself.[7] In many developing countries, however, there is widespread illiteracy, multiple languages are spoken, and the media are often ineffective. Under these circumstances, there are obvious limitations as to how much laws can be known and understood by the average citizen. It is nevertheless essential that laws be as clear and explicit as is technically feasible.

Box 7. Communication of the Law

The Mauritanian Development Management Project. The publication of the *Mauritanian Official Gazette* was done under a contract between the Government of Mauritania and a French printing company located in Bordeaux. This arrangement was, however, not effective, and the *Official Gazette* was rarely published. Then the Government of Mauritania, with the assistance of IDA and the French government, decided to print and publish the *Official Gazette* domestically. To do so, a contract was awarded to a private printer, and the functioning of the Department of the Legislation (Services of the Presidency) was improved within the framework of the abovementioned IDA credit. The French government provided technical assistance in the preparation of the *Official Gazette* using the French *Official Gazette* as a model. The *Official Gazette,* which had not been published for more than two years, has now been published monthly in French and Arabic for the last two and a half years.

The Guinean Second Economic Management Support Project. The *Guinean Official Gazette* was experiencing delays of up to two years in the printing of its issues. In order to correct this situation, the Secrétariat Général du Gouvernement (SGG) obtained, as part of this project, US$80,000 from the U.S. Agency for International Development to finance printing of the *Official Gazette* for two years, and it signed a contract with a private printing company to ensure regular publication. In addition, the contract provided that the backlog caused by the two-year delay be gradually eliminated.

By January 1989, the *Official Gazette* was being published fortnightly. Texts of a general nature and government decrees are published within a month of their signature. The backlog of previously unpublished legislation is being cleared.

The SGG is responsible for the distribution of the *Official Gazette* within the government and for subscriptions and sales to public. It is expected that, as revenues from legal notices increase, the *Official Gazette* will be able to fund itself.

Lao United Nations Development Programme Project. In 1975 the National Congress of the People's Representative in the Lao People's Democratic Republic abolished the former constitution and all existing laws and regulations. In 1989 the government endorsed the establishment of a new economic mechanism, which would separate the state's administrative and regulatory function from production activities and increase the role of the private sector. Under a component of a United Nations Development Programme–funded project supporting the New Economic Mechanism, the World Bank will assist the government to prepare and implement key economic and financial legislation, to train lawyers in business law, and to establish a center of economic law. As part of such activities, the project will make a proposal to the government to establish an official gazette to publish and promulgate new laws and regulations.

To the extent that economic policies are in part implemented through rules, governments need to ensure that these rules are known by all possible means. (Rules are understood here in a broad sense and include legislation, courts' decisions, guidelines, and regulations.)

When land is expropriated, for instance, simple explanatory pamphlets outlining the rights of those affected and explaining how they can exercise these rights should be made available. People's knowledge of their rights helps both to limit the arbitrary behavior of government officials and to create the climate of predictability which is associated with the rule of law.

As regards the coherence of rules, when disbursements for a Bank-financed project are conditional on the enactment or modification of certain laws, it is essential that the country both enact and implement these laws. A decree should not be at variance with legislation. There are, for instance, countries whose constitution forbids private ownership of the means of production. In the context of private sector development projects, the Bank seeks to aid the country in ensuring that the project is based on a sound legal premise (box 8).

Rules That Are Actually in Force

It is not enough for a law to be on the books: it has to be applied, it has to be in force in reality and not merely formally, and most important, it has to be complied with.

In many developing countries, laws may have been transplanted from other countries and not adapted to the local situation, or to economic, social, and technological change. When a law is left in abeyance or is not respected, the remedy is not necessarily a new law. An analysis of why the old law does not work will avoid placing yet another law on the books.

Laws, and a legal system, also require effective administration. Law is not only a set of rules but also encompasses procedures and institutions for implementing these rules. If these are lacking, laws most likely will be in force only on paper.

External lending and aid agencies must be sensitive to the variables for effective transfer and application of legal institutions from one country to another. Sanctions also do not always induce behavioral change. Punishment best enforces already institutionalized law, nudging the occasional deviant into conformity. In many instances, it is more appropriate to use incentives and indirect measures to achieve results—normally at lower costs than punishment and to the relief of overburdened courts and resource-constrained penal systems.

The World Bank can on occasion assist in improving the efficiency or competence of judicial systems to reduce the costs of economic transactions. In advising governments to adopt new laws, the Bank seeks to be fully aware of implementation constraints. As regards

Box 8. Legal Inconsistencies in Eastern Europe and Africa

The centralized systems of the state-planned economies of Eastern European countries face a number of legal problems in their efforts to make economic reforms and develop market economies. Lately, these countries have been introducing reform elements for private sector development. However, contradictions and inconsistencies are often encountered. For example, several countries have started privatization efforts. In this process some have already amended their constitution to make provision for private property rights. Others have not yet changed their constitution to this effect, but, nevertheless, proceed with the privatization effort. In the context of World Bank operations, an effort is being made to address these issues. Following are some examples.

In Romania, there has been considerable legislative activity. With regard to private sector development, the law on Restructuring State Economic Units as Autonomous Units and Commercial Companies was passed in September 1990; a draft law on Privatization (currently under consideration) will govern this issue. Other laws under preparation will cover bankruptcy, commercial and company law, foreign investment, and small and medium-size enterprise development (to supersede Law No. 54 defining and permitting small enterprises, which was passed in early 1990). These laws are reducing the role of the government in productive activities while retaining its monitoring functions, introducing private ownership, and encouraging foreign investment through joint ventures. The legal framework is, however, operating under the severe constraint of the clearly defined property rights. The Parliament has been given two years from the time of its inception to develop the relevant provisions.

By contrast, in Czechoslovakia, amendments were introduced to the Constitution effective May 1, 1990, which recognize all forms of ownership rights, and provide that they (whether state, cooperative, or private) enjoy the same level of protection and that no form of property ownership has a privileged status. A law on Small Privatization was introduced effective December 1, 1990, while a law on Privatization is currently under consideration.

Another example of the effects of inconsistencies and contradictions in a legal system: the socialist economic system has been protected by the rules of constitutional law, labor law, and administrative law, as well as by the rules of criminal law.

Although the Eastern European countries are the most striking example, similar examples can be found elsewhere. For instance, Guinea-Bissau is presently amending its Constitution, approved May 16, 1984, as part of a general political transition from a socialist state to a more "capitalist" state. An impediment to developing the private sector is Article 12 of the Constitution, which provides for state ownership of all land (leases are granted to private individuals), minerals, banks, insurance companies, and so forth. Article 13 also provides for state control of foreign trade and exchange transactions. One of the objectives of the legal technical assistance provided to Guinea under the Second Economic Management Support Project is to coordinate the various pieces of legislation financed by external lending and aid agencies so that they can be dovetailed to form a whole.

enforcement of the laws, some aspects of it have a clear bearing on economic development and have been the subject of Bank operations; for instance, improvement of tax collection, and changes in security laws to permit financial institutions to foreclose on debt and mortgages (box 9).

Ensuring Application of the Rules

A fundamental aspect of the rule of law is that the state, too, should exercise power under the authority of law; that government officials should be subject to law just as private citizens are, and that their actions should derive from and be limited by specific legal authority. The proper and consistent application of rules by government officials is the essential element for establishing legality and—in conjunction with the idea of justice—legitimacy.

Of course, legislation authorizing government actions cannot prescribe precisely for all circumstances. Thus, while application should be predictable, it must always leave some room for flexibility. Market

Box 9. Enforcement

In Guinea, under the Private Sector Promotion Credit, the deficient functioning of the judicial system and the legal void on bank sureties have been identified as major constraints for banking activity in the country. Banks are unable "to enforce their rights as creditors through foreclosures or other court-approved actions, due in particular to debtor-judge collusion and rampant corruption" (World Bank internal report). This operation is a modest start to address these problems, and it will be followed by training of the judiciary and legal professions in banking and commercial matters and by improvements in material working conditions.

In Sri Lanka, the World Bank has been working in two operations in the financial sector to reform the laws allowing financial institutions to foreclose on collateral pledged under loans. Sri Lankan law had prevented direct execution by institutions, which were forced in each case to go to court to get a judgment before they could move against the property. This protection for debtors stemmed from historical concerns about unscrupulous money lenders but did not match the needs of a modern economy. On the advice of the Bank the law was changed to permit direct execution. The result is a law which establishes a better balance between the rights and obligations of debtors and creditors.

In the Philippines, as part of the Financial Sector Adjustment Loan, the Bank not only advised that the lengthy holding period for repossession by debtors of pledged property be shortened to a more reasonable period, but also that the 1905 bankruptcy law be revised to make it less punitive on debtors and more rehabilitative, in the interests of both creditors and debtors.

competition serves to limit this public discretionary power, because citizens can choose private over public provision in many areas of life. Yet choices about how to delegate discretionary power to the bureaucracy, and how much, are enduring and complex problems of modern government. Traditionally, the rule of law tended to provide only for narrow grants of discretion. But delegation of authority to the executive branch has tended to grow to impart needed flexibility and responsiveness in situations which could not have been predicted by the legislatures. (For example, environmental legislation often must accord discretion to local public officials.) Discretion represents a counterweight to legal formalism.

Discretionary power in law is always limited. Basic guidelines for the exercise of discretion require that any exercise of powers be based on reasons that are applied consistently, fairly, and impartially. They should also be related to a framework of purposes, policies, principles, and rules.

As with all exercise of power, there is a need to ensure respect for these limitations. There is a need, for example, for rules governing departures from legal provisions. Ways of controlling administrative action and avoiding the abuse of discretionary power range from review by independent civil and criminal courts to specialized administrative courts and ombudsmen.

The World Bank has assisted borrowers in improving their civil service administrative structures. The Bank is becoming more involved in advising governments on improvements in administrative decisionmaking processes and the establishment of administrative structures that have clearly assigned authority and responsibility. All of these necessarily involve issues of the design and control of discretionary authority.

At times, the proper application of the rules is hampered by an overabundance of—in some instances—contradictory or obsolete rules and regulations which overwhelm the bureaucracy. The World Bank is assisting countries to review, update, and simplify their legal systems.[8] Such reforms of legal systems will improve the capacity of government to regulate the economy efficiently and to reach administrative decisions on the basis of a clear set of new and relevant laws (box 10).

Conflict Resolution

The rule of law loses its conflict-resolving and confidence-inspiring function if there is no independent and credible judicial system to assure that private contractual arrangements are respected and that

Box 10. *Reform of the Regulatory Framework*

Financial Sector Adjustment Credit in Ghana. Banking activities in Ghana have been governed by laws and regulations enacted in the 1960s and early 1970s. A number of amendments and decrees have been issued on an ad hoc basis since the enactment of the original legislation. Several serious omissions in this body of legislation, together with weak bank supervision, have led to the concentration of risk in the portfolios of banks, inadequate capital and reserves, inflated profits, and unrecognized loan losses.

To address these issues, the Government of Ghana has received an IDA-financed Financial Sector Adjustment Credit. In connection with the credit, the government has established a committee of legal experts to review the established legislation, draft the changes necessary to improve the regulatory framework, and introduce prudent standards to ensure the viability of the banking system. Risk exposure limits as a percentage of capital have been set on a bank's relations with a single customer or related group. A minimum capital-adequacy ratio has been established, which takes into account the quality of the bank's assets as well as its off-balance-sheet risks. Banking supervisors will have the ability to mandate an even higher capital-adequacy ratio when, in their opinion, conditions warrant. Banks which do not meet the minimum guidelines are not allowed to pay dividends. New regulations specifying the format and content of audit reports and the minimum scope of audit reviews have been introduced, together with uniform accounting and auditing standards and prudent reporting requirements. The accounting standards include guidelines for loan portfolio review and classification, the treatment of interest on nonperforming loans, and provisioning for potential loan losses. Monetary penalties for violations of laws and regulations have been strengthened and will be periodically revised to deter illegal and imprudent acts.

Structural Adjustment Loan in Poland. In Poland, the Government's Economic Transformation Program pursues structural reform toward the establishment of a market economy. The Structural Adjustment Loan will support reform initiatives mainly in the areas of (a) enterprise restructuring, privatization, private sector development, with emphasis on passing appropriate legislation to define the "rules of the game" (including privatization, de-monopolization, and competition) and on establishing an adequate institutional framework for enterprise restructuring; (b) financial sector reform, with emphasis on improving banking regulation and supervision, introducing adequate accounting and auditing standards, and so forth; and (c) social safety.

Economic Restructuring Credit in Sri Lanka. The Economic Restructuring Credit (ERC) in Sri Lanka supports the government's efforts aimed at stabilizing the economy and implementing structural reforms. In addition to addressing the country's serious internal and external imbalances, the size of the public sector, its claim on resources, and the efficiency with which it uses its resources, the ERC also focuses on the development of the private sector through improvements in the existing regulatory framework and incentive system and through transfer to the private sector of activities and assets now being managed by the public sector.

the law is applied uniformly by the executive. It is evident that confidence in the enforceability of agreements is required for the proper functioning of an economy and for conducting efficient private economic activities. Unreasonable delays, uncertainty, and high costs in enforcing agreements between private parties all tax economic actors inequitably and damage economic efficiency. It is also evident that a strong judiciary is not only vital in enforcing contracts but is a shield against arbitrarily exercised executive power.

The condition of the judiciary is precarious in a number of developing countries. Even in those countries with a nominally independent judiciary, the courts are usually overworked and dispute resolution takes a long time. Often, the courts lack proper facilities, and there is an urgent need to improve the training of the persons involved in the administration of justice. Despite all this, arbitration proceedings outside the court system are not well-developed.

Several World Bank projects which are under preparation will assist member governments in the training of judges in economics and business law and may recommend divisions of labor in the court system so that commercial matters would be handled by specialized courts (box 11).

External aid and lending agencies may need to look beyond the judiciary's training and physical facilities. For instance, many industrial countries have in the past responded to unwieldy, expensive, and slow courts by expanding extrajudicial means of settlement, for example, by permitting commercial arbitration.[9] Another alternative is to search for the causes of the growth of disputes by updating or clarifying archaic or uncertain legal situations. The business world

Box 11. Improving the Judiciary in Bangladesh

The court system in Bangladesh took an average of ten to fifteen years to dispose of suits brought by financial institutions against defaulting borrowers. The result was that transaction costs were extremely high and collection rates were very low. With the assistance of the World Bank and the International Monetary Fund, Bangladesh enacted a Financial Loan Courts Act in 1990 which established special commercial courts in the major economic centers of Bangladesh, whereby financial institutions could bring actions against defaulting borrowers and the loans could be adjudicated. Progress, which to date has been highly favorable, is being monitored under a Financial Sector Adjustment Credit and involves the establishment of courts, appointment of judges, and disposal of cases.

has also responded by rationalizing business practices through the development of standard forms and patterns of doing business. The courts themselves may help by handling certain commercial matters en masse, for example, garnishment and collection of debt. These are areas within the mandate of the World Bank inasmuch as functioning rules and institutions, including an effective dispute-settlement mechanism, are essential for economic development.

Amendment Procedures

The rule of law is instrumental in creating a climate of predictability and stability—the antithesis to governmental arbitrariness. Rules that are constantly or arbitrarily repealed, amended, or waived undermine this. The perception of arbitrariness and subjectivity is created by ad hoc decisions, whereby laws are created, amended, or invalidated without known and established procedures. Laws created in this way will be perceived by those affected as not reflecting "due process." Furthermore, besides inviting disobedience, such laws may lead to a general lack of credibility for the whole legal system.

It is important that procedures for amending or repealing laws exist and are publicly known. It is the prerogative of the country concerned, however, and outside the mandate of the World Bank, to decide how the legislative process is organized, including whether a separate legislative body should exist and how it is selected or who is represented on it.

In the context of attempts by borrowers to introduce legal reforms, the World Bank has stressed the importance of appropriate procedural rules so that laws can be enacted or repealed. To improve the technical capabilities of countries to draft procedural rules and regulations, the projects financed by the Bank support governments' legal offices (for example, the attorney general, the ministry of justice, and so forth) and provide training and technical assistance (for example, in Guinea, Laos, and, under preparation, Angola and Mongolia).

This analysis of the procedural and institutional elements of the rule of law has focused on their contribution to establishing a "good order" understood as "a system in place, based on abstract *rules* which are actually applied and on functioning *institutions* which ensure the proper application of such rules" (Shihata 1991). The existence of such a system is needed for economic development. In particular, the economic reform policies introduced by many of the World Bank's members and supported through Bank operations cannot be implemented effectively if these measures are not translated into workable rules and properly applied by functioning institutions. Thus, the elements of the rule of law discussed above are an important element of the procedural framework and institutional system which—if adhered to by the governments concerned—encourages stability and predictability in governments concerned and elicits compliance with the rules.

The rule of law and the other elements of governance are closely interrelated. By encouraging countries to simplify established rules and limit discretion in certain legal decisions, the World Bank has assisted them to reduce opportunities for corruption. The publicity that the Bank has insisted on for administering such processes as procurement has made decisionmaking more transparent. And the development of systems to communicate laws to citizens has helped make governmental bureaucracies more accountable.

Information and Transparency

> Information is now a crucial determinant of the pace of social and economic change.
>
> —South Commission (1990: 196)

A competitive market economy requires that economic actors have access to relevant, timely, and reliable information. The less available or credible the information, the greater the uncertainty and risk, and therefore the cost, of committing capital or labor. In all countries, government is a primary source of information, and it sets many of the requirements for other providers as well. Information about the economy, about market conditions, and about government policies and intentions is central to private sector calculations, and is either provided by the government or greatly influenced by what it requires other entities to make publicly available.

Governments have legitimate reasons to withhold some types of information—on aspects of state security, for example, or if premature disclosure could invite behavior undermining the policy (for example, changes in exchange rates). Aside from these special cases, there are three areas in which improved information and greater transparency are beneficial: economic efficiency; transparency as a means of preventing corruption; and the importance of information in the analysis, articulation, and acceptance of policy choices.

Information, Transparency, and Economic Efficiency

Economic efficiency requires that information about government policies and actions be available, that major processes of economic policymaking (for example, the budget) be reasonably transparent, and that there be some opportunity for the public to affect policymaking (through, for example, comment or influence). This last aspect is of course greatly influenced by a country's form of government and traditions of political participation and public debate—which are beyond the World Bank's purview. With that limitation in mind, there are three important reasons that greater transparency in policymaking will promote more economic efficiency.

First, if the government's economic decisionmaking is unexamined and uncontestable, the dangers of corruption and diversion of public resources (including external assistance) increase. Transparency is not a sufficient condition to control corruption, but it is in most circumstances a necessary one, as will be discussed below.

Second, closed decisionmaking increases the risk of government error—and of negative reactions. The government's effect on the private sector—through an array of influences from monetary and exchange rate policy to taxation and expenditure policies to public procurement—is pervasive and profound. If decisions in these areas are made in relative isolation from private-sector reactions, the likelihood of costly mistakes increases (fiscal policy is a common example). In other instances, the government may be surprised by angry public reactions to the economic consequences of secretly made decisions (for example, on pricing and subsidies) when a more open process of public education and debate might have both improved policy design and eased public acceptance.

Third, the efficiency and effectiveness of economic actors, and the competitiveness of markets, requires broadly based access to relevant information. For example, a common problem hindering the development of capital markets in general, and of equity-based financing in particular, is the lack of clear disclosure rules based on audited accounts of private and public enterprises. A lack of transparency in financial markets often leads to arbitrary and capricious relations between commercial banks and their clients. Without proper accounts and disclosure, neither bank lending nor investment through the capital markets can be based on a firm assessment of creditworthiness. This assessment is necessary to evaluate risk and adequately price the cost of capital to the borrower. The capital market remains circumscribed to a narrow range of firms and instruments protected by either implicit governmental guarantees or by the "reputation" of the most powerful economic groups.

A lack of transparency may be especially damaging for banking systems. It can lead to a large accumulation of nonperforming assets, which would cause bank failure—except for the fact that throughout the developing world deposits are usually explicitly or implicitly guaranteed by the state. Private losses are therefore socialized, as noncompetitive risk-taking siphons resources from productive uses to speculative activities.

The World Bank has been primarily concerned to work with governments to ensure broad awareness and acceptance of economic reform programs (for example, in the context of structural adjustment operations), and to help governments pay particular attention to the effect of their actions on the confidence of the private sector. Beyond such assistance, one Sub-Saharan African government has on its own initiative issued guidelines for openness (box 12). Not long ago, this government leaned toward secrecy.

The Bank is also active in assisting governments with several kinds of work for which transparency is an important issue: decisionmaking for public expenditures (see World Bank 1991c); improving public procurement; and, more and more, making environmental assessments. The Bank is encouraging governments to make assessments available to the general public as a way of ensuring greater accountability and transparency. This is particularly critical in guaranteeing that the people involuntarily displaced by development projects (such as the Narmada and Upper Krishna rivers in India) are kept fully informed of the results of such assessments. Thus, under the Ecuador Municipal Development and Urban Infrastructure project (approved in fiscal 1991) an attempt is being made to ensure public review of environmental assessments of infrastructure projects.

Prevention of Corruption

Clearly, the main weapon against corruption is to reduce the opportunities for it to a minimum—to eliminate economic distortions and administrative controls, and therefore to reduce the scope for illicit arbitrage and bribery, "dash," "speed money," and the like. Transparency in government business has a vital ancillary role. The World Bank is involved with transparency through its work on public expenditure (transparency of budgets, elimination of "caisse noires")

Box 12. Transparency in Government: The "Ten Commandments" in a Sub-Saharan African Country

The following are excerpts from an Official Communication published in a recent issue of the *Official Gazette* of a Sub-Saharan African Country.

...

The terms of annexed communication from the Prime Minister... will serve as a rule of conduct and as general guidelines... The Government and other institutions of the Republic are requested to ensure that this is given the widest possible circulation and is applied in both the central and the local public services

...

Communications. My own observations and complaints reaching my office lead me to submit the following proposals with a view to establishing a proper code of conduct within the Administration as regards its relations with the public. The principal aim is to improve attitude and behavior in the Administration and to preserve trust between the Administration and the public.

1. The Administration must not be permitted arbitrarily to block correspondence addressed to it.

...

The principle must be that the authority that is addressed must forward the request to the authority with power of decision. The former is free to issue a favorable or unfavorable opinion, but must nonetheless pass the request on. If it believes that the dossier is incomplete, or deficient in some other way, it should inform the applicant and ask him to put matters right; this is particularly important as regards our incentives for investors...

...

2. The Administration should assist the public.

...

3. The Administration should facilitate inquiries by the public.

...

Requests from the public sometimes relate to laws or regulations that contain all the relevant information being sought. The Administration should therefore make leaflets, and so forth, available to the public... In brief, each agency should make available to the public all the necessary information regarding the activity ... Within each agency, a public information unit should be established...

...

4. The Administration must establish and observe set periods for handling requests.

Few laws or regulations stipulate that the Administration must respond within a certain period. As a result, the public is at the mercy of officials and is never certain as to when it will get a reply ... Some departments have made efforts to improve this situation by stipulating maximum periods ... This practice should be extended to all agencies...

5. The Administration must have the courage to question certain principles.

(a) The principle that silence is equivalent to a refusal... it is time to stipulate that silence... after a certain period has elapsed, is equivalent to acceptance...

(b) The legal principle of implicit rejection.

It is high time the Administration understood that time is money.

> 6. The Administration must opt systematically for the automaticity of decisions.
>
> The administration's discretionary power must be reduced to a strict minimum by the publication of clear and precise rules of the game, which it must respect. Regulations and laws that have an impact on the public must move towards this objective, which is also stated as a principle . . . regarding the conceptual framework for the preparation of laws.
>
> 7. The Administration must do away with anonymity.
>
> The myth of the anonymous civil servant is no longer appropriate in a modern administration. The names and positions of agents interacting with the public should appear on nameplates on their doors or be posted on signs in their offices so that people know who they are dealing with. The use of badges could be courteous innovation. . . .
>
> 8. No official should have permanent tenure of a position requiring contact with the public. Periodic rotation, even if only within the organization, is strongly urged . . . the Head of State issued a directive . . . to the effect that enforcement agents should not remain in the same position for more than three years . . . This measure . . . should be extended to other officials in contact with the public. . . .
>
> 9. The Administration must know how to punish and reward.
>
> There are some good officials and they must be encouraged and rewarded... Poor officials, on the other hand, should be punished and their promotion should be prohibited.
>
> The best way to assess an official that works with the public is to listen to what the public thinks about him. An official, fully documented register could be provided for members of the public to record their complaints or their satisfaction . . .
>
> 10. The Administration must evaluate itself and be open to external audits.
>
> Self-evaluation is carried out by an internal audit unit which each agency must establish to monitor its operations, verify how, and how fast, dossiers are handled and study users' complaints. . . .

and through its assistance to governments in establishing transparent procurement procedures and in conducting environmental assessments.

Because central government ministries as principals must—and should—delegate to a wide variety of agents the implementation of policy choices, there are inevitably asymmetries in who has access to high-quality information. Reporting and monitoring systems can update the information base of principals, but there are always opportunities for private agents to engage in rent-seeking, or to make gains from insider information. Monitoring and supervising these agents is a perennial management problem; making most information a matter of public record is one solution. Guidelines on public information policy generally include criteria for users, rules about the time that can elapse before disclosure, and clear rules for access. Precisely because information is scarce, and therefore valuable, information policy needs careful attention.

Few government activities are more prone to corruption than customs and procurement. Some countries try to correct the mismanagement of their customs service by contracting it out to a wholly independent private enterprise (for example, Indonesia). Public procurement, however, is not a self-contained procedure which can be handled in this manner—though private inspection and supervisory services can play a valuable role. Furthermore, procurement is a critical aspect of project and program implementation that must continue to have direct government involvement.

Procurement difficulties are symptomatic of problems of government capacity, and of the inherent pressures of large contracts. Since 1983, the World Bank has been systematically undertaking country procurement assessment reviews (CPARs). CPARs assess public procurement laws, procedures, and institutions in borrowing countries to identify any fundamental conflict with Bank procurement guidelines, and to decide on the acceptability of local procedures for contracts which are appropriate for international competitive bidding. The procedures are evaluated as to whether they promote competition, are transparent, disclose selection criteria, award the contract to the lowest qualified bidder, maintain fair contract conditions, have mechanisms for dispute settlement, and assess institutional capability to implement Bank operations efficiently.

With the advent of adjustment lending, CPARs have expanded to include parastatal and private procurement practices and their compatibility with practices in the market economies of industrial countries. CPARs have been completed for about sixty countries (the remainder are in the process of being completed); they are updated every four years.

Where institutions are weak or procedures are inefficient, a World Bank loan includes support for either technical assistance or hiring procurement agents. Thus, for example, technical assistance has been provided to improve the institutional framework and introduce more efficient procedures in Madagascar and Uganda. In other cases, new procurement codes have been issued. In the Philippines, action was taken under a debt management loan both to streamline procurement rules and procedures so that more authority could be delegated to implementing agencies and also to shorten contract award procedures. The work initiated under this project has been continued under subsequent projects, and guidelines devised with the assistance of the

Bank are now available for local procurement. This has facilitated an easing of regulations for contractors and thereby increased their willingness once again to accept government contracts.

Several countries do not require the public opening of bids and permit bargaining even after bids have been opened. In such cases, the Bank reviews the rationale for the country's procurement regulations rather than simply requiring that it conform to the Bank's guidelines. Through local seminars and discussions, the Bank seeks to help the country pay attention to, for example, the ways a procurement system can help develop local contracting capacity, and the value of revising a national system so that it conforms to international norms. In almost all reforming Central and Eastern European countries, institutions were not familiar with local or international compet-

Box 13. Changing Procurement Policies and Practices in Eastern Europe

The countries of Eastern and Central Europe (Albania, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and Yugoslavia) are rapidly accelerating their transition from centrally planned to market-oriented economies, a process involving many kinds of profound changes, including ones in the field of public procurement. They are increasing their externally supported investment project operations, in cooperation with bilateral agencies and international financing institutions. During the past forty years, the countries have performed public procurement through direct allocation of resources, or negotiated contracts. They do not have a recent background in using open, competitive bidding procedures, and they vary in their ability to apply international procurement practices.

The countries lack the requisite public procurement laws and related legal systems, regulations, and experienced procurement officers. New and comprehensive legal systems for public procurement are required at both national and local levels of government and would ideally apply to all sectors. At the same time, the training of procurement personnel would need to be performed on an urgent and massive basis. The delays in project implementation caused by inefficient procurement practices may result in opportunity, interest, and inflationary costs of considerable magnitude (10–20 percent of total project costs).

The World Bank has, at the invitation of several of the countries, advised their senior officials on the requirements for implementing the needed legal and policy changes, and for training involved personnel. Contacts have also been made with multilateral and bilateral agencies which have a direct interest in the issues, with the objective of their participating financially and technically with the Bank in country and regional projects which would address the problems through technical assistance. Financing for such projects could also come from Bank loans, should the countries so request.

itive bidding. These countries are now, however, requesting the Bank's technical assistance with procurement legislation and procedures (box 13). In 1990, the staff of the Bank who work with African countries convened a conference on public procurement procedures. Both African public officials and procurement experts from industrial countries presented papers on the merits of different methods of improving public procurement.

The Issue of Military Expenditures

Budgets in developing countries often lack transparency. Revenues are sometimes diverted to special accounts outside the budgetary framework. Transactions with parastatals are obscured. A number of expenditure items are off-budget. Military expenditures often escape scrutiny, avoiding accountability expenditure control and auditing, in part because of the reluctance of civilian financial managers to question military procurement. High-pressure salesmanship reinforced by generous trade credits in this area, as in others, can contribute to waste and corruption.

The Bank has actively assisted governments in improving the transparency of their budgets, mainly through its public expenditure work. In undertaking this work, its main concern is that the country systematically ensures that all its expenditures, including military expenditures, are properly assessed and prioritized, that they are transparent, and that they are subject to expenditure controls and auditing. The Bank assists borrowers in ensuring that their overall public expenditures are not excessive in relation to resource availability and that adequate resources are allocated to economic and social sectors, and within these to programs that direct key services to the poor in a cost-effective manner. The Bank is interested in military expenditures because of their crowding-out effect on development spending.

Analysis and Dissemination Capacity

Availability of information and transparency may lower uncertainty and transaction costs, but will not by themselves bring about greater accountability in the absence of organizations and mechanisms that analyze and disseminate information.

The World Bank has long emphasized the importance of collecting and disseminating economic data. For example, it has supported statistical offices, technical assistance, and capacity building. Despite these efforts, adequate economic information has been a casualty of the current global economic crisis and of government stringency, especially in much of Africa. Central banks which once produced excellent reports on the economy (as in Ghana) have ceased to do so, and government statistical series in many countries have become less timely, reliable, and complete. Given the expanded and more sophisticated requirements of the Bank's poverty and environment agenda, these reports deserve more emphasis. China's post-reform *Statistical Yearbooks* are an example of how breakthroughs can be made in the quality and availability of economic information.

The capacity of NGOs and institutions (professional associations, trade unions, business organizations, grass roots groups, research centers, universities, and the mass media) to articulate the needs of important constituencies, analyze policy requirements, and contribute to policy formulation is an important aspect of accountability. Building this capacity is a central aspect of developing an enabling environment for growth. Information must be understood, processed, and used effectively. Capacities need to be developed—in the universities, in policy research institutes, in economic committees of legislatures, and in the media—to understand information about development issues, and in turn to contribute to broader public education. The African Capacity Building Initiative represents a potential instrument for strengthening the roles of a wide variety of nongovernmental institutions. The Bank's External Affairs Department is also working to improve access to economic information for developing-country journalists.

Summary of the World Bank's Role

The World Bank is concerned with governance for two kinds of reasons. First, from a broader perspective, both history (see above) and the Bank's own experience show that good governance, in the sense that it has been defined here, is central to creating and sustaining an enabling environment for development. Second, from the Bank's perspective (as noted above), sound development management is inextricably linked with the efficacy of the investments that the Bank helps finance and thus with the Bank's goals: to assist countries in reducing poverty and increasing sustainable growth.

The Bank has a long record of helping countries build the institutions and discover the practices which are essential for an efficient economy, and it is continuing this effort. The preceding sections have cited many ways in which borrowers are being assisted in improving development management. The Bank is concerned both with the effect of its assistance on country performance and also, as a financial institution, with the place such assistance has in portfolio management.

Until recently, for such aspects of governance as accountability and the legal framework, the Bank has tended to focus narrowly on its own intervention rather than on the country context. Thus the Bank has always insisted on proper systems of audited accounts for its project entities but has not often paid attention to the constraints within which the systems operate. It has often encouraged borrowers to introduce new laws and regulations (for example, trade and investment legislation) without always examining whether the legal system as a whole is operational and whether laws will be implemented effectively. This situation has changed rapidly in recent years. Just as the Bank's work in public sector management has broadened from strengthening project-related agencies to reforming the civil service and parastatals, similar shifts are now taking place in other aspects of governance and related work. This is evident from the following summary of the activities described above which are being pursued by the Bank in different regions of the world.

Accountability

At the macro level, the Bank has assisted countries to strengthen accounting in the public sector through a range of actions, depending on the situation of each country and on need. These include:

- Making comprehensive and timely information available
- Classifying expenditures in a manner consistent with budget and programs
- Doing appropriate analyses for decisionmaking
- Comparing budget and actual results
- Improving the organization and responsibility for accounting in the finance ministry
- Increasing the legal requirements for financial reporting.

The Bank is encouraging auditing reforms to:

- Enable the audit organization specified in the country's legal structure to attain appropriate independence
- Pay greater attention to "value for money" auditing
- Improve the educational system and professional training.

Countrywide accountability assessments and projects have been undertaken in Bolivia, Indonesia, and Madagascar along the above lines. And governments are being assisted to establish or strengthen systems of financial accountability as they devolve financial power to local authorities.

At the sector level, countries are being assisted in strengthening the capacity and accountability of ministries and institutions that develop policies, establish expenditure priorities, and oversee the delivery of essential services.

At the micro level, countries are being helped to:

- Assess choice and participation options in the design and preparation of projects producing and delivering services
- Encourage beneficiary participation, where appropriate, in the design and implementation of Bank projects, on the basis of lessons drawn from the ongoing study of Bank experience with participatory development (see box 5 above)
- Make selective and focused use of local nongovernmental organizations to enhance service delivery and ensure that the voice of the poor is heard in project design.

The Legal Framework for Development

The Bank is assisting countries with legal reforms, including:

- Communicating laws more effectively
- Ensuring the consistency of laws
- Addressing constraints to the implementation of laws
- Updating legal systems
- Training the judiciary in business and economic laws
- Encouraging extrajudicial alternatives when legal systems are overburdened, such as commercial arbitration and other dispute settlements mechanisms.

Legal sector reviews are also being undertaken at the request of borrowers, with a view to removing impediments to private sector activity.

Information and Transparency

To promote transparency, the Bank is:

- Assisting governments improve the transparency of budgets and public expenditure programs

- Assisting with the preparation of environmental assessments and encouraging borrowers to share these with those affected by projects
- Assisting in improving domestic and external procurement mechanisms and institutions to ensure competition, transparency (including disclosure of selection criteria), fair contract conditions in public procurement, and so forth.

The Bank is also assisting governments improve the collection and dissemination of economic and social data. Moreover, it is assisting countries to strengthen their capacity to understand, process, and use information. For example, the Africa Capacity Building Initiative will contribute to this process, as well as to long-term twinning/training arrangements. The training of economic journalists to raise the level of public awareness and policy debate may also yield returns.

Much of the above work represents a natural extension of the Bank's work on public sector management. It is, like that work, technical in nature and complements other efforts undertaken in economic reforms, such as the elimination of monopolies and deregulation or the removal of controls to contribute to good economic management and reduce opportunities for rent-seeking. Indeed, much that the Bank has been doing routinely indirectly contributes to good governance.

Limitations

In undertaking such work, the World Bank faces some inherent limitations: those of any external agency, of its legal mandate, of its comparative advantage, and of the skills and resources available to it. First, as an external agency, the Bank cannot substitute for the political commitment that governments must bring to reforms in this area. Outsiders can assist and advise, but unless governments are committed to reform, changes that are brought about will not be sustainable. Full ownership of reforms is as important in this area as it is with economic policy reforms.

Second, the Bank's legal mandate clearly delimits its areas of concern. By way of illustration, the Bank may support government efforts at decentralization. It may, through its economic and sector work, make a persuasive case for or against decentralization of particular functions. But the decision to decentralize is one that only governments can make. Similarly, the Bank is rightly concerned with financial and economic accountability, but political accountability is outside its mandate. Also, the Bank may assist in strengthening local governments; it may not, however, have conditionality requiring local government elections. With regard to the legal framework for development, the Bank's concern is with its procedural and institutional aspects. The substantive elements of such a framework have political connotations that may sometimes lie outside the Bank's mandate. Here the general counsel's memorandum provides clear overall guidance, although such distinctions can, sometimes, be difficult to make in practice. It is important to note the underlying motivations behind the restrictions in the Articles of Agreement. These restrictions help to protect the Bank's reputation for technical excellence and objectivity and its status as an international institution that is guided solely by its concern for economic development and not by any political agenda of its own.

Third, the Bank's experience provides a counsel of caution. The recent public sector management paper (World Bank 1991c) noted that work in this area is likely to prove difficult and not yield quick results. The Bank's early experience with integrated rural development projects in the 1970s taught many valuable lessons. These projects were ambitious ventures into the public sector and social engineering. Of the many lessons learned from that experience, some reinforce the need for the exercise of care and humility in tackling problems of governance. The lessons include the need for a more differentiated approach between regions, countries, and project type; the need for strong government commitment at an early stage; the need for the training and retraining of Bank staff to meet the complex needs of these projects; the need for long-term institution building and for avoiding project institutional arrangements that lead to frequent conflict with other parts of national and local governments; and the need to emphasize the development of human capital rather than quick physical implementation: the realization that expatriate technical assistance is a poor substitute for developing local capability. There were also other important lessons not directly related to governance that involve the incentive frameworks, the role of the private sector, and overoptimism on the availability of profitable technical packages.

Finally, work on development management and institution building is expensive and time consuming. However, such work will be handled like all other claims on budget resources, through a determination of priorities within existing country programs, based on need, borrower receptivity, and so forth. As noted below, the Bank seeks to be selective in choosing countries and the range of activities to be pursued. The Bank should, of course, not attempt to take too much on itself. There are U.N. and other agencies that have experience in some relevant areas, which the Bank can tap through collaboration and its aid coordination function. Given that the rationale for the Bank's involvement in governance is that it helps improve the effectiveness of its programs and projects, and not as a new line of business, high-quality work and improved Bank practices in this broad area should help the Bank to move further toward an "implementation culture," leading in the long run to increased cost efficiencies for the Bank itself and greater effectiveness of Bank interventions.

The skill-mix problem also raises difficulties. Many concerns related to governance can and are being addressed by various specialists in the broad public sector management field, although experienced auditors, accountants, lawyers, tax specialists, management specialists, and the like are generally in short supply in the Bank. The Latin America and the Caribbean region has gradually built up a range of new skills through judicious hiring and use of consultants. Here again, the Bank needs to assist borrowers to draw on skills in other agencies, but recognize that there will nevertheless be significant tradeoffs.

Implications for World Bank Practice

The World Bank's actions relating to governance are chosen selectively from the following range of options depending upon country circumstances and needs, the state of the dialogue with the borrower, and budgetary constraints:

- To assist governments with reforms that they have identified or to assist them in identifying reforms when they have asked for such assistance. The Bank is already experiencing a growing demand for technical assistance in support of a legal and procurement framework in Africa and Eastern Europe and strengthening decentralization in Latin America.
- To persuade governments through dialogue and economic and sector work of the need for reforms. Institutional and public sector management assessments and public expenditure reviews and financial accountability and legal sector reviews in Africa and Asia are examples of how this has begun to happen.
- To craft country lending strategies and levels to take account of the effect of governance on development performance.

- To help countries deal with the especially complex issues of poverty and the environment (see above), for which the quality of governmental performance is particularly important.
- To project a long-term vision of an enabling environment, as in *World Development Report 1991* but at the country level, and to support such fundamental ingredients as universal literacy, expanded primary education, better information on development issues, and a supportive environment for a growing private sector.
- To improve implementation performance through greater efforts to assist borrowers in building ownership of adjustment programs, to understand the political and social structure of the country as well as its laws and customs, and to increase attention to fostering an "implementation culture" in the Bank, including greater emphasis on beneficiary participation in project design.

As a practical matter, given differing country circumstances as well as budgetary and staff constraints, the Bank must pursue a measured and selective approach. The main elements of this approach are set out, and some of the actions outlined above are elaborated, in the paragraphs that follow.

First, the Bank, through its interventions, will continue to exploit opportunities for improving development management, whenever appropriate, through a variety of means, including assisting borrowers to break up monopolies, remove controls and other avenues for corruption, increase beneficiary participation in projects, and so forth.

Second, the Bank exercises selectivity in allocating budgetary resources and developing work programs. The selectivity is in terms of the choice of countries for specific work on the key dimensions of development management outlined above, and in terms of the range of activities the Bank can take on and support at any given time. Such work can only be embarked upon in countries where there is a clear commitment to and need for improving development management along these dimensions. Many of the Bank's borrowers may neither want the Bank to be so involved nor require such assistance. Where there is need but no commitment, such work would waste resources. Similarly, the dimensions of development management the Bank chooses to assist should reflect both the chances of success from such an involvement as well as the Bank's skills and resources to assist effectively.

Third, in countries where the Bank is active in improving governance, it needs to assist in the design of highly differentiated responses, taking account of the country's institutional needs, political economy, society, and history. The objective in each case is to help strengthen the enabling environment for sustainable and equitable development. This requires high-quality analysis, usually as part of appropriate economic and sector work.

Issues of Country Strategy and Implementation

It is important to note in this context that as the Bank emphasizes prudent financial management and attention to auditing and accounting or a legal framework suitable for development, deeper and more general problems of governance will tend to surface. Thus, for example, sophisticated systems of financial accounting and auditing may be established but the government may not absorb or use the results to good effect. A legal framework could be created, but arbitrariness or corruption in its implementation could undermine its value. This has already been the experience with sensitive issues of public sector management such as civil service reform, during which political constraints on the success of such work have emerged. If lack of progress is due not to weaknesses in capacity but to lack of government commitment, the Bank then faces a problem which needs to be reflected in its country strategy and dialogue.

When political commitment to sound development management is weak, the Bank normally takes up these issues in its dialogue with borrowers while remaining proactive in seeking ways to help the country improve performance in some of the key areas. This dialogue is supported by economic and sector work, where appropriate. In such a dialogue, governance issues are not discussed in isolation but as an integral part of a government's overall development program.

The issue of political commitment to sound development management is also surfacing more and more at consultative group meetings. The general counsel's legal memorandum noted that the Bank should not act as the agent of lending countries at these meetings. As chair of these meetings, it is normal for the Bank to inform the country of lenders' widely held concerns, particularly when these would affect Bank-assisted programs.

When dialogue fails, the Bank's own lending to the country is likely to be affected. Lending levels have long been responsive to issues of development management and development performance, and will continue to be so. Judgments of performance are already routinely made for purposes of IDA allocation and in assessing creditworthiness. This involves judgments about the quality of development management as it relates to growth and to poverty reduction, consistent with the policy paper on poverty (World Bank 1991a). There is no need for additional criteria to reflect concerns with governance: merely the effective and consistent application of existing criteria based on a greater awareness of the importance of issues of governance for development performance.

Poverty and the environment are two critical areas of country strategy which present particular challenges of governance. The Bank needs to pay attention to the equity as well as cost-effectiveness of social expenditures in its poverty assessments and public expenditure reviews, including addressing questions of the adequacy of social safety nets (especially important in middle-income countries). The legal framework can also greatly influence the access of disadvantaged groups, such as women or landless people, to public services and economic opportunities. On environmental matters, even noninterventionist governments face relatively extensive requirements for administrative and regulatory decisionmaking, much of it discretionary, in areas—like forest policy or pollution control—where property rights are uncertain and market processes, therefore, cannot easily produce a socially desirable outcome. The Bank is considering how these inherent difficulties can be overcome and potentially abusive discretionary powers curbed, for example, by separating surveillance from administrative responsibility. *World Development Report 1992* will discuss some of these issues of environmental policy and governance.

Given absorptive capacity constraints, and the long-term nature of the task of developing appropriate institutions and the strengthening of budgetary decisionmaking and accountability, development management concerns must be integrated, where appropriate and relevant, into a long-term perspective of a country's development strategy and prospects. In Africa, as a follow-up to *Sub-Saharan Africa: From Crisis to Sustainable Growth: A Long-Term Perspective Study* (World Bank 1989) and the Maastricht conference which discussed it, the United Nations Development Programme and the Bank, with assistance from the government of the Netherlands, are assisting interested African countries to develop such perspectives. The objective, in this case, is to use the exercise to help develop a national consensus on development objectives and instruments, and to put government adjustment programs within the framework of a long-term development strategy that is both aimed at poverty reduction and consistent with environmental concerns. Countries elsewhere may wish to consider a similar approach. For the Bank, this means taking a long-term view of its own interventions to assist borrowers improve economic management, recognizing that quick results may be unrealistic, and focusing on the development of human and institutional capacity. This also implies that some aspects of this work should be supported by investment operations rather than with adjustment lending. Carefully designed long-term technical assistance is also appropriate.

This long-term approach reinforces efforts under way to strengthen the commitment of the adjusting country to the adjustment program. The technical complexity of the preparatory work on adjustment operations, and the speed with which borrowers require resource transfers, sometimes leave insufficient time for adequate dialogue and can cause the Bank to contribute to programs to which commitment is weak and that are then seen to be externally imposed. In an ideal world, sufficient preparation time would permit a better understanding of the political economy of the country, and through a more intensive and extensive dialogue, greater understanding of and commitment to the program by the borrower is assured. However, governments and Bank staff frequently do not have that luxury. Governments often delay adjustment and come to the Bank for assistance on adjustment when they are facing a serious crisis. There is, then, an inherent conflict between the need for quick support of sensitive policy reforms and the need to build understanding of and commitment to the program. Moreover, greater commitment comes after a program begins to show results. It nevertheless remains important to ensure that operations are designed to take into account the political economy of the country. It is also important to ensure that commitment to the program, however narrow at the start, is genuine and deepens over time. Yet the strength and integrity of adjustment programs must be protected.

Beyond adjustment lending, fostering an "implementation culture" requires attention to good governance in the design of projects, as well as a deliberate focus on implementation. Best practice includes simple project design, discourages the creation of autonomous project implementation units, encourages the use of established structures to implement projects, increases supervision, suggests prior action and conditionality rather than delayed dated covenants, recommends recruitment of key staff well before effectiveness, and pays special attention to the fiscal effects of projects. All of these recommendations, which are becoming more and more Bank practice, are instances of good development management as delineated in this booklet.

Beneficiary participation is, in many instances, an important way to institutionalize orientation toward implementation as well as to improve particular projects. The Bank spreads best practice in this area by encouraging participatory processes, which include the mediation of conflicting points of view yet achieve results in a timely manner. In some cases, intermediaries are identified through which the Bank can work. It may mean working with local NGOs or it may mean searching for specially skilled local sociologists, development managers, anthropologists, or consultants for aspects of project work. Timetables may sometimes need to be adjusted in order to accommodate this time-consuming work—which is often at the beginning of the project cycle. The Bank is attempting to address these issues (see box 5) through its ongoing learning process on participatory development.

Implications for Research

Much of the Bank's current policy and research work in public sector management bears on issues of "governance." For example, studies under way are examining how to introduce greater public accountability into public finance and civil service management, and work on regulatory institutions and on the political economy of adjustment is addressing some of the questions discussed in this booklet. Much uncharted territory remains, and current work could be extended in several directions.

One such direction is further research on the rule of law, to explore the minimal juridical conditions for broadly based development. For example, in areas such as contract enforcement, employment and tenancy transactions, and recourse against public agencies and judicial independence, is there relatively consistent and culture-neutral experience on which countries can base their own efforts? Another important area is the accountability of public agencies, for which it would be useful to evaluate the wide variety of mechanisms and models available. These include contracting out of services to private providers (on which some work is in progress), decentralization of provision or finance, ombudsman mechanisms, "customer-driven" service systems, and others. Further research could follow up some of the findings of *World Development Report 1991* to explore the two-way relations over time between economic growth and changes in governance.

In sum, the World Bank proposes to proceed with the following:

- To disseminate to its staff the main messages for the Bank on governance and development

- To promote a broadly based dialogue with its borrowers, interested academics, and others throughout the world (this has already begun in Africa)
- To undertake a research program along the lines outlined just above
- To make a progress report to its Board of Executive Directors on its ongoing experience with governance.

Notes

1. Both definitions are from *Webster's New Universal Unabridged Dictionary* (London: Dorset & Baber, 1979). Governance, in general, has three distinct aspects: (a) the form of political regime (parliamentary or presidential, military or civilian, and authoritarian or democratic); (b) the processes by which authority is exercised in the management of a country's economic and social resources; and (c) the capacity of governments to design, formulate, and implement policies, and, in general, to discharge government functions. The first aspect clearly falls outside the Bank's mandate. The Bank's focus is, therefore, on the second and third aspects.

2. This discussion was itself partly prompted by criticisms of early drafts of this book from African reviewers who felt this issue needed to be aired.

3. This gives rise to the so-called principal-agent problem, which relates to how the principal can most effectively induce the agent to act the way the principal would like. There is a growing body of literature on "agency theory." See Eisenhardt (1989).

4. North draws an important distinction between institutions and organizations. "Institutions, together with the standard constraints of economic theory, determine the opportunities in a society. Organizations are created to take advantage of those opportunities; as the organizations evolve, they alter the institutions" (North 1990: 7).

5. Lucien Pye argues persuasively that "culture is not a matter of the rule of the irrational as opposed to objective rational behavior, for the very character of rational judgements varies with time and place. Common sense exists in all cultures, but it is not the same from culture to culture. Sentiments about change, judgements about utility, expectations as to what different forms of power can and cannot accomplish are all influenced by cultural dispositions. . . . People cling to their cultural ways not because of some vague feeling for their historical legacies and traditions, but because their culture is part and parcel of their personalities" (Pye 1985).

6. The concepts of "exit" and "voice," which originated in Albert O. Hirschman's classic work, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (1970), have been adapted by Samuel Paul (1991) to the issue of accountability (1991).

7. This is the case of the legal information system included in the Social Sector Management Technical Assistance Project in Argentina (Loan 2984 AR).

8. A practical example is Ghana. The legal and regulatory framework governing private sector activities is being reviewed by the government in order to eliminate obsolete laws and revise other laws to reflect the policy change from a command economy to a free market system. This follows the changes of the regulatory framework for the financial sector, which has already led to encouraging results.

9. For example, a report on Bank work on the legal system in Indonesia concluded that strengthening the arbitration system and arbitral bodies could improve contract enforcement and avoid some of the constraints in the judicial system.

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