

STATES & MARKETS

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Country policies and governance matter for development

Governance matters for economic development. Capable governments and high-quality institutions promote growth, raise incomes, and reduce poverty. Governance indicators are tools for assessing the performance of governments and the strengths and weaknesses of public institutions. Donors and governments use them to identify weaknesses and improve the management of development programs. And by providing feedback to policymakers and citizens, governance indicators can help to improve the quality of governance over time. This section—on states and markets—includes a broad range of indicators showing how effective and accountable government, together with energetic private initiative, help to create opportunities for growth and development.

The World Bank defines governance as the way public officials and public institutions acquire and exercise authority to provide public goods and services, including basic services, infrastructure, and a sound investment climate. Measuring governance and measuring corruption are not the same thing. While governance encompasses all of the state institutions and arrangements that shape the relations between the state and society, corruption is one aspect of poor governance—an outcome and a consequence of the failure of public accountability. Measuring the quality of policies, institutions, and governance—and corruption—is difficult and often subject to margins of error, whether based on objective or subjective information.

The World Bank has used assessments of government performance in allocating concessional resources since the mid-1970s. Focusing at first on macroeconomic management, the assessment criteria have expanded to include trade and financial policies, business regulation, social sector policies, the effectiveness of the public sector, and transparency, accountability, and corruption. Now called the Country Performance and Institutional Assessment (CPIA), the criteria are assessed annually for all World Bank borrowers.

This edition of *World Development Indicators* includes a new indicator table—Table 5.8, Public policies and institutions—showing the most recent CPIA data for 76 countries eligible to receive grants or credits from the International Development Association (IDA), the World Bank's concessional lending arm. Indicator tables 5.2 and 5.3 continue to report on government policies and regulations affecting the investment climate. Improved infrastructure such as roads, ports, and rails (indicator table 5.9), power and telecommunications (indicator tables 5.10 and 5.11), and water supply and sanitation (indicator table 2.15) are crucial for citizens' health, economic growth, and competitiveness. And effective, accountable governments are needed to complement an energetic private sector to deliver these services.

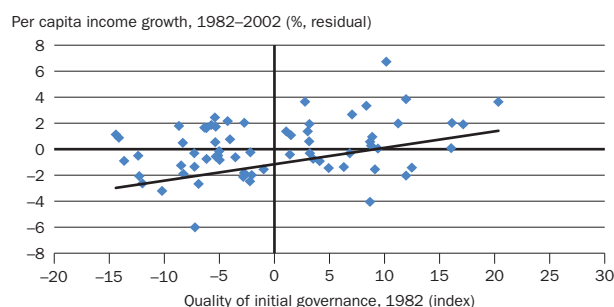
Governance and growth

The first major World Bank discussion of the role of governance was the 1991 World Bank Discussion Paper *Managing Development: The Governance Dimension* (World Bank 1991). A few years later *World Development Report 1997: The State in a Changing World* (World Bank 1997d) argued that a determining factor in development was the effectiveness of the state. The report noted that “an effective state is vital for the provision of the goods and services—and the rules and institutions—that allow markets to flourish and people to lead healthier, happier lives. . . .” The 1997 report presented systematic assessments of the reliability of governmental institutions (predictability of rulemaking, perceptions of political stability, crime against persons and property, and reliability of judicial enforcement) and of corruption from a 1996 World Bank–sponsored survey. Subsequent research suggests that the causality between growth and governance is two-way—that improvements in either income or governance can give momentum to development—but that causation is stronger from governance to growth in income.

Although the links are complex, there is ample evidence of the connection between governance and long-term growth. Figure 5a shows the statistical relationship (controlling for initial income and schooling levels) between the quality of governance measured by an International Country Risk Guide (ICRG) index in 1982 and the growth of per capita income through 2002. The ICRG index comprises five elements of governance: corruption in government, rule of law, risk of expropriation, repudiation of contracts by government, and quality of the bureaucracy in 71 developing countries.

Governance and growth go together

5a



Source: Knack 2006.

Country Policy and Institutional Assessment

The CPIA indicators measure the extent to which a country’s policy and institutional framework supports sustainable growth and poverty reduction and, consequently, the effective use of development assistance. Country performance is assessed against 16 criteria grouped in four clusters: economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions (box 5b).

The overall score for each country, known as the IDA Resource Allocation Index (IRAI), is a key element of a country’s IDA country performance rating. IDA resources are allocated in per capita terms on the basis of the country performance rating and, to a limited extent, per capita gross national income. This ensures that good performers receive a higher IDA allocation, in per capita terms. The individual CPIA criteria are also used to inform the World Bank’s country policy dialogue with member governments and for other operational and research purposes. Reflecting the IDA14 funding agreement, the numerical IRAI scores and separate CPIA criteria were first publicly disclosed for IDA recipient countries in June 2006 to enhance transparency and external scrutiny of these scores (see indicator table 5.8 and figure 5c).

The scores depend on actual policies and performance, rather than on promises or intentions. In some cases the passage of specific legislation can represent an important action that deserves consideration. But it is implementation of legislation that determines its impact. The average

Criteria for measuring economic and sector policies and governance system

Box 5b

Cluster A: Economic management

- Macroeconomic management
- Fiscal policy
- Debt policy

Cluster B: Structural policies

- Trade
- Financial sector
- Business regulatory environment

Cluster C: Policies for social inclusion and equity

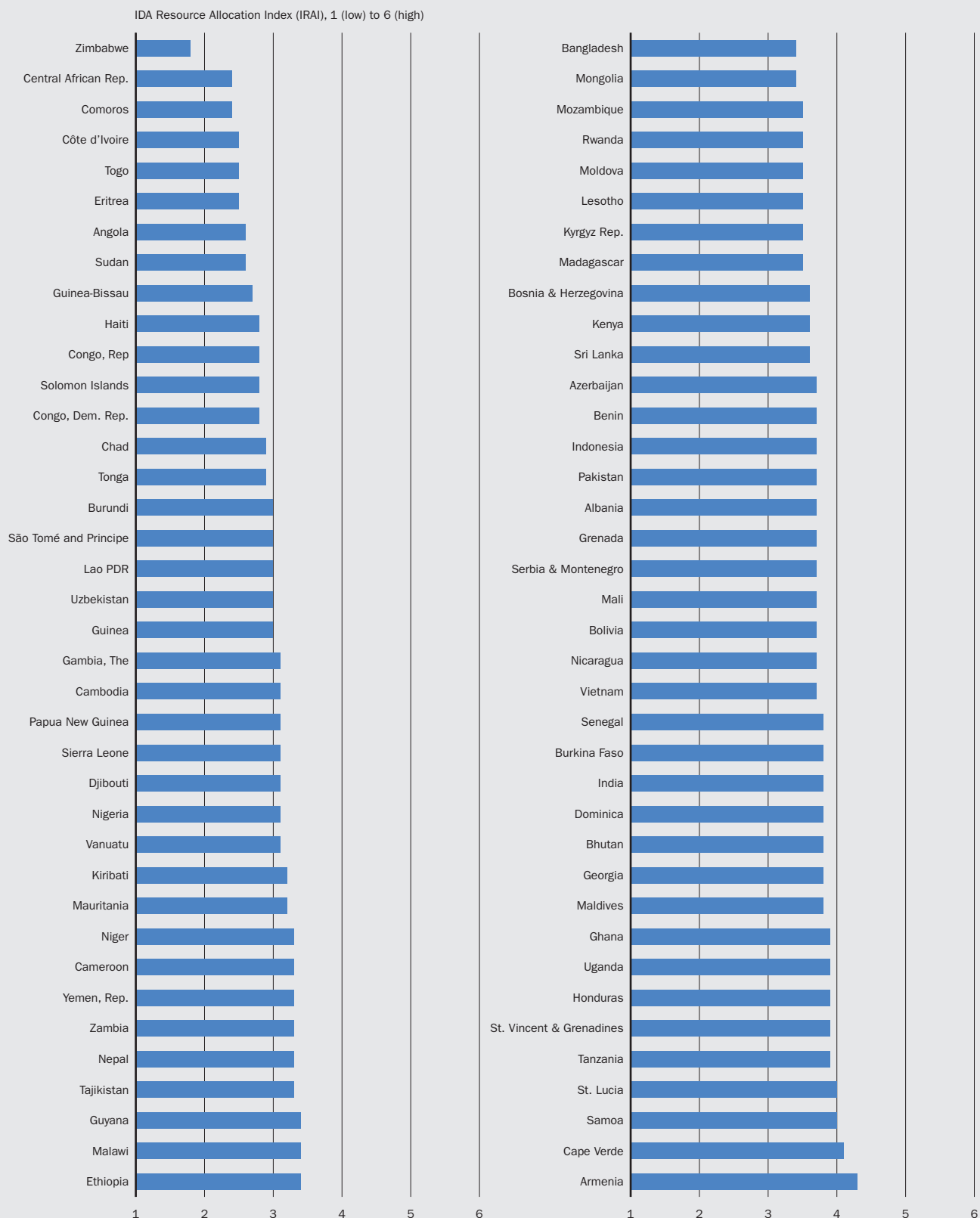
- Gender equality
- Equity of public resource use
- Building human resources
- Social protection and labor
- Policies and institutions for environmental sustainability

Cluster D: Public sector management and institutions

- Property rights and rule-based governance
- Quality of budgetary and financial management
- Efficiency of revenue mobilization
- Quality of public administration
- Transparency, accountability, and corruption in the public sector

The IDA Resource Allocation Index is a key element of a country's IDA performance rating

5c



Source: World Bank.

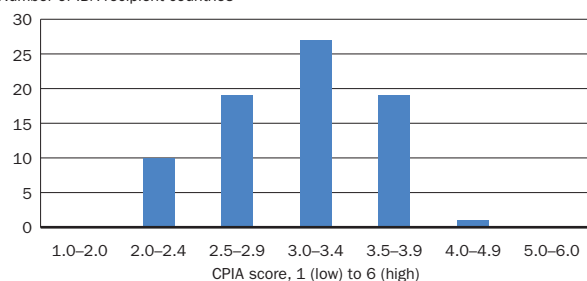
score on public sector management and institutions can be used as an aggregate indicator of the country's governance system (focused primarily on economic governance). It is a part of the "governance factor" that is given extra weight in the IDA country performance rating for determining IDA resource allocations. (For more information see www.worldbank.org/ida.)

Scores on the CPIA public sector management and institutions cluster are bunched around the mid-range, with no countries scoring in either the lowest or highest ranges, and only one country in the 4.0–4.9 range (figure 5d). Although these measures give some indication of the quality of public sector management and institutions, for some countries they do not always match the strong performance on economic management policies (macroeconomic management, fiscal policy, and debt policy). Armenia, Bangladesh, Kyrgyz Republic, Tajikistan, and Uganda score relatively well on CPIA cluster A, economic management, but not so well on cluster D, public sector management and institutions (figure 5e). These patterns reveal the complexity of the relationships between measures of the quality of public sector management and institutions and economic outcomes, requiring better diagnostics and understanding of each country's situation to develop workable approaches to governance reform.

On public sector management, countries bunch around the middle 5d

Distribution of IDA recipient scores for CPIA cluster D, public sector management and institutions, 2005

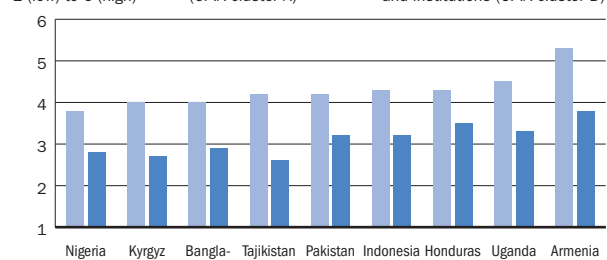
Number of IDA recipient countries



Source: World Bank.

Strong performance on economic management, weaker on public sector management 5e

CPIA score, 1 (low) to 6 (high)



Source: World Bank.

Other World Bank sources of data for monitoring governance

The growing recognition of the link between good governance and successful development has stimulated efforts to monitor the performance of governments and other public institutions by private commercial rating agencies, multilateral development institutions, and nongovernmental agencies. In addition to the CPIA policy and governance measures, the World Bank has several other governance and governance-related measurement programs and indicators that are used in monitoring governance. (See box 5g at the end of this introduction for other selected organizations' governance measurement initiatives.)

- **Worldwide Governance Indicators** are the most comprehensive publicly available governance indicators and among the most widely used by the media, academia, and international organizations for assessing governance. Compiled since 1996, these data measure the quality of six dimensions of governance for 213 countries, based on 31 data sources produced by 25 organizations (box 5f). The underlying data are based on hundreds of variables and reflect the perceptions and views of experts, firm survey respondents, and citizens worldwide on various dimensions of governance. The measures, also known as Kaufmann-Kraay, include the margins of error associated with each estimate, allowing users to identify a range of statistically likely ratings for each country, not just a

Worldwide Governance Indicators—Six key dimensions of governance Box 5f

The Worldwide Governance Indicators measure the quality of six dimensions of governance:

- *Voice and accountability*, the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and free media
- *Political stability and absence of violence*, perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including political violence and terrorism
- *Government effectiveness*, the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies
- *Regulatory quality*, the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development
- *Rule of law*, the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence
- *Control of corruption*, the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

single rating. Margins of error are present in all efforts to measure governance; some sources explicitly report them, while others do not. See www.govindicators.org.

- **Enterprise Surveys and the Business Environment and Enterprise Performance Surveys** capture business perceptions of the biggest obstacles to enterprise growth, the relative importance of various constraints to increasing employment and productivity, and the effects of a country's investment climate on its international competitiveness. Surveys cover almost 58,000 firms in 97 countries. Although designed to monitor the investment climate, which is a product of a number of governance-related factors, these surveys include measures, such as a business managers' perception of corruption as a constraint to doing business, that can be directly linked to governance and are therefore useful for governance monitoring at the country level. See indicator table 5.2 and www.enterprisesurveys.org and <http://info.worldbank.org/governance/beeps>.
- **Doing Business** surveys cover key indicators on the environment for doing business for 175 economies. The indicators identify regulations that enhance or constrain business investment, productivity, and growth. Some indicators, such as enforcing contracts, are useful in monitoring governance. See indicator table 5.3 and www.doingbusiness.org.
- **Anticorruption Diagnostic Surveys** are designed to facilitate governance monitoring by providing inputs to policy-makers and civil society. The World Bank Institute's Governance Diagnostic Capacity Building program aims to strengthen the capacity of countries to conduct governance diagnostic surveys through technical assistance for the design of surveys and governance action plans, training, and partnerships between the government and civil society organizations. Agencies in several countries have undertaken governance and anticorruption diagnostic surveys. See www.worldbank.org/wbi/governance and click on Diagnostics.

- **HIPC (Highly Indebted Poor Countries) Public Expenditure Management Assessment and Action Plans** use expenditure tracking tools developed by the World Bank and the International Monetary Fund to monitor poverty-reducing public expenditures in HIPCs. Data are collected on 15 indicators on budget formulation, execution, and reporting, and 1 indicator on government procurement. A new program to measure public expenditure and management has been developed and will be used for monitoring in HIPCs. See www.worldbank.org/hipc.
- **Public Expenditure and Financial Accountability Program**, started by the World Bank in 2001, is now a partnership with several multilateral and bilateral development institutions that support an integrated and harmonized approach to assessment and reform in public expenditure, procurement, and financial accountability. The public expenditure and financial accountability framework includes 28 indicators on budget credibility, transparency, auditing, and procurement, and three indicators on donor practices that affect the country public financial management system. The program is being implemented in 70 countries; 8 countries have completed reviews and made them available publicly (in addition, one country has published data for the indicators). See www.pefa.org.
- **The Joint Venture on Procurement of the World Bank and the Organisation for Economic Co-operation and Development's Development Assistance Committee** has selected 22 pilot developing countries to test the Common Benchmarking and Assessment Tool for Public Procurement, which developing countries and donors can use to assess the quality and effectiveness of national procurement systems. See www.oecd.org and search for Joint Venture on Procurement. For an overview of the World Bank's framework for global monitoring of governance and in-depth discussion of the uses and limitations of governance measures, see the World Bank and International Monetary Fund's (2006a) *Global Monitoring Report 2006*.

Other selected sources of data for monitoring governance

Box 5g

- **Freedom House**, a private nonprofit advocacy organization founded in 1941, was among the earliest to systematically measure and publish governance ratings. Freedom House has published *Freedom in the World* since 1972; it now includes ratings of political rights and civil liberties in 192 countries and territories. See www.freedomhouse.org.
- **International Country Risk Guide** is privately owned and has been assessing financial, economic, and political risks since 1980 for about 140 countries. See www.prsgroup.com.
- **Transparency International (TI)**, a newer entrant, has attracted media attention since 1995 with its Corruption Perceptions Index. The index is a compilation of surveys of perceptions of resident and nonresident business people and expert assessments of the degree of corruption in a country. See www.transparency.org.
- **Global Integrity**, a Washington, D.C.–based nonprofit organization funded by private foundations and the World Bank, assesses the existence and effectiveness of anticorruption mechanisms that promote public integrity. More than 290 indicators are used to generate the Global Integrity Index for more than 40 countries. See www.globalintegrity.org.
- **The Open Budget Initiative**, sponsored by the International Budget Project, tracks 122 indicators of budget transparency for almost 60 countries. The country reports give citizens, legislators, and civil society advocates comprehensive and practical information that can be used to assess a government's commitment to budget transparency and accountability. The initiative is funded by private foundations and bilateral aid agencies such as the U.K. Department for International Development and the Swedish International Development Cooperation Agency. See www.openbudgetindex.org.