Policymaking in Latin America
Partial summary of a research agenda

Based on joint work by Carlos Scartascini, Ernesto Stein, Mariano Tommasi, and colleagues

Strengthening Policy-Making Capacity in Latin America: What can be learned from the OECD?

World Bank, Washington DC June 1-2, 2010

The views and interpretations in this document are those of the authors and should not be attributed to the Inter-American Development Bank, or to any individual acting on its behalf.
Objectives of the seminar

1. “Finding practical methods by which LAC governments might improve their policymaking”

2. “Improve the analytical framework within which we ask questions about the policy process”
This presentation

- Tries helping to tackle both issues:
  1. It provides a brief summary of the analytical framework that we have been using at the IDB for the last several years.
  - Concentrates on explaining features of policies instead of specific policy content
  - Good features are more probable when the probability of intertemporal cooperation is higher
  - Cooperation is more likely in those cases in which horizons are longer, which allows actors to focus on investing in their capabilities
    - Hence, higher government capabilities are (quasi) endogenous to the equilibrium
This presentation

- Tries helping to tackle both issues:

  2. It allows to think in terms of potential policy recommendations

    - Even though the analytical framework does not lead directly to policy prescriptions, it helps to think about what can and what can’t help

    - Somehow, it will try to make it compatible with D. North assessment that ‘the incremental approach…is wrong. Instead, development requires that a country changes its entire structure’
This presentation

- For this, it summarizes part of a more general research agenda contained in several books, as well as IDB working papers and published articles.
This presentation

- For this, it summarizes part of a more general research agenda contained in several books, as well as IDB working papers and published articles.
The Framework. Inputs from previous literature

1. Workings of political institutions
2. Political institutions and policies
3. Interest groups and rent-seeking
4. Role of veto players in the reform process
5. Organization of “real actors”
6. Economic structure, interests, social cleavages
7. Structure and dynamics of business-State relations
The Framework. The restricted PMP

- Workings of political institutions, PM, and the features of policies
Why looking at policy features?

- After more than a decade of reforms in developing countries, some messages have been extracted:
  - A universal set of right policies does not necessarily exists
    - Same policy adopted in two countries may have very different results
    - For example, compare the different results coming from the introduction of the Fiscal Responsibility Law in Brazil and Argentina in the late ‘90s. Chile was even more conservative in their fiscal behavior despite a less stringent norm.
Why looking at policy features?

- After more than a decade of reforms in developing countries, some messages have been extracted:
  - Certain key features of public policies may be as important in achieving development goals as their content or orientation
    - A stable and credible policy environment may be more successful than continuous switches
      - E.g., Dani Rodrik on credibility
Bolivia and Hydrocarbons

**Nationalization**

1937: Colonel David Toro confiscated all of the Standard Oil Company's holdings.

1969: Alfredo Ovando. Gulf Oil was nationalized and YPFB became the sole supplier of natural gas.

2006: Evo Morales nationalized gas fields and oil industry.

1922: Standard Oil Company built first oil well.


1994: Gonzalo Sanchez de Lozada privatized nearly the entire state-run economy.

**Privatization**

Policy features

- **Policy Stability**
  - Ability to sustain most policies over time.

- **Policy Adaptability**
  - Ability to be able to adapt policies to changing economic conditions and to change policies when they are clearly failing.

- **Policy Coordination and Coherence**
  - Ability to coordinate multiple actors in the policymaking process.

- **Policy Implementation and Enforcement**
  - Ability to implement and enforce public policies

- **Policy Efficiency**
  - Ability to allocate its scarce resources to those activities where they have the greatest returns.

- **Public-Regardedness of Policies**
  - Extent to which policies promote the general welfare and resemble public goods.

- **The Policy Index**
  - Composite index
Policy features

- Regional rankings

Source: Author’s calculation using data from Berkman et al (2008)
<table>
<thead>
<tr>
<th>country</th>
<th>Policy Index</th>
<th>Adapt</th>
<th>Implement</th>
<th>Coordinate</th>
<th>Efficiency</th>
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# Policy features and development

- Better policy characteristics are associated with better development outcomes

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<th>Adaptability</th>
<th>Coordination and Coherence</th>
<th>Implementation and Enforcement</th>
<th>Public Regardness</th>
<th>Efficiency</th>
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<td>0.695***</td>
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<td>0.555**</td>
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<td>0.544**</td>
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<td>0.192*</td>
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<td>0.301***</td>
<td>0.11</td>
<td>0.217**</td>
<td>0.253***</td>
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</table>

Note: Simple correlations between policy qualities and political variables are shown in the first row of each subgroup. Partial-out correlations (controlling for GDP per capita of 1990) are shown in it a second row of each subgroup.

* Significant at 10 percent; ** Significant at 5 percent; *** Significant at 1 percent.

Policy features and development

- The quality of policies seems to matter for the effectiveness of public expenditures.
- Example: Health (preliminary results)
  - If a country’s policy environment is not good, spending more on health has no clear effect on improving life expectancy.
  - As countries develop a better policy environment, they tend to benefit more from a given amount spent.
Figure 3. Effects of Policy Index and Health Expenditures on Changes in Life Expectancy

What explains good policy features?
High government capabilities.

<table>
<thead>
<tr>
<th>Country (by policy index level)</th>
<th>Congress Capabilities Index</th>
<th>Judicial Independence</th>
<th>Party system institutionalization</th>
<th>Party system nationalization*</th>
<th>Programmatic parties</th>
<th>Development of civil service</th>
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<td>Very High</td>
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<td>3.90</td>
<td>59</td>
<td>0.64</td>
<td>2.00</td>
<td>0.68</td>
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<td>60</td>
<td>—</td>
<td>0.00</td>
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<td>66</td>
<td>0.83</td>
<td>7.00</td>
<td>0.11</td>
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<td>0.78</td>
<td>2.00</td>
<td>0.40</td>
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<td>7.00</td>
<td>0.48</td>
</tr>
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— not available.

* Adequate data for party system nationalization are not available for Colombia for 2002. For the case of Ecuador, party system nationalization data correspond to 1998.

Note: Countries are classified first according to their policy index values (“very high,” “high,” “medium,” and “low”) and then alphabetically within those groupings. The values for each country on each variable are shaded such that dark blue represents “very high” or “high” values, light blue represents “medium” values, and white (no shading) represents “low” values.

Sources: Stein and Tommasi (2005); Jones (2005); Zuvaric and Lacoviello (2005); and World Economic Forum (2004).
Table 3. Institutional Strengths and the Characteristics of Policies, One Institutional Variable at a time.

<table>
<thead>
<tr>
<th>Institutional Variable</th>
<th>Policy Characteristic</th>
<th>Stability</th>
<th>Adaptability</th>
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<th>Coordination</th>
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<td>0.417*</td>
<td>0.812***</td>
<td>0.458*</td>
<td>0.595***</td>
<td>0.446***</td>
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<td></td>
<td></td>
<td>(0.185)</td>
<td>(0.260)</td>
<td>(0.222)</td>
<td>(0.257)</td>
<td>(0.233)</td>
<td>(0.214)</td>
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<td>Observations</td>
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<td>89</td>
<td>92</td>
<td>96</td>
<td>84</td>
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<td>95</td>
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<td>R-squared</td>
<td></td>
<td>0.576</td>
<td>0.586</td>
<td>0.644</td>
<td>0.703</td>
<td>0.562</td>
<td>0.775</td>
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Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Controls included in the regressions are: Ln(GDPpc) in 1990 and 7 regional dummies

Source: Scartascini, Carlos, Ernesto Stein and Mariano Tommasi. 2008.
Table 4. Institutional Strengths and the Characteristics of Policies, Multivariate Regression

<table>
<thead>
<tr>
<th>Dependent Variable</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
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<tr>
<td>Congressional Policymaking Capabilities</td>
<td>0.175*</td>
<td>0.170*</td>
<td>0.155</td>
<td>0.222**</td>
<td>0.186*</td>
<td>0.174*</td>
<td>0.175*</td>
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<td>(0.0883)</td>
<td>(0.0899)</td>
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<td>(0.0942)</td>
<td>(0.106)</td>
<td>(0.0881)</td>
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<td>Party System Institutionalization</td>
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<td>Judicial Independence</td>
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<td>0.267***</td>
<td>0.275***</td>
<td>0.267***</td>
<td>0.279***</td>
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<td>Civil Service Capacity</td>
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<td>0.180***</td>
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<td>Effective Number of Political Parties</td>
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<td>Volatility of GDP</td>
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<tr>
<td>Volatility of Terms of Trade</td>
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<td>0.897</td>
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</tbody>
</table>

Standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1
Controls included in the regressions are: Ln(GDPpc) in 1990 and 7 regional dummies

* Controlling for Ln(GDPpc) and regional dummies

Source: author’s calculation based on data in Berkman et al (2008)
Source: author’s calculation based on data in Berkman et al (2008)
The framework

- How do good policy features and high government capabilities relate?
- Good policy features are only possible in context of intertemporal cooperation
  - Otherwise, each new leader would have the incentive to change policies for political advantage and to make them rigid for future policymakers (then, neither stability nor adaptability would be possible in equilibrium).
- Under what conditions is cooperation more likely?
  - There are good “aggregation technologies”.
  - There are well-institutionalized arenas for political exchange.
  - Key actors have long time horizons.
  - There are credible enforcement technologies.
PUBLIC POLICIES

Y

(game of)
POLITICAL TRANSACTIONS

(2)

FUNCTIONING OF
POLITICAL INSTITUTIONS
(rules of policymaking game)

X

BASIC INSTITUTIONS & HISTORY

(1)

(3)

(4)

features of specific policy issues

Z
An Example of the Approach

“Y” Variables
Policy adaptability
Policy stability
Policy coherence
Private vs. public regardedness
Etc

(game of)
POLITICAL TRANSACTIONS

“X” Variables
Legislature:
Fragmentation
Duration
Quality of Leg.

Judiciary:
Judiciary independence

Bureaucracy:
Civil Service
Capabilities

“Deep X” Variables
Electoral System
District Size
Electoral Formula
Term Limits
Etc

features of specific policy issues

Z
Government capabilities and policies

- Government capabilities affect policy content too
- For example, policies that are good for productivity require:
  - Governments should be able to coordinate across several domains (firm decisions depend on policies across areas)
  - Governments should be able to have long term planning capacity (usually ST costs and LT benefits)
  - Governments should be credible so as to elicit demand for the “right kind” of policies
    - For example, “real actors” such as business groups would demand public goods such as infrastructure if the probability of reaping the benefits of long term investments is high (i.e., the “probability of default” by the government on its promises is low)
### Table 2. Policymaking capabilities and the quality of public policies

<table>
<thead>
<tr>
<th>Country</th>
<th>Policymaking Capabilities Index</th>
<th>Infrastructure Index</th>
<th>Credit Index</th>
<th>Extent Distortive Tax System</th>
<th>Extent Distortive Government Subsidies</th>
<th>Administrative Burden Startups</th>
<th>Efforts to Improve Competitiveness</th>
<th>Formal Sector</th>
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<tbody>
<tr>
<td>Chile</td>
<td>Very High</td>
<td>Very High</td>
<td>Very High</td>
<td>High</td>
<td>Very High</td>
<td>High</td>
<td>Very High</td>
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<td>Trinidad and Tobago</td>
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<td>Medium</td>
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<td>Medium</td>
<td>Low</td>
</tr>
</tbody>
</table>


Government capabilities and policies

Government capabilities and TFP Growth

OLS includes controls for LGDpc (1990), trade, and regional dummies.

One example: credit development

- Demand for credit can only be met by governments that are more capable, otherwise
  - Doesn’t have the capacity to enforce those policies that create the conditions for credit
  - The government “uses” the credit market to finance itself
  - The government has a short horizon

Gov. capabilities and institutionalization

- So far we have shown that
  - Better policy features generate better development outcomes
  - Better policy features are possible if government capabilities are high

- Additionally, government capabilities may affect the path of institutionalization
  - That is, they may generate a virtuous or vicious cycle of investments on capabilities
Gov. capabilities and institutionalization

- In some countries decisions are taken in institutionalized arenas
  - If people have grievances they write to their Congressperson

- In others, at least part of the discussion takes place in less institutionalized setting
  - If people have grievances, they block streets
Gov. capabilities and institutionalization

Therefore, at some level, actors decide upon alternative strategies and they end up investing accordingly.

Gov. capabilities and institutionalization


http://www.iadb.org/research/pub_desc.cfm?pub_id=IDB-WP-110
Gov. capabilities and institutionalization

Among the many results coming from the model and data

- Protests seem to be more prevalent when:
  - Individuals have a much higher probability of actually taking part in demonstrations if they live in a country characterized by low government capabilities.
  - If protests are an important part of policymaking, they may reduce the incentive for investing in additional policymaking capabilities.
Summary and recommendations

1. Concentrate on getting the policy features right
   - There are very few policies worth pursuing at any cost
   - The quality of the policies depends on the ability of political actors to cooperate over time
     - Having a “maverick” usually leads only to short run policy switches
       - Argentina shifts back and forth from one model to the other. In the long run, it is hurting (IDB (2010))
Summary and recommendations

2. Concentrate on increasing government capabilities

- Recommendations in Rojas et al (2010) are a very good start
  - Increasing congress capabilities
  - Increasing capabilities in the cabinet
  - Favoring M&E mechanisms
  - Fostering public debate and policy advice
Summary and recommendations

3. Take into account the general equilibrium and the incentives of the actors
   a. In order to make the investments sustainable over time
      ▪ E.g., legislative strengthening has not proven very successful in many LAC countries
      □ Simil CBOs rapidly dismembered or staffed with political appointees
      ▪ E.g., political structures change rapidly (# ministries)
Summary and recommendations

3. Take into account the general equilibrium and the incentives of the actors

b. In order to make the investments effective
   - “Si nos quieren echar de todas las comisiones, que lo hagan; tenemos las calles del pueblo” (N. Kirchner)
   - Role of the commission that evaluates the presidential decrees in Argentina (M&E simil)
Summary and recommendations

3. Take into account the general equilibrium and the incentives of the actors
   
   c. In order to get more “bang for the buck”
      - A combination of fiscal prerogatives, restrictions and the role of the Tribunais de Contas in Brazil seem to be part of the explanation behind why policymaking is working in Brazil.
Summary and recommendations

3. Take into account the general equilibrium and the incentives of the actors
d. To avoid unintended consequences
   - E.g., decentralization and inclusion may prove great for improving policymaking at the local level; it may hurt policymaking at the national level
     - More actors for policy decisions
     - Lower incentives for some actors to invest in their capabilities
       - Recent Colombia?
Summary and recommendations

4. Therefore, invest in those government capabilities that:
   - make the State more credible, and
   - focused on the long-term consequences of current actions.
     - Increasing the horizon of actors may create a virtuous cycle as they find it in their interest to invest in their capabilities
Summary and recommendations

5. Build sustainable consensus to orient policy for the long term
   - The quality of the policies depends on the ability of political actors to cooperate over time
     - Build cooperation and long-term credibility
Summary and recommendations

6. Work also with the private sector
   - Try to bring private actors in the discussion in an encompassing manner
   - Strengthen private sector capabilities
     - They may help to design better policies and may be able to solve some of their own problems.
       - E.g., own public good provision
Summary and recommendations

- What about North’s statement about the failure of incrementalism?
  - If there is no change in the general equilibrium, incrementalism doesn’t work.
  - However, sometimes changing the equilibrium may not take so much work. The problem is to identify the silver bullet.
The Database (Berkman et al (2008))

- It expands the database created for *The Politics of Policies* for LAC.
  - That database was based mainly on a survey of LAC experts

**Purpose**

- To introduce a set of new variables that are relevant and have maximum coverage.
  - To test whether our insights are validated beyond LAC
  - Test other analytical findings (e.g., veto players literature)

**Content**

- Outcome policy variables and institutional variables.
- Variables were chosen according to our conceptual framework
The database. Policy features

- To avoid capturing “mood” we work with averages over long time series
- We have done a number of robustness checks
  - Correlation with Latin America data
    - Created specifically
    - Contrasted with country studies
  - Correlation with more objective data
    - Adaptability and fiscal procyclicalty
  - We have a new database of more objective indicators (joint project with the London School of Economics) (to be published soon)
Stability

The index is composed of the following four variables:

- **Fraser:**

- **GCR Plan:** Global Competitiveness Report (GCR, 2002).
  - This variable measures whether legal or political changes over the past five years have (1=severely undermined your firm’s planning capacity, 7=had no effect)

  - Measures whether new governments honor the contractual commitments and obligations of previous regimes.

- **PI:** Profils Institutionnels (2006).
  - Question A5101 where experts evaluate the “Consistency and continuity of government action in economic matters”.
Adaptability

- The index is based on the following four variables:
  - **BTI flexibility**: The Bertelsmann Transformation Index (BTI, 2006).
    - BTI's adaptability index includes the ability of the political leadership to act flexibly, political leaders' capability for learning, and whether political leaders can replace failing measures with innovative policy.
    - Question 29 where experts (from academia, government, and the media) rate the states' ability to respond effectively to domestic economic problems.
  - **PI capacity**: Profils Institutionnels (PI, 2006).
    - Item A5100 where MINEFI and AFD employers and experts evaluate the decision-making capacity of the political authorities in economic matters (responsibility, rapidity, etc.).
    - Question 21 rating the states' ability to formulate and implement national policy initiatives. The implementation component was included in order to reflect Cox and McCubbins' theory of polity decisiveness.
The index was based on two variables:

- **CUSCS 18**: Columbia University’s State Capacity Survey (CUSCS, 2003).
  - Question 18 rating the effectiveness of coordination between the central government and local-level government organizations.

- **PI coord**: Profils Institutionnels-database (PI, 2006)
  - Item A508 rating co-ordination between ministries and within administrations.
Implementation and Enforcement

- The index was created based on the following sources:

  - **GCR wage**: GCR (2002).
    - Expert evaluation of whether the minimum wage set by law in the country is (1=never enforced, 7=strongly enforced)
  - **GCR tax**: GCR (2002).
    - Expert evaluation of whether tax evasion in the country is (1=rampant, 7=minimal)
  - **GCR env**: GCR (2002-2006).
    - Expert evaluation of whether environmental regulation in the country is (1=not enforced or enforced erratically, 7=enforced consistently and fairly)
  - **BTI imp**: BTI (2006).
    - Analysts’ estimate of the following question: Does the government implement its reform policy effectively?
    - Question 21, rating states’ ability to formulate and implement national policy initiatives.
    - Question 22, rating states’ effectiveness at collecting taxes or other forms of government revenue.
Efficiency

- The index was built based on the following three variables:
    - Expert rating of the composition of public spending and whether it is wasteful.
  - **BTI eff**: BTI (2006).
    - Expert evaluation of whether the government makes efficient use of available economic and human resources.
  - **EIU eff**: EIU (2006).
    - Expert assessment of the effectiveness of the political system in formulating and executing policy.
Public-regardedness

The index was created based on the following three variables:

  - Expert rating of whether when deciding upon policies and contracts, government officials (1=usually favor well-connected firms and individuals, 7=are neutral among firms and individuals)

- **GCR poor**: GCR (2002).
  - Expert evaluation of whether government social transfers go primarily to (1=poor people, 7=rich people).

- **corruption**: Transparency International Corruption Perceptions Index (2005).
  - Perceptions of the degree of corruption as seen by business people and country analysts ranging between 10 (highly clean) and 0 (highly corrupt).
Policy Index

The policy index was created based on all of the variables utilized for the indexes presented above.
Congress Capabilities

- Is based on the following variables:
  - **GCR law**: GCR (2003-2005)
    - Effectiveness of lawmaking bodies (1 = very ineffective to 7 = very effective)
  - **Confidence**: Shared Global Indicators Cross-national Database/World Values Survey
    - How much confidence do you have in Parliament?
Political Party Institutionalization

- The index is composed of five variables:
- **BTI stable**: BTI 2006.
  - To what extent is there a stable, moderate and socially rooted party system to articulate and aggregate societal interests?
- **Confidence**: Shared Global Indicators Cross-national Database/World Values Survey
  - How much confidence do you have in the Political Parties?
- **Vote volatility**:
  - Volatility is calculated by subtracting the percentage of the vote/seats won by every party in an election from that won in the previous election, taking the absolute value of this result, summing the results for all parties, and then dividing this total by two.
- **PI elect**: Profils Institutionnels (PI, 2006).
  - To what extent are political leaders determined by general, free and fair elections?
- **DPI party age**: Data Base of Political Institutions (DPI, 1990-2004)
  - The average of the ages of the 1st government party, 2nd government party, and 1st opposition party, or the subset of these for which age of party is known.
Judicial Independence

The measure is based on the following three variables:

- **GCR jud**: GCR (2001-06)
  - The judiciary in the country is independent and not subject to interference by the government and/or parties to disputes.

- **BTI jud**: BTI (2006)
  - Does an independent judiciary exist?

- **Fraser**: Fraser Index (1995 – 2003)
  - Rating of independence of judiciary.
Bureaucracy Index

- The index takes the following variables into account:
    - Bureaucratic Merit Index, Question 14. Measures the degree to which effective guarantees of professionalism in the civil service are in place and the degree to which civil servants are effectively protected from arbitrariness, politicization, and rent-seeking.
    - Bureaucratic Functional Capacity Index, Question 13. Measures the degree to which the bureaucracy has salary compensation systems and systems for evaluating the performance of public officials.
    - Bureaucratic Efficiency Index, Question 16. Measures the degree to which the bureaucracy is efficient in assigning human capital, given a fiscal policy constraint.
    - High points are given to countries where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in government services.


