

# **Measuring Governance in Developing Asia**

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# Measuring Governance in Developing Asia<sup>1</sup>

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## Overview

The New Public Management paradigm has focused attention on measuring the performance of government agencies. There are some broader questions that will be addressed in this paper. Is it possible to measure the quality of overall governance in a country? Are present measures robust enough to allow the ranking of countries along a continuum from well-governed to poorly-governed? Should these rankings be used by donor agencies and private investors in making investment decisions?

## ADB perspective

Until a few years ago, the Bank had not paid enough attention to governance issues, in part because information is highly subjective and difficult to come by. Also, in comparison to economic issues, governance is more culturally-specific, with greater cross-country differences.

Another objection to taking governance issues into consideration came from Article 36 of the Bank's Charter, which states that the Bank "shall not interfere in the political affairs of any member nor shall they be influenced in their decisions by the political character of the member concerned. Only economic considerations shall be relevant to their decisions..."

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<sup>1</sup> Another version of this paper has been accepted for presentation at the International Public Management Network Conference to be held in Sydney, Australia, 4-6 March 2000. Views expressed in the paper are personal views of the author and may not reflect the views of the institution he is affiliated with.

The term "economic considerations," however, has been widely interpreted by the Bank. Data from recent studies are showing that governance matters for economic development. For example, a survey of governance in around 165 countries found that a one standard deviation increase in any one of 6 governance indicators causes a 2 ½ fold increase in PC income, a 4 fold decrease in infant mortality, and a 15 to 25 percent increase in literacy<sup>2</sup>. A one standard deviation increase would be moving from rule of law in Russia to the Czech Republic, or moving in reducing corruption from levels in Indonesia to levels in Korea. This research indicates a causal link between improved governance and improved development performance. Another study compares development performance in Asia and Africa, and finds the latter suffered because ethnic conflict encouraged policies fostering rent-seeking rather than economic performance<sup>3</sup>. Another study uses regression analysis to show that countries with poorly paid public officials tend towards higher corruption<sup>4</sup>.

The link is strongest for the extremes: the worst performers have the worst governance, and the best, the best. The link is harder to prove when comparing countries closer in rank order. For example, China's economic performance has recently been stronger than India's; yet India has a highly developed (though out of date) legal system and many lawyers, while China's legal system is, by comparison, rudimentary. The reason may be that there are informal substitutes for the legal protection and enforcement of property rights which existed long before states and formal legal institutions (e.g. arbitration, reputation, merger, strong-arm tactics, and altruism), highlighting one of the problems of specifying governance indicators<sup>5</sup>.

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<sup>2</sup> The indicators measure the process by which governments are selected, monitored and replaced, the capacity of the government to effectively formulate and carry out effective policies, and the respect of citizens and the state for laws, regulations and other institutions that govern the economic and social interactions among them. D. Kaufmann, A. Kraay, and P. Zoido-Lobaton (1999). *Governance Matters*. Washington, DC: World Bank.  
[http://www.worldbank.org/wbi/gac/gac\\_pdfs/govmatrs.pdf](http://www.worldbank.org/wbi/gac/gac_pdfs/govmatrs.pdf)

<sup>3</sup> W. Easterly and Ross Levine (1997), "Africa's Growth Tragedy: Policies and Ethnic Divisions," *Quarterly Journal of Economics*, pp. 1201-49.

<sup>4</sup> Van Rijckeghem, Caroline, and Beatrice Weder (1997), "Corruption and Rate of Temptation: Do Low Wages in the Civil Service Cause Corruption?" IMF Working Paper 97/73, International Monetary Fund, Washington, DC., cited in Shang-Jin Wei (1999), "Special Governance Zone", unpublished paper, Harvard University.

<sup>5</sup> J. Dethier (1999), "Governance and Economic Performance: A Survey", Discussion Papers on Development Policy, No. 5, ZEF Bonn, Germany.

In addition, there are a host of problems with data, model specification, and statistical estimation that make any analysis of causal links between governance and development performance exceptionally difficult<sup>6</sup>. Take, for example, the case of a posited link between poor civil service pay and corruption, cited above. Broader comparative research indicates that there is a high correlation between the various governance indicators in most data sets. Thus, a significant regression finding between two variables may be “caused” by one or more other factors not being measured. This paper will not go further into such questions, but rather focus on the task of measuring the quality of governance for its own sake.

Based on the presumption that effective governance is needed for strong development performance, the Bank adopted a policy, *Governance: Sound Development Management* in August 1995, and an anti-corruption policy in 1998. In addition, by launching a governance website in 1999<sup>7</sup>, and hiring a core group of specialist staff, the Bank has moved proactively to address a broad range of governance issues.

The Bank defines governance as "the manner in which power is exercised in the management of a country's social and economic resources for development." ADB's emphasis in its governance programming is on dialogue and local ownership. Every effort is made to ensure that governance programs and conditions are:

- a. based on knowledge of the realities in practice rather than on blueprints and preconceptions;
- b. based on genuine dialogue rather than just pressure;
- c. implemented forcefully but with a realistic sequence and timetable
- d. designed taking into account the constraints of country capacity to carry them through;
- e. flexible enough so that executing agencies can develop individual sub-projects within programs as and when progress permits;

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<sup>6</sup> *Ibid.* and many sources cited there.

<sup>7</sup> See <http://www.adb.org/Work/Governance/>. The “links” page lists many other websites covering governance issues.

- f. funded by a higher proportion of grant-funded technical assistance to lending than would be the case for other types of programs.

A central governance challenge is that while the Bank's overarching objective is to reduce poverty in developing member countries (DMCs), many DMC governments are essentially non-democratic. One might expect these governments to redistribute some minimum amount in order to ensure that some of the most visible manifestations of poverty are reduced. This would reduce adverse publicity (bad for business and tourism), and reduce the threat of socio-political instability. However, it is not easy to persuade these governments to transfer large amounts of public resources to poor and weak segments of society that have little political leverage, or to work for pro-poor, sustainable economic growth.

### **Reasons for measuring governance**

The average citizen needs to know the extent to which the expressed intentions of government are matched by results. If s(he) supports the intentions but doesn't see the results, s(he) might vote for a new representative in the next election (if given the choice), or become active in a citizen's group working for change including reducing taxes paying for unwanted activities, or move to a new locality which is better governed. Citizen's groups and businesses want the same sort of information to help them decide how to design and where to target their advocacy and lobbying efforts. Government officials and politicians want to know these things to determine how good a job they are doing, and whether or not mid-course corrections are needed. Governments may also want to measure the governance of their neighbors to assess security risks<sup>8</sup>.

Donor agencies and other investors want to know these things to help in making sound investment decisions. As official development assistance declines, and is replaced by investment from private investors, pension funds, and the like, development financing is

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<sup>8</sup> A major research effort within the US government (National Research Council, White House, et al) in the mid-90s tried to establish indicators that would predict the risk of state failure. However, the results were never released because of fears of diplomatic problems (and possibly self-fulfilling prophecies) with the high-risk countries.

likely to be more and more attracted to countries with favorable governance indicators<sup>9</sup>. International agencies want to know these things to find out if governments are abiding by international conventions and treaties they have signed. International ratings agencies such as Standard and Poors, Moody's, International Country Risk Guide, and Business Environmental Risk Intelligence, incorporate governance in their indicators of creditworthiness

## **Methodological problems with measuring governance**

Governance can be measured in terms of effort or in terms of results.<sup>10</sup> The former is important for morale, and also fairness when international concessional fund allocations are being made. A small step forward in a country with weak governance may be more difficult to achieve than a larger step forward in a better governed country; The former deserves some credit for its achievements, however meager in comparative terms.

Yet measures of effort need to be combined with measures of tangible progress towards objectives. There are four types of results: in terms of inputs, outputs, outcomes (including impacts), and process. When results measurement is cost effective and appropriate, one should use whatever combination of indicators that is suitable for the activity, sector, country, and time being measured. Choosing the right combination raises many methodological issues and tradeoffs. For example, there is the common problem that "what you see is not always what you get". Laws and regulations enacted may not be enforced. Anti-corruption units may focus on eliminating political opponents. Expatriate advisors may be used not to train counterparts, but to carry out policy formulation and coordination roles, thus sidelining counterparts, who are seen by insecure rulers as potential threats if they know too much. Staff given specialized training may be transferred to assignments where the training is irrelevant for the same reason, thus perpetuating problems of low government effectiveness. Thus, one needs to be careful what one measures, and what inferences are drawn.

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<sup>9</sup> This issue has been explored extensively by the Money Matters Institute, at [www.worldpaper.org](http://www.worldpaper.org)

<sup>10</sup> The section draws from, *inter alia*, "Fostering performance orientation in public administration", in Salvatore Schiavo-Campo and Pachampet Sundaram, *Public Administration and Civil Service in Developing Countries* (Manila: ADB, forthcoming in March 2000).

## Examples of measuring governance in practice

Qualitative reporting can give richness and depth of analysis. It is particularly suitable for measuring outcome and process variables, and may be based on international standards. Here are some examples:

Governance issues studies—International donor agencies carry out these studies to better understand how governance affects their assistance, and to get pointers on how the assistance can better help improve governance in each developing member country (DMC). Since the ADB’s governance policy was approved, governance issues have been analyzed in separate sections of Country Assistance Plans and Country Operational Strategy Studies. In addition, the Bank is selectively carrying out separate governance issues studies in developing member countries, which then become the basis for detailed governance strategies for the countries. A study for Thailand is completed, and posted on the Bank’s website<sup>11</sup>. Other studies are underway in Cambodia, China, Lao PDR, Nepal, Pakistan (a governance issues study team was working in Pakistan during the October 1999 coup), Bangladesh and Vietnam. In addition, a major review of public sector reform in 6 Pacific island countries was completed this year. The World Bank is carrying out comparable “National Institutional Reviews” in selected countries.

Reporting on Fiscal Transparency-- The “Code of Good Practices on Fiscal Transparency” was adopted by the Board of the IMF, in 1998<sup>12</sup>. The Code includes “Requirements for a minimum standard of fiscal transparency”. This minimum standard is far below the standard found in developed countries, but judged to be the minimum necessary for effective functioning of a government. There are four broad requirements covered: clarity of roles and responsibilities, public availability of information, open budget preparation, execution and reporting, and independent assurances of integrity. This minimum standard has provided a useful basis for

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<sup>11</sup> <http://www.adb.org/Work/Governance>

<sup>12</sup> <http://www.imf.org/fiscal/>

both self-diagnosis by countries themselves, and reporting by international donors<sup>13</sup>.

Innovation Awards program-- This provides a competitive opportunity for reporting on governance. The theme of the CAPAM (the Commonwealth Association of Public Administration and Management) International Innovations Awards Program in 1998, was "SERVICE TO THE PUBLIC". CAPAM received 121 submissions to the Program from 24 countries worldwide. The Awards Program was co-sponsored by CAPAM, KPMG, and Binariang a telecommunications company in Malaysia.

Winners included:

1. Education Guarantee Scheme, Rajiv Gandhi Shiksha Mission, State of Madhya Pradesh (India)-- The Scheme was put into operation on 1 January, 1997, and within one year over 16,089 schools have been created, averaging over 40 new schools each day of the year. It has resulted in enrolling nearly 500,000 children.
2. Ontario Delivers - Improving the Delivery of Quality Public Service in Ontario (Canada)-- service delivery changed from paper to electronic service delivery, a "One-Window" approach, attributed by speed, simplicity and borderless transactions.
3. New Pension Delivery Systems (South Africa)-- This new system has enabled the Department of Social Welfare, Free State, to reduce the previous period of three months required to process applications down to as little as two weeks, to provide services 7 days a week, to reduce fraud, to reduce the need for long travel to pay points, and and to increase security at paypoints<sup>14</sup>.

A subsequent competition is being carried out over the period 1999-2000.

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<sup>13</sup> For example, it was used as the basis for country reports by 10 Pacific Island Countries in 1998, and as the basis for part of the ADB's Governance Issues Study for Lao PDR in 1999.

<sup>14</sup> <http://www.comnet.mt/capam/award.html>

In addition to reporting, the use of specific indicators can give numerical precision (although often not as precise as they seem on the surface). In some cases, these tools can allow cross-country comparisons. The example cited earlier<sup>15</sup> combines many performance indicators into six broad clusters, allowing statistical analysis of the relation between governance and economic performance across a range of countries.

Most governance variables are proxies, whether qualitative (e.g. perception of corruption) or quantitative (e.g. percentage of total procurement subject to open, competitive bidding). In the case of the former, subjective values are typically ranked on an ordinal scale. The use of proxies runs a high risk of measurement errors and biased estimates. There is also a common problem that some explanatory variables used in studies are poor proxies for describing actual legal and political processes<sup>16</sup>. A good proxy indicator should be relevant, and permit regular observation and reasonably-objective interpretation to determine the change in its value or status.

Each aspect of governance can be measured in different ways, for different purposes. In the case of corruption, for instance, one can measure the public or experts, perception of corruption, or experiences of corruption (e.g., frequency of bribery in procurement contracts, amount of bribes as a percentage of contract value, frequency of bribery in permit applications, percentage of public sector jobs bought, percentage of public servants income as bribes). Alternatively, one may use costs of public services, costs of construction, assets of leaders, etc. as more indirect (but "harder") proxies of corruption, misgovernance and wastage. A good measurement of corruption can present hard data and generate public debate on the issue of corruption. But corruption is only a symptom of underlying weaknesses in governance. Thus complementary diagnostic (either qualitative or quantitative surveys on governance can potentially identify the underlying causes of corruption. For example, whether a public institution bases its hiring and promotion decisions on meritocracy or favoritism and whether there are auditing and oversight mechanisms in budget allocation may explain the extent of corruption in the institution.

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<sup>15</sup> See note 2

<sup>16</sup> Dethier, *op. cit.*

Diagnostic surveys can also depoliticize the discussion of corruption by shifting public attention from people to institutions<sup>17</sup>.

Here are some examples of uses of specific indicators:

Democracy and Governance Program Indicators: Developed by the US Agency for International Development to measure country and program performance, they are organized under four governance objectives: strengthened rule of law and respect for human rights, more genuine and competitive political processes, increased development of a politically active civil society, and more transparent and accountable governance institutions. Indicators are organized under program “objective” and “intermediate results” being measured. Among the hundreds of indicators listed, one example is: “Judicial salary and benefits as a % of what a comparable professional makes in private practice”. This comes under the first objective, and the intermediate result: “Effective and fair legal institutions”. A suggested guideline is that compensation should ideally be 80-90% of that in private practice. Compensation significantly less than that is a warning flag for rule of law. As with all the indicators, there is an estimate of the cost of obtaining the needed data: in this case, “low” (less than \$500).

This approach stresses the need for cost-effective indicators and tradeoffs. For example, to determine the intermediate result: “improved application of the law in commercial cases”, one could conduct an expert review of sample cases to see if the law had been appropriately applied. A lower-cost proxy indicator would measure “percentage change in the number of commercial cases filed”. The use of this proxy would assume that citizens are more willing to file cases if they think the law will be predictably and fairly applied.

This approach also stresses that indicators be operational: “number of public defenders per 100,000 population”, or “percent change in number of cases handled by public defenders”, rather than “availability of legal services”. Indicators should

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<sup>17</sup> From World-Bank-moderated virtual discussion group on corruption, November 1999.

show the size of the problem when possible: “percent of human rights violations reported investigated/prosecuted” rather than “number of human rights violations reported investigated/prosecuted”. Indicators should measure incremental changes where possible, not just the attainment of thresholds: “percent of civil society organizations showing improvement on an index”, rather than “percent of civil society organizations that have a written strategic plan”. Indicators should also measure the intended result as directly as possible: “percent of citizens understanding basic human rights” rather than “numbers reached by civic education”<sup>18</sup>.

Performance allocation ratings—The World Bank’s International Development Association system is based on a country policy and institutional assessment (CPIA)(80%) and a portfolio performance review (20%). The former is based on ratings on a scale of 1 – 6 of 20 criteria under 4 clusters: economic management, structural policies, policies for reducing inequalities, and public sector management/institutions. Countries whose performance is rated “unsatisfactory” on the governance criteria – criteria from the CPIA and the procurement criterion of the portfolio performance component, are put on a governance watch list. Countries receiving “highly unsatisfactory” ratings on governance criteria have their overall rating cut by a third, called the “governance discount”. A country’s allocation of concessional financing is then calculated through a formula taking into account per capita GNP and the performance rating. The governance criteria of the CPIA are: property rights and rule-based governance, quality of budgetary and financial management, efficiency of resource mobilization, efficiency of public expenditure, and transparency/accountability/corruption in the public sector.

Despite the methodological problems indicated earlier in making cross-country comparisons based on governance indicators, the ADB is currently preparing a similar system. The World Bank is and ADB will adjust the results to take into account special needs of, for example, small (island and landlocked) countries, post-conflict countries, countries facing catastrophes, and countries undertaking

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<sup>18</sup> Center for Democracy and Governance (1998), *Handbook on Democracy and Governance Program Indicators*. Washington: US Agency for International Development.

far-reaching reforms. Both banks are looking for effective means of balancing country-specific and common standardized criteria, and setting the proper balance between measures of effort and measures of results.

Moody's country risk guidelines—These are used as the basis for "sovereign ratings" of a country's creditworthiness, taking into account answers to, *inter alia*, the following questions:

1. Is there a substantial risk of political regime change which could lead to a general repudiation of debts--or a risk of civil war/anarchy or foreign invasion?
2. Does the country have a well-established system of contract law, which allows for successful suits for collection of unpaid debts, seizure of collateral, technical breakdowns?
3. Does the country have a deep financial system which is effective in making payments and avoiding technical breakdowns?
4. Is the regulatory/legal environment malleable, corrupt, unpredictable, etc.?
5. Is there a tendency towards hyperinflation?<sup>19</sup>

The resulting analysis leads to investment ratings for short- and long-term debt. Some examples of current sovereign rankings in the region for long-term debt include both Investment-Grade (Singapore-Aaa, PRC – A3, Hong Kong A1, Malaysia-A3, Philippines-Baa3, Rep. of Korea-Baa1), and and Speculative-Grade (India-Ba2, Indonesia-B3, Pakistan Caa1, Fiji-Ba1, Thailand- Ba1, Papua New Guinea-B1)<sup>20</sup>.

Governance self-assessments – The World Bank in Mozambique and Albania is working with governments to define specific, measurable indicators. The indicators are imperfect, but at least governments and donors are agreeing on an objective set of measures that can be used as a benchmark to check that reform

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<sup>19</sup> “Moody’s Sovereign Ratings: a Ratings Guide” (1999) from website.

<sup>20</sup> All ratings for local-currency debt except for PRC, which is rated for foreign-currency debt. *Moody’s Global Ratings Guide* (1999), pp. 135-7.

programs are really progressing. The anti-corruption plan under discussion for the Balkans region prepared by the EU, OSCE, OECD, World Bank and key countries has this at its heart. If the program is agreed then governments in the region will provide a standard package of data to international observers and to each other - covering various aspects of their civil service arrangements and budgetary processes. This will provide a baseline against which improvements can be measured. Since the data can be verified by any of the donors working in the region, the burden of proof falls squarely on governments to provide accurate figures. Such measures have to be very specific and must be objective if they are to provide incentives for change. There may be, for example, little point in benchmarking government performance by the International Country Risk Guide data and other expert perceptions of bureaucratic quality (however interesting and significant those data might be) as governments might feel that the perceptions of the ICRG experts will not promptly reflect any improvements and so their reform efforts will not be acknowledged<sup>21</sup>.

### **Lessons from work in progress on measuring governance**

Measurement of governance performance over time in a single country is generally more meaningful than measuring performance across countries. Cross-country comparisons are more meaningful when the countries compared are from the same broad category of human and economic development and population size. Cross-country comparisons which group countries into broad clusters are more meaningful than comparisons which rank-order countries. The most useful indicators are clear, relevant, economic, adequate, and monitorable. Such indicators can be helpful for development agencies and private investors if used cautiously.

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<sup>21</sup> Nick Manning, World Bank, from virtual discussion group on anti-corruption, January 2000.