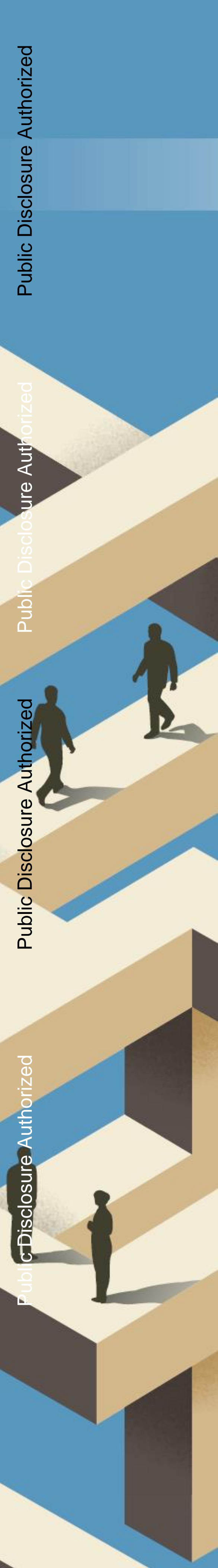

WORLD DEVELOPMENT REPORT 2017

BACKGROUND PAPER

GOVERNANCE *and* THE LAW

Evolution of The World Bank's thinking on Governance

K. Sarwar Lateef

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EVOLUTION OF THE WORLD BANK'S THINKING ON GOVERNANCE

Background Paper for 2017 World Development Report

K. Sarwar Lateef

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Overview

It has been close to 25 years since the World Bank's decision to broaden its public sector management agenda to embrace key issues of governance. This paper traces the evolution of the Bank's thinking on governance through reports that represented its considered views on the subject. The Bank stumbled into addressing governance issues when a 1989 Long Term Perspective Study on Sub Saharan Africa concluded that underlying the region's litany of development problems lay "a crisis of governance". The report's potentially precedent-setting language on African governance provoked the Bank's then General Counsel to issue a Legal Memorandum to its Board of Directors in December 1990 setting out a framework for dealing with this issue "as a prelude to any future analysis of the manner in which the Bank may take it on operationally."

The Legal Memorandum aimed at clarifying what the Bank could or could not do in the area of governance consistent with its mandate as set out in the Articles of Agreement. The Bank, should, inter alia, not be influenced by the political character of a borrowing member, or interfere in its politics. It should not allow political factors to influence its decisions unless these have direct economic effects relevant to its work The Bank, it argued, was free to pursue "good order" in its member countries, by which was meant a system of functioning and effective rules and institutions. The Memorandum suggested that civil service reforms, legal reforms, accountability for public funds and budget discipline would fall within the Bank's mandate.

Bank management on its part issued a discussion paper to the Board in 1991, which set out an approach to governance in the Bank's work. The paper listed three areas for possible engagement beyond public sector management: strengthening public accountability, enhancing predictability and ensuring an adequate legal framework for development. While the paper cleared the way for the Bank to undertake work on governance, it was not until an Annual Meetings speech by the President of the World Bank in 1996 on the "cancer of corruption" that the Bank seriously began thinking about and working on issues of governance.

A series of World Development Reports (WDRs) followed. WDR1997 on the state in a changing world argued that the state should focus its activities to match its capabilities, acting as a partner, catalyst and facilitator of growth and not as a direct provider. This called for reinvigorating public institutions through effective rules and restraints, greater competitive pressures from within the civil service and outside, and increased citizen's voice and participation. The report was widely viewed as moving the Bank towards a more consensual middle-of-the-road position and a corrective to the strong pro-market emphasis of the Bank in the 1980s and early 1990s.

WDR2002 on building institutions for markets provided a diagnostic framework for understanding how institutions support market activity, building on the foundations of WDR1997 and moved more firmly into the realm of institutional economics. Institutions, it argued, performed three critical functions for markets: they channeled information, defined property rights and contracts, and regulated competition. How these three functions worked in practice helped understand institutional gaps. In building institutions for markets, it was important to complement what existed, innovate to suit local conditions and foster open trade and information exchange. The prior existence of supporting institutions and human capital was critical. WDR2002 moved the Bank firmly into institutional economics, recognizing that markets could not function without institutional underpinnings, emphasizing the importance of political institutions and recognizing the critical role of an independent judiciary.

WDR2003 on institutions for sustainable development advanced the Bank's thinking further to embrace institutions that managed environmental and social assets. These were typically underprovided because of externalities, and not always amenable to market solutions. Institutions that restrained the taking of environmental or social assets (through informal norms or formal rules) were intrinsically difficult to bring about. Yet institutions were needed to pick up signals of voice (from citizens, firms, civil society) about environmental and social degradation, balance different interests, and implement decisions. Typically such institutions faced barriers to coordination when trying to organize dispersed interests, forging credible commitments (particularly when the benefits accrued far into the future) and promoting greater inclusiveness.

WDR2004 focused on a central issue of governance: service delivery for the poor, and established an accountability framework that reviewed relationships between clients, providers, and policy makers. The framework was used to discuss weaknesses in each leg of the chain. It argued that the long route of accountability: citizens influencing their elected leaders who in turn influenced service providers faced too many problems: lack of effectiveness of voice and the principal-agent problem between policy makers and providers. The short route of the client-provider relationship, using voice and giving choice among providers to clients was easier. The aim was not to propose a solution but to provide a framework for thinking about service delivery. In this respect it was hugely successful. It demonstrated that service delivery failed poor people, and that throwing money at the problem was not the answer because it would never reach the poor, and therefore it was important to address the incentives facing providers. The authors concede, with the benefit of hindsight, that they should have been clear that the short route was a market route. Had they done so, they would have realized that even markets faced problems in delivering services, as countries that could not deliver services were hardly likely to deliver effective markets

WDR2006 on Equity and Development devoted a chapter to institutions, drawing on historical evidence. The evidence suggested that societies with greater equality of control over assets and incomes tended to have a more equitable distribution of political

power. It emphasized the importance of institutions that underpinned property rights and broad-based investment, and argued that greater political equality led to better economic outcomes. WDR 2011 was devoted to conflict, security and development and the nature and origins of conflict that led to fragile states. Its principal message for the governance agenda in fragile states was to not overload the agenda for states emerging from conflict, but to focus on institutions that resulted in citizen security, justice and jobs.

The evolution of the Bank's thinking from the role of the state to the role of institutions for markets and for sustainable development helped correct the overemphasis on markets in the 1980s and 1990s and brought recognition of the importance of institutions for development and why addressing transaction costs mattered for effective markets. The accountability framework for service delivery was quickly adapted to Bank analytical work on country governance more generally. These were important contributions and enabled the Bank to provide leadership to the development community on governance. The 2003 and 2004 WDRs also put citizens at the center of the development process, a useful corrective from the over emphasis on firms and governments.

Nevertheless the Bank's work has been criticized, with some validity, on three counts. First, while institutions are critical to development outcomes, our understanding of how to build effective institutions is rather limited. We know that institutions take a long time to develop, that they are uniquely endowed by each country's history and culture, and that they cannot easily be transplanted from one society to another or even within the same society over time. This has not stopped the Bank from providing advice on how to build institutions, but this advice tends to offer what one critic describes as "unmodified elements" of institutions in developed country settings into widely diverse developing country situations, with a predictable lack of success. A question not addressed in these criticisms is whether the rapid global economic integration and the communication and IT revolution in developing countries is not resulting in a common global culture more amenable to common solutions and similar institutions.

A second concern is that the Bank's analytical work and its advocacy of good governance tends to ignore the fact that some of the fastest growing economies in the world also rate poorly on governance. It is suggested that the Bank examine these exceptions to better understand why such countries (accounting for a majority of the world's population) have seen rapid growth despite poor governance. Is it possible that, as in Indonesia or Bangladesh, governments did enough to ensure rapid growth and manage public expectations while tolerating high levels of corruption and poor governance?

A third criticism is that Bank work tends to dance gently around the issue of politics, and to recommend technical fixes to problems rather than review the underlying incentives that drive political behavior and address these.
The Bank's thinking on governance, at least in formal published work that reflects the institution's and its Board's considered views, has not progressed much since the middle

of the last decade. In the 25 years since the Bank began to address issues of governance, the world has changed dramatically. On the political side, there has been a major increase in the number of developing countries pursuing electoral democracies. Economic growth in the developing world has accelerated hugely, and the share of the developing world in global GDP has more than doubled to 28%. Developing countries are also much more integrated into the global economy, much more connected by way of media and cellular phones and major users of social media. At the same time there are huge inequalities within the developing world between countries and within countries, and the post "9/11" world is marred by ethnic and religious strife and intolerance and over a billion people live in fragile states. This changed context provides a rich menu for the forthcoming WDR on governance and the law, which will be the first WDR that is exclusively focused on governance.

The Evolution of the World Bank's Thinking on Governance

K. SARWAR LATEEF[1]

I - Introduction

The preparation work for the 2017 World Development Report on Governance and the Law in 2016 will coincide with the 25th anniversary of the World Bank's decision to broaden its ongoing work on public sector management to embrace key issues of governance in the Bank's borrowing countries. This paper provides a broad overview of the major Bank reports on governance that went through a review process at a sufficiently high level in the institution that they can reasonably be described as reflecting the Bank's considered views at the time on the subject. The objective is to review the evolution of the Bank's thinking on governance and assess the relevance and effectiveness of the work and its implications for the forthcoming World Development Report.[2]

Section II of this paper begins with a brief account of how the Bank came to focus on issues of governance, reviewing the major upheaval of governance in many of the Bank's borrowing countries in the 1980s, the legal constraints the Articles of Agreement impose on the Bank's work on governance, and a brief overview of the Bank's initial policy statement on governance issued to the Bank's Board in June 1991. Section III reviews major Bank work on governance as reflected in successive World Development Reports and examines the Bank's analysis of the issue of corruption, reviewing how the Bank's thinking on this symptom of poor governance has evolved. Section IV steps back to assess what the Bank got right and some of the issues it missed or failed to address adequately. Section V draws attention to the dramatic changes experienced by the developing world in these past 25 years, and points to the need to better understand the implications of these changes for the governance context facing developing countries.

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[1] The author specializes on issues of governance and development. As a staff member, and retiree, he has been involved in the Bank's work on governance on the operations side. He also led the Governance Task force that initiated the Bank's work on governance in 1990. The views expressed here are the author's and do not represent the views of the World Bank.

[2] This paper will not attempt to assess the impact this analytical work has had on the Bank's operational policy in terms of what is reflected in the Bank's formal Board-approved governance and anti-corruption strategies, or to assess how this has translated into the design and approach to the Bank's country level lending and analytical work. Also excluded from the purview of this paper are the Bank's governance data products (the World Governance Indicators, the Doing Business Indicators, etc.) although these are often the most cited of the Bank's governance work.

II – How the Bank Came to Focus on Issues of Governance

A. Context

On June 25, 1991, the World Bank issued a discussion paper to its Board of Directors, entitled "Managing Development - the Governance Dimension", which was subsequently discussed at a meeting of the Bank's Board (World Bank, 1991). The paper was the first formal policy statement by Bank management outlining its intention to broaden its analytical and lending work to incorporate selected issues of governance in its ongoing work on issues of public sector management. The decision came after a decade of deceleration of growth in the 1980s and worsening terms of trade for developing countries had contributed to a severe deterioration in their governance and major political upheavals in many parts of the developing world. Military dictatorships gave way to democracy in Latin America with as many as 28 countries categorized as democracies by 1990, including most of the major countries. Dictatorships also collapsed in Korea and the Philippines. The communist governments in Eastern Europe succumbed to this wave of democracy, and in 1989, the Berlin Wall fell, leading to the reunification of Germany.

The release of Nelson Mandela after 27 years in prison in early 1990 marked the beginning of a period of democratization in Sub-Saharan Africa. Just a year earlier, the Africa Region had prepared a Long Term Perspective Study entitled From Crisis to Sustainable Growth" (World Bank, 1989). The report focused on the major economic crisis facing the region. Growth since 1961, at 3.4 per cent a year for the region as whole, had barely kept pace with population growth. Sub-Saharan Africa's population had doubled since independence to 450 million people, while the sub-continent's GDP at $135 billion was about that of Belgium, a country of 10 million inhabitants. Weak agricultural growth, declining industrial output, poor export performance, climbing debt and deteriorating social indicators added up to a serious crisis, requiring, in the Bank's view, a major reversal of the policies and institutions that had brought about this state of affairs (Op. cit. p.2) When an initial draft report with the Bank's prescriptions for change was discussed in the region with African leaders and thinkers, the authors received a strong message that they had neglected the principal issue facing the region: that of poor governance, and its neglect in the report would negate its value.

To their credit, the authors took this criticism to heart and the final version integrated issues of governance into the report, and contained some blunt language on governance, breaking the Bank's tradition of keeping away from politics, consistent with its Articles of Agreement. "Underlying the litany of Africa's development problems" the report argued, is a crisis of governance." Defining governance as "the exercise of political power to manage a nation's affairs", the report argued that in the absence of "countervailing power", "state officials in many countries had served their own interests without fear of being called to account". In self-defense, individuals rather than taking on an all-powerful state, built up their own personal interests. Thus politics became "personalized" and "patronage became essential to maintain power. This broad discretionary authority led to loss of legitimacy. Information was controlled and civil society was "coopted or disbanded". The state became "coercive and arbitrary". Citing Botswana, one of four countries in Sub-Saharan Africa that had adopted a democratic path[3], the Report called for a systematic effort "to build a pluralistic institutional structure, a

[3] Freedom House identified four countries in Sub-Saharan Africa in 1990 as democracies: Botswana, the Gambia (which later ceased to be so qualified), Mauritius, and Namibia) all rather small countries.

determination to respect the rule of law and vigorous protection of the freedom of the press and human rights" (op. cit., p60-61).

After spelling out the nature of reforms needed to remedy the situation (structural adjustment to make Africa more competitive, stability in policies, human resource development, building capacity including a "drastic" overhaul of public administration, enforcement of the rule of law, etc.), the report called for political renewal (op. cit., p192):

"*Failure of governance has become so commonplace that expectations are low. Yet there is an evident popularly felt need for renewal – bordering on desperation – that is widely expressed".*

The report then pointed to donor policies:

"The willingness of the donor community to tolerate impropriety – by failing to insist on scrupulous conduct by their own suppliers, by not ensuring that funds are properly used, by overlooking inadequate accounting and auditing, and by generally lax procurement procedures – aggravates the malaise. Everyone avowedly deplores the situation and wishes it were otherwise. But it will not be so until accountability is instituted."

This rather frank discussion of African governance was, to say the least, unprecedented for a Bank report. That the report covered the region as a whole rather than individual countries made the authors' task somewhat easier, but it is still difficult to think of another region in which the Bank was active that would have tolerated such an open discussion of its governance. The discussion, though, was precedent setting and opened the door to similar reviews of country or regional governance.

The President of the Bank in his foreword to the report defined good governance more narrowly than the Report itself, in terms of "a public service that is efficient, a judicial system that is reliable and an administration that is accountable to its public". He also made it clear that the Long Term Perspective Study was a report prepared by Bank staff, and "did not necessarily reflect the views of the Board of Directors or the governments they represent."

B – Legal Constraints on the Bank's Work on Governance[4]

The Africa report provoked the Bank's then General Counsel, Ibrahim Shihata, to issue a legal memorandum to the Bank's Board of Directors on "Issues of "governance" in Borrowing Members – the Extent of their relevance under the Bank's Articles of Agreement" (World Bank, 1990b). The objective of this memorandum was, in the words of the General Counsel in his introduction to the discussion at the Board, to provide "a legally acceptable framework for handling this issue and to caution against error in an extremely delicate area for the Bank and its members."(Shihata, 1991)

The memorandum noted that political stability and sound economic management had long been recognized in the literature of the Bank and elsewhere as a basic prerequisite for development. However the Bank had deemed political considerations to be irrelevant to its operations, "in

[4] The author is grateful to Andres Rigo, former Deputy General Counsel of the World Bank for detailed comments on this section.

compliance with explicit provisions in its Articles of Agreement that prohibit it from taking such issues into account in its decisions" (World Bank, 1990b, ibid, p.248). The paper argued that the Bank's increasing concern with issues of governance in its borrowing members "seems to have come as a logical step in its gradually expanding involvement in policy reform through adjustment lending."

Noting that this concern had evoked "considerable interest and controversy among Bank staff with some opinions concluding that the 'time had come for the Bank to take on the issue of governance head on', and others cautioning that 'the strength and credibility of the Bank lies in its political status as a quintessential technocracy…. whose exclusive concern is with economic efficiency', the General Counsel felt that before the debate went any further he needed to establish the 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" (op. cit, p.249). This reference to any future analysis was not hypothetical. The then Policy, Research and External Affairs Vice Presidency, anticipating the General Counsel's memorandum, had established a task force on Governance to prepare a discussion paper on what the Bank might take on in its operational work beyond its traditional focus on public sector management. The General Counsel's paper was aimed at ensuring that whatever actions were proposed by this task force would be within the Bank's mandate, as defined in its Articles of Agreement.

The General Counsel saw the Africa report as the first of three factors that were pushing the envelope on governance. The second was the establishment of the European Bank for Reconstruction and Development whose charter included the frankly political objective of helping Central and East European countries to "evolve from their previous one party political systems of command economies to a system based on free market economies and multiparty democracy" (op. cit. p251). The third was what he described as the gradual expansion of structural adjustment lending to cover sectors and to "take measures that enhance government implementation capabilities and to what the Report on Adjustment Lending (RAL-II)[5] called the 'political economy of adjustment' " (op. cit., p.252). The General Counsel noted the escalation of conditionality in adjustment operations, the addition to the Bank's instruments of sector adjustment loans, the increased awareness of the political context of structural reforms, and the RAL II report's view that while the Bank must vigorously avoid interfering in politics, the cost of failure was too great for the borrowing countries and the Bank to "ignore the potential contribution of a better understanding of the reality of the political economy of adjustment". The General Counsel concluded this discussion with the concern that motivated his intervention:

"While none of the above suggests that the Bank has a mandate to introduce political reform or to question the political form of the government it purports to assist, perceptions, coupled at times with vague statements, within and outside the Bank, have tended to give the impression that all issues of governance in borrowing countries may have become part and parcel of the Bank's concern, if not its direct business" (op. cit., p254).

The Memorandum set out the Bank's authorized purposes, as listed in the Articles of Agreement, the prohibition of political activities in the Articles of Agreement, and recognized that distinctions between "political" and "economic" were intrinsically difficult. It argued that

[5] *Report on Adjustment Lending II, Policies for the Recovery of Growth*, as cited in the General Counsel's Memorandum

there were some political considerations of "possible relevance" due to their economic effect or binding international obligations. Thus, for example, the Bank by necessity had to take account of political instability in member countries that would have an adverse effect on the borrowers' ability to fulfill its commitments under loan agreements or its standing in global financial markets. The Bank was also bound, by virtue of its Relationship Agreement with the UN, to pay due regard to Security Council resolutions.

The Memorandum then interpreted the Bank's mandate in relation to governance in borrowing member countries. Governance was defined as "the manner in which a community is managed and directed, including the making and administration of policy in matters of political control as well as in such economic issues that may be relevant to the management of a community's resources" (op. cit., p.268). Arguing that governance straddles both a political and an economic meaning, and that the political agenda of governance had a strong economic content while the economic agenda of governance had political implications, it was difficult to draw a clear distinction between the two. So it was important to be clear about what the Bank could or could not do. The Bank's purpose, the General Counsel argued, was "not to substitute itself for the peoples and governments of its borrowing member countries in deciding how these countries are to be governed." Nor should it be involved in political reform in borrowing countries, "however badly needed such reform may be".

Staff needed to focus on issues of governance that could be taken up in dialogue with the government. The Memorandum, however, noted that the Bank was free to acquire knowledge of the political situation in borrowing countries and "to gain insight on the underlying social and cultural factors behind such a situation". Acquiring such knowledge was not only "legitimate, but also essential for the Bank's ability to provide useful advice on policy reform in economic and social sectors". Without such knowledge, the Bank's assessment of the feasibility and effects of the advice it offered "may be grossly distorted". Such knowledge needed to be acquired without staff "becoming involved in the partisan politics of the country, and without interfering or seeming to interfere in the "political affairs of its members" (op. cit., p.269-270).

The General Counsel saw the Memorandum as a means of enabling Executive Directors to "agree on ways in which the Bank may address certain aspects of governance" without having to amend the Articles of Agreement or to violate them. It first listed aspects of governance that were beyond the Bank's mandate:

- The Bank should not be influenced in its decisions by the "political character" of the borrowing member;
- The Bank should not interfere in the domestic or foreign partisan politics of any member;
- The Bank, when coordinating foreign assistance for a given country, should not act on behalf of donor countries in influencing the member country's political orientation or behavior;
- The Bank should not allow political factors or events to influence its decisions unless "these have direct and obvious economic effects relevant to its work;"(op. cit., p271)
- The staff member should not build their assessment on the "possible reaction of any member country."(op. cit., p.272)

The "don'ts" list appears partly to ensure that Bank staff not compromise the Bank's reputation as an international organization of a non-political character, but also partly to warn against staff being overly influenced by the views of the Bank's major shareholders or by those shareholders' bilateral relations with the country concerned.

Any reader of the Memorandum up to this point would be forgiven for concluding that the General Counsel was about to be fairly restrictive on what was within the Bank's mandate. But his preamble to the list of things which he regarded as within the Bank's mandate began by emphasizing the pursuit of "good order", not in the sense of having "law and order" but in a "system of rules and institutions" that is "reflected in the concept of the rule of law".

"*Concern for rules and institutions is particularly relevant to a financial institution which at present does not only finance projects but is also deeply involved in the process of economic reform carried out by its members. Reform policies cannot be effective in the absence of a system, which translates them into workable rules and makes sure they are complied with. Such a system assumes that a) there is a set of rules which are known in advance, b) such rules are actually in force, c) mechanisms exist to ensure the application of the rules and to allow for departure from them, as needed, according to established procedures, d) conflicts in the application of the rules can be resolved through binding decisions of an independent judicial or arbitral body and e) there are know procedures for amending the rules when they no longer serve their purpose"* (op. cit., p. 273).

While this is not surprising, coming as it does from a Harvard PhD, he resisted pointing out in the subsequent discussion that most developing countries would fail this test of enforcing the rule of law. But he encouraged multi-disciplinary studies on rules and institutions if the Bank is to give "the issue of governance adequate attention".

He listed examples of issues of governance relevant to the Bank's work: civil service reform, legal reform, accountability for public funds, and budget discipline. He did not rule out "other issues of a similar character" which should be considered on their merits, but cautioned against one particular cause of the day: pressure from NGOs on the Bank to encourage popular participation in decision-making. While he saw the importance of such participation, he drew the line at the Bank advocating any particular political system or form of government.

The General Counsel's Memorandum was discussed by Executive Directors on April 11, 1991 and broadly accepted.

C - The Bank's First Policy Statement on Governance

In light of the General Counsel's Legal Memorandum on governance for the Board's review, the Bank's Senior Management decided that the Bank needed to articulate a clear policy on its work on governance. A governance task force was established drawing on 31 senior staff from the Operations, Legal, Policy Research and External Affairs, Corporate Planning and Budget, and Finance complexes to prepare a brief discussion paper for the Board. (World Bank, 1991) [6] The purpose of the discussion paper was to review "issues of governance that lie within the Bank's mandate"(op. cit., p.i), defining major concepts and surveying Bank experience, focusing on issues beyond the Bank's traditional focus on public sector management, on which a parallel paper was issued. The Board was, in effect being alerted to the inclusion of a broader set of issues of governance in the Bank's development agenda. The participation of senior staff from the Legal Department in the core group that drafted the paper was a signal that what was being proposed was within the framework of the Bank's Articles of Agreement.

The paper reviewed the deterioration in governance in the developing world over the past decade and acknowledged the legal constraints facing the Bank's work in this area. Defining governance "for Bank purposes" as the "manner in which power is exercised in the management of a country's economic and social resources for development" (op. cit., p.1), the paper identified three aspects of governance: (i) the form of political regime (parliamentary or presidential, military or civilian, authoritarian or democratic), (ii) the processes by which authority is exercised in the management of a country's economic and social resources and (iii) the capacity of governments to design, formulate, and implement policies and discharge government functions, noting that the first of these fell outside the Bank's mandate.

The paper argued that "only governments can provide two sorts of public goods: rules to make markets work efficiently, and in some cases, corrective interventions, where there are market failures" (Op. cit., p3). Citing Eggertson, it argued that 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. This was because "transaction costs", defined as the cost of "arranging, a contract ex ante, and monitoring and enforcing it, ex post" would inhibit such activities (Eggertson, 1990:p.14, citing Matthews, 1986:p .906).

To address market failures in education, health and essential infrastructure, essential to stimulate private investment and growth, the state needed to tax citizens. This in turn required "accountability within government and from the government to those to whom it delivers services". The paper also emphasized the importance of information flows, without which the rules were not known and accountability was low.

The paper drew on the work of Douglass North to define institutions as "the rules of the game in a society" (North, 1990), and stressed that these would vary hugely between countries, based on cultural and historical traditions. It also warned that mature institutional frameworks took time to develop, and that there was no guarantee that such arrangements would be supportive of economic growth and poverty reduction. Predatory behavior by the state often hindered

[6] The Board paper was followed a few months later by a booklet that produced a more popular version, drawing on a wider body of work (World Bank, 1992). This paper discusses the Board version.

property rights and led to corruption. The authors warned that the concepts discussed in the paper had different meanings in different cultures. The spread of political and legal systems modeled on Western societies and 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'. (World Bank, 1991, ibid. p.5)

While taxonomies were seen as misleading, given the unique imprint of history, geography and culture on each country's institutions, poor governance was easy to recognize, the paper argued listing such characteristics as the failure to make a clear separation between public and private, and to establish a predictable framework of law and government behavior, excessive rules designed to permit rent seeking, misallocation of resources and non-transparent decision making. Poor governance, the paper argued, led to reduced legitimacy and the capture of resources meant for the poor by elites. Pervasive corruption was particularly damaging to development as was a high concentration of political power, and high defense spending in support of large standing armies bequeathed by colonial rule, often resulting in military coups.

The paper then identified four key areas of governance that were of relevance to the Bank's work: improving public sector management, accountability, predictability and the legal framework, and information and transparency. The focus in the paper was on the last three, although none of these were entirely new to the Bank's work, given that the Bank's mandate was seen as coming from its principal role of economic development.

Accountability was defined as "holding public officials responsible for their actions" (op. cit., p.8). But from the point of view of managing development, it was seen as the congruence between public policy and its implementation, and the allocation and use of public resources, i.e., economic and financial accountability. The Bank's experience in these areas was reviewed, including its experience with decentralization. The new emphasis was on micro-level accountability through competition and opportunities for "exit" through deregulation and contracting out of services, and "voice" through dissemination of information on service provision, and popular participation in project design and execution.

Predictability was defined, citing Brautigam (Brautigam, 1991, and World Bank 1991, ibid. p. 10), as "standard operating procedures, institutionalized rules, non-personalized decision making and modest levels of discretion and regularized procedures for establishing and implementing policies". The Bank's concern here was to help governments establish "a minimum level of predictability".

The Legal Framework for Development (op. cit. p10-11) was inspired by the Legal Memorandum of the General Counsel, emphasizing, as noted above, the need for a consistent set of rules known in advance, which are actually in force, and applied in a flexible way but subject to systems of review, and known procedures for amending the rules when they no longer serve their purpose. The paper also emphasized that conflicts must be resolved "through binding decisions or an independent judicial body or through arbitration". The paper noted that this was already a line of business being developed in the Bank (and one, with the benefit of hindsight, which has proved to be somewhat problematic.)

Information and transparency: The paper stressed the importance of information and transparency for the smooth function of markets, and transparency of decision making as a safeguard against corruption. Competition and deregulation in turn were seen as a safeguard against corruption, as were donor policies to discourage corruption in programs they supported and through fair trade practices. The availability of information and transparency lowered transaction cost, but would not bring about greater accountability unless such information was widely analyzed and disseminated including through the mass media.

One of the paper's principal contributions was to bring many of these concepts of governance into the Bank's general vocabulary, and to introduce notions of transaction costs. The "governance" word itself was relatively little used at the time, and Mr. Shihata's memorandum to the Board in a footnote cites Webster's Ninth New Collegiate Dictionary[7], to say that "the word "government" may be considered "to have superseded governance " and Fowler's 1965 dictionary of modern English usage, which states that "governance has now the dignity of archaism"! That trend was sharply reversed and governance today is in wide usage including in the developing world.

While the paper drew on the knowledge of the Bank, it was not based on a major piece of analytical work that underpinned its analysis. It therefore opened itself to criticism[8] on a lack of clarity about which countries were being targeted in the paper, and for conveying a sense that the lessons it drew applied to all developing countries. The East Asian experience "appears to have been largely ignored", this critic argued. The paper was also criticized for the opaqueness it brought to the concept of accountability, with no mention of the principal-agent problem and how it manifests itself in developing country contexts. The rule of law discussion was seen as "unsatisfactory", with a lot of issues not examined, such as the potential costs of law and legal processes, and whether adversarial systems were necessarily the best. Despite the paper's repeated emphasis on the multi-cultural-historical traditions prevailing in the Bank's member states, it was suggested, not unfairly, that it reflected the "current dominant Anglo-American liberal pluralist socio-political doctrine".

[7] World Bank, 1990, see footnote 88

[8] A particularly interesting and useful critique, almost as long in length as the paper it criticized, was that of Mick Moore. While he pronounced the paper as one in which "a great deal is valuable", he concentrated on its limitations. (Moore, 1993)

III - Governance in the Bank's Flagship Publications

A – An Overview

A London newspaper quoted Mr. Lewis T. Preston, the then President of the World Bank, as saying that the Bank had a "flavor of the month syndrome"[9]. It did appear for a while that the Bank viewed governance as flavor of the month, and went about its daily business, having ticked off the governance box. On the occasion of the Bank's 50th anniversary, a short strategy statement noted that the Bank was "increasingly aware that the sustainability of economic reforms depends on strengthened and better managed public institutions, and more generally on good governance" (World Bank, 1994, p.26). It then reiterated the pledge in "Managing Development: The Governance Dimension" to work with countries to "support institutional development and capacity building, place greater emphasis on the legal framework for development and judicial, civil service and public enterprise reforms, and work with borrowers to improve governance". But there was no attempt to follow up the 1991 report with a substantive analytical product till 1996.

The issue came back on the Bank's agenda following a speech by James D. Wolfensohn, who became President in 1995, at the 1996 Annual Meetings. Mr.Wolfensohn said on that occasion:

"And let's not mince words: we need to deal with the cancer of corruption. In country after country, it is the people who are demanding action on this issue. They know that corruption diverts resources from the poor to the rich, increases the cost of running businesses, distorts public expenditures, and deters foreign investors. They also know that it erodes the constituency for aid programs and humanitarian relief. And we all know that it is a major barrier to sound and equitable development (Wolfensohn, 1996).

The speech was prepared in consultation with a World Development Report (WDR) team that was working on the 1997 WDR on the role of the State. This report focused on public sector management and eschewed the use of the word "governance" because the authors felt that it would invite unnecessary debate on issues that they could and did address under the rubric of "The Changing Role of the State". The next WDR to address the issue of governance comprehensively came in 2002, entitled "Building Institutions for Markets". The 2003 WDR on "Sustainable Development in a Dynamic World" addressed issues of institutions for sustainable development as a crosscutting theme. The 2004 WDR focused on the important governance issue of service delivery. The 2006 WDR on equity devoted a chapter to the history of institutions. The 2011 WDR on fragile states dealt with governance issues in failing states. The 2017 WDR will, however, carry the distinction of being the first WDR the Bank has undertaken which comprehensively and exclusively addresses issues of governance and the law.

This section will bring out the main messages of these past WDRs. It will also focus on other analytical work relating to corruption that in part reflected the World Bank's increased emphasis on corruption following the Wolfensohn "cancer of corruption" speech.

[9] The quote appeared in the Independent on Sunday (London) May 10, 1992, cited in Williams, David, and Tom Young, 1994

B – The State in a Changing World – WDR 1997

The 1997 WDR was devoted to the "role and effectiveness of the state: what the state should do, how it should do it and how it can do it better in a rapidly changing world" (World Bank, 1997:p.iii). The messages reflected what have become the main pillars of the Bank's main business in public sector management. The state, the report argued, should focus its activities to match its capabilities. It provided a useful list of state functions, distinguishing between minimal, intermediate and activist. The state should also reinvigorate public institutions: ensure adequate incentives to public officials and adequate restraints to check corruption and arbitrary behavior. By focusing on the State's role as "partner, catalyst and facilitator" of economic growth, and not as a direct provider, its functions could become more manageable.

The report took an optimistic view of the positive effects of the changing context arising from the global integration of economies and the spread of democracy, arguing that it narrowed the scope for "arbitrary and capricious behavior". Formal rules pertaining to taxation, investment and economic policies had to be responsive to a globalized economy. Both citizens and markets increasingly demanded transparency in the conduct of governments and effectiveness in service delivery. The report called for an increased role for the private sector even in areas like household insecurity, and for greater privatization. Effective regulation, it argued, was needed to ensure better market outcomes.

All this called for reinvigorating state institutions. This required "addressing a host of underlying behavioral factors that distort incentives and ultimately lead to poor outcomes". The report lists three basic incentive mechanisms:

- Effective rules and restraints (checks and balances through separation of powers), reducing discretion, better oversight of officials)
- Greater competitive pressures (boosting competition within the civil service, competitive salaries, and exit options through competition in the provision of public goods and services)
- Increased citizens' voice in policymaking, participation in decision-making, and project implementation, and ensuring that decentralization of powers manages downside risks.

While some of the messages echoed the Bank's traditional recipes in this area, underlying these broad conclusions was a fairly detailed analysis in each of these areas. The penultimate Chapter (Chapter 9) carried an analysis of political economy considerations that resulted in resistance to reform, the importance of understanding the redistribution of resources arising from reforms and of undertaking a political cost-benefit analysis of reforms, the pros and cons of different political regimes, an analysis of when and why countries reformed and what it took to implement and sustain reforms. There was also a prescient discussion of fragile states. The report emphasized the critical role of leadership and vision in the reform process.

The report was widely viewed as one which moved the World Bank "to a more consensual,

middle-of-the-road position" from a "state-skeptical to a state-friendly stance."[10] The Guardian newspaper described this as a "Sudden U-turn by the World Bank". This was an overstatement. The Bank was not urging a return to a role for the State that was associated with the immediate post-Independence period, a regime of controls and public ownership. The authors were rather calling for a corrective to the strong pro-market emphasis of the 1980s that was seen as contributing to the crisis in the developing world. The idea of matching role to capability was seen as an "influential public idea", but one that potentially invited skepticism about the ability of the state. Critics argued that markets were just as likely to be imperfect and fragile in developing country contexts. Could there be a vicious circle of decline if the state withdrew in conditions where markets were fragile?

The report was also seen as causing the Bank to cease to be a proponent of the New Political Economy (NPE) and moving towards the New Institutional Economics (Moore, 1998). While the NPE was deployed in the WDR (particularly in Chapter 9), the report recognized the importance of transaction costs and the institutional arrangements needed to help lower transaction costs such as an effective judiciary, the credibility of government policies and rules, etc.:

"Although WDR is theoretically and conceptually eclectic, institutionalism and NIE comprise the most prominent single perspective…and provide a benign, state friendly perspective that contrasts markedly with the state-scepticism of the New Political Economy" (Allison and Moore, 1998, p.42)

The Report was criticized for not paying sufficient attention to the international dimensions of governance in poor countries. While the Report's criticism of donor policies was welcomed, it was felt that it fell short of evaluating the effect of international pressures coming from large corporates and multinationals on domestic policies, and the corruption of leaders. Governance problems, the Report seemed to suggest, were primarily domestic problems. Another critic saw the report as saying that state institutions should be purged of politics. "Politics in this view distorts, even perverts, noble objectives…politics in short is a large part of the problem and certainly not part of the solution…. Politics is part of the problem, for sure. But it must be part of the solution."

Nevertheless, the framework provided by this report for evaluating the role of the state and matching this role to capability has stood the test of time and has informed the Bank's work on public sector management over the past two decades.

C - Building Institutions for Markets - WDR 2002

WDR2002 (World Bank, 2002) built on the foundations of WDR1997, devoting itself to providing "a diagnostic framework for understanding how institutions support market activity". The report drew on the available evidence on the role of institutions and development. It attempted to extend previous empirical work on institutional change and present a framework for

[10] Alison and Moore, 1998. These comments are drawn from an issue of IDS Bulletin (Vol. 29, Number 2, April 1998) devoted to WDR1997. The contributors were members of a European Policy Forum on the role of government in development that was held at the Institute of Development Studies, Sussex on 17-18 September 1997 comprising heads of bilateral agencies, representatives from NGOs and two developing countries, and academics. Ajay Chibber who led the WDR team and Alison Evans from the Bank participated in the Forum. The WDR1997 Overview was reproduced in this publication.

institutional change that could actually be used in "today's world". It cautioned that building institutions took time, and emphasized the importance of history, norms and culture.

Displaying the growing influence of institutional economics on the Bank, the report defined institutions as "rules, enforcement mechanisms and organizations" (op. cit., p.6). The rules, including behavioral norms, enabled agents to interact. Rules could be formal, written into law and codified, or informal, unwritten rules of social conduct. Organizations implemented rules and codes of conduct to achieve desired outcomes. The report distinguished between institutions and policies, (goals and desired outcomes). Policies enabled institutions to evolve, but institutions influenced which policies were adopted.

Institutions, the report explained, performed three functions: they channeled information, defined property rights and contracts, and increased or decreased competition in markets. Effective institutions reduced transaction costs. Analyzing how these three functions worked in practice helped understand the institutional gap. The report first discussed how effective institutions were built, noting the complexity of the task and that one size does not fit all, but country-experience mattered. Institutional change was a step-by-step process, it argued. It recognized the difficulty of reforming due to resistance from constituencies that benefitted from existing arrangements, and because those who would benefit did not argue for change, or were not sufficiently organized to do so. But it suggested optimistically that such reforms were not difficult to implement, and once implemented, would make markets work better. It acknowledged that the sequencing of institutional reform in the sense of which institutions should come first was not clear from development experience, and sometimes some institutions could only come about when complementary or supporting institutions were already in place. It acknowledged the important role of national and international actors. Effective markets required a strong and capable state, while corrupt states could impede market development.

The report carried a useful discussion on the interaction between formal and informal institutions, and the importance of the latter in poorer countries. Innovative designs could help bridge the gap between these, including simplification of formal institutions catering to markets, providing more information about them and increasing their accessibility.

The report drew four main lessons for institution building: Effective institution building required policy makers to "complement what exists, innovate to suit local conditions, foster open trade and open information exchange and foster competition among regions" (op. cit., p.26). The prior existence of supporting institutions and the availability of human capital were critical. If these were weak it was important to keep institutional design simple, and streamline existing regulation. Providing opportunities for trade encouraged market development. Competition among firms or regions created demand for better institutions and improved existing ones.

The report looked in turn at firms, government, and society. In the section on government, Chapters 5 through 8 dealt with institutions that affected markets.

Chapter 5 on political institutions and governance argued that the ability of the state to provide institutions that supported growth and poverty reduction "often referred to as good governance" was essential to development. Political institutions were critical to restraining arbitrary behavior of officials. While there was no blueprint for change, the incentives facing public officials mattered. It warned against an excessive faith in decentralization, or greater

autonomy for regulatory bodies, when the complementary social and political checks and balances were not in place. It advocated a degree of experimentation and competition as a way to identify effective political institutions, both at the regional and local levels.

Chapter 6 emphasized the importance of judicial systems in resolving disputes. Judicial systems, it argued, needed to balance swift and affordable justice with fair resolution. Judicial reforms were typically politically difficult. They were also complex, involving fair wages, promotions, procedural law, substantive law, and the capacity of lawyers and judges. Judicial institutions tended to work as systems, and reform could begin modestly and build up. A key priority was to build accountability and transparency of judges. Simplification of legal procedures yielded high returns. Judicial independence combined with checks and balances and social accountability (through civil society watchdogs and media) was essential to any reform process.

Chapter 7 covered well-trodden ground discussing institutions that promoted competition. It argued that barriers to competition often arose from public policy such as onerous regulations for new entrants or exit barriers. These discriminated against poorer or small entrepreneurs. While many countries had adopted competition laws and competition authorities, it was important that these usually weakly staffed organizations focused on a few key areas, such as exclusive supply or distribution contracts.

Chapter 8 dealt with regulation of infrastructure, focusing in particular on private provision of public infrastructure. It stressed the importance of strong regulatory agencies and argued that small poor countries should attempt to share such agencies with neighbors. Pre-privatization restructuring of the sector and post-privatization monitoring through accounting were important. Information flows among regulators, the regulated and consumers was essential for effective service provision. Encouraging low technology, informal providers and modifying regulations to permit these could be important in poor countries. Subsidies needed to be transparent, and while difficult, targeting was important.

WDR2002 constituted an advance on the Bank's thinking on governance issues in two senses. First, it embraced institutional economics more openly than WDR1997 and reflected the prevailing view of the importance of institutions to the development process, and consistent with current thinking in this area. Second, it dealt with political issues much more directly, emphasizing the importance of political institutions. It also for the first time, devoted attention to the importance of judicial systems, although the focus was on commercial law, using some interesting cross-country surveys. One survey focused on the difficulties of implementing judicial decisions, but the chapter skirted clear of a discussion of the government's contribution to the judicial system through enforcement processes, an independent prosecutorial function, and an effective police force. Prosecution of white-collar crimes requires expertise often lacking in many developing country police departments. While institutions clearly matter, WDR 2002, like its predecessor is open to the criticism that our understanding of how institutions get created is still rather weak. (See Section IV).

D - Institutions for Sustainable Development WDR 2003

While WDR 2002 focused on building institutions for markets, WDR 2003, looked at the

challenge of building institutions that support sustainable development by helping manage environmental and social assets (World Bank, 2003). This Section focuses on the Chapter in WDR 2003 that looks at institutions for sustainable development. The chapters that follow apply this analysis to agriculture in fragile lands, commercial agriculture and the management of cities.

WDR2003 begins with the premise that sustained growth in developing countries is essential for poverty reduction. But past patterns of growth have "generated costs that are not sustainable". These problems were manifested in eco-systems as well as in where people lived. It argued that environmental and social assets matter for wellbeing and productivity but were "underprovided because of externalities". While these sometimes lend themselves to market solutions, problems that cannot be solved by markets required institutional solutions. Institutions needed to "protect people and a broad portfolio of assets" and manage the major changes unfolding in the first half of the 21st century: urbanization, technological innovation, growth, and social values, "changing scarcities for environmental and natural assets". This called for institutions that were both stable and adaptive to change.

WDR2003 defined institutions as "the rules and organizations, including informal norms that coordinate human behavior" (Op. cit., p.37). Informal institutions ranged from trust and other forms of social capital to informal networks and other mechanisms needed for coordination. Formal institutions included codified rules, laws, procedures and organizations. WDR2002 looked at human made assets and markets. WDR2003 "builds on that foundation but expands the discussion to aspects of well-being that are not limited to income or easily amenable to markets, including services from environmental, natural and social assets." (Op. cit., p.39)

The basic premise of the report is that institutions that restrain the taking of assets – whether through informal norms or formal rules that include the threat of punishment – were essential for assets to thrive. If a forest was to provide sustained benefits, it had to be protected against the pressures that arose from population density, changes in technology or people's preferences. Such institutions were not easy to bring about. The WDR, like its predecessors, cited evidence of a strong link between good institutions and per capita income. Yet collective action problems made it difficult to create such institutions often because their benefits flowed in the long term.

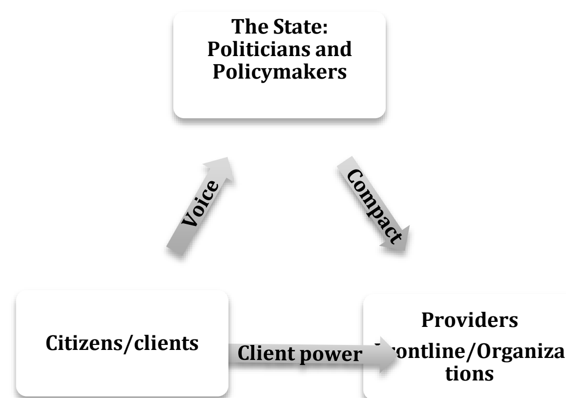
WDR2003 listed three functions that a good institutional environment for sustainable development must perform: (i) pick up signals: signals of social and environmental degradation, and of voice (citizens, firms, civil society). (ii) balance different interests: a tax or an emission standards will affect different interest groups differently, but interests are often dispersed making these difficult to organize or be heard; and (iii) implement decisions. Implementation could be thwarted in many ways, and also reflected the capacity of institutions to be effective.

The report identified three barriers to coordination: *organizing dispersed interests* (coming together to build a school takes more coordination than building individual homes); *forging credible commitments* (when the benefits were far into the future); and *promoting greater inclusiveness*. When institutions became more inclusive, more people "are given protection, voice and support". Citing historical studies, it argued that high levels of inequality and deprivation were harmful to efficiency and growth. "The presence or absence of inclusiveness in institutions and in access to assets tends to have long lasting effects." (Op. cit., p.53)

Thus, WDR 2003 nicely complemented and built on the foundations of WDR2002, emphasizing the importance of institutions to manage environmental and social assets that typically did not lend themselves to market situations. The integration of social capital into the analysis enriched the discussion of informal institutions. The focus on coordination problems helped enrich understanding of the issues confronting many sectors. Its emphasis on the problems posed by inequality remains highly relevant today.

E - Making Services Work for Poor People WDR 2004:

WDR2004 addressed service delivery, a central issue in governance (World Bank, 2004) using a triangular framework of relationships between "clients, providers and policy makers". The focus was on poor people as clients, but the analogy applied to citizens, as a whole. Clients as citizens empowered politicians and policy makers (in democracies by voting for them); policy makers (politicians) in turn undertook to provide services for them so they influenced providers of goods and services needed by citizens. The providers in turn served clients.



The framework was used to discuss weaknesses in each link of the chain. The report argued that the long route of accountability that the triangle specified was weak even in well functioning democracies. "Accountability must have the quality of answerability and enforceability" (op. cit., p.79). Voice was not sufficient to do this. Elections helped, but people tended to vote on ideological or ethnic lines rather than on the quality of service delivery. Protests could be costly for the poor in terms of time and lost wages. Poor people lacked direct influence with policy makers and service provision was used as a means of clientilism and political patronage, benefiting those with direct links to policy makers. Better information helped, as did citizens' charters and report cards. Decentralization helped when information about service delivery quality affected voting intentions.

Politicians and policy makers experienced problems ensuring that service providers actually delivered services effectively. The principal-agent problem was explained. Accountability improved by clarifying responsibilities, choosing appropriate providers and good information on how providers were performing and compacts/contracts were being fulfilled. Public sector providers found it difficult to get good staff, and corruption was common. Community pressures could prevent officials from discharging their duties. Providers often faced multiple principals, and had multiple tasks. (School principals, for example, were accountable to teachers

unions, education departments and civil society). Policy makers could overcome these limitations if they could insulate providers from multiple masters. Performance-based payments could help, as could better supervision. Competition for compacts could attract more provider organizations. NGOs could monitor performance.

WDR2004 argued that given the difficulties in strengthening the long route of accountability, it was important to focus on the short route: the client-provider relationship. Clients, it argued could help tailor services to needs: demanding toilets for girls, for instance, to encourage girls to attend school, or demanding more convenient hours for health clinics. Giving choice to clients among service providers could help clients reveal demand, and monitoring providers and giving clients the ability to discipline them helped. School voucher programs were one way of providing choice. Each solution came with its own problems. The objective was not to propose a solution that worked across the world, but to provide a framework to enable policymakers and citizens to think systematically about what might work in their particular context.

Shanta Devarajan, who led WDR2004, describes in two recent blogs (World Bank 2014a and b) three ways in which the WDR "changed the conversation about service delivery". It demonstrated that services particularly failed poor people. Throwing money at the problem only diverted it to those who were not poor. Responding to the symptom was also not the solution. It was important to understand why incentives were misaligned throughout the system and address the systemic issues.

Devarajan argues that the 2004 WDR also got three things wrong. The first was in failing to point to the dysfunctionality of the underlying politics that made the long route difficult:

"Why should we think that a politician who is not interested in delivering services to poor people would allow programs that strengthen provider accountability? Jim Robinson describes such programs as politician-proof public policy." (Devarajan, 2014b)

Citizen engagement and information campaigns may help, as suggested at a conference on the Tenth Anniversary of WDR2004 (World Bank, 2014). But "there is widespread agreement that information alone rarely leads to improved services, and growing awareness that it is incentives that matter if politicians and service providers are to act on information and data" (Foresti, 2014). Devarajan concedes that there were no easy answers to the question of how one fixed the incentives facing politicians.

He goes on to list two other failings. Firstly the WDR should have "come clean "and say that the only effective short route was the market. Voucher programs still required politicians to decide that students should receive vouchers. Citizen report cards may increase citizen awareness but they did not strengthen clients' ability to hold providers accountable unless clients had a choice among providers, and a provider's remuneration depended on clients choosing him or her. Devarajan further argues that by not recognizing that the only short route was the market, the report had overlooked "a host of distortions in private markets – asymmetric information, oligopolies, etc. As Welham argues, "countries that fail to deliver public services will also fail to deliver effective markets." (Welham, 2014)

Second, the WDR emphasized the role of financial incentives in explaining teacher and doctor absenteeism: they got paid whether or not they came to work, they got paid better elsewhere,

and they had the political power to get away with it. But this was equally true of doctors or teachers in more developed countries. But in these countries, absenteeism would affect their professional reputation and politicians would be blamed if teachers and doctors were absent. There were unlikely to be similar pressures in South Asia or Africa. The importance of professional norms, he argued was not stressed in WDR2004.

WDR 2004 focused on service delivery to the poor, given the Bank's focus on poverty reduction. Some participants at the 10th Anniversary conference argued that the middle classes in developing countries who were still poor by developed country standards should also have access to services as a political right. "More importantly, the way to make politics and service delivery align is to get the articulate and influential middle classes engaged in service delivery. Services for poor people are often poor services, so making public services a political issue for the middle class might, paradoxically do more to make them work for the poor as well." (Devarajan 2014b, Ibid)

WDR 2004 had a powerful impact on the Bank's thinking on governance, creating a framework that has been applied in a variety of ways in different publications. As Devarajan argues, it has become a "workhorse in the service delivery field". Most importantly, the framework has been used to look at the larger issue of governance and the accountability of politicians to citizens and the citizen politician compact.[11] The principal-agent problem, a central issue in institutional economics, is explored in each case. This has permitted a discussion of issues such as court adjudication of disputes between governments and citizens, the role of the media, and the risk of capture and corruption.

F - Governance in Other WDRs.

The four WDRs reviewed above focus strongly on governance. Since the 2004 WDR, there has not been another one that focuses predominantly on institutions or governance. But two other WDRs also extended thinking on institutions in other areas:

World Development Report, 2006 on Equity and Development (World Bank, 2006) devoted a chapter to "Equity, Institutions and the Development Process". It looked at the issue of how institutions were influenced by inequalities in the political and social realm, and considered the "circumstances and processes for creating institutions that promoted prosperity" (Op. cit., p107). The report argued that a society with greater equality of control over assets and incomes will "tend to have a more equal distribution of political power" (Op.cit., p108) The chapter explored historical evidence on this issue (an important departure from previous WDRs which cited historical examples but did not review these in depth), and cited colonial experience where European powers introduced bad institutions in colonies where there were a lot of resources to exploit or cheap labor to enslave; but where there was little to extract, where plantation agriculture was not profitable, and, in sparsely settled places where they became the majority, it was in their interest to introduce better institutions. Local populations were not given property rights in Latin America, whereas the colonial model was not appropriate in North America. The report drew two conclusions: first, that institutions, especially those that underpin property

[11] Two good examples are in World Bank, 2005 and Levy, 2007

rights and broad-based investment, had a causative effect on long run development processes, and second, that greater political equality could lay the basis for better economic causations.

World Development Report 2011 on Conflict Security and Development (World Bank, 2011) focused on factors driving conflict in fragile states. Conflicts were not one-off events. Countries emerging from conflict faced high levels of crime. Different types of conflict were typically related to each other, and grievances could often quickly escalate into acute demands for change, which if not satisfied resulted in conflict. The report recognized that weak institutions often explained why violence repeats in different forms. Breaking the cycle of violence required restoring confidence and transforming institutions that provided citizen security, justice and jobs. Creating institutions that could prevent repeated violence took time. Resolving conflict required first transforming those institutions that deliver citizen security, justice and job. Much depended on the ability of national leaders to win trust that they could make a break with the past. This focus on security as an issue in development is lightly touched in other WDRs but is also a critical factor for countries that may not be in conflict or fragile. Citizens place high value on security for their lives and property. This is often neglected in analysis.

G – How the Bank Viewed Corruption

Corruption features prominently in the World Bank's initial policy statement on governance. It is addressed rather frankly and openly. "Corruption occurs in all countries", the report notes, "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 excessive, and when disclosure and punishment are unlikely". (World Bank, 1991:ibid, p.6). Its consequences are described graphically:

*"Many leaders in countries with serious poverty have amassed extraordinary fortunes. Foreign exchange reserves were transferred to foreign bank accounts. Such abuse, needless to say, adversely affects economic development. It unleashes cynicism which corrodes public trust…private wealth accumulated through abuse of power amidst public squalor undermines legitimacy. Yet graft on this scale is not possible without collusion between major private corporations and public agencies." (*Op. cit., Annex 1, Box 1)

World Bank Group President Jim Wolfensohn's 1996 speech on the cancer of corruption (see above, p10) provided the stimulus for increased Bank attention to the causes of and cures for corruption.[12] WDR1997, which immediately followed the Wolfensohn speech, devoted a chapter to "Restraining Arbitrary State Action and Corruption". The chapter is largely devoted to the underpinnings of an efficient state, i.e., the two mechanisms of restraint: an independent judiciary and separation of powers.

WDR 1997 listed four causes of corruption: wide discretion and lack of accountability, opportunities generated by the policy environment and highly distorted policies, when the probability of being caught is low and the private gain is high, and when the consequences of being caught and disciplined are low. The report conceded that corruption could not be

[12] It also had profound consequences for the way the Bank addressed corruption in its operational work (not the subject of this paper). For an interesting discussion on this see Levy 2014, p. 203-207.

effectively tackled in isolation, being a "symptom of problems at the intersection of the public and private sectors." (World Bank, 1997, Ibid. p. 105)

Recipes for curing corruption flowed from the causes. This included reducing opportunities for corrupt practices (through trade liberalization, removing barriers to entry for the private sector, and making privatization transparent); reducing official discretion (by streamlining laws, making rules more transparent, reducing complexity of the regulatory environment, and competitive bidding for public procurement); strengthening monitoring (independent anti-corruption commissions, ombudsman, better internal controls, whistleblower statutes and more effective supreme audit institutions) and increasing punishment. The report urged watchdog organizations to focus not just on those who took bribes but those who gave them. It explored the emerging possibilities at that time of action by international organizations, such as the OECD, to set common standards to act against foreign corrupt practices along the lines of the US 1977 law. Citizens' groups were important in the fight against corruption as also ensuring greater transparency, including through freedom of information laws.

WDR 2002 generally echoes these messages in terms of its focus on building institutions for markets, and explored other options such as decentralization and a more effective media and civil society. It compared the incentives created for voting corrupt officials out of office by proportional representation and first-past-the-post systems, arguing that the latter was more likely to keep elected officials honest. WDR 2004, focusing on service delivery, called for separating policy makers from providers, civil society activism and greater information flows, as a means of reducing the risk of corruption in service delivery.

But in general, these reports addressed the proximate causes of corruption and did not step back to ask for the underlying political-economy factors that drove corruption. As Mushtaq Khan notes, "the construction of capitalism, while it may be necessary for the long-term prospect of poor countries, is itself an ugly and conflictual process" that "generates powerful incentives and motives for corruption". (Khan, 2002) This view is reflected in a 2000 report from the World Bank's Europe and Central Asia region, entitled "Anti-Corruption in Transition – A Contribution to the Policy Debate" (World Bank, 2000). The report tries to answer the question of why corruption increased sharply in Eastern Europe and the former Soviet Union as that region transitioned to market-based economies, coinciding with a steep decline in output and a sharp increase in poverty and inequality. Attempts to reverse this trend floundered and key reforms were blocked by vested interests. The report is the first one from the Bank that tried to come to grips with the phenomenon of state capture. Defining state capture as: "*the actions of individuals, groups or firms, in both the public and private sectors to influence the formation of laws, regulations, decrees and other government policies (i.e., the basic rules of the game) to their own advantage by means of the illicit and non-transparent provision of private benefits to public officials"* (Op. cit., p1). The report argued that all forms of capture were aimed at extracting rents from the state which inflicted enormous losses on society.

A 1999 Business Environment and Enterprise Performance Survey of some 3000 owners and managers of enterprise, jointly commissioned by the Bank and the EBRD, asked respondents to assess the impact on their business activities of four practices that constituted state capture: the sale of parliamentary votes and presidential decrees to private interests, the sale of civil and criminal court decisions to private interests, corrupt mishandling of bank funds, and illegal contributions to political parties. Capture was measured both by the share of firms affected by

such practices, and by the number who admitted to being engaged in these practices. Respondents were also asked to rate the extent of administrative corruption in terms of practices that involved bribery of officials, grease payments for services rendered, and misdirection of funds by officials for personal gain.

The report constructed a two-by-two matrix, ranking countries as high or medium in state capture and administrative corruption, and examined factors that were common for countries in each of the four categories. Its anti-corruption advice was tailored to where the country was located in the matrix and its particular circumstances. Countries highly endowed with natural resources or well placed on transit routes for natural resources were prime candidates for state capture; countries with stronger administration and better trained officials had lower administrative corruption; countries with greater political competition and stronger civil societies had lower state capture. Where the transition had not resulted in major changes in systems, and civil society was weak, both state capture and administrative corruption were high.

The report tailored advice to countries depending on their circumstance. Much of this echoes WDR1997 (strengthening institutional restraints, civil society participation, fostering an independent media, and creating a competitive private sector and reforming public sector management). The one exception is its emphasis on political accountability through increased transparency of decisions and increased competition through competing political parties. The report marked a significant advance in the Bank's thinking on corruption.

The focus on corruption by successive Bank Presidents had one unfortunate consequence, which was a tendency to conflate governance with corruption. This was despite the clear statement in WDR1997 that corruption was a symptom of problems elsewhere. As Brian Levy notes:

"Governance and corruption often are used synonymously. But they are quite different concepts, and conflating them can be very damaging. Public sector governance refers to the way that the state acquires and exercise authority to provide and manage public goods and services, including both public capacities and public accountabilities…Corruption is an outcome. It is a consequence of the failure of any of a number of accountability relationships that characterize a national governance system – from a failure of the citizen politician relationship (which can lead to state capture) to a failure of bureaucratic and checks-and-balances institutions (which can lead to administrative corruption). Aggregate measures of corruption thus offer a useful overview of the degree to which the national governance system as a whole – rather than any part – is dysfunctional….Yet an exclusive focus on this outcome of a governance system has caused some countries to emphasize simple minded (and largely failed) anti-corruption initiatives – to the neglect of the complex challenge of strengthening national governance systems themselves. (Levy, 2007)

IV – Assessing the Bank's Evolving Approach to Governance

A - What the Bank Got Right

When historians come to judge the Bank's thinking on issues of governance, it is highly probable that they will credit the Bank with a number of achievements. First, the Bank has provided leadership to the development community on governance. The word "governance" itself came to be used widely and prominently[13] after the Bank decided to extend its work on public sector management to embrace governance more broadly. Until then, as noted above, the word itself had fallen into disuse and was described as an archaism. The addition of governance to the Bank's agenda also led to an increasing emphasis on the importance of institutions to the development process, and the adoption by the Bank of much of the prevailing thinking from institutional economics on the role of institutions in development. As Shahid Yusuf notes, "to have assisted in bringing institutions to the center of the discourse on development policy is no mean achievement." The 1996 Wolfensohn speech on the cancer of corruption forced governance onto the Bank's policy and operations agenda, and while opinion is divided on whether the focus on corruption is a diversion in that it focused thinking on the symptom rather than the disease, it provided a powerful incentive to Bank staff to address issues relating to governance that they had till then largely ignored despite the 1990 Board discussion paper.

Various attempts have been made to measure the Bank's impact in the governance area on the global academic community. Plane and Diarra attempt a bibliometric analysis of the role governance played within the organization, but also its worldwide impact (Plane and Diarra, 2010). Publications relating to governance worldwide rose from about 10 in the early 1990s to 800 a year in 2000. The Bank's share varied from less than 1% to 3% of these, with its peak at the turn of the century. Bank authors also contributed to some 150-200 publications a year. The share of articles on governance rose from 1% or less in 1988-1992 to about 8% over the 2005-2008 period. In the decades 1988-2008, governance contributions from the Bank in the form of articles and reviews and proceedings papers in economics, planning and development publications and business and finance publications totaled some 1,215, 2.5 percent of all publications on governance issues worldwide. In these same publications, the Bank's work on governance accounted for 3.1% of all citations. In the 1997-2005 period, the Bank published some 50 articles annually in the 10 leading academic journals. Of these, by 2003-04, some 25% of these were on governance. After 2005, both the number of articles the Bank has published and the share of governance have fallen, suggesting "a significant loss of qualitative impact in the production of knowledge".

Second, with the focus on governance and institutions, and the recognition that market failure was linked to transaction costs, the Bank moved away from what was perceived by its critics as an excessive devotion to the Washington consensus and the dominant emphasis on markets. A more balanced perspective where the importance of an effective state for effective markets was accepted and advocated led to a strong positive response among the donor community and the Bank itself became very active both on the policy front and lending and the integration of issues of governance and institutions in country development strategies.

Third, WDR2003 and WDR2004 added a strong focus on the centrality of citizens to governance

[13] For a left-wing perspective on this, see Moretti and Pestre, 2015.

in developing countries. WDR2003 did this by defining sustainability broadly to embrace not just issues of sustainable management of environmental assets but also of social assets, and by stressing the importance of social capital to the development process. WDR2004 did this by putting citizens, albeit poor citizens, at the center of the service delivery accountability triangle. The triangle in turn has been adapted to address issues of governance more broadly, and particularly political governance, stressing the accountability of governments to citizens.

B - What the Bank Missed or Failed to Address Adequately

The Bank's thinking on governance has also had some shortcomings, which have attracted criticism from academics and others. These partly arise from the state of the art and the current level of knowledge particularly about the nature and role of institutions in the development process. They also arise because the Bank is principally concerned with rendering sound advice and assistance to countries based on what it perceives to be the current state of knowledge. As in most professions, development economists and specialists must work with the knowledge that is currently available. The tension between these two explains at least some of the shortcomings discussed below. The challenge lies in ensuring that the advice being rendered is well grounded and not in the realm of unfounded beliefs or institutional ideologies.

There are three principal criticisms of the Bank's work. First, while the Bank's conversion to the importance of institutions is indeed welcome, the reality is that our understanding of how effective institutions develop is still rather weak, and yet this has not stopped the Bank from rendering advice on the subject. The second is that the Bank has not made enough effort to understand why many of the fastest growing economies of the world are also among those, which are relatively poorly governed, based on widely used indicators of governance. The third is that the Bank understates the importance of political governance to development outcomes.

The Role of Institutions: The Bank's recognition over time of the importance of institutions to the development process has won praise because it implied a belated recognition that in most developing countries it was more important to know how effective markets developed rather than how they operated, and to recognize the critical role of institutions to that process. Institutions matter, but it begs the question of how institutions developed. What we do know is that institutions, defined as the rules of the game, both formal and informal, take a long time to develop, that they are a product of the unique history and culture of each society within which they exist, that institutions that work in one setting do not necessarily work in another, or even over time in the same setting. The path dependence implied, echoing the Hindu doctrine of *karma*, does not suggest that there are any clear recipes for how one builds sound institutions that enable effective markets to function effectively or that address failures of markets. As Shahid Yusuf puts it, "what we now know about the making, the working and the effectiveness of institutions in promoting growth, reducing poverty and distributing the benefits evenly is difficult to translate into effective policy instruments that can be put to good use in a variety of developing countries[14]." The recent work by Douglass North, et al, on limited and open access orders (LAOs and OAOs) is also unclear about what it takes for LAOs to meet the door-step

[14] World Bank, 2009, p.74. The report carries a useful discussion on the state of knowledge of institutions in development economics.

conditions to becoming OAOs, and is generally skeptical about the ability of any LAO to do so in the near future (North, et al, 2009, and World Bank, 2007b).

The articulation of a theory of the role of institutions in development is still a work in progress. "Institutions" is often a catchall term to include everything under the sun. Each WDR reviewed above cites dozens of examples from across the world of institutions that work, and this in turn results in recommendations of the need to build new institutions or suggest changes to existing institutions that would help them perform better. The Bank's development operations are full of examples of institution building that reflects a confidence about what works when there is no accepted theory of institutional change. As a development institution that is in the business of helping countries improve their performance, this is understandable. But as Stiglitz argues, "while it is easy to identify the outcomes of good institutions and to cite examples of institutions which work well and those which do not, it remains far from clear how to go about creating those institutions. As a result, the international community has increasingly resorted to exhortations for good governance in the public and private sector but without correspondingly clear prescriptions to achieve that goal in general" (Stiglitz, 2006).

A related criticism is that the Bank's advice on governance and institutions, as rendered in the WDRs in particular, has a "one-size-fits-all" look and feel. In the terminology of Douglass North et al, the "typical recommendations aim to introduce unmodified elements of open access orders into developing societies" (Ibid., World Bank, 2007b), such as property rights, markets and the rule of law. Insufficient attention is placed on the vast diversity of developing country situations: vastly divergent economies and rarely a taxonomy of advice related to typical country settings. In global documents that are focusing on the messages they are conveying it is not easy to tailor advice to specific country settings. But it is important to be clear about what will work in which country settings, which is not always possible given the state of the art.

The focus on path dependence tends to rely on the unique history and culture of each country and society. The question that is relatively underexplored in the Bank's work, and in the development literature, is what is the impact of the very rapid pace of global integration, not just in economic terms but also in terms of the revolution in communications and IT technology and the increasing exposure of most societies to global influences.[15] Does this imply that the concept of path dependence and historical and cultural specificity needs to take into account increasing global integration of values and culture? The United States has been open to immigration from around the world and is a melting pot of cultures and diverse histories, and yet functions effectively under Anglo-Saxon institutions. European Union integration imposes a common set of rules on all its new member states, which come from relatively diverse historical and cultural traditions. The former British and European colonies operate institutions that have their origins in their former colonial powers. The United Nations Charter sets common standards for global institutions and human rights. Are there some institutions, such as financial institutions, that in a globally integrated world should expect to operate under very similar institutional frameworks? The answers to these questions lie in the diversity of the developing world. Some countries, which have experienced relatively rapid development, are more likely to be open to influences emanating from global economic and cultural integration.

[15] North, et al recognize the importance of the technology revolution in their work on limited access orders and its role in undermining state control. (World Bank, 2007b)

Governance and Growth: A second criticism has been that in arguing that good governance is essential to development, the Bank has tended to gloss over the East Asian experience where growth came despite authoritarian regimes with interventionist states. In these countries, growth preceded the emergence of effective markets. But this issue is not confined to East Asia. Many of the current fast growing economies, as Table 1 shows, are also economies that perform poorly on those attributes of governance that WDRs have tended to see as critical to sound development. They mostly all have relatively high rates of corruption and generally score low on such attributes of good governance as voice and accountability and the rule of law.

Table 1: Growth and Governance

Country	Gross domestic product			TI Corruption Perception Index	World Governance Indicators: Voice and Accountability	World Governance Indicators: Rule of Law
	Average annual growth (%)			Rank	Percentile rank	Percentile rank
	1990-2000	**2000-2009**	**2009-2013**	**2014**	**2013**	**2013**
Bangladesh	4.8	5.9	6.2	145	35.1	22.8
Cambodia	7.0	9.2	7.0	156	20.4	16.1
China	10.6	10.9	8.7	100	5.2	39.9
India	6.0	7.6	6.9	85	61.1	52.6
Indonesia	4.2	5.3	6.2	107	48.8	36.5
Mozambique	6.1	7.6	7.3	119	39.3	21.8
Tanzania	3.0	6.9	6.6	119	41.7	38.9
Uganda	7.0	7.8	5.9	142	30.8	44.1
Vietnam	7.9	6.8	5.8	119	11.8	39.3

Source: World Development Indicators, 2015; Transparency International 2014, and Worldwide Governance Indicators 2015

Grindle suggests that good ideas had a tendency to be credited with more importance in the development process than they may actually have (Grindle, 2010). Large number cross country analysis were undertaken to look for regularities and patterns that held across countries and that "illuminate the importance of particular variables in these patterns….inevitably, because patterns are rarely universal, some countries may exhibit good performance in the dependent variable – economic growth, say – but not score well on the independent variable – property rights. Characteristically, researchers disregard these outliers and focus on the explanatory value of the cases that fit the regression line". Researchers needed to pay attention to outliers especially if they were as large as China or have as poor a record on governance as Bangladesh.

Dani Rodrik notes that "The long run association between good governance and high incomes is incontrovertible. The existence of a causal link from the former to the latter is now also widely accepted. What is less well understood is that this long run association provides little guidance for appropriate strategies to induce high growth." (North, et al, 2008) He notes that a lot of countries grow despite poor governance, and that governance reform as a means to growth, rather than an end of development is neither a "necessary nor sufficient" condition. This is because removing sufficient binding constraints to growth, which may not have much to do with

governance, may be more important. Moreover, sustaining the fruits of good governance reforms may be difficult without accompanying economic growth.

Perception-based governance indicators may not capture what is happening on the ground in these countries. Indonesia under Suharto was likely to have received low scores on governance and yet recorded substantial growth for three decades. The Suharto regime was a classic case of limited access order. Access to licensing for domestic production was routed through a small coterie, which were carefully chosen to ensure that they would deliver and remain loyal. They often became the domestic partners of foreign investors who came for Indonesia's natural resources. The regime ensured fair treatment to these foreign investors. Disputes could be settled through agreed adjudication processes, often managed out of Singapore, and the rents were shared with Suharto who became infamously rich, along with his children (Time Magazine, 1999). State enterprises were often the direct partners of foreign investors and they reported directly to Suharto. A group of outstanding Berkeley graduates (the so called "Berkeley mafia") was deployed to ensure macro-economic stability and an open economy to keep the IMF at bay. Legitimacy of the regime in the eyes of the public and its ability to deliver on its social contract with citizens was ensured by investing in primary health and education resulting in substantial progress in Indonesia's human development indicators, and the growth that came from investor-friendly policies, which ensured jobs for new entrants to Indonesia's labor markets.

Indonesia's score on today's governance indicators would have been even lower during that period[16], but the regime ensured "good enough governance", good enough to ensure that investors felt secure, that Indonesia's human development indicators improved impressively, and to permit citizens to give the government the benefit of the doubt. The East Asian crisis brought this era to an end. Indonesia's economy has outgrown its Suharto era institutions which have become a constraint to growth, as a larger, more sophisticated economy needs to have its markets managed and regulated professionally and independent of political influence.

Bangladesh is another example where governance indicators are poor, and for good reasons. It has low rankings on most governance indicators including corruption, a relatively poor record on revenue mobilization and public financial accountability, a weak civil service, a lack of transparency in public procurement, and a weak judiciary, particularly in the lower courts.[17] But governance in Bangladesh also delivered on some key fronts. Despite its divided polity, there has been a high level of continuity in the country's policies and economic management. Influenced deeply by the factors that led to the break-up of Pakistan and the creation of Bangladesh as an independent state, successive governments were anxious to prevent a repetition of the failure of Islamabad to respond effectively to the devastating consequences of the Bhola cyclone of 1970 in this disaster prone country, and the subsequent failure of the newly independent country ravaged by the war of 1971 to cope with the famine and floods of 1974. These two events, it is argued, led Bangladesh's elite to recognize the importance of protecting citizens from the frequent natural disasters and food crises to which the country is prone, if only to ensure their own survival, and to adopt market-friendly policies that would ensure growth, and attract foreign resources, as part of an elite commitment "to protect the masses against the crises of bare life" as Naomi Hossain puts it (Hossain, 2015, p.42). "The most

[16] When Transparency International launched its Corruption Perception Index in 1995, Indonesia was listed as the most corrupt country in the world (among those initially included in the Index).
[17] This discussion draws on a 2007 paper by the author, which appeared in World Bank, 2007a

significant achievement of the Bangladesh state is the dog that did not bark – the disasters that never struck," she argues (ibid, p.38). Strategies were developed to ensure an adequate response to the frequent cyclones and floods that occurred. Bangladesh's state of preparedness for disasters has proved resilient till today, despite frequent floods and cyclones.

At the same time, the state created space for a vibrant private sector, both through relatively sound macro-economic management, and government policies that favored the private sector and liberalized foreign trade. Successive governments also encouraged the migration of Bangladeshi workers to West Asia and other destinations, causing revenues from this source to add significantly to domestic savings, demand for goods in the country side, and investment in land, agricultural inputs, human capital and business start ups. They made relatively wise public expenditure choices, containing military spending, financing rural infrastructure and investing in public health and education. Further, the state empowered a vibrant civil society to deliver key services to the poor, including the management of climate shocks, micro-credit, health and education, and allowed the private sector to provide secondary and tertiary education.

These two examples suggest that the Bank's work on governance would have benefited from a closer look at why growth is strong despite poor governance in several important countries. Is it simply that growth precedes improvements in governance, or is it that governments in these countries created conditions for growth which assured investors a certain degree of stability and created incentives that favored growth. The evidence points to the latter and suggests that the way governance is being measured fails to take into account the complexity of the compact between rulers and the ruled.

Rapid growth accompanied by poor governance should have also attracted greater attention to questions about the quality of growth. Did a corrupt elite that invested in real estate and conspicuous consumption largely feed the growth? Do the choices governments make cater to the needs of an elite that prefers private cars to public transportation and whose life style requires energy-intensive goods and services and large investments in real estate and luxury goods? This would certainly explain some of the high income and asset inequality that one sees accompanying growth in the developing world. Limitations of data tend to focus attention on income inequality, which understates inequality, partly because the incomes of the top 10% of the population get grossly underreported. Surveys are also poor at catching those who are in extreme poverty. Inequality tends to perpetuate poor governance. Asset inequality rarely gets surveyed or reported but should not be so difficult to estimate. Powerful elites typically distance themselves from the plight of the have-nots in society and capture state institutions to perpetuate their interests. Their impact on the quality of governance is rarely positive.

The Role of Politics: A third criticism is that the Bank remains highly cautious in addressing issues of politics. Political governance tends to shape economic governance. The Bank recognizes this in most of its publications. But politicians are mostly viewed as part of the problem, and seldom viewed as part of the solution. WDR97 does emphasize the importance of leadership, but visionary leaders are those who are seen to be above the political fray. The solutions to governance issues take a technical approach. The importance of understanding the political economy of proposed reforms is almost always recognized, but this is used to get

around the political hurdles rather than address these directly.[18]

Earlier Bank work was more cautious in this respect. WDR1997, in discussing the challenge of building effective states, argues that *"One reason the task is so difficult is political. Strong interests may develop, for example, to maintain an inequitable and inefficient status quo, whereas those who lose out from this arrangement may be unable to exert effective pressure for change…. (however) often politicians and others have strong incentives and a sincere interest in improving public sector performance. But managing a public bureaucracy is a complex business."* The Bank was clearly letting politicians off the hook. As argued above, there is a tendency to find technical solutions that work around politicians. One critic reviewing WDR1997 argued that it was important to "take politicians and political motivations as a fixture and try to design institutional arrangements in light of these, not despite them". (Sheple, 1999)

WDR2002 is more open about discussing the role of politics and political institutions. But the focus of a chapter on political institutions and governance is on how to ensure that checks-and-balances institutions constrain the power of public officials from being exercised arbitrarily. Given its focus on markets, the chapter is not a discussion of political institutions per se, but how the state interacts with markets, and the role of institutions in issues relating to budget deficits, financial market regulation, international trading rules, etc.

As the discussion on WDR2004 above shows, the approach taken to the politics of service delivery also comprised technical fixes to get around political constraints, ("politician-proof public policies"), and reliance on the role of information to overcome market failures, which, with the benefit of hindsight, the authors feel would also be subject to political constraints.

The WDRs fail to discuss political markets and the role of political parties and voter behavior, beyond discussing information failures relating to voter behavior. Yet distorted and malfunctioning political markets account for the lack of effective political competition. There is little or no effective inner party democracy within major political parties in most developing country democracies, little transparency about their financial affairs, and lack of independent oversight that reduces risks of political capture. In countries that are not democratic, the situation is clearly worse.

Politics is at the heart of governance failures. And yet, it has been a subject the Bank has danced around rather than addressed directly. For an international institution that must jealously guard its reputation for neutrality and objectivity and earn the trust of its member countries, it is important to ensure that the Bank is not seen as addressing issues that they feel violates that trust. Yet any effort to try to understand why governance fails is clearly flawed if it does not take politics into account. The Bank's Articles of Agreement prevent it from involving itself in or interfering in a country's politics. But as the General Counsel's 1991 Legal Memorandum noted, it is equally important for the Bank to understand the political context in which it operates, and the cost of poor governance, including political governance.

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[18] This failure is about to be partially remedied in the forthcoming ground-breaking (for the World Bank) Policy Research Report, "Making Politics Work for Development", which brings together research findings on the interface between politics and economics, focusing in particular on transparency and citizen engagement.

V – A Changing Context for Governance in the 21st Century

Most of the Bank's major documents that can be safely described as the collective views of the institution on governance were prepared nearly a decade ago. The last ten years have not seen any fresh thinking by the Bank on governance. In part this reflects the cost the institution incurred by conflating its own anti-corruption agenda in the middle of the last decade with the governance agenda as a whole, with a resulting pushback from developing countries. In part it reflects the fact that the Development Economics Vice Presidency has had only two or three staff that specialize on issues relating to governance and political economy.

Much of the Bank's thinking on governance in the 1990s and early 21st century was shaped by the crisis in the developing world of the 1980s and 1990s. However, in this quarter of a century since the Bank rather tentatively discovered governance, and particularly in the first decade and a half of this century, the context within which the world is governed has changed dramatically in at least three major respects. In terms of political governance, a large number of countries have embraced democracies, and at the same time, a significant and growing number of states are fragile or fail in meeting their basic governance functions. In economic terms, the developing world has seen increased global integration and relatively rapid economic growth, although this growth has been very uneven both between and within countries. Thirdly, there has been a major social revolution as a result of the communication revolution.

Table 2: A Changing World: Rise in Number of Electoral Democracies

Region	1990	2000	2014
Countries under electoral democracies	76	120	125
Developing countries under democracies	49	89	95
East Asia and Pacific	10	16	18
Europe and Central Asia	3	18	19
Latin America and the Caribbean	28	29	29
Middle East and North Africa	1	1	2
South Asia	3	4	7
Sub-Saharan Africa	4	21	20

Source: Freedom House

The trend towards democratization had set in by the 1980s, as noted in Section II, with Latin America leading the way. It continued strongly through the 1990s. The total number of electoral democracies, going by the stringent criteria of Freedom House, rose from 76 in 1990 to 120 in 2000 and 125 in 2015 (Table 2), with Sub-Saharan Africa, shedding its military dictatorships and the communist regimes in Europe and Central Asia losing power, accounting for most of the increase. With some exceptions, countries have by and large stayed on the democratic path.

Roughly three in five people on this planet are governed by democratically elected governments. In the developing world, some 3.3 billion people now live in democracies, out of a total of 5.8 billion[19]. The quality of these democracies varies hugely, and those early in the game see a lot of abuse of the system, and political capture. Democracies do not necessarily result in

[19] The Freedom House data has been adjusted to include Nigeria and Sri Lanka, which, when Freedom House was making its assessment, were rightly not being categorized as democracies.

better governance, but they are rated higher on scores of voice and accountability, and the more mature ones get higher ratings under rule of law indices.

At the same time, wars in the Middle East and political instability, particularly after September 11, 2001 have created a great degree of instability and a significant refugee problem. Many countries are seen as fragile and conflict prone. Large numbers of ordinary people are escaping the misery of war or simply poor governance to seek refuge in the richer countries of the world – a rude reminder of the truth of the saying for the developed world: "as you sow, so shall you reap". Huge inequalities in both political and economic terms carry a price. Getting governance right in the developing world and addressing the root causes of fragility and conflict is no longer an option for the global community.

Developing countries have enjoyed much higher growth rates in the past 15 years than in the second half of the 20th Century (Table 3). This is principally due to significantly more open economies, a greater role for markets, and - till recently - the boom in commodity prices that benefited some economies and created demand for others. As a result their share in global GDP also rose substantially. Almost half of the 63 countries categorized as low income by the World Bank in 1995 graduated to lower middle income or upper middle-income status. China jumped to upper-middle income status over this period and almost all of South Asia graduated to lower-middle income status. Low-income countries are now confined largely to sub-Saharan Africa and a handful of least developed countries like Haiti and Nepal.

Table 3: Growth of Gross Domestic Product

Income Groups and Regions	Average Annual Percentage Growth (% Per annum)		
	1990-2000	**2000-09**	**2009-2013**
High Income Countries	2.6	2.1	1.8
Low and Middle Income	4.3	6.4	5.8
East Asia and Pacific	8.5	9.4	8.1
Europe and Central Asia	0.2	5.4	4.3
Latin America and the Caribbean	3.1	3.6	3.8
Middle East and North Africa	3.9	4.9	2.3
South Asia	5.6	7.2	6.6
Sub-Saharan Africa	2.3	5.7	4.2

Source: World Development Indicators

Developing countries' domestic economies are also significantly more integrated due both to rapid urbanization and improved transport and communications (Table 4). The pace of urbanization has risen sharply, from a little over a third of the population living in urban areas to nearly one half. These global averages reflect the relatively slower urbanization of Sub-Saharan Africa and South Asia. In Latin America, four out of five people live in cities; in Europe and Central Asia, three out of five, and in East Asia, one of two.

The telecommunication revolution is even more remarkable in its impact. Mobile cellular subscribers rose from just 4 in a 100 at the turn of the century to 97 out of 100. The growth in Internet users is related to this since mobile cellular phones have enabled greater Internet access. This is reflected in the rapid use of social media. In January 2016, Internet users

numbered some 3.4 billion people, 46% of the world's population. Some 2.3 billion people today worldwide have social media accounts, about 31% of the total population, of which 2.0 billion are accessed through mobiles. In 2015 alone, the number of active internet users rose by 332 million or 10%, while the number of active social media accounts rose by 219 million, or 10 per cent (We Are Social, January 2016).

Table 4: Greater integration both global and domestic of low and middle income countries

Indicator	Unit	1990	2000	2014
Share of world GDP	Percent	13.1	15.8	28.1
Trade as % of GDP	Percentage of GDP	31	44	46
Personal remittances	$ bn	28.9	78.2	221.0
Foreign Direct Investment Net Inflows	$ bn	18.6	124.9	270.3
Urban Population as % of total	Percent	34	39	47
Mobile cellular subscriptions	Per 100 people	0.01	4.03	97.0
Internet Users	Per 100 people	0.1	1.4	31.1

Source: World Development Indicators

The implications of these trends for governance in developing countries have yet to be properly analyzed. They are complex and an adequate understanding would have to be based on high quality surveys and fieldwork. But three areas require attention. First, increasing global integration in an economic, social and communication sense suggests that the information and knowledge available to the average world citizen is rising by leaps and bounds and greatly reduces the ability of governments to manage or censor this flow. Second, rapid economic growth has created a large urban middle class in most developing countries that is demanding better services and greater accountability from its governments. The rapid transition from low to middle income status increases the need for stronger institutions that can better manage the many transitions that governments in middle-income countries face (Gill and Kharas, 2015). Third, social media has opened the door to mobilization of opinion on governance-related issues very rapidly. This can be a force for both good and bad, since organized groups can terrorize innocent people on the web.

But it is also important to remember that large numbers of people and countries have been left out of these huge gains, and that there are significant inequalities within countries in terms of access to assets broadly defined and to information. Both have implications for the global governance agenda. Over a billion people live in fragile states, while in this post "9/11" world, wars and conflicts prevail in many parts of the Middle East and North Africa, and in Sub-Saharan Africa, resulting in a refugee crisis that is proving increasingly unmanageable. Inequality also prevails in terms of access to the growing information revolution, both within countries and between countries. The middle classes in middle income countries and the fast growing Asian economies dominate access to social media and the Internet.

The Bank's governance thinking will need to reflect this increased complexity if its advice to developing countries is to stay relevant. Apart from an occasional glimmer of awareness of these issues in past WDRs on governance, there was not much sense that the Bank was prepared for and foresaw this technological and social revolution. Hence there is an opportunity here for innovative work that will inform the citizen and poverty centric agenda of the World Bank about the governance implications of a fast changing and unequal world.

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