DEVELOPMENT IN PRACTICE

Governance

The World Bank's Experience

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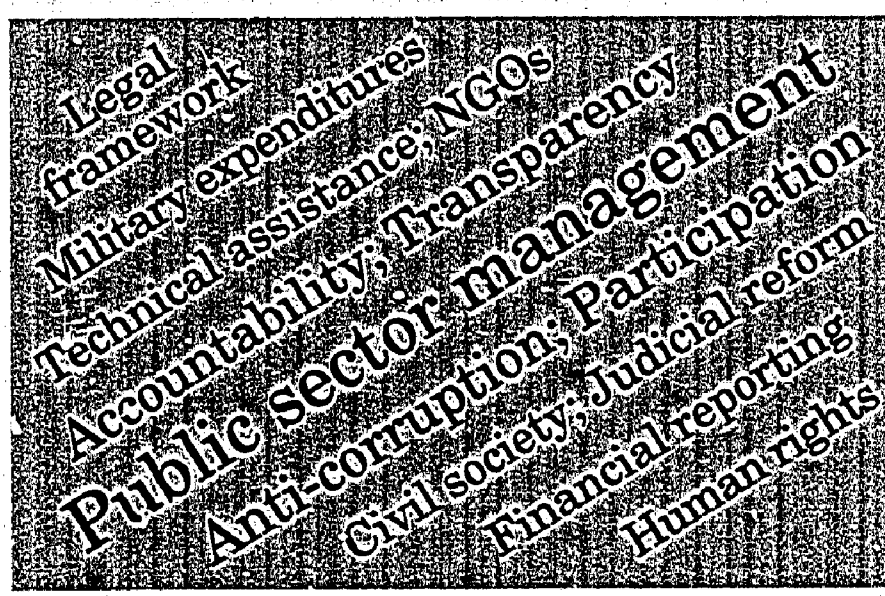

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Contents

Boxes

Preface

Two years ago the World Bank published *Governance and Development* (World Bank 1992b), its first report expressly on the topic of governance. In that report, the Bank explored the meaning of governance and why it is important for development. Governance was defined as *the manner in which power is exercised in the management of a country's economic and social resources for development.*

The World Bank's interest in governance derives from its concern for the sustainability of the programs and projects it helps finance. If sustainable development is to occur, the 1992 governance report concluded, a predictable and transparent framework of rules and institutions for the conduct of private and public business must exist. Good governance is epitomized by predictable, open, and enlightened policymaking (that is, transparent processes); a bureaucracy imbued with a professional ethos; an executive arm of government accountable for its actions; and a strong civil society participating in public affairs; and all behaving under the rule of law.

In analyzing governance, the World Bank draws a clear distinction between the concept's political and economic dimensions. The Bank's mandate is the promotion of sustainable economic and social development. The Bank's Articles of Agreement explicitly prohibit the institution from interfering in a country's internal political affairs and require it to take only economic considerations into account in its decisions. Thus, the Bank's call for good governance and its concern with accountability, transparency, and the rule of law have to do exclusively with the contribution they make to social and economic development and to the Bank's fundamental objective of sustainable poverty reduction in the developing world.

The purpose of this report is to summarize the Bank's activity in the area of governance in the past two years. The record shows that the Bank's work on governance has greatly expanded, albeit with different points of emphasis, in all regions of the developing world and in the countries that are in transition from socialism to market economies.

Following the pattern established by the 1992 report, the current report describes developments under four sub-headings of governance: (i) public sector management; (ii) accountability; (iii) legal framework for development; and (iv) transparency and information. Despite their inevitable overlap, these headings provide a template against which the Bank's governance work can be assessed.

Of the four, public sector management (PSM) is the most readily identified dimension of the Bank's governance work. The language of PSM is predominantly technical: changing the organizational structure of a sector agency to reflect new objectives and to retrain staff; making budgets work better through better integration of capital and recurrent components; sharpening civil service incentives through new pay and grading structures; or placing public enterprise managers under performance contracts. Behind the emphasis on PSM as a key dimension of governance is the growing conviction that an efficient government is a *sine qua non* for sustainable economic growth. The other three dimensions of governance underpin PSM. Collectively, all four profoundly affect the performance of the public sector by shaping the environment in which it exists. Accountability and transparency are desirable qualities in the private sector and make government agencies responsive; and the legal system supplies a framework of rules for the public and private sectors. Institutional development in both the public and private sectors occurs when the various dimensions of governance reinforce one another. Institutional decay and loss of capacity ensue when the governance conditions in a country are adverse.

One result of the World Bank's work on governance has been innovation: in the types of projects undertaken; in fresh ways of preparing projects; and in the development of new topics for economic and sector work and for research. Another result, not susceptible to measurement but nevertheless important, is the way governance concerns have influenced the regular economic and project work of the Bank. In the process, the complementarity of the public and the private sectors and the importance of public sector management have been underscored. In turn, the Bank itself has been affected by the governance agenda, and this report looks at how Bank processes are changing, how governance considerations are increasingly being taken into account, and where more could be done.

As with *Governance and Development,* this report has been adapted from a World Bank board document, discussed and endorsed by the Bank's Executive Directors on December 16, 1993. In the interest of providing greater transparency about the Bank's own operations, the report discusses not only Bank-financed projects and Bank research but also its internal processes. This has been done deliberately to show how governance has influenced the work and decisions of Bank management and staff and to make clear those aspects of governance that the Bank may take into account in its lending decisions and those that lie outside its mandate.

Acknowledgments

This report, which has been prepared by the Operations Policy Department of the World Bank, draws on material provided by the public sector management staff in the Bank's technical departments and on contributions by the World Bank Legal Department. The principal authors were Mike Stevens, Roberto Gonzalez Cofino, Ernesto Betancourt, and Shiro Gnanaselvam, who drew extensively on contributions from Ladipo Adamolekun, Barbara Nunberg, Geoffrey Lamb, Richard Moore, Claude Salem, and Hans-Juergen Gruss. The report was produced under the general guidance of Jim Adams.

Acronyms

AGETIP	Agence d'Exécution des Travaux d'Interêt Publique
BP	Best practice
CAP	Community action plan
CAS	Country Assistance Strategy
CEE	Central and Eastern Europe
CG	Consultative Group
CPPR	Country Portfolio Performance Review
CSR	Civil service reform
DAC	Development Assistance Committee of OECD
DRP	Demobilization and reintegration program
ECA	Europe and Central Asia
ESW	Economic and sector work
FSU	Former Soviet Union
GDP	Gross domestic product
GTZ	German Technical Assistance Agency
IDF	Institutional Development Fund
IDTA	Institutional development technical assistance
IFC	International Finance Corporation

IMF	International Monetary Fund
NGO	Nongovernmental organization
NIEs	Newly industrialized economies
ODA	Overseas Development Administration (U.K.)
OECD	Organization for Economic Cooperation and Development
PE	Public enterprise
PER	Public expenditure review
PMTF	Portfolio Management Task Force
PSA	Private sector assessment
PSM	Public sector management
TA	Technical assistance
UNCITRAL	United Nations Commission on International Trade Law
UNDP	United Nations Development Program

Executive Summary

This report summarizes the governance work undertaken by the World Bank in the last two years. It provides an overview of governance activities in lending, economic and sector work (ESW), and in research and dialogue. Progress across regions is reported under the four major components of governance identified in the 1992 governance report: (i) public sector management; (ii) accountability; (iii) legal framework for development; and (iv) transparency and information. In addition, other issues that are related to Bank activities—such as more participatory approaches to policy, program, and project design and implementation; military expenditures; and human rights—are raised. Internal procedures and organizational issues relevant to the Bank's governance work are also discussed.

Although the magnitude of the World Bank's work on governance cannot be directly measured because of the diffuseness of the topic (box 1), the report concludes that the volume of governance-related lending, ESW, and research by the Bank is substantial and growing (box 2). Consistent with the Bank's Articles of Agreement, this work has concentrated on the economic and social dimensions of governance, using a variety of approaches, both traditional and innovative. The intensity of governance work varies from country to country according to country circumstances and needs. In the past two years the most comprehensive governance work has been carried out in Latin America and the Caribbean and in Africa. However, in all regions, World Bank staff have given prominence to assisting borrowers in strengthening governance in their countries. Worldwide, countries are seeking to improve the performance of their governments.

BOX 1 DEFINITIONS OF GOVERNANCE

Governance was a rarely used term in development circles until employed in the World Bank's 1989 report, "Sub-Saharan Africa: From Crisis to Sustainable Growth." Later, *Governance and Development* provided a specific definition relevant to the Bank's purposes:[a] "the manner in which power is exercised in the management of a country's economic and social resources for development." The World Bank has identified three distinct aspects of governance: (i) the form of political regime; (ii) the process by which authority is exercised in the management of a country's economic and social resources for development; and (iii) the capacity of governments to design, formulate, and implement policies and discharge functions. The first aspect is deemed outside the Bank's mandate; thus the Bank's focus has been on the second and third aspects.

The term usually describes conditions in a country as a whole. However, it may be applied in a more specific sense, such as *corporate governance*—the framework of laws, regulatory institutions, and reporting requirements that condition the way the corporate sector is governed.

The African Development Bank has introduced the notions of *macro-, meso-*, and *microgovernance* to conditions at various levels of government, suggesting that authoritarian regimes committed to development might exhibit good governance at the middle and lower levels.[b]

Other multilateral lending institutions use the term in the same way as the World Bank, although the Inter-American Development Bank gives special emphasis to the modernization of public administration. Some bilateral donors (for example, the United Kingdom's ODA) prefer the terms *good governance* or *good government*. These terms emphasize governance's normative aspects and facilitate its use as a guide to aid allocation using criteria drawn from the political as well as economic dimensions of governance. The OECD's Development Assistance Committee uses the World Bank's definition of governance and links it with participatory development, human rights, and democratization. It sees an overall agenda emerging in the aid policies of its member states, with the following links: legitimacy of government (degree of democratization); accountability of political and official elements of government (media freedom, transparent decisionmaking, accountability mechanisms), competence of governments to formulate policies and deliver services; and respect for human rights and rule of law (individual and group rights and security, framework for economic and social activity, and participation).

a. World Bank 1992b, p. 52.

b. African Development Bank 1993.

BOX 2 MEASURING GOVERNANCE IN WORLD BANK OPERATIONS

Precisely how much governance work is being carried out in the World Bank is difficult to estimate numerically. This is because governance is a broad term that straddles the functional classifications the Bank uses to classify its lending operations. One dimension, public sector management, can be partly measured. Others, such as accountability and transparency, defy quantification. In short, there are governance components in all projects. In an attempt to quantify these components, this report aggregated data covering 455 projects across three regions during the 1991 to 1993 fiscal period. This provided examples of projects in which governance was a major component. These data manifest the extent to which governance topics pervade World Bank lending operations.

In a parallel exercise, the World Bank's Latin America and Caribbean Region recently reviewed its lending program according to the program's impact on governance, using a definition that emphasized public sector management (PSM) improvement. The review concluded that some 90 percent of the World Bank's current or pending operations in the region are expected to have an impact on governance, half of them a major one.

The volume of PSM work can be partially quantified because it is one of the functional categories used to analyze the lending program in the Bank. In fiscal 1993, total lending classified as PSM was US$609 million. However, this figure does not include the many projects where PSM is not the primary purpose of the loan but a subsidiary activity, for example, in a sector project. Nor does the amount include technical assistance.

Category	Proportion of lending operations with governance content (percent)
Legal framework	6
Participation	30
State-owned enterprises reform	33
Economic management	49
Capacity building	68
Decentralization	68

Public sector management

A substantial part of the governance work in which the World Bank currently engages includes traditional public sector management (PSM) categories such as civil service reform, public financial management, and public enterprise reform. Experience in all regions confirms that PSM is a key issue of development effectiveness. Renewed emphasis on PSM has been influenced by changing perceptions of the role of the state. The new model requires a smaller state equipped with a professional, accountable bureaucracy that can provide an "enabling environment" for private sector-led growth, to discharge effectively core functions such as economic management, and to pursue sustained poverty reduction. With respect to civil service reform, work has focused not only on retrenchment and cost containment but also on performance improvement and human resource management.

In public financial management, there is a trend toward integrated financial management reforms rather than isolated improvements to budgeting and public investment programs. The World Bank provides extensive advice to governments on the allocation of budgetary expenditures, within and among sectors, through *public expenditure reviews* (PERs), increasingly carried out on a joint basis. Public enterprise reform has been a key feature in virtually all countries undergoing structural adjustment reforms as governments have sought to downsize and seek better performance from inefficient parastatal sectors through divestiture, privatization, and management reform. In so-called transition countries—that is, those making the transformation from socialized to free-market economies—privatization has been a central thrust of the Bank's overall assistance. Reflecting the complexity of the task, the vested interests at stake, and the uneven commitment of governments to the task, the success with which public enterprise sectors have been reformed varies greatly among countries and regions.

Accountability

The World Bank has also made an effort in the last two years to help its borrowers, in a variety of ways, to improve the accountability of their public sectors. Decentralization of government as a means to improve accountability has been a major focus of lending and ESW. Financial accountability has been strengthened through lending operations focused on improving accounting and auditing practices and promoting compliance with financial management standards. *Financial accountability assessments,* a new form of ESW, are beginning to be undertaken. Microlevel accountability has been promoted by encouraging beneficiary participation in projects and, in some cases, competition in service delivery.

Transparency and information

Support for greater transparency and information has been closely linked to the Bank's work on accountability. Improvements in financial management and introduction of transparent budgeting systems have been a feature of a number of lending operations. *Country procurement assessment reviews* by Bank staff and the policy dialogue between Bank staff and governments have been used to raise the issue of public procurement systems with borrowing governments, and in many countries the Bank is assisting reform. Training programs (provided by the Bank's Economic Development Institute) for developing-country journalists have attempted to raise public awareness and improve public debate on economic reform.

Legal framework

Support for the legal framework for development has taken the form of Bank advice on new laws to establish a framework for economic activity in transition countries. For example, laws on property rights, companies (bankruptcy laws), banking, competition, foreign investment, and the establishment of regulatory bodies. In addition, the Bank has been providing assistance to a growing number of countries for legal training and judicial infrastructure. Several research programs on a variety of legal issues have supported the Bank's assistance in this area.

Policy dialogue

Governance issues have featured prominently in the Bank's policy dialogue with many countries. In its role as chairman of the Consultative Group (CG) meetings between donor agencies and governments, the Bank has at times communicated to borrowing countries the views of donors on issues relevant to the political dimensions of governance that fall outside the Bank's mandate. In such circumstances the role of the chairman of a meeting of aid donors and recipients is to facilitate a constructive exchange on matters that may affect aid commitments and thus the financing of a government's aid program. In other settings, high-level meetings between Bank senior management and government policy makers, Bank mission work with country counterparts, the day-to-day communication between the Bank's resident mission staff and government officials, and special workshops have all been vehicles for an expanding dialogue on governance issues.

Participatory approaches

A major effort is under way within the Bank to explore and mainstream participatory approaches to the design and implementation of Bank-financed projects and the preparation of economic reports on countries. Case studies of best practice are being analyzed, workshops organized, and a handbook prepared. This is likely to have a significant impact on the way projects are prepared, and it has the potential to greatly improve country ownership of the projects the Bank finances and, thus, relevance and sustainability.

Military expenditures

The World Bank has confronted the issue of military expenditures in several countries where such spending is crowding out budget allocations for social and other development-oriented programs. In some countries, the Bank has responded to the government's request to develop options for bringing military expenditures more into balance with other spending priorities. To assist in the conversion of defense industries, the Bank has supported macroeconomic and sector policy reforms for providing an environment in which the restructuring of market-based enterprise may take place. To help countries in the aftermath of civil war, for example, the Bank has studied the comparative experience of other countries in demobilizing and reintegrating their economies.

Human rights

The Bank's contribution to human rights is embodied in its strategy on poverty reduction through economywide and sectoral policies that encourage rural development and urban employment and through the provision of basic services to the poor. These efforts are augmented by targeted transfer programs and social safety nets. The share of Bank lending to human resources development is strongly rising, and a greater proportion of resources is being allocated to primary services or targeted to the poor and other marginalized groups. Accompanying this has been a sharp increase in country-specific analytical work through *country poverty assessments* and other ESW.

Internal procedures

Improvements in the World Bank's internal procedures following the recommendations of the Task Force on Portfolio Management ("Wapenhans Report," World Bank 1992a) will raise the profile of governance issues. For instance, the *country assistance strategy* (CAS) papers will bring relevant governance issues to the Bank's Executive Board in the context of country strategy discussions; country portfolio performance reviews will highlight systemic problems of project implementation; and the new system of operational policies and procedures will provide best-practice advice to Bank staff on many topics where governance is a factor.

Institutions

The past two years of work on governance underscore the importance of institutions in the development process. In the coming years, the Bank's ESW and research efforts should focus on how to assist countries in building strong institutions and should explore further the relationship between institutional development, PSM, and the other dimensions of governance. There is a need for more determined efforts to foster local ownership of reform programs and to direct support to the institutions of civil society. Within the framework of the World Bank Articles of Agreement there is likely to be continued scope for substantial governance work in future years.

GOVERNANCE CAPACITY AND STRUCTURAL ADJUSTMENT

A research program is currently under way in the Private Sector Development Department of the World Bank to investigate the relationship between governance capacity and successful economic reform in developing countries. Governance, in this instance, is assessed in terms of the capacity of the state to avoid *capture* by prominent economic interests and to formulate and implement policy independently in the public interest.

Structural adjustment imposes high costs on diverse segments of society. Experience has shown that states are chronically weak in withstanding pressure from prominent economic interests. The research program explores the conditions under which developing country governments can deploy enough governance capacity to overcome political resistance, design and implement appropriate adjustment policies, and sustain the course of economic reform.

Based on the analytical framework of the conceptual paper that has been prepared,[a] ten case studies (Bolivia, Brazil, Egypt, Ghana, Malaysia, Mexico, Pakistan, Tanzania, Turkey, and Zambia) will be carried out.[b] The aim is to analyze and contrast the experiences of successful, or attempted, reform in these countries in relation to their governance capacity and to study ways in which governments have tried to increase this capacity. The findings of the research program will serve to educate World Bank staff as well as inform future policy decisions.

a. Frischtak 1993.

b. All the case studies, except one, will be written by local researchers. Work has begun on seven of the ten studies. The final versions of the papers will be presented in a conference in the Bank in June 1994.

CHAPTER ONE

The World Bank's Experience with Governance, 1991–93

Public Sector Management

Public sector management (PSM) is the most visible of the four dimensions of governance.[1] PSM has to do with the capacity of governments to make and implement public policy, the effectiveness of public programs, and the strength of public institutions. The subject matter of PSM is the means to achieve these—the civil service, the government budget, the public investment program, accounting, auditing, and other financial management systems, strategic planning and program evaluation, aid coordination, economic management agencies, the cabinet system, and other parts of the machinery of government that are essential to a well-functioning public sector. PSM is also concerned with the relationship between central government, agencies, and public enterprises, on the one hand, and between central and subordinate tiers of government on the other.

Over the years, the World Bank's approach to PSM has grown beyond project-linked institutional strengthening and attempts to improve the workings of specific parastatal agencies. This approach generally worked when conditions in the public sector were less strained and governments were still expanding the coverage of their programs. However, the limitations of restricting attention to individual agencies became increasingly apparent as the structural adjustment agenda in many countries lengthened. As systemic problems became more evident, the Bank began to expand its approach to PSM with broad-based sector adjustment loans; with support for improved financial management; and with civil service reforms focused initially on cost containment and retrenchment. In response to the deteriorating condition of the parastatal sector, the Bank began to encourage the divestiture and privatization of public enterprises. At the same time, it became evident that dispersed and disconnected reform efforts were not adequate to cope with the institutional modernization demands that emerged from the structural adjustment process, both in scope of work and in terms of the effort required.

Civil service reform

In the past two years, the World Bank's best-practice work has evolved further. In civil service reform, the Bank has tried to move beyond cost containment and retrenchment and to deal with issues of improved performance and more effective management of human resources. Thus, current programs contain measures to strengthen personnel management in government and civil service ministries, install human resources management information systems, and in some cases, revise civil service codes.

However, although civil service reform programs are being implemented in many countries (thirty with Bank assistance), most countries have yet to face up to the magnitude of change needed within the government sector to sustain efficient, market-led economies.[2] Moving from a highly interventionist paradigm of government to one in which the role of the public sector is to create an *enabling environment* for the private sector, to regulate where necessary, and to ensure efficient delivery of key public services requires major changes (box 1.1). In addition to decentralization, these changes affect staffing levels and orientation, departmental functions, and the machinery of government for policy coordination. They may also entail a sharper distinction between the core functions of government and those that can be contracted out or otherwise left to the private sector. In this way, governance is strengthened by shifting the boundary between the public and private sectors, thereby enlarging the latter, with the government's role changing from direct provision to regulation. Many civil service reform programs provide for *functional reviews,* but contrary to what the term suggests, these have been concerned mainly with adjusting staffing levels to existing, not redefined, functions. How to manage the transition from an overstaffed, underskilled, and poorly motivated civil service to a smaller, realistically paid, and professional one in a way that does not provoke resistance to change is not yet adequately understood (box 1.2). In many countries, bureaucratic attitudes are part of the problem and require alteration. In others, the social consequences of massive layoffs are understandably feared.

BOX 1.1 PRIVATE SECTOR ASSESSMENTS

The World Bank has been surveying private enterprises in borrowing countries to assess the institutional and policy framework that governs private sector activity. Private Sector Assessments (PSA) have been carried out in twenty-four countries.

These surveys highlight constraints in the private sector; provide detailed information on specific constraints, such as access to finance, infrastructural bottlenecks, and regulatory weaknesses; and identify areas where institutional reforms will improve the business environment. The findings are valuable for developing an institutional and policy framework that supports private sector-led growth.

The results of nine recently completed surveys indicated the following:

- In countries facing serious macroeconomic problems, inflation and policy instability are the greatest constraints to business. High taxes and interest rates are also a problem. Access to finance is not a major constraint overall, although the surveys suggest that it has affected small firms more than larger ones.

- Among the regulatory constraints that businesses face, tax and labor regulations are the most burdensome. The surveys found regulatory compliance costs to be high—in one instance, taking up as much as 26 percent of senior management time. Registration processes were found to be long and costly.

- Failure of public infrastructure is a large problem. Infrastructure problems tend to be sector specific, although larger firms in any sector are better able to bear the costs of infrastructure failure than are smaller firms.

- Government arbitrariness and the lack of predictability in official policies discourage long-term investment.

Finally, it has become increasingly clear that the loss of capacity in many governments and their continued unsatisfactory performance are due to governance factors. This means that reform programs based on technical measures alone will fail.

Financial management

The trend in this area has been toward integrated financial management systems rather than isolated reform efforts in public investment, budgeting, accounting, auditing, and information systems. Best practice in public financial management is well understood in technical terms. The challenge is to adapt it to country circumstances, to provide adequate amounts of training, and to ensure that leadership in both the executive and the legislature is committed to improved financial management in the public sector. In some regions the requirement is system modernization. In others, existing systems are fundamentally sound, but capacity has been eroded.

State enterprise sector

In virtually all countries undergoing structural adjustment reforms with the assistance of the World Bank, the reform of the state enterprise sector has

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BOX 1.2 CLIENT AND CIVIL SERVICE ATTITUDE SURVEYS IN ZAMBIA

The Government of Zambia recently embarked on a major civil service reform (CSR), a complex process that must take many factors into consideration, such as the attitudes that civil servants bring to their work and the views the general public has of civil service efficiency.

In Zambia, the government decided to conduct attitude surveys prior to developing its civil service reform program. The data from the surveys would be used to formulate the CSR strategy so that constraints to civil service efficiency and responsiveness could be identified and addressed.

Two surveys were conducted with assistance from the World Bank's Institutional Development Fund (IDF). One questioned the attitudes of clients toward the civil service. Its objectives were to:

- Assess client satisfaction with service delivery
- Determine client needs
- Find out about client willingness to cooperate with the bureaucracy
- Determine public perception of the accountability of civil servants
- Assess the extent to which traditional values influence attitudes toward the civil service.

The other survey assessed civil servants themselves. Its objectives were to:

- Understand how officials viewed their work
- Identify behavior patterns associated with superior performance and explain them
- Identify better-performing units
- Assess the influence of traditional values on bureaucratic behavior.

This is the first time the World Bank has financed work of this nature. The survey has provided valuable inputs for program design and is an example of the innovative use of IDF money for upstream institutional work. In addition, this project also supported capacity building in Zambia's National Institute of Public Administration (NIPA), which carried out the survey. NIPA can now design and carry out other surveys and act as the monitoring and evaluation unit of the CSR program in Zambia.

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been an important component. The Bank has devoted much attention to both reforming individual enterprises under public ownership and supporting systemic reforms. The latter include performance contracts; performance evaluation systems; changes in the composition and role of boards of directors; changes in the selection, remuneration, and incentives of managers; improvements in pricing and labor policies; and removal of the so-called soft budget constraint by ending easy access to subsidies and government-guaranteed loans, among other things. These efforts to corporatize and reform state firms continue in all regions and in the former Soviet Union.

In the mid-1980s the Bank added an emphasis on privatization and divestiture to promote competition and efficiency and on the liquidation of nonviable firms to ease the crushing budget deficit and the crowding-out of the private sector. Experience has greatly varied among countries and regions, ranging from highly successful public enterprise reform programs in Chile, Malaysia, and Mexico to disappointing results in most of Africa. Public enterprise reform has also been an important part of the Bank's PSM research program. For example, a major research project on the lessons of experience with privatization in middle-income and industrialized countries was completed last year by the World Bank Country Economics Department and demonstrated the gains from privatization (Galal and others forthcoming). Follow-up work on low-income countries in Asia and Africa is under way. In additon a major research study is proceeding using the experience of twelve countries to articulate a taxonomy of reform strategies for improving public enterprise performance compatible with countries' differing economic, institutional, and political conditions. Finally, important work has been done on the governance foundations for utility regulation (box 1.3).

As with other aspects of governance, Bank work by regions differs depending on the state of development of public administration and the absorptive capacity of the member countries.

■ In the Latin America and Caribbean Region, reforms are driven mostly by the desire of governments to modernize public sector management.[3] In many countries, the work of the Bank has moved from partial to comprehensive reform within a medium-term framework, using an array of Bank instruments. In a growing number of countries in the region, an integrated approach to financial management reform is being adopted, comprising changes in budget laws, the modernization of accounting and auditing systems, computerized financial information systems, the introduction of corporate planning techniques, and revenue administration reform. Examples range from Argentina (box 1.4) and Ecuador to Guyana, Honduras, and Jamaica. Comparable efforts are being made to modernize civil services, and the Bank has been assisting

BOX 1.3 INSTITUTIONAL FOUNDATIONS OF UTILITY REGULATION

Where utility services are provided by private companies, regulation has two goals: to encourage investment and to support efficiency and equity in the provision of the service. These two goals can often be contrasting. A research program, undertaken by the World Bank's Policy Research Department, comparing the regulation of private telecommunications utilities in a number of countries[a] has produced some interesting results on how the divergence in goals has been resolved. The basic finding is that the success of private utilities depends on achieving the best *fit* between the regulatory system and other institutions (legislative, executive, and judicial) in the country.

A particularly useful output from the research program has been a checklist of questions that enables World Bank staff to determine which regulatory systems are appropriate to the specific conditions in a country. The questions focus on administrative capacity, the prevailing institutional framework, and the capacity of existing institutions to support regulatory systems. Answers to questions such as the following determine the choice of the regulatory system.

- Is the judiciary independent, and do other conflict-resolution mechanisms exist?
- Are there constitutional features that limit the power of governments to reform the law?
- What is the political structure in the country, and are there frequent changes of government?
- Are there intermediary agencies that are capable of functioning independently of political influence and that could be involved in the regulatory system?
- Is administrative capacity in the bureaucracy and the judiciary sufficient to implement complex regulatory systems?

Research has shown that the success of regulatory reform depends on the match between the structure of the reforms and the underlying governance institutions in the country.

a. Five country case studies as well as a comparative paper have been prepared (Levy and Spiller1993).

with divestiture of public enterprises in those Latin American countries having a good record.

- For South Asia, Bank-supported programs aimed at administrative and civil service reform have been more limited, notwithstanding substantial ESW by the Bank and a regular discussion of PSM issues in the dialogue with governments. This reflects partly the hitherto weak commitment of governments and partly their ambivalence toward seeking technical assistance ac-

BOX 1.4 PUBLIC SECTOR REFORM IN ARGENTINA

In 1989 the Government of Argentina instituted one of the most comprehensive public sector reform programs ever undertaken: complete restructuring of the state. Administrative reforms have since reduced the size and scope of government and improved control over expenditures. Increased transparency in revenue sharing with the provinces was achieved, and selected expenditures were decentralized. A massive program of privatization and asset sales occurred. As of December 1992 this program had raised US$5.3 billion in cash and reduced public debt by US$9.4 billion. Reforms in tax administration increased federal revenues from 17.6 percent of GDP in 1989 to 25 percent of GDP in 1992.

The results of the reform program have been striking. From a state of insolvency in 1989, Argentina's public finances have stabilized, and the economy is now in its third year of strong expansion.

The World Bank has supported Argentina's efforts through a number of lending operations.

- *Public Sector Reform Adjustment Loan* and *Public Sector Reform Technical Assistance Loan.* These two complementary operations supported a wide range of changes. Administrative reforms included a 20 percent reduction in federal employment, ministerial reorganization, wage decompression, and strengthening of administrative capacities. The enactment of new legislation improved accountability and transparency in public financial management. Tax policy reform and restructuring of the Central Bank were also undertaken. In addition, management information systems for customs, the civil service, and budget administration were developed.

- *Public Enterprise Reform Adjustment Loan* and *Public Enterprise Reform Execution Loan.* Privatization and restructuring of public enterprises (PES) in the telecommunications, railways, and hydrocarbons sectors, among others, were supported under these two operations. In addition, the World Bank financed capacity building in the government to plan, execute, and monitor public enterprise reform. A more recent loan will support reform of PES in the defense sector as well as improve the environment for private sector activity.

- *Second Tax Administration Loan.* This project's objective is to strengthen further the tax system. It supports simplification of the legal framework governing tax administration, decentralization of tax administration systems, improvements in service quality, and increased efficiency in collection and taxpayer auditing.

cording to the Bank's loan terms. This situation now appears to be changing, and Bank assistance in administrative reform features prominently in the fiscal 1994–95 program. For example, work will be undertaken in Sri Lanka on administrative reform; civil service reform is being discussed with the

BOX 1.5 THE IMPORTANCE OF INSTITUTIONS: EVIDENCE FROM THE EAST ASIAN MIRACLE ECONOMIES

From 1965 to 1990 East Asia sustained a rate of economic growth that was greater than that of any other region in the world. Much of this growth has been concentrated among just eight economies—Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, Singapore, Taiwan (China), and Thailand. These so-called *newly industrialized economies* (NIEs) have managed to combine high levels of economic growth with social equity as well.

Various factors have contributed to this economic success, one of which is the existence of strong institutional frameworks in all eight economies. Some specific aspects of the institutional framework that enabled rapid growth were emphasized in a recently completed major research study by the Bank.[a]

■ *Competent, honest, and realistically paid bureaucracies.* Explicit mechanisms were adopted to attract highly qualified individuals into the civil service. These included merit-based recruitment and promotion, incentive-based compensation, and clearly de-

Government of Nepal; and Bangladesh has requested assistance for training public servants and improving civil service management.

■ In East Asia and the Pacific the Bank's work on public sector management reform has varied considerably, according to the type of country involved. Most governments in higher-performing economies do not require assistance from the Bank. Their budget systems operate satisfactorily; civil services are skilled and professional (box 1.5); and public enterprise sectors, in the main, perform satisfactorily. Bank PSM work has therefore tended to be concentrated in countries such as Indonesia, which, while performing well economically, still require assistance in government financial management and civil service reform. In countries such as the Philippines and Papua New Guinea, the dialogue on PSM reform has been more intense, but results have been elusive. In the smaller transition countries, there is growing Bank involvement in financial management and civil service reform, and the Bank has been assisting China in decentralizing public administration. The Bank may assist with civil service reform and aspects of central government reorganization as well.

■ Bank assistance to Africa is dominated by the collapse of public sector capacity in many countries, brought about by a combination of state overextension, delayed adjustment to changed external economic circumstances, fined, reward-oriented career paths. Such competition-based mechanisms induced competency. Mechanisms were also created to protect officials from political interference.

▪ *Corps of economic technocrats in the bureaucracy responsible for formulating and implementing economic policy.* Several governments had a deliberate policy of sending local university graduates and in-service staff to the best postgraduate training available in Europe and North America. These technocrats were allowed to function with relative independence and developed a professionalism that ensured continuity in economic policymaking and minimized dominance by special interests.

▪ *Early development of legal and regulatory frameworks.* Their maintenance has been conducive to private sector development.

▪ *Creation of formal institutions and informal channels to facilitate communication between the public and private sectors.* This ensured that transparent information systems were available to all economic agents and minimized rent-seeking behavior.

a. World Bank 1993a.

natural events, and poor governance. The emphasis is thus on rebuilding capacity while addressing the systemic failures that have contributed to a downward spiral of public sector performance. This task has made Sub-Saharan Africa both one of the regions where the Bank is most intensively engaged in PSM lending, ESW, and research, and one where it is being innovative (for example, by examining indigenous management systems). Civil service reforms are being supported in close to half the countries in the region, with a clear progression of approaches, from the first pay and retrenchment reforms of the mid-1980s to the current governance approach being tested in The Gambia (box 1.6) and radical government restructuring in Uganda. State enterprise divestiture programs have long been a feature of Bank lending, though the implementation record in many countries has been disappointing. In a growing number of countries, the Bank is helping rebuild government accounting and auditing capacity.

■ In Europe and Central Asia, the primary emphasis has been on redefining the role of the state in the economy. The main thrust of Bank work has been supporting privatization and private sector development to help countries move away from the command system and to create the institutional basis for functioning market economies. More broadly, however, the Bank is supporting the development of social safety nets, the clarification of property rights,

BOX 1.6 THE GOVERNANCE APPROACH TO CIVIL SERVICE REFORM

The World Bank's Africa region recently published "A Governance Approach to Civil Service Reform in Sub-Saharan Africa" (Dia 1993), in which a new approach to civil service reform was advocated for the region. The paper reviewed prior Bank experience with civil service reform and drew attention to the rather disappointing results of these operations. The outcomes were traced to the patrimonial character of the state, which, in the context of civil service, referred to, among others, such features as recruitment based on subjective criteria; remuneration levels unlinked to productivity; and loyalty of employees to individuals rather than the state.

The new approach advocates civil service reform that begins with an assessment of the institutional environment in which the civil service functions. The institutional assessment would focus on key governance issues such as accountability, openness and transparency, and rule of law and would yield a *patrimonial profile* of the country. The type of civil service reform strategy that is adopted will be linked to the patrimonial profile. Thus, a *comprehensive approach*, an *enclave approach*, or a *hybrid approach* would be adopted, depending on whether the patrimonial profile of the country was high, low, or average, respectively. Different lending instruments would be used in each instance.

The concepts developed in the paper are in the process of being made operational. The World Bank soon will carry out an institutional environment assessment in The Gambia. The results of the assessment will be used to develop a civil service reform strategy that is appropriate to the Gambian context.

the establishment of market-based financial systems, and other institutional elements necessary to separate civil society from the state while putting the business of government on a sounder footing. The Bank has made particular use of institution-building loans to help governments develop new capacity to implement reforms—former Soviet republics such as Armenia, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Ukraine, and Uzbekistan have benefited. These loans have included capacity building for macroeconomic management, aid coordination, budgeting and treasury management, tax and customs administration, statistics development, and public enterprise divestiture. However, while these loans are undoubtedly addressing core functions of governments in transition to a market economy, unsettled political conditions and bureaucratic resistance to change are inhibiting their full implementation.

In Albania work is under way to build core economic agencies, and ESW has focused on fiscal aspects of decentralization. In Poland a Bank study started an effort to reform public administration, which may lead to a public sector loan, and a study of decentralization has also been undertaken. In the Baltics, Russia, and Romania, *public expenditure reviews* are under way or in the planning stage. At the same time in Russia, the Bank's work at the *oblast* level is expanding.

■ In the Middle East and North Africa, the Bank's efforts in public sector management have concentrated on state enterprise reform, including privatization, deregulation, and better financial discipline for enterprises. Improving economic management and decentralizing have also received attention. Public administration and civil service reform are now beginning to come to the fore in several countries as governments respond to the needs of modernization.

Lending in Algeria, Egypt, Morocco, Tunisia, and Yemen has dealt with issues of improved economic management. In Morocco there has been support for decentralization through the Municipal Finance Project. In Lebanon the Bank will assist the government in restoring essential administrative capacity, and with the unification of North and South Yemen the Bank will provide support for the reform of the newly unified public administration. In Egypt, civil service reform, a huge and long-term task, is likely to focus initially on economic agencies, while in other countries, such as Algeria and Tunisia, restructuring of key sectoral ministries is under way or envisioned, with Bank support. In the special case of the Occupied Territories, the Bank is assisting in the establishment of a Palestinian entity to manage the emergency development program and will provide support for the institutions taking responsibility for public management functions under the evolving agreements on self government.

Emerging lessons

There is a need for further work within the Bank, drawing lessons from existing civil service reform programs to develop new approaches, particularly for countries where the mismatch between numbers on the payroll and the ability to pay is so large that the transition to a smaller, better paid and motivated civil service seems intractable. One example of a new initiative has been taken by the Bank's Africa Region, which has adoped a new governance approach to civil service reform. Questions abound, for example, whether reform programs should be more radical in their approach to retrenchment, how commitment and ownership can be built and change managed, how performance incentives can be sharpened, and whether traditional bureaucratic models are appropriate in the cultural and social settings of some countries.

Across regions, progress with divestiture and public enterprise reform has been uneven. Progress in Latin America and the Caribbean has been strong whereas performance in Sub-Saharan Africa has been disappointing. Countries with weak governmental institutional capacity have found it especially difficult to resolve public enterprise sector problems either through making enterprises accountable for their performance or through privatization.

As with economic reforms, the sequencing of PSM reform is important. In transition countries the immediate priority is to create capacity in core agencies for economic management tasks, such as macroeconomic policy, privatization policy, aid coordination, fiscal management, and revenue collection. Subsequent priorities include creating a civil service, rebalancing central and local responsibilities, reorienting economic statistics collection, changing departmental functions, and reorganizing the machinery of government for a market economy. In countries where government capacity has collapsed, civil service reform must be high on the agenda even though it takes a great deal of time. Countries that are beginning to modernize public administration should make the government budget a focus of attention. And many countries should give priority to strengthening revenue collection agencies. In all countries, actions that promise visible success early are needed to generate support for reform and to offset *adjustment fatigue.*

Experience with budget reform has been uneven, underlining the importance of ownership and sustained commitment. In some countries the requirement may be for evolutionary reform of budget processes whereas in others, wholesale systemic reform may be indicated. The latter, especially, requires commitment over a long period of time if the benefits of new budget systems are to be enjoyed. Work is needed in this area to understand better the reasons for failure and how government budgeting, the arena in which key resource allocation choices and tradeoffs should be made, could be made more effective.

In all regions there is strong confirmation that public sector management is a key issue of development effectiveness and that systemic issues of governance, institutional development, and public sector management are at the core of country development performance and therefore must be central in the Bank's dialogue with governments.

Accountability

Accountability is at the heart of good governance and has to do with holding governments responsible for their actions. At the political level it means making rulers accountable to the ruled, typically through the contestability of political power.

Although accountability has always been something that Bank operations have sought to enhance, systematically assisting countries in improving the accountability of their public sectors has been an important thrust of the activities of the Bank in the past two years. This has coincided with an increased emphasis on accountability by both aid agencies and borrowing countries.

Demand for greater accountability

At the official level of government, accountability takes several forms. The traditional form is hierarchical, based on administrative structures reporting, ultimately, to the political level. The Bank's 1991 governance report termed this *macrolevel accountability*. It can be reinforced by mechanisms of microlevel accountability, involving decentralization, participation, and competition. The last two factors enable the public to influence the quality and quantity of a service by articulating its views or shifting its demand. In almost all countries, citizens have become more critical of government performance in the management of the economy, in the delivery of services, and on other occasions when they encounter officialdom. Within government, particularly in the more advanced countries, emphasis is being given to managerial accountability based on the production of outputs rather than the use of inputs and an expanding use of performance indicators.

The global trend is toward less authoritarian modes of exercising power. One reason is the decline in many countries in the effectiveness of public institutions and, thus, their credibility. Another is the growing importance of the private sector and a realization that the private rather than the public sector is the driving force of sustained economic growth. Information on what is happening at home and abroad is widely available through multiple channels. A further factor is the attenuation of state power, caused on the one hand by the globalization of the world economy and on the other by the trend toward decentralization. And all countries have been affected by the systemic changes under way as a result of the end of the Cold War.

The move toward more democratic and therefore participatory modes of exercising power, as well as the abandonment of centralized economic management schemes, affects the manner in which power is exercised even in countries that were not members of the socialist bloc. This is taking the form of demands for greater accountability of governments for the functions that must be performed centrally and for decentralization of the functions that can be carried out more responsively at local levels.

The trend toward *decentralization of government*, therefore, has become one of the principal ways in which this demand for greater accountability is being expressed. For the Bank this has meant both renewed involvement in an area that has long been associated with Bank lending and an opportunity to review traditional approaches. One outcome has been the involvement of staff from all regions in local government studies, leading in many cases to project preparation and lending.[4] Another outcome has been an in-depth review of the Bank's approach to municipal development, which has already begun to influence the design of projects in the urban sector (World Bank 1993d). The review suggests that interventions based on strengthening the internal workings of local government administrations—the Bank's traditional approach—are unlikely to be effective by themselves and that a new approach must be adopted that places local governments within a broader framework. This entails taking a fresh look at the assignment of functions to lower tiers of government: whether these are commensurate with revenue-raising capacity, how local government bodies are held accountable, and whether there are problems of public sector management that must be addressed systemically if local governments are to function properly. At the same time, it means taking care not to dilute the capacity of central governments to perform tasks that must still be carried out centrally.

Another aspect of accountability in which the Bank has been actively involved is *financial accountability* in both the public and the private sectors, but especially in the former. Again, Bank efforts and results differ, depending on the region. In some cases, such as in South Asia, in East Asia and the Pacific, in Africa, and in Europe and Central Asia, much effort has been dedicated to establishing the infrastructure for sound financial management. This has entailed improved budgeting, accounting, and information systems; building professional cadres of accountants and auditors; and strengthening the legal framework of modern accounting practice. These efforts should be reinforced by regular assessments of the country's financial accountability, following the recommendations of the Bank's Financial Reporting and Auditing Task Force (World Bank 1993e). These assessments, proposed for all regions, will review borrower countries' accounting and auditing standards, laws, and regulations and will take stock of professional capacity within the country to undertake accounting and auditing work and training arrangements. The assessments will also examine the independence of auditors, in both the public and the private sectors.

Some of the Bank's work in all regions has been oriented toward strengthening auditing offices to counter misuse of funds and to promote compliance with financial management standards. At the same time, in recognition that obsolete auditing practices can be an obstacle to prompt and effective delivery of government services, one of the goals of auditing reform has been to introduce modern post-auditing practices to expedite governmental processes. In many countries, for obvious reasons, it has been necessary to proceed with accounting and auditing reforms in tandem.

Mention should be made of a third manifestation of the demand for greater accountability, the beginning of a *change in attitudes toward corruption*. This change is by no means uniform, but two distinct trends can be observed. First, in the main bilateral donor countries, corruption has become part of the debate on aid effectiveness, and the perception that aid resources are diverted by corrupt elites in developing countries is one factor weakening the long-standing consensus on aid programs. Second, in certain developing and industrialized countries, exposure of large-scale corruption has brought down political leaders in unanticipated ways and shed light on systemic corruption, suggesting that a shift in public tolerance may be happening.

These events are likely to have an impact on how power is exercised in many countries. In terms of the Bank's work, reform measures that directly help countries control corruption have been part of structural adjustment programs for years. These measures comprise, first, ways to reduce rent-taking by simplification of rules and by replacing administrative with market mechanisms; and second, institutional strengthening to improve financial controls and to ensure that civil servants have fewer incentives to become corrupted. A reduced government role through deregulation and direct involvement in the production of goods should reduce opportunities for rent-seeking. Reinforced by dialogue and research, these measures could be regarded as building blocks of a strategy against corruption (box 1.7). Meanwhile, acceptance of World Bank efforts to improve financial accountability in many of its borrower countries has been made easier by the publicity that widespread political corruption has attracted. The expectation is that there will be increased calls on the Bank to assist countries in combating corruption.

World Bank experience

Because World Bank membership is diverse, such general trends have a different impact on member countries, depending on the political system and the cultural context in which power is exercised. This diversity is reflected in Bank experience in the last two years and, as can be observed, leads to different approaches from region to region in supporting improved accountability:

■ In Latin America and the Caribbean the Bank is moving beyond assistance solely to the executive branch of governments and extending technical assistance for improvements to the legislative and judicial branches. Illustrations of this trend are the loan to Chile to improve access to information by the legislative branch and the loan to Venezuela for judicial modernization (box 1.8). In Colombia the legislature is being assisted in monitoring and evaluating public spending. These operations, although modest in themselves, show how modernization of the state for effective governance requires actions in new areas that are nevertheless within the boundaries of the Bank's mandate.

■ A major theme in the Bank's lending and economic and sector work is decentralization. Many loans to strengthen municipal or provincial govern-

BOX 1.7 TOWARD AN ANTI-CORRUPTION STRATEGY

Although such action was not conceived in the first instance as an element in an anti-corruption strategy, the intervention of the World Bank in a number of areas helps countries to control corruption.

The first four types of action reduce opportunities for rent-taking by simplifying rules and by replacing administrative with market mechanisms:

- *Trade regime reforms,* which limit the scope for discretionary treatment by customs officials and replace administrative actions with price mechanisms in the allocation of import licenses and foreign exchange.
- *Tax reform,* based on lower, uniform rates and simpler rules and the strengthening of tax administration and record-keeping.
- *Regulation reform,* such as the abolition of price controls, the simplification of license requirements, and similar deregulation measures.
- *Privatization,* to reduce the size of the state enterprise sector under bureaucratic control.

The next three actions are examples of institutional strengthening to improve controls and reduce incentives for corrupt behavior.

- *Civil service reform,* to restore a professional, accountable, realistically paid, and well-motivated bureaucracy.
- *Strengthening public procurement systems,* through the reform of laws, more transparent procedures, adoption of improved bidding documentation, competitive bidding, and staff training.
- *Modernization of public sector accounting,* upgrading internal auditing capacity, and strengthening the supreme audit institution.

This agenda could be broadened to include a research program aimed at better understanding of: (i) the framework of economic incentives for corrupt behavior; (ii) whether some kinds of corruption are more dysfunctional than others; (iii) the relationship between corruption and political systems; (iv) best practice in countries that have succeeded in curbing corruption; and (v) measures that industrialized countries could take to discourage corrupt practices by exporters. In addition, the World Bank should maintain a dialogue with watchdog organizations established to fight corruption and with governments seeking practical ways to reduce the moral and economic costs of corruption.

ment have been or are being made throughout the region, such as in Argentina, Brazil, Chile, Colombia, Mexico, and Venezuela. Decentralization, however, is a complex process that requires simultaneous attention to capacity building, transfer of responsibility, fiscal reform, and the participation of

BOX 1.8 LEGISLATIVE AND JUDICIAL REFORM IN LATIN AMERICA: NEW AREAS OF WORLD BANK INVOLVEMENT

Good governance requires improvements not only in the executive branch of governments but in the judicial and legislative branches as well. The World Bank has begun to extend its support in the latter two areas. Two operations in Latin America merit attention.

■ *Second Public Sector Management Project (PSM II) in Chile.* The ability of Chile's Congress to evaluate new legislation is tied to the quality of information and analysis it receives. The primary institution responsible for providing this type of information is the Library of Congress. However, the services provided by the Library of Congress have deteriorated considerably, thereby affecting the legislature's ability to carry out its responsibilities.

The PSM II project has a significant legislative assistance component. It aims to improve the ability of the legislative branch to review and formulate policy by strengthening the Library of Congress. This will involve computerizing communication systems, strengthening reference holdings, and conducting training programs. In addition, communication links between the legislative and executive branches of government will be strengthened. All these efforts will contribute toward increasing the efficiency of government policymaking.

■ *Judicial Reform Project in Venezuela.* The judicial system in Venezuela is extremely weak, characterized by long delays and inconsistent rulings. Among the underlying causes for this are an inefficient court management system, inadequate remuneration for Judicial Council staff (the principal administrative organ of the judicial system), and weak information systems. Personnel policy lacks transparency and is often politically motivated. In addition, the physical infrastructure of the court system is severely run down.

The project aims to improve the efficiency of the judiciary. To achieve this the institutional capacity of the Judicial Council will be strengthened. Measures such as automating courtroom procedures, improving training in the Judicial School, and strengthening the planning, budgeting, and management capacity of the council will be supported.

Speeding up the process to reduce litigation and transaction costs generally is an important objective.

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beneficiaries if it is to be successful. In the case of Venezuela, which passed a comprehensive decentralization law in 1989, experience has demonstrated that more attention has to be given to municipal development before attempting full-scale political devolution of responsibility to local governments for provision of services.[5] The Public Administration and Decentralization Project is now being prepared, which combines municipal capacity building with transfer of responsibility and authority, and at the same time creates competition in the delivery of local services. In the Municipal Development Project in Chile an incremental approach is being used that offers hope of an orderly process, based on applying learning experiences from selected municipal governments to the design of reform programs for other local governments.

■ In South Asia, a region that contains the world's largest democracy and where institutional structures are long established, the thrust of the Bank's governance work is to assist governments in improving the financial accountability of their public sectors. In Pakistan, a major project to modernize accounting and auditing is in an advanced stage of preparation (box 1-9), and in Bangladesh, public utilities have been a focus of attention. Another thrust has been privatization and deregulation, redrawing the boundary between the public and private sectors and thereby improving governance. Continuing reforms in Bangladesh and India reflect this approach. Although decentralization programs have been implemented in the region, the Bank has been only peripherally engaged. More striking is the large number of projects the Bank is supporting in all countries with strong community participation to improve accountability. It is in this area that the Bank's work has been the most innovative.

■ In the East Asia and Pacific region, progress in performance accountability differs substantially. Transitional economies undergoing systemic changes face the greatest challenges, and progress has been uneven. In China, decentralization of decisionmaking authority to local levels is occurring more rapidly than anticipated, and the Bank is supporting local government development in several provinces. In other transition economies, decentralization is less advanced, and there have been reversals. As to the high-performing economies, accountability mechanisms are well established, and the Bank's involvement, understandably, has been less, although in one country (Indonesia) the Bank is supporting a major accountancy project. In the case of low-performing economies in the region, progress in strengthening accountability mechanisms has been uneven, and the Bank's involvement may increase. Overall, there has been an emphasis on improving governance through privatization and deregulation, and this is particularly reflected in the Bank's work in Indonesia and the Philippines.

■ In Africa, much of the Bank's operational work has been focused on financial accountability, where the need is to rebuild accounting and auditing capacities in government. Support has also been provided for the strengthen-

BOX 1.9 PROMOTING FINANCIAL ACCOUNTABILITY IN ASIA

Strengthening financial accountability has been a major focus of the World Bank's public sector management reform efforts. Transparency and consistency in accounting practices, as well as an independent auditing body, are vital underpinnings of a well functioning financial system. The Bank is supporting a number of initiatives throughout the world to strengthen public and private accounting and auditing functions. Two projects in the Asia region merit attention.

- *Financial Sector Technical Assistance Project in China.* The project seeks to strengthen several key elements of China's financial sector infrastructure. One component focuses on modernizing accounting and auditing practices and making them more suitable to a market economy. Accounting standards that conform to international generally accepted accounting principles (GAAP) will be developed and disseminated. Staff will attend seminars to be trained in the use of the new standards and systems. Auditing capacity will be strengthened and new, internationally acceptable procedures instituted. The project also finances technical assistance to develop a continuing professional education program for Chinese CPAS.

- *Accountancy Development Project in Indonesia.* This project seeks to improve accounting and auditing practices in both the public and private sectors by improving the processes of accounting and auditing and conducting training programs for personnel in the field. The operation will finance efforts to promote consistency and improve the utility of accounting processes in government. Technical assistance and equipment will be provided to improve the quality of accounting education, which will involve programs at the university as well as at the secondary level. Nonformal accountancy training programs will also be offered. Finally, the project will develop a set of accounting standards for the private sector and establish a code of ethics for accountants.

A third project, to be implemented in Pakistan, is currently under preparation. Financial accounting and monitoring are extremely weak in Pakistan, largely because of the Pakistan Audit Department's (PAD) having the dual responsibility of maintaining the accounts of the entities it audits. The proposed project will create a new entity to undertake the accounting function, revise accounting standards, improve financial reporting and financial administration procedures, and modernize auditing approaches. Computerized systems for accounting and financial reporting will be introduced and human resource development programs undertaken.

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ing of professional associations of accountants and auditors. In Zambia, assistance is planned for the parliament's Public Accounts Committee. Decentralization has also been a theme of the Bank's governance work. The Bank has played a leading role in the Municipal Development Program, a multidonor initiative to strengthen municipal governments in Sub-Saharan Africa, with coordinating centers in Cotonou and Harare. The Bank has increasingly used nongovernmental organizations (NGOs) in the delivery of services, and in several countries, public works agencies have been set up with Bank encouragement outside the structure of government to manage and implement public works and employment creation.[6] These agencies have promoted beneficiary participation in the design of schemes, reduced construction costs, and improved service delivery. However, at present they are sustained almost exclusively by donor funds and leave untouched the issue of capacity rebuilding within governments.

■ In Europe and Central Asia, problems of accountability are set in the national contexts of state rebuilding as a result of the transition from command to market economies and the introduction of democratic institutions. Traditionally, government agencies and subordinate tiers were highly subservient to the central governments. With the collapse of communism, the power of central authority has greatly diminished, and with the fragmentation of political authority, de facto decentralization has occurred. In some of these countries the situation has become particularly complicated as a result of regional conflicts, political instability, and power struggles between the executive and the legislative branches, which have severely affected the World Bank's ability to undertake normal lending actions. Within this broad situation, the Bank's work on decentralization has been concentrated more in Central and Eastern Europe, in those countries where political reforms are a few years older than in the republics of the former Soviet Union (FSU). In several transition countries, the Bank is also assisting in establishing a framework of financial accountability and the adoption of modern public and commercial accounting systems to supplant the previous politicized and state-centered system.

■ In the Middle East and North Africa there has been limited progress in performance accountability beyond the level of particular projects, in part because, until recently, many governments in the region preferred to limit their interaction with the World Bank to a narrow set of issues, mostly related to project work. This situation, however, is changing rapidly as a result of economic changes and because of political developments such as the end of the Cold War, the Gulf conflict in 1992, and the current Arab-Israeli peace process. Middle East governments are embarking on economic reforms that also entail changes in the traditionally closed governance of some of the countries. In various sectors there have been a number of innovative projects that encourage local initiatives (box 1.10).

Emerging lessons

A number of lessons and issues arise from the Bank's recent experience assisting countries in strengthening accountability.

■ Modernizing accounting and auditing to improve the overall accountability of public organizations means putting better financial management systems at the disposal of both government leaders and the legislature. They are tools for

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BOX 1-10 ACHIEVING MICROLEVEL ACCOUNTABILITY: *VOICE MECHANISMS* IN WORLD BANK PROJECTS

World Bank operations in the Middle East and North Africa have been successful in promoting microlevel accountability. In particular, the Bank has been incorporating so-called voice mechanisms in its projects by encouraging popular participation and NGO involvement.

The *Matruh Natural Resource Management Project in Egypt* is an excellent example of a participatory operation. Natural resource degradation is extremely high in the project area, and the main purpose of the intervention is to couple agricultural and livestock development with improved natural resource management practices. The project is being implemented in the northwestern coastal zone of the country, an area inhabited by a tribal Bedouin population.

Popular participation was identified early as a means of gaining local support for an action program and has been encouraged from the outset. A participatory rural assessment (PRA) at the identification stage helped determine the priorities and needs of the affected population, and this information was factored into the project's design.

Once the project had been prepared, community groups (CGs) formed to involve the local population in the implementation of the project. Each CG represents a subtribe operating in the project area and is responsible for preparing a community action plan (CAP). The CAP allows the objectives of the project to be tailored to the specific needs of individual communities. Although government and project personnel are available to assist, the main idea is to draw on local knowledge in defining the state of resources and understanding customary practices for land use, grazing, and so on in that community. Once the CAP has been prepared and approved, the CG becomes involved in both implementing and monitoring the program in its community. Any revisions to the CAP after periodic evaluations will follow the same participatory process.

The mechanisms developed in this project ensure that the community has a voice in the interventions affecting them. The method not only builds support for the initiative and increases the likelihood of sustainability but also ensures that the project conforms to the particular needs of each community.

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greater accountability; to be effective, they need to be matched by a demand for accountability from government managers by the legislature or by the public through an active press. The World Bank can facilitate the process but not substitute for it.

■ In several regions where government capacity has been eroded (Africa in particular) efforts to strengthen accounting skills and upgrade systems require parallel action to address deep-seated civil service problems, including pay and working conditions. Before capacity can be rebuilt the causes of its erosion in the public sector must be addressed. Many of these causes are governance related in origin.

■ The World Bank's experience with decentralization across the world in the past two years corroborates the conclusions of the Bank's Municipal Development Sector Report. This stresses a broad approach and the importance of synchronizing fiscal decentralization, transferring service responsibility, supporting municipal capacity building, and tackling systemic public sector management problems. In most countries the factors contributing to weak local government are complex, and World Bank interventions that do not address the fundamental causes of this weakness will not be successful.

■ The number of investment projects with significant participatory components has expanded rapidly. In this area, the Bank has found it easier to incorporate *voice mechanisms* (for example, involvement of local NGOs) for beneficiaries than *exit mechanisms* (for example, competition in service delivery and an opportunity for beneficiaries to seek alternative suppliers). In administrative terms it is easier to set up consultative mechanisms than to erect a framework for competition in service delivery and the transfer of entitlements (Paul 1991[7]).

■ The World Bank's experience confirms the importance of rooting accountability in local processes and institutions and the need to avoid substituting international governance for local governance. This is an inherent risk in heavily aided countries with weak institutions and must be guarded against when developing new channels for service delivery outside the traditional framework of government departments.

Legal Framework for Development

The laws and regulations, the processes through which they operate, and the institutions that apply them comprise the legal framework of a country. Although in all societies a range of informal mechanisms exists to resolve conflicts, and enduring business relationships are based on trust, market economies require a framework of clear laws and efficient legal institutions within which the interaction between economic agents and the state can take place. An appropriate legal system will provide stability and predictability, which are essential elements in creating an economic environment where business risks may be rationally assessed and the cost of transactions lowered.

Economic and social development and the legal system

The legal framework in a country is as vital for economic development as it is for political and social development. Creating wealth through the cumulative commitment of human, technological, and capital resources depends greatly on a set of rules securing property rights, governing civil and commercial behavior, and limiting the power of the state. As *Governance and Development* emphasized, this set of rules must be clearly defined and known in advance; effective institutions must be in place to ensure its uniform applicability; there must be mechanisms to resolve conflicts based on the binding decisions of an independent judiciary; and procedures should exist for amending the rules when it becomes clear that change is necessary. In many countries the inappropriateness of laws, uncertainty in their application, weak enforcement, arbitrariness of discretionary power, inefficient court administration, slow procedures, and the subservience of judges toward the executive branch greatly hinder development, discourage and distort trade and investment, raise transaction costs, and foster corruption. Laws may be unenforceable because they contradict economic logic, thereby destroying the incentive for compliance.

The legal framework also affects the lives of the poor and, as such, has become an important dimension of strategies for poverty alleviation. In the struggle against discrimination, in the protection of the socially weak, and in the distribution of opportunities in society, the law can make an important contribution to an equitable and just society and thus to prospects for social development and poverty alleviation. Conversely, the legal framework can cement existing inequalities through laws that discriminate by race, religion, ethnic affiliation, national origin, or sex, or where tax laws, land laws, family laws, and social security laws fail to protect the weak or discriminate against them. Inherent in the concept of the rule of law is the notion of fairness and social justice.

The World Bank's experience

In helping countries to improve their legal systems, the Bank has used a variety of instruments. New laws and judicial reform have been components in sector or economywide programs supported by adjustment loans; investment loans have included legal system components; there have been standalone technical assistance projects and, more recently, grant assistance from the Bank's Institutional Development Fund. In addition, through its own staff, the Bank has provided extensive advice directly to governments. Although the passing of specific legislation or the amending of regulations has long been a feature of investment projects financed by the Bank, the bulk of the Bank's present activities in the area of legal systems is new.

- In Eastern Europe and Central Asia, substantial technical assistance has been extended to countries moving from a command to a market economy. A first step has been the passing of privatization laws. Second, with Bank assistance, transition countries are enacting banking laws, bankruptcy laws, company laws, contract laws, fair competition and consumer protection laws, foreign investment laws, mineral laws, and land laws (in Belarus, Latvia, Lithuania, Romania, Russia, Ukraine, and Uzbekistan, for example). At the same time, the Bank is assisting the countries with legislative, administrative, and judicial reforms so that the institutional framework is in place to enact, administer, and enforce laws. Law reform units within government structures have been established with the Bank's help (box 1.11). Antimonopoly and financial supervision agencies are being set up or strengthened, and training programs for judges, lawyers, and court officials have been launched. In addition, a major research program is under way in the World Bank Policy Research Department to analyze the economic impact of legal reform in Central and Eastern Europe (box 1.12).

- In East Asia, similar efforts are being made to introduce new laws and to create an institutional framework for the transition economies of that region. Major new laws have been enacted with the Bank's assistance in the Lao People's Democratic Republic and Viet Nam, and a large commercial law reform project is under preparation for China. In addition, the Bank has supported court administration and the dissemination of laws in Indonesia, where the slowness of courts and their lack of specialization have eroded confidence in the legal system.

- In the Middle East and North Africa the Bank's work has focused on improving the effectiveness of legal and regulatory frameworks, particularly those governing economic life. In Egypt, Iran, Morocco, and Tunisia, the Bank has supported the reform of banking and finance laws, and in these and other countries the Bank is supporting an array of legal reforms to simplify trade and customs procedures, encourage new businesses, and generally improve the legal environment for the private sector.

BOX 1.11 LEGAL REFORM AND INSTITUTION BUILDING IN THE REPUBLICS OF THE FORMER SOVIET UNION

The transition from a command to market economy requires substantial changes in the legal and regulatory framework governing economic activities in the Eastern European and Central Asian republics. Legal reform has begun in the financial sector and the energy and mining sector, and privatization rules and regulations are in place. But there is an urgent need to develop an overall program for legal reform in the various sectors of each economy.

So far, the republics have focused on the passing of new laws. However, newly enacted laws and decrees may: (i) be contradictory; (ii) ignore the implementation capabilities of the enforcing agencies; (iii) deal with issues in isolation; and (iv) reflect transplanted concepts and structures alien to the country's legal tradition.

To overcome these deficiencies, the World Bank has supported components in existing or planned institution building projects (in Armenia, Azerbaijan, Georgia, Kazakhstan, Tajikistan, Turkmenistan, and Uzbekistan) or technical assistance components in rehabilitation loans and credits (in the Kyrgyz Republic and Moldova) to establish central legal reform units. The objectives have been the following:

- to coordinate all legal reform activities within the various sectors of the economy
- to provide liaison with foreign donors of technical assistance in the area of law
- to monitor the implementation and enforcement of the newly enacted laws and regulations
- to assist government agencies in strengthening their enforcement capabilities.

The legal reform component of the Rehabilitation Credit to the Kyrgyz Republic illustrates this approach. Thus far, legal reform in the areas of agriculture, auditing and accounting, banking, corporate governance, mining, and privatization has been uncoordinated. A central legal reform unit will be established, financed by the credit, in the Office of the President. The credit will finance office equipment, library facilities, a computerized legal database, the services of a resident legal adviser, and short-term legal consultants, and it will provide for in-country and foreign legal training for the staff of that unit.

It is the expectation that these legal reform units will foster the development and implementation of comprehensive and integrated legal reform programs and enable the countries to promote the rule of law as a governing principle for all economic activities.

- In South Asia the emphasis is on modernizing commercial laws and strengthening judicial administration and staff training (in Bangladesh and Pakistan) by using industrial and financial sector adjustment credits. In Nepal, changes

BOX 1.12 LEGAL FRAMEWORK FOR PRIVATE SECTOR DEVELOPMENT IN TRANSITIONAL ECONOMIES

A number of countries throughout the world are transforming their economies from centrally planned to market-based systems. This transition needs support from a variety of institutional reforms, including changes in the legal framework. A clear and consistent legal framework for private sector development promotes efficiency and ensures sustainability of the reforms.

In 1992 the World Bank began a research program to understand better the evolving legal framework in transitional economies and to determine how additional reforms could improve the environment for private sector development. The Economics of Legal Reform in Reforming Socialist Economies is well under way in the Policy Research Department of the Bank. Its aim is to monitor and evaluate the economic impact of legal reform in selected Central and Eastern European (CEE) countries. Later stages of the exercise will extend to other reforming socialist economies as well. The program has three components:

- An initial evaluation of legal frameworks in Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and Slovenia was carried out.[a]
- In-depth cross-country comparisons, drawing heavily on the experience of advanced market economies, are in progress. Five core areas of the legal framework for private sector development have been identified—competition, corporate governance, debt collection and bankruptcy, foreign investment, and real property rights—with work well under way in the first four. The research hopes to identify best legal practices in advanced market economies for each of these areas and consider their applicability to CEE countries.
- The final component of the program extends the area of study beyond the CEE region to the former Soviet Union and to socialist countries in Africa and Asia. Studies of property rights reform in Tanzania and Ghana and of postprivatization corporate governance in Russia are already in progress.

a. The country case studies have already been published individually and in a synthesis book (Gray and Associates 1993).

in water and forestry legislation are being pursued to increase the efficiency of the sector and the involvement of local communities.

- In Latin America and the Caribbean, the Bank has also helped countries in modernizing their economic laws. Particularly noteworthy is Venezuela, where the Bank is helping to strengthen the judicial system. Here the Bank is assisting the government upgrade court infrastructure, install modern management systems, train personnel, and publish the laws. Similar projects are being prepared in Argentina, Bolivia, and Peru. As already noted in Chile, the Bank is helping to strengthen the legislature's capacity through better information systems.

■ In Sub-Saharan Africa the Bank is helping to strengthen legal institutions relating to property rights and contracts in the context of private sector development loans and credits (in Angola, Cape Verde, Côte d'Ivoire, Ghana, Guinea, Mali, and Uganda). A start is being made with projects specifically addressing legal institutions, such as legal training and court infrastructure in Tanzania and Zambia as well as in Burkina Faso and Mozambique. A particular feature of the former is targeted training for legal draftsmen. As part of the World Bank Africa Region's research program, legal aspects of the role of women in development are being studied (box 1.13).

Emerging lessons

From the Bank's growing experience with legal reform across regions, lessons are emerging:

■ Legal reform cannot be successful without the full conviction and political commitment of the government concerned.

■ There is a need to avoid wholesale transfer of particular Western-based legislation without due regard for the legal traditions of a country (a particular risk in transition countries). More generally, in all countries the effectiveness of legal reforms depends greatly on how the reforms take into account the social, religious, customary, and historical factors in a society.

■ Scope, however, does exist for sharing the Bank's experience among regions. Projects developed in Latin America, for example, are influencing the work of Bank staff on legal system reform in other regions.

■ Of crucial importance is the institutional framework so that new laws can be applied firmly but fairly and the right balance is struck between license and regulatory control in a market economy. In this way, legal framework reform involves broader issues of public policy and institutional development.

■ Excessive use of administrative orders issued under delegated powers can result in a conflicting and nontransparent legal framework that deters invest-

BOX 1.13 LEGAL REFORM AND WOMEN IN AFRICA

Legal reform is essential to the economic empowerment of women. A program of studies and workshops to support this has been launched by the World Bank Africa region's Women in Development (WID) unit, in consultation with the Legal Department, and is currently in its second phase.

The first phase of the program explored the relationship of law, gender, and economic development.[a]

The second phase is more operationally focused. Drawing on the framework developed in the first phase, the WID unit and the Legal Department plan to address legal issues through the lending program and sector work. At present the WID unit supports the following types of activities:

- *Preparation of country case studies.* In Uganda, for instance, the World Bank is working with the Department of Justice, the Ministry of Women's Affairs, and the national university to prepare a legal reform strategy for women.

- *Provision of workshops at the request of legal associations.* Where there isn't sufficient momentum to initiate legal reform, workshops are held to build this momentum (for example, recently in Mali). The workshops are conducted at the request of a local legal association, and they identify strategic entry points for legal reform efforts with the assistance of the Bank.

- *Participation in subregional workshops on legal literacy.* The Bank recently participated in a workshop on legal aid clinics for women in francophone Africa. The workshop provided an opportunity for the Bank to become familiar with other donors'

ment and raises transaction costs for the private sector generally (a pervasive problem in South Asia).

- Legal reform requires a long gestation period, particularly if it is seen as more than drafting new legislation. It is therefore advisable to pursue free-standing legal reform projects and to include legal reform components in conventional investment projects.

- Although the Bank is assisting countries in all regions in strengthening aspects of their legal systems, the subject is likely to remain a politically sensitive one, and the extent to which the Bank is involved in legal system reform will continue to depend greatly on country circumstances. In addition to the assistance in the drafting of individual laws, the Bank is increasingly emphasizing the need for the formulation and implementation of comprehensive legal reform agenda, including the establishment of appropriate enforcement mechanisms, and the strengthening of the judiciary and regulatory instiefforts in the region as well as to make contact with women's jurist organizations in West Africa.

- *Consultation with existing research groups.* Regular consultation with organizations such as Women in Law and Development in Africa (WILDAF) and Women in Law in Southern Africa (WILSA) is under way. These regional associations of practicing women lawyers work to identify and address common legal issues that affect women in their region. Consultation with these groups enables the Bank to draw on local expertise, build consensus, and identify legal reform strategies that are appropriate to the country.

To include the reform efforts in a region's lending program, the World Bank's WID unit focuses on operations that typically include a legal reform component—primarily financial sector and private sector development operations. In such cases, the Bank encourages the borrowing country to take women's issues into consideration when planning its law reforms. For example, a recent privatization operation in southern Africa was conditional on a study of land reform, which thus provided an opportunity to examine the impact of land reform on women.

Existing legal frameworks can be a major impediment to economic development. Identifying the legal constraints faced by women in Africa will help the Bank to design and implement more effective development projects in the region.

a. Three papers were prepared: "Law as an Institutional Barrier to the Economic Empowerment of Women"; "Gender, the Evolution of Legal Institutions, and Economic Development in Sub-Saharan Africa"; and "Women in Development: The Legal Issues in Sub-Saharan Africa Today."

tutions. In this respect, the Bank has to recognize and respect the exclusive jurisdiction and responsibility of each country over its own legal and institutional framework.

Transparency and Information

The themes of transparency and information pervade good governance and reinforce accountability. Access to information for the various players in the market is essential for a competitive market economy. Transparency improves both the availability and the accuracy of market information and thereby lowers transaction costs. Governments come to value transparency as they depend more on market mechanisms for economic management. Transparency is important for specific public programs, such as the divestiture of state-owned enterprises, which will quickly forfeit public confidence if privatization is not seen as an open process. Furthermore, transparency is a prerequisite for successful beneficiary participation in program design and implementation.

Markets, government, and transparency

Transparency assists governments in implementing market-environment policies by clarifying government policies and programs. In this way, expert opinions can be voiced, and those affected may have an opportunity to express their views. Programs to change the functions of departments and agencies, to tackle excess numbers of staff, and to redeploy the remaining staff also need to be transparent. Without transparency there will be resistance to change, a characteristic of many civil service reform programs in the past. Because it means removing the walls that bureaucracies build around themselves, transparency implies more open government. Thus, it is an essential element in any effort to improve performance accountability. Transparency is also a deterrent to corruption. It underpins competitive public procurement and generally creates a climate in which the scope for public corruption is lower and the chances of exposure higher.

Transparency should extend to private sector as well as public sector organizations so that reliable information is available to all decisionmakers. Although relationships with customers may be confidential, banks require accurate financial information on companies to assess credit risk. Banking systems as a whole will not be healthy if depositors cannot rely on the published accounts of the banking institutions with which they place their money. Insider trading undermines confidence in capital markets. As state enterprises are privatized, it may be necessary to set up new regulatory agencies, with processes that include provision for public disclosure.

Closely linked to transparency and information is freedom of the media, of which a free press is especially important if there is to be an informed debate on public policies. The press plays an important role encouraging community organizations and other civil society groupings to become engaged in policy and program debate. At the same time a free press, by exposing wrongdoing, encourages accountable behavior by public officials and politicians while discouraging corruption. Furthermore, the information media must build responsible self-policing mechanisms to maintain professional reporting standards and to avoid government censorship.

Although specific aspects of transparency, such as requiring companies to publish financial results in a standard format, opening public procurement tenders in the presence of bidders, and the timely publication of government budgets and accounts, can be readily addressed in World Bank operations, in a broader sense transparency reflects what goes on in a society as a whole. Thus, a willingness to make public processes more open depends, in turn, on the culture, tradition, and attitudes toward openness in society as a whole, which may change only slowly. Transparency requires supportive institutions, political commitment, pressure from civil society, and free media. For many of the players involved, information is power and money. Secrecy and nontransparent decisionmaking provide an opportunity for private gain or for political arrangements against the public interest. And there could be occasions when government may be right to withhold information, such as on national security issues or when reforming governments have had to move stealthily to prevent vested interests from coalescing to block reform. Improving transparency, therefore, is a necessary but complex process that will take time in many countries.

The World Bank's experience

Bank experience in relation to transparency and information in the various regions can be summarized as follows:

■ The situation in Latin American and the Caribbean geographic region has traditionally been characterized by substantial political obstacles to greater transparency. However, the trend toward democratic rule and freedom of the press has created a more favorable climate for actions that promote transparency. In this regard, World Bank work in this region has concentrated at the level of improving financial management and in the introduction of transparent budgetary systems, which allow a clearer disclosure of the relationship between performance and expenditure. Revenue administration reforms supported by the Bank in several countries have made tax and customs schedules more easily comprehensible. As an illustration of the role of transparency in regulatory reform, an NGO in Argentina was engaged to monitor complaints by the public and how they were resolved by the new private telephone companies.

■ In South Asia, World Bank efforts to promote transparency have included support for the introduction of program-oriented budget systems. This type of budget makes more explicit the relationship between goals and expenditure than the line-item budgeting systems commonly in place and facilitates the possible use of value-for-money assessments. Past experience in the region with budget-reform, however, has not been encouraging. Another effort related to transparency has been in the area of procurement through the promotion of standard bidding procedures in all countries in the region.

■ In East Asia and the Pacific, transparency is a new issue for the governments of those countries in transition to market economy, and thus far the principal instrument has been the policy dialogue. The World Bank has urged trade liberalization, more informative budgeting, legal reform to encourage foreign investment, and more clarity in privatization programs. Elsewhere in the region, considerable progress has been made removing trade and investment barriers, with the Bank's encouragement, thereby reducing opportunities for rent-seeking behavior. In several countries, the Bank has assisted governments in introducing more open and predictable procurement processes.

■ Bank action in Africa has been to encourage a variety of actions to improve transparency in the public and private sectors. Economic reform programs supported by the Bank have led to simpler tax and tariff structures, which have aided transparency and reduced opportunities for collusion between tax collection officials and taxpayers. To improve public debate on economic reform programs, the World Bank's Economic Development Institute has organized programs for journalists. *Country procurement assessment reviews* have been used to situate procurement issues prominently in policy dialogues, and procurement reform has become a component in many structural and sectoral adjustment loans. One means of encouraging government transparency in this region has been to support publication of official gazettes (in Burkina Faso

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BOX 1.14 TRANSPARENCY OF FINANCIAL REPORTING SYSTEMS

Transparent financial reporting by both the private and public sectors is essential for a well-functioning market economy. It lowers transaction costs, reduces misuse of funds and theft, and improves decisionmaking. In the public sector, transparency helps enforce policymakers' accountability. In the private sector, adherence to internationally accepted reporting standards is necessary to attract foreign investors and lenders, and it facilitates the growth of financial markets.

The World Bank is now directly addressing this subject in its economic and sector work. A recent report ("Republic of South Africa: An Assessment of Financial Accountability") examined the transparency of accounting and auditing practices in South Africa—specifically, the legal framework, standards of accounting, and the independence of the auditing profession in both the public and the private sectors. The main findings of the study were the following:

■ The regulatory framework is well established, and several improvements have already been made. In the public sphere, new legislative enactments have increased the independence of the Auditor General's office. Other legislation has strengthened disclosure requirements for private institutions. Standards have also been drafted to ensure uniformity in financial reporting across private institutions.

■ Wide disparity exists in financial reporting and accountability at the local and Mauritania, for example), which advertise public tenders and announce their award, and publicize new laws and changes in administrative regulations. In addition, the World Bank has encouraged governments to publish their budgets in a timely manner and in some cases prepare a summary version for wider distribution. (In Kenya, at the Bank's urging, the government began publishing a summary booklet of the budget proposals, throwing into sharp relief the imbalance between the civil service wage bill and supporting expenditures, which triggered lively debate in parliament and the media.) Concern for transparency has led to a new form of economic sector work, *financial accountability assessments,* thus far carried out in Ghana and South Africa (box 1.14).

■ In Europe and Central Asia, the notion of administrative openness was nonexistent under the former regimes. Thus there is no tradition of consultation with interest groups and other affected parties prior to the introduction of new policies, and there is little experience of explaining reform policies to the

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government level, for obvious historical reasons. The large municipalities populated by whites have well-managed, transparent financial systems that facilitate accountability. The self-governing states and the black municipalities lack this capacity, and accountability is weak.

■ Inadequacies beset the financial reporting practices of central government departments. This is partly related to the absence of government accounting standards as well as to the lack of a professional body dealing with central government accounting.

■ The private sector still has room to increase disclosure requirements in the areas of fixed assets, reserves, and transfers to employee pension funds.

■ The auditing profession needs greater independence when dealing with potential conflict of interest cases.

■ There is also a need to increase participation of nonwhites in the auditing profession. Although accredited bodies of accounting professionals exist in South Africa, their membership policies, as well as the education system, continue to discriminate indirectly against participation by nonwhites.

The direct focus on transparency in this report marks a new direction in World Bank's economic and sector work and emphasizes the Bank's commitment to addressing governance issues. This commitment also provides the basis on which to develop lending operations that support greater transparency.

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population at large. More specifically, there is no tradition of open and competitive procurement in the region, since previously there were only administratively determined transactions between state agencies. Public procurement at present is at a half-way stage between administrative orders and market bidding, with little clarity or consistency and wide open to the diversion of public monies. Nevertheless, compared with the past, there is now much more openness in decisionmaking.

In support of greater transparency in policymaking and implementation, the World Bank has stressed the need for open privatization and procurement processes in its considerable assistance to governments in this region. To encourage a wider debate and greater understanding of reforms, the Bank has sponsored seminars on aspects of economic management in market economies, involving its own Executive Directors and resident mission staff, on one hand, and local policymakers, legislators, government officials, and opinion makers on the other. The Bank has also forged links with local institutes and think tanks to help build a cadre of high-quality technical and policy expertise beyond the core of government. And in several countries (Belarus, Russia, and Ukraine), Bank operations have supported publicity and public-awareness campaigns to deepen popular knowledge about voucher schemes, small-scale privatization, and the like. In doing so, it has helped spread understanding about the emerging opportunities in a market economy. Advice has also been provided on procurement legislation (box 1.15).

As to transparency in privatization, the centerpiece of the World Bank's strategy in the region, the Bank has emphasized quick marketization measures and wide distribution of ownership under transparent and unambiguous rules.

■ Many governments in the Middle East and North Africa have not been accustomed to publishing information about public policy, encouraging public debate and participation, and conducting government business openly. This picture is now changing in important respects, with elections, newly empowered legislatures, and other developments. The World Bank is contributing to this process through a much broadened dialogue with opinion leaders in the region (for example, through the Council of Middle Eastern advisers), wider dissemination of Bank reports, outreach public affairs activities by resident missions, and regional research initiatives involving nongovernmental research institutions. As the process of political renewal and opening advances, recognition of the benefits of greater transparency in both the public and private sectors is growing. Through individual projects and through the World Bank's *country portfolio performance review* process, the Bank is also working for more transparent approaches to procurement, foreign exchange allocation, and tax codes, among other things.

BOX 1.15 STRENGTHENING THE LEGAL FRAMEWORK FOR PUBLIC PROCUREMENT

The legal framework governing procurement is weak in many of the countries borrowing from the World Bank. In most of the reforming socialist economies of Central and Eastern Europe and in the former Soviet Union, for example, a public procurement code does not exist. Nevertheless, this is an important component of the legal framework, needed both for a market economy and for effective public sector management.

Recently the Bank has worked closely with the United Nations Commission on International Trade Law (UNCITRAL) to develop a model procurement law that can be useful to countries trying to develop procurement codes of their own. The model was developed in consultation with representatives of member governments as well as representatives of international organizations such as the World Bank, the Inter-American Development Bank, and the International Bar Association.

The model code seeks to achieve transparency in the procedures relating to procurement; to promote the integrity of the procurement process; to provide fair and equal treatment of all suppliers and contractors while promoting competition; to foster participation in procurement proceedings by suppliers and contractors; and finally, through all of these endeavors, to maximize economy and efficiency in procurement. At present the model law covers procurement of goods and construction; work is under way to develop a similar framework for the procurement of services.

The World Bank is now using this instrument to assist its borrowers in drafting legislation in this area. So far the model has been applied only in Eastern European countries where the need for this type of legislation is the greatest. In Poland and Bulgaria the Bank has financed consultant services to draft procurement codes based on the UNCITRAL model. The work is at an advanced stage in Poland, where the draft code is ready to be presented to parliament. In Bulgaria the drafting process is well under way. Use of the model code is being encouraged in other countries of the region as well.

Although a sound legal framework is an essential foundation for improvements in public procurement, it is not the only determinant. Institutional development and training of personnel are also required to ensure success. The Bank's efforts in this area mark an important and necessary first step in the direction of improved procurement practices.

Emerging lessons

Transparency in government policies and programs is important if progress is to be made with participatory approaches to project design. By the same token, transparency is crucial for effective environmental policies and to combat corruption.

Transparency in procurement is not an established feature of government processes around the world. Governments may conform with best procurement practice for goods and services acquired under World Bank–financed projects, but procurement using governments' funds is often much less transparent. Without transparency, the full benefit of competitive bidding will not be realized, and opportunities for bribery will exist. Assisting countries in improving public procurement is likely to continue to be an important part of public management reform supported by the Bank. In several countries, the Bank's own procurement guidelines have become a model for national procedures.

Finally, transparency and accountability are closely linked. Thus, efforts to strengthen accountability are likely also to involve parallel measures to increase transparency. To be accountable, the activities of government agencies need to be visible. Progress toward greater transparency in governments is likely to be a gradual process in which there will be opportunities for the Bank to assist, most likely as a by-product of interventions in other areas.

CHAPTER TWO

Issues that Arise in Relation to World Bank Activities

Governance and World Bank Processes

Major changes are under way in the Bank following the work of the Portfolio Management Review Task Force in 1992 and the adoption by the Executive Board of the *Next Steps* action program (World Bank 1992a, 1992c). The task force examined the declining performance of the World Bank's portfolio of project loans and made recommendations for improvement. The recommendations included the need to build commitment and local ownership of projects and to emphasize *project quality at entry*—the phrase used to capture the relevance and quality of project design—and how the latter could be addressed. The task force also stressed attention to portfolio performance, taking into account, more systematically, various implementation issues in the country dialogue and the lending program.

These recommendations are now being put into effect through the *Next Steps* program. From a governance point of view, the most significant measures are, first, two new instruments: the *Country Portfolio Performance Reviews* (CPPRs) and the *Country Assistance Strategy* (CAS) discussions; and second, the new system of *Operational Policies and Bank Procedures.* A related factor is the Bank's new disclosure policy.

These developments are likely to have a significant impact on the Bank's governance work. The CPPRs, which will be carried out on an annual basis for most countries, address, much more systematically than before, key implementation issues, such as borrower ownership and commitment to projects under implementation, the identification of generic implementation issues, and the development, with the borrower, of time-bound remedial action programs. Because many of the implementation problems Bank's projects face are public sector–management related, and ownership and commitment are linked to underlying governance conditions, the new emphasis on country portfolios is likely to bring governance issues to the fore in the dialogue between the World Bank and individual countries.

This is likely to be reinforced further by the CAS process, which is already ensuring that portfolio implementation issues are discussed alongside the future lending program and are taken into account in decisions on the volume and composition of lending. However, as box 2.1 indicates, there is room for more systematic treatment of governance issues in the CAS.

The World Bank's new Operational Policies and Procedures system is likely to reinforce the positive effects of portfolio reviews and country assistance strategies through the progressive revision and reissue of all previous

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BOX 2.1 GOVERNANCE AND COUNTRY STRATEGIES

The *Country Assistance Strategy* (CAS) statement is one of the primary vehicles for reviewing the World Bank's lending strategy in a given country. In determining the components of a country's lending program, the CAS should provide a frank evaluation of factors that constrain the effectiveness of development assistance. A discussion of governance issues is therefore necessary in this context.

An analysis of a recent representative sample of forty CAS statements from all the geographic regions examined whether governance factors were being sufficiently considered in the formulation of country strategies. The purpose of the analysis was to assess, first, whether all governance issues were being taken into consideration and, second, whether certain aspects of governance were receiving more attention than others.

The overall finding was that the majority of CAS statements covered governance but that the treatment was almost exclusively directed toward public sector management. Other governance concerns, such as accountability, transparency, and rule of law were almost never raised. Twenty-nine of the CAS statements reviewed contained only a discussion of public sector management concerns (civil service reform, economic management, an enabling environment for private sector development, and public enterprise reform, for example).

Public sector management was the only governance concern consistently raised. Only eight of the CAS statements discussed additional gover-

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operational directives in a new format during the next two to three years. This reinforcement will happen in two ways: first, by providing more explicit best-practice guidance to staff and, second, by emphasizing governance in the reissued *Operational Policies and Procedures* handbook.[8] Another contribution is the technical assistance handbook (box 2.2), which provides best-practice guidance to staff on the preparation of technical assistance projects and project components, with a particular emphasis on technical assistance for institution building.

With regard to staff and organizational matters, the World Bank has seen in recent years an increase in the number of specialists in public sector management (fifty-two specialists as of this year) and the formation of public sector management units in the Bank's Technical Departments.[9]

Nevertheless, there is a need for an enhanced training effort in areas such as institutional development, participation, technical assistance, public expenditure management (including financial management), and civil service reform. This is required not just to keep specialist staff on the cutting edge of their field

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nance topics but did not cover the full range of the topic. Three CAS statements did not discuss any aspect of governance.

Interviews with World Bank regional managers suggest the following reasons for the failure to cover governance issues consistently in country strategy documents.

First, because the subject matter of governance is often highly sensitive, Bank staff might be reluctant to commit their analysis to paper.

Second, because the political and economic dimensions of governance are closely linked, staff might feel that just raising certain governance issues involves treading near the boundaries delineated by the Bank's Articles of Agreement. This would account for the predominance of comment on familiar issues such as public enterprises and the condition of the civil service and the absence of discussion on more sensitive governance topics.

Third, staff might be unfamiliar with the subject matter and uncomfortable with concepts of accountability and transparency.

However, the absence of governance from the CAS statements does not mean that it plays no role in decisions on the Bank's country lending. As the report elsewhere makes clear, both the number of projects with governance elements and the extent to which governance issues have featured in the country dialogue with the Bank suggest otherwise. Whatever the reason for the relative absence of governance analysis in written Bank documents, governance issues are of such fundamental importance to the development agenda that they warrant more systematic treatment.

BOX 2.2 TECHNICAL ASSISTANCE HANDBOOK

Institutional development is the basis of public sector management reform. Much of the World Bank's support for institutional development is provided in the form of technical assistance (TA). In March 1993 the Bank published the *Handbook on Technical Assistance* to give substance to the recommendations of the Technical Assistance Review Task Force. The handbook focuses primarily on institutional development technical assistance (IDTA) and is intended to guide staff in capacity-building initiatives.

The handbook takes a comprehensive approach to institutional development and covers a broad range of activities that increase the capacity of institutions to perform their functions. The first section of the handbook discusses the role of TA in furthering institutional development in recipient countries. Subsequent sections deal with the formulation of a TA strategy for institutional development, the design and implementation of that strategy, and finally the supervision, monitoring, and evaluation of TA operations. In this context, topics such as the process approach to institutional development, modes of transferring expertise, management concerns, and the costs of IDTA are covered.

The handbook is presented in modules, facilitating easy access to detailed information on matters of particular interest to the user. In this way it provides brief, yet well-focused, training for World Bank staff. It will be updated periodically to keep staff informed of experience gained from new TA operations. The handbook marks an important step toward consolidating best practice and providing guidelines for staff in this area.

but also to keep the large number of operations staff, such as country economists, country officers, and sector specialists current with governance issues. Upgraded training programs are under preparation in all of these areas and will be put into effect in the coming year (Arnold 1993).[10]

Policy Dialogue on Governance

The Bank's policy dialogue with its borrowing members is being carried out in a political and economic framework that has changed substantially over the last ten years. Because of these changes, the environment for discussing development policy is much more open than it was before. In this new climate, certain governance issues have become important components of the Bank's overall policy dialogue with many of its borrowers. This dialogue has generally been carried out at four levels: first, in coordination with other donors through consultative groups and similar meetings of donors and aid recipients (box 2.3);

second, through discussions between the Bank's senior management and the political leadership of borrowing governments; third, through the regular exchange of ideas between the Bank's country teams and their counterparts on the government side; and fourth, through the day-to-day interactions of the Bank's resident missions. In countries that have no consultative groups (such as most of those in the Latin America region and East Asia) the dialogue is maintained through the last-named channels.

The World Bank also pursues consultations at the regional level and with groups outside government. Discussions between Bank staff and advisory groups, such as the World Bank's Council of African Advisors and the Council of Middle Eastern Advisers, as well as Bank seminars for public policymakers from Africa in particular, have helped to place governance on a regionwide agenda as well. In Bolivia and Venezuela, at their governments' invitation, the World Bank held seminars recently with the leading presidential candidates and their advisers to explain Bank strategies and to relate them to policy options prior to the elections. Although not explicitly focused on governance, these sessions added transparency to the local political process and allowed the Bank to place important development issues in the context of the different parties' political platforms.

Policy dialogue has become a critical vehicle for raising governance issues with borrower countries. In its role as head of consultative group meetings, the Bank coordinates complementary approaches to the provision of aid in a way that strengthens the adoption of good governance practices.[11] Chairing the meetings also often puts the Bank in the position of having to act as an intermediary between donors and the borrower countries. Sometimes this involves issues that the Bank will not address in its own dialogue with borrowers because the issues relate to the political dimensions of governance that fall outside the Bank's mandate. However, the Bank has advised borrowing governments on such issues in the context of adequately communicating bilateral donor concerns—as these may have an impact on subsequent aid commitments and, thus, the financing of the government's economic program.

The Bank has also used policy dialogue as the vehicle for discussing issues that fall within the framework of economic governance but are nevertheless of a sensitive nature. Such concerns are raised both in the context of consultative group meetings as well as in senior management discussions with a country's political leadership. The issue of military expenditures has been discussed with a number of African and Asian governments. Aspects of human rights that have an impact on the effectiveness of the Bank's assistance have also been raised in this way, and in a number of countries, public sector corruption and its implications for continued Bank lending have been part of the dialogue agenda.

Finally, the World Bank's economic and sector work is being used as an

BOX 2.3 GOVERNANCE ISSUES AT CONSULTATIVE GROUP MEETINGS

Governance has been a recurring theme of the consultative group meeting of donors and governments chaired by the World Bank since 1990. The different dimensions of governance—political, institutional, technical, and material—have been recognized by donors and governments as important factors in development. Consensus has evolved on the need to ensure accountability of government officials to their superiors and to the public, to enhance transparency in government expenditure programs and policies, and to develop and enforce a legal framework to promote development.[a]

Donors urged the governments to:

- Strengthen their accounting and auditing capacity; decentralize decision-making to encourage the growth of responsible local governments
- Ensure greater participation of NGOs and civil society in the development process
- Make reliable, timely, and relevant economic information available to the players
- Develop a legal framework to promote private sector development and public sector management
- Ensure independence of the judicial process, transparency of laws, and freedom of the media
- Protect the legal rights of women, children, and labor.

effective tool for dialogue on governance issues. *Country economic memoranda, public finance reviews, public expenditure reviews, sector reports, Country procurement assessment reviews,* and *private sector assessments,* for example, have all been used to bring to governments' attention the Bank's analysis and recommendations on governance issues.

Participation and Governance

Participation is intrinsic to good governance. Indeed, participatory development can be thought of as a local-level reflection of good governance. Measures at the national level to improve the effectiveness and efficiency of government have direct parallels at the microlevel as well. *Transparency* enables people affected by development plans to know the options available to them. *Accountability* of government structures and officials to local organizations (for example, civil councils and village committees) reinforces macrolevel accountability. *Due process* of public hearings and other local-level consulta-

Corruption in some governments was also a concern.

In all meetings, the importance of public sector management was discussed. Administrative, financial, and institutional capacity for an effective and efficient public sector was recognized as the central issue. Donors stressed the need to privatize public enterprises, eliminate excessive rules and regulations that constrain private sector development, and enhance procurement capacity for efficient use of external assistance. Greater transparency in budgeting was deemed key to the continued availability of counterpart funds.

Clear consensus did not emerge from any side on reducing military spending. Although most governments agreed that expenditures on defense take important social and economic resources away from development programs, some governments argued that these expenditures ought to be looked at in the geopolitical context of the country. Bilateral donors also emphasized that observing democratic processes and respect for human rights are part of good governance and sustainable development.

a. From October 1990 to January 1993, forty-five consultative group meetings were held for twenty-nine countries. Following is a list of the issues discussed and the number of countries for which each issue was discussed: military expenditure (12); transparency (13); human rights and democracy (18); accountability (21); legal framework for development (22); and public sector management (28).

tions ensures that people affected by development activities can voice their concern, debate alternatives, and negotiate compensation. Finally, the effective *voice* of local people, particularly the poor, can be increased by policy reforms at the national level that allow greater freedom to join nongovernmental organizations, trade unions, and other bodies to understand better and influence decisions that affect them.

Public involvement thus helps improve information flow, accountability, due process, and voice and thereby improves public sector management.

Instruments for participatory development

Participatory development requires good governance policies and practices within borrowing countries. The World Bank is assisting government efforts in this respect, as part of its regular institutional development work, by looking at factors that impede participation in borrowing countries. Staff incentives, training, and the skills mix of civil servants can be strengthened. In addition, the

Bank can promote participation in borrowing countries through its support to governments in their administrative and fiscal decentralization efforts and by strengthening the dialogue between governments and civil society.

The Bank is also encouraging a more participatory approach in its own economic and sector work and lending operations—to involve a wide range of entities that have a stake in the outcomes, from government bodies to NGOs and local community groups. The World Bank's report on portfolio management (World Bank 1992c) lists a variety of actions that can deepen borrower ownership and public participation through information sharing, consultation, wider decisionmaking, and increasing local groups' initiatives on behalf of their own development. Available instruments include joint sector work with government agencies; beneficiary assessments and stakeholder workshops during project preparation and appraisal; and greater NGO and community-level involvement in the design, preparation, and implementation of projects. Other methods would include broader and more substantive borrower participation and leadership in implementation planning, project launch workshops, joint implementation reviews of the country portfolio, and joint discussions of country strategy, including the development of a pipeline of projects for future financing by the World Bank.

The World Bank's new information disclosure policy, will facilitate public participation in borrowing countries and increase transparency and accountability. Although NGOs by themselves do not ensure greater participation of the beneficiaries of World Bank projects, they are nonetheless likely to continue to play an intermediary role in channeling information to and from beneficiaries. In the past year, NGOs have participated in 73 (30 percent) of the 245 World Bank projects approved by the Executive Directors.

Recent initiatives

Against this background, an effort has been under way since 1991 throughout the World Bank to learn more about and strengthen efforts to promote participatory approaches in Bank work. This learning process has been supported by the Swedish International Development Authority and guided by the Bank's *Participatory Development Learning Group.* After the Bank's hosting of an international workshop on participation in February 1992 and with the support of senior management over the past year, the learning process has been transformed into a major effort to mainstream participation concerns into the Bank. In this respect the learning process has yielded several important products, and there have been some encouraging developments in participatory approaches throughout the Bank:

■ Select Bank-supported operations, including economic and sector work and lending, that are considered participatory have been identified and are being documented as best practice. About thirty-five cases are being analyzed, fifteen of them in depth.

■ A number of other studies are being produced on particular aspects of Bank or country experience in promoting participation. One study focuses on popular participation in economic theory and practice (Gerson 1993). Another study examines how the Bank's procurement and disbursement procedures facilitate or hinder efforts to support community participation in projects. A study is also under way to determine the costs and time implications of supporting participatory approaches in Bank-financed operations. A further study, almost completed, statistically analyzes the experience of 121 completed rural water and sanitation projects around the world and shows clearly that participation is the single most important determinant of project effectiveness.

■ A handbook for World Bank staff on participatory approaches to development is being prepared with technical and financial support from the German Technical Assistance Agency (GTZ)[12].

■ The World Bank's Africa Region has taken a clear lead in exploring and supporting efforts to promote participatory approaches. Workshops on participatory planning techniques have been held, and a few *country implementation reviews* have been conducted in a consultative manner. The Southern Africa Department issued an instruction requiring that each new project under preparation include a provision for systematically listening to relevant stakeholders and beneficiaries. On the basis of its growing experience, this department is preparing a guide for the staff on participatory assessments. Other regions are also actively pursuing participatory approaches. The Latin America and Caribbean region has made explicit the link between strengthening popular participation early in the design of operations and ensuring borrower commitment to improving the quality, impact, and sustainability World Bank projects. And the Bank jointly sponsored with the South Asian Association for Regional Cooperation a regional workshop on poverty in South Asia, with a particular focus on promoting greater participation by the poor.

■ Complementing its continuing work on poverty assessments, the World Bank has started to develop and employ participatory techniques to listen to poor people's own views on their condition and on poverty reduction strategies. Guidelines on *participatory poverty assessments* have been prepared and some ten participatory poverty assessments are expected to be undertaken in the coming year.

■ In July 1993 a *participation fund* was established in the amount of US$300,000 to support innovative activities in both lending operations and economic and sector work. Through the benefit of a matching requirement, the fund allowed World Bank staff to lay claim to up to US$600,000 in the past six months. More than thirty proposals have been submitted from twenty-five different units representing a wide range of countries and sectors; of these, seventeen have been approved. The fund was almost fully committed in less than two months and should be replenished in the current year in a larger amount.

The final report of the *Participatory Development Learning Group* will expand on the above lessons and draw on the cases and other studies commissioned for the learning process. A workshop will take place in May 1994 to review these lessons, to recommend how to make the World Bank's core business processes more participatory, and to improve staff incentives, training, and administrative procedures.

Making participation effective

Early lessons from the learning group on the practicalities of encouraging participation include the following:

■ It is already clear that there is growing staff awareness of the importance of participatory approaches, more so as a result of the work of the World Bank's Portfolio Management Task Force and the *Next-Steps* program. To ensure that the World Bank is in a position to support these efforts will require major investments in training and some changes in the skill mix of Bank staff.

■ Participatory development is not without risk: those with a stake may not gain directly from their efforts, or their benefits may be negated by external factors; local voluntary organizations may not represent the views of ultimate beneficiaries; and elected officials and bureaucrats are often out of touch with the needs and interests of their constituents or are actively hostile to local initiatives.

■ The extent to which participatory approaches yield better projects varies from sector to sector. In the water sector, for example, the experience with participation is well documented, and the approach clearly works—all participants have an interest in cooperating to share water. In the education and health sectors, the scope for participatory approaches requires further exploration. Progress has been slower than expected with participatory poverty assessments.

■ More work needs to be done on the cost of using participatory approaches for project preparation. There are incremental overhead costs associated with participation, in the form of increased pressure on World Bank staff time and support costs. This may require tradeoffs with staff budgets and work programs, given the expectation of zero growth in the Bank's budgetary resources. Participation also implies a more flexible approach to the Bank's traditional project cycle.

■ Despite these risks, there is evidence that projects requiring beneficiary contributions of time or money are more effective. The World Bank Operations Evaluation Department's review of fiscal 1992 project evaluations brought out the importance of borrower ownership and beneficiary participation in the success of the twenty-four projects evaluated as outstanding. The greater the intensity of participation (in terms of information sharing, consultation, decisionmaking, and initiating action), the greater the sustainability.

■ Government has a key role to play in promoting an environment for participation. With the right incentives, including a degree of autonomy, public agencies have been able to reorient themselves in support of beneficiary participation. Linked to this is the need to strengthen public sector management capacity and to encourage greater decentralization in governments. The legal framework for intermediary organizations is also critical in supporting participation of the poor.

Military Expenditures

The level of military expenditures in some countries has long been a concern of the Bank. In many developing countries, government budgets lack transparency, especially with regard to military expenditures. The latter may be no more than a single-line entry in budgets, tax revenues may be directed to extra-budgetary funds, and military debt is often unrecorded. Military spending may not be properly scrutinized when budgets are prepared or accounted for and audited when the money is spent. Furthermore, the military in some countries may control protected state enterprises that impose a heavy fiscal burden. Because of the secrecy that traditionally surrounds military budgets and the sensitivity of governments to the questioning of defense outlays, and because providing for security needs is intrinsic to political sovereignty, the level of military expenditure has been seen as a governance issue rather than a straightforward matter of public expenditure priority.

In recent years, the World Bank's interest in military expenditures has grown. First, as countries struggle to contain fiscal deficits and create conditions for sustained growth, there is a need to shift resources from public consumption to more productive spending categories, such as infrastructure and the social sectors, which contribute more directly to economic performance. There are member countries in which the high share of military spending in the budget is crowding out allocations to programs more directly relevant to social progress and economic growth.

Second, the end of the Cold War provides an opportunity to reassess military budgets that owed more to a country's association with major power blocs than to domestic or regional security needs.

Third, there is the perception by many bilateral donors that because of the fungibility of budget resources, aid has indirectly financed higher levels of military spending than would otherwise have been possible. This concern applies as much to World Bank Group lending as it does to bilateral aid. Donors have raised the subject of military expenditure in aid coordination forums in which the Bank is looked toward for leadership. Some bilateral donors have made reductions in the level of military expenditures an explicit allocation criterion for their aid. Finally, there have been countries whose governments have directly sought Bank assistance, either for the conversion of defense industries to peaceful purposes or for demobilization and reintegration of former combatants into the civilian economy.

To explore the implications of military expenditures for the Bank's mandate, a working group was convened in 1991. This working group reviewed the issues raised by military expenditures in relation to the Bank's Articles of Agreement, whether the Bank had a comparative advantage in the field, and the types of assistance that might be sought by governments trying to reduce military outlays. In addition, a symposium on military expenditure issues was held (Lamb and Kallab 1992). A clarification of the Bank's approach was provided to the Executive Board and to World Bank staff in December 1992 while the Bank agreed to work closely with the International Monetary Fund (IMF) in seeking from borrowers better information on military-related aggregate expenditures and military-related debt.

Within the framework of its guidelines, the World Bank has confronted the issue of military expenditure in the case of several countries in which such allocations seemed excessive relative to spending on development objectives and when important social and physical infrastructure programs were being starved of resources. Because of the sensitivity of the topic, the dialogue has been at the level of Bank senior management and country leaders. The Bank stands ready to work with borrowers to analyze the impact of nondevelopment expenditures, including military expenditures, with a view to reducing them to the extent feasible.

In some countries (Argentina and Uganda, for example), the World Bank has responded to government requests to develop options for bringing military expenditures more in balance with other spending priorities and has provided broad support for implementing such changes. In such circumstances, care is taken to ensure that a proper distinction is made between those aspects of the subject that fall within the competence of the Bank to advise on and those that lie outside it. Although the aggregate level of military expenditure is an appropriate area for the Bank to focus on if such expenditure has an adverse impact on development programs, the focus on specific equipment purchases, for example, is not. The Bank addresses the level of military expenditure in the context of the resources needed for economic development.

An important study has recently been completed by staff of the Bank's Africa region on the comparative experience of eight countries in demobilization and reintegration of military personnel, following civil war. The purpose of the study is to better equip the Bank to provide assistance to countries that seek to reintegrate former combatants (box 2.4), a task that has some parallels (as well as major differences) with civil service reform and downsizing.

Several conclusions may be drawn from the Bank's experience of grappling with the issue of military expenditure. The first is the complexity of the topic. Although there may be a number of countries where high levels of military expenditure crowd out budgetary allocations to more directly productive programs in the social and economic sectors and also contribute to high fiscal deficits, a direct inverse relationship between military expenditure and economic growth is difficult to establish. In an econometric study of data from 71 noncommunist countries (Landau 1993), no clear relationship could be found between military spending and economic growth except at very high levels of the former. A strong correlation, however, was found between military expenditure in one country and the level of military spending in neighboring countries.

Second, the cases where the Bank has discussed military expenditure as an issue have tended to be countries with a relatively high dependence on external aid flows. Since bilateral aid donors are increasingly making the level of military expenditure a criterion of their assistance, the issue inevitably arises in the dialogue with governments, given the Bank's central role in aid coordination forums. Elsewhere, the Bank's treatment of this highly sensitive issue has depended on country circumstances and the state of the dialogue with the government.

Third, as Argentina's experience shows (box 2.5), there is scope for developing what might be termed a governance approach to military expenditure. In contrast to many developing countries, civilian control over the military is

BOX 2.4 DEMOBILIZATION AND REINTEGRATION

For many African countries it has become painfully clear that continuing insecurity and the diversion of resources caused by civil war represent the primary roadblocks to economic and social development. African countries embroiled in such conflict routinely spend between 15 and 40 percent of their national budgets and between 5 and 10 percent of their GNP on the military. These countries rank in the bottom 15 percent of the UNDP's human development index and spend only between 0.6 and 6 percent of their GNP on priority development expenditures. However, the combination of economic deterioration and the end of the Cold War rivalry between East and West has created a climate in which many African governments are starting to explore ways to shift human and material resources to nonmilitary sectors of the economy.

It is in this context that the World Bank is increasingly receiving requests by member governments for technical and financial assistance to reintegrate demobilized combatants. However, experience with such programs is limited, particularly in weak economies with low administrative and institutional capacities. Thus, in April 1992, the World Bank's Africa Region sought to educate itself by undertaking informal research on the experience with demobilization and reintegration programs (DRPs) to date. The report focused on seven countries—Angola, Chad, Mozambique, Namibia, Nicaragua, Uganda, and Zimbabwe.

Analysis of the programs shows up their institutional, logistical, and political complexity. Some programs have required disarming former combatants and transporting and targeting benefits to more than 80,000 people in a relatively short period of time. Moreover, in most cases, governments were newly formed, in transition, or weakened after years of civil war.

firmly established in the industrialized democracies. Budgets are transparent, defense priorities are regularly debated and reviewed by officials, legislators, and an informed media, and spending proposals are subject to the same scrutiny as civilian programs. The more extensively other countries are able to apply this approach, the more likely military budgets will become consistent with a country's genuine security needs and resources will be used efficiently and be properly controlled and accounted for.

The conclusion relates to defense industry conversion, a major issue for countries in Europe and Central Asia. Here the World Bank's Articles of Agreement explicitly permit the Bank to assist countries in conversion of wartime facilities for civilian use, and the Bank's reluctance to become directly involved in the restructuring of specific defense industries has to do with the

DRPs thus demand close coordination among a diverse group of players who may not be in the habit of communicating among themselves—the military, the civilian government, NGOs, donors, and local communities. Reintegration programs that were planned, even notionally, while combatants were still demobilizing, provided crucial information on ex-combatants' background, skills, and intended place of settlement and allowed officials to issue identification cards for benefits eligibility.

Although virtually all DRPs ended up providing some form of cash compensation (ranging from 12 percent to five times GNP per capita), program planners stressed the importance of basic and vocational training. Anecdotal accounts suggest that smaller, privately run training programs were more efficient and effective than large government-run programs. Program planners also stressed the importance of involving veterans in program management, as has been done in Uganda with the creation of local veterans' organizations.

The cost of a DRP is generally similar to or less than that of a civil service retrenchment program, ranging from US$1,050 per combatant in Chad to more than US$3,000 per combatant over a period of five years in Zimbabwe. In the latter, which had a program offering the highest total payments to ex-combatants, 83 percent of former guerrillas had found employment eight years after the DRP. However, 55 percent of them found that employment in either the civil service or the military. Analysis noted that in Uganda the "peace dividend" generated US$14 million in fiscal 1993 alone; in Nicaragua, defense expenditures dropped from 28 percent of GDP in 1989 to 5 percent in 1991, and in Zimbabwe defense expenditures as a percentage of GNP decreased from 8.8 percent in 1980 to 6.7 percent in 1989.

practical difficulty of achieving a successful outcome rather than an absence of mandate. Instead it has emphasized the role of macroeconomic and sector policy reforms to provide an environment in which market-based enterprise restructuring may take place.[13] This would appear to be a more realistic approach than direct intervention. Defense industry is often spread across many different industrial sectors, and the Bank has concluded that isolating military conversion as a topic for special attention other than in the context of policies for overall industrial restructuring would be inappropriate for the institution. The Bank's review of the experience of defense conversion in Western industrialized economies has found few successful examples to follow (H[illegible]witz 1992). Where alternative product lines had been developed, they absorbed only a fraction of the labor force formerly employed in defense production.

BOX 2.5 DEFENSE BUDGET RESTRUCTURING IN ARGENTINA

Argentina's achievements in stabilization and structural reform in the past two years are widely recognized. One element in the reform of the public sector has been a reduction in military spending, accompanied by a program to rationalize the armed forces in tune with the country's security needs.

At the request of the Ministry of Defense, a recent World Bank internal report analyzed military expenditure in detail. Although Bank reports in the past have touched on defense expenditures, this was the first deep analytical work on the subject in a country context. Specifically, the discussion on military expenditure covered the following:

- Analysis of military expenditure, historically and by major categories, highlighting shares and trends (downward relative to GDP but with a growing imbalance between the wage bill and operations and maintenance

- Review of defense enterprises and the government's plans to privatize them, along with recommendations on asset disposal policy

- Analysis of the military and civilian wage bill of the Ministry of Defense, including pensions. Costs and benefits of different downsizing options (in terms of wage bill savings and severance costs—not military effectiveness); recommendations on rationalizing pensions, simplifying pay scales, and retrenchment.

- Basic principles for treating military expenditure: subjecting defense spending proposals to same budgetary processes as other categories; transparency; use of asset sales proceeds to finance structural reforms in the military; or overall deficit reduction, not consumption.

The public finance review is pathbreaking not only for the topic chosen but also for the way in which the analysis proceeded. This was to treat military expenditures as essentially no different from other categories of spending. At the same time, care was taken to analyze options that the Argentina authorities were already considering and to avoid making judgments about military expenditures. A follow-up project assisting the defense ministry in privatizing airports and disposing of real estate is under preparation, using divestiture techniques applied in other sectors.

Human Rights

Within the donor community the political dimensions of governance are becoming increasingly important in determining the allocation of bilateral aid flows. The Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) links the World Bank's definition of governance with participatory development, human rights, and democratization. It sees an overall agenda emerging in the aid policies of its member states with the following links: legitimacy of government (degree of *democratization*), accountability of political and official elements of government (media freedom, transparency of decisionmaking, accountability mechanisms), competence of governments to formulate policies and deliver services, respect for human rights and rule of law (individual and group rights and security, framework for economic and social activity, and participation) (OECD 1993).

Although human rights are in a larger sense indivisible, the World Bank, as an international financial institution, deals with those aspects of human rights relevant to its mandate. Except in situations where the violation of human rights has created conditions hostile to effective implementation of projects or has other adverse economic consequences, or where there are international obligations relevant to the Bank, such as those mandated by binding decisions of the U.N. Security Council, the World Bank does not take into account the political dimensions of human rights in its lending decisions. The World Bank's Articles of Agreement prohibit the institution from taking political considerations into account, interfering in the political affairs of any country, or being affected by the political form or orientation of a country. Consistent with the Articles, the focus of the Bank's efforts in the area of human rights is on those rights that are economic and social in nature.[14]

The Bank's contribution to economic and social human rights is embodied in its strategy on poverty reduction and has two mutually reinforcing elements. As elaborated in *World Development Report 1990*, the first element in this strategy is to promote the productive use of the poor's most abundant asset—labor—through policies that provide opportunities and enable poor people to participate in economic growth. In turn, this means economywide and sectoral polices that encourage rural development and urban employment, such as relatively undistorted product and factor markets, sound macroeconomic management, public provision of infrastructure, and an environment that makes technical change accessible to small farmers and the poor. The Bank's strategy for economic and social human rights also means specific policies to improve the participation of the poor in growth by increasing their access to land, credit, and public infrastructure and services, together with special measures for resource-poor regions where poverty and environmental degradation are interrelated.[15]

The World Bank has also been concerned with the treatment of indigenous people, such as in regard to resettlement and land titling. An example of the latter is the new Natural Resources Management Project in Colombia.

The second element in the Bank's poverty reduction strategy is to provide basic social services to the poor, such as primary health care, family planning, nutrition, and primary education, thus enhancing economic and social human rights. These policies may also need to be augmented by targeted transfer programs and social safety nets.

The promotion of human rights through the Bank's poverty reduction strategy is reflected in the growing share of World Bank lending commitments to human resources development. As noted in the Bank's 1993 poverty report (World Bank 1993c), total Bank lending to human resources development has increased almost fivefold in dollar terms since the early 1980s and rose from 5 percent of total Bank lending in fiscal years 1981–83 to 14 percent in fiscal years 1990–92. The share of lending further rose in fiscal 1993 to 16 percent.

Accompanying the rising share has been a shift in the composition of World Bank lending to human resource development, with lending now concentrated in the development and extension of basic social services, such as primary health care and primary education, with special emphasis on maternal and child health and on improving educational opportunities for girls. There has also been increased targeting of resources within projects toward the poor. An increasing number of World Bank adjustment loans are addressing poverty-related issues, such as the promotion of social safety nets, the protection and reorientation of public spending for social services, and the development of poverty policy and the monitoring of poverty conditions by the government. In addition, in recent years a major shift has occurred in human resources lending, with a growing number of investment loans supporting the introduction, development, and extension of the various facets of social safety nets and labor market interventions, such as social security systems, health and social insurance systems, and social assistance schemes. Accompanying this has been a sharp increase in the amount of country-specific poverty analysis the World Bank is carrying out, through its country poverty assessments and poverty related economic and sector work. By mid-1994, twenty-nine country poverty assessments had been carried out, with a further forty under way. These assessments provide a vehicle for dialogue on poverty issues—in some countries not just with governments but with a wider audience (for example, Uganda and Zambia).

CHAPTER THREE

Findings and Future Directions

As this report makes clear, the volume of governance-related lending, economic and sector work, and research currently being conducted by the World Bank is substantial. Across regions, it is clear that the areas where the World Bank is most comprehensively involved in governance are Latin America and the Caribbean and Africa. In the Latin America and Caribbean a driving force behind the Bank's engagement is the region's strong desire for public sector modernization. In Africa the Bank's governance work is mostly a response to a continentwide crisis of public sector capacity. Within geographic regions, the intensity of governance work varies from country to country. This unevenness is consistent with the original expectation that the Bank's support for governance, the approaches used, and the instruments chosen would vary according to country circumstances and be driven by country requirements. In many countries the Bank is at an early stage of support in tackling governance issues, and the Bank's efforts must be judged in that light. Looking to the future, the volume of the Bank's governance work is likely to continue to grow, and in regions such as Europe and Central Asia to expand significantly.

A substantial part of the governance work in which the Bank is currently engaged comprises traditional public sector management categories such as civil service reform, public expenditure management, and public enterprise reform. This is a reflection that these categories are central to how power is exercised and that in these areas there is a substantial agenda of rehabilitation, modernization, and change. At the same time the Bank has extended its governance activities to new areas of support, specifically accountability, rule of law, and transparency.

Much of this work is in response to a change in the paradigm of the state as governments seek to adjust from a pattern of control and intervention to one in which the role of government in the economy is to provide an *enabling environment* for the private sector. Here the requirement is for macroeconomic management, selective intervention, greater use of indirect means for the delivery of public services, and a capacity to regulate where private providers enjoy a monopoly. This model requires a smaller state equipped with a highly professional bureaucracy that is accountable for results. Currently, divestiture of state enterprises is uneven, with disappointing progress in regions such as Africa where the need for the state to dismantle large parastatal sectors through divestiture and the reform of the remainder is very great. Few governments have transferred responsibility for functions to the private sector, and although there is widespread interest in contracting out, achievements have been modest.

In civil service reform, new approaches are needed for restoring a professional bureaucracy, ensuring accountability, and dealing with formidable transition problems caused by historical overcommitment of functions and excess staffing. Although the need to reform the role of the state and expand the private sector is recognized in many countries, the transition is proving difficult. A major constraint is the problem of government itself—the *unreconstructed state* acting as a resource drain and an obstacle to both market-oriented economic adjustment and effective social action. The challenge for the World Bank is to assist in restructuring the public sector in ways that go beyond employment reduction and bureaucratic rationalization to effect a new synergy between smaller, more focused governments and a renewed private sector.

Encouraging progress has been made in the past two years developing new ways of improving accountability and effectiveness in the Bank's sector lending operations through the participation of beneficiaries in the design and implementation of projects. Although progress has been made with *voice mechanisms* to improve microlevel accountability, the creation of *exit mechanisms*, through such devices as competition in service delivery and vouchers, has been slower. This partly reflects the greater managerial demands *exit mechanisms* make on governments. The challenge now is to continue to expand the Bank's knowledge of participatory approaches and to apply them in areas where their use demonstrably improves the quality and sustainability of projects. For the Bank this will require considerable investment in training and the recruitment of staff with new skills. It may also mean an increase in project preparation costs, although this should be amply repaid by higher economic and social returns and more sustainable projects. Furthermore, the challenge is not just to use participatory approaches in Bank projects, but to encourage governments to adopt them more widely for their own programs.

A major thrust of the World Bank's governance work has been support for decentralization, responding in many countries to a fundamental shift in attitudes toward central government. At the same time there has been a reassessment of past approaches to local government strengthening and the adoption of a comprehensive approach that views capacity building of local governments in the context of the allocation of functions between different tiers. This approach also asks whether this is matched with revenue capacity and examines the effectiveness of accountability mechanisms. Of critical importance is the nature and quality of the relationship between central and local or municipal agencies and the capacity of the central agencies to support the decentralization process. It is likely that the World Bank's support for decentralization, through economic and sector work and capacity-building projects for lower tiers of government, will continue to be an important part of the Bank's governance work and increasingly will incorporate a more comprehensive approach.

As mandated, the World Bank's work has been exclusively on the economic and social dimensions of governance (also consistent with the existing Bank staff skills and the comparative advantage of the institution). This is in contrast to bilateral aid donors who have made performance in the political dimensions of governance a criterion of aid allocation. The Bank, nevertheless, may find itself close to the political dimensions of governance in the policy dialogue with governments. This derives from its position as chairman of the consultative group process, which entails responsibility for coordinating external aid in support of a country's economic program. In addition, within its mandate, the Bank has discussed sensitive issues such as the level of military expenditure where it is clear that high military expenditure is impairing fulfillment of a country's social and economic programs. In a more general way, consultative groups have proven to be an important forum for a governance dialogue between the Bank, bilateral donors, and governments and for the coordination of external support for a country's development efforts. Since the current policy of donor governments—making good governance, in both its political and economic dimensions, a condition for the allocation of bilateral aid—is likely to be maintained, the Bank's aid coordination role in facilitating a constructive exchange on these issues will continue to require sensitive handling.

The Bank's governance work is highly relevant to present concerns of bilateral donors and international agencies with the development effectiveness of aid. Bilateral donors and other regional development banks are reviewing their aid programs. In the case of many bilateral donors this is occurring against a background of declining domestic support for aid, partly a consequence of fading Cold War imperatives. More fundamentally, it reflects disillusionment with patterns of aid that have channeled resources to governments without commensurate performance improvement, institution building, and accountability.

This crisis of development effectiveness has several implications for the Bank. First, it underscores the importance of Bank work on governance, the need to deepen it, and the need to draw lessons from experience. Second, it points to research on the impact of aid on public sector management and governance. Third, it suggests that the Bank should broaden its understanding of corruption, how it affects development, the economic calculus that drives it, and the measures that governments may take to control it.

More broadly the past two years of work on governance in the World Bank underlines the key role played by institutions in the development process, both from the perspective of the enabling environment for the private sector and for effective programs in the public sector in poverty alleviation and other areas. Central objectives of the Bank's economic and sector work and research efforts in the coming years should be how to assist countries in building strong institutions and to explore further the relationship between institutional development, public sector management, and the other dimensions of governance. A better understanding of these key relationships should help operational staff develop more coherent country strategies for institutional development and public management reform.

A major strategic issue for the Bank is how much further the governance agenda should be developed. As this report makes clear, the main thrust of the Bank's governance work has been public sector management, but being mainly technical in character, it addresses the processes and machinery of public sector performance, not necessarily its causes. This suggests action at two levels: first, more determined attempts to foster local ownership of reform programs and, second, encouragement of institutions of civil society so they can grow and demand greater accountability from governments in the economic sphere.

Within the World Bank the new procedures now being introduced to improve project preparation and portfolio management are likely to have a strong positive influence on the work on governance.

- First, the new *country assistance strategy process* will raise the profile of governance issues by bringing them to the Executive Board in the context of country strategy discussions.

- Second, through the *country portfolio performance reviews*, emphasis will be increased on systemic problems of project implementation. Many of these are governance related, thereby bringing governance issues that are relevant to the Bank's mandate to the fore in the dialogue with the country, in economic and sector work, and in the planning of future lending operations. From the Bank's perspective, there must be a determined search for higher efficiency and greater service, to balance the country dialogue's traditional emphasis on government constraints.

- Third, the World Bank's new system of *operational policies and procedures* will provide guidance and best-practice advice to staff on relevant aspects of governance.

- Fourth, simplified procedures for the *institutional development fund* should facilitate its use for innovative governance-related purposes.

- Fifth, the Bank's new *disclosure policy* provides an excellent opportunity to make much more transparent to the outside world how the Bank approaches complex situations in borrowing countries. This is particularly opportune in terms of the Bank's efforts to improve participatory processes.

The final area for emphasis is on staff skills to deal with governance issues. There is a need to upgrade staff skills in the broad areas of public sector management, institutional development, financial management (including accounting and auditing), procurement, and participatory approaches in the design and implementation of projects.

Notes

1. If projects in which PSM and Technical Assistance (most TA is for institutional development of public sector agencies) are the primary components are aggregated, their combined share of total lending commitments rose from 3.7 percent in fiscal 1991 to 4.7 percent in fiscal 1993. This greatly underestimates the amount of PSM the World Bank is supporting because there are PSM components in almost all projects.

2. Countries with Bank-supported civil service reform programs include Argentina, Benin, Bolivia, Burkina Faso, Cameroon, Central African Republic, Cape Verde, Comoros, Costa Rica, Gabon, The Gambia, Ghana, Guinea, Guinea Bissau, Guyana, Lao People's Democratic Republic, Madagascar, Mauritania, Mozambique, Nigeria, Papua New Guinea, Rwanda, São Tomé and Principe, Senegal, Sierra Leone, Sri Lanka, Tanzania, Uganda, Yemen, and Zambia.

3. Reflected in the World Bank's newly named Public Sector Modernization Division, formerly the Latin America and Caribbean region's Private Sector Management Unit.

4. As an illustration of this trend, lending to urban development projects rose from 5.5 percent of total lending commitments in fiscal 1991 to 8.4 percent in fiscal 1993 (World Bank Annual Reports).

5. This is an issue of sequencing addressed in World Bank 1993d.

6. The first such public works agency, AGETIP (Agence d'Exécution des Travaux d'Interêt Publique), was set up in Senegal in 1989, followed by similar agencies in Benin, Burkina Faso, Mali, and Niger. They are established as NGOs to respond to community project initiatives, using aid monies channeled through the government. Not

constrained by government salary scales, they recruit staff at market rates and typically include a general manager with a private sector background. Their accountability is through a framework agreement with the government minister responsible for public works and through the production of quarterly financial accounts, independently audited and scrutinized by government donors.

7. Drawing on Albert Hirshman's pathbreaking work (*Exit, Voice and Loyalty*), Paul develops a framework for making public services more accountable through (i) *exit mechanisms*, which allow beneficiaries to withdraw from a government-provided service to a more competitively provided service, at no additional cost to them, or which in other ways promote competition and choice; and (ii) *voice mechanisms*, which allow beneficiaries a say in the design and operation of services. "Capture" occurs when special interests gain control over a program to the disadvantage of others. Follow-up research is now being conducted in the irrigation sector in Indonesia to explore ways to increase voice and improve accountability and efficiency.

8. For example, the World Bank's best-practice guide, to be issued shortly, requires the CAS document to assess "any governance issues related to the government's willingness and capacity to carry out needed reforms...." Future best-practice guidelines, covering such topics as investment lending, recurrent cost financing, cost recovery, enterprise reform and divestiture, and public sector management, are likely to include explicit directives on governance issues.

9. Public sector management has been identified as one of the areas for emphasis in World Bank staff recruitment, and a modest expansion in number of staff is expected relative to other categories.

10. See also the World Bank's "Report of the Financial Reporting and Auditing Task Force" (October 1993), which recommends that "due attention should be given to developing a family of training courses to ensure that staff are properly equipped to deal with borrower accountability issues." (para. 29)

11. In recognition of the importance of aid coordination and the policy dialogue, the Bank's Africa Region held a symposium on consultative groups in October 1992. The symposium's work has been incorporated into the work of the region's so-called Thematic Team on Governance.

12. A workshop in May 1993 assessed training objectives and explored strategies for increasing staff awareness and improving skills in participatory approaches. As reflected in the *Next-Steps* action plan, the Personnel Management Department of the World Bank is committed to offering an initial course for Bank staff in the coming year.

13. Assisting countries in adjusting their economies to peacetime is specifically mentioned in the World Bank's Articles of Agreement. Article I (i) gives one of the purposes of the Bank: "The reconversion of productive facilities to peacetime needs..."

14. Article III, Section 5(b). For a fuller account of the Bank's position on human rights, see the World Bank's report to the Vienna Conference on World Human Rights, "The World Bank and the Promotion of Economic and Social Human Rights" (report submitted to the World Human Rights Conference, Vienna, June 1993).

Thus, "through its contribution to economic growth, its lending for human resources development, especially education, and for poverty reduction, its emphasis on participatory development and on good governance (including the need for systems based on objective rules and efficient institutions) and its support of legal, regulatory and judicial reform, the Bank promotes human rights in all fields in a manner compatible with its charter." From the address of the Vice President and General Counsel, Ibrahim Shihata, before the conference.

15. World Bank 1990, pp. 3 and 73.

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THE WORLD BANK

Governance is the manner in which power is exercised in the management of a country's economic and social resources for development. Good governance is epitomized by, among other things, predictable, open, and enlightened policymaking. Good governance fosters strong, but sharply delimited, states capable of sustained economic and social development and institutional growth.

The World Bank's interest in governance derives from its concern for the sustainability of the development work it finances. Because so much of what the World Bank seeks to achieve through its lending is at risk from indifferent or poor governance, the matter is vital for the Bank.

In analyzing governance, the Bank draws a clear distinction between the concept's political and economic dimensions, since the Bank's mandate explicitly prohibits the institution from interfering in a country's internal political affairs. Thus, the Bank's call for good governance and its concern with accountability, transparency, and the rule of law have to do exclusively with the contribution they make to social and economic development and to the Bank's fundamental objective of sustainable poverty reduction in the developing world.

The purpose of this report is to summarize the Bank's activity in the area of governance in the past two years and provide a rounded picture of the Bank's governance efforts across regions. The record shows that the Bank's work on governance has greatly expanded, albeit with different points of emphasis, in all regions of the developing world and in the countries that are in transition from socialism to market economies.

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