

KEY THEMES AND PRIORITIES  
FOR GOVERNANCE & CAPACITY BUILDING  
IN THE ASIAN AND PACIFIC REGION

## I. INTRODUCTION

Issues of governance and capacity building (GCB) are at the center of many of the most pressing challenges confronting countries throughout the Asian and Pacific region today. In East and Southeast Asia, the need for greater transparency and accountability in regulating the financial sector has been one of the key problems behind the currency turmoil, corporate bankruptcies, and falling stock markets that have plagued the region over the last six months. In South Asia, issues of restricting the reach of state intervention and improving the delivery of basic services, such as health care and education, are high on the agenda. Economies in transition in Central and Southeast Asia are grappling with redefining the role of the state, changing the balance between central and local power, and developing civil service cadres with appropriate skills for managing a market economy. In the Pacific, issues of public sector efficiency, effectiveness and accountability are particularly important in ensuring the long-term viability of small island economies.

The challenge of framing a GCB program that addresses the needs of these countries is one of seeing consistency through diversity. It requires combining a cohesive and well-established set of priorities with adequate flexibility to respond to the tremendous disparity that exists throughout the ADB's sphere of operations. Asian and Pacific countries differ markedly in their politi-

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**

cal and administrative traditions. They are at varying levels of development and have different sources of comparative advantage. The spheres of activities allocated to their public and private sectors diverge markedly, as does their management capacities and the strength of their civil societies. Problems of scope and size are enormous, and many of the institutions and practices that work effectively in China, with its 1.2 billion people, will not be relevant to Nauru, with its population of 10,000.

Yet these governments also share many basic features in common. They face similar responsibilities, in that they will be called upon to establish a basic policy framework, provide critical goods and services, protect and administer the rule of law, and advance social equity. In executing these responsibilities, they will be required to perform a variety of similar tasks, such as organizing themselves to formulate and coordinate policy, and mobilizing human and financial resources to implement their decisions. Perhaps most importantly, there is growing agreement that they should perform these tasks as efficiently and effectively as possible; in a responsive, transparent and predictable fashion; and with clear strategic focus and appropriate participation.

The Bank's approach to date, which was codified in the August 1995 Board Paper, *Governance: Sound Development Management*, has sought to overcome problems of diversity by articulating a set of basic principles to be advanced in a wide variety of settings. From a policy standpoint, the only constraint upon operations has been that the Bank's work on GCB issues should be grounded in economic and not political considerations and that it should avoid overtly politicized initiatives, such as the strengthening of parliamentary democracy or the protection of civil liberties. Operationally, the Bank's existing effort takes place in a largely ad-hoc, "bottom-up" fashion, with minimal central guidance or direction. Although this approach allows for flexibility in tailoring programs and projects to diverse local circumstances, it is not well-suited for enabling the Bank to develop expertise and a clear comparative advantage on critical governance issues.

Any effort to augment the Bank's capacity needs to be grounded in a clear sense of substantive priorities. Greater vision and clarity of purpose are necessary to identify key governance issues in the Asian and Pacific region where the Bank can work closely with its developing member countries (DMCs) to build institutions that will support rapid and sustainable economic growth. Towards this end, several factors must be considered, including the nature of evolving best practice in governance and public sector management; the diverse problems and challenges that many Bank DMCs are experiencing in the governance area; the comparative advantage of the ADB vis-à-vis other bilateral and multilateral donors; and the way in which the Bank's internal staffing, organization and work procedures can support or hinder its effort to respond to these issues promptly and effectively.

The paper will begin by framing the basic parameters within which the Bank operates. After briefly addressing definitional questions, it will discuss the principles to be advanced by the Bank's GCB effort, the type of work that the Bank has traditionally supported, and the activities of other aid agencies. It will then outline the basic functions that governments must provide in advancing development and the tasks they must perform in providing these functions. Having established the overall context, the paper will then outline general themes for future Bank programming on GCB issues and conclude with some observations regarding the nature of this exercise and the challenges (some would say contradictions) inherent within it.

While the paper articulates the basic themes to be addressed in the ADB's governance programming, this agenda is extensive and presented at a fairly high degree of abstraction. Greater selectivity and prioritization is required. More detail is needed in identifying specific issues and sub-themes for Bank involvement and in exploring a number of critical questions. Can regional priorities be established for South Asia, Pacific island states or economies in transition? Are there potential thematic synergies to be exploited? Issues of sequencing to be ad-

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**

dressed? Fruitful areas for collaboration with other donors? Feedback from DMC officials and international experts will play an essential role in helping Bank staff address these questions.

## II. DEFINITIONS, PARAMETERS AND PARTNERS

The field of governance is vast and ranges from narrow problems of institutional development to broad questions relating to the manner in which power is exercised within society. Development institutions have tended to use the word “governance” in a fairly sweeping fashion. The World Bank was the first international financial institution to explicitly define the term in its 1992 publication, *Governance and Development*, as “the manner in which power is exercised in the management of a country’s social and economic resources for development.”<sup>5</sup> The IBRD identified four areas for sustained engagement: public sector management, accountability (which includes financial accountability, accountability for economic performance, competition and participation), the legal framework for development, and information and transparency.

The ADB’s governance policy holds many similarities with that of the World Bank, although (as will be discussed in greater detail below) the practice of the two institutions has varied significantly. The definition of governance offered in the ADB’s Board Paper is identical to that utilized by the World Bank. Just as the World Bank has emphasized the close linkage between governance and public sector management, the ADB’s approach has from the outset linked governance closely to capacity building, which Bank publications define as, “strengthening the national framework within a DMC that affects the direction, management and sustenance of the development process

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5 *Governance and Development* (Washington D.C., the World Bank, 1992), p. 3. The United Nations Development Programme has adopted an even more expansive definition, in which “governance” includes the state, the private sector, and civil society and the interaction among these three elements. See United Nations Development Programme, *Reconceptualising Governance: Discussion Paper 2* (New York: UNDP, 1997).

in the sector and the economy as a whole.”<sup>6</sup> The title of the ADB Board paper, *Governance: Sound Development Management*, was chosen carefully to underscore the Bank’s instrumental and pragmatic approach to these issues.

### Internal Constraints

The Bank’s work on GCB issues does not take place in a vacuum. The institution faces a number of internal and external constraints that influence its operations and limit the number of options available. Its work also takes place within a particular historical and institutional context that shapes its approach to these issues.

At the most basic level, the Bank’s work is governed by its Charter and subsequent Board approved policies. The principal constraint arises from Article 36(2) of the Charter, which reads:

"The Bank, its President, Vice President(s), officers and staff shall not interfere in the political affairs of any member, nor shall they be influenced in their decisions by the political character of the member concerned. Only economic considerations shall be relevant to their decisions. Such considerations shall be weighed impartially in order to achieve and carry out the purpose and functions of the Bank."

In an opinion dated August 1995, the Bank’s General Counsel noted that the intention of the Charter is to create a technical and functional multilateral financial

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6 In.161-94, *Bank Support for Capacity Building in Developing Member Countries*, p. 1. Although these definitions of “governance” and “capacity building” are useful in framing the discussion, they are too broad to give concrete operational guidance. Furthermore, the practical or analytical rationale for differentiating between them is often unclear. At the most basic level, some have argued that “governance” deals with fundamental questions regarding how power is organized and utilized within society, whereas “capacity building” focuses upon more narrow and technocratic issues, particularly within line agencies. However, in practice, the two quickly become blurred, and any meaningful distinction is lost. Since most of the Bank’s work on governance is devoted to building the capacity of public sector institutions, Bank staff are encouraged to use the shorthand term, “governance and capacity building” (or GCB) when referring to these issues. References to capacity building are relatively rare in World Bank literature, where the term “public sector management” is utilized instead.

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**

institution insulated from ideological and partisan considerations. However, the Charter also does not prohibit the term “economic considerations” from being defined quite broadly to include social and institutional factors that relate directly to the effectiveness and efficiency of economic programs. The only caveat is that governance operations must pass a test of being justified on economic considerations alone, and that the economic effect of non-economic factors must be demonstrable and direct, and not merely hypothetical.

In an effort to upgrade the Bank’s practice on these issues, the ADB’s Board passed a policy on Governance in August 1995. It specified that the Bank’s work on Governance and Capacity Building would be guided by a number of key principles, which reflect the institution’s best judgment as to the essential attributes of a well-functioning public sector. The Bank’s Board Paper, *Governance: Sound Development Management*, highlighted four essential elements of good governance: accountability, participation, predictability and transparency. Other principles can also be added to this list, including strategic focus, efficiency and effectiveness, and responsiveness. The underlying rationale for these principles is provided in pages 70-73

In practice, it is difficult to identify any tangible constraints that the policy has exerted over Bank programming with regard to GCB issues. While certain topics are clearly “off limits,” such as democratization and human rights, they tend to fall in areas where the Bank has little experience, expertise or comparative advantage.<sup>7</sup> Under the existing policy, Bank staff may work with all three branches of government (executive, legislative and judicial) and all three levels of government (national, sub-national and local). They can also work at the interface between the public and private sectors and civil society. They can address a wide range of topics, including issues

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7 The one potential exception is corruption, which has historically been omitted from the development debate and country dialogue but has become increasingly visible over the last couple of years. The Bank is currently preparing a Working Paper on Anti-Corruption Policy for Board circulation and approval in February 1998.

voice, participation, accountability, and the fostering of stable and predictable legal frameworks—provided such issues can be directly linked to the furtherance of specific economic objectives.

Far more pressing limits are posed by the Bank's current staffing, organization and work processes. Like many institutions, the ADB has been confronted with an external environment that in recent years has not been supportive of expanded development assistance. In recognition of this political reality, the Bank's Board has been committed to increasing productivity through a policy of zero real budgetary growth from 1995 to 1997. No increase in staff is anticipated for 1998, and only minimal increases are planned for 1999 and 2000. In practice, this has meant that a major redirection of resources in support of GCB activities has not been possible. Through attrition and the reallocation of internal resources, the Bank has been able to incrementally increase the funding and staff devoted to GCB issues. But a number of important constraints remain:

**Staffing:** The institution currently lacks sufficient critical mass to move the GCB agenda forward rapidly, and numerous Bank studies have identified shortages in staff skills as one of the most pressing bottlenecks.<sup>8</sup> In certain crucial areas, such as public expenditure management or capital market regulation, there are only one or two staff with relevant experience. Preliminary assessments have indicated that approximately 20-25 experts would be needed to fully staff the Bank's GCB agenda; currently, there are fewer than ten with detailed substantive expertise on these issues. What skills are in greatest demand, and how can the Bank best recruit staff who possess them?

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8 The 1994 *Task Force on Improving Project Quality*, for example, noted that the thoroughness of ADB institutional assessments is sometimes compromised because "the expertise to undertake such assessments professionally and effectively is relatively scarce, both within the Bank and among consulting firms." (See paragraph 30.) Other problems included inadequate resources being devoted to institutional issues, the pressure of an "approval culture," and the fact that institutional assessments were often undertaken as an addendum to a feasibility study or loan fact-finding rather than being a basic part of the design.

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*Key Themes and Priorities for Governance in the Asian and Pacific Region*

**Organization:** In January 1997, the Bank created a Governance and Capacity Building Resource Group within the Strategy and Policy Office to serve as the institutional focal point for these issues. The intention was to have the group serve in a temporary capacity for a couple of years until GCB issues were fully mainstreamed into Bank operations. While this approach has served as a useful short-term measure, important issues regarding the permanent location of staff with GCB expertise within the ADB's organizational structure will need to be resolved in the near future. What type of organizational set-up would best advance the institution's practice on these issues?

**Work Processes:** The procedures through which Bank projects and programming takes place are currently being examined as part of a major work process review exercise. There are several ways in which GCB issues can be more effectively integrated into Bank operations, beginning with the Country Operational Strategy Study (COS) and Country Assistance Program (CAP) documents.<sup>9</sup> Improvements can also be made in the way in which Bank missions conduct institutional assessments during the project fact-finding and appraisal stages.

None of these problems are insurmountable, and most can be solved relatively easily once the basic parameters of the Bank's approach to GCB issues are established. However, in the absence of a clear set of substantive themes and priorities, it is difficult to recruit staff with relevant experience or to decide where staff with certain skills should be located.

The Bank's GCB work is heavily influenced by the particular institutional context and traditions from which

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<sup>9</sup> The COS is a major study conducted every three years that frames the Bank's lending strategy to that country for this period. The CAP is an annual document that examines the pipeline of lending and TA projects for a particular year.

it arises. Lending on GCB issues is undergoing a transformation that mirrors the Bank's broader shift towards becoming a more comprehensive development institution. Historically, the Bank has concentrated upon the financing of large engineering projects, such as dams, roads and irrigation projects. GCB issues were addressed narrowly and as a relative afterthought, and project designers were primarily concerned with issues such as training to ensure that staff could properly operate and maintain new equipment. This experience stands in contrast to that of the World Bank, where most governance work grew out of macroeconomic stabilization programs in the 1980s and was focused upon efforts to contain the central wage bill.

The ADB's current GCB program reflects this historical evolution. A survey of Bank projects from 1995 to June 1997 reveals that GCB issues have become much more prominent in project design, to the point where virtually all Bank projects have some components that are devoted to institutional strengthening. However, approximately 92 percent of Bank GCB work during this period took place at the sectoral level. Only approximately 6 percent of Bank projects during this period sought to reform central government mechanisms, such as the Ministry of Finance or Civil Service Board, and 15 percent addressed issues of sub-national governance.<sup>10</sup>

Proportionally, the percentage of Bank work with central governments has been much higher in the Pacific than in other areas, with South Asia following a distant second place. The level of sector work has been greatest in the Peoples Republic of China, Mongolia and Central Asia, although the numbers are comparable for other regions. The Bank's work on issues of sub-national governance has been greatest in Southeast Asia. However, with minor variations, the pattern described above can be found consistently across all of the regions where the Bank is

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10 Internal SPO Survey, 1997. In light of the multiple objectives under some projects, the totals do not equal 100 percent.

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**

active: a heavy emphasis upon sector work, with sub-national governance and work with central governments a distant second and third.

Most often, Bank assistance to line agencies has been for technical training, equipment upgrades (typically computerization), and the provision of expatriate and/or domestic consultant advice on various aspects of institutional restructuring. Although its level of achievement is comparable to that of other aid agencies, the Bank has not attained the success for which it is aiming. Numerous independent studies and post-evaluation reports have detailed the lack of consistent, sustainable progress in this area. One particularly telling critique examined Bank technical assistance (TA) grants for institutional strengthening and noted that they are, “often ad hoc and have a short-term, narrow focus, concentrating on superficial symptoms of institutional inadequacies...and missing key institutional areas in need of strengthening.”<sup>11</sup>

**External Factors**

The Bank’s internal capacity is not the only constraint upon its operations. Other bilateral and multilateral aid institutions are active on GCB issues, and in some cases they have more experience, capacity or expertise. Any effort to frame a GCB strategy must be cognizant of the synergies and opportunities for collaboration with these institutions, as well as areas where the ADB can refrain from active involvement and rely upon others to “carry the ball.” The major players include the International Monetary Fund (IMF), the World Bank (IBRD), the United Nations Development Programme (UNDP), and various bilateral donors.

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11 The quotation is from a supplemental report to the Bank’s *1993 Task Force on Improving Project Quality*. Other donors have experienced similar frustrations in addressing GCB issues. A 1995 World Bank Study, *Civil Service Reform and the World Bank* (Washington D.C.: The World Bank, 1995), notes that the impact of emergency programs to contain the cost and size of the civil service “has so far been small;” that more long-term efforts to reduce the wage bill have “yielded only modest results;” and that attempts to reduce distortions in pay and employment has also had only limited success.

The IMF has traditionally been concerned with macroeconomic stabilization and balance of payments issues. Its institutional development work has historically focused upon tax policy and administration, treasury and central bank operations, issues of budgeting and expenditure management, official statistics, and intergovernmental grants and transfers. The IMF's new guidelines regarding governance issues, adopted in August 1997, call for the Fund to become more proactive in developing a transparent and stable regulatory environment conducive to efficient private sector activities. Issues to be addressed include price systems, exchange and trade regimes, and banking systems and their related regulations. However, it is likely to be some time before the IMF builds up adequate expertise to be active on all of these fronts.

The World Bank has clearly been the most active international financial institution in addressing issues of governance and public sector management. It currently has the largest aggregate number of staff with experience in this field, and their credentials and technical skills are generally strong. The recent *World Development Report 1997*, "The State in a Changing World," represents a significant contribution to the development community's understanding of how governments can advance economic growth. The bulk of the World Bank's governance work tends to take place either at the central government level, where it focuses on issues of civil service reform and public expenditure management, or at the municipal government level, where it addresses issues of urban finance, management and service delivery. Sector work also takes place in priority areas ranging from environmental management to education and health care.

With aggregate lending totals of \$5.4 billion in East Asia and \$2.9 billion in South Asia in 1996, the World Bank is clearly the largest supplier of development funds in the Asian and Pacific region.<sup>12</sup> However, public sector man-

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12 These figures do not include funding for the Central Asian Republics, which totaled an additional \$363.5 million for 1996. The categories utilized by the World Bank in reporting this work may understate the extent to which it is involved in sectoral GCB initiatives.

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*Key Themes and Priorities for Governance in the Asian and Pacific Region*

agement issues constitute a relatively small part of the World Bank's total activity in the region. In East Asia, lending for public sector management has been under 1 percent of aggregate IBRD lending to the region for 1992-96, and in South Asia the figure stands at 2.6 percent. Staffing is currently an important constraint for the World Bank's work on core governance issues in both regions.

For the future, the World Bank has identified the building of market-oriented institutions, including the financial and state enterprise sectors, as one of its fundamental priorities for East Asia. Other priorities include poverty reduction, infrastructure, social insurance systems, managing structural change, upgrading labor, dealing with environmental problems and maintaining macroeconomic stability. IBRD governance activities in South Asia have placed emphasis upon consensus building and participation, decentralization, and private sector development.

Unlike the Asian Development Bank and the World Bank, which approach issues of governance primarily through the lens of capacity building or public sector management, the UNDP emphasizes the link between governance and broader issues of sustainable economic development. UNDP has supported a diverse range of governance-related initiatives, including topics such as election monitoring and human rights, as well as advancing cultural diversity and social integration, gender and governance, and poverty alleviation and governance. According to UNDP figures, in 1995 one third of its resources was allocated for governance issues, or \$1.3 billion. In July 1997, UNDP launched a \$36 million pilot program to advance innovative approaches for promoting good governance and support the documentation of best practices on a global scale.

Most of UNDP's work takes place at the country level through its 137 country offices, which enhances responsiveness to local conditions but creates problems of consistency and quality control. Resource constraints are also a factor, for UNDP's funding must cover a large number of countries and a wide variety of issues. In Africa, the Middle East, Eastern Europe and the Commonwealth of

Independent States, the largest total contribution is allocated to aid management and coordination, whereas programs in Latin America and the Caribbean tend to emphasize planning and support for policy formulation. Within the Asian and Pacific region, the largest allocation is for economic and financial management.<sup>13</sup>

A number of bilateral donors are also active on GCB issues. Australia and New Zealand have sought to advance these issues in the South Pacific. Britain's Overseas Development Agency has been active in many Commonwealth countries. Organizations such as the Commonwealth Secretariat and its related arm, the Commonwealth Association for Public Administration and Management, have played a useful role in developing networks among countries and serving as a repository of best practice. The United States Agency for International Development has supported a number of innovative programs, particularly in the area of municipal governance, and Dutch and Scandinavian donors have been active on selective governance issues. As a general rule, bilateral donors can be quite innovative in the projects that they support, but they also tend to be highly selective and focus on a relatively narrow set of issues and/or countries.

Although the presence of other funding agencies may affect certain aspects of ADB operations, far more powerful influence is exerted by Bank DMCs. Ultimately, any DMC has the right of veto over Bank operations within its jurisdiction. If the Bank's efforts do not address the needs and priorities of our developing member countries, then there will be little demand for our services. It is therefore incumbent upon Bank staff to communicate closely with officials from member countries to ensure that Bank programming responds to their agenda for reform.

At the same time, the Bank has a fiduciary responsibility to ensure that its GCB funding is put to the highest

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13 UNDP is supporting some particularly innovative programs in the South Pacific, where it is seeking to improve policy management by strengthening linkages between strategy and operational reforms; to support parliamentary reform, legal reform, and anti-corruption measures; to improve the engagement of civil society in the reform process; and finally, to improve information dissemination on best practice in policy and managerial reform.

possible use. As such, it must ensure that—in its desire to respond to the perceived needs of many of its clients—it does not neglect more fundamental problems of institutional development. Close consultation and cooperation between Bank staff and DMC officials is essential to avoid the twin dangers of non-responsive and unsustainable projects, on the one hand, and quick fixes that fail to address more basic issues, on the other.

### III. THE ROLE OF THE STATE

Implicit within the ADB's governance principles is the belief that the state's sphere of operations should be limited. It should not serve as an employer of last resort, or as a vehicle for patronage. It should not occupy a commanding position within the economy or serve as the "engine" for economic growth. Rather, it should serve as a catalyst and a facilitator for development, and it should target its efforts carefully and selectively upon performing a certain core set of functions and tasks well.

Governments perform thousands of functions, from providing for national defense to handing out parking tickets. Which of these are of greatest importance for development? What activities must states undertake in order to fulfill these functions? Where should one draw the line between "essential" and "nonessential" functions, and to what extent should the Bank engage in dialogue with its DMCs about the size and scope of their public sector? Are there particular countries or approaches that can serve as "models" for the Bank's work?

With the end of the Cold War, the ideological divide surrounding these issues has greatly diminished. At the same time, East Asia's rapid economic growth has fostered a more pragmatic and empirically-based discussion about the proper role of the state in advancing economic development. Although legitimate differences exist about the extent to which governments should engage in an activist industrial policy, there is an emerging consensus that the High Performing Asian Economies (HPAEs) got many of

the basics right. Their growth combined relatively stable monetary and fiscal policy with solid investments in infrastructure, health and education. Behind these accomplishments lay the creation of a civil service that was, by global standards, relatively small, efficient and meritocratic in nature. Additional institutional mechanisms, such as deliberation councils, were developed to consider how the public sector could best encourage private sector growth. This experience has served as an example for other developing economies that are still struggling to achieve these basic goals.

At the broadest level of abstraction, governments are responsible for four basic functions that have a direct impact upon the speed and sustainability of their economic growth. These functions are of greatest interest to Multilateral Development Banks (MDBs):

- (1) They set macroeconomic and sector policy;
- (2) they establish a basic legal and regulatory framework for the private sector;
- (3) they provide critical goods and services; and
- (4) they promote equity and assist the disadvantaged.

Focusing upon the first item, few problems are more detrimental to economic growth than runaway inflation and chronic, unsustainable deficits. The World Bank and IMF have historically placed heavy emphasis upon government's role in establishing a sound macroeconomic environment, including relatively modest fiscal deficits and inflation rates, low unemployment, and a positive balance of payments. With the exception of the South Pacific, where the ADB has played a role similar to that of the IBRD with regard to structural adjustment lending, the Bank has historically been less engaged on these topics.

The recent currency crisis in Asia has resulted in an enormous and unprecedented expansion of Bank lend-

ing this area. Issues of macroeconomic policy will continue to play a critical role in the Bank's dialogue with its DMCs, as reflected in major strategy documents such as the Country Operational Strategy Study (COS) and Country Assistance Program (CAP), and the Bank may be engaged in more intensive monitoring and surveillance activities. As to whether lending for macroeconomic stabilization represents a unique, one-time departure or a new area for sustained involvement, it is as yet too early to tell.

As the ADB has evolved from providing project finance to becoming an integrated development institution, sector policy dialogue has become an increasingly important component of its lending. Managers and staff from projects departments argue that their job is fundamentally about policy reform, and the lending is merely the carrot to entice governments to change their policies. This transformation is particularly pronounced in sectors where significant private financing is available, such as energy and transport.

Even prior to the recent currency crisis, the development of a stable legal and regulatory environment for private sector growth has been a rapidly expanding area of Bank programming. In 1996, in addition to the legal component in the Bank's project and program loans, the Bank undertook, continued or completed work in 22 DMCs on 90 law-related technical assistance operations covering a wide range of sectors and individual subjects. Between 1995 and 1996 (the last year for which final numbers are available), Bank lending for issues of private sector development increased from 35 projects to 48—or approximately 60 percent of total Bank lending for 1996. The number of projects to strengthen regulatory frameworks increased from 18 to 26, and the number of projects targeted at strengthening financial and capital markets increased from 10 to 18.

Asia's recent currency and structural adjustment problems are precipitating a major expansion of ADB activities on regulatory reform. Many HPAEs have stumbled upon what the World Bank has termed "intermediate" government functions, such as the management of exter-

nalities (i.e., pollution); or the regulation of public enterprises and financial markets.<sup>14</sup> To overcome obstacles at this level will require injecting greater regulatory independence, transparency, predictability and accountability into systems that have often been opaque and relied heavily on personal connections. Towards this end, the Bank is currently supporting reform in the securities and banking sectors in countries such as Indonesia, the Republic of Korea and Thailand as part of their IMF-brokered stabilization packages.

The Bank is also heavily engaged in legal and regulatory reform issues in South Asia and in the transitional economies. For the next decade or more, these topics are likely to continue to be of major importance, as countries seek to redraft their commercial and investment codes, streamline their customs procedures, improve access to land title, set up viable debt and equity markets, reform their public pension programs, etc. Although a dominant short and mid-term priority, the long-term future of the Bank's involvement in this area is less certain. Interventions targeted at strengthening the private sector tend to be more discrete and one-off in nature, in that they focus upon drafting a given piece of legislation or establishing a particular regulatory body, rather than investing consistent, sustained efforts to improve the performance of large institutions. After the basic legal and regulatory frameworks are in place in many countries, the demand for the ADB's services in this area may slacken.

Turning to the delivery of goods and services, neo-classical economic theory has traditionally allocated government a role in providing certain products. These include public goods, such as defense and law and order, where it is difficult or impossible to exclude beneficiaries, as well as

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14 In the World Bank's *World Development Report 1997*, the authors present a matrix in which state functions are defined in "minimal," "intermediate" and "activist" terms. The minimal function includes providing pure public goods, such as defense, law and order, property rights, macroeconomic management, public health, anti-poverty programs and disaster relief. Intermediate functions include addressing externalities, the regulation of monopolies, overcoming imperfect information and providing social insurance. Activities functions include coordinating private activity and fostering asset redistribution. See *World Development Report 1997*, p. 27.

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*Key Themes and Priorities for Governance in the Asian and Pacific Region*

goods with significant positive externalities and spill-over effects, such as education. The bulk of the Bank's work on GCB issues has historically concentrated upon enhancing the delivery of such goods, either by tackling impediments at the central level through civil service reform or public expenditure management, or far more frequently, by working to improve the capacity of individual ministries, agencies and departments. This work is likely to continue to comprise the majority of the Bank's GCB effort. The growing movement towards decentralization could open up vast possibilities for work on enhancing service delivery in Asia's provinces and municipalities.

One of the major accomplishments of many East Asian countries is the degree to which the benefits of growth were distributed widely among the populace. The Bank will continue to play a significant role in advancing equity through programs on poverty reduction and by ensuring that various sector loans and grants advance the welfare of the poorer members of society. This is particularly true for programs in the field of health and education, where the provision of primary services is a top priority.

In performing these basic social functions, governments must be able to properly execute a variety of tasks. At the most basic level, five essential activities must be performed:

- (1) Governments must make decisions about strategic and operational policy;
- (2) they must organize themselves and design business processes and procedures to implement these decisions;
- (3) they must mobilize human and financial resources in pursuit of their policies;
- (4) they must perform work and produce outputs that are related to their broader social function; and

(5) finally, they must monitor their performance.

Table 1 presents these basic development functions, the specific tasks that support their implementation, and the units that typically perform them. Some ministries, departments and agencies will be much more concerned with certain elements of this schema than others. At the center, several units will have responsibility for conducting these tasks for the government as a whole. They include the Cabinet Office, Council of Ministers or other central mechanisms for policy formulation, coordination and implementation; the Ministry of Finance and Ministry of Development for recurrent and capital expenditure; the Civil Service Board, Ministry of Personnel, or Public Service Commission, for human resource management and development issues; and supreme audit agencies, anti-corruption units and ombudsman offices for monitoring performance.

Line ministries, agencies and departments will have at least partial responsibility for each task within their respective spheres of competence, as will regional and local governments. Many have ministerial cabinets, policy units or strategic planning units to support management decisionmaking. They design their organizational structure, either independently or with the approval of a central government unit, and establish business processes to conduct a wide variety of tasks. They allocate resources internally through their Budget Office; in decentralized systems, they manage their personnel resources; and they utilize internal management information, control and audit systems to monitor their performance. Most importantly, they are engaged in service delivery and producing outputs that serve a broader social purpose.

The ADB's governance and capacity building work seeks to support the efforts of our client DMCs to perform these basic functions and tasks in accordance with the guiding principles outlined above. However, several important questions remain. The first is the extent to which the Bank should become engaged in dialogue with individual DMCs over the size of their public sector and the

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**
**Table 1**
**BASIC LIST OF DEVELOPMENT  
FUNCTIONS, TASKS, AND RESPONSIBILITIES**
**Social Function**

Foster Stable Macroeconomic and Sector Policy Environment

- *Political Leadership*
- *Central Bank*
- *Ministry of Finance*
- *Sector Ministries, Agencies and Departments*

Establish Appropriate Legal and Regulatory Framework

- *Legislature*
- *Judiciary*
- *Sector Ministries, Agencies and Departments*
- *Independent Regulatory Authorities*
- *Sub-National Authorities (Where Applicable)*

Provide Critical Goods and Services

- *Sector Ministries, Agencies and Departments*
- *Sub-National Authorities (Where Applicable)*

Advancing Equity and Poverty Reduction

- *Sector Ministries, Agencies and Departments*
- *Sub-National Authorities (Where Applicable)*
- *Social Service Agencies*

**Specific Tasks**

Policy Formulation, Coordination and Implementation

- *Cabinet Secretariat or Other Supreme Coordinating Body*
- *Sector Ministries, Agencies and Departments*

Develop Organizational Structure and Work Processes

- *Sector Ministries, Agencies and Departments*
- *Sub-National Authorities (Where Applicable)*

Mobilize and Deploy Human and Financial Resources

- *Revenue Agencies · Ministry of Finance and Ministry of Development*
- *Civil Service Board or Personnel Management Agency*
- *Sector Ministries, Agencies and Departments*
- *Training Institutes*

Perform Work and Produce Outputs

- *Sector Ministries, Agencies and Departments*
- *Sub-National Authorities (Where Applicable)*

Monitor Performance

- *Political Leadership*
- *Management*
- *Internal Audit*
- *Supreme Audit Agencies*
- *Ombudsman Offices*

type of functions it performs. In practice, governments throughout the Asian and Pacific region differ widely in the range of goods and services they provide to their citizens. At one extreme, New Zealand is experimenting with ways in which elements of the government's policy advisory function can be privatized or contracted out. At another, government agencies in India are involved in the production of textiles and a variety of consumer goods.

Such questions are often technically complex and politically sensitive, yet they run to the core of Bank operations. From the ADB's vantage point, basic decisions about the size and scope of the public sector must reside with our individual DMCs. The optimal public/private mix may vary significantly depending upon local circumstances, such as the presence of alternative service providers or the degree to which a country's public sector is already overburdened. DMC governments are often much more attuned to the nuances surrounding such decisions than are MDBs or international consultants. In addition, many of these issues are predicated upon fundamental assumptions about the role that the state *should* play within society. As such, they reflect basic questions about values—which will differ between countries and individuals and are not amenable to technical solutions. Finally, and perhaps most importantly, the freedom to define the basic institutions of government and the role they should play is an essential prerogative of sovereignty.

There are occasions, however, when the Bank can play a role in facilitating the discussion of such issues, including:

- (1) Structural adjustment lending and balance of payments support, when the overall size of the wage bill and scope of government activity are clearly unsustainable and may require significant contraction, for which Bank assistance is sought;
- (2) In economies in transition, where fundamental questions regarding the nature and scope of the state have yet to be resolved, and the

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**

Bank can help to expand the range of choices and bring in examples of best practice through training and technical assistance;

- (3) On a sectoral basis, where competing policy options or alternative means of service delivery are under consideration by our DMCs; and
- (4) When the Bank is working on issues of legal and regulatory policy, and there is a need to ensure the independence of the regulatory body.

One additional area where the Bank may be justified in entering the debate over the provision of goods and services would be if a particular DMC's public sector is so over-stretched that it is incapable of delivering even the most basic functions effectively. Under these conditions, some type of consolidation may be necessary, and Bank staff would be justified in raising the issue during programming and policy dialogue. This consolidation need not be permanent, for as a country's bureaucratic capacity expands, it should be able to take on more responsibilities.

A second question is the choice of appropriate models or solutions for GCB problems. The ADB is fortunate to be located in a region that is home to numerous examples of global best practice. Japan has managed to avoid the "boom and bust" cycles that have characterized government employment in many other countries, and it has attained a high level of civil service professionalism at staffing levels that are among the lowest in the developed world. Australia and New Zealand have been able to implement fundamental reforms in their systems of public expenditure management that have given line agencies and departments much greater freedom in their use of resources and resulted in significant productivity gains. Singapore and Hong Kong, China have been able to move within only a couple of decades from situations in which corruption was widespread and systematic to where it is rare and isolated.

While these and other models provide a vast reservoir of comparative experience from which to draw, care should be taken in assuming easy transferability from one context to another. Careful diagnosis is required to distill the appropriate lessons from any given “success story,” whether it is the relationship between government and business in East Asia or the lessons of “New Public Sector Management” from Australia and New Zealand. The history of failed public sector reform initiatives is littered with the uncritical importation of inappropriate or not feasible solutions from abroad.

For this reason, the Bank will avoid championing one particular model or approach to development. It will instead seek to make available a range of experience, so that our DMCs will be able to carefully consider which solutions are most appropriate to their unique political and administrative traditions. In pursuing this task, the Bank will seek to identify, gather, analyze, disseminate and (where necessary) generate high-quality research, case studies and comparative assessments of examples of best practice drawn from both the Asian and Pacific region and throughout the globe.

#### **IV. GOVERNANCE AND CAPACITY BUILDING THEMES**

The ADB’s mission is to build a world-class practice in the field of governance and capacity building. Towards this end, the Bank needs to develop a more balanced and comprehensive approach to GCB issues. Sector work has been and will continue to constitute the major area of Bank involvement for the next decade or more. But sector work alone will not respond to several of the more pressing GCB challenges currently confronting the Asian and Pacific region. At the central government level, problems of enhancing transparency and accountability are systemic in nature and will require an integrated approach across sectors and the reform of key institutions with responsibility for the government as a whole. The tremendous

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*Key Themes and Priorities for Governance in the Asian and Pacific Region*

demographic explosion at the municipal level will also require governance solutions at that level. The proportion of the Bank's effort devoted to improving the efficiency and effectiveness of line ministries, agencies and departments will therefore need to be reduced to make way for greater effort at the central and sub-national levels. In a similar fashion, to ensure consistency in the ADB's strategy and work program, the Bank will need to address several critical themes that cut across both sectors and levels of government.

During the next decade, Bank staff anticipate that there will be six priority areas for the ADB's governance and capacity building effort. The first three are organized according to levels of government. They include: (1) core institutions of government; (2) sector work with line ministries, agencies and departments; and (3) sub-national governance.

The second three are organized along priority themes, and include: (4) issues regarding the interface of the public and private sectors; (5) issues of law and development; and (6) issues of civil society, social capital and participation.

These themes represent a mix of areas where the Bank has traditionally been active, emerging priorities for the region, and the fundamentals for a well-functioning public sector outlined in Section III above. Each is discussed in greater detail below, along with a list of more narrow topics to be pursued under each thematic heading.

Even at the sub-theme level, this agenda is vast and cannot be addressed at once. Careful prioritization and sequencing is needed to identify the most critical sub-themes and more narrow issues from within each sub-theme that should be pursued. A more subtle and nuanced understanding of the interaction between these themes and sub-themes is needed to exploit promising substantive or geographic synergies and to avoid overlap, duplication or contradictory initiatives.

## **1. Core Institutions of Government**

Core government agencies, such as the Cabinet Office, Ministry of Finance, Ministry of Development, Civil Service Board, and Supreme Audit Agency, are essential to the effective functioning of government. If they fail to perform their work properly, the implications are felt throughout the system. Government policies are poorly coordinated and may work at cross purposes. Ministries and agencies devote their energies to frequent and bitter battles over turf. Resources are not allocated to their optimal use. Departments are starved for operating funds, and critical priorities are neglected or chronically underfunded. The civil service may be large, unproductive, poorly motivated and lack essential skills. Corruption can flourish, and the abuse or misallocation of government resources can remain undetected and uncorrected.

In keeping with the framework introduced in Section III, there are four areas where the ADB's involvement could be most beneficial: (1) strengthening central mechanisms for policy formulation, coordination and implementation; (2) strengthening the management of public finances; (3) enhancing the development of human resources and human resource management; and (4) strengthening accountability mechanisms, particularly supreme audit agencies. Each will be discussed in greater detail below.

The ability of governments to effectively manage the process of policy formulation, coordination and implementation will have a decisive impact upon the functioning of the public sector as a whole. When these functions are not performed properly, ministers lack adequate information to make appropriate decisions. Cabinet meetings go on for hours without reaching consensus. Policies are adopted without adequate consideration of appropriate alternatives or a proper understanding of their implications for the recurrent and capital budgets. Decisions are not followed up on to ensure their successful implementation. Lack of coordination among ministries, agencies and departments results in costly overlaps, bureaucratic fric-

tion, policy confusion and unnecessary duplication of functions.

Although work with central policy mechanisms is often politically sensitive, within government agencies, the budget has long been recognized as one of the most powerful tools for organizational change. The ADB's work will concentrate upon enhancing the strategic use of public sector financial resources. Towards this end, several options are under active consideration, including strengthening the capacity of the budget office in the Ministry of Finance and budget units in various ministries, agencies and departments; supporting the integration of accurate cost data into the budget; enhancing budget preparation and execution; improving financial and physical monitoring of expenditures; and the introduction of techniques such as a Medium Term Expenditure Framework, which can help capture the downstream cost of current expenditure decisions. Procurement reform—a key element of many Bank TA Grants—will also remain an area of important concern.

The quality and professionalism of the civil service exert a critical influence upon the performance of the public sector as a whole. Civil service reform should be an important priority of the Bank, including issues of recruitment, training and promotion; establishment management and control; performance monitoring and evaluation; manpower planning and forecasting; pay and employment; and code of ethics. In the past, many Bank efforts have focused upon isolated components of human resource development, such as training. Staff are now proposing a more integrated approach, in which training is embedded within the broader array of human resource management issues discussed above in the Bank's work at all levels of government.

Finally, several reform efforts currently unfolding throughout the Asian and Pacific region, ranging from decentralization to increased emphasis upon performance monitoring and measuring, presuppose a robust capacity to monitor financial and managerial accountability. The Bank is already pursuing several innovative efforts to strengthen

supreme audit agencies, and these efforts should be strengthened and expanded into other regions. Additional ways to strengthen accountability should be considered, such as supporting the Office of the Ombudsman or various anti-corruption agencies. Programs to strengthen internal audit will also be considered in the context of work with individual ministries, agencies and departments.

To avoid unnecessary duplication and ensure consistency in approach, much of this work will need to be carefully coordinated with other aid agencies. This is particularly true with the IMF regarding expenditure management and with the World Bank on civil service reform. Yet in spite of the presence of other donors, a strong case can be made for expanding the ADB's practice on these issues. As was noted above, the core institutions of government are of critical importance to improving the quality of the Bank's sector work by enhancing the broader institutional environment under which sector ministries operate. Furthermore, all development institutions have only limited GCB staff resources for the Asian and Pacific region, and even operating at full capacity they are unlikely to satisfy the demand for timely and appropriate assistance on the part of our DMCs.

*Top Priorities:*

1. Strengthening central mechanisms for policy formulation, coordination and implementation;
2. Public financial management reform, including procurement reform;
3. Civil service reform; and
4. Strengthening the capacity of supreme audit institutions to conduct both financial and performance audits.

## **2. Sector Work with Line Ministries, Agencies and Departments**

As was noted above, the vast majority of the Bank's GCB effort has historically concentrated upon sector work within line ministries, agencies and departments. For the next decade, such efforts will probably continue to make up the bulk of the Bank's work. To avoid dissipating resources thinly over a wide variety of issues and interventions, and to facilitate the development of greater institutional expertise on the most pressing sectoral issues, it is critical that greater focus be achieved along two dimensions: the identification of priority substantive issues of involvement, and the identification of specific sectors and functions that will be of greatest importance to the Bank over the next five years.

Turning first to questions of substance like issues of strategic management will be critical for Bank's involvement. These issues reflect our belief that governments must be selective in the tasks they perform. They must limit their interventions to areas where there is a powerful economic rationale for their involvement and where they can clearly make a difference. This category includes topics such as defining organizational mission, scope and objectives; identifying the needs and interests of clients and stakeholders; assessing the role of alternative service providers; linking organizational structures and processes to products; and ensuring that products reflect the most desirable social outcomes. It also includes questions of decentralization and the optimal devolution of authority and responsibility. Strategic management has clear links to a host of other issues, such as reengineering, performance management, and privatization or commercialization, which are discussed separately below.

Organizational restructuring and process streamlining or "re-engineering" will be another major theme of the ADB's sectoral governance work. Although the term "re-engineering" has been used to describe a wide variety of reform initiatives, its proper usage connotes the

fundamental redesign of organizational business processes to support the attainment of a unit's basic objectives. In many developing countries, reforming these processes can be a "win-win" situation, in that it can be done relatively inexpensively; it can lead to marked increases in productivity; and it can help to free up additional staff for retrenchment or redeployment. It can also generate positive externalities, such as reducing the opportunity for bribes and "speed money."

The third area, performance monitoring and measurement, reflects the global trend of moving away from public sector systems and processes that are highly input oriented in favor of those that place a greater premium upon results. The question of how one can develop appropriate performance monitoring and measuring tools, in which both ministers and managers can properly be held accountable, is a complicated one and can be fraught with risks if done incorrectly. Systems for performance monitoring in advanced countries often require the ability to gather, manipulate and integrate vast quantities of data. They also presuppose the need to give managers greater flexibility, which could be problematic in countries with a history of corruption and lacking a strong civil services ethos. Nevertheless, through the careful and appropriate selection of indicators and monitoring systems, it is likely that solutions can be found that will allow for productivity gains, enhanced managerial flexibility within limits, and a greater focus upon results.

It should be noted that personnel management and financial management are clearly critical elements in enhancing the performance of sectoral ministries, agencies and departments. To the extent that Bank GCB work can make headway on these issues at the sector level, progress should be made as part of an integrated reform package. However, if control over these issues is highly centralized (and experience varies significantly among countries in the Asian and Pacific region), they should then be addressed under core government reforms.

Regarding the ADB's sectoral focus, the Bank should direct considerable resources towards sectors where it is

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**

likely to have a significant long-term presence in Asia. These would include the social sectors, such as health and education, and the environment. The Bank should also devote attention to assisting government units with “market friendly” missions. Such measures would include providing assistance to regulatory and divestiture boards, as well as to agencies and departments (such as customs or business registration) whose activities can have a significant impact upon private sector growth. Sectors that are of lower importance include the traditional industrial sectors (energy, transport, telecommunications) and agriculture.

*Top Priorities:*

1. Issues of strategic management;
2. Streamlining government organizational structures and business processes;
3. Performance measurement and orientation;
4. Human resource management and development.

**3. Sub-National Governance**

Within the Asian and Pacific region, urbanization is proceeding at a rapid pace. Demographers predict that the percentage of people living in Asian cities will increase steadily from a current level of 34 percent to 54 percent by 2025. Overall forecasts are for 1.5 billion new residents in Asian urban areas over the next 30 years, equivalent to a growth of 137,000 persons per day. Asia is also currently home to nine of the world’s fourteen “megacities,” each with a population of over 10 million. These changing demographic patterns will place tremendous pressure upon many municipalities that are already struggling to provide critical goods and services, such as basic infrastructure, potable water, sewerage, solid waste disposal, and adequate low income housing.

Many Asian governments have developed or are starting to implement ambitious decentralization schemes. Although such initiatives hold long-term promise for more responsive and effective service delivery, in the near term there is a critical need for assistance in developing an appropriate division of labor among central, regional and municipal governments and for upgrading capacity in management at the sub-national level. The allocation of resources commensurate with newly devolved responsibilities is also likely to be a priority topic.

Possible ADB efforts in this area could fall under three general categories. The first could focus upon supporting the appropriate division of responsibilities and resources among various levels of government, with particular emphasis upon ensuring that provinces and municipalities have adequate financial resources to fulfill the new responsibilities being allocated to them. Issues of inter-governmental fiscal relations, grants and transfer payments, municipal taxation, issuance of local bonds, and development of municipal debt markets and rating agencies will be of critical importance.

In a fashion similar to the Bank's work with the core institutions of central governments, the second area could focus upon improving the performance of core government functions and tasks at the sub-national level. The question then arises as to which tasks and functions should be given priority. Urban planning? Human resource management and development? Financial management?

The third area could address enhancing municipal service delivery. Under this rubric, emphasis should be placed upon enhancing municipal service delivery in certain key areas, such as solid waste removal, water and sewerage, and urban transport. Emphasis should also be given to developing appropriate performance indicators and establishing links with civil society to encourage greater accountability for results.

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**Key Themes and Priorities for Governance in the Asian and Pacific Region***Top Priorities:*

1. Intergovernmental fiscal relations and finance;
2. Strengthening government institutions at the sub-national level; and
3. Enhancing the delivery of critical municipal services.

**4. Public/Private Interface**

Over the last two decades, attitudes towards the role of the state in enhancing economic growth have shifted markedly. The former emphasis upon the state occupying a commanding role in the economy has given way to the belief that governments should foster an “enabling environment” for private sector growth, whose elements include a stable macroeconomic policy; transparent and predictable commercial and investment codes; labor regulations that avoid overly cumbersome restraints upon the hiring and firing of staff; and a legal system that supports the timely and fair adjudication of disputes. Within this paradigm, government bureaucracies must operate in a reasonably efficient and transparent fashion in providing access to critical goods and services, such as licenses and import and export permits; customs clearance; title for land; and access to utilities. They should also foster the creation of good infrastructure and a healthy and literate workforce.

Beyond these prerequisites, the optimal role of the state becomes more controversial, particularly with regard to issues such as industrial policy. Many Bank member governments favor a traditional *laissez-faire* approach, in which the state creates an enabling environment through sound macroeconomic policy and transparent legal and regulatory frameworks and leaves fundamental decisions about investment and entrepreneurship to the private sector. Other Bank members feel that the state should play a more proactive role, favoring certain sets of industries or “national champions” through policies such as

protectionism (in the nascent phases of industrial development), the awarding of public procurement contracts, and the subsidized use of credit.

Practices differ both within Asia and among the High Performing Asian Economies (HPAEs), with some such as Hong Kong pursuing an essentially *laissez-faire* approach and others such as Korea engaging in active industrial intervention. The Bank's approach should concentrate first upon helping our member countries to get the fundamentals right, for they are an essential prerequisite to rapid economic growth. Beyond this, it is up to our individual DMCs to determine the nature and scope of their industrial policy, although the Bank can serve as an "honest broker" in making available information about differing approaches in a neutral and unbiased fashion.<sup>15</sup>

The ADB's governance work can focus upon several key priorities at the intersection between the public and private sectors. The first could be the establishment of business-government deliberation councils and other mechanisms for fostering sustained dialogue between the public and private sectors. Originally pioneered in Japan, these councils have been replicated in a number of other HPAEs and have shown themselves to be remarkably effective at facilitating the exchange of information and removing impediments to private sector growth. Although particular care must be taken to avoid capture by vested interests in countries where the bureaucracies are relatively weak, these councils could hold promise for careful replication in other settings.<sup>16</sup> Are there other "lessons" from East Asia's growth that merit consideration in this context?

The second priority area should be the reform of public enterprises, with particular focus upon issues of corporate governance. The Bank has historically been heavily engaged on this topic, primarily in the power and water sectors. In 1995 and 1996, approximately 30 percent of Bank projects dealt with the privatization, corporatization or commercialization of specific state enterprises.

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15 The Bank's approach will be subject to the caveats discussed above on pages 17-18.

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**

This work is likely to be increasingly important in the future, since many governments will be strapped for cash, and privatization and divestiture have not proceeded as rapidly in Asia as they have in other regions. Corporate governance will be a priority in virtually all of the Bank's DMCs, as economies in transition seek to limit their sphere of state activity and countries in East and South Asia seek to inject greater independence, accountability and transparency into the operation of their public enterprises. Underlying these initiatives will be the need to ensure that public corporations operate under sound management and hard budget constraints, with as little political interference as possible.

The third area for ADB involvement should be helping to establish transparent and predictable legal and regulatory frameworks for DMC financial markets (including the banking, securities markets, and non-banking sectors). The failure to establish sound supervision and to adequately regulate these sectors has been at the root of much of the turmoil that has gripped East Asia over the last six months. The Bank is currently involved in substantial policy-based lending in Korea, Indonesia and Thailand, where IMF-brokered recovery programs place a major emphasis upon enhancing the transparency and independence of the regulatory function.

The fourth priority area for Bank involvement should lie in supporting the commercialization, privatization and divestment of select public sector agencies, functions and tasks. There are often persuasive reasons for divesting the state's share of these entities, including the need to reduce their drain on the budget and their disproportionate share of credit markets. Often, efforts to divest all or a part of government shareholding in public enterprises should be accompanied by changes in competition policy, the

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16 On this point, see Jose Edgardo Campos and Joaquin Gonzalez, "Deliberation Councils and Effective Policy Making: Experiences from Malaysia, Singapore and Canada," in Suzanne Taschereau and Jose Edgardo Campos, eds. *Building Government-Citizen Business Partnerships* (Ottawa: Institute on Governance, 1997) pp. 7-26. See also the section, "Why Deliberation Councils Assist Growth," in the World Bank's *The East Asian Miracle: Economic Growth and Public Policy* (New York: Oxford University Press, 1993), pp. 181-188.

imposition of a hard budget constraint and reduction in state subsidies, financial sector reform and changes in management and corporate governance.

These issues are of particular importance in South Asia and economies in transition, where the degree of state intervention in the economy is large. They will also be quite important in infrastructure. Asia's demand for infrastructure investment, estimated by some at over \$1.6 trillion over the next decade, will be beyond the capacity of both central and local governments to meet. Will the optimal solution involve mobilizing a combination of domestic and foreign capital from the private sector, in which Bank funding can play a useful and catalytic role?

Finally, as was underscored above in the section on improving the performance of line ministries, governments should devote particular care to streamlining the operations of those units dealing directly with the private sector on issues such as licenses, permits, customs, etc.

*Top Priorities:*

1. Strengthening forums for business-government interaction;
2. Public enterprise reform and governance;
3. Financial market regulation; and
4. The privatization and commercialization of select public sector goods and services.

## **5. Law and Development**

The nature of a country's legal system is fundamental to a wide variety of economic and social activity. It is impossible to create an enabling environment for private sector development or to advance the status of certain social groups or categories without addressing the underlying laws and legal institutions which govern that sector. For this reason, the Bank places a premium upon assist-

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**Key Themes and Priorities for Governance in the Asian and Pacific Region**

ing DMCs in drafting appropriate legislation and creating an effective legal framework. In the area of private sector development, critical areas for assistance include commercial codes and laws governing finance, capital markets, foreign investment, privatization, competition policy, and the regulation of natural monopolies. Legislation covering social and environmental sectors will also be a key priority.

It is not enough to merely provide assistance in drafting the relevant statutes, for the institutions charged with implementing them often need strengthening to ensure that laws are effectively and fairly applied and enforced. In this context, the Bank is currently providing assistance in legal education and training, creating transparent and easily accessible legal information systems for judges and government lawyers, streamlining court procedures and eliminating judicial backlogs, in upgrading the quality of the judiciary, and developing alternative mechanisms for dispute resolution.

*Top Priorities:*

1. Capacity building and institutional enhancement of the legal system;
  2. Legal framework for Private Sector Development; and
  3. Law in the Social and Environmental Sectors.
- 6. Civil Society, Social Capital and Participation**

The ADB's interest in participatory development is not new. A growing body of research demonstrates that the robustness of civil society will have an important impact upon government performance. Our operational experience suggests that projects can be made more effective and sustainable when they involve those they are intended to help. Participation can also be complex and time consuming. Important judgments and tradeoffs are necessary

in the process of engaging with affected groups and potential beneficiaries, especially in large-scale projects and programs. But experience adequately demonstrates that participation increases the effectiveness of development.

One area of consideration is what the Bank's member countries can do to support participation. Projects supported by the Bank are not Bank projects, but merely Bank-financed projects. The ownership of these projects lies with their executing agencies and the borrowing DMC. If governments are not sympathetic, what implicit or explicit strategies can the Bank employ to strengthen borrower commitment to participation? In selecting development priorities or making resource allocation decisions, how responsive should the borrower be to priorities chosen by the disadvantaged groups themselves? Can the Bank or external donors attempt to determine which partners should be invited to participate in a development activity? Should the Bank work with governments to focus upon participation by all relevant stakeholders, or direct its efforts to focus primarily upon participation by those who are normally excluded, who lack exit and voice options, and who face the risk of "capture" by local elites?

Although the ADB's governance program places a premium upon participatory methods for project preparation and implementation, the modalities for participation will vary depending upon the nature of the project and its objectives, as well as the broader social and cultural context in which it is being implemented. Greater information on these questions is needed, which should form a critical part of the ADB's GCB research agenda.

The ADB could also advance initiatives relating to the creation of an "enabling environment" for NGO activity, including an appropriate legal framework, which will allow NGOs to form and operate in a stable and predictable setting with a minimum of interference and red tape.

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**Key Themes and Priorities for Governance in the Asian and Pacific Region***Top Priorities:*

1. Participatory methods for project preparation and implementation; and
2. Creating an “enabling environment” for NGOs.

**V. CONCLUSION**

In the first instance, the effectiveness of the ADB’s programming on governance and capacity building will depend upon the Bank’s ability to select the appropriate issues for intervention and the proper solutions to these problems. If the wrong issues are selected, then even a successful intervention will not result in a sustainable improvement in the quality of governance within our DMCs. If the wrong solution is selected, then the task of reform will suffer a significant setback, and the appropriate answer will be that much more difficult to implement in the future. Since the cost of failure is high, it is incumbent upon Bank staff to consult widely and ensure that the problems and solutions targeted for intervention are the right ones.

In the second instance, the Bank’s effectiveness will depend upon its success in managing several important tradeoffs. The Bank must articulate a clear set of priorities that will allow it to develop recognized areas of comparative advantage, while at the same time preserving flexibility in responding to differing local needs and circumstances. It must change its staffing mix to address the future priorities of countries in the Asian and Pacific region while continuing to service existing operational work. It must respond to the immediate and perceived needs of our clients while engaging in dialogue aimed at addressing deeper and more fundamental problems. It must coordinate with other aid agencies to exploit synergies while avoiding areas of duplication and gaps in coverage.

This will not be an easy task, and there will inevitably be areas upon which reasonable parties may differ.

However, these disagreements should be able to be accommodated within a framework that does not sacrifice clarity for comprehensiveness. The development of this initial set of themes is but the first step in a lengthy and iterative process, in which the priorities identified in this document and during the workshop discussion will be continuously tested and refined in light of experience and on-going dialogue.

During the course of this dialogue, several fundamental issues will need to be addressed. Perhaps the most critical is the applicability of principles developed in one political, institutional and administrative context to another. Do the “Lessons of East Asia” or the “Principles of New Public Sector Management” represent transcendent economic and managerial truths, or successful local conventions? The overarching intellectual goal of this framework—and a question of paramount importance to the Bank’s future governance and capacity building work—will be to separate the principles and practices that have universal applicability from those of a more limited and contextual nature. In this sense, the Bank’s themes and priorities provide both a guide and an agenda for “action research,” in which critical reflection and feedback loops will play an essential role.

## ATTACHMENT

**PRINCIPLES TO BE ADVANCED  
IN THE ASIAN DEVELOPMENT BANK'S  
GCB PROGRAMMING****Principles from the Board Paper, *Governance: Sound  
Development Management***

**Accountability:** It is a fundamental tenant of management theory that employees, whether working individually or collectively, need to be placed within a framework that will articulate goals, establish incentives towards desired outcomes, and monitor progress towards these ends. Accountability has many components. Legal accountability ensures that the actions of public sector entities are in accordance with the officially sanctioned “rules of the game.” Financial accountability ensures that public resources are actually spent upon the purposes for which they were intended. Managerial accountability ensures that government officials will be held responsible for delivering a specified set of goods and services within a given budget and time horizon. Political accountability (which lies beyond the ADB’s scope of operation) ensures that senior government officials are selecting and implementing policies in a fashion consistent with the preferences of their citizenry.

**Transparency and Predictability:** These principles reflect the belief that economic development will proceed most rapidly when the private sector is confronted with a set of stable and clearly understood “rules of the game” that facilitate investment decision-making and provide investors with confidence. In a similar fashion, the tight congruence between formal and informal “rules of the game” is often a key determinant of the

ability of public sector institutions to function effectively.

**Participation:** Governments do not operate within a vacuum. At the broader, societal level, recent research has demonstrated that they are often most effective when they operate within a robust civil society with an abundance of “social capital” (i.e. common norms and practices that lower transaction costs between individuals and enable them to attain higher utility functions than they would otherwise enjoy). At the project level, a growing body of empirical evidence demonstrates that initiatives tend to be more successful when stakeholders and beneficiaries are integrated into the planning process. This element also contains a normative component, in the belief that people have a right to be consulted about initiatives that will have a major impact upon their welfare and lifestyle.

### **Other Important GCB Principles**

**Strategic Focus:** In an environment where needs are infinite and resources are scarce, organizations need to have a clear sense of purpose if they are to have sustained positive impact. Otherwise, they are likely to dissipate energy and resources over a range of activities that may not be directly related to their fundamental social objectives. This maxim is particularly relevant where institutional capacity is weak or underdeveloped.

**Efficiency and Effectiveness:** Efficiency is the relationship between inputs and outputs. It ensures that a particular public sector entity is utilizing its staff and financial resources as parsimoniously as possible to produce a specified unit at a given level of quality. Effectiveness examines the nature of the outputs produced and considers their ability to have a positive impact upon a given social issue or prob-

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*Key Themes and Priorities for Governance in the Asian and Pacific Region*

lem. Together, they provide an approximate qualitative guide as to the performance of a given government agency.<sup>17</sup>

**Responsiveness:** This principle is important in a number of areas. Responsive organizations tend to be client centered and to focus their efforts upon providing items that the public wants, which over the longer term will foster higher customer satisfaction and reduce the diversion of resources into unnecessary or undervalued goods and services. Such organizations also tend to be more farsighted in their orientation, and they are better able to identify and respond to changes within the broader environment so as to ensure their continued relevance.

For the most part, these principles are supportive and mutually reinforcing. A focus enhancing on efficiency and effectiveness, for example, will need to encompass efforts to strengthen financial and managerial accountability, such as the delineation of clear spheres of responsibility and reporting relationships, the accurate costing of inputs, and the setting of specific performance targets and benchmarks. Efforts to articulate a clear strategic focus, if accompanied by a comprehensive vision and detailed set of mission statements linked to operational guidelines, will have a positive impact upon the effort to enhance transparency and predictability.

Occasionally, these principles may conflict—particularly in the area of responsiveness and participation. Participatory processes often require extensive mechanisms for consultation, which can be time consuming and hamper the ability of organizations to respond quickly to new developments. On the other hand, such processes enhance sustainability and encourage organizations to be more responsive to client demands. These trade-offs are hardly

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<sup>17</sup> Cost per kilometer of road paved, or cost per vaccination, or cost per pupil per year are all measures of efficiency. A decline in travel time and the cost of vehicle maintenance, mortality and morbidity rates, or adult illiteracy rates are measures of effectiveness.

new; Machiavelli described them in *The Discourses*.<sup>18</sup> But they need to be carefully managed.

It should be noted that several common managerial principles are missing. Flexibility, a key element of public sector reforms in countries such as Australia and New Zealand, has not been listed as a guiding principle because efforts to provide managers with greater discretion may not always produce better results, particularly if a professional ethos is underdeveloped and accountability mechanisms are weak. In a similar fashion, decentralization is not emphasized. There are persuasive reasons for decentralizing and devolving responsibility, including increased willingness to pay on the part of service beneficiaries, improved responsiveness to local tastes and preferences, and placing authority at the level where staff have the greatest information. Yet in the absence of robust systems for monitoring and controlling expenditures, or if skilled staff are scarce, then governments can often be worse of than they would be under more centralized arrangements. Nevertheless, both flexibility and decentralization are important principles to be advanced where institutional conditions permit.

Implicit within the ADB's governance principles is the belief that the state's sphere of operations should be limited. It should not serve as an employer of last resort, or as a vehicle for patronage. It should not occupy a commanding position within the economy or serve as the "engine" for economic growth. Rather, it should serve as a catalyst and a facilitator for development, and it should target its efforts carefully and selectively upon performing a certain core set of functions and tasks well.

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18 In Machiavelli's *Discourses on the First Ten Books of Titus Livius*, he writes: "Although one man should organize a government, yet it will not endure long if the administration of it remains on the shoulders of a single individual; it is well, then, to confide this to the charge of many, for thus it will be sustained by the many. Therefore, as the organization of anything cannot be made by many, because the divergence of their opinions hinders them from agreeing as to what is best, when once they do understand it, they will not readily agree to abandon it." See Chapter IX.