

Special Theme

Governance in Asia: From Crisis to Opportunity

“At the core of our dark experience lies the ugly truth that there was an absence of transparency, accountability, public interest, and public responsibility.”¹

Issues of governance are at the center of many of the most pressing challenges confronting countries throughout the Asian and Pacific region today. In East² and Southeast Asia,³ 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 since July 1997. In South Asia,⁴ 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 Central⁵ and Southeast Asia are grappling with redefining the role of the state, shifting the balance between central and local power, and providing civil service employees with appropriate skills for managing a market economy. In the Pacific,⁶ issues of public sector efficiency, effectiveness, and accountability are particularly important for ensuring the long-term viability of small economies.

Each nation’s path to good governance is different, depending on culture, geography, political and administrative traditions, economic conditions, and many other factors. The scope of activities allocated to the public and private sectors diverges markedly. Variation in scale is also enormous. Many of the institutions and practices that work effectively in the People’s Republic of China (PRC), with its 1.2 billion people, will not be relevant in Nauru, with its population of 10,000.

Yet governments share many features. They face similar responsibilities in that they need 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 need to perform a variety of similar tasks, such as organizing themselves to formulate and coordinate

1 From the keynote address of Anand Panyarachun, former Prime Minister of Thailand, at the United Nations Development Programme Regional Workshop on Integrity in Governance in Asia, Bangkok, June 1998.

2 East Asia includes the newly industrialized economies of Hong Kong, China; Republic of Korea; Singapore; and Taipei, China; and the People’s Republic of China and Mongolia.

3 Southeast Asia includes Cambodia, Indonesia, Lao People’s Democratic Republic, Malaysia, Myanmar, Philippines, Thailand, and Viet Nam.

4 South Asia includes Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

5 The Central Asian republics include Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan.

6 The Pacific includes Cook Islands, Fiji, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

Box 1. Does Governance Matter? Empirical Evidence from Japanese Foreign Direct Investment Flows

A study examining the locational determinants of Japanese foreign direct investment shows that the quality of governance in a country has a significant impact on the decision of Japanese private firms on whether to make investments in the country. Other factors are shown to exert an influence on this decision, namely, the exchange rate, wage rate, size of the local market, inflation, quality and depth of infrastructure (as proxied by the level of electricity generation per person), availability of skilled labor (as measured by the enrollment rate for secondary education), and presence of Japanese firms in the country. The authors use a conditional logit model to establish statistically that all these factors (including the quality of governance) affect the probability that Japanese firms will opt to locate facilities in a country.

The quality of governance was constructed from a weighted average of five indicators with values that were derived from responses of businessmen to structured surveys: government repudiation of contracts, risk of expropriation, corruption, law and order tradition, and bureaucratic quality.

The authors also show that governance plays a relatively more important role in the decision in sectors that are more capital- and technology-intensive. This is consistent with the theory that weak rule of law discourages investments that include large sunk costs.

Sources: Shujiro Urata and Hiroki Kawai, "Governance and the Flow of Japanese Foreign Direct Investment," in Campos, J. Edgardo (ed.), *Corruption: The Boom and Bust of East Asia* (forthcoming).

specific policies, and mobilizing human and financial resources to implement their decisions. They need to focus on core public tasks. They need proper incentives to perform these tasks as efficiently and effectively as possible in a responsive, transparent, and predictable fashion, and with clear strategic focus and appropriate participation. They need to confront corruption from the highest level.

The Bank's approach to helping its developing member countries (DMCs) improve governance practices, 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. This approach builds on the recommendations of the Bank's task force on improving project quality to ensure that Bank projects help build sustainable public sector capacity in DMCs.⁷ The July 1998 Board-approved Anticorruption Policy shows further deepening of the Bank's thinking in the governance area.

This chapter provides an overview of the Bank's thinking on good governance and capacity building, gives examples of how these ideas have been put to use in helping DMCs carry out governance reforms, and concludes with some thoughts on the next steps.

What is governance?

Governance is a simple concept at heart: good governance is good government. The concept relates to the quality of the relationship between government and the citizens whom it exists to serve and protect. The Bank defines governance as the manner in which power is exercised in the management of a country's social and economic resources for development. Put more simply, governance means the way those with power use that power. Governance has, therefore, political and economic dimensions. Issues of political governance include the mechanisms by which the public's political preferences are ascertained and leaders chosen. These are fundamental governance concerns, but are generally outside the scope of the Bank's work. But economic governance—sound development management—is at the core of sustainable development. This is supported by empirical evidence (*Box 1*) that the quality of governance has a significant impact on investment and growth.⁸

The instrumental nature of governance implies that the four governance "pillars" (*summarized in Box 2*) are universally applicable regardless of the economic orientation, strategic priorities, or policy choices of the government in question. However, their application must be country-specific and solidly grounded in the economic, social, and administrative capacity realities of the country.

Also, while it would be misleading to identify key problems and suggest solutions without first conducting detailed assessments of the governance landscape in each country, it is possible to illustrate the general governance

7 ADB, *Project Quality: An Agenda for Action* (Manila: Asian Development Bank, 1995).

8 Shang-Jin Wei, "How Taxing is Corruption on International Investors?" Working Paper W6030 and "Why Is Corruption So Much More Taxing than Tax? Arbitrariness Kills," Working Paper W6255 (Cambridge, Mass.: National Bureau of Economic Research, 1997); and Paolo Mauro, "Corruption and Growth," *Quarterly Journal of Economics* (1995), 681–712.

Box 2. Four Pillars of Governance

The four key components of governance are accountability, transparency, predictability, and participation.

Accountability is the capacity to call officials to account for their actions. Effective accountability has two components: “answerability” and consequences. “Answerability” is the requirement to respond periodically to questions concerning one’s official actions. There is also a need for predictable and meaningful consequences, without which accountability is only a time-consuming formality. In addition, both internal (administrative) and external accountability are needed. Particularly with the dramatic improvements in information and communication technology, external accountability through feedback from service users and the citizenry can now be obtained at low cost and for a greater variety of government activities, and is an essential adjunct to improving efficiency and effectiveness of public service delivery.

Transparency entails low-cost access to relevant information. Reliable and timely

economic and financial information is a must for the public (normally through the filter of responsible media). It is essential not only that information be provided, but also that it be relevant and understandable. (Dumping on the private sector vast amounts of raw economic information does not improve transparency.)

Predictability results primarily from laws and regulations that are clear, known in advance, and uniformly and effectively enforced. Lack of predictability makes it difficult for public officials to plan for the provision of services (and is an excellent alibi for nonperformance). Predictability of government economic actions is also needed as an indicator on which the private sector can rely to make its own production, marketing, and investment decisions. Most importantly, to be predictable, the application of economic regulations must be effective, fair, and uniform.

Participation is needed to obtain reliable information and to serve as a reality check and watchdog for government action. Among

other things, participation by external entities is needed as a spur to government operational efficiency, and feedback by users of public services is necessary for monitoring access to and quality of the services.

Empirical evidence suggests that a strong civil society plays a critical role in advancing good governance.¹ Improving formal rules and organizations without any change in informal customs and ways of doing business avails little; importing procedures and mechanisms without reference to the incentive and local capacity framework is likely to be fruitless; interacting only with central government or, indeed, only with government, is not conducive to good implementation of reforms. Above all, governance intervention should encourage the formation of social capital, i.e., the stock of trust and information exchange at the base of civil society.

1 See, for example, Robert D. Putnam, *Making Democracy Work* (Princeton: Princeton University Press, 1994).

challenge in different types of country circumstances. Although some of the challenges listed under one type may apply to others, Table 1 (page 18) suggests priority concerns being addressed in each set of countries. In addition, challenges such as controlling corruption and improving civil service salaries cut across most of the region.

Development organizations and governments the world over widely share the views embodied in the four governance pillars, although each has its own approach in applying them. This consensus on governance has been accompanied by recognition of the costs of and damages from corruption, and the adoption by many international organizations of robust anticorruption measures. For example, in December 1996, the United Nations General Assembly passed the Declaration Against Corruption and Bribery in International Commercial Transactions. In December 1997, a landmark convention against bribery was negotiated under the aegis of the Organisation for Economic Co-operation and Development (OECD), making bribery of foreign officials a crime at par with bribery of national officials. Because corruption is by definition two-sided, this convergence between the emphasis on combating corruption in the developing countries and the Anti-Bribery Treaty offers a historic opportunity to reduce drastically the negative impact of corruption on development. In 1998, the ADB’s Board of Directors approved the Anticorruption Policy, which is congruent with that of the World Bank and other regional development banks.

Table 1. Governance Challenges Being Addressed in the Region

| Subregion/Type | Governance Challenge | Priority Action |
|------------------------------------|---|--|
| Former centrally planned economies | Overextension and overcentralization of the state Lack of appropriate legal framework and skills Greater reliance on the market | Encourage carefully timed and tuned process of decentralization |
| Least-developed countries | Very weak administrative system | Extend the scope and accelerate the pace of administrative reform Encourage exposure to good practices |
| South Asia | State tries to do too much given limited resources and capabilities Regulatory ossification | Better matching of role of the state to its capability Cut red tape Encourage administrative renewal |
| Southeast Asia | “Crony capitalism” Weak checks and balances in public-private relations Barriers to competition | Improve openness, reciprocity, and checks on administrative discretion Strengthen corporate governance systems Encourage competition |

The role of governance in the Bank’s response to the Asian financial crisis

“East Asia reeled. The world paused. The Bank acted.”⁹

The financial crisis that erupted in mid-1997 quickly spread to other Southeast and East Asian economies. The worldwide repercussions of the crisis required a coordinated approach. The Bank acted, therefore, in concert with other organizations and institutions, to introduce fundamental reforms in governance and the manner of economic management.

Governance-oriented interventions in crisis-affected countries

Bank assistance to the countries worst hit by the crisis—Indonesia, Republic of Korea, and Thailand—has also focused on governance. In Indonesia, the centerpiece of Bank assistance is the Financial Governance Reforms: Sector Development Program loan of \$1.5 billion, which supports a major streamlining of the regulatory framework and provides for transparency in the banking subsector and other reforms (*Box 3*). Fiscal decentralization is being further encouraged through a Community and Local Government Support Sector Development Program of \$300 million; this is currently at an advanced stage of preparation. In the Republic of Korea, the Bank provided a \$4 billion Financial Sector Program loan to the International Monetary Fund (IMF)-led multilateral assistance package. The loan supports the restructuring of financial institutions, combined with strengthening regulation and supervision, and with measures to liberalize the capital market and develop it further

⁹ From the speech delivered by ADB Vice-President Peter H. Sullivan at the farewell ceremony for ADB President Mitsuo Sato, Manila, 14 January 1999.

(Box 4). In Thailand, two sizeable loans have major governance components. The Financial Markets Reform Program loan of \$300 million underpins fundamental reforms for transparency and accountability in the financial sector; and the Social Sector Program loan of \$500 million supports, among other things, the administrative decentralization of health and education services (Box 5).

Governance-oriented assistance to other countries

The years 1997 and 1998 also saw an expansion of Bank activities in countries in the Asian and Pacific region in various aspects of public institutions and the public/private interface. Of course, some interventions were under way well before the onset of the Asian financial crisis, but the crisis gave them added impetus. Interventions have ranged from corporate governance in the Kyrgyz Republic to public administration diagnosis in Nepal; civil service reform strategies in Pakistan; governance reviews for Lao People's Democratic Republic, Thailand, and Viet Nam; anticorruption in Indonesia (in conjunction with the Financial Governance Reforms: Sector Development Program loan); urban governance in the Philippines; public sector interventions in the Pacific; and more. *Some illustrations are provided in Box 6.*

Bank assistance to its Pacific DMCs has broadened in scope since the formulation of the 1996 *Strategy for the Pacific: Policies and Programs for Sustainable Growth*. Working in consultation and agreement with governments, the Bank has taken the lead role in the aid community as a catalyst and facilitator of policy reform and capacity building in development management, while retaining the traditional role of project financier. Economic reform programs in seven Pacific DMCs (Cook Islands, Marshall Islands, Federated States of Micronesia, Nauru, Samoa, Solomon Islands, and Vanuatu) have been undertaken with Bank technical and financial assistance during 1996–1998.

These programs aim at generating sustainable economic growth through the creation of a leaner, more efficient public sector, and a better enabling environment for the private sector. Program effectiveness in improving governance and the economic policy framework is expected, in turn, to increase the effectiveness of project-based and sector-specific lending. To improve Bank interventions in the Pacific DMCs, the Bank established an interdepartmental task force to review the design, implementation, and impact of its program loans and associated policy reforms. Lessons learned from the review will influence Bank assistance, especially to the Pacific DMCs, in the fields of policy reform and governance.

There is no doubt that in 1999 and beyond, both the geographic coverage and the scope of Bank financial and technical assistance for governance and public management (including anticorruption) will widen even further.

Interventions beyond the crisis

Nineteen ninety-eight was a landmark and eventful year in many ways beyond the crisis. The Bank's Board of Directors approved policies that essentially complete the policy framework for governance and public

Box 3. Financial Governance Reforms in Indonesia

The Asian financial crisis had a major impact on Indonesia, with the rupiah depreciating more than 70 percent against the US dollar since July 1997. This depreciation has adversely affected the economy and there is an urgent need to restore confidence through financial governance reforms. The Government is now implementing a program of policies and institutional measures to strengthen governance in the financial and corporate sectors and in the area of public sector financial management.

The Bank approved on 25 June 1998 a total of \$1.5 billion to Indonesia for the Financial Governance Reforms: Sector Development Program. The overall objective of the program is to improve the governance of the financial and public sectors resource allocation through (i) adoption of good practices in financial governance, (ii) increased disclosure and transparency of financial information, and (iii) strengthened legal and regulatory frameworks of the financial sector. The goal is to build up credible financial institutions and prudent regulation that will help restore investment flows.

The program involves assessing the financial status and, where feasible, restructuring of existing banks; strengthening the supervisory capacity of Bank Indonesia; rationalizing the supervision and regulation of nonbank financial institutions, and the legal and regulatory environment to facilitate debt recovery and structural adjustment; improving accountability and transparency in both the public and private sectors; implementing anticorruption and antimoney laundering measures; improving fiscal management; strengthening the Capital Market Supervisory Agency; and establishing a secondary mortgage facility. The program—which is being coordinated with the overall ADB/International Monetary Fund/World Bank policy package—will be supplemented with support to specific financial institutions, and capacity-building assistance to sector institutions.

Box 4. Financial and Corporate Sector Reforms and Governance in the Republic of Korea

In December 1997, an International Monetary Fund (IMF)-led assistance package of \$58 billion was provided to the Republic of Korea to tackle an immediate balance-of-payments crisis, as well as address the more fundamental issues in the financial and corporate sectors. The package included a \$4 billion Financial Sector Program loan (FSPL) from ADB. The FSPL contributed to the initiation of reform measures designed to address four issues: (i) restructuring financial institutions, (ii) recapitalizing financial institutions, (iii) strengthening prudential regulation and supervision, and (iv) capital market liberalization and development. The goal is to establish transparent, arms' length relationships among the Government, the banks, and the conglomerates, and thus restore investor confidence in the economy of the Republic of Korea.

While resolution of nonperforming loans and recapitalization of financial institutions have been the immediate concerns of the Government and external funding agencies, the institutionalization of sound business practices has been emphasized equally to ensure sustainability of the reforms over the long term. The FSPL emphasized improving governance standards in the financial sector, including strengthening prudential regulation and supervision.

The large volume of nonperforming loans in the financial sector is closely linked to the structural problems in the corporate sector. The widespread excess capacities in the country's industry sector reflect the previous questionable business decisions of the large conglomerates (*chaebols*). Lasting solutions to the economic crisis and the

financial sector problems cannot be realized unless the corporate sector is significantly restructured.

As part of the IMF-led assistance package, the Government initiated several measures to rectify weaknesses in corporate governance. The Government has now made compulsory the appointment of outside directors to the boards of listed companies. It has passed a law prohibiting companies from issuing new cross-guarantees, and requiring all such existing guarantees to be terminated by April 2000. Financial institutions are now required by the Financial Supervisory Commission to provide quarterly reports on their holdings of cross-guarantees. The Government has also announced that, beginning in 1999, financial statements of companies will be prepared and audited in accordance with international standards and practices.

management. The Bank intensified its efforts at disseminating the lessons of international experience in public management and—most important for the future of the Bank as a broad-based development institution—managed to strengthen internal capacity significantly. In the process, partnerships with other multilateral finance institutions (particularly IMF and the World Bank) have become even closer, because an enhanced ADB role in governance is intended to lead to greater development impact of all external assistance to this vast and extraordinarily varied region. Policy framework, disseminating the lessons of experience, and enhancing the Bank's capacity for governance work—the key building blocks for an enhanced Bank role in governance and public management—are reviewed briefly below.

Policy framework

The Bank's 1995 governance policy provided a sound basis for its future work. This work was carried forward through the adoption of policies that gave tangible content to the principles embodied in the governance framework. Directly related to governance and public management, Board papers were prepared on participatory development and anticorruption,¹⁰ and elements of good governance were increasingly reflected in other Board policies on crosscutting issues, such as indigenous peoples, and gender and development. Governance issues have also started to permeate traditional sector

10 ADB, *Mainstreaming Participatory Development Processes* (Manila: ADB, 1996); and ADB, "Anticorruption Policy" (Manila: ADB, 1998).

Box 5. Social Sector Reforms in Thailand

A \$500 million Social Sector Program loan in Thailand is part of the Bank's \$1.2 billion contribution to the \$17.2 billion IMF-led rescue package. The loan and the related \$2.1 million technical assistance grant take a dual approach to (i) mitigate the short-term social impact of the crisis and (ii) implement structural reforms to increase economic competitiveness in Thailand and to bring governance systems in line with the country's 1997 Constitution. To mitigate the social impact of the crisis, creative partnerships are being built between the Government and civil society to maintain access to health, education, and nutrition.

Structural reforms are being undertaken in health and education, and in labor market policies. For example, health financing reforms being considered include capping the civil service medical benefits

system, streamlining the Social Security and Workmen's Compensation systems, improving the targeting of the Low-Income Card Scheme, and increasing insurance coverage for the unemployed. Long-term health reforms will include better integration of curative, preventive, and educational activities; increasing the role of provinces, districts, and communities in public health care provision; and corporatizing a public sector hospital. The redeployment of health personnel will also require many changes in the administrative and incentive structures of the Ministry of Public Health.

Educational management and financing reforms will include explicit operational plans for decentralizing four functional areas: (i) education policy and planning, (ii) budget and procurement management,

(iii) personnel systems, and (iv) curriculum development and planning. Reforms are being designed to increase autonomy for vocational training institutions and universities, introduce a new personnel management system for school teachers outside the civil service personnel structures, issue a clear statement on the role of the Government vis-à-vis the private sector in the education sector, and downsize the Ministry of Education administrative staff by 25 percent.

In labor markets and welfare, there will be better targeting of poverty programs by linking budget allocations explicitly to poverty incidence. In addition, there is a rethinking of the legal framework, organization, and coordination practices of all agencies dealing with welfare, labor, and training issues.

work, as demonstrated in the policies currently being developed for integrated water management, urban development, health, nutrition, and education.

Law and development: The Bank's law and development activities promote legal reforms,¹¹ building on empirical findings that a policy, legal, and regulatory environment, which secures property rights and enforces contracts, is supportive of economic growth and poverty reduction.¹² Although law and development activities have a general focus on the development of legal and regulatory frameworks that support private sector development (Box 7), they take into account the need for "ethnically conscious interventions into the market" with a view to spreading market-generated wealth.¹³

Participation: People are at the heart of development; they are not only the ultimate beneficiaries, but are also the agents of development. Since development is both for and by the people, they need to have access to the institutions that promote it. Participation, as a component of the Bank's governance policy, implies that people will have the opportunity to improve the design and implementation of public programs and projects.

11 ADB, *A Review of Law and Development Activities of the Asian Development Bank* (Manila: ADB, 1998).

12 For example, research funded by the United States Agency for International Development finds such a statistically significant link among sample countries, with appropriate qualifications given the complexity of the subject (Steve Knack, "Institutions and the Convergence Hypothesis: The Cross-National Evidence," Working Paper No. 59 [College Park, Maryland: IRIS, University of Maryland, 1993]).

13 Amy L. Chua, "Markets, Democracy and Ethnicity: Toward a New Paradigm for Law and Development," 108 *Yale Law Journal* (1998), 1-107.

Box 6. Illustrations of Bank Loans with a Major Governance Focus

India: Gujarat Public Sector Resource Management Program (in combination with technical assistance for reforming public finances and restructuring state-owned enterprises [SOEs])

The State of Gujarat in India faces wide-ranging structural challenges in the public finance area because of stagnation in resource mobilization, weak fiscal management, growing inefficiency of SOEs, and lack of support for efficient infrastructure. The Bank's program loan of \$250 million, approved in 1996 as the first subnational operation in India, supports the Government of Gujarat in augmenting domestic resource mobilization, improving the allocation and efficiency of public resources, and reducing the Government's role in commercial activities while promoting market-oriented policies to enhance private sector participation in physical infrastructure. To support the program loan, the Bank provided technical assistance to strengthen institutional capacities for budget policy, planning, and modernizing tax administration to improve transparency and accountability. An additional technical assistance of \$600,000 approved in 1996—Restructuring Program for State-Owned

Enterprises in Gujarat—is aimed at strengthening the technical secretariat charged with restructuring the SOEs.

Kyrgyz Republic: Corporate Governance and Enterprise Reform Program Loan

Subsidized government loans to private and public enterprises caused a huge drain on the Kyrgyz Republic's budget. Inefficiencies in insolvency procedures allow nonviable enterprises to operate, and lack of regulatory sanctions means that management of many enterprises functions improperly. The Bank's Corporate Governance and Enterprise Reform Program loan of \$40 million, approved in 1997, aims to develop and implement guidelines to improve corporate governance, including statutory mechanisms to ensure enforcement. Internal enterprise efficiency will be improved by the introduction of better management practices, and long-term competitiveness will be enhanced by requiring enterprises to seek new financing arrangements on commercial terms, without the benefit of government guarantees. The legal framework, including the court system, will be strengthened to expedite liquidation or

restructuring of nonviable enterprises. Sector capacity building will include a public information and education project and will reinforce stakeholders' rights and obligations.

Samoa: Financial Sector Program

Improved governance calls for competitive markets with efficient, effective, accountable, and transparent public sector management. This is the aim of the Bank's Financial Sector Program loan of \$7.5 million approved in 1998 to Samoa. Direct monetary controls, interest rate controls, rigid loan rates and credit growth ceilings, and the existence of inefficient SOEs placed constraints on Samoa's economic development. The Government concluded that this called for comprehensive financial sector reform. The loan is assisting the Government to implement the reform program by liberalizing the financial sector; adopting indirect instruments of monetary management; enabling Samoa's central bank to effectively manage liquidity through open market operations; strengthening the prudential and regulatory frameworks; and, equally important, privatizing and corporatizing public utilities.

The Bank's Framework on Mainstreaming Participatory Development Processes defines participatory development, notes its importance to the Bank, and tells how Bank staff, in collaboration with DMC counterparts, can support it. Additionally, it shows how participatory processes can be systematically incorporated in the Bank's business processes, and what modifications are required in the Bank's procedures, policies, and practices to mainstream participatory development in the Bank's work. Participatory development as a key to the Bank's thinking is elaborated in Box 8.

Anticorruption—a key dimension of the governance agenda: The Anticorruption Policy deserves special attention, owing to the corrosive effect of corruption on Asian and Pacific economies, and its central role in weakening governance institutions that contributed to the Asian financial crisis. The Board of Directors approved the Bank's Anticorruption Policy on 2 July 1998, exactly one year after the onset of the crisis (Box 9).

The Bank's Anticorruption Policy rests on conclusive evidence that systemic corruption exacts a heavy price from developing economies by, for example, reducing investment, increasing capital costs, and increasing the

time business executives need to spend negotiating with government officials.¹⁴ It is fully compatible with the policies of other multilateral financial institutions, including those of the World Bank,¹⁵ and is complemented by the OECD Anti-Bribery Treaty that took effect in December 1998. The Treaty, among other things, makes bribery of foreign officials a crime at par with bribery of national officials, and is thus a fundamental advance over earlier practices. Thus, for the first time in contemporary history, this convergence of policies and circumstances offers the opportunity to effectively combat corruption at both public and private levels, and to substantially reduce its burden on the peoples of the Asian and Pacific region.

Corruption can be defined briefly as the use of public or private office for personal gain. Samples of corrupt activities of greatest interest to the Bank include

- design or selection of uneconomical projects because of opportunities for kickbacks and patronage;
- procurement fraud;
- illicit payments to government officials to facilitate access to goods, services, or information to which the public is not entitled, to deny the public access to goods and services to which it is legally entitled, or to prevent the application of rules and regulations in a fair and consistent manner;
- misappropriation of confidential information for personal gain, such as using knowledge about public transportation routings to invest in real estate that is likely to appreciate;
- deliberate disclosure of false or misleading information on the financial status of corporations;
- theft or embezzlement of public property and monies;
- sale of official posts or promotions, or nepotism; and
- extortion and the abuse of public office, such as using the threat of a tax audit or legal sanctions to extract personal favors.

Experience demonstrates that significant progress can be made in the struggle against corruption if the proper legal, institutional, and policy frameworks are in place. The Bank's policy is "zero tolerance."

The first objective is convergent with the public sector management agenda, consisting of actions to make markets competitive and supporting improvements in public administration. For example, strengthening audit functions can improve resource allocation while making embezzlement more easily detected; instituting procurement reform can reduce costs while making fraud more difficult to perpetrate; improving procedures for recruitment and promotion can build capacity while helping reduce patronage and nepotism; and, most importantly, streamlining regulations can improve public management while reducing opportunities for corruption.

In pursuing the second objective, Bank assistance will be guided by three considerations: (i) the nature of the country request, (ii) the consistency

Box 7. Bank Activities in Law and Development

In 1997 and 1998, the Bank's law and development activities supported operations in almost all areas, such as energy regulation, promotion of participation in agriculture and forestry, reform of banking and capital market laws, and strengthening of bankruptcy and liquidation regulation.

Apart from the legal components of sector loan and technical assistance operations, the Bank's law and development activities comprise specific law-related technical assistance projects, which increasingly focus on issues facing its developing member countries' legal systems as a whole.

The creation of in-country capacity for continuing legal education is an important feature of the Bank's law and development activities. In the transitional economies, the main focus of capacity building has been to prepare government lawyers and members of the judiciary to administer newly enacted laws and regulations and to adjudicate disputes relating to such new laws.

One systemic issue common to all economies is the lack of adequate systems for dissemination of information about laws to the public. This issue is being addressed under the Bank's technical assistance in the People's Republic of China and through regional technical assistance for improving access to legal information, particularly comparative legal reform materials to government lawyers and parliamentary draftsmen via the Internet.

14 Daniel Kaufmann, "From Analysis of the Evidence to Anticorruption Action Programs: Evidence and Implications from Research on Corruption," draft handout (World Bank, 1998).

15 World Bank, "Anticorruption Policy" (Washington, DC, 1997).

Box 8. Strengthening Participatory Development

Participation has always been important to the Bank—it is after all a development finance institution owned by 57 members, with a portfolio of projects covering virtually every aspect of development. But with the approval of the governance policy in 1995 and its subsequent implementation in Bank activities, the importance of stakeholder participation has been highlighted. In 1996, the Bank established a focal point for participation in its Social Development Division, Office of Environment and Social Development, and issued guidelines on mainstreaming participatory development processes. The following resulted from these guidelines.

- (i) A conceptual framework that defines participatory development was prepared.
- (ii) A new generation of Bank operations is being designed in a participatory manner from the beginning (examples

are the People's Republic of China Hebei Roads Development Project loan and the Lao People's Democratic Republic Shifting Cultivation Technical Assistance Project).

- (iii) Beyond loans and technical assistance, there is an increasing trend toward greater participation in the formulation of Bank policies. A broader range of stakeholders is being consulted on new policy development issues such as water, health, and education.
- (iv) Participation is increasingly being incorporated in the Bank's business processes, as demonstrated in the ongoing review of the technical assistance and loan processing cycle and of country programming. An illustration is the extensive participation undertaken in the country operational strategy study for the Philippines.

(v) Participation-related training programs are being developed for Bank staff. For example, the Bank pilot-tested a field-based workshop on community development in India, where Bank mission leaders learned from nongovernment organizations, local governments, and community members.

(vi) Participation is encouraged through the Bank's Policy on Confidentiality and Disclosure of Information, and the establishment of the Inspection Panel to investigate complaints from groups affected by the Bank's operations.

The Bank subsequently approved on 19 July 1996 a regional technical assistance for \$300,000 to facilitate and support a variety of small-scale participatory capacity-building activities for 11 countries and covering 10 subsectors.



of the request with the Bank's country operational strategy and efforts in the field of governance and public management, and (iii) the Bank's expertise.

If the Bank's efforts to reduce illicit behavior by outside entities are to be credible, it is essential that Bank staff be beyond reproach, and that the Bank's internal regulations and procedures support the highest ethical standards. Toward this end, the third pillar of the Bank's Anticorruption Policy calls for a range of actions to consider issues of corruption more explicitly, use independent internal mechanisms to address allegations of corruption, improve the quality of supervision of Bank loans and grants, and ensure that Bank staff are familiar with the policy and act in a manner consistent with both the letter and the spirit of it.

In its anticorruption activities, the Bank is cooperating closely with other international multilateral and bilateral organizations in supporting international and country-specific efforts to combat corruption.¹⁶ It will also work with nongovernment organizations (NGOs) on various international efforts to control corruption, and on specific anticorruption initiatives within a particular country. Mechanisms for Bank staff to report corruption are in place, and specific training for anticorruption efforts is being initiated.

Disseminating the lessons of experience

Dissemination is another key building block for an enhanced role in governance, and the Bank has undertaken a variety of internal and external dissemination initiatives since early 1997, including a seminar on governance at the 1997 Annual Meeting in Fukuoka and one on regulatory issues at the 1998 Annual Meeting in Geneva.¹⁷ A range of regional technical assistance (RETA)¹⁸ grants has been a valuable instrument for the Bank, and has proven especially useful in the initial phase of the governance agenda. Topics covered by these RETAs include governance and development in South Asia; sharing best practices in municipal governance, and enhancing municipal service delivery capability; case studies on the functions of cabinet offices in selected DMCs; meetings of Chief Justices and Ministers of Justice; workshop on NGOs in development; and audit training program for Supreme Audit Institutions. In addition, several technical assistance activities for specific DMCs have dealt with core governance issues (*examples are shown in Box 10*).

16 A working group of all multilateral development banks has been formed to ensure cooperation and mutually supportive efforts.

17 A seminar on public financial management and accountability will be held at the 1999 Annual Meeting in Manila.

18 These are (i) RETA 5611: Megacities Management in Asia and the Pacific, approved on 22 December 1994; (ii) RETA 5646: Regional Study on Urban Infrastructure Finance, approved on 10 October 1995; (iii) RETA 5664: Governance and Development in South Asia and Other DMCs, approved on 22 December 1995; (iv) RETA 5685: Capacity Building for Development Management, approved on 16 May 1996; (v) RETA 5688: Regional Long-Term Audit Training Program for Members of the Asian Organization of Supreme Audit Institutions, approved on 13 June 1996; (vi) RETA 5764: Enhancing Municipal Service Delivery Capability in Selected DMCs, approved on 24 December 1997; and (vii) RETA 5768: Definition of Key Governance Themes and Priorities in the Asian and Pacific Region, approved on 31 December 1997.

The Bank's approach rests on both relevance and technical soundness: (i) public sector management reforms do not travel well, and innovations must be carefully assessed in light of the specific country's characteristics and administrative capacity; and (ii) the risk of ad hoc or contradictory advice must be avoided through wide consultation with other institutions concerned, in the DMCs and elsewhere. For example, the Bank's public expenditure management handbook, currently nearing completion, has benefited from the advice of technical reviewers from the World Bank, IMF, United Nations Development Programme (UNDP), and OECD. Also, the Bank has proceeded from general issues to more concrete topics. Thus, the initial dissemination of broad problems of governance and development has provided the basis for more focused events on fiscal transparency and financial accountability.

Enhancing the Bank's capacity for governance work

The Bank has identified six key areas of governance, for which it is acquiring an internal core capacity: (i) participation, civil society, and social capital; (ii) law and development; (iii) public/private interface; (iv) sector and project work; (v) core government functions at the national level; and (vi) decentralization. Ongoing program and sector development program loans with governance components are listed in the table on page 28. As mentioned earlier, anticorruption efforts can and must be incorporated in all governance areas, as appropriate to the circumstances of the specific country.

Box 9. The Bank's Anticorruption Policy

From Central Asia, through South, Southeast and East Asia, and into the Pacific, issues of corruption have risen to the top of the development agenda. Many have credited corruption and cronyism with playing a major role in the Asian financial crisis. A growing body of empirical evidence indicates that corruption—the use of public or private office for personal gain—has a strong negative impact on economic and social growth. Various studies have indicated that corruption has added 20–100 percent¹ to the cost of procuring government goods and services in several Asian countries. Corruption can lead foreign investors to look for more transparent and predictable sites.

To extend the Bank's ongoing work on governance, the Board of Directors unanimously approved the Anticorruption Policy on 2 July 1998. The policy is intended to reduce the burden that widespread, systemic corruption exacts from the

governments and economies of the region. Specifically, the Bank's policy is centered upon three objectives:

- (i) supporting competitive markets, and efficient, effective, accountable, and transparent public administration;
- (ii) supporting promising anticorruption efforts on a case-by-case basis and improving the quality of the Bank's dialogue with its developing member countries on a range of governance issues, including corruption; and
- (iii) ensuring that the Bank's staff, projects, and programs all adhere to the highest ethical standards.

A task force has been established to oversee the policy's implementation. Bank procurement guidelines have been changed to allow for loan cancellation, blacklisting, and the right for audit, and to require full disclosure of all fees and commissions. The Bank has set up an internal Anticorruption Unit within the Office of the General

Auditor to investigate cases of fraud and corruption. New staff guidelines addressing anticorruption issues have been issued. A series of training programs for Bank staff have been initiated, and the Bank is supporting research in areas such as accounting institutions and improving public expenditure management. The Bank is moving to promote anticorruption issues in country programming and to improve project monitoring and supervision. The Bank is hosting a number of global and regional anticorruption initiatives, including the next meeting of the Multilateral Development Bank Coordinating Committee on Governance, Corruption, and Capacity Building, and a joint conference with the Organisation for Economic Co-operation and Development on the relevance of the Anti-Bribery Treaty to Asia.

¹ ADB, "Anticorruption Policy" (Manila, 1998), 9.

- (i) *Participation, civil society, and social capital*: Mainstreaming participation in the Bank entails modifying the conceptual framework on participation, based on lessons from the field; operational support in projects, sector work, and country strategies; work on policies, guidelines, and procedures; training and information sharing; capacity building in DMCs to strengthen participatory approaches; and networking with other development finance institutions, NGOs, and DMC-based organizations. The piloting of participatory approaches in Bank operations is continuing.
- (ii) *Law and development*: A common theme in the Bank's dialogue with many DMCs is the need to address systemic problems that undermine the efficiency and, ultimately, the legitimacy of legal, judicial, and law enforcement institutions. Laws need to be enforced fairly. Predictability, one of the four pillars of governance discussed earlier, relies largely on a legal and judicial framework that is clear, uniform, public, and robust. Among the systemic problems found in many developing countries are delays in court hearings; poor physical infrastructure; low status of judges, and terms and conditions under which they work; weak judicial accountability mechanisms which, in some countries, permit widespread buying of favorable verdicts (particularly in the rural areas); lack of trained support staff and case management systems; and poor state of legal education and training. Accordingly, assistance on specific project-related law reforms also takes into account the need for development of institutional capacity of the legal and judicial systems.
- (iii) *Corporate governance and the public-private interface*: Regulatory issues are relevant in every sector, and the development impact of Bank assistance will depend to a major extent on the existence of a sound balance between the public and private interests in the sector in question. While the public-private interface is too diverse to be amenable to meaningful

Box 10. Technical Assistance in Governance and Public Management

People's Republic of China: Study of Extrabudgetary Expenditures and Revenues

This technical assistance for \$600,000, approved in December 1996, is helping the Government identify the responsibilities that various levels of the Government will assume under the fiscal reform program announced in March 1994. It will also help the Government redefine the concept and scope of the extrabudgetary funds (EBF) and self-raised funds (SRF), and reinforce the management and distribution of these resources to ensure that expenditure responsibilities are adequately funded and a minimum level of service delivery prevails across the various levels of Government. The technical assistance is expected to rationalize intergovernmental revenue and expenditure assignment, especially at the subprovincial levels, and consolidate budgets to incorporate many of the resources now managed by the Government as EBF and SRF.

Sri Lanka: Institutional Modernization of the Ministry of Finance and Planning

The quality of public administration in Sri Lanka needs strengthening. The Bank's intervention strategy for public administration and public sector reform is based on the assessment of the reform experience of recent years. Elements of an overall public sector reform and strengthening program were

proposed to the Government in November 1997. This includes support to institutional modernization of key aspects of public expenditure management. Technical discussions with the Ministry of Finance and Planning (MOFP) revealed specific opportunities for significant improvements in public financial management.

The Bank approved in July 1998 a small-scale technical assistance for \$148,000 for institutional modernization of MOFP to improve specific functions of MOFP identified as important and amenable to rapid improvement. It is also expected to help MOFP define the scope and modalities for further institutional modernization of the public finance apparatus. The technical assistance will assist MOFP to (i) create a centralized payroll management system; (ii) improve cash management systems to minimize the opportunity cost of idle balances; (iii) define options to automate pension payments; (iv) strengthen public investment programming, particularly to improve its integration with recurrent budget and, hence, with the medium-term economic framework; and (v) define MOFP's role and limitations in the provision of management and organizational advice to central and subnational government entities. These activities would also systematically involve sector ministries and agencies.

Table 2. Program Loans and Sector Development Program Loans with Governance Components, 1995–1998

| Loan Title | \$ Million | | | Date Approved | Sector |
|---|------------|------|---------|---------------|-----------------------------------|
| | OCR | ADF | Total | | |
| Bangladesh | | | | | |
| Capital Market Development Program | 0.0 | 80.0 | 80.0 | 20 Nov 97 | Financial |
| Bhutan | | | | | |
| Financial Sector Intermediation Facility (Policy Loan) | 0.0 | 4.0 | 4.0 | 23 Oct 97 | Financial |
| Financial Sector Intermediation Facility (Development Finance Loan) | 0.0 | 4.0 | 4.0 | 23 Oct 97 | Financial |
| Cambodia | | | | | |
| Agriculture Sector Program | 0.0 | 30.0 | 30.0 | 20 Jun 96 | Agriculture and natural resources |
| Cook Islands | | | | | |
| Economic Restructuring Program | 0.0 | 5.0 | 5.0 | 26 Sep 96 | Others |
| India | | | | | |
| Capital Market Development Program | 250.0 | 0.0 | 250.0 | 28 Nov 95 | Financial |
| Gujarat Public Sector Resource Management Program | 250.0 | 0.0 | 250.0 | 18 Dec 96 | Financial |
| Indonesia | | | | | |
| Financial Governance Reforms: Sector Development Program | 1,400.0 | 0.0 | 1,400.0 | 25 Jun 98 | Financial |
| Financial Governance Reforms Support | 47.0 | 0.0 | 47.0 | 25 Jun 98 | Financial |
| Capacity Building for Financial Governance | 50.0 | 0.0 | 50.0 | 25 Jun 98 | Financial |
| Kazakhstan | | | | | |
| Agriculture Sector Program | 100.0 | 0.0 | 100.0 | 23 Nov 95 | Agriculture and natural resources |
| Korea, Republic of | | | | | |
| Financial Sector Program | 4,000.0 | 0.0 | 4,000.0 | 19 Dec 97 | Financial |
| Institutional Strengthening of the Financial Sector | 15.0 | 0.0 | 15.0 | 19 Dec 97 | Financial |
| Kyrgyz Republic | | | | | |
| Agriculture Sector Program | 0.0 | 40.0 | 40.0 | 23 Nov 95 | Agriculture and natural resources |
| Corporate Governance and Enterprise Reform Program Loan | 0.0 | 40.0 | 40.0 | 25 Sep 97 | Financial |
| Capacity Building in Corporate Governance and Insolvency | 0.0 | 4.0 | 4.0 | 25 Sep 97 | Financial |
| Lao People's Democratic Republic | | | | | |
| Second Financial Sector Program | 0.0 | 25.0 | 25.0 | 12 Sep 96 | Financial |
| Marshall Islands | | | | | |
| Public Sector Reform Program | 0.0 | 12.0 | 12.0 | 30 Jan 97 | Financial |
| Micronesia, Federated States of | | | | | |
| Public Sector Reform Program | 0.0 | 18.0 | 18.0 | 29 Apr 97 | Financial |
| Mongolia | | | | | |
| Agriculture Sector Program | 0.0 | 35.0 | 35.0 | 5 Dec 95 | Agriculture and natural resources |
| Financial Sector Program Loan | 0.0 | 35.0 | 35.0 | 19 Dec 96 | Financial |
| Nauru | | | | | |
| Fiscal and Financial Reform Program | 5.0 | 0.0 | 5.0 | 16 Dec 98 | Financial |
| Nepal | | | | | |
| Second Agriculture Program | 0.0 | 50.0 | 50.0 | 22 Jan 98 | Agriculture and natural resources |
| Pakistan | | | | | |
| Capital Market Development Program | 250.0 | 0.0 | 250.0 | 6 Nov 97 | Financial |
| Capacity Building of the Securities Market | 0.0 | 5.0 | 5.0 | 6 Nov 97 | Financial |
| Papua New Guinea | | | | | |
| Health Sector Development Program | 45.0 | 0.0 | 45.0 | 20 Mar 97 | Social infrastructure |
| Health Sector Development Program | 0.0 | 5.0 | 5.0 | 20 Mar 97 | Social infrastructure |
| Health Sector Investment Project | 0.0 | 10.0 | 10.0 | 20 Mar 97 | Social infrastructure |
| Philippines | | | | | |
| Power Sector Restructuring Program | 300.0 | 0.0 | 300.0 | 16 Dec 98 | Energy |
| Samoa | | | | | |
| Financial Sector Program | 0.0 | 7.5 | 7.5 | 19 Feb 98 | Financial |
| Solomon Islands | | | | | |
| Public Sector Reform-Program Loan | 0.0 | 25.0 | 25.0 | 27 Aug 98 | Financial |
| Privatization of State-Owned Enterprises | 0.0 | 1.0 | 1.0 | 27 Aug 98 | Financial |
| Thailand | | | | | |
| Financial Markets Reform Program | 300.0 | 0.0 | 300.0 | 19 Dec 97 | Financial |
| Social Sector Program | 500.0 | 0.0 | 500.0 | 12 Mar 98 | Multisector |
| Vanuatu | | | | | |
| Comprehensive Reform Program | 0.0 | 20.0 | 20.0 | 16 Jul 98 | Financial |
| Viet Nam | | | | | |
| Financial Sector Program | 0.0 | 90.0 | 90.0 | 19 Nov 96 | Financial |

generalizations, the main goal is a regulatory framework that is suited to the characteristics of the sector in question and that protects identified public interests while minimizing private transaction costs. A good regulatory framework does this by fostering accountability, transparency, and predictability in the formulation and application of the rules and regulations (as in the case of Indonesia's Financial Governance Reforms: Sector Development Program loan, Box 3). This is especially necessary for issues of corporate governance of public enterprises, which must reflect the general principles of good private management as well as the interests of the state as owner, in furtherance of some public aim. The general influence on good governance of market-based and other nongovernment mechanisms is also important. First, contestability, i.e., the possibility of market entry, can sometimes be as effective as actual competition to stimulate good public sector management. (A lively and competent private audit capacity has implications for the efficiency of public audit; a competitive private labor market influences positively human resource management in the public sector; an efficient financial market helps foster public financial accountability; and so on.) Second, actual competition is optimal for the effectiveness of the public-private interface.¹⁹

- (iv) *Governance considerations in sector and project work:* Governance aspects of sector and project operations can be incorporated in the Bank's work through improvements in project approach and design rather than through radically different projects. Rarely will a sector strategy or a project have governance improvements per se as its central focus. However, all sector strategies and projects should consider the possibility of strengthening accountability mechanisms, reducing the cost of information, or improving predictability—even if no particular action turns out to be appropriate to the situation at hand. Thus, more effective incorporation of governance considerations at the sector and project levels should flow from individual manager's leadership, a better-equipped staff, and career incentives consistent with the time and effort required.
- (v) *Core government functions at the national level:* Empirical evidence underlines the strong link between capable government and economic growth.²⁰ Technical assistance or program lending can help DMCs in areas such as (a) revenue administration; (b) public expenditure management, from budget formulation through budget execution and audit; and (c) public administration and civil service, including policy coordination and machinery of government. Public expenditure management can be further subdivided between

19 A good case in point is private involvement in power generation, where direct negotiation of build-operate-transfer projects has sometimes led to excessive tariffs or overcapacity.

20 Peter Evans and James Rauch, *Bureaucratic Structure and Economic Growth: Some Preliminary Analysis of Data on 35 Developing Countries* (Berkeley, California: University of California, 1996).

the “upstream” issues of budget formulation (including the link to the overall fiscal and macroeconomic framework) and the “downstream” issues of budget execution and monitoring, including procurement and audit.

- (vi) *Decentralization*: Priorities for Bank support include (a) promoting intergovernment fiscal relations and finance; (b) strengthening government institutions at the subnational level; and (c) enhancing the delivery of critical municipal services. 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. This is a particular concern in settings with limited administrative and financial capacity and low levels of accountability. If decentralization means only a shift in the control of resources to local institutions monopolizing task-related roles, service delivery performance may suffer from low capacity and weak accountability. A more promising model would be to promote networks of service delivery partners, including central and local government agencies, private businesses, and NGOs. By increasing the number and diversity of partners, accountability will be increased, risk reduced, and public sector tasks better adapted to local needs.²¹

The Bank is fully committed to its transformation into a broad-based development institution, of which governance is a core dimension. While the transformation in Bank operations is well under way, to be sustainable it requires, among other things, appropriate organizational arrangements, and a small core of specialist staff in the various areas of public sector management and institutional development. Some specialist staff have been brought on board already, and the required core should be in place by the end of 1999. The new organizational arrangements revolve around a Governance and Public Management Cluster,²² which assembles all Bank specialists in the area (including focal points from each operational department and from central units). Governance is too important to be marginalized or isolated into any single office at the Bank. It must become an integral part of all analytical, lending, and technical assistance activities. Hence, at

21 John M. Cohen and Stephen B. Peterson, “Administrative Decentralization: A New Framework for Improved Governance, Accountability and Performance,” Development Discussion Paper No. 582 (Harvard University, 1997).

22 The cluster is intended as a mechanism to prevent fragmentation of efforts as well as to make Bank activities cost-effective, by (i) giving the members a venue for professional interaction; (ii) providing the Bank with quality control advice, guidance in training and recruitment, and leadership in applied research and dissemination activities; (iii) serving as a focal point for partnership with other institutions, and as a mechanism to soften boundaries among the Bank’s departments and offices; and (iv) making the Bank specialists available for work throughout Asia. The cluster is coordinated by the Senior Advisor for Governance and Public Management in the Strategy and Policy Office.

the top of the immediate agenda is the mainstreaming of governance activities into the Bank's operational departments. At the same time, the Bank is ensuring that governance considerations are appropriately incorporated into other policies being formulated and is actively monitoring implementation of the governance and anticorruption policies.

The Bank is well aware that its external credibility is partly a function of the internal adjustments it makes to adapt to its new role as a broad-based development institution. Thus, in addition to recruiting specialist staff and introducing efficient organizational arrangements for governance, the Bank is making all necessary efforts to mainstream governance considerations throughout the institution, and to streamline the Bank's own business processes and operational procedures. In particular, the Bank has strengthened its procurement policy, has updated its Code of Conduct for staff, and created independent reporting mechanisms to address allegations of corruption among Bank staff and in Bank operations, and is improving the quality of oversight and management of its loans and technical assistance.

One may anticipate that, by the end of 1999, the Bank will be well on its way to assuming a lead role for governance and public management in the Asian and Pacific region. Given the delicate nature of the topics and the vastness of the problems and of the region, the Bank will also use to the maximum all possibilities for constructive partnership with other institutions. It is expected that the enhanced role of the Bank in this area will not only raise the effectiveness of its own assistance, but also facilitate efforts by its partners to improve the impact of all external assistance to the countries of the region.

Next steps

The Bank reacted quickly to the Asian financial crisis by supporting banking, financial sector, and corporate governance reforms; fiscal decentralization; and structural reforms in health, education, and labor market policies. Aside from the response to the crisis, new governance policies are in place, specialized staff are being recruited, and Bank loans and technical assistance are increasingly targeted at improving governance in DMCs.

The basis for concerted and successful assistance has been laid. For this initial progress to be consolidated and expanded, progress in three priority areas is needed in the medium term: (i) better diagnostic tools and drawing on knowledge of good practice, (ii) improved implementation processes for governance reforms, and (iii) tracking evolving notions of good practice.

- (i) *Better diagnostic tools and drawing on knowledge of good practice:* All governments need some basic capabilities to carry out essential functions effectively. The Bank needs to draw on appropriate knowledge, including manuals and guiding principles, to define good practices that most DMCs should consider. Diagnostic tools can help DMCs monitor their governance reforms.

As noted at the outset of this chapter, the application of models evolved elsewhere has historically led to major problems in countries that have very

different income levels, implementation capacities, and institutional landscapes. Careful and realistic assessment is needed of the costs and benefits of possible institutional innovations, in light of the characteristics and administrative capacity of the individual country. The Bank can build on recent work of other international organizations, as it pulls together knowledge about good practices and diagnostic tools in this complex area.²³

The main efforts at external dissemination of good practice will revolve in 1999 and 2000 around a series of in-country workshops on public expenditure management, civil service/public administration, and local government, eventually covering every DMC in the Asian and Pacific region. The Bank's Strategy and Policy Office is producing manuals and handbooks for these workshops in cooperation with staff of OECD, and with the advice of individual experts from other major international financial institutions and academia. Also, accountability institutions and mechanisms in different countries will be reviewed. Finally, several new technical assistance operations are ongoing or under preparation (Box 11).

- (ii) *Improved implementation processes for governance reforms:* As manuals and diagnostic tools are developed and governments set strategies for organizational development and policy reform, the second priority for medium-term improvement is the processes for carrying out these strategies. The Bank needs better processes for addressing governance concerns in its projects, and for anticipating and dealing with crosscutting governance issues affecting the Bank's project portfolio in each DMC.

Too often the Bank and other development partners invest large sums to design institutional reforms that are not effectively implemented.²⁴ Again, the Bank is fortunate to be able to build on recent work by other organizations.²⁵ The following are the lessons of this work.

23 See, for example, World Bank and UNDP, "Special Program of Assistance," *Guiding Principles for Civil Service Reform* (Washington, DC and NY, 1995); World Bank and ADB, "Civil Service Discipline and the Budget Structure" (draft, 1999); John M. Cohen and Stephen B. Peterson, "Administrative Decentralization Strategies for the 1990s and Beyond" (NY: United Nations Secretariat, 1995); IMF, *Manual on Fiscal Transparency* (Washington, DC: IMF, 1998); IFAC, *Auditing for Compliance with Authorities: A Public Sector Perspective* (New York, NY, 1994); IFAC, *Guidelines for Governmental Financial Reporting* (exposure draft, 1998); South Pacific Forum Secretariat, UNDP, and Pacific Financial and Technical Assistance Center, "Accountability Stocktake Questionnaire" (Suva, Fiji: South Pacific Forum Secretariat, 1998); Jeremy Pope, *National Integrity Systems: The TI Sourcebook* (Berlin: Transparency International, 1996); CIET International, *Community Voice in Planning in Pakistan: Sentinel Community Surveillance* (New York: CIET International <<http://www.ciet.org/www/text/asia.html#pakistan>>); and CIET International, *Nepal Multiple Indicator Surveillance, Second Cycle—Primary Education: Final Report* (New York: CIET International, 1996).

24 See, for example, ADB, *Assessment of the Effectiveness of Bank Technical Assistance for Capacity Building to Vanuatu* (Manila, 1996); ADB, *Assessment of the Effectiveness of Bank Assistance for Capacity Building to Western Samoa* (Manila, 1995); and Louise G. White, *Implementing Policy Reforms in LDCs* (London: Lynne Rienner, 1990).

25 See, for example, UNDP, *Process Consultations: Systemic Improvement of Public Sector Management* (New York, NY: UNDP, 1995).

Box 11. Major Activities for External Dissemination in Core Governance

*Public Expenditure Management and Public Administration*¹

The objective of this regional technical assistance (RETA) is to improve the practice of public administration, with specific emphasis on expenditure management, among Bank members. It supports work in three areas: (i) strengthening public expenditure programming and financial management, (ii) reviewing key aspects of public administration and civil service reform, and (iii) describing the main issues and options for effective local governance.

Three sets of outputs are expected: (i) a public expenditure management manual, (ii) a public administration and civil service guidebook, and (iii) a local governance sourcebook. They are to be produced by Bank staff, in collaboration with the ADB Institute and in consultation with top international experts in the respective areas from major international organizations as well as academia. These manuals will be the basis for in-country workshops for upper

and middle-level managers in developing member countries, to be conducted in 1999 and 2000, and will eventually cover all countries of the region.

*Accountability Mechanisms in the Asian and Pacific Region*²

While the Bank is already active in strengthening several key accountability institutions such as Supreme Audit Institutions, this RETA will systematically examine the various institutional mechanisms for advancing managerial, legal, and public accountability. Detailed case studies will be compiled, including analysis of several core and line accountability functions, and the agencies or departments that provide them; review of central mechanisms for policy coordination and implementation; and examination of the functioning of key institutions such as anticorruption agencies and ombudsman offices.

A number of governance strategy studies are also being initiated, to serve both as

inputs into country strategies and as the basis for constructive interventions suited to the requests and specific characteristics of each country. Studies for the Lao People's Democratic Republic and Viet Nam are under way; those for Cambodia and Thailand will be initiated in early 1999. Finally, the RETA will support a joint ADB/Organisation for Economic Co-operation and Development seminar on anticorruption, covering both the internal aspects of the issue and the likely contribution from the Anti-Bribery Treaty.

1 RETA 5813: *Public Expenditure Management and Public Administration*, for \$500,000, approved on 27 October 1998.

2 RETA 5829: *Accountability Mechanisms in the Asian and Pacific Region*, for \$500,000, approved on 31 December 1998. Cumulative Bank lending since the Bank's inception in 1966 to the end of 1998 amounted to \$77.3 billion for 1,500 projects in 37 DMCs.



- Governance reforms should take place within the context of a comprehensive vision that is coherent, owned, and public.
- Reforms should be sequenced in ways that consider underlying political opportunities and constraints.
- Organizational changes are only likely to take hold if fully understood and supported by the stakeholders concerned. External agents can suggest improvements based on their knowledge of good practice from other countries, but the leadership of the change process should be from those that will have to live with the changes.

One might say that DMCs need to adopt the “Noah Principle” of management: “No more prizes for predicting rain; only prizes for building the ark.”²⁶ The difficulty is in finding leverage points that can be empowered to bring about the required changes in practice. Some of the steps needed are as follows.

- Identify leverage point(s) in each country, which might be a government ministry, parliament, the judiciary, ombudsman’s commission, NGO, women’s rights group, local government body, or religious organization.
- Select leverage points based on demonstrated commitment to good governance, and leadership potential for changes that can ripple through government and civil society.
- Build capabilities of leverage points through advice and proper incentives, including training on strategy and systems, action planning workshops, access to knowledge about best practices, and links to professional networks.

This will be a two-tiered approach. The first tier will be the leverage point. The Bank will proactively seek this out, based on the criteria above. The second tier will be weaker organizations that have not yet demonstrated their commitment and effective contribution to good governance principles. The Bank will directly support the first tier, and use it as a catalyst for change of the second tier. This assumes that commitment in the second tier is best forged by national leverage points, rather than directly by the Bank.

- (iii) *Tracking evolving notions of good practices:* The Asian financial crisis shows that change can be rapid and unpredictable at the dawn of the 21st century. Institutional forms that have worked in the past are being continuously challenged and reinvented. Governments cannot be left behind in this change process. Some of the institutional forms best suited to achieving good governance will be changing. The Bank will be tracking these trends, and advising DMCs on them.

The explosive growth of electronic networks is already facilitating new forms of citizen participation in governance, and new organizational forms. For example, an increasingly common form of business organization is set up around individuals and small businesses linked by the Internet. Tasks are carried out by independent contractors without layers

²⁶ David Osborne and Peter Plastrik, *Banishing Bureaucracy* (Reading, Mass.: Addison-Wesley, 1997), 245.

of managers, deadlines, budgets, and other traditional control systems of bureaucratic hierarchies. This emerging organizational form is perhaps best understood from a metaphor.

“When we look up in the sky and see a flock of birds flying in formation, we tend to assume that the bird in front is the leader and is somehow determining the organization of all the other birds. In fact, biologists tell us, each bird is following a simple set of rules—behavioral standards—that result in the emergence of the organization. The bird in front is no more important than a bird at the back or a bird in the middle. They are all equally essential to the pattern that they’re forming.”²⁷

These and other changes are already encouraging nations to adhere to global standards to compete for trade and investment. Some aspects of sovereignty, such as those related to economic regulation and public accountability, are becoming structured around international instruments. Even though these are normally legally nonbinding, there are still agreed mechanisms for surveillance and compliance.²⁸

No one can predict the speed or the extent to which these changes will alter the face of governance in DMCs. Yet it is necessary to conceive of completely new organizational landscapes where underlying good governance values will not only likely prevail, but also where the way governments carry out their business drastically changes. The Bank will work to keep its governance policies, manuals, and diagnostic tools fully up to date on emerging practices from the region and beyond, and draw from these practices to give DMCs support appropriate to their cultural, historical, and economic situations.

Governance institutions are also changing. Many governments are changing the way they do business, forming partnerships, contractual arrangements, and electronic networks with private businesses, NGOs, and individual citizens to develop public policies and deliver public services. As these trends continue, large, hierarchical government organizations in DMCs may give way to smaller, network-facilitating groups, joining with various partners to carry out particular tasks, all of whom can work together because they follow the agreed “rules of the game.”

27 Thomas W. Malone and Robert J. Laubacher, “The dawn of the e-lance economy,” *Harvard Business Review* (1998), 76, 5: 152; see also Murray Weidenbaum and Samuel Hughes, *The Bamboo Network: How Expatriate Chinese Entrepreneurs Are Creating a New Economic Superpower in Asia* (New York: Martin Kessler Books, 1996); Paul Krugman, *The Self-Organizing Economy* (Cambridge, Mass.: Blackwell, 1996); and Robert J. Laubacher, Thomas W. Malone, and the MIT Scenario Working Group, “Two Scenarios for 21st Century Organizations: Shifting Networks of Small Firms or All-Encompassing Virtual Countries?” (Cambridge, Mass.: Massachusetts Institute of Technology, 1997); and Jessica Lipnack and Jeffrey Stamps, *The Age of the Network: Organizing Principles for the 21st Century* (New York: John Wiley & Sons, 1994).

28 These include, inter alia, standards of international intergovernment organizations such as the World Trade Organization, regional intergovernment organizations such as the South Pacific Forum, and standards of professional bodies such as the International Federation of Accountants. See, for example, Wolfgang H. Reinicke, *Global Public Policy* (Washington, DC: Brookings Institution Press, 1998).

Summary and conclusions

Issues of governance are at the center of challenges facing the Bank's DMCs. Over the last five years, the Bank has deepened its thinking on governance matters, including legal and judicial reform, combating corruption, and banking and financial sector strengthening. This thinking, and the underlying policies based on it, helped the Bank to respond quickly to the Asian financial crisis.

The Bank will further deepen its understanding of the basic principles of good governance, and evolve notions of good governance practice. It will help DMCs adapt these ideas to local conditions, and help them manage the risks of complex governance reforms.

Future government organizations may look very different from those we see today, but the basic principles will stay the same. As Republic of Korea President Kim Dae-jung recently pointed out,

“Looking back on the past year of reform, I can draw one important conclusion. It is that introducing new laws and institutions alone is not enough. Reform can succeed only when these institutional changes are accompanied by changes in people's attitude. This is the real test.”²⁹

²⁹ From an address delivered by the President of the Republic of Korea, Kim Dae-jung, at the Conference on Democracy, Market Economy and Development, February 1999.