

C H A P T E R O N E

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

Public Sector Management

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

Over the years, the World Bank's approach to PSM has grown beyond project-linked institutional strengthening and attempts to improve the workings of specific parastatal agencies. This approach generally worked when conditions in the public sector were less strained and governments were still expanding the coverage of their programs. However, the limitations of restricting attention to individual agencies became increasingly apparent as the structural adjustment agenda in many countries lengthened. As systemic prob-

lems became more evident, the Bank began to expand its approach to PSM with broad-based sector adjustment loans; with support for improved financial management; and with civil service reforms focused initially on cost containment and retrenchment. In response to the deteriorating condition of the parastatal sector, the Bank began to encourage the divestiture and privatization of public enterprises. At the same time, it became evident that dispersed and disconnected reform efforts were not adequate to cope with the institutional modernization demands that emerged from the structural adjustment process, both in scope of work and in terms of the effort required.

Civil service reform

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

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

BOX 1.1 PRIVATE SECTOR ASSESSMENTS

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

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

The results of nine recently completed surveys indicated the following:

- In countries facing serious macro-economic problems, inflation and

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

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

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

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

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

Financial management

The trend in this area has been toward integrated financial management systems rather than isolated reform efforts in public investment, budgeting, accounting, auditing, and information systems. Best practice in public financial management is well understood in technical terms. The challenge is to adapt it to country circumstances, to provide adequate amounts of training, and to ensure that leadership in both the executive and the legislature is committed

to improved financial management in the public sector. In some regions the requirement is system modernization. In others, existing systems are fundamentally sound, but capacity has been eroded.

State enterprise sector

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

BOX 1.2 CLIENT AND CIVIL SERVICE ATTITUDE SURVEYS IN ZAMBIA

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

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

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

- Assess client satisfaction with service delivery
- Determine client needs
- Find out about client willingness to cooperate with the bureaucracy

- Determine public perception of the accountability of civil servants
- Assess the extent to which traditional values influence attitudes toward the civil service.

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

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

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

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

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

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

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

BOX 1.3 INSTITUTIONAL FOUNDATIONS OF UTILITY REGULATION

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

A particularly useful output from the research program has been a checklist of questions that enables World Bank staff to determine which regulatory systems are appropriate to the specific conditions in a country. The questions focus on administrative capacity, the prevailing institutional framework, and the capacity of exist-

ing institutions to support regulatory systems. Answers to questions such as the following determine the choice of the regulatory system.

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

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

a. Five country case studies as well as a comparative paper have been prepared (Levy and Spiller 1993).

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

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

BOX 1.4 PUBLIC SECTOR REFORM IN ARGENTINA

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

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

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

■ *Public Sector Reform Adjustment Loan and Public Sector Reform Technical Assistance Loan.* These two complementary operations supported a wide range of changes. Administrative reforms included a 20 percent

reduction in federal employment, ministerial reorganization, wage decompression, and strengthening of administrative capacities. The enactment of new legislation improved accountability and transparency in public financial management. Tax policy reform and restructuring of the Central Bank were also undertaken. In addition, management information systems for customs, the civil service, and budget administration were developed.

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

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

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

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

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

growth with social equity as well.

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

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

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

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

■ Bank assistance to Africa is dominated by the collapse of public sector capacity in many countries, brought about by a combination of state over-extension, delayed adjustment to changed external economic circumstances,

fined, reward-oriented career paths. Such competition-based mechanisms induced competency. Mechanisms were also created to protect officials from political interference.

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

nunity in economic policymaking and minimized dominance by special interests.

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

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

a. World Bank 1993a.

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

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

**BOX 1.6 THE GOVERNANCE
APPROACH TO CIVIL SERVICE
REFORM**

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

The new approach advocates civil service reform that begins with an assessment of the institutional environment in which the civil service func-

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

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

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

In Albania work is under way to build core economic agencies, and ESW has focused on fiscal aspects of decentralization. In Poland a Bank study started an effort to reform public administration, which may lead to a public sector loan,

and a study of decentralization has also been undertaken. In the Baltics, Russia, and Romania, *public expenditure reviews* are under way or in the planning stage. At the same time, in Russia, the Bank's work at the *oblast* level is expanding.

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

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

Emerging lessons

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

Across regions, progress with divestiture and public enterprise reform has been uneven. Progress in Latin America and the Caribbean has been strong whereas performance in Sub-Saharan Africa has been disappointing. Countries

with weak governmental institutional capacity have found it especially difficult to resolve public enterprise sector problems either through making enterprises accountable for their performance or through privatization.

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

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

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

Accountability

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

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

Demand for greater accountability

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

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

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

The trend toward *decentralization of government*, therefore, has become one of the principal ways in which this demand for greater accountability is being expressed. For the Bank this has meant both renewed involvement in an area that has long been associated with Bank lending and an opportunity to review traditional approaches. One outcome has been the involvement of staff from all regions in local government studies, leading in many cases to project preparation and lending.⁴ Another outcome has been an in-depth review of the Bank's approach to municipal development, which has already begun to influence the design of projects in the urban sector (World Bank 1993d). The review suggests that interventions based on strengthening the internal workings of

local government administrations—the Bank's traditional approach—are unlikely to be effective by themselves and that a new approach must be adopted that places local governments within a broader framework. This entails taking a fresh look at the assignment of functions to lower tiers of government: whether these are commensurate with revenue-raising capacity, how local government bodies are held accountable, and whether there are problems of public sector management that must be addressed systemically if local governments are to function properly. At the same time, it means taking care not to dilute the capacity of central governments to perform tasks that must still be carried out centrally.

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

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

Mention should be made of a third manifestation of the demand for greater accountability, the beginning of a *change in attitudes toward corruption*. This change is by no means uniform, but two distinct trends can be observed. First, in the main bilateral donor countries, corruption has become part of the debate on aid effectiveness, and the perception that aid resources are diverted by corrupt elites in developing countries is one factor weakening the long-standing

consensus on aid programs. Second, in certain developing and industrialized countries, exposure of large-scale corruption has brought down political leaders in unanticipated ways and shed light on systemic corruption, suggesting that a shift in public tolerance may be happening.

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

World Bank experience

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

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

BOX 1.7 TOWARD AN ANTI-CORRUPTION STRATEGY

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

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

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

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

- *Civil service reform*, to restore a professional, accountable, realistically paid, and well-motivated bureaucracy.

- *Strengthening public procurement systems*, through the reform of laws, more transparent procedures, adoption of improved bidding documentation, competitive bidding, and staff training.

- *Modernization of public sector accounting*, upgrading internal auditing capacity, and strengthening the supreme audit institution.

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

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

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

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

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

The PSM II project has a significant legislative assistance component. It aims to improve the ability of the legislative branch to review and formulate policy by strengthening the Library of Congress. This will involve computerizing communication systems, strengthening reference holdings, and conducting training pro-

grams. In addition, communication links between the legislative and executive branches of government will be strengthened. All these efforts will contribute toward increasing the efficiency of government policymaking.

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

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

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

beneficiaries if it is to be successful. In the case of Venezuela, which passed a comprehensive decentralization law in 1989, experience has demonstrated that more attention has to be given to municipal development before attempting full-scale political devolution of responsibility to local governments for

provision of services.⁵ The Public Administration and Decentralization Project is now being prepared, which combines municipal capacity building with transfer of responsibility and authority, and at the same time creates competition in the delivery of local services. In the Municipal Development Project in Chile an incremental approach is being used that offers hope of an orderly process, based on applying learning experiences from selected municipal governments to the design of reform programs for other local governments.

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

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

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

BOX 1.9 PROMOTING FINANCIAL ACCOUNTABILITY IN ASIA

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

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

■ *Accountancy Development Project*

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

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

ing of professional associations of accountants and auditors. In Zambia, assistance is planned for the parliament's Public Accounts Committee. Decentralization has also been a theme of the Bank's governance work. The Bank has

played a leading role in the Municipal Development Program, a multidonor initiative to strengthen municipal governments in Sub-Saharan Africa, with coordinating centers in Cotonou and Harare. The Bank has increasingly used nongovernmental organizations (NGOs) in the delivery of services, and in several countries, public works agencies have been set up with Bank encouragement outside the structure of government to manage and implement public works and employment creation.⁶ These agencies have promoted beneficiary participation in the design of schemes, reduced construction costs, and improved service delivery. However, at present they are sustained almost exclusively by donor funds and leave untouched the issue of capacity rebuilding within governments.

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

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

Emerging lessons

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

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

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

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

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

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

formation was factored into the project's design.

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

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

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

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

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

■ The number of investment projects with significant participatory components has expanded rapidly. In this area, the Bank has found it easier to incorporate *voice mechanisms* (for example, involvement of local NGOs) for beneficiaries than *exit mechanisms* (for example, competition in service delivery and an opportunity for beneficiaries to seek alternative suppliers). In administrative terms it is easier to set up consultative mechanisms than to erect a framework for competition in service delivery and the transfer of entitlements (Paul 1991⁷).

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

Legal Framework for Development

The laws and regulations, the processes through which they operate, and the institutions that apply them comprise the legal framework of a country. Although in all societies a range of informal mechanisms exists to resolve

conflicts, and enduring business relationships are based on trust, market economies require a framework of clear laws and efficient legal institutions within which the interaction between economic agents and the state can take place. An appropriate legal system will provide stability and predictability, which are essential elements in creating an economic environment where business risks may be rationally assessed and the cost of transactions lowered.

Economic and social development and the legal system

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

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

The World Bank's experience

In helping countries to improve their legal systems, the Bank has used a variety of instruments. New laws and judicial reform have been components

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

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

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

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

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

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

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

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

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

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

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

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

**BOX 1.12 LEGAL FRAMEWORK
FOR PRIVATE SECTOR
DEVELOPMENT IN
TRANSITIONAL ECONOMIES**

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

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

- An initial evaluation of legal frameworks in Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and Slovenia was carried out.^a

- In-depth cross-country comparisons, drawing heavily on the experience of advanced market economies, are in progress. Five core areas of the legal framework for private sector development have been identified—competition, corporate governance, debt collection and bankruptcy, foreign investment, and real property rights—with work well under way in the first four. The research hopes to identify best legal practices in advanced market economies for each of these areas and consider their applicability to CEE countries.

- The final component of the program extends the area of study beyond the CEE region to the former Soviet Union and to socialist countries in Africa and Asia. Studies of property rights reform in Tanzania and Ghana and of postprivatization corporate governance in Russia are already in progress.

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

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

- In Latin America and the Caribbean, the Bank has also helped countries in modernizing their economic laws. Particularly noteworthy is Venezuela, where the Bank is helping to strengthen the judicial system. Here the Bank is assist-

ing the government upgrade court infrastructure, install modern management systems, train personnel, and publish the laws. Similar projects are being prepared in Argentina, Bolivia, and Peru. As already noted in Chile, the Bank is helping to strengthen the legislature's capacity through better information systems.

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

Emerging lessons

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

- Legal reform cannot be successful without the full conviction and political commitment of the government concerned.
- There is a need to avoid wholesale transfer of particular Western-based legislation without due regard for the legal traditions of a country (a particular risk in transition countries). More generally, in all countries the effectiveness of legal reforms depends greatly on how the reforms take into account the social, religious, customary, and historical factors in a society.
- Scope, however, does exist for sharing the Bank's experience among regions. Projects developed in Latin America, for example, are influencing the work of Bank staff on legal system reform in other regions.
- Of crucial importance is the institutional framework so that new laws can be applied firmly but fairly and the right balance is struck between license and regulatory control in a market economy. In this way, legal framework reform involves broader issues of public policy and institutional development.
- Excessive use of administrative orders issued under delegated powers can result in a conflicting and nontransparent legal framework that deters invest-

BOX 1.13 LEGAL REFORM AND WOMEN IN AFRICA

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

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

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

- *Preparation of country case studies.* In Uganda, for instance, the World Bank is working with the Department of Justice, the Ministry of Women's Affairs, and the national university to prepare a legal reform strategy for women.
- *Provision of workshops at the request of legal associations.* Where there isn't sufficient momentum to initiate legal reform, workshops are held to build this momentum (for example, recently in Mali). The workshops are conducted at the request of a local legal association, and they identify strategic entry points for legal reform efforts with the assistance of the Bank.
- *Participation in subregional workshops on legal literacy.* The Bank recently participated in a workshop on legal aid clinics for women in francophone Africa. The workshop provided an opportunity for the Bank to become familiar with other donors'

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

- Legal reform requires a long gestation period, particularly if it is seen as more than drafting new legislation. It is therefore advisable to pursue free-standing legal reform projects and to include legal reform components in conventional investment projects.
- Although the Bank is assisting countries in all regions in strengthening aspects of their legal systems, the subject is likely to remain a politically sensitive one, and the extent to which the Bank is involved in legal system reform will continue to depend greatly on country circumstances. In addition to the assistance in the drafting of individual laws, the Bank is increasingly emphasizing the need for the formulation and implementation of comprehensive legal reform agenda, including the establishment of appropriate enforcement mechanisms, and the strengthening of the judiciary and regulatory insti-

efforts in the region as well as to make contact with women's jurist organizations in West Africa.

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

To include the reform efforts in a region's lending program, the World Bank's WID unit focuses on operations that typically include a legal reform component—primarily financial sec-

tor and private sector development operations. In such cases, the Bank encourages the borrowing country to take women's issues into consideration when planning its law reforms. For example, a recent privatization operation in southern Africa was conditional on a study of land reform, which thus provided an opportunity to examine the impact of land reform on women.

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

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

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

Transparency and Information

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

Markets, government, and transparency

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

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

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

Although specific aspects of transparency, such as requiring companies to publish financial results in a standard format, opening public procurement tenders in the presence of bidders, and the timely publication of government budgets and accounts, can be readily addressed in World Bank operations, in a broader sense transparency reflects what goes on in a society as a whole. Thus, a willingness to make public processes more open depends, in turn, on the culture, tradition, and attitudes toward openness in society as a whole, which may change only slowly. Transparency requires supportive institutions, political commitment, pressure from civil society, and free media. For

many of the players involved, information is power and money. Secrecy and nontransparent decisionmaking provide an opportunity for private gain or for political arrangements against the public interest. And there could be occasions when government may be right to withhold information, such as on national security issues or when reforming governments have had to move stealthily to prevent vested interests from coalescing to block reform. Improving transparency, therefore, is a necessary but complex process that will take time in many countries.

The World Bank's experience

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

- The situation in Latin American and the Caribbean geographic region has traditionally been characterized by substantial political obstacles to greater transparency. However, the trend toward democratic rule and freedom of the press has created a more favorable climate for actions that promote transparency. In this regard, World Bank work in this region has concentrated at the level of improving financial management and in the introduction of transparent budgetary systems, which allow a clearer disclosure of the relationship between performance and expenditure. Revenue administration reforms supported by the Bank in several countries have made tax and customs schedules more easily comprehensible. As an illustration of the role of transparency in regulatory reform, an NGO in Argentina was engaged to monitor complaints by the public and how they were resolved by the new private telephone companies.
- In South Asia, World Bank efforts to promote transparency have included support for the introduction of program-oriented budget systems. This type of budget makes more explicit the relationship between goals and expenditure than the line-item budgeting systems commonly in place and facilitates the possible use of value-for-money assessments. Past experience in the region with budget-reform, however, has not been encouraging. Another effort related to transparency has been in the area of procurement through the promotion of standard bidding procedures in all countries in the region.
- In East Asia and the Pacific, transparency is a new issue for the governments of those countries in transition to market economy, and thus far the principal instrument has been the policy dialogue. The World Bank has urged trade liberalization, more informative budgeting, legal reform to encourage foreign investment, and more clarity in privatization programs. Elsewhere in

the region, considerable progress has been made removing trade and investment barriers, with the Bank's encouragement, thereby reducing opportunities for rent-seeking behavior. In several countries, the Bank has assisted governments in introducing more open and predictable procurement processes.

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

**BOX 1.14 TRANSPARENCY
OF FINANCIAL REPORTING
SYSTEMS**

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

The World Bank is now directly addressing this subject in its economic and sector work. A recent report ("Republic of South Africa: An Assessment of Financial Accountability") examined

the transparency of accounting and auditing practices in South Africa—specifically, the legal framework, standards of accounting, and the independence of the auditing profession in both the public and the private sectors. The main findings of the study were the following:

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

■ Wide disparity exists in financial reporting and accountability at the local

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

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

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

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

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

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

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

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

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

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

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

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

**BOX 1.15 STRENGTHENING
THE LEGAL FRAMEWORK
FOR PUBLIC PROCUREMENT**

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

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

The model code seeks to achieve transparency in the procedures relating to procurement; to promote the integrity of the procurement process; to provide fair and equal treatment of all suppliers and contractors while

promoting competition; to foster participation in procurement proceedings by suppliers and contractors; and finally, through all of these endeavors, to maximize economy and efficiency in procurement. At present the model law covers procurement of goods and construction; work is under way to develop a similar framework for the procurement of services.

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

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

Emerging lessons

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

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

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