C H A P T E R T H R E E

Findings and Future Directions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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