Overview: Strengthening Mutual Accountability—Aid, Trade, and Governance

It has been five years since the Millennium Declaration was signed by 189 countries, and one decade remains to achieve the Millennium Development Goals (MDGs). Several events and publications in 2005 marked this milestone: the Paris High Level Forum in March, the UN World Summit in September, the World Trade Organization meetings in December, and several major reports on how to advance the MDG agenda.

The year brought forth new commitments of resources and actions, and a reaffirmation of the principle of **mutual accountability.** World attention is focused on how to scale up resource flows to developing countries—and how to make certain that aid is used effectively toward reaching the MDGs. These two issues cannot be separated. Scaling up is about changing the way in which development business is done. Donors and the international financial institutions must increase aid flows, improve aid quality, and better align their support with country strategies and systems. Donors also need to open up their markets to the developing world. Developing countries, for their part, must commit to sound development strategies and stronger systems of governance to ensure that resources will be effectively used. These commitments are the essence of mutual accountability.

This report examines key developments in 2005 and monitors progress toward meeting the main MDG targets. As with past Global Monitoring Reports (GMRs), it reviews international efforts to support the Millennium Declaration, including new commitments by donor governments to augment aid flows and commitments by the international financial institutions (IFIs) to improve their effectiveness.

One element widely recognized as essential to the success of the mutual accountability framework is **governance.** Measuring and monitoring governance pose major challenges, yet, with interpretive caution, they are feasible. Part II of the report provides a platform for including governance in the ongoing MDG monitoring of mutual accountability. It shows how such monitoring can track progress across both broad and specific (actionable) indicators of governance. Monitoring can also help to clarify options for scaling-up assistance and can support broader efforts to strengthen transparency and accountability, both nationally and globally.

Part I: Monitoring Progress

Reducing Income Poverty

The favorable global growth environment that has helped sustain poverty reduction in recent years continued in 2005. Growth per capita for both low- and middle-income countries averaged just under 5 percent in 2005, well

BOX 1 Global Monitoring Report 2006: six key messages

Reducing poverty. Growth continues to be favorable, and progress with poverty reduction is accelerating globally. But progress is too slow in improving the business climate (including access to infrastructure) in many poor countries.

Meeting human development goals. Many countries are off track to meet the human development MDGs. But tangible evidence is emerging that there has been significant progress in some countries. Critical to expanding this progress is increasing the ability of aid to cover recurrent costs (such as the salaries of teachers or health service providers) and governance reforms to improve service delivery.

Meeting commitments on aid, debt relief, and trade. In 2005 there were major new commitments for increased aid and debt relief to low-income countries. The risk is that they may not materialize, or that debt relief may simply substitute for aid. Aid transfers need greater predictability, less fragmentation, better alignment with needs, and targeting to where aid can be productively used. Multilateral trade negotiations need to be accelerated.

Strengthening results management. There is progress in shifting the emphasis of IFIs and country programs toward results management—managing for *outcomes* rather than managing inputs to the production process. However, this shift requires a long-term vision, more resources, and support for capacity strengthening in partner countries.

Monitoring governance. Governance should be monitored regularly. To complement existing aggregate indicators, additional effort is needed to monitor specific, actionable indicators, such as quality of public financial management, procurement practices, and checks and balances. This monitoring can help to track progress, generate greater accountability, and build demand for good governance. It can also help underpin long-term dialog between countries and development partners to develop realistic goals and sequencing of governance reforms.

Good governance is everyone's responsibility. IFIs and donors should support the emerging global framework for good governance, encourage country participation, strengthen their own anticorruption controls, and provide assistance in ways that strengthen transparency and country systems.

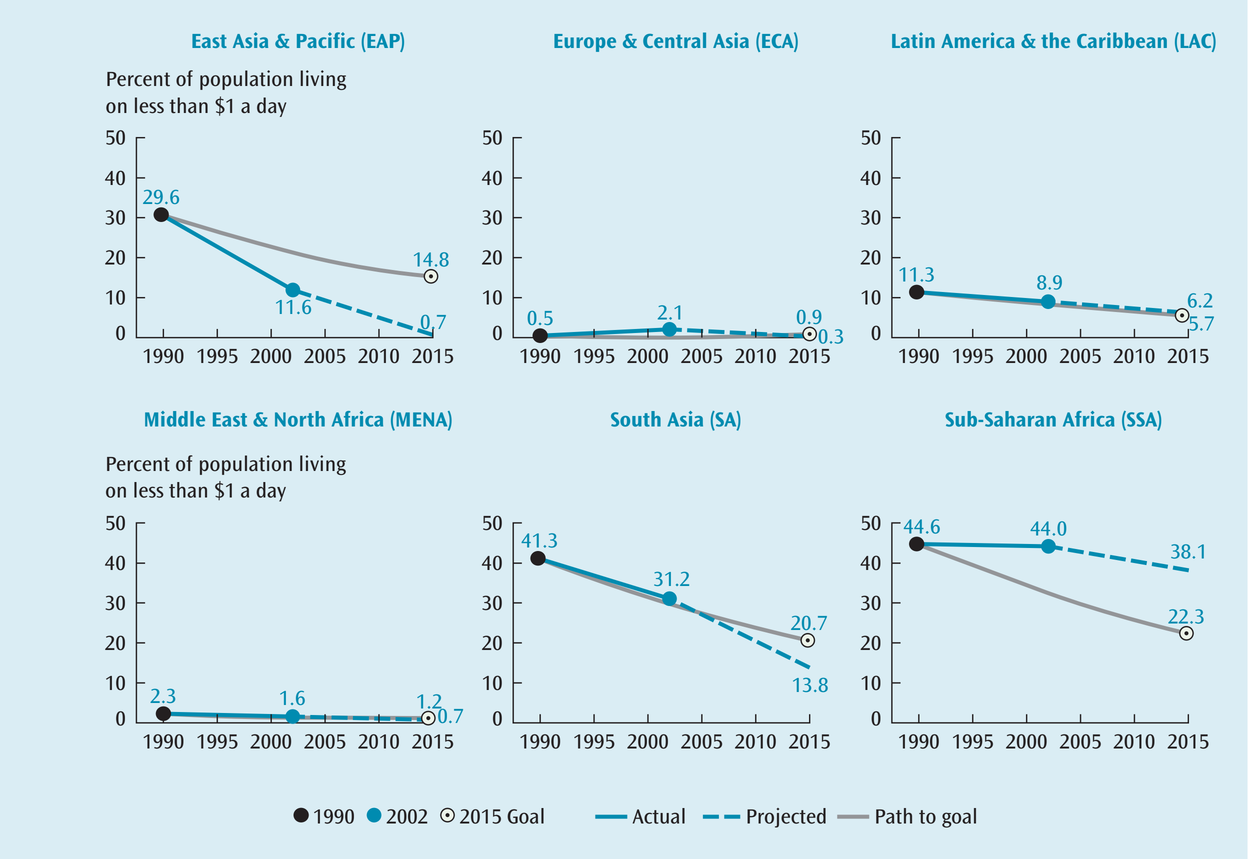
above historic rates, as buoyant trade, low interest rates, and strong growth in Organisation for Economic Co-operation and Development (OECD) countries helped sustain performance. More rapid growth is likely to have reduced poverty between 2000 and 2005 significantly—simple projections based on aggregate income growth suggest by as much as 10 percent, or over 100 million people.

Contributing to this growth is the improvement in macroeconomic policy management. For low-income countries, macroeconomic indicators are now significantly better than in the 1990s. Middle-income countries, with higher (and less volatile) growth than low-income countries, have become more resilient to economic shocks. Deficits have fallen, more flexible exchange rate regimes are in place, and financial sectors are sounder. But room for improvement remains.

The strong expansion in trade volumes and higher commodity prices provide additional evidence of the favorable growth environment. World exports grew by 14 percent in 2005. Oil exporters reported the fastest growth, buoyed by the surge in energy prices. Both China and countries in Sub-Saharan Africa enjoyed a healthy 25 percent increase.

However, while strong overall growth has helped reduce poverty, the gains remain uneven. All regions have, to varying degrees, shared in the recent favorable growth, but there are major differences in regional performance in reducing poverty (figure 1), and in individual country performance. Much of the improvement occurred in East and South

FIGURE 1 Poverty headcount by region, 1990–2002, and forecasts to 2015



Source: World Bank staff estimates.

Asia, and in Eastern Europe and Central Asia, as stronger growth resumed after the Asian financial crisis, and the transition economies adjusted to market systems. In Latin America, growth is up over the past two years, but it is still too low to make strong inroads into poverty reduction. African growth has also improved, outpacing its historical average, by accelerating to more than 2 percent per capita in 2005—but on current trends, few African countries will reach the MDG income-poverty target. However, several countries within Africa have performed well over the last decade, due to a combination of better policies, enhanced trade performance, and foreign aid. This demonstrates the potential for more rapid progress.

Near-term prospects for growth and income-poverty reduction appear fairly good—low-income countries are projected to continue to rebound from their contraction of the early 1990s (growing by nearly 4.5 percent per capita in 2005), and middle- income countries are projected to grow by 4.6 percent per capita. But the global environment also poses risks. High oil prices threaten to slow growth in low-income, oil-importing countries, particularly if non-oil commodity prices weaken; stronger terms of trade helped offset oil import costs in 2005. Other continuing risks include abrupt adjustment in global current account imbalances, further increases in global interest rates, and the failure of the Doha Round trade talks. Of added concern is the potential impact of avian influenza on global commerce. Singly or in combination, these factors could undermine recent gains in poverty reduction.

Strengthening poverty reduction will require greater emphasis on the domestic growth environment through improving the investment climate, strengthening access to infrastructure, and enhancing opportunities for the poor. The quality of the investment climate contributes strongly to growth, employment, and productivity, all of which are important for sustainable poverty reduction. Tools for monitoring the investment climate—Investment Climate Surveys and Doing Business Indicators—show that poor countries place the highest burdens on entrepreneurs, and on reform business regulations the least. Africa had the lowest reform intensity in 2004, and Eastern Europe and Central Asia had the highest.

Basic infrastructure services—transport, electricity, water, sanitation, telephones—are key both to a strong investment climate and to sustained progress in human development outcomes. Half a billion people gained access to electricity between 1995 and 2004. Telephone subscribers quintupled in the 1990s and are believed to have tripled since. But while East Asia and the Middle East have shown marked improvement, other regions are losing ground for most infrastructure services on a per capita basis. For the rural population, and for the poor in both rural and urban areas, access gaps are large and reinforce their vulnerability. More resources and greater innovation in service delivery and easy-to-maintain technologies are needed.

Finally, increasing access and opportunities for poor and vulnerable groups is complementary with improving growth performance. Equality of opportunity is at the heart of the MDG agenda, particularly access to public services and opportunities for human development—the focus of *World Development Report 2006*.

Meeting the Human Development Goals

Regional progress toward the human development MDGs remains a cause for concern. All regions are off track on at least some of the goals, and the two regions lagging most seriously behind—South Asia and Sub-Saharan Africa—are off track on all of the goals. Children's nutrition is worsening in many parts of Africa; a majority of countries are not making sufficient progress to reduce child mortality and maternal mortality; and HIV/AIDS continues to spread across the world. In many countries much more needs to be done to reach the poor.

However, the latest data also provide some encouraging signs of progress:

- The number of countries that have achieved or are on track to achieving universal primary completion (MDG 2) has increased significantly since 2000, and the pace of progress has also increased. Even faster rates of progress are observed in countries that have joined the global Education for All Fast Track Initiative (EFA FTI). Gender disparities in primary and secondary education (MDG 3) are also narrowing, with girls' enrollment rates growing faster than boys' in all regions, although the target of achieving gender parity by 2005 was not met.
- While only 20 percent of developing countries are on track to reducing child mortality (MDG 4), the most recent survey data suggest that rates of progress are accelerating in some countries, and very significant progress is being made to reach the poor with key interventions, such as childhood immunizations.
- Access of women to trained birth attendants, the best indicator of maternal mortality (MDG 5), shows strong improvement in East Asia, more modest in Latin America, but shows little gain in Sub-Saharan Africa.
- The first signs of decline in HIV/AIDS infection rates (MDG 6) are emerging in high-prevalence countries such as Haiti, Uganda, and Zimbabwe. Evidence is growing that prevention programs work when they are intensive and sustained. The number of AIDS patients under treatment in the developing world has scaled up

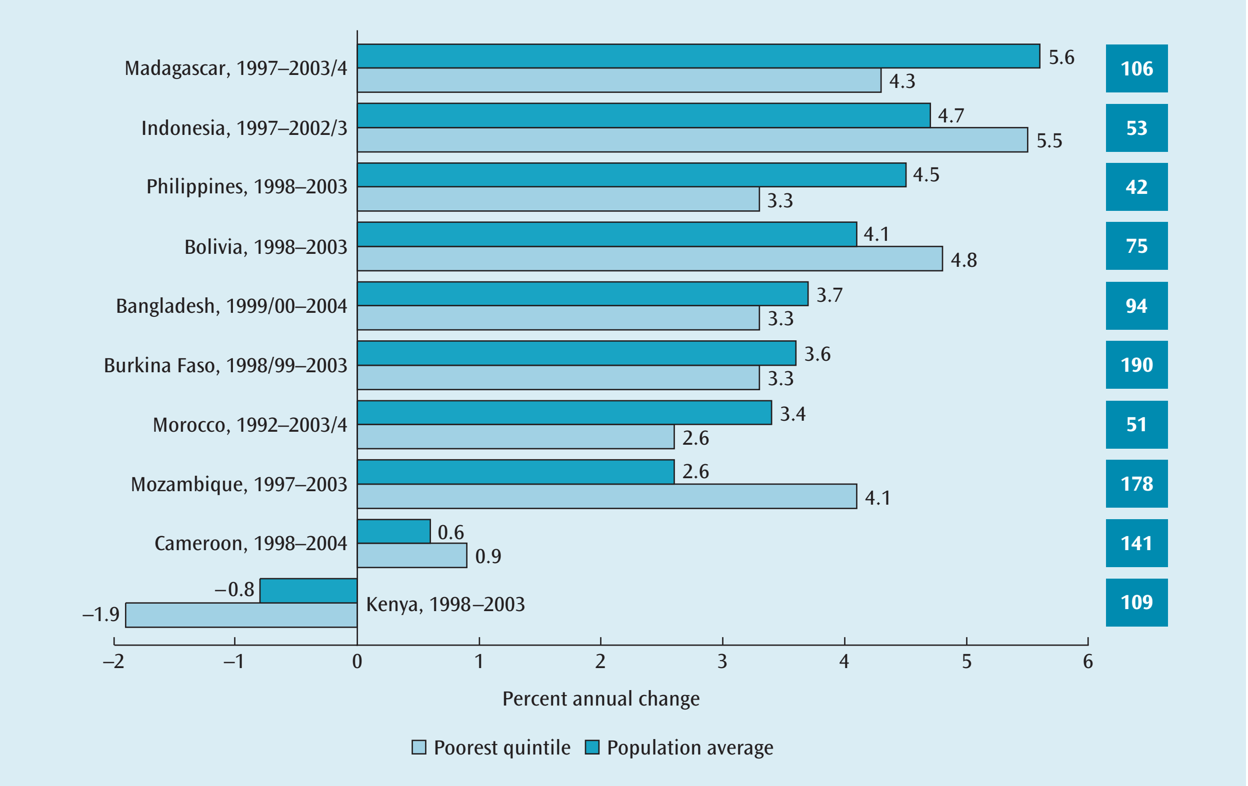
rapidly, approaching 1 million in 2005, from less than 100,000 in 2000. And new global efforts to combat malaria are improving treatment and rapidly spreading the use of treated bednets.

Figure 2 shows the annual reductions in child mortality between survey years in all 10 countries for which the Demographic and Health Survey data are available since 2002. It shows that nine of the countries have made gains, over half at quite rapid rates, ranging from Burkina Faso (3.6 percent per annum) to Madagascar (5.6 percent per annum). Moreover, the gains are reaching the poor. In four of the countries, child mortality fell fastest among the poorest quintile households. This is helping to reduce, albeit gradually, the gap in performance of poor households. The survey evidence on primary school completion yields a similar conclusion.

Better policies in the social sectors explain some of the progress. An increasing number of countries in all regions are adopting reforms to make education and health systems more effective and responsive to the people they serve: increasing community voice in the management of frontline schools and health facilities; allocating funds more transparently; managing the recruitment and deployment of providers more effectively; measuring and publicizing student learning outcomes and other key results; and conditioning income transfers to families on their use of education and health facilities.

There has also been a substantial increase in external support. Official development assistance (ODA) for primary education

FIGURE 2 Annual reductions in child mortality (number of child deaths per 1,000 live births)



Source: World Bank estimates from Demographic and Health Surveys.
Note: The boxed numbers show the number of child deaths per 1,000 live births in the most recent survey.

nearly tripled between 2000 and 2004. Aid is also better aligned with MDG priorities, and in education, the EFA FTI is producing tangible gains in donor harmonization at both the country and global level. However, spending on health and education in government budgets is tracked only by the World Bank and the IMF, and there is a need to improve the consistency of the data.

Extending and sustaining these gains will require more flexible and predictable aid. The main financing need in health and education is recurrent expenditures, yet less than one-third of bilateral aid to low-income countries is in non-special-purpose grants that can more readily be used for both recurrent costs and investment. The volatility of aid disbursements is another serious constraint to expanding social services, which depend on multi-year financing of recurrent costs. Finally, there is evidence that transactions costs in health are increasing, with the growth of "vertical" global health initiatives. These are key issues for the development community to resolve in order to accelerate MDG progress.

Ultimately, however, the achievement of the MDGs is in the hands of developing countries. Increased and more flexible aid is unlikely to materialize unless countries reduce resource leakages and strengthen accountability of service providers to the public. Cross-country studies show that, on average, one in three health care workers is missing during unannounced facility visits, and one in six teachers is also absent. Funds may fail to reach their intended level in the budget if they are diverted before reaching local clinics and schools. Sound expenditure management systems are needed to address this issue and to meet the fiduciary concerns of donors and finance ministries. While many developing countries are taking steps to generate greater accountability in social service delivery, in most places deeper and broader reforms are still needed, as discussed in Part II of this report.

Meeting Donor Commitments of Aid, Debt Relief, and Trade

Meeting donor commitments is a central facet of the mutual accountability framework. Major progress was made in this area in 2005: the international community sharpened its focus on the Millennium Development Goals and reaffirmed commitments to increase aid, advancing the agenda for donor harmonization and alignment, and to expand debt relief to the poorest countries. But concerns over delivery remain.

In 2005 there were major new commitments to expand aid flows and deepen debt relief to the poorest countries. The UN World Summit in September helped maintain the focus on the MDGs. Along with the Commission for Africa Report, "Our Common Interest," and the Millennium Project Report, "Investing in Development," the UN report, "In Larger Freedom: Toward Development, Security, and Human Rights for All," helped focus international attention on development. Several initiatives were launched at the G-8 Summit (July 2005) in Gleneagles, including pledges to:

- Increase aid to Africa by $25 billion a year by 2010—more than doubling the current assistance to the region—and to all developing countries by about $50 billion.
- Extend and deepen debt relief to the poorest countries. The G-8 proposal, the Multilateral Debt Relief Initiative (MDRI), aims to cancel the roughly $50 billion of debt owed by Heavily Indebted Poor Countries (HIPC) to the African Development Fund (AfDF), International Development Association (IDA), and the International Monetary Fund (IMF).

However, concerns arise over whether these new commitments will be delivered, and if so, how effectively. Delivering on commitments will require spelling out the mechanisms for their implementation and monitoring their execution against well specified benchmarks. It will also require greatly improving aid quality, and delivering it where it can be effectively used.

INCREASING THE VOLUME AND QUALITY OF AID

Aid from the Development Assistance Committee (DAC) countries of the OECD totaled \$80 billion in 2004, and rose further in 2005 to an estimated \$106 billion, averaging 0.33 percent of GNI. Most of the large increase in 2005 is due to debt relief to Iraq and Nigeria, and total aid has yet to reach relative levels of assistance in the early 1990s. There is a wide range in country contributions: five DAC members provide over 0.7 percent of GNI in aid, while the United States provided the lowest share (0.17 percent of GNI in 2004). Non-DAC donors also increased their aid contributions 9 percent in 2004, which brings the total assistance to \$3.7 billion, or 0.18 of GNI (of which Arab countries contributed 0.85 percent of GNI in ODA).

The aid *commitments* by DAC countries, however, add up to much more than \$106 billion. If all aid committed over the 2006–10 period were disbursed, it would lift DAC contributions further by \$24 billion—to about \$130 billion—in real 2004 dollars. More aid will need to be in non-debt relief forms as large opportunities for debt relief are exhausted. Monitoring real aid disbursements by DAC members is important for holding donors accountable to their international commitments.

Of equal importance for enhancing the contribution aid makes to the MDGs is the quality and composition of ODA. Three key elements warrant attention: aid flexibility, harmonization and alignment of support, and country selectivity.

Flexibility. Increasing the share of flexible aid, which can be targeted at meeting MDG needs, is a priority for scaling up. Over 70 percent of bilateral aid from DAC countries between 2001 and 2004 was in the form of special purpose grants: debt relief, technical cooperation, food aid, emergency aid, or administrative costs. Flexible aid (non-special purpose grants and multilateral ODA), which could be used to meet recurrent and capital costs for MDG-related expenditures, increased by only 8 percent, from \$38 billion to \$41 billion.

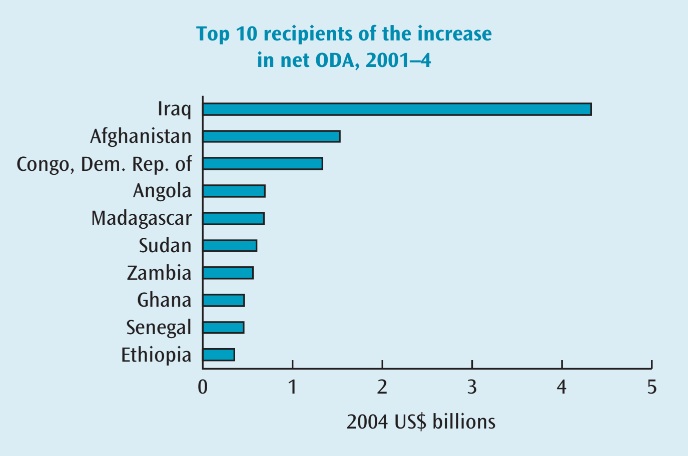
Harmonization and alignment. Progress with the agenda on harmonization and alignment, as embodied in the “Paris Declaration” of the High Level Forum in March 2005, is a priority. The 12 global targets for enhancing aid effectiveness by partner countries, donor countries, and the multilateral development banks are not just symbolic. Implemented, they will radically transform the way most aid is delivered. A preliminary baseline has been developed, but the gap between the baseline and the targets is wide. Donors and the IFIs face challenges in changing management practices and incentives. Regular monitoring and peer pressure, it is hoped, will advance this agenda.

Selectivity. Aid allocation will need to shift if support for the MDGs is to be the objective. Evidence on aid allocation among countries underscores that aid is often not channeled to where the impact on the MDGs is likely to be greatest. While aid selectivity is increasingly based on need (poverty level) and ability to effectively use aid (quality of policies and governance), there is evidence that other factors still determine a large share of aid disbursements. For example, over 60 percent of the increase in ODA between 2001 and 2004 was directed to three countries—Afghanistan, the Democratic Republic of the Congo, and Iraq, although these three countries collectively account for less than 3 percent of the poor people in developing countries (figure 3).

MAKING PROGRESS IN DEBT RELIEF

The Multilateral Debt Relief Initiative (MDRI) that emerged from the G-8 Summit in July 2005, complements the existing efforts to reduce the debt burden facing HIPCs. The existing HIPC initiative has delivered debt relief to 28 countries as of end-2005. Debt ser-

FIGURE 3 ODA increases concentrated in a few countries



Source: OECD DAC database.

vice to fiscal-revenue ratios was halved, and expenditures related to poverty reduction are estimated to have increased from $6 billion to nearly $11 billion. The new MDRI initiative goes beyond this level to cancel all of the debt claims of the African Development Fund (AfDF), IDA, and the IMF for countries that have reached, or will eventually reach, their completion points under the HIPC initiative. The IMF has already fully implemented the initiative, while the AfDF and IDA are finalizing arrangements. As a result, the estimated annual debt service flows of these countries will fall by around $1 billion annually over the next decade, and by somewhat higher amounts after that.

To lock in these gains (estimated at about $1 billion annually for the first decade) careful benchmarking and monitoring are needed. With the MDRI a new benchmark in aid is needed to ensure that there is no counting of debt relief against higher DAC country aid commitments to the IFIs. Accumulation of new, unsustainable debt is another risk facing MDRI recipients. The debt sustainability framework is currently under review to ensure that it helps guard against this risk and supports HIPC country efforts to improve expenditure composition.

MEETING COMMITMENTS TO LIBERALIZE INTERNATIONAL TRADE

Advances in multilateral trade reform talks in 2005 remained elusive. The roadmap that emerged from the Hong Kong, China talks still requires concurrence on the most divisive issues—agriculture and industrial products. This roadmap is scheduled to be agreed on by April 2006, and finalized by October 2006. Other outcomes of the Hong Kong, China meetings were modest. Agricultural export subsidies are to be phased out by 2013, conditional on disciplining equivalent programs such as food aid. Duty-free and quota-free access to developed country markets for products from the least-developed countries was significantly weakened by the likely exemption of 3 percent of tariff lines in key products.

Some success was achieved in support for "aid-for-trade," in recognition that the potential gains from trade are not evenly distributed and many countries, particularly in Sub-Saharan Africa, lack the requisite infrastructure and skills base to benefit from multilateral trade liberalization. The United States, the United Kingdom, Japan, and the European Commission have all committed to increasing resources for building trade capacity in low-income countries. There is a critical need to ensure that aid for trade is effective and is not a substitute for allowing greater market access.

IFI Performance: Strengthening Results Management

A final key element of the mutual accountability framework rests with efforts by the IFIs to support development outcomes. However, assessing their contribution to actual development outcomes is complex, because there are many other determinants and partners, in particular, country governments. The focus here is on evaluating the IFI progress with the results orientation of their management practices, their contributions to development finance, the strengthened impact evaluation, and aspects of institutional integrity and transparency.

Implementing the results agenda. The 2004 Marrakech Roundtable on Results called for a monitoring system to assess the results orientation of the multilateral development banks (MDBs); that system is COMPAS, the Common Performance Assessment System, which draws on MDB frameworks and action plans to implement managing for development results (MfDR). While it is still too early for robust assessment, the initial COMPAS efforts are promising: awareness of results is increasing, and frameworks, systems, and procedures are being put in place in all the institutions.

The degree and manner in which MDBs are carrying out the results agenda varies. A key challenge will be to establish an institutional culture of using the information on results to inform decision making. MDBs face trade-offs that complicate implementation. There is tension between alignment with country systems and fiduciary concerns. There are also significant gaps between institutional harmonization policies and country level practices, raising questions about aligning staff incentives with the MfDR framework. Focusing the MDBs on outcomes, rather than on the more traditional input management, will require a sustained effort. Implementation will require both a strengthened MfDR capacity in partner country governments and long-term MDB commitment.

Impact evaluation is a key component of results management. Each IFI has an independent evaluation unit that conducts both institution-wide assessments—for example in support of health sector reforms, pension systems, or the quality of analytic work. The MDBs also assess specific country programs and projects. Additional efforts are under way to help develop more robust, evidence-based advice to partner countries that can help define the types of interventions they should support. Two examples are the Development Impact Evaluation initiative (DIME) at the World Bank, and the program of impact evaluations launched in the Inter-American Development Bank (IADB)'s Office of Evaluation and Oversight. Two dozen rigorous evaluations are currently under way through DIME, on education projects, conditional cash transfer programs, and slum-upgrading initiatives.

Financing flows. In 2005 lending through the concessional and non-concessional windows of the MDBs declined, although the dip in concessional lending was due, mainly, to constraints on IDA-13 resources and to a spike in IDA disbursements the previous year. In general there is an upward trend in MDB financing to low-income countries, and the IDA-14 replenishment provides for this to continue through 2007. In contrast, disbursements to middle-income countries have steadily declined for some years, and net lending has been negative. Several factors shape the middle-income country demand for funding: shifting demand toward sovereign bond financing; prepayment of older, higher-cost loans; greater financial market access with improvements in creditworthiness; and slow development on the part of MDBs of new, innovative financing mechanisms for the middle-income countries. Better alignment of MDB strategies with evolving middle-income country needs is necessary.

Improving alignment, integrity, and transparency. An outgrowth of the Paris Declaration is the commitment by donors and IFIs to support the development of national systems over parallel donor structures. MDBs are adopting different approaches to this goal, including technical assistance to strengthen country systems and testing country systems in select countries. The IMF's experience with safeguard assessments of Central Banks provides a positive example in this area. So far there has been limited progress in the use of country systems, due, in part, to inherent risks and fiduciary concerns.

MDBs' concerns about corruption range from preventing fraud and corruption in MDB-financed projects, to promoting good governance in country programs, and to supporting international efforts to fight corruption. Efforts are under way to improve their ability to reduce corruption in the use of their own funds, and to empower investigative departments. However, numerous challenges remain: ad hoc reactions to instances of corruption remain the norm while systematic management of risks is still being developed. Moreover, ring-fencing of projects cannot substitute for strengthening country systems, which is a much more challenging and lengthy task.

Improving transparency is part of the effort to strengthen IFI accountability. Evidence shows that transparency is improving, which makes it easier for country partners to scrutinize policies that affect them and to participate more in the development dialogue. Disclosure of country performance ratings by the IADB, and those planned for 2006 by the AfDF, Asian Development Fund (AsDF), and IDA, are cases in point. The IMF's speedy publication of country reports is another.

Part II: Governance as Part of Global Monitoring

Governance has emerged as an essential element of the mutual accountability framework. The UN Millennium Project report cites "governance failures" as one of four obstacles to reaching the MDGs. The UK's Commission for Africa report recommends improved governance, together with market opening, as keys for alleviating poverty. Governance is also highlighted in new donor approaches, for instance in the European Union's Cotonou Agreement—effective in 2005, and the United States' Millennium Challenge Account. Developing countries, too, have noted the centrality of governance; for example, in the New Partnership for Africa's Development (NEPAD)'s Africa Peer Review Mechanism. Yet, while empirical research links governance-related institutions and development, there is not yet a consensus as to how to approach governance and its measurement.

This GMR aims to provide a platform for the inclusion of governance as an ongoing part of MDG monitoring. To do so, it provides a governance monitoring framework that can enable a more empirically grounded dialogue, and notes some indicators that might be used in going forward, together with some additional work to develop them. This framework identifies some patterns of governance across countries and over time, and highlights challenges for strengthening governance. The complexity of governance and the need to proceed with caution should be borne in mind.

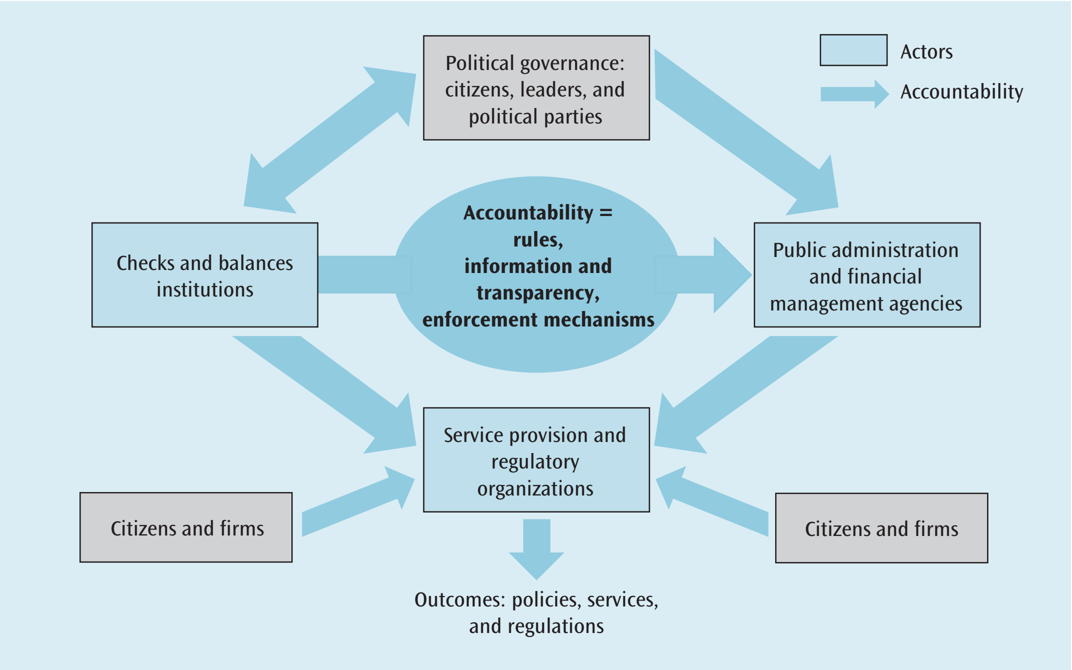
Improving governance is not simply a matter for aid recipients. The global milieu has powerful influences on governance systems in developing countries. Global markets can be a source of virulent, corrosive corruption or a powerful disciplining device. Donors and IFIs can impose practices and reporting requirements that fragment and overwhelm already fragile country systems, or they can provide support in ways that help strengthen governance. Global mechanisms can help poor countries strengthen governance to meet the MDGs, including promoting standards and codes to provide sources of good practice for all countries. For this reason, the establishment of global checks and balances is another priority.

A Framework for Monitoring Country Governance

Public sector governance can be defined as the way the state acquires and exercises its authority to provide and manage public goods and services, including regulatory services. A governance system has both a supply side (the capabilities and organizational arrangements embodied in its players) and a demand side (the accountability arrangements that link the players to one another). To monitor governance—and to improve it—a framework is needed to cut through the complexity. The GMR lays out one possible framework, which identifies the key actors in a national governance system and the key accountability relationships among them (figure 4).

Political leaders are the prime drivers, setting the objectives for the rest of the governance

FIGURE 4 National governance system



Source: Authors.

system. Often they work for the general interest; other times they cater to special interests and core supporters. Sometimes these powerful interests may capture the state. Even a democratic electoral process does not guarantee that politicians will focus on the general interest.

Checks and balances institutions are important for the sustainability of effective governance. They include parliaments, independent oversight agencies (audit institutions, ombudsmen, and anticorruption commissions), the judicial system, a free press, and accountable local governments.

The *public bureaucracy* is the implementing arm of government. It includes both cross-cutting public administration and financial management control agencies (such as the Ministry of Finance) and agencies that directly deliver social and regulatory services to citizens and firms (for example, education or licensing).

Citizens and firms are central to effective accountability. Citizens select political leaders; as users of services, citizens and firms can also hold providers accountable for the efficiency and effectiveness of service provision.

Within such a system, effective *accountability* requires clear rules and expectations, transparent information to monitor performance, and incentives and enforcement mechanisms that reward success and address failure. Transparency is not sufficient, on its own, for good governance, but it is a powerful feature for improvement, with broad applicability across an array of public actions.

Corruption is one outcome of a governance system. It can reflect the failure of any number of accountability relationships—for instance, political failure leading to state capture, bureaucratic failure, or a failure of checks and balances.

While it may be difficult to get more than a subjective measure of political governance, the capability of the bureaucracy, the strength of checks and balances, and some aspects of service delivery can be measured more objectively. The framework thus points to three different ways in which governance can be monitored, and for each, specific foci for measurement are suggested:

A: *Overall governance performance*:
- (i) Summary measures of governance system quality;
- (ii) Control of corruption;
- (iii) Quality of economic and sectoral policies.

B: *Quality of bureaucracy:*
- (i) Public financial management and procurement systems;
- (ii) Public administrative systems;
- (iii) Front-line service provision and regulatory agencies.

C: *Performance of checks-and-balances institutions:*
- (i) Constraints on the executive;
- (ii) Justice and the rule of law;
- (iii) Transparency and voice.

The Challenge of Monitoring Governance

Measuring governance is difficult. Formal systems can be categorized and rated—but the gap between formal arrangements and realities on the ground is often wide. Institutional processes are difficult to observe and measure systematically. Two complementary approaches respond to these measurement challenges.

One approach is to use broad measures to monitor aggregate governance. The GMR highlights as useful several aggregate indicators, including the so-called Kaufmann-Kraay (KK) indicators compiled by the World Bank Institute on the basis of a large number of (mostly external) assessments, Transparency International (TI) indicators, and the Country Policy and Institutional Assessments (CPIAs) compiled by the World Bank (the 2005 ratings are to be released for IDA countries in 2006).

These broad governance indicators have many uses. They can be powerful forces for raising awareness, and they can also focus attention on broad areas in which individual countries can strengthen their national systems. However, these broad indicators, as with all governance indicators, are also subject to quite wide measurement errors.

Ranking countries on the basis of the KK corruption indicators, for example, only 87 out of 203 can be confidently assigned to top, middle, and bottom thirds. The standard measurement error in the CPIA is of a similar relative magnitude. Assessments can therefore broadly distinguish high-, middle-, and low-rated countries, but some are likely to be misclassified when ratings are broken down on a much finer scale. Governance indicators also may not be able to pick up with precision the modest, short-run changes in governance, although they will do better at signaling longer-run trends. In sum, broad governance indicators are useful but have limitations, including their margins of error; as a basis for cross-country comparison, they need to be applied with caution.

A second approach is to use narrow measures of the quality of specific governance subsystems. While these too can have nontrivial measurement error, the narrow focus of specific indicators makes them "actionable" in the sense that they can help to identify governance weaknesses and to monitor improvements. Specific governance indicators are being used in diverse ways:

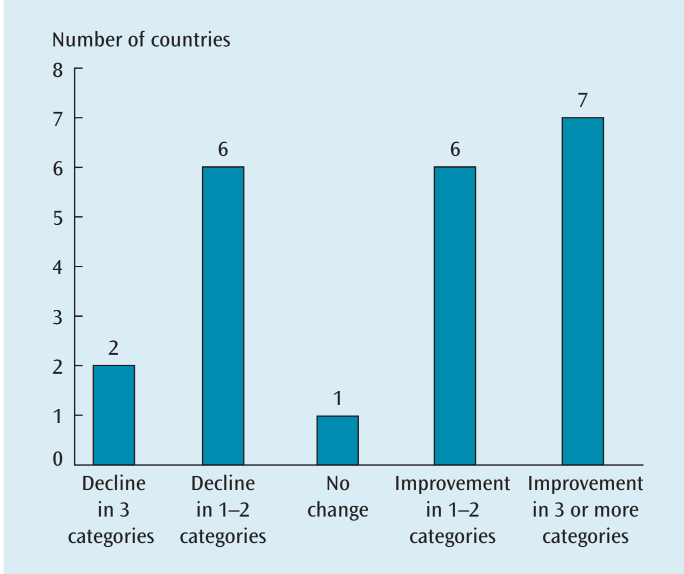
- The Public Expenditure and Financial Accountability (PEFA) program uses 28 indicators to track public financial management.
- The Doing Business and Investment Climate Surveys are creating monitoring baselines for regulatory performance, including a baseline for corruption.
- The Center for Global Integrity has applied a detailed set of indicators on the quality of checks and balances in 26 countries.
- Detailed indicators have been developed for monitoring procurement, the quality of statistical systems, and administrative reform.

- User scorecards and similar surveys provide an entry point into governance from the perspective of service delivery.

So far, however, other than in the areas related to private sector development and to the public financial management for HIPC countries, there has been no focus on refining and applying such indicators systematically.

Between them, the broad and narrow approaches to governance monitoring yield 14 governance measures that are currently available, offer comprehensive country coverage, and cover each of the diverse facets of national governance systems. These measures can provide a useful baseline for ongoing governance monitoring to move forward. The greatest value-added for governance monitoring will come from the improvement of specific indicators. More sustained use and investment in specific, actionable, governance indicators is a recommendation of this GMR.

FIGURE 5 Net change in HIPC indicator tracking scores, 2001–4



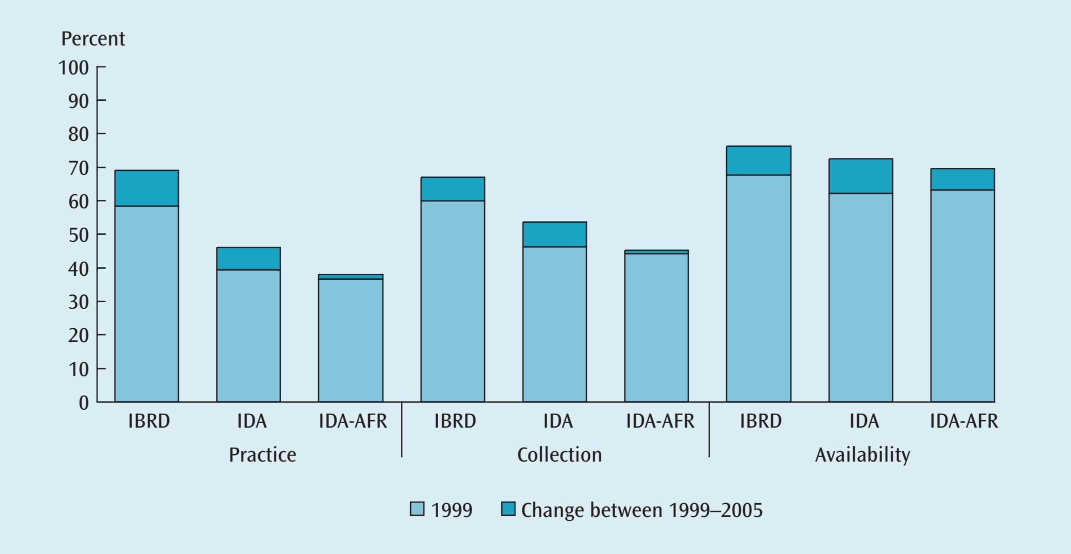
Source: IDA and IMF 2005, update on HIPC tracking.

Strengthening Bureaucratic Capability, Checks and Balances, and Service Delivery

Bureaucratic capability. Strengthening public financial management (PFM) is an area of great importance for scaling up aid, and it is also the area in which most progress has been made in developing and applying specific, actionable indicators. Assessments of the quality of budget and financial management systems conducted in both 2001 and 2004 for 22 HIPC countries showed that, while progress is uneven, countries that are determined to improve their public financial management systems can do so quite rapidly. Seven countries, including Ghana, Mali, Senegal, and Tanzania, achieved substantial improvements between 2001 and 2004 (figure 5). Especially for countries that receive budget support, improvement in PFM should be monitored. With political commitment and support, many countries should be able to achieve reasonably strong PFM within a 5- to 10-year period. Similar approaches can be used to monitor and guide reforms in other areas, including public administration and procurement, where monitoring has been piloted in 10 countries.

Checks and balances: the role of transparency. While transparency is alone not sufficient for good governance, its role in national governance systems is pervasive—from the political apex of the system, through the publication of judicial decisions, to a free press, and all the way to the service provision front line. Transparency has a supply side and a demand side. On the former, quality information built on a platform of robust statistical capacity is key, as is assuring that citizens enjoy a right to information. Over 50 countries had adopted the Freedom of Information Laws by end-2004, with efforts under way in an additional 30 countries. However, assessments done for IDA-14 paint a worrisome picture of the statistical capacity in IDA countries (figure 6). Many lack the capacity to produce high quality information, which leads to a vicious circle of low attention to data and low demand for improvement; progress in this area is slow, especially in low-income Africa. Extended support for the

FIGURE 6 Measuring statistical capacity in IBRD, IDA, and IDA-Africa, 1999–2005



Source: Country Statistical Information Database (www.worldbank.org/data/countrydata/csid.html).

Marrakesh Action Plan for Statistics, an international response to the challenge of improving capacity to monitor the MDGs, is an important component of efforts to strengthen transparency.

On the demand side, an active civil society is key to translating transparent information into action. Together with government agencies, a Philippine citizen monitoring program identified losses of more than $3 million that the Department of Education promised to rectify. In Tanzania, the Rural Initiatives and Relief Agency helped local communities track government program expenditures and ensure that funds were indeed delivered. Both cases, with grants of under US$25,000, help to underscore the notion that empowerment through information can be a low-cost/high-return strategy for improving governance. The donor and IFI community should design its operations and programs to systematically go beyond technocratic dialogue with officials and actively foster transparency by bringing information on analysis and performance into the public domain.

Service delivery can be an entry point for better governance, and may be one of the few options in weak governance settings. Some facets of the business environment, such as levels of unofficial payments for specific services, can be linked to governance and are increasingly being monitored through instruments such as the Doing Business Indicators and Investment Climate Surveys. Surveys for Europe and Central Asia, for example, found that corruption was most pervasive in licensing, tax administration, and obtaining government contracts.

In countries where formal "top-down" accountability is weaker, sector-wide programs, decentralization, and community-based (CDD) approaches have become increasingly used to enhance service delivery. The World Bank alone channeled over US$10 billion directly to poor communities between 1999 and 2005. All of these approaches have limitations. Donors fail to harmonize; for instance, in 2004 Tanzania had 110 education projects on the books with an estimated average size of under $1 million. Donor financial projects often bypass line ministries and subnational governments. While a 2005 review concluded that CDD projects have supported participation and helped to get services to citizens cost-effectively in various administrative settings, the wider impact on governance of such approaches is still debated. In difficult governance settings, sectoral and bottom-up approaches may be the most feasible entry points for governance reform, although their effects are slow, indirect, and uncertain. These approaches need to be monitored for their impact on both the demand for, and supply of, good governance.

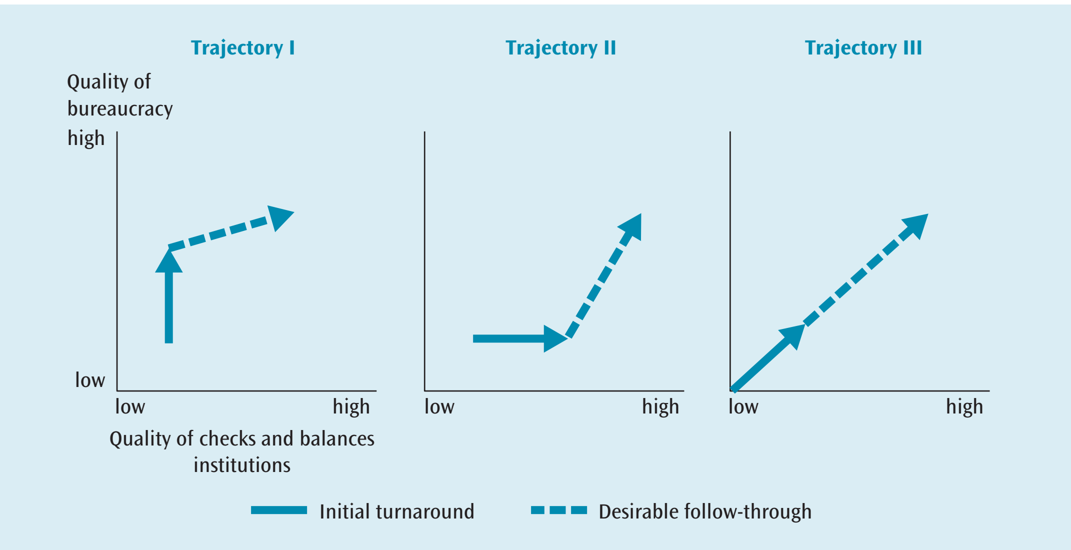
Approaching Country Diversity: The Need for a Long-Term Perspective

Even taking margins of error into account, some judgment as to governance quality can be made for about two-thirds of the 66 low-income countries. At the upper end of the spectrum, about one-third of countries generally score well across all or most measures. At the lower end of the spectrum, another one-third generally are in the bottom two quintiles on the outcome measures, and generally do not score well on the measures of subsystem quality either. These latter countries are basically stuck in clientelism, or state failure.

But many countries (including some in these two groups) have a strikingly uneven mix of governance strengths and weaknesses. Some countries have relatively capable public bureaucracies, but weaker checks and balances institutions; others have the reverse. Some with weak policies appear to be less corrupt; others, who are stronger on the policy front, seem to be less successful in controlling corruption. Bangladesh is perhaps the best known example of a country with relatively weak perceived control of corruption but strong performance on policies and on poverty reduction. Several other countries share this paradoxical pattern. These patterns reflect many institutional and historical factors.

Figure 7 illustrates three possible trajectories for governance turnarounds. In the first trajectory (Indonesia in the 1970s and Uganda in the 1980s are examples), a developmental political leader takes power and focuses on liberalizing the economy and strengthening the performance of the public sector—with checks and balances a lower priority. Poverty reduction gains can be rapid in this scenario, but if country reformers and development partners wait too long to put the challenge of strengthening checks and balances onto the agenda, the conse-

FIGURE 7 Governance turnarounds: three trajectories



Source: Authors.

quence (as in Indonesia during the latter Suharto years) can be rising corruption, financial crisis, a difficult process of political succession, and a reversal of earlier gains.

In the second trajectory, a country moves to political pluralism (for example, Albania in the early 1990s and Nigeria more recently). Only sometimes does this new political openness translate into stronger bureaucratic capability. In the third trajectory, following state collapse, international intervention or support helps to provide an umbrella of security under which both the bureaucracy and checks and balances institutions are reestablished (Mozambique offers an example of a country that appears to have followed a balanced trajectory).

In the short term, none of these turnarounds is superior to any other, but eventually improvements in governance need to evolve in a balanced way. Development partners need to take the different governance trajectories into account and to engage, on a *long-term basis,* to strengthen lagging elements of the governance system. It took many years for durable governance institutions to emerge in today's industrial countries.

Strengthening Global Checks and Balances

Since the early 1990s, a framework of global checks and balances has emerged, which is centered around three types of programs:

- International law enforcement: OECD's anti-foreign bribery convention and the anti-money laundering activities of the Financial Action Task Force complement each other; they help to tackle international corruption and they enable OECD countries to share in the prosecutorial burden. This is valuable for poor countries, which often lack the capacity and reach to pursue complex cases across international borders.
- Anti-corruption treaties: the UN Convention Against Corruption (effective December 2005), provides a global legal framework to address corruption, which complements regional anti-corruption treaties. It recognizes the recovery of looted assets as a "fundamental principle."
- International transparency initiatives: recognizing the special challenges posed by concentrated natural rents, the Extractive Industries Transparency Initiative for hydrocarbons and other minerals, and the Kimberley Process Certification Scheme for raw diamonds, build on broad international support for transparency.

The success of these international initiatives is not easy to monitor. Assessments suggest that a promising start has been made, but there is a very long way to go before global good governance becomes really effective, and this will require sustained support. The Kimberley process has been relatively successful. Almost all producer countries participate, as do all major rough-diamond importing countries. But recovering looted assets is still difficult, with low rates of asset recovery. Of the estimated $12 billion to $20 billion looted by Presidents Mobutu, Abacha, and Marcos, only some $1.5 billion has been recovered. Offenders frequently have to be charged with tax evasion rather than corruption. Some programs still have noticeable loopholes, such as the exclusion of transactions related to the financing of political parties. Still, it is worthwhile recalling that only a few years ago foreign bribes were considered a legitimate business expense by many OECD counties.

IFIs and donors can assist these checks and balances processes by providing technical assistance and funding to support countries' participation, and by encouraging the participation of middle-income countries, which loom larger in commercial dealings with poor countries. More generally, donors can strengthen their own anti-corruption controls (including through the debarment and cross-debarment of suppliers engaging in bribery and corruption), increase transparency, and provide aid in ways that encourage good governance rather than fragment and deplete already weak country systems. Implementation of the Paris Declaration is needed both to improve the quality of aid and to contribute to good global governance. Developing countries have begun to implement mutual programs to support good governance, in particular the NEPAD African Peer Review Mechanism: donors can also help to support such programs.

The stakes are high. While worldwide corruption is difficult to quantify, one estimate puts the proceeds at $1 trillion annually. For a single case, the Iraq Oil-For-Food Program, the Volcker report documents kickbacks of $1.5 billion by 2,235 suppliers. How this is settled will provide a strong signal on the seriousness with which the OECD countries support the fight against corruption.

Scaling Up: Moving the Agenda Forward

Scaling up is about much more than aid: it is, at heart, a question of making mutual accountability work. Donor governments, IFIs, and partner governments must all work together to reinforce their accountability to deliver on commitments for enhanced aid, to reform trade, to harmonize and align support with strategies, and to implement sound national development strategies.

Governance is a critical part of this agenda. Donors, IFIs, and developing countries are broadly accountable for strengthening the checks and balances that are fundamental for development and its financing, through both global and national systems. For developing countries, well functioning and transparent budget, administrative, and procurement systems; a political process responsive to the country's citizenry; and strong checks and balance systems are key to a well functioning governance system—and provide a straightforward basis for support.

Given this set of challenges, how might the international community scale up flexible ODA to help meet the MDGs? For the one-third or so of IDA-recipient countries that score well on most governance measures, the task is easier. They have in place budget management and administrative systems that are reasonably capable of targeting spending to developmental priorities, and executing and monitoring expenditures. From a *governance* perspective scaling-up can proceed with fewer constraints.

In the remaining countries, scaling up may require some alternative approaches. First, even where current systems fall short, aid might be scaled up based on a clearly improving trend in the quality of budget and administrative management systems. In such settings, aid can be seen as an investment in strengthening country systems. For countries determined to improve their administrative budget systems, achieving a "good enough" standard within 5 to 10 years may be feasible.

A further objective could be to focus on reforms that foster transparency—in budget management and more broadly. Transparency relies on public information as a source of pressure for better public sector performance—in a less technocratic way than is implied by top-down reforms of bureaucratic capability. Even with continuing weakness in administrative systems, a case could be made for scaling up aid to countries that clearly commit themselves to facilitating transparency in how public resources—and state power more broadly—are used.

The third approach is to target scaled-up aid more directly toward poverty-reducing services. In countries where bureaucratic capability may be on the upturn but is at an early stage of improvement, sector-specific approaches that focus on improving governance and service provision in parts of the overall system are attractive. In countries where there is little sign of political commitment to improve governance and capacity, opportunities at the local level will need to be identified.