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Governance and Poverty Reduction:

Paths of Connection

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Good governance is crucial to address poverty reduction and strengthening the link demands a balance between state efficiency and accountability. Economic growth, aid efficiency and linking governance with human development will contribute significantly to poverty reduction. This will involve taking account of formal institutions and their underlying power relationships. External actors who promote governance as a means to reduce poverty should be aware of how their actions can affect the political capacities of the poor. They also need to employ a case by case analysis to avoid a normative and formalistic approach.

"Good governance" appears to be the missing link in the road to development and poverty eradication. Furthermore, promoting good governance is part of the deal developing countries have undertaken in the framework of the "global partnership for development" enshrined in the Millennium Declaration and ratified at the Monterey Financing for Development Summit.[2] Currently, the relationship between governance and poverty reduction is practically taken as given. It is so deeply rooted in the discourse of multilateral institutions, bilateral donors and even non-governmental organisations (NGOs) that we need to scrutinise it carefully in order to identify its rationale, coherence and the evidence supporting it. This task is of great importance, since the way that link is understood is shaping the overseas development assistance (ODA) agenda, including its justification, tools, actors and methodologies.

This article aims to examine critically three ways of making the connection between governance and poverty reduction. First, by way of economic growth; second, through aid efficiency; third, through the link between governance and human development. Each of the three has different underpinning ideas of what governance is, what the role of the state should be, what is most relevant to lifting people out of poverty and what the external supports for that might be.

The emergence of the governance agenda

The statement that governance and institutions matter for development could hardly be challenged today. But that was unclear not so long ago. It is well known that the strategy promoted by the international financial institutions (IFI) during the 1980s and part of the 1990s was based on the central tenet that free markets are the main and foremost tool for growth, development and welfare. Those beliefs were summarised in the so-called Washington Consensus. The idea of getting prices right was at the centre of that strategy. For that to happen, markets need to suffer no distortion that hinders their free operation. State institutions and policies were seen to be part of the problem and the root of all evil, impairing the expansion and proper functioning of markets and therefore policies were adopted to minimise state input.

Within a short time, however, governance has risen to the top of the development agenda. How can this change be explained and what are the factors which prompted it? Two elements help explain the shift: practical and theoretical. In reality, both are intrinsically connected, but for analytical purposes it is useful to separate them. In terms of practical reasons, it is obvious that policies inspired by this consensus did not work and failed to spur growth and poverty reduction in the way they were intended.[3] Rodrik (1999) points out three specific situations that made policymakers rethink the role of governance and institutions:

(i) the failure of privatisation and price reforms in Russia in the absence of a political, legal and regulatory framework;

(ii) the disappointment with the results produced by market reforms in Latin America; and,

(iii) the Asian financial crisis, that shows how liberalisation before regulation leads to disaster.

Not only did the policies of the consensus fail to bring sustainable economic growth, but in many places they had severe social consequences as a result of neglecting and weakening the institutions that acted as a safety net during the adjustment programmes. Little by little it became clear that the lack of consideration for institutional arrangements was one of the most prominent flaws in economic and development policy design. Mainstream economists took for granted the existence of those institutional requirements without which no market can work. The collision of neoliberal economics with developing countries shed light on, for instance, the relevance of a legal framework that protects property rights and on the need for a judicial system that enforces contracts.

It is now widely recognised that the absence of reflection on institutions and, more specifically, the weakening of the state, was a mistake (Fukuyama, 2004). But there is no agreement when assessing the scope of that mistake. For some, there was a failure in the *implementation* of the "consensus", but nothing wrong *per se* in its content. Fukuyama argues that the problem lies in the confusion of two dimensions of statehood: scope and strength. Whereas consensus policies were intended to reduce the role of the state, they ended up eroding its strength. More adequate measures would have been to limit the scope of the state whilst simultaneously strengthening it. There is no need for a minimum state; development requires an effective state. For others, the problems of the consensus were not only of implementation, but of content too. According to this opinion, state regulation is needed where the market on its own is not able to promote development. Stiglitz (2002) is one of those who think that markets which function well require more than keeping inflation under control. Tax policies, transparency, policies for competitiveness and so on were beyond the scope of the consensus but are nonetheless extremely important for development. Finally, there is another set of critiques that more profoundly challenge the idea of development underlying the consensus, namely, the identification of development with efficiency and economic growth, raising questions about the goals of this consensus; we will get back to this topic later.

At the theoretical level, the influence of neo-institutional economics, and especially the work of Douglass North has been particularly important. This school explains the historical process of market extension as one of institutional improvement. Institutions matter because their level of development determines the costs of exchange. The more developed the institution, the lower the transaction costs and the uncertainty. The idea of a regulatory state, acting as an arbitrator of the rules of the market stems from this perspective. However, nothing about political regimes can be derived from this theory[4] as we are in the area of bureaucratic and administrative effectiveness.

Another theoretical contribution that has helped raise the question of institutions and political arrangements is the human development paradigm, nurtured by the work of Amartya Sen, who argues that "individuals live and operate in a world of institutions. Our opportunities and prospects depend crucially on which institutions exist and how they function. Not only do institutions contribute to our freedoms, their roles can be sensibly evaluated in the light of their contributions to our freedom. To see development as freedom provides a perspective in which institutional assessment can systematically occur."[5] Sen contends that democratic rights and participation are part of the very definition of development. Therefore, the mission of the state is not simply to provide a hot-bed for the market, as state institutions are responsible for the fulfilment of citizens' rights and for providing basic services. While neo-institutionalism stresses the "effective state", the human development approach underscores the "accountable state" which is subject to citizens' demands, some of which are articulated as rights.

In short, after two decades of neglect, the state is once again receiving attention as an important actor in development. Nevertheless, this return to the scene does not mean that it again occupies centre-stage. This is by no means the resurrection of the developmental state of the 1950s and '60s. The state has to share its prominence with two other key actors: market and civil society. It is precisely in this context of rethinking the role of the state that the term governance enters the debate. It had been employed in different areas of social and political sciences, especially in a Western context, to refer to the various dimensions of state crisis: the crisis of the welfare state; the blurring of limits between public and private; the incapacity of the state in the face of emerging global and local powers, etc. (Graña, 2005). Hence, governance is used to mean horizontal and participatory modalities in management, as opposed to the centralised and interventionist state. According to this vision, several actors (private sector, experts, civil society) take part in decision-making, along with public officials, to tackle a range of problems of growing complexity and interconnectedness.

It is probably this mixed array of theoretical and practical sources that makes the term governance so difficult to grasp.[6] In spite of some good definitions and research highlighting its relevance for development,[7] we cannot avoid the strong impression of being dealt another buzzword in development jargon with different actors investing the term with different meanings. As Cornwall and Brock (2005) have pointed out, particular combinations of buzzwords appear linked together in development policies. As a result of this phenomenon, the meaning of the terms relies heavily on the words accompanying it, the connection amongst them and on who is voicing them. The case of governance is a clear example. Configuring governance along with participation, democracy and rights evokes a completely different set of meanings compared to talking about governance and property rights, or governance and corruption. Similarly, governance sounds different – and legitimises different practices – in the reports of the World Bank, the UNDP, bilateral donors or NGOs.

Therefore, when governance and poverty reduction come together it is necessary to examine the other words and ideas forming the link between them. How are the connections between both terms made? The following sections give an account of three ways of connecting governance and poverty reduction: 1. economic growth; 2. effectiveness of aid; and 3. human development. A number of other ways could be found such as concern over security and failed states which would certainly be relevant, but due to constraints this article focuses on poverty reduction specifically.

1. Governance and economic growth

Over the last few years, empirical research intended to show the correlation between quality of governance and economic performance in terms of growth has proliferated. "Good governance spurs economic growth that consequently reduces poverty", could be a simple formulation of the idea. These studies have demonstrated that the higher a country ranks in governance indicators, the higher is its growth ratio or per capita income. However, showing this correlation says nothing about its direction of causality. It can be argued that governance is the factor explaining this economic performance, or that a better economic record produces better institutions. One could even find a third factor conspiring in favour of a positive relationship between them.

World Bank Institute researchers, especially Kaufmann and Kraay, have devoted much energy to understanding the causal relationship between governance and economic growth. In their last revision of governance indicators (Kaufmann, Kraay and Mastruzzi, 2005) – for more that 209 countries and based on 352 variables with 32 sources – they maintain the existence of a clear development dividend of good governance. They have devised a figure for that dividend: a positive deviation of one point in a given governance indicator produces an increase in per capita income in the long run.

World Bank researchers are not the only ones sustaining the thesis of a positive causal relationship. Although it is not within the scope of this article to develop their ideas, among the most relevant studies are those by knowledgeable economists such as Rodrik (1999) and Acemoglu et al. (2004).[8]

Some other prominent researchers have challenged the approach of "governance first" to development, pointing out there is an actual relationship, but its causal arrow runs the other way around. That is, it is good economic performance which leads to better governance. Chang is probably one of the best known proponents of this and through an historical analysis he tries to dismantle the hegemonic discourse of institutional development.[9] His conclusions are important, not only theoretically but for their policy implications. Chang argues that: (i) today's developed countries were less institutionally advanced when they were at the same stage as today's developing countries; (ii) in spite of this, developed countries have grown faster during the last two decades than developing countries – a period where institutions in these countries have improved substantially; hence, (iii) it took a long time for developed countries to set up a proper set of institutions. Requiring developing countries to create western style institutions in a very short time is thus unrealistic.

Sachs also opposes the idea of governance preceding economic growth. That is implicit when he argues that comparing the performance in governance of African countries with other regions or countries is unfair unless a discount is applied to compensate for low African income (Sachs, 2004, p.120). Once this is taken into account, the quality of governance in Africa and other developing countries tends to be similar.

As well as refuting the direction of causality in the relationship between governance and economic growth, it is worth considering at least another two critiques of this theoretical approach.

First, such a theoretical position takes for granted the automatic translation of economic growth into poverty reduction. In a well known piece of research, *Growth is Good for the Poor,* Dollar and Kraay (2000) gather evidence on the benefit economic growth brings for the poor. Based on a sample of 80 countries over four decades, the study shows how the income of the poor increases at the same pace as general growth: one point for one point. In the official discourse it is generally accepted that growth is good for the poor. In fact, growth is currently regarded as the most effective way of pulling people out of poverty and use of the expression "pro-poor growth" is now widespread, although its meaning is disputed. For some, "pro-poorness" will be a feature of growth, provided the poor benefit from it (Dollar and Kraay, 2000). Others point out that growth will be pro-poor only if it benefits poor more than non-poor people. Nonetheless, other researchers (see Dagdeviren, Hoeven and Weeks, 2002) reject the notion that in its own right growth is good for the poor. According to their data, poverty reduction is better explained when growth comes with progressive changes in income distribution. In the absence of equitable distribution, growth will be more effective in reducing poverty where initial inequality is lower. Therefore, a regressive change in distribution of income can offset the positive effects of growth in poverty reduction and reduce the impact of future growth on poverty. Growth alone does not suffice and following the thread of redistribution must lead us to considerations on tax policies: Who makes those policies, whose interests are protected, and so on.

The second additional critique is the underlying idea of poverty that fits into the rationale of this section: income poverty. Whereas nobody will challenge the relevance of income as one of the components of poverty, it has to be put into perspective in relation to the increasing awareness of the multidimensionality of poverty. Income, Sen argues, plays a fundamental role in the access by individuals to different opportunities and capabilities. But the relationship between income and freedoms and achievements is not constant nor automatic. Several other factors contribute to systematically alter the conversion of increased income into pro-poor change (Sen, 1999b, p.139). Institutions, of course, are among those factors.

There are a number of important policy implications of this approach to governance and poverty reduction. On the one hand, governance interventions will be focused mainly on economic institutions. There will be an attempt to emulate institutions that have worked well in western countries, in the hope that they will spur economic growth. One of the features of these institutions is their independence from politicians. Accordingly, there is a clear risk of a one-size-fits-all approach to institutional development, regardless of the historical, cultural and political background of the country. Aid will be dedicated to improve government financial management through technical assistance. The government will be incentivised through the mechanism of conditionality. This is a market oriented and technocratic governance model, inspired by the idea of reduced but effective market-friendly state institutions.

2. Governance and aid effectiveness

The late 1990s witnessed strong criticism of the usefulness and efficacy of ODA as after four decades of aid, slim results had been achieved between aid on the one hand and growth and poverty reduction on the other. Concerns around aid fatigue prompted a reaction in the form of research addressed to assess aid effectiveness and under which conditions it could be increased (World Bank, 1998). The approach of these studies has sought to show, on the one hand, the connection between aid and economic growth and, on the other, how that link becomes more robust when recipient countries enjoy an adequate level of institutional quality. Currently this debate is on the rise, since ODA flows are expected to scale up in the coming years as result of MDG commitment.

To a great extent, the analysis applied to the second section could be considered as a variant of the previous one, for both share the common link of economic growth. In essence, foreign aid is regarded as any other foreign investment. Hence, the factors taken into account when investing resources (risks, returns, etc.) will have weight in the decisions about aid allocation. According to the *World Development Report 2005* dedicated to Investment Climate, governance quality is among the most relevant factors contributing to an improved investment climate in a country (World Bank, 2005).

The literature on aid and economic growth has reached three different conclusions. For some researchers, aid always generates economic growth, regardless of recipient countries' features, yet conversely, others do not find any positive impact of aid on growth, pointing out that aid could even be harmful. Finally, a third position maintains that the effect of aid on growth depends heavily on recipient countries' characteristics, especially those with reference to governance and today this is the most popular among multilateral and bilateral donors.

Burnside and Dollar (2000) carried out the most influential research supporting the third conclusion. As suggested, the main contention is that aid is effective, but in a conditional way as it depends on domestic variables. Further research has tried to find the relationship between aid effectiveness and political stability or aid effectiveness and democracy. The major finding of Burnside and Dollar is that political instability hampers aid effectiveness. Instability (measured against regime changes and coups d'état) also has a direct impact on growth, but this effect is not as strong as aid effectiveness. As far as democracy is concerned, Svensson (1999) argues that democratic institutions implement checks and controls on the government, making it harder for them to waste foreign aid. Measuring democracy with the indicators of *Freedom House* (civil and political rights), he concludes that democracy makes it easier for aid to have a positive impact on growth. However, he does not find such a sound direct connection between democracy and growth.

Alongside the macroeconomic approach outlined so far, a microeconomic approach can help to highlight the importance of institutional quality as a factor contributing decisively to the success of development projects (Dollar and Levin, 2005). These researchers find there is a positive relationship and refer, for example, to projects in China which have worked well regardless of the sector, while most projects failed in Sub-Saharan Africa on grounds of poor governance.

Finally, several researchers point to the issue of absorptive capacity of aid in recipient countries as another important factor in governance. This is especially important when it is foreseeable that ODA levels will soon increase so much. There is no doubt that the absorptive capacity of aid has to do with governance and institutional capacity. This analysis has tabled the idea of an aid "saturation point". That is, at some point between 15% and 40% of GDP, aid returns become negative (de Renzio, 2005). At this threshold aid dependence erodes governance quality, as a recipient government is held accountable more by foreign agencies than by its own citizens. At the same time, aid dependence encourages corruption and can unleash the fight for control of resources. It can also produce "brain-draining" from state institutions to the "aid industry". Knack (2000) observes that whereas the impact of aid on growth depends on the institutional gap, the latter widens in line with rising aid levels.

However, a subsequent study by Ear (2002) reaches the opposite conclusion: governance improved where more aid as a percentage of GDP had flowed. As in the first section, the arrow of causality is also challenged here.

In terms of policy implications, the reflections on aid effectiveness and governance have given rise to the selectivity approach to aid allocations. According to this, only poor and well-governed countries are suitable for receiving aid.[10] Of course, there are various levels of selectivity. Performance on governance is not only used to determine if a country is included or excluded from aid, it also can shape the instruments, tools, agents, duration and other modalities of aid. Nevertheless, this also gives rise to some questions. First, if as Ear's research shows, aid helps improve governance, excluding poorly governed countries does not seem to be the best way of proceeding. Second, it is no easy task to design criteria and apply them with consistency across different countries. Kaufmann and Kraay (2002), referring to the US Government Millennium Challenge Account, have warned about the risk of using indicators that suffer from a significant margin of error. Third, selectivity leaves unanswered the question about poor countries with bad governance. In these cases, donors tend to bypass governments, providing assistance to populations through NGOs or promoting an independent service authority[11] that in turn might happen to further erode the institutional capacity. Therefore, this can only be a temporary solution.

3. Governance and human development

The area of human development presents a completely different range of meanings about governance and poverty reduction. Through this section, governance will be accompanied by words such as democracy, rights and participation. In fact, governance is usually characterised as democratic. A good point of departure in our reflection is to recall the three dimensions that, according to Sen, democratic institutions and political rights have in relationship to human development. First, there is an *intrinsic value* of democratic governance for human development, because of the intrinsic value social and political participation have for human wellbeing. People not allowed to participate suffer from poverty. Second, there is an *instrumental value* in democratic governance. It allows citizens to voice their demands before decision-makers, so that the latter can provide a consistent response to the former's needs. Third, democratic governance also presents a *constructive value* by which citizens engage in an open debate about the definition of social needs and priorities. Democratic governance not only favours a response to social needs, but is indispensable to conceptualising and defining them.

In this article there is no scope to develop further intrinsic or constructive values but this paper will focus on the instrumental value of democratic governance, since it represents another popular way of linking governance and poverty reduction. The main thesis can be formulated in either a positive or a negative way. The positive way argues that democratic governance makes institutions responsive to poor people's needs. The negative formulation states that lack of democratic governance hurts the poor especially. More sophisticated statements with this underlying idea can easily be found in multilateral and bilateral donors' documents and reports. This article indicates in more detail how damaging poor governance is and how democratic governance is healthy for poor people.

Addressing the topic of failures in accountability, Goetz and Jenkins (2005) point out four ways that poor governance exacerbates the deprivations of the excluded. First, it weakens their ability to benefit from markets and achieve sustainable livelihoods. Second, it aggravates the institutional obstacles that hamper full access to services such as health and education that enhance their capabilities. Third, poor governance obstructs access to adequate accommodation. Finally, it threatens the physical safety of poor people as they are easy prey for both criminals and the police and never receive redress since access to justice is also often denied. Moreover, when poor people come up against the wall of institutions, it reinforces their sense of inferiority and limits their ability for collective organisation.

There are, at least, three commonly used arguments to show how democratic governance can help reverse these trends. Firstly, it allows poor people to express their needs and organise themselves politically to defend their interests. In other words, it gives them a voice. Secondly, and related to this, one of the main features of democratic governance is that those in power can be held accountable. Accountability mechanisms allow people to withdraw their support for politicians who do not meet the demands of the people. Given that poor people are usually the majority of the population in developing countries, they are in the position to take full advantage of democracy. Their demands, needs and priorities will inform policymaking, ensuring policies are more "pro-poor". For their interests, as UNDP (1997) puts it the voices of the poor must be heard in the corridors of power.

Despite these general principles, democratic governance does not have an automatic effect on poverty reduction. The mere existence of democratic institutions does not improve the lives of the poor (UNDP, 2002). This is a voluntaristic approach that does not take into account the phenomenon of *institutional capture* and *internalised bias* in institutions. The former describes the process by which powerful groups take control of institutions in order to benefit from their policies. They develop undue influence on such institutions – not always unlawful – so that instead of serving the general interest, they are placed at the service of a particular minority group, be they domestic elites or international corporations with excessive influence on the orientation of laws, policies and regulations. If institutional capture is not easy to deal with, *internalised bias* is an even more deeply rooted factor, since it is not seen as pathological but is normalised. For example, there is a bias when basic services provided by state institutions do not reach the rural poor and instead focus on urban middle classes. There is also gender bias when justice systems do not value women's testimony equally with men's and there is an ethnic bias when indigenous languages are not permitted for communication between citizens and the administration.

These questions lead to what is probably the core issue of governance problems: power distribution in societies. The social distribution of power is reflected in formal institutions. Voice and accountability mechanisms and institutions cannot shift the balance of power on their own. An exclusive focus on those mechanisms might lead us to forget about the unequal and asymmetric power relationships within a society. That underlying reality may well erode all the efforts devoted to improve democratic institutions.

There are similar considerations with the third argument which makes the case for political decentralisation on the grounds that proximity to citizens favours participation, accountability and more adequate service provision through better detection of needs. Decentralisation appears to be immediately pro-poor. Nevertheless, several case studies underscore the idea that decentralisation sometimes enhances the power of local elites which manage to capture local institutions.[12] The pro-poorness of local institutions, it is argued, will increase where there are pro-poor political groups at national level offering external support to local groups who face those elites.

Although at policy level, the human development approach to governance tends to focus on formal institutions such as parliamentary and electoral programmes, access to justice initiatives and the capacity building of local authorities, it has helped raise the question of political power as a core issue of governance. In fact, it has opened the space for such concepts as citizenship, rights and empowerment. Through them, the governance agenda is moving from a technocratic towards a political approach to development and poverty reduction. But such a transition is not without its opponents and critics. The controversy over the meaning of concepts and the scope they adopt also impacts on participation, rights and empowerment.[13] Ultimately, an often neglected dimension of poverty is its origin (Oyen, 2005) and the groups and political processes involved in its creation have much to do with the "rules of the game".

Moving forward: governance and political actors

The previous sections have pointed out how the discourse and strategies with regard to governance and poverty reduction have points of convergence and divergence. Some stress the need for both effective and accountable state institutions, others emphasise economic growth as a starting point. Underlying each, there is a different perspective on the role of the state, markets and civil society, resting on diverse understandings of development.

Whilst in the first perspective there is little direct conceptualisation of the impact of governance on the poor, the latter perspectives both deal with the state institutions' effectiveness and accountability and are of great relevance for the poor. For some authors (Centre for the Future State, 2005), the critical point is how to strike a balance between efficiency and accountability. Historically, they argue, this balance has been achieved through a process of interaction and negotiation in society. Negotiation between state power holders and other organised groups.

At the heart of this reflection there is the view that building an efficient and accountable state takes more than transferring technocratically formal institutions, be they financial or political. Institutional designs alone cannot produce pro-poor policies but institutional arrangements are, of course, relevant. The existence or absence of a legal rights framework matters. The electoral system matters. The party system matters. The very existence of a legitimate state acts as a precondition for the political organisation of the poor, otherwise from whom do you demand your rights? But saying that is far from accepting that there is a pre-existing (western) institutional design that works everywhere. Interventions on governance for poverty reduction should be based on a very good knowledge of the cases, and not on previous normative recipes. Basically, institutional reform has to do with the political actors who use institutions and take advantage of them.

Therefore, any strategy on governance and poverty reduction should address two key issues. First, under which conditions of incentives, interests and institutional arrangements will those in control of state power engage in such processes with other social groups, especially the poor? Second, how could the political capacities of the poor be enhanced to enable them take advantage of the opportunities for participation that democratic governance offers?

Notwithstanding the enormous complexity of each question, and accepting that every situation is unique for historical, cultural and political reasons, there are some general points to take into account when working in governance and poverty reduction.

Firstly, what prevents powerful social groups from engaging with excluded groups? We have said that democratic institutions do not on their own always push through pro-poor reforms. One reason for this is the existence (or absence) of certain global governance regimes that permit elites to find external support (Moore, 2002). The following reflect some examples of that support. They can easily transfer their savings abroad, wealth which may have been generated from exploitation of the poor. They can trade domestic natural resources and can be bribed by transnational corporations, evading the obligation to report such payments to public officials. They may benefit from policies imposed by IFIs or international trade bodies or can blame those bodies for the policies they adopt. Certain modalities of aid can even contribute to this problem. The point here is that, unlike the usual discourse on governance and poverty reduction – which locates the problems exclusively at the domestic levels – one needs to be aware of the global connections of governance shortcomings, and its relationship to global governance issues.

The second point is how the political capacities of the poor need to grow stronger. They have to compete and negotiate with wealthy and elite groups so they need to be well equipped for this purpose. Political capacities of the poor refer to institutional and organisational resources, including collective ideas, available for effective political action (Whitehead and Gray-Molina, in Moore and Houtzager, 2003). By way of political action they are able to put poverty issues onto the country's agenda. A very relevant dimension of poverty is the lack of resources for getting involved in politics, such as time, money, education, ideas, connections, etc. The two are, according to the aforementioned authors, the most crucial political capacities for the poor. An autonomous organisation, with the ability to table its own political initiatives – meaning that it is ideologically independent from definitions and proposals made by others – needs coalition building capacity with other groups in order to promote pro-poor policies.[14]

What are the policy implications arising from these questions?

The emergence of efficient and accountable states is to a great extent an endogenous process. Therefore, it is first of all very important to be aware of the limitations of external interventions (Unsworth, 2005), be they in the form of institutional transferring or incentivising institutional reform through aid.

Having said that, we cannot forget that "bad" or "poor" governance has causes as well as consequences. A careful analysis is required to find out which connections can be made between poor domestic governance and poor global governance. All the incentives established through aid towards good governance might be offset by the existence of access to rents by the elites permitted by shortcomings in global governance arrangements.

Another consequence of the endogenous nature of those processes is the fact of institutional pluralism as opposed to a one-size-fits-all approach to institutional design. Institutions emerge, take shape and are reformed as a result of political and social processes of bargaining and competition among social groups.

The way aid is delivered (instruments, actors, etc.) may well have an impact on governance. There is a need for specific assessments of how governance might be affected by different aid amounts and instruments. Aid can be given in ways that enhance the capacity of poor people to organise and identify common interests. Whilst NGOs do much good work in strengthening the political capacities of the poor, too often well-meaning interventions hinder the emergence of collective political actors.[15] The identification of relevant processes and actors for change and the brokering of coalitions among supporters of pro-poor reforms should be an important item when considering an intervention on governance.

Conclusion

This article has analysed how governance has become a central issue when addressing poverty reduction, through the most popular connections that link both governance and poverty. The first two connections – spurring economic growth and improving aid efficiency – to a great extent share the idea of governance as something related mainly to state efficiency. The third, governance and human development, stresses the need for state accountability to poor people, and paves the way for a more political understanding of governance and poverty issues.

This article argues that moving forward an agenda that strengthens the link between governance and poverty reduction requires a balance between state efficiency and accountability. Such a balance is achieved through interaction among different social groups. This means the focus should be not only on formal institutions but take into account underlying power relationships, since democratic institutions by themselves do not necessarily achieve benefits for the poor. Institutional design certainly matters, but what is needed is fresh attention to who uses these institutions and how, i.e. political actors.

As a result, external actors, especially those promoting aid focused on improving poverty reduction through governance interventions, should take into account how these interventions affect the political capacities of the poor, state capacity and the incentives of powerful groups to engage in negotiation processes with poor people's groups. This requires a contextualised and case-by-case analysis to avoid normative and formalistic approaches to the issue.

Footnotes

1 The author expresses his gratitude to Ben Ramsden who revised and corrected the text.

2 See paragraphs 4 and 11 of the final document, A/CONF.198/11.

3 See SAPRIN (2002)

4 For instance, the *World Development Report 1997* addresses the issue of the state and development. No position is taken about the desirability of democracy, since no clear link is found between democracy and development outcomes. Only four years later, the *World Development Report 2000/01* declares that democracy is intrinsically valuable for human wellbeing, and a good in its own right.

5 Sen (1999b), p.142

6 A careful look at all the development issues clustered under the heading of governance reveals a number of reform proposals in a tremendously heterogeneous range of areas. Indeed, the governance agenda has been constantly growing, becoming amorphous and without clear limits. Judiciary reforms, citizen participation, anti-corruption measures, empowerment, bureaucratic effectiveness, private property protection legislation, accountability, dialogue with private sector, citizens' rights…everything is governance.

7 Recommended is Hyden et. al. (2004), *Making Sense of Governance*. Its definition of governance is "the formation and stewardship of the rules that regulate the public realm. The space where state as well as economic and societal actors interact to make decisions" (p.16).

8 See Rigobon and Rodrik (2004) and Acemoglu, Johnson and Robinson (2004). Instead of using aggregate indicators for governance, other research disaggregates them, and looks for the positive relationship between economic growth and a particular indicator. This is the case with Evans and Rauch (1999) and Keefer (2004).

9 See Chang (2002).

10 The US Government's Millennium Challenge Account applies the selectivity approach based, among others, on governance indicators; see Radelet (2005). IDA's Country Policy and Institutional Assessment, while not exactly adopting selectivity (it is a performance-based allocation system), takes governance as the more prominent factor to explain aid allocations.

11 This is the case with the World Bank for countries classified as LICUS: Low Income Countries Under Stress.

12 For example, Osmani (2000) and Crook and Sverrisson in Moore and Houtzager (2003)

13 The case of PRSP (Poverty Reduction Strategy Papers) illustrates this point. While in some countries the PRSP process has helped raise the profile of poverty on the domestic political agenda, there are serious doubts about who shapes that poverty agenda. In some cases urban and international NGOs are reported to have acted as representatives of the interests of the poor but others show how the participatory process bypasses domestic political institutions (e.g. parliament), apparently contributing to their further weakening. See Stewart and Wang (2003), Booth (2003) and Alsop (2004).

14 It is interesting to see how this coalition building ability of the poor is sometimes conceptualised as "bridging social capital" (see Narayan, 1999). However, the social capital discourse has been criticised on the grounds of depoliticising development (Harris, 2001).

15 For instance, when NGOs replace the state's role in service provision, it may be difficult to use the category of "rights" to mobilise people. In fact, NGOs are not responsible for achieving rights and good service delivery by an NGO may even increase the credibility of a government.

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