



CENTER FOR GLOBAL DEVELOPMENT

Presents

***Governance Matters:
Debunking the Afro-pessimism Myth***

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Dennis de Tray: It is my great pleasure to welcome you all to this event. My name is Dennis de Tray. I am the Vice President at the Center for Global Development. For those of you that were initially concerned, I am not Steve Radelet. He has not gone prematurely gray and shaved of his signature beard. He is home today with laryngitis and as we agreed this morning, whispering about governance and corruption probably leaves the wrong impression when you are having this discussion. So, I agree that I would step in and take over for him which is a great, great pleasure.

It is a great pleasure to step in and moderate these events on several fronts. One, this is an issue that I am personally and deeply concerned about and have been for sometime and I think many of you may know that I have as they say my views on these issues.

Second, our speaker today Dani Kaufmann is an old and dear friend and someone with whom I worked for many years when I was at the Bank. And, it is pleasure to serve as the warm up act for him.

And third, we have an enormously talented panel to discuss the presentation that Dani is going to give whom I will introduce at the appropriate time.

The issue, I was thinking in terms of introductory remarks which I am going to keep very brief. So, we can go on with the main event. Maybe it is time Danny for a new title. I think we are beyond the stage where the title Governance Matters is an issue anymore. I think it is one of the great, great wins of the last five to ten years, the debate and the work that Dani himself has lead, the work to transparency international he has lead and others in putting on firmly on the development agenda, the issue of governance and corruption and transparency.

So, governance does matter. It matters enormously and we are going to learn today about what has happened to governance in the course of these surveys that Dani is going to report on. I think it is an interesting observation that it would probably have been true a decade ago. Dani can correct me if the date is wrong, but I think most analysts who are working on the survey would have questions whether or not governance could be measured in a way that was analytically useful.

Again, I think we are passed that. We have series of measures that have held up to technical scrutiny, that have held up to the passage of time, that have clearly been critical and informing the debate of our governance and development around the world. And, that have really shapes in many respects of the international conversation about development.

It is one thing of course to measure something and another thing to extract lessons from those measurements. And I want today is to make sure we get into both of these issues. What has happened on the measurement side and

what are the implications of what we have measured for development policy, for our approach to governance and corruptions, for our approach to development more generally.

So with those as brief introductory remarks, it is my enormous pleasure to welcome Dani Kaufmann to the table. I am not going to give him a long introduction because Dani is well known to all of you here. His work is seminal in this area. He has been a leading lights and bringing analytics and hard-nosed analysis along with his colleagues at the World Bank to the issue of governance. He is just sufficiently well known that I think that I would be spending time that I do not need to spend to tell you about his illustrious career. So, with that Dani, the stage is yours.

Welcome please, Dani Kaufmann.

Dani: Thanks Dennis and I was feeling quite lonely there. I thought I was going to be with all of you because I look very much forward to the discussion and what the eminent panelist have to say. In fact, first before I get going, I have a few clarifications. I am not a big expert on Africa. Our Vice President of the Africa region and ***** a lot and many others here. So, we will keep that in perspective and I am not going to pretend that we will have a very definitive recommendations and answers at the end but it is more to elicit discussion on the basis of the empirical evidence that we bring.

Second, on the title, I preempted you, Dennis and this governance matters in title itself but it was a very interesting recommendation you made because with my partner in crime, one of my partner in crime, not long ago we made a presentation at a seminar in London with a very eminent institutions involved and basically was addressing contentions and debating issues with what we labeled the Governor Skeptics. They are stay still very significant group out there which are Governors Skeptics. It is not that important and that is worth flashing out for the discussion. But I am glad that you made that comment because maybe we saved a few minutes or at least a few seconds of some of the slides.

And third, those who know me, I do not have a comparative advantage in being particularly diplomatic. I am very frank and I am a very proud member of the International Organization of the World Bank. I am also a very proud citizen of a developing country which has gone through many of these challenges and quite successfully now, that is Chile. So, allow me to also speak a little from that prospective and allow me to be frank. After all the data is mostly what does the speaking and that gets me to the last point before starting which is partnership. This does reflect totally joined work with my partner Aart Kraay who is going to be here very soon and also with key inputs of Massimo Mastruzzi who is sitting in the audience and there are some other members of my group and many others in the World bank who have helped. This is not the work of one person.

Without further adieu, I am getting to the frankness and to put the debate starkly, even if it is a bit of an instrument. I like to give the end of what the

main message is will be to frame the discussion. And the main messages, we will divide them between fallacies and what we would prefer to call realities. Fallacies or quasi myth and fallacy one is the notion that governance is intrinsically immeasurable and one can only, if measuring something one can only rely on so called, “objective data or official data.” We have been working for a very long time suggesting that that is not the case.

Second fallacy, to move away is the Afro-pessimism, particularly in Africa, there have not been any changes and improvements in governance by enlarge is very poor performance. We also take exceptions. We challenge the notion of having irrational exuberance just because there have been recent good news in the continent as well as other continents. If we focus too much on short terminism that can lead also to a false sense of exuberant optimism so, we will take more on the middle view.

And, we also want to move away and that is from the power of the data from generalizations about the whole African continent. We also address the issue where the governance is a luxury good with only a country can afford as its income growth. So, instead we will suggest, we will claim the governance can be measured, is measured very importantly. So, governance matters for developments which are current to use a settled issue.

Instead of focusing on average, we want to suggest the importance of understanding more deeply the great variety and controls across countries in the continent. For economies, it is a major bonus to have a lot of variance or variation. It allows learning particularly from the good performance but also from the failures and suggesting that there are some leaders, countries and institutions within countries that they are showing they are possible in governance. We want flash out certain important potential implications including the demand side of governance and all of the civil society, the media and so on and also suggest that it is important to always think about ourselves, international community, private sector also on how we can do better.

It is not only the homework for the public sector in developing countries. If we take a long view, let us start with the Afro-pessimist view. If we took the long view, of course it is very sovereign picture about Africa. No wonder that it is considered the largest challenge in development. This is in terms of GDP per capita since 1960 and roughly we see the thickest line is a flat line and that is Africa. Extremely flat and in fact they peaked around close to the mid 70s and it went down and only now an incipient of good news. This is even a 2007 figure they predicted which will be quite a bit higher than the previous year because Africa on average is doing better.

But, if we compare with low income countries in general, they have been growing more although not tremendously and of course here is a great success story of the East Asia and Pacific. So, this is just a sovereign view although very recently, some incipient good news. But, when we start unbundling this, a different reality begins to emerge. On average it has been disappointing, the growth of Africa, if look at the five fastest growing economies in Africa they

do stock up well with East Asia even as we see here in terms of the top performance. Particularly recently they have been doing well.

If we look at some areas of policy areas, we look at microeconomic management in particular. There has been a revolution in Africa, also in the rest of the world. But Africa has been no different in terms of here we see the declining inflation rates. But when we look at budget deficits, other measures of that, we see that they are serious good news. This is the past six or seven years in Africa. Average, all important country, all exporting country in general there has been a significant improvement.

And, if we look at the top performers, first, we see of course there is a special group, the blue group here which they are all rich countries which have particular reasons why they have been growing very, very fast with a couple of exceptions but the equatorial Guinea is found all very recently. So, it basically is off the chart. But then, 13% of the population of Africa, Asian countries with per capita growth rates over 3% over the past decade or so, which we see reflected here. This is a significant amount, almost like a quarter of per capita growth of 2-3%. So, there is a group comprising half of the population in the continent and over the past decade has been growing in a robust fashion. Then the others also included negative per capita growth rate.

But, it begins to suggest how important is to unbundle this averaging that is a constant instinct that we have when we analyze this as economies and presenting the diversity of the picture which is not just in Africa obviously. Well, it leads to a question. Okay, so we have some good news. Some good news in terms of policies, some good news or some good performance in terms of growth, what is the situation of governance which is a major focus of our remarks here. So, let us give a look at the issue of Africa's governance, the performance including its diversity and so on.

First, in terms of what do we do to measure governance. We start by defining it and I will go through this very fast. I apologize in advance. Many of you have already seen this material before. We define it as a traditional institution by which the authority the country exercise which includes three major clusters of governance, the political cluster, the economic cluster of governance, and the institution or institutional respect cluster of governance. Each one of these three in turn is then approximated for measurement by two indicators.

So, the first one the political which is a process by which government are selected, monitored and replaced, we approximated with the two indicators, voice and democratic accountability and second, political stability and the absence of violence and terrorism. The second, the more economic cluster is a capacity of the state to formulate and carry out good policies and deliver public services to the citizenry that is approximated by the indicators measuring the extent of government bureaucratic effectiveness and the quality of the regulatory framework. And the third, the institutional respect is approximated by rule of law and control of corruption. This begins to put also in perspective the issue of corruption that sometimes is misunderstood. It is

one within a much broader notion of governance, much more broadly defined in a much more narrow definition of corruption and that we feel it is very important because corruption is often a symptom of much more fundamental underlying weaknesses.

And, we construct them. This set of six governance indicators and these dimensions covering basically the world, 212 countries from 1996. The last release few months ago was up to the end of 2006. It is based on hundreds of indicators taken from 33 different sources. It is all transparently in the web including the disaggregated data. All the individual indicators go into that. We tried to be transparent also on the degree of imprecision of the data. We take the margins of errors very seriously. We are helped by very advanced model and observed component method that is used to aggregate the individual governance.

Why measure it? First, because we do agree that it matters enormously for development outcomes, for a defectiveness. We do not use it as a scorecard or as a horse race in large measure because of the margins of error but that is also not the main objective and purpose but as an entry point for serious and practical analysis. It empowers reformers, advocates for change and enables what we strongly believe in which is evidenced by this policy making.

And, I am now going to go through the all the 33 sources but just so that you trust us that we do have these sources. This is a list. It is all there in the web and it is also in the handout you have. The handout you have by the way has many more slides than what I am showing because I am skipping some so to get to the discussion at some point in the near future.

Now, we started looking at governance now and the basis of these indicators is in Africa. We see that on balance and on average, Africa is challenged in terms of governance doing significantly less well than obviously the tigers in Asia and some of the successful developing countries. On average, Africa is doing less well than that. It is a way more or less the former Soviet Union in many dimensions. So also, it is important to place that in perspective. Within Africa though, once we start unbundling which is extremely important, it is very stark.

The differences between different groups of countries and here we see the enormous difference between the oil rich countries, resource rich countries and that is an enormous challenge and we look forward to the panel to give us insight of why do they score solo in terms of governance and sharply contrasting. This is the oil rich. On the other extreme, the very strong growth performing countries which are doing much, much better in governance and then the rest of the countries which are not growing very fast, which are oil importers, which are somewhere in the middle. And this is for the six dimensions of governance. One sees a very similar picture in that context.

Again, if we start unbundling further, country by country basis, here we are depicting the almost 50 countries in Southern Africa for one dimension to show up and to be in control of corruption. And we see the whole government

between the very good performance of the Botswanas of this world. South Africa is doing relatively well and then all the way down to extremely challenge or governance crisis. On the other extreme are the Somalia and Zimbabwe and so on. We are very, very clear and it appears everywhere in our graphs, in the web and everywhere about the margins of error in each case which is a thin line atop the bar. This is our level. This are the margins of error which given this margins of error, it is extremely important to be cautious about the data and not to try to run the precise horse races that I beat my neighbor by a nose, it has no meaning, whatsoever.

Instead, basically clustering the countries for understanding where one stands into four or five meaningful categories that make statistical and rigorous sense but not the precise ranking and that is why we caution against that and that is why we have this color coded maps which is for the world that one can zoom. If this looks like a cut and paste from the web, it is. It is a cut and paste from the web, we zoom and this is Africa.

Again, the case to control corruption, we see the whole government between green light which is example for the world and rating better than some industrialized OECD country in the case of Botswana for instance, all the way to deep at right.

So the whole notion of generalizing for a continent is totally defined by this data. Government effectiveness and other one of the six dimensions, a similar picture emerges. In this case, South Africa rating excellently well and all the way down to the yellows, and to the reds, and to the dark reds. That is the level of governance. But as important, given history and so on, is to look at what has happened overtime. What do changes tell us? And there is this other conventional or popular notion which is the ***** address, the notion of lack of change.

To the contrary, we see very significant change for about a quarter or more of the sample in the world in general and in Africa in particular. Even more also, we see that over the period of eight or nine years, governance has significantly changed in the statistical sense for the country in at least one if not more dimensions. In many of those cases, in fact in the case of Africa and let us look and hear the voice in accountability, we see all the greens whether it is dark green or light green. It is a large improvement in terms of governance. This is an improvement versus particular ratios. The Sierra Leone, Ghana, Nigeria on voice of democratic accountability and Kenya since ***** left and so on. There have been clear gains and on the other extreme unfortunately there are obviously deteriorations like in the case of Zimbabwe and so on.

And then the other changes which have deteriorations or improvements but one cannot say with significant confidence that they are meaningful in the statistical sense and that is why they are yellow. The methodology and the data that we bring allow this distinction. What is meaningful versus what is just elevates their economics that may not be very meaningful.

But what we do take from this graph is that in a relatively short period of time, a number of African countries can demonstrate that they can significantly improve very quickly if instead we cut and paste the data from just one country every time for the six dimensions. Here we have the six dimensions in bar chart and we compare overtime, 1998 was at lower bar, 2006 the upper bar. You can choose any period but I chose 1998 to 2006. We see Ghana how it has improved very systematically across the board. Mozambique in many of their dimensions and the testament to the great work that of course the leader of Liberia is doing now but helped by people like Steve Radalet who has been working so hard that he fell sick for that but I was going to show anyway the rate of return to that type of investment.

Of course it is still very challenging but starting from a base of basically failed state. There it was zero, at the very bottom. Quite a dramatic improvement in a relatively short period of time, of course, sense of frankness and reality, with Mali also, the ambassador is sick again. It has been going in the right direction. I wonder whether this is a correlation between that type of effort and what is happening to the leaders and advisers working on that.

Then there are countries of course moving in the opposite direction unfortunately like Zimbabwe. That is what gets hidden in this averaging that we constantly make. This was just a very brief or quick overview on why measure governments, how do we do it and what is it showing in various simple terms about Africa. Then, I was going to address and do it very quickly since I already took care of it where it does not matter, what is the link between governments and development.

One instinct is always for many economists is to try to do a plot gram between GDP per capita and government. GDP per capita in the horizontal or x-axis versus rule of law in this case as one key dimension and government in the vertical axis. If we look at it like that, and we do plot gram and then we just label the African countries and not the 212, but only 49 African countries. We notice that 2/3 of the African countries are above the fitted line, that plotline.

So, it would be easy to conclude that for a particular level of income per capita, in terms of governance, this 2/3 of African countries are not doing too well. The problem with that argument is that it implicitly presumes that the whole action is going from high incomes to getting better governance, what the economist call it is a luxury good.

As the country gets richer, it can afford the luxury of better governance. We did that homework sometime ago with Art, so have done other academics particularly Cambridge, Massachusetts and others. The bottom line that it is found is that there are very little if any causal effect going from getting higher incomes, if the country gets a windfall of income today, that gets automatically converted to better governance.

Instead, we find that the real action is in the other direction. It is going from improving governance, improving rule of law, improving control of corruption to having a higher income. We find in fact the very large income dividend of

the 300% dividend, where one standard deviation improvement in governance raises income per capita in a country by about 300% in the long run.

That one standard deviation is not unrealistically high. It is going from level of Somalia today to either Togo or Guinea-Bissau, from Guinea-Bissau to Namibia, Rwanda, or from Namibia, Rwanda to the very good level of Botswana or Portugal or from Portugal to Netherlands or Sweden which are not at the very top, it is not where I think they are but quite close to it. That impact is from governance to incomes and not vice versa. Higher income alone does not automatically do that in the summary of four different studies that have looked into that issue of both sides of the causality direction.

In fact, for Africa, we have been trying to and this is insipid but it is worth doing more research, that not only in the context of this work which is a long run is a result, the 300% dividend is in the very long run that the country can go from \$5000.00 to \$15,000.00 per capita per year because it takes many generations to get to that result. But even in the short term, we are finding that it is real in those countries other than the oil rich countries. If we take those out of the sample, the seven countries that are all rich, those countries that have been improving since '98, and their governments which we saw before, they have been experiencing a much more robust growth rate than the other. It is worth looking further but it is also a very hopeful result that even in the short term on balance, it does pay and it does matter.

Now, going beyond the question of how much it matters. There is the question what to do about it and that is from the perspective of policy makers or the leaders. Ultimately, they will say this maybe interesting, we may criticize or be pleased about this type of work that was just shown but what do we do with it for policy? With your colleagues in Nigeria and so on and so forth. So, it is very important not to stay in cloud nine at that such aggregate level and begin coming down at a much more disaggregated level.

That can be done first not only but first, by using all the disaggregated data set which is provided together with the aggregate which are the inputs to the aggregate data that was just shown. This is one example, one such disaggregated data set comes from the collaboration with a wealth economic firm. It is survey of 10,000 enterprises around the world and one can begin then unbundling the different aggregate concepts to something that is more useful to a policy maker that needs to take action and decisions. What manifestations of bribery among important than others and we see here different countries. South Africa doing relatively well but on procurement having some challenges in Kenya particularly so, in procurement and judiciary. Judiciary is not the big challenge in Botswana at all but procurement is.

So, one begins in bundling irrelevant having just one average for corruption. The same can be done for many other dimensions of beginning to drill down in that context. But even is not enough to really have an empirical evidence-based input for policy on how to do the country's specific diagnostic type of home work.

There are many different models. One such model that we have been assisting with in many countries are these governance and anti-corruption diagnostics where the country takes elite and in a very participatory process, they organized and implement three different surveys, household firms and public officials with very experiential questions on very specific issues and the local institution. They implement, it is joined work between governments, civil society, private sector, and so on. It is a major input to an action program that in many cases they do in implementing some that has gone unimplemented.

In Africa example of such recent diagnostics cover Ghana, Zambia, Mozambique, Sierra Leone, Madagascar, Guinea. Nigeria, Malawi, Benin, and Burundi are hopefully coming up over the next year. One of the types of results that come out just to illustrate in one minute the type of results that come out from this type of diagnostic which are very specific, is the extent to which corruption is a regressive tax. It comes from the service of the citizens. I am not showing the slide to save some time but it is very similar to this.

What this shows is essentially the sort of enterprises. Basically, small-scale enterprises paid more as a proportion of their revenues than larger enterprises in terms of price. The same happens to citizens. This is just to give a sense of how specific this type of diagnostic can be. Even in a country like Guinea, 2004, where on average the rating of corruption control was not very good. The fact is that there are many institutions and that is true for every country who have done diagnostics. Enormous variance and diversities, central banks in many countries are bastions and islands of integrity and so on.

In here, we see the red flags falling in terms of institutions which are with significant challenges in many countries, traffic police and others. The greens are doing much better but also in many different dimensions not just in corruption, in transparency, in politicization, quality of rules, enforcement of the rules, audits and so on.

These are real actionable diagnostics in terms of the type of data that comes out. Let me start concluding then and because most importantly is to draw on the experts in the room and in the panel in terms of what to do about it. We are not going to try to put a bible on what are the answers to these. Much of these are still being learned and written.

I would like to suggest that we are in this field of governance, maybe we are in the field of microeconomics or trade policy about 15 or 20 years ago. In the whole empirical revolution and rigorous analysis, it is more recent and it is very complex. It is multidisciplinary. It is still evolving so we do not pretend to have the answer. We make many mistakes also and we are trying to learn from that. So, first obviously governance matters and so does measuring it matters, matters not only for research but it matters for policy but for activists and so on.

Learning from considerable country and institutional variation, a major message is frankly acknowledging that is enormous variance. I know that

sometimes from the spirit of collegiality, we do not do that. We make that mistake perhaps. We can see it in Latin America for a very long time. We bring ourselves down a little bit because we do not want to stand out in the crowd.

But, in our global competitive world nowadays, it is a reality. There is enormous variation and those that are performing strongly are making it, others are staying behind and in terms of how the data hits us is very important to acknowledge that and draw the implications. It is not just in Africa. In Latin America, we have the same map going all the way from green to red. This type of analysis also leads to the suggestion of a very candid assessment and realistic role of donors. What we can realistically achieved or we cannot. Ultimately, it is the domestic leadership that is absolutely crucial.

We can play a very important support role but only supportive role. There are also very important implications for the private sector multinationals. For lack of time, I did not show one slide that shows that multinationals are also engaged in this government. How multinationals when they go to a developing country, multinationals based in the same country in OECD behave differently going to developing countries than if they operate in another OECD country. Even though, they had the transnational revival convention. The probability of bribing is much higher when they go to other countries. I am sure all our panelists and Oby may have something to say. So here, there is much more collective responsibility and collective action issues than just pointing fingers and looking at public sectors in developing countries.

Private sector multinationals, our source in terms of donors, what we have done well and what we have not done well is extremely important. One of the lessons that we do learn from this data, this is a bit controversial and we put it for debate. Not everybody agrees with some of this is that the notion of corruption for instance, is extremely important but most often it is a symptom. One does not fight corruption by just fighting corruption and having superficial reforms by fleet. Superficial reforms by fleet could be just adopting another law in anti-corruption. The whole world has decent laws in anti-corruption. That is what is not making the difference. It is implementation and systemic reform or creating yet another anti-corruption or ethics commission in the country or adopting another international convention. Again, the issue of global responsibility comes in. That is very important.

There are lots of international conventions. Some have bite but most do not have it instead focusing more on incentives and they are our bias as economists come in. From an initiative standpoint, does this reform make sense or not? Why all this whole effort and I see that there are some experts here that I am sure would like to comment on that. There is a lot of effort of voluntary codes of conduct by the private sector. Some firms are just joining in into some of this voluntary codes of conduct. Some of which have absolutely no monitoring, not even peer review and there is absolutely no initiative not to join and no initiative basically to do something serious against corruption in and of itself.

So, the whole issue of incentives is very important so that is talking about the private sector. Another example in the previous sector which is by contrast is the effort not just the World Bank but now other multinational development bank of publicly delisting companies that have been engaged in corruption in IFI in Development Bank funded projects.

The firm obviously cares much more than being sanctioned for having been engaged in corruption and saying that for three years you cannot bid for a World Bank project. They care much more than that than if they publicly delisted. Once they are publicly delisted, basically nobody else of a certain reputation would want to work with them. So, it is an enormous incentive to change and alter behaviors. Deeper incentive driven reforms and I just gave two contrasting examples in the private sector to highlight that this is important also to focus on the private sector but there are many in the public sector are very important. That leads back to some basic type of reforms that I am sure we will discussed by the panelists in more detail. They know more than me and some other areas are totally outside of the World Bank, but it is part of the analysis, contestable politics.

So, there is more competition in the political arena but also in the economic arena, so competition in terms of less regulatory burden. The whole area of transparency is an enormously uncharted or unexploited field where some countries in Latin America, the Mexico of this world and my own country in Chile, there are some in Africa like South Africa and few others are engaging in very important transparency related reforms which are crucial in the next stage in creating millions and millions of auditors the citizenry essentially rather than relying on just reforming one audit function within the government, much more voice and free press. Judicial reform is another area which request major reform and this is not just in Africa. I just came from Latin America. It is a major issue there.

Let me finish just to illustrate this and to also challenge the panelists to give us more insight with these data, that comes from again the disaggregated data set that is available. This is freedom house, the extent of press freedom, 1995 and 2006, an 11 and 12 year difference. Basically, in southern Africa, it is a very similar picture. The red is for getting a rating for freedom house of not free at all, almost half of the countries. The yellow about 40 to 45% are the partly free and greens are rated as fully free between 9% to 15%.

Few countries in fact have improved, but overall, it is very, very simple. During that period, however, there has been a major move in Africa towards electoral democracies. In fact, freedom house itself has a rating for formal electoral democracies and basically, nowadays, it is half and half, 24 democracies and 24 non-democracies. It is just one different variable of the half where they call them democracies or non-democracies. Now, there is an overlap and that is nice news between democracies and free press but by no means just pushing for an electoral democracy assures that voice in a broader sense and freedom of the press in particular would take place and not at least in this time period. So, we see that the partly free of not free press number of countries significantly dominates the free press countries even among so-

called democracies. This is we think the same institution so it is not an issue of two different institutions having different views on the issue. But it begins to suggest that there is not going to be one recipe, just having elections will make this...

Obviously, it can be argued that it is necessary condition but we see here that it is far from sufficient and therefore, the answers are going to be much more difficult and complex and we will have to take it into account the diversity of the countries, the problem of oil rich countries which is an unresolved issue, fragile and frail states and so on which I will not delve any further because there are much larger experts here. Thank you very much.

Dennis de Tray: Thanks very much, Dani. May I ask the panelists to just step up and while they are doing that, I would like to tell you a story. Those of you who know me know that almost all my stories come from Indonesia. I was the World Bank's country director in Indonesia for five years, beginning in 1994 and one of the first speeches I gave in Indonesia was to a group of government people and economists, and I was talking on poverty and development and Indonesia's actually quite substantial successes in that. Somewhere during the conversation, one of the audience members got up and asked me a question about legal reform and have been known to answer in hyperbole occasionally and I did at this point.

I said if I could throw a switch or press a button and Indonesia could have a world class legal system, judicial system, courts, laws, etc., I would be prepared to recommend to the World Bank that they simply sign a check over for budget support for all the money that were currently lending Indonesia that I would put no constraints on it, if that were to pass.

It is a signal of how important I thought they could reform and governance was even in those early days. Someone from the audience got up after me and was very angry to this answer at and he said Mr. de Tray, all you are telling us to do is develop. I think there is a basic issue about the breadth of the conversation around governance that I hope we can get into at some point. Is this a conversation about governance or about development?

It is very close, if you look at the World Bank's governance papers, and you take the governance out, you will be talking about the development agenda. That is not necessarily bad and it may not matter but these are not new issues that are on the table today. Some of them are being put in new bottles, old wine in new bottles but they are issues that we have been struggling with for very long time. Let me now introduce our wonderful panel. I thank Dani for a very nice presentation first. It is my great pleasure to first introduce. It will be Obiageli Ezekwesili who is the vice president for Africa at the World Bank.

I was reading over Oby's background her CV and I must say, Oby, it is hard for me to imagine, anyone who could bring better credentials to this table that can you bring, quite extraordinary. She began her career as an auditor and management consultant. She is a founding member of Transparency International. She was the special assistant to the President of Nigeria on

budget monitoring. She was the minister of solid minerals development having to struggle with Nigeria's cursive resources issues in the mining sector, chairman of the Nigerian Extractive Industries and Transparency Initiative in 2004, a person that is literally have been embedded in these issues, I think from the very beginning of her career such an enormous pleasure to have Oby here.

Our second panelist today is Mort Halperin and in many respects Mort also is a person that has dedicated virtually his entire professional life to these sorts of issues, to the issues of governance of the rights of people. Mort has a long history of involvement in this government as adviser in other areas but the thing that struck me most about his background that he was the director of the Washington Office of the American Civil Liberties Union from 1966-1968, I believe or something like that.

But it is an indication of the commitment that these two people have brought to this issue for a lifetime. They had not discover governance and the importance of voice and the importance of transparency because the World Bank or somebody else discovered it. They discovered it because it was a part of their soul in their life. I am very happy to have Aart Kraay here. Art is a compatriot in crime with Dani in producing this report. He has been a long time collaborator with Dani on this work and I think shares an equal credit with the extraordinary advances that have been made in these areas.

The way we are going to work now is I am going to a.) sit down and b.) I am going to basically guide the panel a bit with some questions. We have asked the panel not to give statements. We are going to try to generate a real conversation on this extraordinary people and you as we go forward. It will take a few minutes at the beginning of this to them engage and to give them a little time to react into some questions and then we are going to open it up to the conversation with all of the people in this room. So be prepared.

I would like to start the discussion by asking each of our panelists and Oby if I may start with you to reflect on Dani's presentation and tell me what is the most important policy takeaway that this presentation, that the new information or that the information that Dani has presented us or the whole spectrum of activities and measurements that is involved in the governance matters studies, what is the single most important message for you that comes out? Just one message, there is a lot of subtle messages that are going on but I am interested to see, what is the big takeaway? I would like to each of you to just give me one takeaway from this year's governance matters presentation. Oby, we will start with you and then to Mort.

Oby Ezekwesili: You can see I am already smiling because here we go again looking for that silver bullet that makes corruption go away.

Moderator: No, just to takeaway.

Oby Ezekwesili: But in terms of just sort of like really striking at an important issue that came out in Dani's presentation. It is the fact that in spite of what you say

about taking it for granted about governance matters, we cannot afford to do that. The truth is that the constituency for really foiling the necessary impetus for change has not been very formidable enough for us to take this for granted. So what is important is that the kind of work that Dani's team does should enable us to instigate for that drilling down in terms of, what are the necessary tributaries of constituencies that we will have to galvanize by virtue of the empirical evidence that we are establishing.

One of the things when this latest report came out, within the African Region. I said to my colleagues, I said, let us take the Africa Action Plan within which we have three categories of countries we see and imagine in the continent. The high performing countries, the slow growing countries and then the mineral rich country and to superimpose that what we see of these indicators across their own performances and how they are doing and one of the things that came out clearly is that the high performing countries are clearly the countries that have scored very well over the decades on the governance indicators. The slow-growing countries have done worse, oil rich countries have done even worst.

That gave us a sense that governance is really so key to any discussion or dialogue on growth. Now, let takes me to the next issue of—if that is the case, should the emphasis on governance be as though it were an end in itself. Of course, it is not because if the whole fetish obsession about getting better governance is about just being able to show a scorecard of countries doing better with growth or whatever then it would to have done or fulfilled its purpose. I dare say that any fight against corruption or any policy action towards improving institutions and procedures and systems and structures within countries must be targeting the ultimate goal which is improved living standards of citizens.

Anything about governance that does not result in the improvement in the quality of lives of the people that we are entrusted in who are often the victims of poor governance then it would simply be an academic titillation of ourselves and that is not the way it goes.

I have lived through environments where countries can potentially do a lot of things better but some of the times, what you consider to be poor governance and corruption and lack of transparency is not particularly coming from a desire to do the wrong things. There are issues of knowledge and issues of institutional capacity. When we drill deeper into this conversation as we go ahead and as we disaggregate for each country, what is the driver of the epidemic of corruption might be, what would then happen would be that for each country we are able to identify where the gaps are and the kinds of skills and talents that those countries maybe in need of in order to enable them to bridge the gap that we currently see in the way that governance is delivered. Thank you.

Dennis de Tray: Thanks Oby very much. Mort.

Mort Halperin: I am still reeling from the fact that as I think about it, I do not have the single Indonesian story. So I think I need to improve my vocabulary on that subject.

One of the things that I have learned is that everybody takes away from whatever is presented to them on what they already believed and so I take away from this that governance matters but also that maybe 20 years from now, we can go on to the next point. But it is going to take I think at least that long until everybody understands that.

Until everybody understands that, I think that efforts at development and developing sound policies are going to fall victim to failing to understand that governance matters and that therefore if we are interested in development or interested really in the quality of people's lives, we need to start with asking ourselves the question about a country, is it well governed? If it is not well governed, understand that the way to help the quality of life for the people of the country, is to help it become well-governed not to pretend that we know how to improve the quality of life without fixing the problem of bad governance.

I would add to that, I think the quality of life of people and I am sure that you will agree has to do with their freedom as well as whether they can eat. We sometimes in the West make the mistake of thinking that civil and political rights are all that matter and certainly economic and social rights matter as well but for people working on development, I sometimes find the reverse problem that is that the focus is entirely on economic success, improving the quality of life in the sense of people's economic wellbeing and I would argue that we ought to care as much about whether people have political freedom as well as whether they have economic development.

Now, fortunately, I think that the lesson that governance matters is that the two are not incompatible. We used to teach our students that they were incompatible that if you wanted eventually to have democracy, you had to put it off because poor countries would not develop and therefore, the only way to both develop and become a democracy was what we call the Scandinavian Model. You first got rich and white and middle class and then you could afford democracy and you could have it. I think we are learning that the two do go together and that it is necessary to advance both of them simultaneously.

Let me just say a word about the question of, why states have bad government. I think the oil companies, the oil-rich countries provide part of the answer to that question. That is to say, they have poor governments for the same reason that Willie Sutton explained that people rob banks because that is where the money is.

The problem with oil-rich countries is that they attract terrible evil people because it is, if you are a terrible evil person who simply wants to amass a lot of money, you do not go to a non-oil-rich country. You go to an oil-rich country and you try to capture the government of that country or to corrupt the government of that country so that you can share in the wealth. That is why

we have come to learn that resources are a curse and not the key to development which we used to be taught when we were taught the only way to develop and was to have resources and to postpone democracy.

The other fallacy of that motto which I think it is relevant to this issue is the notion that all autocratic leaders are benign and what they are interested in is not shipping money to Geneva but to helping their country grow. Now, I think once or twice in history, there have been benign autocratic leaders. But it is a very small number and therefore, I think the substantial portion of bad government comes not because people do not know how to do it. I think, for example, the people of Pakistan actually know how to do good government. It is because they have evil people with guns who decide that they would rather run the country than develop.

So, I come back to, in terms of a policy notion, that donors, the United States, the World Bank, and others, would finally recognize that governance matters, that an essential part of governance is democracy and that if our objective is to help people live better, and to live freer, that what we need to do is to create incentives for people, to function in a way that leads to good government, democratic government, and a government that cares about the quality of life of its people and provide these incentives for people who want to lead their country in a different direction for their own self interest.

Dennis de Tray: Thank you, I would like to come back to the incentive issue in a minute, but I want to pose that question to Aart slightly differently because it is not fair to ask him what he took away from the presentation as he probably helped prepare it. What would you have like us, what is the key message you wanted to deliver from this year's work, what it is that came out of this work that was new to you, or interesting or specialized that you hoped the audiences leaves with?

Aart Kraay: It is not often that I have the opportunity to be the discussant of my own work, so it is tempting just to say I think it is fantastic and turn the floor over to other people. Let me say two things that I think are actually still in response to that, that I think are complimentary to what the other panelists have said. The first thing is that when Dani and I set down almost 10 years ago, working on the first paper in the governance matters series, and discussed the title, I had no idea that I would hear the phrase "governance matters" as said. I lost count. I have been counting in the last 10 minutes and it has been said at least 20 times. I guess it is a catchy phrase. I am not sure that I would choose that as a title now.

The reason for it is that the more I think about it, the more I fail to understand what Dani referred to as the "governoskeptics" and the reason for that is straight forward, when you think about what all these discussions of governance are about, they are very simple. In fact, I did not hear Mort correctly or maybe he was just speaking fast. But, half the time, he said government and half the time, he said governance. Really, governance is about how governments function, except for a few people on this sort of extreme one end of the political spectrum, most people agree that governments

with all the powers that they have themselves and how they use it, have enormous influences for good or for bad on people's lives.

So, if governance is about how governments operate and we take it as given that governments do matter. Then, it really is almost a tautology to keep saying we have to argue after we assert the case that governance matters. It is almost a truism. Sometimes, truism is good for a title but recognizing it in those terms, I think maybe we can move on to really thinking about what it is that brings about good governance and what brings about bad governance. That point is the same thing that it is not really so much that my takeaway from the presentation.

One point that I think is particularly important in the presentation, it was also touched on by the other two panelists, is the really striking difference when you look in Africa, at the difference between the oil exporting and the other countries in Africa. The reason why I want to come back to this point is because I want to make sort of three connections to other areas in the presentation that are perhaps implicit and are worth making explicit. The fact is striking and Dani showed a lot of slides as he usually does.

So, it is worth reviewing what the fact is. The fact is that when you look at the oil exporting countries in Africa, they tend to be, in all dimensions of governance, as an average for that group of countries below the 20th percentile. You look at the fast growing non-oil countries in Africa, and they are all on average for that group, for all six dimensions of governance above the 40th percentile of all countries in the world, or is that a regional group averages. Those are colossal differences.

That difference in governance performance, I think, leads naturally into a number of different issues that we have been talking about. The one has to do with this whole issue of whether governance is a luxury, good, or not because that is actually something that we tend to hear much more often. It is not that people say governance does not matter. It is really about development as it is presenting when countries get richer than, we can have good governance and proceed and so on. Again, this is not a profound observation but it is worth making this connection explicitly.

There is a direct link between this and the experience the oil-exporting countries. These countries who have had, on the backs of rising oil prices, have big increases in income, are not the countries where you see big improvements in governance. That by itself, I think, it is anecdotal but I think it is very instructive on this big issue of is it getting richer that enables countries to afford good governance. I think that is simply not the case.

The second thing has to do with, again, these debates with the "governoskeptics." The governoskeptics are often very happy to say that look, the relationship between measures of governance and growth, really is not all that great and if you look again at these three groups of countries in Africa and you imagine drawing a graph where you have the governance performance of these three groups on the horizontal axis, and their growth performance on the

vertical, you would get sort of a truncated V. So, you would have the extreme left, you would have the countries with very weak governance performances, and the oil exporters with a very, very rapid growth.

We saw that on one of Dani's first slides. Then you would have these countries with moderate governance. These are the non-high performing, non-oil rich countries that have had, on average, probably about zero growth. Then, you have got this group of countries with good governance and good growth performance, but not nearly as good as the oil exporters doing the small uptake on the other side of the V. So, the governoskeptics like to point to a graph like that and say there is no relationship between governance and growth. But, I think when you put it in these very stark terms about looking at the difference between the oil exporters and non-oil exporters that is really driving this non-relationship, it shows how superficial these arguments are.

It is important to realize that growth, and particularly growth performance over the short to medium run depends on a whole lot of other things. I do not presume to tell the former Minister of Nigeria what is behind rapid growth in Nigeria recently, but surely, high oil prices are a big part of that, and there are many other factors that matter for growth that we should not allow to obscure the fundamental and important relationship between governance and growth. The last point that I want to make that I think this points to, I was worried that Martin was about to hint at this point and steal my thunder on it.

I think the idea that natural resources attract feeds is a powerful one, and I think it also points to a dimension in which a donor should be additionally concerned about governance and aide effectiveness. The usual argument for why governance matters for aide effectiveness, mostly, has to do with the idea that aide works better in a good policy institutional environment. I think that is so commonsensical but it is hard to argue against.

The other dimension that this points to is to remember that aide is a lot like oil. Aide is a concentrated pot of money that gets into the hands of governments initially, and thinking carefully about the incentives that it creates and the circumstances under which, particularly countries receiving massive amounts of aide and debt relief the extent to which, that might undermine the institutions of governance is something that I think we are only really beginning to think about in the development community. I think it is potentially a very important issue that requires more research.

Dennis de Tray: Thank you very much, Aart. I just want to make a couple of comments and I want to ask one more quick question and we are going to open it up. First, I really liked Oby's point about the fact that it is not about governance, it is about making people's lives better. The question that one has to ask oneself about, this work is really not designed to do this but how one would trail down, is a point that I have made in a couple of the papers that I have written, in some ways, corruption is one of many, many constraints that countries face. They have weak institutions, they have corruption, and they have poor governance, developing countries. They are short of infrastructure; they are short of human resources. It is definitional.

They are underdeveloped. They need to have these things. When you approach the issue of infrastructure in a country, you do not say give me the full list of things you need to do for infrastructure. It is just not the way you approach the question. I think when you approach corruption; you need to do the same way. You need to figure out where the biggest impact is, where the biggest costs are to the development objective, and figure out a way to take on that cause. Dani's point about the fact that dealing with it at the stratospheric level of corruption commissions, of asset declarations, of better laws, is demonstrably not effective, unless there is real leadership behind it and if there is real leadership behind it, maybe you do not need those things.

So, I very much like that point. On Aart's point, I still am concerned; Aart made the point which is exactly right. Governance is about the way governments operate. Governments operate through institutions. Institutions are what development is about. You are talking about development. Development is not building a road; it is creating institutions that let countries do for themselves that is an institutional development phase. Corruption and bad governance undermines institutions, or if institutions do not exist, they do not function, a second Indonesian story. We can argue about it but he produced a huge amount of development in 30 years. In fact, there is a wonderful contrast in Nigeria. In 1965, Nigeria's per capita income was three or four times Indonesia's. By 1995, it was a quarter.

Indonesia had the best poverty reduction record of any large country in the world during those 30-year period. It really had a remarkable development picture. Many people did not like Mr. Suharto and he was clearly not a democrat, but he was an institution and one of the great costs of having that kind of institution is that other kinds of institutions are not allowed to develop. It was a challenge to his authority to have a good civil service, to have a good judiciary, to have a good banking system. I think that is the cost of even, often benevolent dictators that are going forward.

But it is about institutions in the end and that is, I think why I sometimes find that when we are discussing governance and the institutional consequences of governances, I also slip over into the issue of development more broadly. I would like to ask a question that stems from a point that Dani made in his presentation in that economists answer to most everything are incentives. "It is like get the prices right, development will occur." "Get the incentives right, people will behave appropriately." I have said it myself, if you want to fix the World Bank, get the internal incentives right. In this case, we all know, I am not sure if it is about really bad guys coming to steal money.

I am not sure that Venezuela is a good example of that but big money, oil money, does create obviously, extremely difficult and counterproductive incentives for development of institutions, sustainable development. It substitutes for those things. How do we actually create incentives to get governments... governance and corruption are clearly internal issues. They are issues that only countries themselves can deal with, and they must deal with them if they are going to be effective. But, how do we, beyond saying,

we need to focus on incentives. What does that mean? How do we actually move to the concrete in that regard? How would you create incentives in an oil-rich country for the bad guys to go away, and the good guys to do the right thing? In this case, I would actually like to let all four people sitting here, including Dani respond. Dani, can we start with you and then just move this direction?

Dani Kaufmann: I thought I had spoken enough and I will be brief and just on things on incentives. Obviously, the answer is going to be contact specific. Again, this is not macrographic stabilization. There are three things that matter, no matter where one is in the world. That is why the expertise and in depth diagnosis within a country is crucial. But, at the broad basic level, when we talk about the incentives, we need to think about costs and benefits. How does one raise the cost of a corrupt act for the corruptor, for the corruptee, and many people have been giving thought to that. In that context, and just to give one set of very concrete recommendations is a whole field of transparency for literal forms to check quickly, I am not going to go through a litany of lists, not to take too much time but it happens to be in page 21, slide 41, which I did not show in our presentation.

The whole initiative, just to give two or three examples of the extractive industry transparency initiative which Oby led among many other things she did so I am not going to speak for that but she leaded for Nigeria which was the mother country in terms of getting that started is in vain and it is raising the cost, both on the government side and also in the multinational oil companies of engaging in misgovernance versus engaging in governance. They mentioned I made about the World Bank publicly delisting in these government companies so basically to think in very simple terms about now to raise it the cost of misgovernance and raise the benefits of good governance. Corruption, the whole notion of eProcurement and what Mexico has done, and Oby herself, in terms of procurement reforms in Nigeria.

But, just basically totally transparent and making competitive procurement on line that has made already a number of Latin-American countries which are more advanced in some OICD countries is crucial. Having websites, by NGOs and other public interest groups on political campaign contributions, but not only political campaign contributions from who to whom, but also in terms of expenditures. Very primary work have been done by NGOs in Argentina in that context of monitoring expenditures given the difficulty of monitoring exactly the contribution and implementation of freedom of information, the whole transparency of it is basically putting sunshine and making many more auditors is raising it, completing the whole equation of cost and benefits in this context when implemented appropriately and that is a one way of incentive.

So, it is not incentives in the very narrow economics 101 sense of just the official price of an apple, but incentives understood in a much more broader sense. There are very, very interesting innovations in this context, applying the game theory just to give one type of example, which is part of one scheme being piloted by the World Bank, but it has been also being piloted in a

country was being tried. If you are the first in going forward, you are firm and you go forward and you tell all and you open all your books to what you have done in terms of misdeed, you get a much more lenient treatment from the World Bank in terms of debarment and public disclosure.

But, whoever, in terms of the partners you had, in terms of collusion you tell about, they will get the full extent of the law. So, basically, if you Dennis and myself, had on that, we can not sleep well at night anymore, not knowing who is going to tell first. This is just an example of applying very hard no incentive thinking in terms of the issue of rising the cost of that because at that moment, the cost has increased significantly of either you or me colluding for a corrupt act, just are some examples.

Dennis de Tray: Oby, how do we create incentives in African governments to be more transparent, if that is a secret?

Oby Ezekwesili: Recently, I was reading something about Louisiana and as it readily happens out there, I said is this not proof of the fact that it does not matter where. If people believe that bad behavior will cost them nothing, they would behave worse. If they know that bad behavior will not be profitable, they will stay away from bad behavior. So, clearly, the whole incentives argument, therefore, is quite logical. Yet, if you just went into the issue of incentives without thinking of the context on the whole variables that leads to an organized society, having rules and having procedures and having responsibilities for which people are accountable for, they would have jumped a particular stage.

I think that what we are seeing in a lot of ways is that in order to get a handle on better governance, greater transparency, more accountability, and therefore, reduced corruption, you need the political systems to function well. This is not an area that people have been able to; we almost are unable to reform political systems in the kind of efficient way that we are quick at showing that economic reforms have worked. So, there are certain citizens in certain countries that are almost just waiting for that streak of divine intervention that occasionally could happen and pop up a good leader.

Who then, by virtue of that authority, remember the definition of governance, the right usage of authority? They use that authority as a basis for laying the fundamentals. Meaning is that if the citizens are able to once again, take over the power to be able to determine the character of leadership then they have set the stage for leadership understanding that bad behavior will not be rewarded. So, fixing the political systems and getting election processes to work on the basis of the power that the citizens hold by virtue of their capacity to determine that you are not the kind of government we want so we get rid of you.

Now, you can say about the US elections and its own challenges how much of citizens or corporate welfare activities interact and determine the electoral outcomes. But, at least you have passed the stage where you could get a

situation where not much of an election can be considered to have really, in the real sense of it, happen.

So it is important for us to take a step back. The political economy dimension of how do we get proper leadership towards establishing the political framework that would determine that these are the priorities on the basis of which we want to provide good governance. That is very important. Upon building that particular framework, the next thing would then be is that because that leader has got some moral pedestal on the basis of which they stands, to enter into such a dialog. They can provide a leadership for the change of the climate of corruption. When they provide that leadership for the change of the climate of corruption, what then happens is that they can then go into structural reforms of many kinds, including the things that Dani had said. It is going to range from looking at the issues of the tax system.

The truth is that in most of the environments where you see huge corruption, tax as an instrument of citizen participation in governance is not prioritized and then the issues of the judiciary being able to build a judicial system that is strong enough and able to enforce, and to enforce that whole concept of the rule of law and that nobody is above the law that is important. Then looking at the whole budget process and public financial management in a kind of way that you can relate expenditure of the state to outcomes that make a difference in the lives of the citizens. So, it is a whole umbrella of many issues within it. So, with all of that, we cannot in one stroke find that silver bullet, as I said, that would deal with corruption but we can build in a very incremental kind of way, on the important nuggets toward dealing with the problems of corruption.

But, one thing that I have to leave you with and I would then beg to take my leave because of another meeting, is that the demand for transparency, the demand for anticorruption effort, the demand for better governance is not coming from the outside anymore. It is coming more from within. Within the continent, people are looking beyond their boundaries and saying that some of these countries that have been able to tackle corruption are doing better than ourselves. We want to equally do better, and corruption is part of the reason that we are not doing better. So, the space for that kind of dialogue between the citizens and those that lead them, which is a very important tool for owning the good governance agenda so that it is not a moralistic agent where people are coming from somewhere and moralizing the people and saying it will be good for you to be transparent.

That stage is over. What we see, and I am very pleased about it in the work that I currently do, is that when ministers of finance and their delegations walk into the bank, what they are asking from us is what kind of support can you give us in building up our institutions whether the auditor-general's office or whether it is in getting their public financial management to be good, or whether it is in the huge number of requests that we now from countries on helping them to implement the extractive industries transparency initiative. The demand is coming from within and so, it is important that we not continue to speak as though we do not have a place to start from. We have a place to start from. They are interested in this work. How are we going to equip them

more and more to be able to have the kind of capacity that would enable good governance to become the order of the day in a generalized form in Africa? I thank you very much.

Dennis de Tray: Oby, thank you very much. We are sorry to lose you but we understand you have to go. Thank you so much for joining us for this time. It has been wonderful and marvelous to have you.

Mort Halperin: People in poor countries want good governance because they want to be free and they want to be better off and they are coming to understand that that requires good governance, and so, the policy proposals from us, from the side of rich developing countries, I think starts with the rule “Do no harm” and we do an enormous amount of harm. We do harm by giving aid in a way that is like oil, and it corrupts the society. We do harm by tolerating and indeed, conspiring with and sometimes encouraging corrupt leaders to take over countries and not caring about the fact that they have destroyed good governance.

There are many dictators in the world who exist because the United States in particular but also other countries have tolerated them, welcomed them, conspired with them, knowing that they were stealing the money of their governments or a substantial portion of it. As we know if I can tell an Indonesian story, we know about Indonesia. It was not a secret that however benevolent this man was, however he was doing about poverty reduction, his children were doing a lot better than the average Indonesian, and not because they were working harder.

On the extractive industry side, the simplest thing we can do is to not allow people to raise capital in our societies if they give it in secret to countries to get their oil and other minerals from them. It is a simple concept called “Publish what you pay”. The United States and Western Europe should require any company that operates in their society to publish the amount of money they give the governments for their oil or their diamonds or their other minerals. This would enable the citizens of that country who are eager to do so, to make sure that the amount of money that shows up in the treasury as a receipt is the same amount as the amount of money that is paid by the company getting the oil or the diamonds. That is not now the case.

The numbers are very different and we continue to be complicit in that by not making it a crime for our companies not to publish those numbers. I published a book with two colleagues on the democracy advantage, arguing that we ought to give an advantage to well-governed democratic countries in deciding who to give development assistance to. The extraordinary thing is that we do not, and we still do not. If you look at development assistance from the United States from Western Europe, which claims to do the opposite, or from the World Bank which claims to be indifferent, what you discover is there is no advantage to being well-governed democracy. Development assistance is distributed according to some other rule has nothing to do with whether you are a well-developed democracy.

We ought to give an advantage to that and the United States has started in small measures which something called “The Millennium Challenge Corporation, which many people in the development field do not like for lots of reasons. But, the fact is what that program does is to say to the people in a country, if you govern yourself well, if you have good economic policies, if you are democracy, if you care about education and welfare, you will be eligible for what in African term is substantial, additional American assistance, and you can decide if you want to be corrupt and have a bad government and pocket all the money, you are just not eligible for this money. We do not do that with most of our grand making. My view is we should do it almost all of it.

Dennis de Tray: Thank you very much Mort. Aart, is it critical that you have something to say because I am worried that we are going move to the audience.

Aart Kraay: It is not critical but it is critical in the sense of criticizing what was just said before. I think that actually, Dennis, you asked exactly the right question when you formulated the question, and it was mostly ignored subsequently because the right question is, given that governance reforms really in the end are purely an internal matter, what do you do about this? I can not resist given the time of year it is to use the old joke that turkeys do not vote for Thanksgiving. Think about it for a second and you understand why they do not vote for Thanksgiving.

Moderator: This is the bird, not the country.

Aart Kraay: This seems very relevant here because a lot of the things that Dani and Oby were talking about, really in the end are about external pressures. It is very moving to hear Oby’s stories about all the ministers of finance coming in to the World Bank and asking for help with governance-related reforms. But, surely, a small part of that has to do with the fact that you get more money from the World Bank if you ask for those things. This is a slightly critical perspective on this but I think the problems really are much deeper because any kind of model, any kind of theory that you think about, you realize that there is a very powerful inertia to poor governance caused by a variety of different governance traps. While you can dress it up in fancy theory, it all comes back to the fact that turkeys do not vote for Thanksgiving.

When there are bad institutions, there are generally, powerful people who benefit from bad institutions. So we need to think a lot harder. There is going to be some mix of external pressures that may help with the margin but a lot of it is thinking about how you break out of these internal traps, and that is a much deeper question I do not think has been addressed yet.

Dennis de Tray: All right, figure out whose ox is going to get gored before you start. To mix of metaphors turkeys and oxen. All right, you have been a very patient audience but this has been a fascinating discussion, at least, for me, I hope for you as well. We are now open for questions. Please, there is gentleman right here, identify yourself and if your question is directed to

anyone in particular say so. Keep them short because I am sure there are a lot of people that would like to ask questions.

Audience member: When you look at the changes in voice and accountability and you look at the questions, you will find that the charts for voice and accountability, and growth, you see a very little correlation between the countries. More generally, if you look at rigorous econometric studies their instrument for democracy, you often find that democracy tends to be insignificant when you look at growth outcomes. So, what I am saying is not that governance does not matter but I think it is important that when we discuss policy changes, we do not conflate the issue of governance with that of the political regime more generally after all governance is what structures economic transactions and interactions in the economy. That is what drives growth but the political regime is at least, in my view, a second order effect.

Dennis de Tray: We are going to take several questions and then come back. The lady here please identify yourself.

Audience member: Judith Clones, Independent Consultant and Development, I want to focus and congratulate the office for the report giving worthwhile information. Looking, however, at your table about diversity among the countries, you seem to focus in terms of growth, as being a key parameter and comparing with governance. My question is did you also look in to the trend in income distribution and to what extent the spread in the income distribution might be a factor that we looked at together when we analyze the governance?

Dennis de Tray: A very good question. Gentleman way in the back there and then, there was somebody over here.

Audience member: Thank you, thanks for a great presentation, a great panel. My name is Richard Cole. I worked for Management Systems International where I develop a consulting firm. My question for the panel is, I want to focus particularly on one of the subcategories of governance which was governance effectiveness. Do we know enough about government effectiveness and how to measure it so that if we want to really improve outputs in a particular sector, let us say health, we can tell how much of the poor outcomes, let us say in health or education, pick whatever sector you want, are due to poor governance as opposed to bad strategy as opposed to lack of resources.

Could you probably come up with a short list of about five factors of which the effectiveness of the health ministry, or education ministry would be one of them? Can we actually measure that, and if it is a significant contributor, we would know when and be, can we measure it in enough detail so that we would know how to improve the effectiveness of that particular ministry?

Dennis de Tray: Can we, do we, and if we do not, why not? There was a gentleman back here and then this gentleman. Then we will stop for a few answers.

Audience member: Alex Greenbaum from Nathan Associates. I wanted to get back actually to something that Aart Kraay said. He said something which I think

is quite profound at the end that the whole body of work that they are starting to put together now in terms of whether aides doing more harm to governance than good. I would love it if you could actually talk a little bit more about any conclusions that have come out. Because obviously, if all of us here, we would not have jobs if this was true, and it is something that is really important to reflect upon and then we are in the situation of being the turkey obviously, and we do not want to be cooked and it is a real problem.

Dennis de Tray: It is called the problem of the unholy alliance between the givers and the receivers. The gentleman right here.

Audience member: The previous questions inspired me. My name is Larry Bridwell and I teach MBA students and at a panel earlier this year by the Center for Global Development, the emphasis was that improvements in living standard come from the growth of small and medium-sized businesses and in terms of the aide question, one of things that is being emphasized, if you want an improvement in living standards, you have to have growth in the business sector. I was inspired by this because some people say, and I do not want to get into discussion, it is just an example, that China is one of the most undemocratic places. But, it has 10% growth and it might be simply, because there is a lot of thriving, small, and medium sized businesses that are able to export around the world and so, how does this private sector dimension fit into this governance indicators?

Dennis de Tray: Thank you. Let us stop there and ask our panel to answer those questions they would like to answer. Do we have a volunteer to start?

Aart Kraay: Since I am a turkey, can I do the turkey question?

I think that is actually an interesting question. There is some work being done on it, and some of it actually is going to lead into a small comment and response to the question that Richard made at the back as well. How can aide undermine governance? I think one thing to remember is that at the end of the day, we are interested in our net effects. So, one can imagine that aide can be dispersed in a way that it is not as conducive as it might be to good governance but net, it still is quite beneficial to the country.

So, let me say that first, it is not that we think that this turns on its head the entire logic for aide. I think where the evidence is most compelling, and actually people who have run country operations for the bank the way that Dennis had can say a lot more to say about this, is particularly in small countries that receive a lot of aide. How, in effect, aide donors place a lot of unintended taxes on recipients, both through the trivial things like 57 donors come into a country and everybody wants to see the Minister of Finance once a week.

That just is not feasible. Two, more subtle things like sort of Dutch disease kind of effects in aide where you see, particularly again, in small countries, a lot of aide money is coming in and the aide agencies tend to suck a lot of talent out of government agencies in the countries where talent is scarce, and

all the sort of nuts and bolts of development program administration that can be a problem. So, development agencies have to balance this sort of competing pressures on the one hand to try ring fence their projects and work through project implementation units versus, on the other hand, trying to work through national systems that might be imperfect but might be strengthened by working through them.

So, there are whole lot of nuts and bolts levels at which aide can have this unintended consequence of weakening institutions. Let me put your question slightly differently. Would you use R indicators to assess whether the health ministry in a particular country in the world like governance indicators, or the health ministry in a particular country to pinpoint time of doing a good job and the answer surely is no. These are indicators that are very good for cross country benchmarking purposes. They are not particularly good for giving very specific policy advice at the level of individual ministries in individual countries. That said, of course, there are many things that when you start thinking in about a particular sector that you can measure as indicators of whether governance is working well.

In education, very simple or health simple things like asking whether teachers or doctors, even show up for work, something that can be measured that people are measuring in various projects, and these kind of things can tell us a lot more about governance failures at that more microlevel.

Mort Halperin: Let me just tell you that those of us who do not work in the field of aide and development have known for a long time that development assistance can easily be and often is kind of productive to development. It is not a new idea. There has even been a literature about it with all the ideas referred here, and many others for a very long time. They just get reinvent and relearned every few years but, like the turkeys, the people in the business do not want to learn them. Part of the problem is reflected in the fact that we have been told several times that oil-rich countries have grown more than poor well-governed countries.

I would suggest that that is a measurement problem, not a truth about the world. If you look at, for example, Iraq, under Saddam Hussein, to take now a non-controversial example, it was growing because he was getting a lot of oil revenue, and he was building palaces and putting moneys in Swiss Banks. But, all of that account is economic growth, and what we really want to measure, as we have said several times, is income distribution, is the quality of life, is the reduction of poverty and I would summate if you look and compare the oil-rich countries of Africa in terms of those measurements with the poor, well-governed in development countries.

The answer will be that those poor, well-governed countries are doing a lot better on measurements that actually affect people's lives than most, if not all of the oil-rich countries. But, when we try to measure success over development, we look at the economic growth in the aggregate which is, in my view, totally misleading.

Dennis de Tray: In defense, we look at more than that, and have done for quite some time. But, the point you are making is correct. There is a long literature on the counterproductive effects of aid, but I think in the more nuanced discussion that takes place about aid effect and to speak that they understand that it matters that three people in a country of three million people get rich and the other people get poor.

Dani Kaufmann: Since some questions were taken, I will take two or three first, starting from the last, on the growth of business, a great question, absolutely crucial and crucial in our work. In fact, one of the six governance dimensions is the quality of the regulatory framework. There is also other work in the bank on doing business. We measure the de facto reality on the ground, they measure the rules and that is shown in all these types of work to be absolutely crucial for income and growth. That is at the aggregate level. At the more disaggregated level, I presented a little bit but in the handout, there are more slides particularly in page 17, at the top, slide 33, it shows for Africa in particular, what the results of the survey of entrepreneurs. What do they say are the most important impediments for them to operate?

I think it is extremely important to continue doing the very simple task of just codifying the information from the entrepreneurs themselves what are the major obstacles for them. As we have shown all of this type of work to be absolutely crucial. The issues of bureaucracy, red tape, corruption, and so on, they come up again and again not only in Africa but in many other countries and it is in that slide there. Last but not the least; on the issue of business, it is on the question of policies. One major type of reaction in the past in which they did not deliver the goods, but to the contrary, in declaring what not to do in this area is, there is another corruption scandal, the initial reaction is a tendency to over regulate, to clam down all of the kinds of processes, procedures, more regulations and so on. That creates even more corruption.

Instead, the reason that one of the stresses we made in the presentation is on transparency-related reforms because it has a wonderful trait of being institutionally relieving. It goes away from over regulating, and it puts the whole issue of oversight and so on in the hands of the population or the interperson. The transparency-related reforms are we find the great substitute to overregulation. Instead, there should be less regulation rather than more very quickly because it was a great question on income distribution which was fully addressed to be perfect.

First, there is a literature. The others are working in their map showing more corruption, worsening income distribution, and so on. We have done some work in the past in terms of capture, and inequality of political institutions related to income distributions, related to poor governance, but we have done it more focused on the former socialist economies and more in Latin America, because we are hoping that in 10 years or in 20 years, we are discussing this as a major problem in Africa. In Africa, right now, we are talking did we just hear 85% or 90% of the population living still at \$2.00 a day or less. So, this is the type of problem that we do have in my own continent, in Latin America

and others. But, it was not the main focus of presentation because of the basic poverty issue in Africa.

Last but certainly not least, on the question from the World Bank, in fact, then he gets to the basic question of what is governance again where I like to end is not to be broad enough that it becomes tautological with development, and that often, one sees in some definitions which includes the whole delivery of the development goods. Then, it tautological to that. It is more – the inputs including the civil and political liberties which is also in itself but without encompassing the essential outcomes in terms of health, income, and so on. However, not to be overly narrow to just focus on the government, one of the six dimensions that we have and part of this already is basically the effectiveness of the government.

We are talking about essential another absolute key dimension which goes to what Mort is saying, the process by which governments are selected, monitored, and replaced. I am a Latin-American and my comment on this and that and unfortunately, I find that in English, there is not a sufficiently as nuance word. Governance is one, in Spanish, there are two. There is *gobernanza* and *gobernabilidad*. *Gobernabilidad* is essentially the business of government. *Gobernanza* is essentially the whole balance between government, civil society, and the private sector and all the actors. In that sense, I would prefer to view it in that latter sense where voice and accountability is absolutely crucial, and we have found a clear causal link and that is what we have showed.

It applies all of basically our governance indicators between better governance including voice and democratic accountability, and higher income. Of course, it is not a full proof and it applies in the long term. But, I would like to take my friend Mort again and that is why I gave the appetite wetter at the end of the presentation is that voice and democratic accountability, the way that we are measuring and interpreting it is broader than formal electoral democracies. I do not know which results you are referring to but sometimes they are done in a very formalistic sense that type of link we have where an indicator that encompasses civil liberties, the free press, and freedom of expression and so on. In there, we do find a very clear link.

Let me end by suggesting also, and that is also a point to my friend Mort here is that we find from the data, from the evidence, and looking at Africa and other countries, and also looking at the great work of other colleagues in the World Bank like Phil Kieffer that it is all well and fine to talk about electoral democracies and again, I say, maybe necessary but not sufficient. But, the enormous challenge and what needs to be done to help young democracies, fragile democracies, and not to speak about the managed democracy problem that we have. It is not a zero-one gain.

The enormity of the challenge is that these young democracies are finding and we see that they are not delivering the goods even in terms of some civil liberties, freedom of expression, freedom of the press, and they are with your best knowledge. We hope we can get more insight and from the rest of how

we can go to the next stage there because it is too facile to fall into the Anglo-Saxon, rich country divide of just are you a democracy or are you not when basically, we are all in the muddy middle in that sense and they are so young and fragile democracies. It is an enormous challenge.

Dennis de Tray: We are all in the muddy middle. I am afraid we are out of time. So, before I thank our panelists, I would like to break for a short commercial. The CGD is putting together a book entitled *The Whitehouse and the World*, advice to the next administration on development assistance which I hope will be out in April of next year. Some colleagues and I were tasked with writing the corruption and development chapter which is really more about what the world needs to do about corruption and governance, and development than it is about what the US needs to do, although somewhat on both sides, that deals with three broad sets of issues.

One, is corruption in the private sector which is both international corruption and the kind of gate keeping corruption that Dani was pointing to that is really, incredibly debilitating for local private sector development. The second is how to deliver development assistance and to keep aide from becoming a problem, and the argument there is that if you focus on outcomes, you inherently limit the effect of corruption and if there is no outcomes, there is no money.

The third is a conversation, a very brief conversation, but an important one about global public bads, and about how existing rich country policies on things like illegal drugs are actually, in some instances, worsening the world's global public bads and actually generating the incomes that are undermining countries and providing much of the corruption resources. So, watch this space and we will look forward to your comments and reactions on that when it comes out. To Dani, to Mort, to Aart, thank you so much for what has been a fascinating discussion. To all of you, thank you for sticking it through the whole two hours. That was terrific. I hope you have enjoyed it, and we look forward to seeing you next time. A round of applause for our panelists.