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How Does Public Governance Make a Difference for Long-Term Economic Development?

- Good morning.

- Thank you for the opportunity to join such a distinguished gathering of policy makers from around the world at this year's **SIGMA Ministerial Conference** on **Good Public Governance.**

- The **European Union** and **OECD** have been essential partners over the years in the World Bank's work on governance reform. Attendance at this event further signals the center of excellence that **SIGMA** has become for countries that are working toward membership in the **EU** and **OECD**.

- **These are extraordinary times for governance.** Mounting pressures, such as large migration flows, increased fragility and violence, and disruptive technology, have changed the world in which we live. Many of the pressures we face today are not new – they have been mounting for some time now; but the magnitude, the pace and the combination of these pressures are unprecedented.

- At the same time, the ability of governments to respond effectively to these pressures and mitigate their effects on citizens is being questioned. Over the past years, citizens' trust in government has plummeted in many countries that had previously enjoyed high levels of trust and legitimacy.

- In this complex environment, the World Bank's attention to governance and institutions as a fundamental driver of development effectiveness has grown and expanded its ambition over time.

- We have long recognized the importance of effective governance when it comes to allocation of our own resources. In fact, our fund for the poorest, IDA, explicitly links resource allocations to governance levels.

- But strengthened public sector institutions and systems allow resources deployed to leverage their financial impact *beyond* donor-supported projects. At the same time, if the governance reforms supported by donors are to have any chance of succeeding over the long term, governments must develop institutions that are capable, efficient, inclusive, and accountable to citizen needs.

- The international community's commitment to governance reform– as exemplified by the theme of this Ministerial Conference – is noteworthy. But this brings us back to the fundamental question and theme of this plenary session, ***"How does public governance make a difference for long-term economic development?'***

- There is strong evidence showing that there is a clear positive relationship between aggregate measures of governance and long-term growth rates across countries. This is a premise that we have long accepted in the global development community.

    - Well-functioning public institutions may create incentives for investment and technology adoption, for businesses to invest, and the opportunity to accumulate human capital for workers. On the other hand, poorly functioning institutions can diminish these opportunities.

    - As our recent **World Development Report** on ***Governance and the Law*** frames it – governance can affect investment and efficiency, and in turn growth, through two types of "institutional functions":

        - The first deals with **commitment** – this is creating an environment in which firms or individuals feel secure in investing their resources thanks to well-defined property rights, credible enforcement of contracts, and the design and implementation of regulations.

        - The second pertains to **coordination** – or the government's ability to incentivize socially beneficial collective action to coordinate investment decisions and promote investment decisions to prevent free-riding, and solve potential market failures that can impede growth and investment in public goods.

- Now while this likely sounds intuitive and second-nature to everyone in this room, it is when we "zoom-in" to the shorter time-span in which we operate as policymakers – ***years*** and ***decades*** instead of ***centuries*** – that the relationship between governance and growth seems to break down.

    - Over the last century, growth accelerations do not seem to have been correlated with major changes in governance.

    - This is exemplified in some East Asia's rapidly growing countries such as **China**, **Laos**, and **Vietnam,** which have achieved sustained growth over the past three decades despite receiving relatively low scores on traditional governance measures.

- And, likely of interest to many in the room, how does governance and institutional reform relate to the "middle-income trap," which leaves many worrying that economic growth will slow once their countries reach middle-income status?

- And so, while we all seem to agree that governance ***does*** matter in the long-term – it is the question of ***how*** it matters in the short and medium-term, where we must continue to be modest and admit we are still beginning to understand how exactly specific institutions influence economic outcomes. This leads to some key questions facing everyone in this room:

    - How much does governance **really matter** for growth?

- What types of governance reforms have the **greatest impact**?
- How should policy makers go about **designing reform strategies**?

- We have been working to try to unravel this complex puzzle, and push the frontier on the understanding of these vexing questions.

- I want to quickly speak to **three main lessons** that are emerging for us, as we continue to innovate our approach to public sector reform.

1) **First, there is a need to adjust how we approach our "working definition" of governance**

- **The World Development Report** on ***Governance and the Law***, focused on addressing the question: "Why are carefully designed, sensible, policies too often not adopted or implemented?"

- To begin to answer this question, the report defines **governance** as:

  - "The process through which state and non-state actors interact to design and implement policies within a given set of formal and informal rules that are shaped by power."

- The report recognizes that power is distributed unequally in every society, and that power asymmetries can lead to exclusion, capture, and "clientelism" that undermine the core functions of institutions.

- It therefore posits that governance reforms must take the current power asymmetries into consideration – with meaningful change happening by **shifting the incentives** of those in power, reshaping their **preferences and beliefs** in favor of positive outcomes, and crowding in **previously excluded participants** into the policy-making process to increase contestability.

- So what does this definition and approach practically mean for how we address public sector reform?

    - **Importantly,** it has further institutionalized the conclusion that one "cannot export good governance" and that successful reforms are not just about transplanting the "best practice" institutions that have been successful elsewhere (and, indeed, have been traditionally modeled in high-income countries).

    - There is no recipe for successful institutional change. It means there must be a focus on designing policies that are implementable – and consider the probability of capture. This means that policies that are compatible with the existing power asymmetries may not deliver optimal growth, but they can effectively deliver incremental gains.

    - **Additionally,** with this lens, it means framing work on public sector reform around helping to **close these implementation gaps**. This

involves taking a problem-driven approach to governance reform that is focused on identifying the public-sector bottlenecks that are preventing growth-oriented policies from being carried out effectively.

2) **Second, one must not only think about the <u>form</u> of institutions, but also about their <u>function</u> to unravel the "governance and growth paradox"**

- More than a decade ago, two World Bank researchers coined the term **"middle-income trap"** to capture the puzzle that there was no easily understood growth strategy for middle-income countries that were being squeezed between low-wage, low-income country competitors and rich-country innovators undergoing rapid technological change.

- Since that term was first popularized in 2005 – there has been an explosion of literature aiming to disentangle the mechanisms behind the supposed trap – and a number of a reflections on the growth experiences of the past decade.

- One of the main take-aways has been a deeper recognition of the "institutional transitions" that middle-income countries must pass through to avoid getting "stuck" in the trap.

- The literature has now repeatedly come back to recognize that one of these key transitions is about ensuring effective and responsive government

bureaucracies that create the coordinated commitment needed to promote growth strategies.

- In Latin America, for example, this is exemplified by some of the region's large middle-income countries which, despite various gains over the past several decades, remain hampered by institutions that undercut the fight against corruption, and undermine public trust.

- Despite this evidence, there are also clear outliers that have still enjoyed sustained economic growth over the past several decades despite scoring relatively low on commonly used measures of governance such as the **World Governance Indicators.** Some use this as an argument that "governance does not matter for growth".

- One of the primary lessons of WDR 2017 – and its approach to the definition of governance – is that it is important to think not only about what form institutions *should* have, but also about the functions that institutions must perform.

- For example, while the **form** of a country's governance regime may score low on established governance indicators – a more nuanced examination reveals the **function** of that country's informal mechanisms that have

enabled credible commitments by leaders, a public goods orientation, and a performance-oriented civil service.

- Now I want to be very clear that I am not implying that aspects of governance such as accountability or liberty are not needed for growth – as the precedents of most high-income countries suggest that sustaining growth beyond middle-income levels is strongly associated with the transparency, accountability, and responsiveness of institutions.

- So what does this lesson mean for the World Bank and how we are approaching public sector reform in our client countries?

    - We are taking the lessons of a focus on function seriously – particularly in **fragile, conflicted, and violent states.** Experience has repeatedly shown that the attempt to impose best-practice models of Public Financial Management Systems or Civil Service Recruitment on institutions that, in many cases, need to start from square one is doomed to fail.

    - Second, we are investing in innovation. For example, we have recently launched a **Bureaucracy Lab** whose goal is to generate empirically-driven research on public administration reform by transforming the quality of data on the public service, rigorously

experimenting with different solutions to better understand the mechanisms driving impact, and using this evidence to provide client governments with actionable information for policymaking.

3) **Finally, transparency, openness, and citizen engagement are instrumental for success**

- While we've learned that we cannot export institutional reforms, international organizations such as the World Bank have an obligation to advocate for openness and transparency in the policymaking process.

- Open government reforms such as deliberative transparency, citizen engagement, and freedom of information laws facilitate inclusive decision-making processes, strengthen accountability, and build citizen stakeholders' capacity to engage in development dialogue.

- Transparency increases the predictability of transactions. It stabilizes citizen's expectations from governments, and can help build trust in government. It matters for reducing corruption, especially at points of service delivery at the local level.

- And for the private sector, regulatory certainty, accurate market data, and contract transparency are needed to provide firms with predictability and opportunity and to reduce non-commercial risks.

- The transparency and openness agenda is also closely linked to the World Bank's broader work on **Anti-Corruption**.

- As many of you know, it has been more than 20 years since former World Bank President **James Wolfensohn's "Cancer of Corruption"** speech – which formally and publicly identified corruption as one of the biggest roadblocks to effective, lasting development.

    - In fact, last week **President Wolfensohn** returned to the Bank for a discussion with our current **President Jim Yong Kim** to reflect on the past twenty years of anti-corruption efforts, and to provide a vision for the next phase of these efforts.

- At the **London Anti-Corruption Summit** in **May 2016**, **President Kim** further committed the Bank to an agenda of "radical transparency" in which we seek to further leverage information and transparency to reduce corruption.

    - We have been pursuing key issues such as strengthening beneficial ownership and building public databases of firm sanctions and remedies, as well as using data and data analytics to strengthen procurement processes.

- At the global level, we are working with partners in a wide range of efforts such as those to stem illicit financial flows, to reducing tax evasion, and to supporting open government.

- And we are complementing these global efforts with our "boots on the ground" at the country and project levels – where we continue to work hand-in-hand with national and local authorities to identify entry points to strengthen institutions and develop mechanisms for identifying, mitigating, and addressing corruption in World Bank-financed projects.

- **In sum,** the attention to public governance as a driver of long-term economic development has never been more critical.

    - Reflections of the past several decades on our own efforts – and through collaborations with partners such as **SIGMA** – reveal that governance reforms certainly pave the way for inclusive and sustainable economic development.

    - These reflections only further emphasize, however, that continued success requires a nuanced attention to **governance constraints** and **enablers** in each environment in which we work – and a focus on making sure, that at the end of day, any reform efforts are ultimately focused on **making lasting change.**

- I look forward to hearing the reflections on these challenges and opportunities from our distinguished panel ahead – and to the next 25 years of continuing this agenda with steadfast partners like the EU and OECD through SIGMA.

Thank you.