Governance, Economy, and Foreign Aid

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Much of the current donor discussion of governance takes place outside of a historical or theoretical context. This article locates the governance issue within recent political science, development management, and institutional economics literature. The review focuses on accountability, participation, transparency, and predictability or the rule of law, and includes a discussion of the impact of these variables upon economic performance. It concludes that donors can best assist good governance to develop by helping to foster conditions under which developing societies can push their governments to deliver the accountability, transparency and rule of law that sustainable development requires.

Governments determine how well, or how poorly, markets function. This simple truth explains the current concern in international aid agencies with “governance” as the world shifts toward an overwhelming endorsement of markets as the base of economic activity. If governments are assumed to be neutral, and committed to serving the public good, then deviations from optimum economic performance can generally be corrected simply through policy reform, or through improving information systems. And yet economic performance is not easily explained by the logic of economic theory alone. Governments are not neutral. To understand economic performance, it is important to factor in the political role of governments. “Markets cannot play a dominant role in the way in which a political economy functions unless allowed to do so by whoever wields power and possesses authority” (Strange 1988: 23).

The exercise of power and authority lies at the heart of governance. Governments use their power and authority to establish and maintain the institutions that regulate

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social and economic interaction. Governments create the rule of law necessary to underpin accountability, participation, transparency, and predictability in interactions. Governments—in interaction with their citizens—determine many of the preconditions for a thriving, or a declining, domestic economy.

This article attempts to give the current concern with governance a historical dimension, and to locate governance as a technical and intellectual issue within a body of literature that has long addressed these concerns. It examines a limited number of governance dimensions: accountability (including legitimacy); participation and institutional pluralism; transparency; and predictability (or the rule of law). It makes no claim to be exhaustive, but rather to offer a selective review of recent work that is built in part upon the analysis of how politics and economics interact in shaping economic development.

The issue of governance rose to the forefront of development agendas at the close of the 1980s, following nearly a decade of concern with macroeconomic policy reform. In Africa, calls by citizens and leaders for greater openness and accountability were joined by international donors. The World Bank’s 1989 review of African development issues, From Crisis to Sustainable Growth, charged that Africa’s development problems could be traced to “a crisis of governance” (1989: 60), citing illegitimate leadership, abuse of authority, lack of official accountability, the control of information, and a failure to respect the rule of law and human rights. As both an academic and a policy issue, the new concern for governance has been pushed furthest with regard to Africa (e.g. Joseph 1990; Hyden and Bratton 1992).

Although calls for change have perhaps been loudest in Africa, other regions have undergone dramatic shifts in governance. In Latin America, with the rapid transitions from authoritarian to democratic regimes over the past decade, newly elected legislatures moved to transform old legal regimes and to reinforce the institutions that make government accountable to citizens. Governance issues surfaced in Asia over the past decade as well, most prominently in China, where a decade that opened with a dramatic transition to economic liberalization closed with the forceful suppression of calls for political change—in Tiananmen Square. Across Eastern Europe, political openness encouraged citizen’s demands for accountability, and the move toward a market economy underscored the need to establish legal guidelines and well-defined property rights in order to secure private investment. These events prompted related changes in the assistance offered by many bilateral and multilateral donors—most noticeably, the establishment of the European Bank for Reconstruction and Development (EBRD), mandated to reinforce changes in Eastern Europe through support for multiparty governments. Increasingly, donors have organized and funded projects and programs centered on governance issues.1

Although governments exercise their power and authority in different ways, they all affect economic activity. Many have tried to draw a distinction between what Carol Lancaster (1990) has termed social or economic governance, and political governance, although the line is difficult to position with any assurance. This article focuses on those aspects of governance (in addition to skill and capacity) that appear to affect economic performance: accountability, participation, transparency,
and the rule of law. These variables affect economic performance through their impact on fiscal integrity, on predictability, on sustainability, and on the creation of an environment conducive to productive investment.

In keeping with the limited focus on these four aspects of governance, this review does not directly address the relationship between development performance and the form of government. Although empirical research exists on hypothesized relationships between regime type (democracy, dictatorship, etc.) and growth and development, the evidence to date is mixed. Indeed, one of the puzzles for political scientists continues to be “how it is that many nondemocratic governments seem to be as strongly motivated to guard the welfare of citizens as democratic governments” (Lindblom 1977:x).

Background to the Concept of Governance

Governance itself is a neutral concept, meaning the “exercise of authority; control,” or, more broadly, “government.” As a synonym for government, governance can be further defined as “the political direction and control exercised over the actions of the members, citizens, or inhabitants of communities, societies, and states.” Work in this area is often interdisciplinary, cutting across the boundaries of economics, political science, philosophy, sociology, law and management. Governance has been analyzed both normatively (how should governments behave?) and positively (how do governments behave?). This distinction has ancient roots in the works of philosophers who have struggled with both the theory and the practice of governance.

Perhaps the oldest theories of governance date from the fifth century B.C. with the writings of Confucius, an experienced bureaucrat forced into exile by Chinese political intrigue. Confucius argued that a well-ordered society required government based on superior morality and on the fulfillment of duties and responsibilities inherent in social roles: ruler, minister, father, and son, for example. The heaviest responsibility fell on the leader: if he fulfilled his duty, then the chain of rectification and social order would be in place; if not, social chaos would result. The Greek philosopher Plato (advisor to the ruler Dionysius II of Syracuse) and his pupil Aristotle grappled in their turn with questions of political reform, the rule of law, the nature of authority, and the principles that ought to determine the shape of the ideal state, and its relation to production and other economic questions.

Modern analyses of governance date from the seventeenth-century Germanic tradition of politikwissenschaft (political science) and the eighteenth-century innovations of the European Age of Enlightenment. Shifts from religious to secular issues, transitions from feudalism, a rising concern for individual rights, and the expansion of the self-regulating market as an increasingly important medium of exchange raised questions about the relationship of political authority to individual and group welfare. The foundation for many who write today on questions of the evolution of governance was laid by people such as John Locke, in his concern with structures to prevent the abuse of authority; Jean-Jacques Rousseau, and his idea of a social contract between rulers and citizens; and Thomas Hobbes, who wrote about the
propensity of people to engage in conflict and to seek power, and ultimately, to submit themselves to the coercive rule of the absolutist state, the Leviathan.

German social theorist Max Weber's analysis of modern, rational-legal states, published in the nineteenth-century, still underlies many western ideas of governance. Weber pointed to the "process of rationalization," arguing that modern states differ from primitive states in their reliance on hierarchy, in the base of the leadership's legitimacy, and in their monopoly of the use of legitimate force. Modern bureaucracies are, in principle, structured with management hierarchies, have clear rules for advancement, and maintain information systems that assure continuity and predictability, although clearly many fail to live up to this ideal.

How does "good governance" develop? Relations between rulers and ruled differ in every country. History, custom, law, society, and political economy affect the way in which the ruled in a country held rulers to account for their performance, the relative openness of a sociopolitical system or an economy, and the degree of predictability in government decision making and interaction with the public. The development of accountability, participation, transparency, and the rule of law in Western Europe offers a useful perspective on the evolution of governance in one region.

**Historical Perspectives: The Evolution of Governance in Western Europe**

The concept of governmental accountability in much of Western Europe and the establishment of transparency and an impersonal rule of law developed slowly—as a result of evolving relations between rulers and elites. Although these relations were stimulated by ideas of personal freedom and government responsibility rooted in the eighteenth-century Enlightenment, they had much earlier roots. In Britain, for example, the Magna Charta, sealed in 1215, signaled the first formal attempt by social elites to elicit accountability from their monarch.

Early European states resembled many of today's developing countries. Caught between cumbersome taxation systems and their need for revenues, monarchs borrowed heavily and operated under chronic deficits: financial crises brought Spain to bankruptcy five times between 1575 and 1647 (Eggertsson 1990: 342). The need to raise revenues to pursue state activities (wars, in particular) brought monarchs into repeated struggles with their barons and dukes. Accountability was wrested from personal rule of royalty by the pressure of domestic elites: "The admission of the right of parliament to legislate, to enquire into abuses, and to share in the guidance of national policy was practically purchased by the money granted to Edward I and Edward II." Taxation evolved from a unilateral act by the crown to a right that involved reciprocity. The evolution was slow. Only in 1782 was it possible in Britain for Parliament to clearly separate the crown's personal account from general government accounts (Theobald 1990).

Concerned about their lack of control over revenues, other European elites demanded institutions like Britain's Parliament. In France, this led to the establish-
ment of the Estates General; in Spain, the Cortes. French elites based their support for the Revolution of 1789 on the argument that royal financial discretion must be limited, that the public should be able to debate and influence economic policy, and that public institutions were needed to carry out these objectives. The evolution of legal systems and institutions necessary for market economies paralleled these developments.

Only later did the establishment of popular organizations—trade unions and other independent associations—lead to pressure for more complete representation and political participation, extending accountability from elites to the people at large. The evolution toward greater openness was also not rapid. European institutions based on the principle that the bureaucracy should serve the public rather than a narrow group of elites only emerged in the nineteenth century. British public servants only began to receive salaries in 1816 (Theobald 1990: 27), and the principle of merit rather than "spoils" as the primary vehicle for recruitment and promotion in the European public services evolved only in the past hundred years (Hyden 1983: 58). Both movements enhanced predictability and accountability in European governments.

The previous brief sketch illustrates broadly how institutions supporting better governance developed in Western Europe. In other parts of the world, these institutions are likely to have developed in alternative ways. The colonial period, for example, affected institutional development in a number of countries. In many cases, Western European institutional forms were transferred directly to developing areas during periods of colonial rule. Brought in as part of a system based on rule by powerful external actors, the colonial civil service was never directly accountable to those whom they ruled.

The tragedy of mismanagement and corruption in many modern nations can often be related to this colonial imposition of states and bureaucratic institutions. Peter Ekeh (1975) points to the reputation for honesty among local ethnic associations in Africa and contrasts this with corruption in local governments. Associations based on a moral economy of reciprocity, responsibility, and duty contrast sharply with imposed government structures, as Theobald put it: a "profane amoral world based on instrumental relationships premised on the accumulation of rights rather than duties" (1990: 9).

Improving governance thus involves more than simply adopting standard operating procedures and other tools of rational-legal bureaucracies. In the first place, many of these institutions are difficult to transfer. Bureaucracies, courts, the military, and so forth, must be rooted in a local culture before they can reach a level of complexity and efficiency that enables them to support effective state action (Badie and Birnbaum 1983). But even more fundamentally, this institutional evolution takes time. As Douglass North points out: "The single most important point about institutional change, which must be grasped if we are to begin to get a handle on the subject, is that institutional change is overwhelmingly incremental" (1990: 89).
Governance in the Literature: Three Approaches

A common theme linking the political science, institutional economics, and development management literature is their concern about the framework for decision making in the allocation of scarce resources. Political scientists analyze the process and structure of government: bureaucracies, political parties, popular participation, economic regulations, procedures for resolving conflict and for selecting and implementing policies (Huntington 1968). In Lasswell’s classic formulation (1958), political scientists study “who gets what, when, and how?”

Institutional economics commands a broad scope of inquiry, nothing less than “the nature of political and economic institutions and how they change” (North 1990: vii). Institutional economists extend neoclassical theory by tracing the evolution of the institutions—norms, rules, values, and patterns of behavior—that affect the performance of economic systems and the cost of market transactions. They argue that politics must be factored into analyses of economic performance: “when transaction costs are positive, the distribution of political power within a country and the institutional structure of its rule-making institutions are critical factors in economic development” (Eggertsson 1990: 248).

Development management explores the operational side of governance: improving efficiency in the allocation of resources and expanding participation in allocation decisions. Development management writing generally emphasizes the empirical, focusing on projects, programs, and policies within the context of public and private sector decision making and resource allocation. As a multidisciplinary field, development management draws on economics, management, and organization theory, as well as on sociology and political science (Bryant and White 1982). In general, analysts from all three schools argue that contemporary governance problems cannot be understood outside of their political and historical context—the context that gives political “mismanagement” its underlying logic and that creates the environment in which economic activity operates.

Accountability

Although the meanings and practices of accountability follow changes in societies, “it is found where rulers readily delegate authority, where subordinates confidently exercise their discretion, where the abuse of power is given its proper name and is properly punished under a rule of law which stands above political faction” (Lonsdale 1986: 135).

Political accountability involves ensuring that political leaders are answerable to the public, that institutionalized procedures such as elections and referendums exist for citizens to choose their rulers and influence broad policy. Electoral systems are built to enforce political accountability, and accountability is reinforced through institutionalized methods by which citizens can question government ministers, debate policy and public expenditure decisions, and lobby for policy changes. Public
accountability concerns the methods and practices whereby stakeholders—users of
government and public services, and those who supervise service providers—ensure
adequate levels of public service. Oversight problems, or “principle-agent” dilem-
mas, abound in the provision of public services, and governments have adopted
methods ranging from ombudsmen to privatization in order to promote public ac-
countability (Paul 1991).

Accountability thus has several related components: (1) the existence of constitu-
tional or legislated protection of the public interest through a code that regulates
both public and private behavior; (2) the enforcement of such laws through specific
institutions that receive adequate budgetary allocations and are independent of the
political system; and (3) a set of social expectations shared by rulers and ruled that
provides the underpinnings of enforcement and compliance.

Legitimacy, leadership, and accountability

Jean-Jacques Rousseau’s eighteenth-century idea of a social contract between
rulers and ruled described a bargain with mutual responsibilities, but it also im-
plied—much as the Chinese philosopher Mencius argued⁵—that failure of the ruler
to live up to his side of the bargain removed his mandate. Thus the failure of
accountability can lead to the loss of legitimacy. Even though legitimacy cannot be
directly addressed by institutions such as the World Bank, it is fundamental to many
analysts’ conception of governance and accountability. A legitimate system is legal,
but more importantly, citizens believe in its appropriateness and adhere to its rules.
Legitimacy thus influences the effectiveness of a government: greater efficiency
comes from the promotion of voluntary compliance with laws and regulations rather
than from reliance on coercion, threats, and personal loyalties.

Traditional systems, according to Max Weber, base governmental legitimacy on
sacred and inviolable norms and deeply held beliefs about appropriate leadership.
Compliance often relies on religious sanction and on social pressures as much as on
codified rules. Weber argued that more modern systems generally base their legiti-
macy on constitutional grounds. Constitutional legitimacy is derived from adher-
ence to the rule of law and to valued, institutional procedures that are considered
morally proper and that generally include orderly, predictable transfers of power.
Constitutional political systems build legitimacy through institutions that allow for
citizen participation in politics. The authority of government officials is underpinned
by this legitimacy.

In systems undergoing transitions from traditional to constitutional legitimacy,
leadership and governmental authority is often based on a mixture of personal
appeal and impersonal institutions. Centralized authority in many areas, for ex-
ample, is based on both traditions of hierarchy and strong personal leadership.
Legitimacy is frequently promoted and reinforced through the use of ideology,
images, and cultural symbols. Acquired in this manner, legitimacy is easily uprooted
and may ultimately rest on only lightly sheathed force.
Accountability, the state, and civil society

The existence of constitutions and formal law alone cannot explain the presence or absence of accountability. Some political scientists argue that in Africa political accountability depends "almost entirely on the ability of civil society to curb the hegemony of the state" (Chabal 1986: 13), while others point to the East Asian experience as a demonstration that in order to be accountable to society at large for the country's economic performance, the "hard" state may insulate itself from particular interests in civil society—for example, rent seekers, special interest groups, even labor (Haggard 1990).

The relationship between states, their societies, and the development of accountability is controversial. Many contend that problems of accountability are rooted in states that are "all powerful" (World Bank 1989: 61). Joel Migdal (1988) argues that states with low accountability and legitimacy are engaged in a struggle for survival: they are weak states with strong societies. Weak states have not effectively institutionalized their authority. The struggle to do so leads to the politicization of the bureaucracy and a lack of effectiveness, accountability, and control. Migdal criticizes the tendency of academics and donors to simplify bureaucratic reform failures as a product of "slothfulness, lack of will, and absence of commitment" (242), pointing out that these are rational responses to the nature of the pressures faced by bureaucrats. Attempts to promote reform must grapple with the political issues that choke administrative initiative and make it difficult to translate policy choices into policy outcomes.

One result of this state-society struggle is the fear by government officials of independent economic power. When the state is the primary route to accumulation, rent-seeking becomes an important basis for wealth, keeping control of financial resources ultimately with the state, but hamstringing efficient production. As Jean-François Bayart argues: "Where there is a greater distance between accumulation and power, there develop autonomous indigenous business classes separate from the bureaucracy ... and capable of strengthening civil society" (1986: 115–116). Separating the state from private sector accumulation provides the basis for building a separate economic arena and ultimately creates the constituency that enforces government accountability.

Accountability and foreign aid

Accountability depends in part on technical inputs: effective accounting systems, training and supervision for those who manage these systems, hardware such as fax machines, telephones, and computers to collect data and disseminate information necessary for citizens and high-level managers to hold government officials accountable. Foreign aid may have a role in assisting the development of these technical supports for greater accountability. But the historical discussion of accountability developed earlier suggests that foreign aid may also have contributed indirectly to problems of accountability currently facing many nations.

First, foreign aid in many parts of the world reduced the need for national govern-
ments to raise taxes locally in order to fund their governmental programs. When aid transfers reach ten percent or more of total GNP (as they did for at least 24 countries in 1989)\(^6\) and exceed total current revenue from other sources, those with the loudest single voice on revenue and expenditure issues are international lending agencies. Accountability thus becomes a matter not between a government and its producers, but a matter between governments and donors. Governments may face less domestic pressure to be accountable, because their elites also benefit from the international transfers. When government revenues and spending are dependent on successfully negotiating direct taxation of citizens, domestic pressure builds to enforce accountability for the use of those revenues.

Second, in many developing areas, extensive amounts of outside aid established the government’s position as the primary source of capital accumulation. Without international aid transfers, governments lacking extensive natural resources may have been forced to seek more revenue from other sources, thus giving them a greater interest in providing a conducive environment for productive activities. The private sector, on the other hand, responded to the natural incentive structure that resulted: they sought rents rather than engaging in risky production ventures; they exported capital rather than investing it locally.

Thus, foreign aid may contribute to a suppression of the state-society dialogue and may have distorted the development of nations dependent on these outside funds. While foreign aid was originally designed to fill critical savings and skills shortages, in the process it inadvertently contributed to critical political shortages. Lack of accountability has been an inevitable and perhaps, quite natural result. This strongly suggests that those who channel funds to foreign governments must find ways in which to stimulate the accountability process between governments and citizens, not only between governments and donors. Greater participation, plus a healthy sector of independent local organizations (institutional pluralism), can be important channels for structuring accountability.

**Participation and Institutional Pluralism**

Participation is an umbrella concept embracing activities by citizens intending to affect government decisions. On the national or regional level, participation can link citizens to decision making through electoral politics, lobbying, and large-scale membership organizations. At the local level, it offers opportunities for citizens to organize, solve problems jointly, and affect decisions made on projects and in communities.

Institutional pluralism refers to a “market” of institutions in addition to the state: nongovernmental organizations (NGOs), business associations, unions, youth and women’s groups, and other intermediate organizations. These institutions are the vital structures of a civil society composed of autonomous intermediate organizations (Bratton 1989). Although these organizations may not have an explicitly political role, pluralism has long represented the idea of empowerment for groups of people vis-à-vis the government. This leads many to regard official tolerance for
institutional pluralism as a vital precondition for accountability, for it allows the organization of institutions and groups as a political base from which to challenge governments to serve the public good.

Whether electoral or not, participation creates channels by which people influence their leaders. Nigerian political scientist Claude Ake criticizes the "delinking of leaders from their followers, which, among other things, has led to a dissociation of public policy from social needs and a lack of accountability and self-corrective mechanisms for public policy" (1990: 15). Ake argues convincingly for a definition of participation that involves not simply reacting to policies and programs, but of shaping them: "One is not just exercising a right of assenting or dissenting from outputs or options that are already predetermined by processes over which one has no control whatsoever" (1990: 16).

A plurality of institutions outside of the government offers opportunities for informal representation, enabling people to "reach up" to governments. Yet many political scientists dispute assertions that representative government is necessarily more effective—at least in the short run. Some argue that the development of community-based popular organizations can reinforce accountability by constraining government abuses, while others point out the risks that may accompany decentralization. Robin Theobald (1990) argues that basing structures of accountability in local community organizations risks their overpwerment by national needs. However, analysis of the Asian newly industrialized countries (NICs) suggests that their authoritarian national governments were tempered by member-controlled, local organizations that channeled rural concerns to the state. Effective interaction between local groups and government depends on formal instruments of power held by community groups: "to the extent that they contribute to salaries, or influence promotions, or determine work priorities, local communities or groups can compel field staffs to be more responsive to their concerns" (Upoff and Esman 1984: 148). For local groups, open access to the information they need to hold government officials accountable can also be critically important. Ultimately, greater openness and transparency of government decision processes and budgetary allocations may be preconditions for more accountable—and responsible—governance.

Transparency and Openness

The development of accountability, whether international, national, or local, requires an underpinning of information and a system that is open to the discovery and correction of abuses of power. An open, transparent system has low levels of government controls on the flows of ideas and information, a wide range of government information is accessible through published gazettes and other public records, and confidential classifications are strictly limited.

Transparent systems have clear procedures for public decision making; they publish budget information, including military expenditures, and minimize caisses noires and other hidden budget categories. Subsidies are clearly stipulated; appointing,
promoting, and dismissing personnel done according to stated, objective criteria. Information availability can range from requirements such as the publishing of audited accounts that add confidence to capital markets, to the disclosure of procurement procedures and the release of complete national budgets. Open channels of communication between citizens and officials provide checks on public officials and enhance accountability. Access to information, freedom of expression, and transparent channels are fundamental to the responsible exercise of voice, and they enable citizens to discover—and publicize—abuse.

Many aspects of openness and transparency can be traced to capacity problems, rather than to conscious decisions to restrict access. Funding for compiling economic statistics may be absent; auditors may not be available; those available may not be well trained. Mechanisms that impede information flows may not signal deliberate closure, yet these can affect performance.

Closed systems also multiply opportunities for corruption. Theobald’s (1990) thoughtful review of corruption in less developed countries defines corruption as “the illegal use of public office for private gain.” Theobald notes a number of ways in which societies have reduced their tolerance for corruption, although scandals continue to plague rich and poor countries alike. Theobald shows how the development of civil society and alternative economic bases outside both the aristocracy and the government served eventually to reshape government behavior. In Europe, for example, the development of the private sectors, a free press, and citizen groups led to the gradual discontinuation of behaviors now considered corrupt but once considered quite normal.

Lack of transparency is clearly not the only factor involved in corruption. Weber noted that regular salaries are one distinguishing characteristic of rational bureaucracies, as they provide for more effective government control over officials. Chronic fiscal crises, and problems with regular payment of salaries distance officials from that government control while also providing strong incentives to supplement income from corruption. Privatization, or the reduction of government controls and regulations and the sale of public enterprises to the private sector, has potential to increase transparency and reduce corruption abuses. However, privatization may not enhance accountability or efficiency if the service is a monopoly, is not purchased, or if oversight and regulation are not in place (White 1990).

Diminishing corruption is related not only to issues of openness, transparency, and civil service reform, but very fundamentally to issues of the distribution and nature of power and to those of accountability. Without accountability, corruption and power frequently coexist. As Lord Acton noted in another context: “Power tends to corrupt, and absolute power corrupts absolutely.” As market-based production opportunities develop and give entrepreneurs bases of wealth outside of politics, the emergence of an entrepreneurial class may force the attachment of “real risks and penalties . . . to the pursuit of wealth through political corruption” (Diamond 1990: 403).
Predictability and the Rule of Law

“A market,” comments Jeremy Paltiel, “is not just an economic mechanism; it is a legal regime” (1989: 266). The development of a rule of law establishes the standards of accountability against which both public and private sector actions are measured. It regulates the market system through establishing exclusive property rights, the sanctity of contract, and common standards—all of which underpin market exchanges (Cerny 1990). It provides the conditions under which openness and transparency become the norm in public-private transactions.

The “rule of law” may be defined as “the subordination of the behavior of state officials to rational, predictable, and publicly recognized procedures” (Paltiel 1989: 266). It is an essential precondition for accountability, and predictability. A rule of law implies standard operating procedures, clearly promulgated and indiscriminately applied rules, and regularized procedures for establishing and implementing policies. In systems with high predictability, lines of authority are clear and capriciousness at a minimum. The civil service is insulated from politics rather than penetrated by it; when political leadership changes, the civil service acts as a stabilizing source of continuity. But no system of law, whether constitutional in origin or not, can persist over time unless the laws themselves represent the crystallization of society’s values and are seen as legitimate.

This crystallization is a topic of research for many political scientists who are concerned with political stability as a function of regularized patterns of interaction, and the successful institutionalization of rules, norms, and procedures. Samuel Huntington set the terms for the modern discussion of post-Weberian rationalization in Political Order in Changing Societies (1968) in which he argued that social and economic change breeds instability when it destroys traditional institutions without creating “new bases of political association and new political institutions combining legitimacy and effectiveness.” Huntington pointed out that:

political institutions have moral as well as structural dimensions. A society with weak political institutions lacks the ability to curb the excesses of personal and parochial desires. . . . Morality requires trust; trust involves predictability; and predictability requires regularized and institutionalized patterns of behavior. Without strong political institutions, society lacks the means to define and to realize its common interests (1968: 12, 5, 24).

Development management and public administration theorists focus much of their field of inquiry on the practical aspect of these questions: how can institutional evolution be accelerated? They argue that while change occurs slowly, institutions are social creations, and hence can be modified by purposive action. The learning process that underlies directed institutional and organizational change occurs most efficiently when an organization can “embrace error” and promote conscious social adaptation (Korten 1980).

The work of Douglass North and other institutional economists explores the origins of the legal and political institutions that create predictability through defining clear property rights. Barzel defines property rights of individuals over assets as
"the rights, or the powers, to consume, obtain income from, and alienate those assets" (Barzel 1989: 2). The structure and enforcement of property rights determines economic incentives and their stability and predictability. How do these rights evolve? States interact with their societies over the definition (and redefinition) of property rights, the provision of public goods such as infrastructure, and the establishment of standard weights and measures. As economies develop, legal institutions and property rights evolve to support transactions that increase in complexity and impersonality—although states will define property rights in different ways depending on the distribution of political power and the structure of local legal systems.

The rule of law is also essential in another respect—to protect the rights of citizens in their efforts to force accountability from governments. In Latin America, "crucial individual and collective rights were made effective before the convocation of competitive elections, the organization of effective interest representation, and the submission of executive authority to popular accountability" (O'Donnell and Schmitter 1986). Barzel, in fact, argues that "the distinction sometimes made between property rights and human rights is spurious. Human rights are simply part of people's property rights. Human rights may be difficult to protect or exchange, but so are rights to many other assets" (1986: 2).

While the relation of political rights to good governance is not necessarily direct, historically, political rights and personal or human rights appear to be necessary to underpin market systems. Free movement of goods, freedom to establish businesses, security from arbitrary expropriations—property rights—are all related to the protection of personal liberties. Recent experience in the Asian NICs (Korea, Taiwan) provides some evidence that sustaining open economies in the long term appears to require a degree of political openness, at least guarantees of certain political freedoms such as speech, association, and the media, as spelled out in the 1983 United Nations Universal Declaration of Human Rights.

The establishment of appropriate legal systems takes time, particularly when they must support rapid economic transition, from command to market systems, or from a precapitalist to a fully capitalist economy. Paltiel argues that where law and property rights are weak, entrepreneurs often seek to enhance security and reduce risks through finding governmental patrons to protect their business activities. This clientelism, he suggests, becomes "the functional substitute for property rights" (1989: 257). While Paltiel points out that contemporary clientelism "subverts the impersonal operation of predictable rational-legal norms within the state," his description could easily apply to earlier periods in European history, where human relations rather than an impersonal market governed economic transactions.

Establishing the rule of law is a process involving effective communication of the content of the laws. It involves predictable and legally enforceable methods for changing the content of the laws, so that ad hoc decrees do not continually change the legal and regulatory environment, rendering both people and their property insecure. It also involves the effective enforcement of law through adequate budgets, salaries, staff, and workable institutions. Governments may enact and promulgate laws, but this hardly guarantees their enforcement. Constitutional establishment
of codes of conduct and monitoring tribunals to address public corruption may be thwarted without enabling legislation and an independent budget, as Larry Diamond points out in the case of Nigeria (1990: 384–385).

Finally, the rule of law is closely intertwined with legitimacy, whether based on traditional law (patrimonial legitimacy) or modern law (rational-legal legitimacy). In many postcolonial areas, European legal systems were imposed through conquest or implemented adjacent to indigenous legal systems. In Europe these systems grew out of traditional norms and experience, but they were not so rooted in the former colonies. They lacked the legitimacy of tradition. And yet legitimacy is not a function of tradition alone, but of broader notions of justice. As Rhoda Howard points out: “The key to legitimacy will be, however, not the indigenous nature of the law, but whether it is perceived to be fair and nonarbitrary. The criteria of fairness will depend not upon the law itself, but upon public consciousness of how [ruling class elites] accrue political and economic privilege, and the public perception of whether or not such privilege is, in its turn, legitimate” (1985: 347).

Does Governance Matter? Governance and Economic Performance

Empirical research relating specific aspects of governance to economic performance is quite scarce. Most of the political science literature reverses the dependent and independent variables, examining the impact of economic conditions on the development of democratic institutions. Those who do address the issue of government and economic performance tend to examine regime-types (authoritarian, patrimonial, democratic, and so forth) rather than the narrower elements we are concerned with here (accountability, openness, predictability). Their conclusions support the practical view that in its earlier stages, economic growth is correlated with adherence to known policies: good fiscal management, skillful use of government instruments to manage the market, competitive enterprise systems that reward performance, broad-based education, and support for the rule of law. These policies show up in both authoritarian and democratic regimes.

Accountability and Economic Performance

The relationship of accountability to economic performance is contingent upon numerous intervening variables; there is no clear evidence that accountability “guarantees social justice and economic development” (Lonsdale 1986: 128). And yet, responsible administration is clearly critical in economic development. Economist L. G. Reynolds’s analysis of economic growth from 1850 to 1950 in forty developing countries suggested that “political organization and the administration of government” constituted “the single most important explanatory variable” (Reynolds 1983: 976).

The Asian NICs (Korea, Taiwan, Singapore) provide a useful foil for this discussion. Although for most of their modern history these nations have been nondemocratic, their governments drew much of their legitimacy from deeply held
social norms, based on acceptance of the view that governments must take the lead in creating conditions that support prosperity for their people, and on their position as small neighbors of larger and potentially threatening countries. Confucian ideals underscored the economic responsibilities of wáng (kingly) government, based traditionally on equitable land distribution and broad-based growth. In modern times, the powerful capacity of these governments to select and implement their chosen policies, together with the integrity of the government bureaucracy, explains much of their economic success, which in turn enhances legitimacy. They are accountable to their people for economic performance.

The skill and capacity of the NIC governments is self-evident. Yet capacity is in large part a function of political decisions. Governments decide where to allocate scarce resources: to education, or to parastatal subsidies, for example. They create the conditions under which skills can be effectively used. Governments in a number of developing countries have lost some of their most skilled public servants, who left their countries, not only for financial reasons, but also to escape the frustration of corruption, rent seeking, and patronage politics.

The absence of legitimacy can affect economic performance. Governance based on personal loyalties, patron-client ties, appeals to particular ethnic groups, or through the “purchase” of allegiance offers only limited legitimacy. Military budgets may absorb a large portion of the nation’s scarce resources—and often for use against domestic opposition. Those who do not benefit from these narrower bases of legitimacy may be more apt to challenge the government through strikes, demonstrations, and violence. In systems with high legitimacy, citizens may be more willing to save, to defer gratification, and to accept unpopular economic decisions in the belief that the government is acting in their interests.

Participation, Institutional Pluralism, and Economic Performance

Participation, in the sense of democratic processes and electoral representation, has received considerable attention in the literature. However, as previously mentioned, the choice of the dependent and independent variables does not always provide much evidence of the economic impact of open polities (Kohli 1986; Haggard and Kaufman 1989; Remmer 1990). The evidence suggests a correlation between participation and broad-based growth with equity. Tatu Vanhanen’s (1990) statistical analysis suggests that in the long term, effective political participation and “popular accountability” are correlated not simply with market systems, but on an equal distribution of economic power resources (wealth and assets), and on education. Morris and Adelman’s extensive study comparing paths of development from 1850 to 1914 found clear evidence that “increased political power to nonelite groups is essential (but not sufficient) to government policies that spread growth widely” (1989: 1428).

However, a growing body of literature has documented the important role participation plays on the grassroots level in increasing the effectiveness of project and program decisions, not simply through accountability, but in increasing the appro-
priateness of project investments. Popular participation enhances sustainability of benefits, particularly for family planning, local irrigation, agricultural extension, urban upgrading, and community water supply (see, among others, Bryant and White 1984; Uphoff and Esman 1984; World Bank 1985; Salmen 1987). Economic performance on the microlevel can be strengthened by citizen participation, particularly by grassroots organizations able to influence project design decisions and affect the management of project activities. Some evidence exists as well that economic policy reforms may be more sustainable when governments consult with major societal groups during planning and implementation of adjustment (Nelson, 1989, 1990; White 1990).

But participation has its constraints, as well as its potential benefits. Huntington and Nelson argued that effective land reform, one of the key components to later economic equality, is best introduced under “noncompetitive and nondemocratic governments,” i.e., those with low participation. When medium-sized landowners are able to use legislative means to obstruct reforms, “land reform becomes difficult or impossible” (1976: 76). In a related vein, rational choice economist Mancur Olson (1981) has argued that pressure by trade associations and other economic advocacy groups in advanced industrialized nations led to policy decisions that lowered economic performance. Olson argues that the problems of collective action—free riders, the need for selective incentives, the near impossibility of organizing mass groups (the poor, the unemployed, consumers) to bargain for their common interests—make it unlikely that any society will achieve equity or efficiency through comprehensive group bargaining. It is more likely that small groups will exercise “lobbying and cartelistic power” for redistribution on behalf of their special interests—to push society away from equity and efficiency; i.e., it is easier to bargain over a slice of the pie than to join forces to make the pie bigger. As these distributive groups increase in number, Olson argues, regulations increase in complexity, government bureaucracies expand, and growth slows.

Furthermore, many of those who study the Asian NICs argue that the autonomy of the state from social groups enabled it to conduct economic policy free from distributive pressures. With the possible exception of Japan with its contestable political system and respect for civil liberties, the industrialized countries of Asia achieved their remarkable economic performance with very little political openness. In fact, they frequently created a politically insulated bureaucratic elite, with planning concentrated in semiautonomous institutes and councils. As mentioned earlier, Stephan Haggard argues that low formal participation—limits on party representation, interest group formation, and labor organization—allowed political space for these Asian governments to move rapidly in devising, adjusting, and implementing growth-oriented policies without significant societal pressures. Each of the Asian NICs he examined was marked by “tightly controlled” channels of representation, and economic policymaking processes “relatively insulated from direct political pressures and compromises” (1990: 262).

The case of the authoritarian but developmental NICs raises important questions
about the fundamental nature of accountability and its relationship to pluralist systems based on representation. Most political scientists educated in the Western European tradition link accountability directly to electoral representation, even though the literature does not support clear causality. If rulers are ultimately accountable to their people for the performance of the economy, then a measure of accountability existed even in the nonpluralist authoritarian states that lacked representation, but had fairly honest rulers, low corruption, and equitable income distribution. Given the events of the past few years in Korea and Taiwan, however, acquiescence in a nonrepresentative but prosperous system may be only temporary. Sooner or later, people seem to demand the right to participate in society’s major decisions.

Openness, Transparency, and Economic Performance

Although economic openness has been correlated with economic efficiency since the days of Adam Smith, other aspects of openness are less clearly empirically related to development. Some specific examples exist in the literature of the economic cost of a lack of transparency in the form of a highly discretionary bureaucracy. High levels of executive discretion can “weaken auditing, oversight and planning” leading to “increasing uncertainty, loss of confidence, a decline in productive investment, capital flight, and finally, open political opposition” (Haggard 1990: 128). Yet, paradoxically, high levels of discretion are not always correlated with poor growth. Many countries with superior economic performance exercise a high degree of discretion, rewarding performance, channeling extra resources toward high efficiency activities, and even “negotiating all investments on a case-by-case basis” (Haggard and Cheng 1987: 116).

As mentioned earlier, lack of transparency can increase the costs of monitoring compliance in contractual relationships: the principal-agent dilemma. With poor information, or information deliberately withheld, the costs of enforcing contracts and conducting transactions rise, with an overall negative impact on national economies.

Lack of transparency creates a “moral hazard” whereby the actions of agents are difficult or impossible to monitor, a situation that can promote corruption, with its own impact on economic performance. Some have argued that corruption provides economic benefits; in effect, in countries with uneven adherence to formal rules of law, corruption can increase predictability through lowering risks, offering a form of insurance, and softening the distortions of quotas and licenses by creating a de facto market for their allocation. Yet corruption clearly wastes national resources, undermining stability and administrative capacity, and postponing the evolution of bureaucracies based on universalistic criteria. Perhaps the most serious consequence of corruption is that it erodes the confidence of citizens in government—it undermines legitimacy and ultimately weakens the state. As that happens, governments encounter even greater problems acquiring strength to enact policies and to implement them.
Predictability, the Rule of Law, and Economic Performance

Adam Smith commented in 1755 on the importance of the rule of law for economic prosperity: "Little else is required to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things."9

Economic policies always encounter uncertainties. These uncertainties are worsened, however, when there is great capriciousness or instability surrounding either the way policies are made or by whom they are made. Predictability is essential for long-term capital investment. Market-based economies depend on legal regimes composed of property rights and the sanctity of contracts. A legal system and government administration in harmony with the market enhance predictability, calculability, and efficiency. This relationship reduces transaction costs and makes possible the interactive economic management needed for economic performance.

A major vehicle for this predictability, as recently argued, is well-defined and protected legal rights, particularly property rights. Institutional economists argue that economies need incentives to operate close to the technical production frontier; incentives depend on the structure of property rights, which is determined primarily by the state. Secure property rights enhance stability and predictability; they shape the "structural frontier" of an economy (Eggertsson 1990: 326–327). When property rights are incomplete, easily abrogated, or unstable, economies suffer. Acts of the predatory state alter investment in profoundly costly ways, affecting choice of technology and inputs, production processes, and social discount rates. The nature of investment, and sometimes its very presence or absence, depend on investors' reading of the likelihood of appropriation through decree or through suddenly adjusted "taxation."

Economic performance is a matter not simply of growth, but of growth with equity. This discussion of the development impact of predictability and the rule of law would be incomplete without a warning on the problem of unequally distributed property rights (Lindblom 1977; North 1990). Governments play a significant role in determining both the structure of laws and their enforcement. Depending on the motivation of government actors, the institutional base of property rights may be politically derived and dependent on clientelist or patrimonial ties. Thus, the rule of law may operate smoothly and still suppress broad-based growth. For example, legal discrimination against women's participation in the labor force can lead to distorted labor markets and lower economic performance.

It is difficult to draw a correlation between governance and economic performance with any degree of precision. In part, this is due to the dearth of research focused on the specific variables under discussion in this review: accountability (including participation and institutional pluralism); openness and transparency; and the rule of law. In keeping with the intellectual and professional interests of many who work and practice in this area, research tends to focus more on the relationship of regime type to growth, or stability to growth. In addition, political questions by
their nature tend to promote value-based assumptions, for example, that institutional pluralism, participation, and the rule of law are "good" in and of themselves, leaving the scope of inquiry focused on the means to these ends.

Research attempting to correlate economic performance to governance variables must necessarily use a relatively short time frame. The recent economic performance of Chile, Taiwan, and South Korea took place with very low levels of political openness, and their market economic systems seemed to work in the absence of pluralistic political systems. In the past few years, however, all three have made significant transitions toward more open, competitive, and participatory political systems, suggesting that sustaining as opposed to establishing market based growth may require the development of political representation. With the renewed interest in open political systems as a corollary to open economic systems, we can expect a new generation of research on these variables.

**Conclusion: Governance, Economy, and Foreign Aid**

Improving governance is a long-term endeavor; the issues are complex and interrelated: accountability needs both openness and a rule of law for its effective enforcement. It takes generations and perhaps centuries to build effective bureaucracies; the issue is not simply skills but volition—and much of that volition comes from effective social pressure on the state. This needs to be understood by donors who may wish to make "governance" the temporary trend of the 1990s. The question for donors should be: how can the process by which accountability and the rule of law become the norm in a society best be nurtured?

This article indicates that effective property rights and accountability are more likely to result from a long-term, participatory dialogue between governments and their private sector, rather than between governments and donors. The historical discussion, in particular, underlined the potential for danger in supplementing domestic resources with foreign aid funds. Too often, donor programs replace rather than encourage domestic savings. But the problem is potentially more profound than this. In Europe, accountability developed through a state-society struggle over the collection of tax revenues and their use. In many of the world's least developed countries tax revenues make up a high percentage of GDP but are derived largely from taxes on international trade, not domestic consumption. While individual importers may bargain with government over the import duty levels, the political base of local elites that would support enforced accountability does not feel the impact of these taxes directly. With foreign aid in many of these countries making up a towering proportion of national revenues, the dialogue over accountability naturally becomes one between states and donors. The process of assistance inadvertently undercuts the historical process of rulers first becoming accountable to elites for the use of their tax revenues.

What can be done? Donors must be aware of the distorting effect of such large sums of external assistance. They must make concerted efforts to foster internal debate, dialogue, and negotiation on decisions to allocate foreign assistance—ef-
forts that push the new concern for "local ownership" toward a deep commitment to work together to develop economic policies, even if such a process is slow and involves frustrations. This should encourage the development of accountability as a matter between governments and citizen, and not only one between governments and donors. For in the final analysis, the quality of governance is a reflection of the quality of the relations between a state and its society, and only over time can societies push their governments to deliver the accountability, openness and predictability that sustainable development requires.

Notes

An earlier version of this article was produced while I was a visiting researcher at the World Bank under an International Affairs Fellowship from the Council on Foreign Relations. I am grateful to both institutions for their support. Coralie Bryant and Sarwar Lateef provided particularly valuable suggestions and contributed greatly to refining the ideas and their presentation. I acknowledge as well the helpful comments of Leslie Snyder, Lisa Pachter, Salvatore Schiavo-Campo, Ladipo Adamolekun, Pierre Landell-Mills, David Beckmann, Valeriana Kallab, Geoffrey Lamb, Samuel Paul, and Dunstan Wai. Of course, any errors or misinterpretations that may persist are the responsibility of the author alone.

1. See, for example, the Stockholm Initiative on Global Security and Governance, the United States Agency for International Development's Democracy/Governance program in Africa; the Global Coalition for Africa; the Governance session at the 1991 World Bank Annual Conference on Development Economics, and so forth.


5. Mencius (c. 371–c. 289 B.C.) elaborated the Confucian idea of governance by arguing that the people had the right to overthrow a leader who lacked the necessary moral qualities: such an act was not regicide; since the ruler did not live up to the responsibilities inherent in his title, he was not really a ruler.


7. For a review of the material in this field, see Coralie Bryant and Louise G. White, Managing Development in the Third World (Boulder, CO: Westview Press, 1982).

8. Nathaniel Leff suggests that under certain conditions, corruption may have "important positive effects," enabling entrepreneurs to cut through restrictive business regulations and eliminating red tape. See Nathaniel H. Leff, 1964. "Economic Development through Bureaucratic Corruption." The American Behavioral Scientist vol. 8, no. 3 (November): 8–14. Theobald echoes this in his admission that corruption "assists capital formation; it fosters entrepreneurial abilities; allows business interests to penetrate the bureaucracy and, lastly, permits the logic of the market to insinuate itself into transactions from which public controls attempt to exclude it" (Theobald: 116). For one of the latest contributions to this debate, see M. S. Alam, "Some Economic Costs of Corruption in LDCs," Journal of Development Studies, vol. 27, October 1990: 89–97.

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