

World Governance Survey Discussion Paper 8**July 2003****ECONOMIC SOCIETY AND GOVERNANCE IN 16 DEVELOPING COUNTRIES****Goran Hyden, Julius Court and Ken Mease¹****Introduction**Assessing Governance

UN Secretary-General Kofi Annan has stated that ‘good governance is perhaps the single most important factor in eradicating poverty and promoting development.’² If governance matters, so does the need for more reliable and valid data on key governance processes. Many analysts believe, however, that current indicators provide inadequate measures of key governance processes. Based on the perceptions of experts within each country, governance assessments were undertaken in 16 developing and transitional societies, representing 51 per cent of the world’s population. The aim of the World Governance Survey (WGS) was to generate new, systematic data on governance processes.

To facilitate cohesive data collection and analysis, the governance realm was disaggregated into six arenas:

- (i) Civil Society, or the way citizens become aware of and raise political issues;
- (ii) Political Society, or the way societal interests are aggregated in politics;
- (iii) Executive, or the rules for stewardship of the system as a whole;
- (iv) Bureaucracy, or the rules guiding how policies are implemented;
- (v) Economic Society, or how state-market relations are structured; and,
- (vi) Judiciary, or the rules for how disputes are settled.

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² Kofi Annan, *Partnerships for Global Community: Annual Report on the Work of the Organisation* (UN, 1998).

The project identified 30 indicators based on widely held ‘principles’ of good governance – participation, fairness, decency, accountability, transparency and efficiency – with five indicators in each arena.

In each country, a national coordinator selected a small panel of experts – c35-40 well-informed-persons (WIPs) to complete the assessment. The panel included, amongst others, government officials, parliamentarians, entrepreneurs, researchers, NGO representatives, lawyers and civil servants. Respondents were asked to rank each answer on a scale from 1 to 5; the higher the score, the better. In addition, respondents were invited to provide qualitative comments. The total governance scores have a very robust correlation (0.77) with the country scores in Kaufmann et al’s aggregate governance indicators, indicating the validity of the results.³ Previous discussion papers looked at the issues of *Governance and Development*⁴ and *Assessing Governance: Methodological Challenges*⁵. This paper focuses on the economic society arena.

Economic Society

“Economic society”, a term that we borrow from Linz and Stepan⁶, refers to state-market relations. This arena is constituted by the rules that apply to these relations. It is different from civil society in that economic society is made up of actors engaged in the pursuit of monetary gain. Thus, a private corporation or a small, one-person business is part of this arena. Any organization that speaks on behalf of businesspersons, e.g. a Chamber of Commerce, carries out its activities in civil society. Like civil society, economic society has gained prominence in both academic and policy-oriented circles in recent years. Two recent Nobel Laureates in economics – Douglass North and Joseph Stiglitz – have devoted much of their professional career to examine the nature of economic society. The World Bank,

³ Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, ‘Governance Matters II: Updated Indicators for 2000/01’, *World Bank Policy Research Working Paper No. 2772*, 2002.

⁴ Goran Hyden and Julius Court, 2002, *Governance and Development, World Governance Survey Discussion Paper 1*, Tokyo: UNU.

⁵ Julius Court, Goran Hyden and Kenneth Mease, 2002, *Assessing Governance: Methodological Challenges, World Governance Survey Discussion Paper 2*, Tokyo: UNU.

⁶ Juan Linz and Alfred Stepan, *Problems of Democratic Transition and Consolidation: Southern Europe, South America, and Post-Communist Europe*. Baltimore: Johns Hopkins University Press 1996.

the most visible and influential actor in this field, has devoted two of its recent reports on the state of the world economy to the significance of state-market relations⁷.

Although there has been a convergence in economic thinking in the past two decades in the direction of accepting the value of a free market, no country follows a pure laissez-faire approach to economic management. No less an advocate of the ‘invisible hand’ of the market than Adam Smith acknowledged that the state is necessary to perform certain economic functions. These include formulating economic policy, regulating the economy, providing economic infrastructure and services, providing public goods and dealing with other ‘market failures’. Governments fulfill these tasks in different ways and to different degrees.

The rules that apply to economic society are often referred to as the economic regime of a country. This regime is shaped by several factors, but at least three important ones deserve mentioning here. The first is the extent to which economic and financial markets have been liberalized. Much economic reform in the past twenty years has focused on reshaping public finance through monetary, budgetary and trade policies that reduce control by the state. The second is political democratization. Some countries have carried out extensive political reforms simultaneously with economic liberalization; others have been more cautious. Argentina is an example of the first approach; China an example of the second. The third factor is globalization. With fewer regulations at state level, international economic factors are bound to play a greater role in shaping national economies. Countries with developed economies dependent on modern technology start from a stronger position than countries, which are economically less developed and in a more peripheral position in the global economy. How much the latter will benefit from globalization is an important factor in shaping the rules of this arena.

It is against this background that our survey was conducted. What we are concerned with here is the perception of the rules of the arena, not the outcome *per se*. As we have stated earlier in this volume, the legitimacy of the rules is an important determinant of policy

⁷ World Bank, *World Development Report 1997: The State in a Changing World*. New York: Oxford University Press 1997; and World Bank, *World Development Report 2002: Building Institutions for Markets*. New York: Oxford University Press 2002.

outcome. Governance interventions to shape or reshape these rules tend to be noted not only by the business community but a lot of other people too. Thus, it is clear to us that how they are actually handled matters a lot to various aspects of national development.

This paper is organized in the same fashion as the previous four. It starts with a review of the literature on the subject matter of this paper. It proceeds by analyzing the aggregate findings of the World Governance Survey with a comparison both among countries and over time. After examining more closely responses related to each individual indicator, we conclude with a discussion of the implications for research and practice.

Governance Issues in Economic Society

State-market relations have come to occupy an increasingly important position in the literature on development. The first part of this section discusses this literature in more general terms, focusing on some of the more important contributions. The second part concentrates on which specific issues are of interest in the governance context of this arena.

Economic Society and Development

Several theorists have contributed to our understanding of the role that rules and institutions play in economic development. On the academic side, at least three authors stand out as especially influential: Douglass North⁸, Ronald Coase⁹ and Oliver Williamson¹⁰. Drawing here especially on North, he demonstrated that institutions, the formal and informal rules of the game, create a powerful incentive system for a society, thus affecting decision-making by public and private actors. North also argued, that the rules – at least formally – are often created to serve the interests of those with the bargaining power. The result is that benefits and other outcomes are not distributed evenly. As one can see in many countries – both developed and developing – what is good for the group in power is not necessarily good for

⁸ Douglass North, *Institutions, Institutional Change and Economic Performance*. Cambridge: Cambridge University Press 1990.

⁹ Ronald H. Coase, 'The Institutional Structure of Production', *American Economic Review*, Vol. 28, No. 4 (1992), pp. 713-720.

¹⁰ Oliver Williamson, "The Institutions and Governance of Economic Development and Reform", in *Proceedings of the World Bank Annual Conference on Development Economics 1994*, Washington, D.C.: The World Bank 1995.

the country. Private interests are pursued at the expense of a common or public interest. Similarly, the interests of those living and benefiting now are often favored over those of coming generations. These are issues that countries around the world are increasingly faced with, because of the way state-market relations have been structured in recent years.

Because so much of a person's welfare or a country's development rests on the rules of this arena, it is no coincidence that such principles as transparency, accountability, efficiency and fairness have become of special significance here. A growing number of studies commissioned by the World Bank and other international bodies like Transparency International (TI) confirm this observation. Based on an extensive survey of firms, the *World Development Report 1997* demonstrated the importance of policy stability, the nature of regulations, and the effects of corruption on business performance.¹¹ Knack and Keefer highlight the importance of institutions that protect property rights for investment and growth.¹² As noted already in Working Paper Seven, Mauro shows that corruption is negatively associated with economic growth.¹³ In its most recent global corruption report, TI discusses the relationship between access to information, corruption, governance, and development.¹⁴

Some of the clearest evidence about the importance of state-market relations for growth and development comes from the work of Kaufmann and his colleagues.¹⁵ Based on aggregating much of existing data, Kaufmann et al. have created indices for "Corruption" and "Regulatory Quality" (the latter including policy issues such as price controls as well as perceptions on issues such as excessive regulation) and ran regression to see whether governance mattered.¹⁶ Their findings are clear, that better regulatory quality and lower corruption are positively associated with per capita incomes and adult literacy and

¹¹ World Bank, 1997, *op cit.*

¹² Stephen Knack and Philip Keefer, "Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures", *Economics and Politics* 7 (1994), pp. 207-227.

¹³ Paolo Mauro, "Corruption and Growth", in *Quarterly Journal of Economics*, No 110 (1995), pp. 681-712.

¹⁴ Transparency International, *Global Corruption Report 2003*. London: Profile Books 2003.

¹⁵ D. Kaufmann, A. Kraay, and P. Zoido-Lobaton, "Governance Matters", *Research Policy Working Paper No 2196*. Washington D.C.: The World Bank, 1999; D. Kaufmann, A. Kraay, and P. Zoido-Lobaton, "Governance Matters II: Updated Indicators for 2000/01", *World Bank Policy Research Working Paper No. 2772*. Washington D.C.: World Bank 2002; and, D. Kaufmann and A. Kraay, "Governance and Growth: Causality Which Way?" *World Bank Research Working Paper*, Washington D.C.: World Bank, February 2003 •

¹⁶ D. Kaufmann, A. Kraay, and P. Zoido-Lobaton, "Governance Matters", *op cit.*

negatively associated with infant mortality. Another recent contribution by this group of analysts was prepared for the World Economic Forum.¹⁷ It shows convincingly that the business climate in a given country is very much shaped directly by governance issues. In short, how transparent rules are, how reliable they are, and what results they encourage make a lot of difference to investment as well as other related indicators of economic development.

Which Rules Matter?

As we have shown above, governance issues in economic society have an important bearing on the overall quality of governance as well as economic development. But are some rules more important than others? In designing this project, we were faced with prioritizing those that both literature and development practice indicated are the most important.

Although we were unable to rely on it in 2000 when this study was designed, the *World Development Report 2002* provides a useful framework for our discussion here since it synthesizes the latest research and practice regarding why and how institutions affect growth and poverty reduction. When the Bank refers to institutions it implies rules that guide specific phenomena in the economy, e.g. ownership of property, conduct of business, or resolution of conflict between contending parties. More specifically, it argues that institutions support the functioning of markets with regard to access to information, protection of property rights and regulation of competition. Our approach is quite similar and covers much the same ground. Thus, we include here four specific issues that are of relevance to the reader of this paper: (1) information sharing, (2) property rights, (3) competition, regulation and corruption, and (4) global influences.

Information sharing

Institutions support markets by channeling information about markets products, participants and conditions. It is easy to see that this has a critical impact on the efficiency

¹⁷ D. Kaufmann, 2003, "Rethinking Governance: Empirical Lessons Challenge Orthodoxy", *World Bank Research Working Paper*, Washington D.C.: World Bank, March 2003.

of markets. Buyers and sellers need to know about prices in order to make informed decisions about purchases and investment. Stiglitz is particularly known for studies on information and its impact on economic efficiency.¹⁸ Actors in the marketplace are not equally well placed to take advantage of information. Some are even excluded from it by virtue of their location. This is especially true in developing countries, where markets are still emerging and functioning in less efficient ways. A sense of being at the mercy of the ‘invisible hand’ of the market is a very common reason for aversion to its operations. For instance, smallholder farmers or micro-entrepreneurs in Africa or Asia are often reluctant to use the market, because they suspect that others who are better informed and more powerful exploit them¹⁹.

Information sharing goes beyond the issue of how it affects business in the short term. As Fukuyama shows, information sharing is a key indicator of trust. Information flows more easily and effectively in some channels or circles than in others²⁰. It typically begins with relatively closed circles, e.g. a family or clan. Once it reaches efficiency at that level, the challenge becomes that of sharing information over longer distances and with people whom one doesn’t know personally. This is an issue that business faces in most developing countries, but is rarely covered in the literature on the role of business because it deals with corporate entities that already are operating across national and cultural boundaries. These consolidated giants have their own culture and sharing information within them for purpose of effective corporate governance is much less of an issue, if at all.

Information sharing within or among businesses, however, is not the sole issue here. The extent to which business people have access to information stemming from government and may actually be part of a consultation process is also important. Do rules allow for such consultation and information sharing? This is an important question in many countries, where transparency is not institutionalized and government officials are used to making decisions at their own discretion. We know from what business leaders tell us that consultation and information-sharing is not only good for business, but also for the

¹⁸ For example see Joseph E. Stiglitz, “Information and Economic Analysis: A Perspective,” *The Economic Journal*, Vol. 95, Supplement: Conference Papers (1985), pp. 21-41.

¹⁹ James C. Scott, *Weapons of the Weak*. New Haven and London: Yale University Press 1985.

²⁰ Francis F. Fukuyama, *Trust: The Social Virtues and the Creation of Prosperity*. New York: Free Press 1995.

government, because it tends to enhance the legitimacy of the rules that guide economic society.

Issues of relevance here would include, among others, whether firms are consulted about potential changes in economic policy, whether forums for interaction exist (e.g. consultation committees), whether information is provided in an exclusive manner, whether private sector groups are seen as legitimate and representative.²¹ Much of the literature on this set of issues comes from Asia.²² For example, Japan is seen to have deep and multiple mechanisms for interaction between state and private sector actors, both formal and informal.²³ In Thailand, business government collaboration is institutionalized in many industries, but co-exists with endemic corruption.²⁴

Property rights

Security of property has been a universal concern for a long time. It was a sufficiently strong issue when the United Nations was formed and nations came together to write and adopt the Universal Declaration of Human Rights in 1948. This document states in Article 17 that “everyone has the right to own property alone as well as in association with others,” and, “no one shall be arbitrarily deprived of his property.” In recent years, this universal principle has been turned into a global policy prescription: private property provides the best incentive for material progress.

The theory of property rights comes out of economics. Among those who have contributed to its specification are Demsetz²⁵ and De Alessi²⁶, both of whom argue and accept that the structure of property is a more powerful predictor of organizational behavior than any other

²¹ I. Marsh, “Economic Governance and Economic Performance”, in Ian Marsh, Jean Blondel and Takashi Inoguchi (eds), *Democracy, Governance and Economic Performance: East and Southeast Asia*. Tokyo: UNU Press 1999.

²² World Bank, *The East Asian Miracle: Economic Growth and Public Policy*. New York: Oxford University Press 1993; and, Peter Evans, *Embedded Autonomy: States and Industrial Transformation*. Princeton: Princeton University Press 1995.

²³ D. Okimoto, *Between MITI and the Market*. Stanford: Stanford University Press, 1989.

²⁴ Anek Laothamata, *Business Association and the New Political Economy of Thailand: From Bureaucratic Polity to Liberal Corporatism*. Boulder CO.: Westview Press 1992.

²⁵ H. Demsetz, “Toward a Theory of Property Rights”, *American Economic Review*, vol 57 (1967), pp 347-359.

²⁶ L. De Alessi, “The Economics of Property Rights: A Review of the Evidence”, *Research in Law and Economics*, vol 2 (1980), pp 1-47.

variable. Property rights, in their view, specify the social and economic relations that people must observe in their use of scarce resources, including not only the benefits that owners are allowed to enjoy but also the harms that they are allowed to cause.²⁷

Some authors have taken the issue of property rights to a different level. For instance, North²⁸ suggests that in a historical perspective there is a relationship between private property rights and national economic development. What works at the micro or intermediate level, also works at the macro level. Hernando de Soto makes a similar point with reference to Peru. He argues that, among many benefits, having clear titles to land allows owners to use their property as collateral for loans that assist in home development²⁹. The 2002 *World Development Report* brings much of the recent evidence together and points to evidence that property rights are highly correlated with variables at both micro and macro levels.³⁰

The problem that many developing countries encounter because property rights are not fully institutionalized is that there is lack of respect not only for private but also public property. Because the line between the two is not respected, private property may be confiscated on flimsy grounds and public property is being used to ‘feather’ private nests. One of the first to draw attention to this issue was Colin Leys in an account of Kenyatta’s Kenya in the 1970s³¹. He provides a rich sample of ways by which public property was being used by well-connected managers to build their own personal capital. The point here is that this form of abuse of public office is harmful not just to the individual enterprise, but also to the reputation of the regime at large. In other words, without governance interventions to enforce the rules, the legitimacy of a key aspect of the arena is in doubt.

²⁷ P. Starr, “The Meaning of Privatization” in S.B. Kamerman and A.J. Kahn (eds.), *Privatization and the Welfare State*. Princeton: Princeton University Press 1989.

²⁸ North, *op.cit.*

²⁹ H. de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. New York: Random House 2002.

³⁰ World Bank 2002, *op.cit.*

³¹ Colin Leys, *Underdevelopment in Kenya*. London: Heinemann Educational Books and Berkeley: University of California Press 1975.

Competition, regulation and corruption

The WDR 2002 provides a wealth of evidence that the level and nature of competition in markets affect innovation and growth.³² Although one of the hallmarks of a market economy is competition, it rarely functions without some form of regulation. The market alone does not produce all the goods on which a society's development depends. For instance, regulations are often needed to protect the public interest against private profit motives. The challenge in economic society is that business people and the public at large view these regulations very differently. What looks like a blessing to the ordinary citizen is a curse to the person in business. Because of such differences, one of two problems tends to arise. The first is that regulations are unevenly applied. Those with the right political connections can escape them without being penalized. Others who are not so lucky are being sought out with a view to making them pay. This is one of the 'softer' spots in the governance realm in many countries. Rules are not sufficiently transparent and often applied in discretionary ways. This leaves the business community in uncertainty about what rules prevails. This issue tends to become especially pronounced in countries with a privileged minority dominating the economy. Examples are the Chinese minority in Indonesia and several other Southeast Asian countries, the Lebanese in West Africa, or the Indians in East Africa³³.

The second problem is corruption. Over the last decade, there have been massive efforts placed on studying corruption and the practice of combating it.³⁴ A favorite concern has been to examine the process associated with obtaining a business license. Governments typically have a formal licensing procedure for establishing a business. How long it takes to get such a license and the additional payments involved are often viewed as indicative of the business climate in a country. In some countries, investors – foreign and local – are unable to obtain such licenses without first paying a bribe to some public official. Such situations increase transaction costs and make the process less efficient in the long run.

³² World Bank, 2002, *op cit*.

³³ Amy Chua, *World on Fire*. New York: Doubleday 2003.

³⁴ See Mauro, *op cit*; also Robert Klitgaard, *Controlling Corruption*. Berkeley and Los Angeles: University of California Press 1998; and, Transparency International, *The 2003 Anti-Corruption Report*. London: Profile Press 2003.

However, corrupt payments also substantially affect the trust that key actors have in the system. The legitimacy of the regime is being called into question.

Global influences

Changes in economic society in recent years have been very much influenced by global factors. With economic liberalization has come a greater scope for exchanges across national – and cultural – boundaries. This is particularly true in the areas of trade, finance, and technology³⁵. Governments often fall behind in terms of dealing with these new challenges. Conflicts arise between government and business. The task of managing this kind of conflicting relations is exacerbated by the fact that economic liberalization and political democratization are not always mutually supportive. Several scholars have devoted their attention to this issue. Przeworski³⁶ and Dryzek³⁷, for example, have both called into question the extent to which these two processes are complementary. They specifically point to the fact that economic liberalization gives the already well endowed a greater chance to win, while pressures from the losing majority tend to challenge the extent to which democracy can be consolidated. Events in Argentina in the last few years are reminding us of the reality of this observation.

In sum, there is plenty in the literature to indicate that governance in the economic society arena is full of challenges. We were not necessarily able to deal with all of them, but after careful scrutiny of the literature and consultation with practitioners, we chose five indicators that reflect the prevailing concerns among those who think about governance issues in this arena.

³⁵ See e.g. Linda Weiss, *The Myth of the Powerless State: Governing the Economy in a Global Era*, Cambridge: Polity Press, and Ithaca, New York: Cornell University Press, 1998.

³⁶ Adam Przeworski. *Democracy and the Market*. New York: Cambridge University Press 1991.

³⁷ John Dryzek. *Democracy in Capitalist Times: Ideals, Limits, and Struggles*. Oxford: Oxford University Press 1996.

Economic Society: Aggregate WGS Findings

Before presenting the aggregate findings for economic society, we like to briefly introduce the specific indicators that we chose. Each is accompanied by a sentence or two discussing the rationale behind our choice.

1. Respect for Property Rights: Those in positions of public authority have a vital role in ensuring that property rights, whether private, common or public, are respected and enforced. As suggested above, these rules are very important for material progress, both at micro and macro levels.
2. Equal Application of Regulations: This indicator assesses the extent economic regulations are applied equally to firms in the economy. Applying and enforcing regulations equally is important in providing a positive business climate. Wherever regulations are applied in an ad hoc manner or where special treatment is given to cronies of those in power, the credibility of the rules governing economic society is very much in doubt.
3. Corrupt Transactions: The issue here is whether a business license can be obtained in a straightforward and transparent manner or it involves a number of other transactions that go contrary to the stated rules and regulations. This indicator gives us a sense of the extent to which respondents see corruption prevailing in state-market relations.
4. State-Private Sector Consultation: This indicator assesses the extent to which there is consultation on policy issues between public and private sector actors. Such consultation is a measure of the trust and cooperation that exists between state and market actors. What do the rules allow in terms of such consultation?
5. New Global Economic Rules: International economic interactions (trade, finance and technology flows) have become an increasingly significant factor in national development. The challenge is how to manage these processes so as to enhance the benefits and reduce the negative effects upon people. How well do state and market actors respond to this challenge by establishing and enforcing rules that are perceived as helpful to their country?

Differences Among Countries

By disaggregating economic society this way, we expect to get a sense of what the more critical or controversial dimensions of economic society are overall and in each country. The discussion below of the aggregate score for each country draws on both the country ratings and contextual comments by the experts. For consistency, we divide the countries into the same groups -- high, medium, and low -- based on their overall 2000 WGS scores.

Table 8.1. Aggregate Economic Society Scores, 2000.

<i>Country</i>	Property Rights	F a i r Regulation	Corruption	Public-Private Consultation	Global Rules	Country Average
High scoring countries						
Chile	3.87	3.83	3.80	3.50	4.18	3.84
India	3.21	3.18	2.43	3.22	3.89	3.19
Jordan	4.03	3.50	3.25	3.00	4.18	3.59
Mongolia	2.92	2.72	2.44	2.67	3.13	2.77
Tanzania	3.12	2.97	3.33	3.27	3.35	3.21
Thailand	3.41	3.12	2.78	3.41	3.59	3.26
Medium scoring countries						
Argentina	2.74	2.36	1.91	3.16	3.54	2.74
Bulgaria	2.76	2.27	3.83	2.76	2.85	2.89
China	2.94	2.94	2.12	2.32	3.30	2.72
Indonesia	2.26	2.40	2.06	2.66	3.09	2.49
Peru	2.70	2.78	2.88	2.41	3.16	2.79
Low scoring countries						
Kyrgyzstan	2.38	2.41	3.77	2.69	2.85	2.82
Pakistan	2.58	2.67	2.82	2.39	2.94	2.68
Philippines	2.77	1.60	2.37	2.34	3.54	2.53
Russia	2.29	2.32	2.34	2.87	2.84	2.53
Togo	2.67	2.76	2.90	2.02	2.57	2.59
Arena Avg.	2.92	2.74	2.81	2.79	3.31	2.91

The average scores for economic society are not as high as those for civil society or the government arenas but slightly better than the average ratings for the bureaucracy and political society. Also worth noting is that compared to other arenas there is less variation

in the ratings among individual indicators within the economic society arena. While there are obvious variations by country, no issue emerges as a particular challenge across countries. Regulatory issues are the more problematic; somewhat surprising, adjustment to global economic rules, the one that respondents regard as least challenging. The most salient, though not surprising, difference among countries is that those with a longer tradition of a functioning market economy score higher than those who lack such a legacy. Thus, countries that have embarked on economic liberalization only in the past twenty years or so, e.g. Bulgaria, China, Mongolia, and Russia, tend to have a lower score for this arena.

There are a number of individual countries, which deserve attention here. Jordan is the biggest surprise in our sample. It is the second highest rated country in this arena. This score reflects the relative success of liberal economic reforms undertaken in the 1990s. As a result of these reforms, Jordan has joined the WTO and established free trade areas with Arab countries, European Union and the United States. Its laws and regulations for this transition are in place and working satisfactorily, according to our respondents.

It is also worth noting that Asian countries tend to score on the low side in this arena. This reflects the disappointments that respondents in many countries felt as a result of the Asian financial crisis in the late 1990s. Although the average score for Thailand is well above 3.0, respondents highlight problems associated with corruption and the enforcement of government regulations.

The situation in China is of special interest. Corruption is an issue that most respondents identified as problematic. Much of it stems from the legacy of over-regulation that characterized its socialist economy before liberalization. Also highly problematic in China is the relationship between the public and private sectors. Genuine privatization is slow in coming and there is little, if any, consultation between actors in the two sectors. Many respondents see unfair competition as another issue that adversely affects the perception of this arena. These comments confirm points highlighted in the literature on China's economic transition³⁸. While governance of the economic society arena in China has its

³⁸ Howell, J., *China Opens its Doors: The Politics of Economic Transition*, Boulder: Lynne Rienner Publishers 1993. See also: Saich, T., *Governance and Politics of China*, London: Palgrave 2001.

clear weaknesses, there is much praise for its adjustment to the global economy. It scores high on the question of how well it has taken on its entrance into the world economy, including its membership in the World Trade Organization. There is, however, a simultaneous realization that as China enters the world economy more head on, new issues are arising, notably growing social stratification and thus tensions between the rich and poor in society.

Russia has liberalized to a greater degree than China and provides another interesting case of a troubled economic transition. Respondents highlight the troubled privatization of formerly state-owned property and mention that private property generally remains vulnerable and poorly protected. The enforcement of regulations is inadequate and/or unfair. The most common comment was regarding cronyism – with special treatment given mostly to friends and relatives. Licenses are a main source from which some officials make their living so bribery and other forms of corruption are widespread. There is no systematic consultation between private and public organizations. Our WIPs noted that those in power consult only with oligarchs of their own choice. The only real bright spot in Russia is the same as in China: progress made with regard to taking a more active role in the world economy, including negotiations to join WTO.

We also like to add a few comments about Argentina. Our survey was undertaken in 2000, i.e. before the economic situation turned into a crisis in Argentina. Ratings as well as comments by our respondents suggest an awareness of the problems underlying the country's economy and the causes of its crisis since 2001. They specifically refer to the prevalence of corruption, poor or unfair enforcement of economic regulations, and discrimination against small and medium sized enterprises. The ratings by our WIPs stand in marked contrast to the perceptions prevailing elsewhere in the world at the time – not the least in the United States – of Argentina as a country taking advantage of 'best practices' in economic development.

Finally, the mean scores for each category of countries suggest that the high scorers do particularly well in this arena. They are well above the other two groups, even though one country – Mongolia – is an outlier scoring much lower than the average. Governance of the economic society arena in Mongolia is problematic because the transition to a market

economy continues to be associated with the same kind of problems that we noted above are present in the transition in Russia and China.

Table 2. Mean scores of economic society indicators by groups of countries.

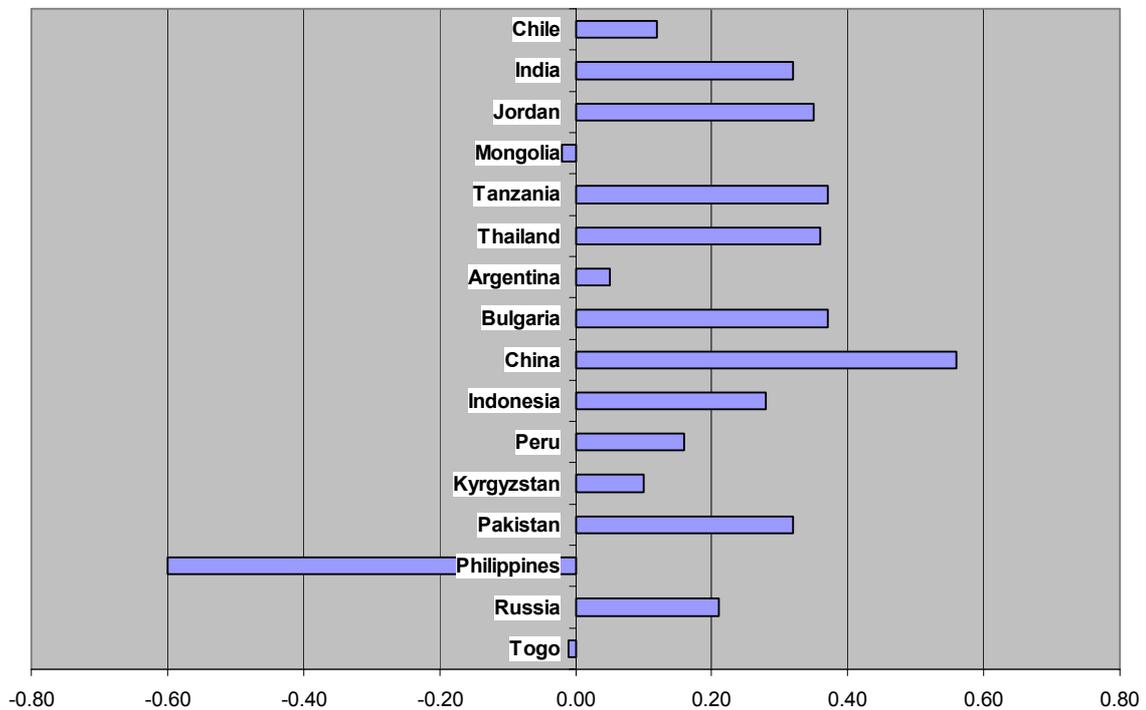
Category of countries	Mean score
High scoring	3.31
Medium scoring	2.73
Low scoring	2.63

The relatively low average scores for the other two categories suggest that governance in the economic society arena is going to be problematic as long as rule of law is not institutionalized. This raises the question of whether the quality of the judicial arena is a determinant also of what happens in some of the other arenas such as economic society.

Changes Over Time

In spite of the shortcomings associated with the economic society in year 2000, there is an improvement from 1996. The rating for the mid-90s was 2.73, compared to 2.91 for 2000. Only one country – the Philippines – shows a marked deterioration. Improvement is associated especially with adjustment to the world economy, but there is also some shift to the better with regard to respect for property rights and consultation between government and private sector bodies. In short, market reforms have continued, although each step forward creates its own problems that tend to overshadow some of the progress made.

Figure 1. Changes over time in Economic Society, 1996-2000



It is worth noting here that although former socialist countries scored less highly than those with a market economy legacy, many of the countries that show great improvement over the five years are in the former category. For instance, both China and Bulgaria record a considerable improvement, as do Tanzania and Russia, albeit to a lesser extent. This improvement, however, does not apply to all ex-socialist countries. Mongolia, in fact, suffered a slight deterioration as progress toward a market economy ran into problems in the late 1990s.

Improvement in countries which already had a market economy in place has been less dramatic, yet, in most cases, steady. It was more noticeable in Asian countries than in our sample from Latin America. India, Pakistan, and Thailand show a better record over the five-year period than Argentina, Chile or Peru, although all three were very much the target of economic liberalization during this period. In Africa, there is a big difference between Tanzania and Togo. While the former is seen as having made good progress with regard to financial stabilization and structural adjustment, Togo has gone slightly backwards.

Widespread corruption, accentuated favoritism, and dishonest transactions by the government are cited as main reasons for the decline there.

In sum, like in the other arenas, improvement exceeds decline, but there is variation also among the individual indicators. It is to this issue that we now turn.

Analysis of Individual Indicators

As suggested above, it has been impossible to cover everything that possibly might fall under the rubric of ‘economic society’. Our set of indicators, however, represents a cross-section of important variables. They were all treated as being of equal importance in our survey. We shall begin our discussion on that basis.

Property Rights

There are three important observations that we want to make in regard to this particular indicator. The first is that respect for property rights varies and is not necessarily associated with the top-scoring category of countries only. The best scores on this indicator belong to a range of quite different countries: Islamic Jordan, middle-income Chile, technologically advanced India, rapidly growing Thailand, and rural and agricultural Tanzania. This suggests to us that property rights can flourish in very different settings.

The second observation is that countries where private property has been enshrined in law for a long time – Argentina, India, Peru, Philippines, and Thailand – may have an advantage over those where such regulations are recent, but even so they face problems with enforcement. As indicated above, the situation in the Philippines has been particularly alarming. Respondents told us that violation of property rights in order to enhance private interests increased significantly during the Estrada regime in the late 1990s. Favoritism and other forms of corruption are mentioned as common also in several of these other countries. These problems also feature prominently in countries with an autocratic government, e.g. Indonesia, Pakistan, and Togo.

While enforcement of laws guaranteeing property rights is a serious issue everywhere in our sample, the countries that have made the transition from a socialist economy face special problems. Weaknesses in those countries often stem from lack of clarity in the laws themselves and also from a lack of public understanding of the new laws. As respondents told us, for instance in Kyrgyzstan, there was no such thing as private property five years ago, leave alone laws providing for it. While it may not take long time to learn what is 'mine', how this affects the relationship with others in society is something that Kyrgyzians are still learning. Thus in Kyrgyzstan as well as Russia, respondents indicated that there is widespread anger with the way private property is being allocated – or seized – as a result of inadequacies in the legal system. The WIPs in Russia talked about the 'destruction' of state property by those responsible for privatization, because it was allocated to a small group of already well placed individuals with connections in the government.

While the issue in most ex-socialist countries is the lack of control in the process of privatizing state property, the issue in China is somewhat different. It has undertaken far-reaching economic reform but has been much more cautious with political reform. Appreciation of these reforms is recorded in our survey, but there is also a widespread awareness among respondents that these economic reforms need to be complemented by changes in the way the country is being governed. Uncertainty about the future stems from the fact that China lacks a 'road map' for political development. People are not sure how things will develop and that adds to worries about the sustainability of the economic reforms that have already been undertaken.

One or two comments on Tanzania may also be warranted here. Property rights were very much ignored in the past. During the socialist days of the 1970s, in particular, violations of these rights were particularly frequent. The situation since then has changed and is now stabilized. Private property rights are respected. To the extent that people feel threatened, it has more to do with personal security. It is in this light that the relatively high score for Tanzania should be seen.

Our concluding observation is still that many countries included in this study do face problems with regard to respect for property rights. While progress may have been made,

most countries are far from living up to the obligations entailed in the Universal Declaration of Human Rights that they have all signed and ratified.

Fair Regulation

As we have already indicated above, how regulations are being applied matters for the quality of governance in this arena. To some extent, the problems associated with this indicator are similar to those identified in relation to property rights. This is especially true for the former socialist countries, where the legal apparatus is outdated, causing problems when it comes to application to the emerging market economy. We want to comment on two other issues that came out quite strongly in our study.

The first is the extent to which personal connections play an important but often detrimental role in economic society. Every one knows that business deals are dependent on trust and often direct personal contacts. These contacts, however, sometimes become too close and operate at the costs of following specific regulations. This phenomenon, that many respondents call ‘cronyism’, is prevalent in varying degrees in virtually all countries. It is mentioned quite frequently by respondents in Bulgaria Indonesia, Pakistan, Russia, and Togo, countries which scored quite low on this indicator. In these places, comments by our WIPs suggest that relatives and friends of powerful politicians often enjoy privileges that others are denied.

The second point is that our respondents indicate that even where cronyism is not such a big issue, problems of fairness exist. They suggest that government officials are more prone to listen to representatives of big business than to those who operate smaller enterprises. This sentiment was strongly articulated in Argentina as well as Philippines. In the latter, respondents also believed that some sectors are favored over others. In countries like Tanzania, there is a common belief that foreign enterprises are favored over local ones. It is no coincidence that our Tanzanian respondents had the lowest score of all in this arena here.

Our findings confirm that this is a problematic part of the economic society. The market is not supposed to discriminate against any one, but in practice unfairness is common. Our

respondents had few suggestions about what to do, although increased transparency and accountability would be measures that should produce results.

Corruption

Corruption is rife in many countries included in our study and it is associated not just with obtaining a license but also other aspects of conducting business. This suggests to us that focusing only on the issue of obtaining a license may under-report the extent to which corruption is a problem in a given country.

The main complaint seems to be that authorities are ineffective or slow in dealing with corruption. This is especially true in countries that are undergoing economic liberalization. WIPs e.g. from Mongolia and Russia lament the fact that corruption and political patronage remain despite over a decade of economic reform. The case of Indonesia provides some insights into why progress has been limited. While certain forms of corruption – collusion and nepotism – that were associated with the Suharto government have become less prevalent, new forms – notably bribes – have emerged as serious threats to the legality of business deals. The lesson that can be learnt is that opening up the economy is much easier than getting it to function in a credible and reliable fashion.

One of the most striking things about the scoring on this indicator is the very low ones for both Argentina and India. Theirs is considerably below their average for this arena or the country average. This clearly indicates a serious problem that our respondents also highlighted. Bribery in business is viewed by some of our Indian respondents as every day practice, but many of them also outright point to it as a very detrimental feature. The sentiments in Argentina, which incidentally has a much lower score than Chile, or even Peru, are very similar to what their Indian counterparts told us.

The problem is that most countries lack effective institutional mechanisms for controlling corruption. Even where they exist, they don't have much effect, as the cases of India, Pakistan, Tanzania, Togo, and even China imply. In terms of what may be possible to do, Peru and Thailand offer some constructive lessons. In Peru, the Fujimori government was seen as so corrupt that it caused a public outcry. The incoming President could not afford to

let his officials engage in corrupt practices. Relying on public opinion – or the media, for that matter – as the sole mechanism of control is not likely to be enough. That is why the Thai case is of interest. The government there has set up an independent agency – the National Counter-Corruption Commission – to monitor its performance. It is instructive that in a 2002 poll, it was found to be Thailand’s most trusted government institution.³⁹

Public-Private Consultation

Consultations between government and private sector representatives are generally considered to be important for effective development. Information sharing creates trust and also facilitates negotiations over and adoption of policy. Rules for such activities and what they are expected to achieve are important for understanding governance of economic society.

Our study suggests that consultations on economic policy issues do not happen that often, but the fact that the high-scoring group of countries does better on this indicator than the others confirms the value of information sharing between government and the private sector. On the one extreme are countries where respondents tell us that government never consults business. It prefers to spring surprises on the latter. This happens in Russia and it seems the ex-socialist countries have fewer mechanisms for consultations, if any at all, that really work. These countries generally score lower than the others on this indicator. In Argentina and Bulgaria some consultation takes place, but, according to our respondents, the issues raised are never acted upon. In yet other places, consultation is with individual enterprises rather than corporate bodies representing the business community at large.

Although many countries have bodies like Chambers of Commerce, Confederations of Industries and Manufacturers’ Associations, their involvement in policy-making is often quite marginal and often ad hoc. There is nothing resembling a corporatist arrangement whereby the state provides a special chamber or council for consultation on economic policy. Governments prefer to decide policy on their own and tend to see regular consultation with the private sector as a complicating factor. There are two exceptions to

³⁹ *The Economist*, August 17, 2002, p. 25

this point. One is Chile, which, not surprisingly, scores high on this indicator, the other is Thailand. Both countries have established patterns of policy consultations and this type of collaboration between public and private sector institutions is seen as an important factor contributing to economic success. The fact notwithstanding that China has succeeded economically without any such consultative practices our study indicates that professional and business-like consultations between government and the private sector are helpful for national economic development. The challenge is to make them more effective and representative of the business community at large.

Global Rules

Governments are faced with new challenges as the result of increasing global economic liberalization. New rules and practices regarding trade, finance and technology flows have become an increasingly significant factor in shaping the conditions for economic and social policy. The degree to which governments include considerations of international opportunities and risks in policy-making is an increasingly important governance indicator. The governance challenge is how to manage these processes so as to enhance their benefits and mitigate their negative effects upon people. We were asking respondents to consider the extent to which government takes international economic rules into account in formulating economic policy⁴⁰.

This indicator received the highest average rating in the economic society arena – 3.31 in 2000. Many WIPs believe that their government does take new global economic issues into account in formulating policy. It is also evident that the high-scoring group tends to do best on this. The former socialist countries generally have lower scores but they are also among those that have made greatest stride forward. As one WIP put it, “Five years ago Bulgaria was isolated from the rest of the world. Now our country is mostly open and we are part of the global processes.”

⁴⁰ Some respondents commented to us that this question was phrased too broadly; global economic rules could simply include too many things. For instance, some argued that it was not enough to consider just what governments had done in formulating policy but also how serious they have been in implementing it.

Based on the ratings and WIP responses, countries can roughly be divided into three groups with regard to government response to the new economic rules. The first group is somewhat agnostic – they see globalization as inevitable and government needs to take rules regarding trade, finance and technology into account. But they grudge about it. Countries in this group include Bulgaria, Indonesia, Philippines, Russia, India, Togo and Tanzania.

India provides an interesting case study. Substantive comments by the respondents support the perception that there is approval for the economic liberalization policies implemented since 1991. On one hand, there is certainly a better relationship between the state and private sector, which had been antagonistic previously. The increased consideration of international economic issues is seen as necessary. But, this does not mean that respondents are blind to the potential adverse effects of globalization. Several make references to the challenges that these new policies pose to the poorer segments of society.

A second group of countries is more positive. While accepting the challenges and risks, this group tends to see an outward-oriented strategy as good. It includes Chile, Thailand, China, Jordan and Kyrgyzstan, countries with an ambition to join WTO, if they haven't already done so.

The third group has a negative view of new global rules and view changes coming as a result of pressure from outside. This is largely the view in countries where economic problems have required external intervention. Countries in this group include Argentina, Mongolia and Pakistan. WIPs in these countries are not only critical of specific international institutions like the IMF, but suggest that members of the public as well as the media view globalization as favoring developed countries and discriminating against the Third World.

Despite these variations, there are WIP concerns that cut across the groups. The first – and most common – is that not enough is done to protect people against the negative effects of social changes due to new global rules. A second concern is that the pace of change does not enable countries to react. Globalization is simply too fast. The third is that governments

have not yet found solutions to the economic risks and challenges the new global rules will bring. Many of them are still fumbling in the dark.

Implications for Research and Practice

This concluding section is divided into three parts. We begin with some concluding observations and then discuss more specifically the implications for research and practice. The first among our concluding observations is that governance in the economic society arena can make a difference regardless of existing level of economic development and cultural orientation. The top scorers in this arena are countries with widely different backgrounds. The second point is that ex-socialist countries seem to encounter greater difficulties in this arena than those countries, which have had already for some time an exposure to a market economy. Their transition to a market economy is relatively recent and it must be acknowledged that it takes time. The third point is that most countries have made progress, including those with problems. Economic reform is paying off, even if it may be in more slowly manner than consultants and advisors would like it to be. Even if globalization and liberalization have had positive impacts on these countries, most of them continue to battle with issues that affect the business climate, in particular, and governance of the regime, in general.

Research

We have three points to make regarding implications for research. The first relates to property rights. Although this set of issues has received growing attention in the literature, our study concludes that more work is needed to understand how these rights affect development. Because private property rights have been seen as the most effective, there has been less interest in other types of rights – common or public – that may be the most appropriate in certain circumstances, as Elinor Ostrom⁴¹, among others, has argued. This is particularly true in many countries where communal property legacies are still present and affecting the way people think about ownership and inheritance. It is also necessary to take a more critical look at the results of implementing private property rights in developing countries. What does the record tell us? Furthermore, given that so many rights are

⁴¹ Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action*. New York: Cambridge University Press 1990.

informal, i.e. not contained in a written contract, it is necessary to study how these informal rights may serve as the basis for formalization and the development of a legalized property rights system.

The second issue concerns the prevalence of informal relations and how they affect the enforcement of rights and contracts. Our study has shown that a good number of our respondents believe that regulations are not applied equally. Patronage and favoritism often determine the outcome of policy rather than formal rules. This is an issue that is receiving growing attention in the literature, as researchers realize that formal institutions are not always as important as they look on paper.

The third point is that what is going on in the economic society arena should be considered in the context of what happens elsewhere in the governance realm. We have indicated above, that countries which do generally well in our governance survey do well in this arena, in particular. So there may be reason to ask, for instance, what are the effects of a strong civil society on economic society? What effects does media freedom have on development?⁴² And, what about the character of the judicial arena: how does it bear on what happens in economic society? A focus on economic society alone may be too narrow and technical in many instances. Real underlying problems are not adequately understood through such an approach⁴³.

Practice

We will end with four points regarding implications for practice. The first concerns the scope of issues that is important for understanding economic society and how it operates. There is a tendency to regard it primarily in terms of efficiency – how can transaction costs be lowered? While that is a legitimate concern, our study highlights the importance of including other objectives, among which the legitimacy of the rules and regulations that apply is of special salience.

⁴² The 2002 World Development Report, for instance, presents evidence to show that the quality of regulation declines with less competition in the media.

⁴³ This is a conclusion that Kaufmann also reaches; see D. Kaufmann, “Rethinking Governance”, *op.cit.*

A second point is that the market is often promoted as if it is the only hope for the future. There is no question that the move towards a market economy has been beneficial for development in many countries, but unleashing the private sector largely unregulated also carries a lot of risks. The cases of both Argentina and Russia illustrate how easy it is that a radical restructuring of economic society may go awry. Our study suggests that a more comprehensive strategy of improving both state and market institutions as well as linkages between them may be a more sustainable strategy to pursue.

The third point is that although the vast majority of countries are seen to make progress in economic society, much remains to be done, especially in ex-socialist countries. One issue that is of special policy relevance is how private sector voices can be incorporated into the policy-making process. As we have suggested above, there is little, if any, effort to listen to private sector representatives and their concerns. Policy is made above the heads of the latter. Organizing the economic society regime in such a way that there is more consultation on a regular and formal basis between government and the private sector would be an important challenge for those concerned with improving governance in this arena. In so doing, it may also be important to pay attention to context, especially the extent to which there is a legacy of state-market relations involving private sector representatives.

The fourth and final point concerns globalization and the costs and benefits it brings to individual countries. Our study shows that globalization is associated with gains, but also with potential risks, especially for already vulnerable groups in society. More attention clearly needs to be paid to the social implications of the new economic rules that globalization is bringing to each national economy. Thus, although the existing liberal orthodoxy continues to be the driving force behind much of the improved governance in this arena, it needs to be sufficiently tempered so that its gains to date are not reversed by a backlash caused by hubris.