WORLD DEVELOPMENT REPORT 2017

MAIN MESSAGES

Governance and the Law

Too often, governments fail to adopt pro-growth or pro-poor policies. And even more often, when adopted, these policies fail to achieve their intended goals. In the process of designing and implementing policy, who is—and who is not—included at the bargaining table can determine whether policy makers deliver effective solutions. That process, what this Report calls *governance*, underlies every aspect of how countries develop and how their institutions function. Inequities in the ability of actors to influence policy decisions and make the policy-making system more responsive to their needs can lead to a persistent cycle whereby effective policies are not adopted or they are not successfully implemented. Although such a cycle often appears immutable, history is full of instances in which societies have improved rules, institutions, and processes that have helped them move closer to reaching their development goals. Putting governance front and center of the development debate is therefore essential for promoting sustained economic growth and encouraging more equitable and peaceful societies.

Ineffective policies persist, while potentially effective policies are often not adopted

Why do policies fail to achieve desired outcomes?

The *World Development Report 2017: Governance and the Law* is about what makes some policies work while others fail. Frequently, policies that fail to generate development outcomes endure across countries and over time. For example, inefficient and regressive subsidies have proven difficult to eliminate. Conversely, other policies that could potentially be effective are often not chosen or implemented. It is well known that teacher absenteeism reduces student learning, yet policies to change this dynamic have repeatedly failed during implementation.

To understand why, it is important to remember that policy making does not occur in a vacuum. Rather, it takes place in complex political and social settings in which individuals and groups with unequal power interact within changing rules as they pursue conflicting interests (*governance*). The space in which these interactions take place, what this Report calls the *policy arena,* can take many different forms, ranging from formal arenas (parliaments, courts, intergovernmental organizations, government agencies), to traditional arenas (councils of elders), to more informal arenas (backroom deals, old boys' networks). In many cases, these arenas overlap. Actors in the policy arena include both state actors (such as policy makers and bureaucrats) and nonstate actors (such as private sector and civil society groups or individual citizens). The entry barriers and the distribution of power among actors in this space determine who gets a seat at the table and who is excluded. Who participates in the decision-making process fundamentally matters for the selection and implementation of policies—and consequently, their impact on development outcomes.

The success of policies depends on governance

To be effective, policies must enhance commitment, coordination, and cooperation

As experience around the world and throughout history demonstrates, development can take place within a variety of institutional trajectories. Many unorthodox institutional arrangements have enabled development, whereas many so-called best practices have not been successful. When policies and technical solutions fail to achieve their intended results, the blame tends to fall on lack of capacity. Typically, the solution proposed is to "improve" institutions by transplanting the same form of institutions that have been successful elsewhere. For example, policy advice for curbing corruption tends to focus on replicating strategies successfully employed by high-income member countries of the Organisation for Economic Co-operation and Development (OECD), such as establishing anticorruption agencies or legislating harsher punishments. These strategies, however, have repeatedly delivered poor results in countries in which levels of development and political arrangements do not yet allow the effective enforcement of formal rules. Proximate factors—such as the specific form that institutions take—certainly matter. Nevertheless, this Report argues that what fundamentally matters for policy effectiveness is whether those institutional forms are able to perform their intended functions in a particular setting.

Specifically, this Report draws attention to *commitment, coordination,* and *cooperation* as the three core functions of institutions that underlie policy effectiveness.

- *Commitment.* Effective policies have devices that guarantee a credible commitment over time. Commitment problems abound around the world. Despite pledges of fiscal sustainability, decision makers spend windfall revenues instead of saving them for the future. Or after negotiating peace-building agreements, leaders defect in the absence of a binding enforcement mechanism. Solving commitment problems is about making policies stick over time, even in the face of changing circumstances and incentives.

- *Coordination.* Effective policies—often through rules, standards, and regulations—help coordinate actors' actions based on shared expectations. Coordination problems occur in many contexts, from finance to industrial clusters and urban planning. Financial stability, for example, relies on beliefs about credibility. Just consider the bank runs that occur when credibility falters. Despite the rationale for leaving their money in the bank during times of distress, people rush to withdraw their deposits if they believe that others will as well, ultimately causing banks to lose liquidity and crash. Solving coordination problems is about eliciting socially desirable actions.

- *Cooperation.* Effective policies help promote cooperation by limiting opportunistic behavior, often through credible mechanisms of rewards or penalties. Individuals may have incentives to behave opportunistically by, for example, not paying taxes while enjoying the public services that other tax-paying individuals are funding. When actors are excluded from the benefits of policies, or perceive they are being shortchanged (such as in the form of low-quality public services), compliance can further weaken. Over time, this dynamic can lead to fragmentation within society and can weaken the fabric of the social contract. Solving cooperation problems is about ensuring that all actors, including public service providers, uphold their end of the deal.

Power asymmetries can undermine policy effectiveness

Unequal distributions of power can lead to exclusion, capture, and clientelism

Power is distributed unequally in every society, but *power asymmetries* are not always harmful. They can be a way to achieve effectiveness—for example, through delegated authority. However, if powerful actors fear that certain policies to enhance welfare may reduce their relative power (now or in the future), they may attempt to block adoption or undermine implementation. This tendency has significant implications for the poorest and most marginalized groups because of their limited bargaining power. Power asymmetries can lead to harmful consequences and undermine the core functions of institutions through *exclusion, capture,* and *clientelism.*

- *Exclusion.* Individuals or groups may find themselves systematically sidelined from policy decisions that affect their interests. Individuals from disadvantaged groups often face barriers to bargaining with policy makers, just as consumers, a diffuse constituency, face difficulties in advocating their policy preferences compared with large firms. Exclusion in these cases has implications for inclusive economic growth. Worse yet, if powerful actors are excluded from the policy arena, violence may become the preferred way for people to pursue their interests, with serious implications for security. As a result, policies tend to be inconsistent, reflecting whichever group has more power at a given time, undermining the core function of commitment. Ultimately, exclusion can lead to a breakdown in perceptions of legitimacy.

- *Capture.* Influential groups often have the ability to capture policies and make those policies serve their narrow interests. For example, powerful and well-connected firms that operate in the least productive sector of the economy may advocate for policies to protect their economic power, obtain preferential treatment, and block competition, thereby taking a toll on resource allocation, innovation, and productivity. The impacts of capture can help explain the lack of effectiveness of many policies in promoting growth—and those impacts should be considered upstream by those designing policies. For example, second-best policies that may involve some trade-off with efficiency but are less susceptible to capture may be more effective in the long term for enabling economic growth.

- *Clientelism.* In some settings, benefits are exchanged in return for political support. One type of clientelism involves public officials "buying" votes from citizens in exchange for (usually) short-term benefits such as transfers or subsidies. The short-term nature of these bargains leaves the poor and the disadvantaged particularly vulnerable. A different type of clientelism occurs when politicians become responsive to those groups that wield greater influence—for example, favoring the interests of teachers' unions over those of students or the interests of telecom providers over those of consumers—with nontrivial costs for society. In exchange for their political support, service providers may extract rents through the diversion of public resources, withhold their efforts in the form of absenteeism, or engage in other corrupt practices. These behaviors hamper the delivery of basic services, with a toll on equity and development.

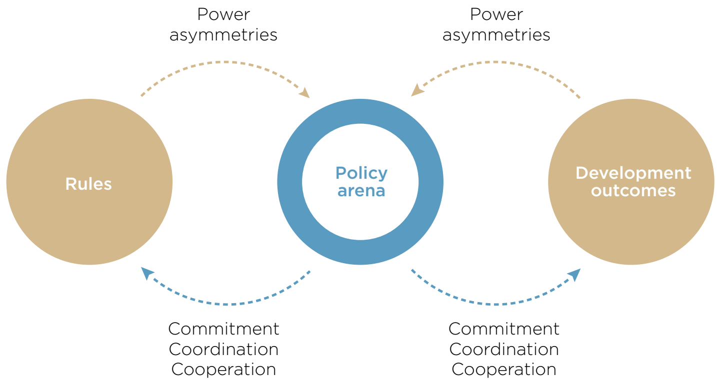
Law is an important tool in the policy arena

It is not only about the rule of law, but also about the role of law

Actors interact not only to select and implement policy, but also to design and change the rules under which that interaction takes place. Indeed, rules can be considered in terms of three different levels: rules as policies (such as budgetary allocations); rules as organizational forms (such as the independence of the central bank); and rules as mechanisms to change the rules themselves (such as electoral norms). Law is a particularly powerful instrument in this regard. By its nature, law is a device that provides a particular language, structure, and formality for ordering social affairs. However, just like policy making, state law does not operate in a vacuum. It interacts with many other normative and legal frameworks, both formal and informal, ranging from customary law to social norms and economic transactional systems.

Although every society aspires to the "rule of law"—where rules are applied impersonally and the ruler is also subject to the rules—the rule of law in itself is a norm: it is achieved when the principles of law become a shared value among people in society. This sharing is the result of a long historical process and simply cannot be instilled overnight. As Gordon Brown, the former prime minister of the United Kingdom, observed, "In establishing the rule of law, the first five centuries are always the hardest." For the rule of law to be established, one must first understand the *role* of law.

Figure 1 **WDR 2017 framework: Governance, law, and development**



Source: WDR 2017 team.

Note: *Rules* refers to formal and informal rules (norms). *Development outcomes*, in the context of this Report, refers to security, growth, and equity. The actors in the *policy arena* can be grouped into elites, citizens, and international actors.

This Report discusses three roles of law: in shaping behavior, in ordering power, and in providing a tool for contestation. Think of the proxy-means test used to select beneficiaries for social programs. Based on household information, the test produces a score to determine eligibility. The rule shapes the behavior of program operators by establishing an objective indicator to select beneficiaries. The rule orders power and constrains the ability of influential actors to manipulate the program by ensuring objective rulings on eligibility. And, finally, the rule offers a means of contestation through which potential beneficiaries can dispute their exclusion from the program based on their score. Over time, actors in the policy arena can change the rules in concrete ways to strengthen the different roles of law and propel countries toward a stronger rule of law.

Figure 1 illustrates the interaction between governance and development. For a set of rules, the right-hand side of the framework shows how commitment, coordination, and cooperation among actors lead to specific development outcomes. But actors can also agree to change the rules, as illustrated on the left-hand side. Both changes in development outcomes and changes in rules reshape the power asymmetries manifested in the policy arena.

Change is possible

Incentives, preferences and beliefs, and contestability are levers for change

The distribution of power in society is determined in part by history. But there is room for positive change.

This Report reveals that governance can mitigate, even overcome, power asymmetries and bring about more effective policy interventions that promote security, growth, and equity. Change happens by shifting the *incentives* of those with power, reshaping their *preferences and beliefs* in favor of positive outcomes, and taking into account the interests of previously excluded participants, thereby increasing *contestability.* These changes can be brought about through bargains among elites, through greater citizen engagement, as well as through international actors whose efforts can influence the relative ability of domestic coalitions to push for reforms.

- *Incentives.* Incentives are fundamental to enabling commitment in the policy arena. Sometimes, incentives change so that powerful actors are willing to tie their own hands. The idea behind this type of political insurance is that any rules will bind not only these actors but also their successors, thereby ensuring that future actors will not abuse their power. The more competition between powerful groups, the more incentives there are for the incumbent to introduce constraints on power such as access to information laws or transparency laws. As the evidence shows, freedom of information laws are much more likely to be passed when opposition parties are stronger and there is greater executive office turnover.

- *Preferences and beliefs.* The preferences and beliefs of decision-making actors matter for shaping whether the outcome of the bargain will enhance welfare and whether the system will be responsive to the interests of those who have less influence. Changes in preferences can help jump-start coordination working toward a better-for-all situation. For example, consider gender norms that direct domestic work disproportionately toward women. When these norms shift, it may allow the social investment made in terms of human capital—in education and health for women—to pay off by enabling women to participate more actively in the labor market to the betterment of society as a whole.

- *Contestability.* Who is included—or excluded—from the policy arena is determined by the relative power of the competing actors and barriers to entry. When procedures for selecting and implementing policies are more contestable, those policies are perceived as fair and induce cooperation more effectively—that is, they are seen as more legitimate. As rigorous empirical evidence from developing countries shows, participation and ownership in the design of rules can increase voluntary compliance. When producers know that rules have been created jointly (along with the government and other main actors), they are more likely to have a positive perception of policies and the compliance of others with the rules.

Rethinking governance for development

Three guiding principles

This Report starts by acknowledging that "good" policies are often difficult to introduce and implement because certain groups in society who gain from the status quo may be powerful enough to resist the reforms needed to break the political equilibrium. Successful reforms thus are not just about "best practice." They require adopting and adjusting institutional forms in ways that solve the specific commitment and collective action problems that stand in the way of pursuing further development. More than 70 years after the Bretton Woods Conference that launched the World Bank and the International Monetary Fund, the international community continues to recognize that promoting sustained development requires taking seriously the underlying determinants related to governance. Future progress will require new frameworks and analytical tools to harness the growing evidence on what has worked and what has not. The guiding principles shown in table 1 summarize the discussion in this Report of thinking about reform.

Table 1 Three principles for rethinking governance for development

Traditional approach	Principles for rethinking governance for development
Invest in designing the right **form** of institutions.	Think not only about the form of institutions, but also about their **functions**.
Build the **capacity** of institutions to implement policies.	Think not only about capacity building, but also about **power asymmetries**.
Focus on strengthening the **rule of law** to ensure that those policies and rules are applied impersonally.	Think not only about the rule of law, but also about the **role of law**.

Source: WDR 2017 team.

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