The LIMITS *of* INSTITUTIONAL REFORM *in* DEVELOPMENT

Changing Rules for Realistic Solutions

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THE LIMITS OF INSTITUTIONAL REFORM IN DEVELOPMENT

Billions of dollars of institutional reforms have been introduced to improve governments in developing countries. Unfortunately, many governments remain dysfunctional despite these reforms. This book asks why reforms seem to have been limited and how they can be improved to yield better results in the future.

In answering the questions, the book argues that reforms face limits when they are introduced as short-term signals to make governments look better, not as realistic solutions to make governments perform better. Reforms as signals introduce unrealistic best practices that do not fit developing country contexts and are not considered relevant by implementing agents. The result is a set of new forms that do not function.

Reforms are not always subject to such limits, however. Realistic solutions are emerging from institutional reforms in some contexts and are yielding more functional governments in the process. Lessons from these experiences suggest that reform limits can be overcome by focusing change on problem solving, through an incremental process that involves multiple agents. The book combines these lessons into a new approach to doing institutional reform in development, called problem-driven iterative adaptation (PDIA). It suggests that PDIA offers a better way of fostering reform to governments across the developing world and beyond.

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Preface

This book emerged in response to mounting evidence that institutional reforms in development often do not work. Case studies and multicountry analyses show that many governments in developing nations are not becoming more functional, even after decades and hundreds of millions of dollars of externally sponsored reforms. These studies increasingly suggest that disappointing results cannot be explained by routine excuses, either. One cannot simply blame governments in these countries for not doing reforms, because many governments remain deeply dysfunctional even after many satisfactorily completed projects introducing best practices advocated by international organizations. The work on institutional reform in development has seldom explored reasons for failure beyond such excuses, however. This has created a gap in the literature, which is important from academic and practical perspectives. The academic challenge is to see if theory and evidence can help promote a better understanding of why many reforms do not lead to better governments. The practical imperative is more fundamental: Can a better understanding of past experience help improve the likelihood of more institutional reform success in more developing countries in the future? Driven by these questions, the book seeks to provide a product that is useful to academics and practitioners in the development field. It combines ideas from various streams of institutional theory to analyze a diverse set of institutional reform experiences. This analysis yields an argument that reforms are limited when governments adopt them as signals to garner short-term support. Such reforms are often unrealistic; they may produce new laws that make governments look better, but these are seldom implemented and governments are not really better after the reforms. The analysis points to examples where reforms are not simply adopted as signals, however, and have helped make governments more functional. These experiences inform an alternative approach to doing institutional reform called problem-driven iterative adaptation (PDIA), which yields realistic reforms that actually produce better governments over time.

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ONE

Change Rules, Change Governments, and Develop?

SQUARE PEG REFORMS IN ROUND HOLE GOVERNMENTS

Government often dominates developing countries. Sometimes government is the only game in town. Countries suffer when rules of this game are deficient and governments are ineffective or predatory. Because this frequently seems to be the case, public sector institutional reforms have emerged as central to development. These reforms are an essential element of interventions by players like the World Bank and other multilateral and bilateral agencies. They focus on improving governmental rules of the game and establishing effective governments that facilitate economic growth. These goals are often not met, however, even when countries adopt advised reforms, at considerable expense, and with great anticipation. *This book asks why institutional reforms in development often do not lead to improved governments and how they can be better structured to achieve such goal.*

These questions emerge when looking at recent cases. Consider Afghanistan, where the international community proposed in 2003 that institutional reform would help "within seven years . . . [to] build a stable centralized state . . . arranged around the rule of law and a technocratic administration."[1] Seven years; billions of dollars; and many new laws, regulations, and structures later, the government is still criticized as corrupt and inefficient. Although promises suggested the country could be a new Korea, "[i]t is now hoped that good development in Afghanistan might allow it over decades to draw level with Pakistan."[2] Think also of Georgia, where government streamlined taxes, reorganized public organizations, and cut regulations in 2004 to catalyze private industry and create jobs – with talk of becoming a Caucasian Singapore. Georgia's government received the

[1] Stewart 2010, 1.
[2] Ibid.

World Bank's *Doing Business* Most Improved Business Reformer award in 2008 and enjoyed rapid growth between 2004 and 2007. Unfortunately, this was driven by foreigners buying up privatized assets and not by expanded local economic activity.[3] Domestic innovation, market competition, and employment stagnated between 2004 and 2008.[4] Government regulations may no longer burden entrepreneurs, but reforms have not led to a government that effectively catalyzes employment-generating production either. Why? What could be done differently in the future?

These are important questions to ask in many countries beyond Afghanistan and Georgia, where public sector institutional reforms have not delivered better government. As a matter of fact, this book is not the first piece of work to ask these questions. Others have raised them before, with different opinions on why reforms do not work. The list of critics is long and includes prominent voices like Bill Easterly, Dani Rodrik, Peter Evans, and Merilee Grindle.[5] The list of reasons offered for failure is even longer, and these are often presented as exclusive of each other, with limited explanation for why reform persists despite mixed and often disappointing results.[6] This book builds on such work. It offers a specific argument about why many reforms fail, and draws on lessons from more successful experiences to identify a potentially new, improved approach to doing reform in the future:

- The argument builds on existing views that reforms often fail because they do not fit many developing country contexts – looking like square pegs in round holes. It provides a novel explanation for why this poor fit is common and recurrent: many reforms are introduced as short-term

[3] See the International Finance Corporation (IFC) 2009 Sector Competitiveness Overview, http://www.ifc.org/ifcext/georgiasme.nsf/AttachmentsByTitle/1GeorgiaManufacturingSectorCompetitivenessAssessmentEng/$FILE/1GeorgiaSectorCompetitivenessAssessmentFinalReportEng.pdf.

[4] Georgia ranks 5 for ease of doing business but 90 on the World Economic Forum's Global Competitiveness Index, 115 of 133 on internal competition, 98 on market dominance, and 125 for "monopoly problems." See http://www.weforum.org/pdf/GCR09/GCR20092010fullrankings.pdf. Unemployment rates in 2010 ranged from 16.5 percent officially to 29 percent in Transparency International's estimates. See http://www.transparency.ge/en/blog/p2-2-5-georgias-official-statistics-and-unfolding-greek-tragedyp.

[5] Rodrik (2007, 2) opens *One Economics Many Recipes* with a story similar to the Afghan and Georgian vignettes and asks, "What had gone wrong?" Consider also Andrews 2010; Chang 2003; Easterly 2001; Evans 2004; Goldsmith 2010; Grindle 2004; Pritchett and Woolcock 2004; and World Bank 2008.

[6] Some claim, for example, that reforms impose inappropriate ideological models on governments. Others argue that appropriate reforms are not sufficiently owned, or that reforms fail because of capacity constraints, and so on.

signals that ensure developing countries attain and retain external support and legitimacy. The argument posits that reforms introduced as signals are commonly designed with limited attention to context, involve impressive-looking but hard-to-reproduce best practice interventions, and emerge through narrow engagements with agents that outsiders consider champions. Such reforms are prone to having limited success, however. They may produce new forms (like laws) in the short term, but these typically have poor functionality. Governments look better after reform but often are not better.

- An improved reform approach takes shape after the analysis of interventions that have yielded more functional governments. This approach, called problem-driven iterative adaptation (PDIA),[7] is akin to the way one imagines carpenters craft pegs to fit real holes – where the process is as important as the product. This process begins with problem identification, given the argument that reforms are more likely to fit their contexts when crafted as responses to locally defined problems. Relevant solutions – those that are politically acceptable and practically possible – emerge through a gradual process of step-by-step experimentation to solve such problems. This process yields solutions that resemble bricolaged hybrids blending external and internal ideas. The solutions arise through engagements between many agents playing multiple functional roles, and not solitary champions.

The book uses institutional theory to frame the argument and inform this new approach. It not only takes ideas from the new institutional economics as a starting point but also draws from broader work in new institutional theory, applying ideas about institutional logics, isomorphism, institutional entrepreneurship, and decoupling. Such ideas are common in studies crossing political science, sociology, and management fields. They have yet to be applied prominently in the development domain, however, and are presented here to show how interdisciplinary thinking can enrich the development dialogue. The theory is accompanied by empirical studies to illustrate and validate arguments.

Before outlining the book's content in more detail, this chapter introduces the topic and shows why it matters. A first section argues that institutional reforms have become pervasive in development and thus demand attention. A second section shows that reforms involve similar types of interventions across different contexts, reflecting confidence in a specific agenda of action. The third section notes that results of these reforms are varied and often

[7] Andrews, Pritchett, and Woolcock 2012.

lower than anticipated, raising questions about how effective the new agenda really is.

INSTITUTIONAL REFORMS ARE NEW AND PERVASIVE

New institutional economics has informed public sector reform in developing countries since the 1980s. This theory posits that formal and informal rules – institutions – influence all people, organizations, and economies. Governments are the hub of many such rules, bound by some and the maker and enforcer of others. Think of civil service laws, budget rules, norms of information disclosure, building permit requirements, or the tests government inspectors use to assess whether one should get a driver's license. These "rules of the game" determine the size, scope, operation, and influence of government.

Theorists claim that different institutions create incentives for different behavior, leading to different outcomes. A strict driving test may create better incentives for safe driving than a lax one, for example, which impacts the safety of public streets. In so shaping behavior, theory posits that different institutions have different effects on social and economic progress – the sine qua non of development. The key to development, this argument suggests, is "finding the right institutional framework" or rules of the game.[8] Governments have been the focus of this search, and many efforts to improve public organizations are thus called institutional reforms.

In developing countries, these reforms are frequently influenced by external entities like the International Monetary Fund (IMF), World Bank, regional development banks, and bilateral agencies. The influence manifests in many ways. It comes, for example, through external identification of what the right rules are, and through financing, facilitation, and sometimes even implementation of interventions intended to introduce these rules. Such reforms target improvements in core public administration processes, the way governments interface with business, and service delivery mechanisms in areas like health and education.

These reforms are relatively new to development, featuring in fewer than 1 percent of World Bank projects before 1980.[9] This reflected a policy of nonpolitical engagement that dominated international development at the

[8] World Bank 2000a; Yeager 1999, 113.

[9] This is the number of projects benefiting activities in the public administration, law, and justice (PAL&J) sector. This approach to measuring World Bank–sponsored institutional reforms builds on work by Kim Moloney (2009). Only 18 of the 2,782 World Bank projects started before 1980 were classified as such.

time.[10] Such policy kept many development organizations out of the business of government in developing countries. Interventions focused rather on building infrastructure and productive economic sectors, with little attention to rules of the game affecting the use and impact of these assets and sectors.[11] This started changing in the late 1970s, when international organizations noted that governments had become key players in developing countries. A 1988 World Bank report states, for instance, that "[t]he public sector now appears to be as important in developing countries as in industrial countries."[12]

Public sectors were in turmoil during this period, many burdened with overwhelming debt and facing economic slowdown. International organizations offered assistance in various forms. These included much-discussed structural adjustment operations, which contributed to an expansion of institutional reform activities in the 1980s. Such projects constituted about a fifth of World Bank loans in the decade.[13] This was only one part of a growing engagement, however, which was boosted by the Soviet Union's dissolution and various global, regional, and country-specific crises in the 1990s and 2000s. New governments emerged from these events, or replaced old governments that had lost legitimacy. There was a general sense that many of these new states were looking for help in discerning and adopting the kind of institutions that could ensure their effectiveness.

As a result of such events, the last twenty years have seen a number of multilateral and bilateral agencies introducing institutional reform strategies and advisory, aid, and lending mechanisms. Great Britain's Department for International Development has engaged in such reforms since the early 1990s, for instance, and first formalized a strategy on the topic in the mid-1990s.[14] The Asian Development Bank introduced a governance policy to guide such interventions in 1995,[15] and the African Development Bank did the same in 2000.[16]

Engagements like these have ensured the continued growth and influence of public sector institutional reforms in development. These reforms are

[10] Wright and Winters 2010.

[11] More than 750 World Bank projects before 1980 sought to strengthen rural infrastructure and agriculture sectors. A total of 550 constructed railroads, highways, and seaports; 350 established electric power and energy sources; 300 built schools and hospitals; and 220 developed water and telecommunications infrastructure.

[12] World Bank 1988, 5.

[13] A total of 469 World Bank projects had PAL&J sector content in this decade.

[14] Department for International Development 2011.

[15] Asian Development Bank 2006, i.

[16] African Development Bank 2012, 15.

now a major line of business for most development agencies. They can be identified in more than half of the operations carried out by Great Britain's Department for International Development between 2004 and 2010.[17] They are also evident in more than half of the Asian and African Development Banks' project portfolios in the late 2000s,[18] having comprised less than 10 percent of interventions prior to the 1990s.[19] The emergence of such activities is probably most obvious when considering World Bank experience, where projects likely to incorporate public sector institutional reforms comprised 65 percent of all operations between 2000 and 2010.[20] In some respects, these reforms are now the most common part of the organization's agenda.[21] They featured in more than $50 billion worth of World Bank–sponsored projects between 2006 and 2011, a quarter of spending in the period.[22]

The pervasive nature of these reforms is further evidenced in the variety of affected countries. Bilateral agencies and regional development banks typically sponsor such interventions in more than one hundred countries.[23] World Bank projects supporting these reforms can be identified in more than 140 countries.[24] A randomly selected sample of forty countries illustrates the variety of these contexts.[25] It includes Afghanistan, Algeria, Angola, Argentina, Azerbaijan, Benin, Bolivia, Bulgaria, Burundi, Cape Verde,

17 Spending on governance accounted for about 20 percent of the Department for International Development's (DFID) activities, whereas more than 20 percent of the spending focused on economic reforms tended to involve interventions at the interface of the public and private sectors. Beyond this, DFID documents note that institutional reforms are common in sectoral engagements (like water supply and sanitation, health, and education). Department for International Development 2010, 2011.

18 African Development Bank 2012; Asian Development Bank 2012, 34.

19 Governance operations in the African Development Bank between 1967 and 2006 accounted for 15 percent of all loans. Most took place after the mid-1990s. African Development Bank 2012.

20 More than 3,200 projects had some spending in the PAL&J sector in the decade.

21 The World Bank had supported 13,121 projects as of April 2011; 5,981 of these had activities in the PAL&J sector. Essentially, therefore, about one in two projects has sponsored institutional reforms. This exceeds the World Bank focus in any other sector. Fewer than a third of projects have incorporated an agricultural sector focus. Fewer than one in five disbursed in the education, health, transportation, electricity, and water sectors.

22 This is the project spending benefiting activities in the PAL&J sector, as reported in the World Bank's 2012 financial report. The amount could be much greater if capturing institutional reform content in various thematic areas. For instance, $28 billion was spent on the public sector governance, $1.7 billion on rule of law reforms, and more than $51 billion on financial and private sector reforms.

23 African Development Bank 2012; Asian Development Bank 2012; Department for International Development 2010; Inter-American Development Bank 2012.

24 One can see this when searching for projects in the PAL&J sector in the World Bank projects database.

25 The forty-country sample was chosen using a random number technique.

Central African Republic, Chile, China, Georgia, Ghana, Guinea, Haiti, Honduras, Kyrgyz, Laos, Madagascar, Malawi, Mauritius, Moldova, Mongolia, Mozambique, Nicaragua, Niger, Poland, Rwanda, Samoa, Senegal, Serbia, Sri Lanka, Tanzania, Thailand, Togo, Uganda, Ukraine, and Uruguay. One can think of the incredible variation in the countries listed here – in economic size and complexity, political and social structures, geography, and history. One thing they all share, however, is the recent experience of having engaged with external donors to introduce public sector institutional reforms.

INSTITUTIONAL REFORMS ARE SIMILAR, EVEN IN DIFFERENT CONTEXTS

The country coverage of these reforms is impressive, especially considering their relative newness. One consequence of this is that multilateral and bilateral development organizations are increasingly shaping the ideas, opportunities, demand, and supply of public sector institutional reforms in developing countries. Many would expect this influence to be varied, with different reform types across the wide range of affected countries. This reflects a belief that the "right rules" are different for different contexts. Such sentiment is regularly voiced in formal pronouncements on reform by development organizations like the World Bank. These typically decry attempts to generalize government reform solutions.[26] A more skeptical set of observers argues that generic models do, however, exist and actually dominate reform designs supported by development agencies.[27] Some refer to a strong neoliberal influence on reform content.[28] Others infer that interventions commonly impose modern managerial solutions on developing countries.[29] Although many hold to these beliefs, they are seldom supported by empirical research beyond isolated case studies.[30]

A number of sources facilitate more rigorous identification of similarities, however. World Bank project documents provide information about the way

[26] A 1992 World Bank document notes, "The institutional characteristics for managing development [varies] widely among countries and do[es] not permit easy generalization" (World Bank 1992, 7). Ahrens (2001, 54) writes: "There are still no clear or settled ideas about how effective governance should be defined, let alone how key governance issues can be appropriately incorporated into externally-financed programmes."

[27] Andrews 2010; Chang 2003; Grindle 2004.

[28] Rodrik (2007, 182) claims that a "'neoliberal' socio-economic model" pervades development.

[29] Kenny 2008.

[30] World Bank (2008, 38) argues, for example, that reforms are "likely to be one size fits all," but does not show evidence for such or explain what the generic model looks like.