

Modernization of the State

Strategy Document



Inter-American Development Bank

Washington, D.C.
July 2003

**Cataloging-in-Publication provided by the
Inter-American Development Bank
Felipe Herrera Library**

Modernization of the State : strategy document.

p. cm.

“The strategy document was favorably reviewed by the IDB Board of Executive Directors on July 23, 2003”—t.p. verso

1. State, The. 2. Administrative agencies--Reorganization. 3. Inter-American Development Bank. I. Inter-American Development Bank. Sustainable Development Dept.

306.02 M282 —dc21

This Strategy has been prepared by a team that includes: Edmundo Jarquín (SDS/SGC, team coordinator), Orlando Reos (RE1/SC1), Jorge Sapoznikow (RE2/SC2), Xavier Comas (RE3/SC3), Rosina de Souza (LEG) and Koldo Echebarría (SDS/SGC). The document is part of a group of strategies whose preparation has been coordinated by Carlos M. Jarque (Manager, SDS) and benefited from the specific contributions of Ernesto Castagnino (SDS/SGC), Christina Biebesheimer (SDS/SGC), Fernando Carrillo (SDS/SGC), Carlos Cordovez (SDS/SGC), Janine Perfit (SDS/SGC), Mark Payne (SDS/SGC), Leslie Harper (SDS/SGC) Betty Rice (RE1/SC1), Francisco Mejía (RE1/SC1), Lynette Asselyn (RE1/SC1), Fabricio Operti (RE2/SC2), Rodrigo Tamayo (RE2/SC2), Carlos Pimenta (RE3/SC3), Raimundo Arroio (RE3/SC3), Gustavo Yamada (SDS/POV), Robert Vitro (SDS/ICT), Carlos Perafán (SDS/IND), Luis Fierro (SDS), David Wilk (SDS/ENV) y Renato Puch (DPP). Groups of civil society organizations were consulted in Argentina, Brazil, Bolivia, Chile, Honduras, Jamaica, Mexico and Peru and with the Network of Civil Society Organizations on Justice (Quito), the Latin American Association of Popular Organizations, The Consultative Committee on Central American Integration and the Transparency and Public Management Network of the IDB (Washington). Workshops with experts on the topic were organized by the Institute of International Governance in Barcelona (Spain) and by the Latin America Council of Administration for Development (CLAD) in Caracas. In addition, comments were received through the Bank's website, the International Governance Institute and the Inter-American Network for Democracy.

The strategy document (GN -2235-1) was favorably reviewed by the IDB Board of Executive Directors on July 23, 2003.

Inter-American Development Bank
Sustainable Development Department
1300 New York Avenue, N.W.
Washington, D.C. 20577

E-mail: sdsinfo@iadb.org
Fax: 202-623-2405
Web site: www.iadb.org/sds

TABLE OF CONTENTS

	EXECUTIVE SUMMARY.....	i
1.	OBJECTIVE	1
2.	DIAGNOSIS.....	3
3.	LESSONS LEARNED	7
4.	AREAS OF ACTION FOR THE BANK	10
	A. Democratic System	12
	B. Rule of Law and Justice Reform.....	15
	C. State, Market and Society.....	17
	D. Public Management.....	19
5.	OPTIONS FOR BANK SERVICES AND IMPLEMENTATION GUIDELINES.....	22
6.	MONITORING, EVALUATION AND PERFORMANCE INDICATORS.....	26
Annex:	Areas of action for the Bank and their relation to the Sustainable Economic Growth and Poverty Reduction Strategies	

EXECUTIVE SUMMARY

Objective

The objective of this strategy is to establish the basic concepts that should guide Bank operations with regards to modernization of the State. According to the mandate contained in the Eighth Capital Replenishment of the institution, the strategic framework that until now has guided Bank action in this field, and the experience that has been accumulated as much by the Bank as by the countries of the region, this document uses the expression Modernization of the State as a synonym for state reform for the consolidation of democratic governance. This option is justified by the growing accumulation of academic thought and wide empiric evidence that shows that sustainable and equitable development requires a democratic, modern and efficient state that promotes economic growth, providing a regulatory framework that is conducive to the functioning of markets; guarantees a stable and reliable macroeconomic environment, legal predictability and political security; is capable of adopting appropriate economic and social policies for poverty reduction and environmental protection; and that implements these policies in an efficient, transparent and responsible manner.

Diagnosis

In the region, there has historically existed a deficient relationship between the state and the market on one hand, and the state and citizens on the other, which has resulted in an erosion of the possibilities for a sustainable and equitable development. In fact, from a historic perspective it is clear, with differences between countries, that there has been a “democratic deficit” that on occasion has been expressed in the phenomena of authoritarianism, clientalism, populism, corruption, and the “capture” of institutions and public policies by particular interests. These political system features have resulted in state actions that discourage efficient market functioning and instead promote rent seeking and speculation. At the same time, these aforementioned phenomena have contributed to a policy-making process in which the resulting policies do not reflect the processing and aggregation of the demands of the majority of citizens but rather lead to the exclusion of broad sectors of society from the benefits of growth.

Nevertheless, in the last few decades, positive tendencies have been affirmed. Democratic governments have been established in the region, which has implied significant improvements in terms of the protection of human rights, freedom of expression, exercise of individual political freedoms and the widening of opportunities for citizen participation in public decision-making. Accompanying this progress with regards to political freedom and the protection of human rights, in the region as a whole there have been very important efforts achieved to consolidate the rule of law and the independence between different branches of the state. At the same time, important reforms have been adopted to improve the regulatory capacity of the state, provide technical capacity and professional independence to the macroeconomic management and supervisory and regulatory agencies, transfer to the market a set of productive activities, open economies and improve the process of formulating and implementing public policies in the different fields. For the most part, the region has moved toward an improved legal and political environment that is more secure and predictable.

In spite of these positive tendencies, in some countries the following problems have been detected: delays, independence, reliability and access to the judicial system; low levels of credibility in the representative institutions such as parliaments and political parties; weaknesses in the administrative and in the supervisory and control agencies; administrative and fiscal disfunctionalities in the decentralization process; high indicators of perceived levels of corruption, and an environment of citizen insecurity that imposes high human, economic and social costs. It is recognized therefore that these political and institutional

limitations demand additional efforts to achieve the institutional requirements for a solid democratic governance.

Lessons Learned

From the experience of the Bank and other development agencies, a set of lessons has been gleaned that are as much related to the conceptual framework of state reform as to the design and execution of operations. Among the former, the following stand out: i) to conceive reform and modernization of the State as part of a political reform process oriented toward consolidating the rule of law and democratic governance and subordinate, therefore, the organizational designs of management and procedures to this objective; and ii) consider that there is a reciprocal and complementary relationship between state reform on one hand, and the strengthening of civil society and market expansion on the other. With regards to the lessons related to project design and execution, it is important to emphasize: i) having a comprehensive and long-term conceptualization of the reform process, but to be selective and gradual in project identification; ii) ensuring a solid political consensus centered around the reform process; iii) paying special attention to the particularities in the political-institutional environment in each country; and iv) adopting flexible designs that permit adaptation when faced with changing situations.

Areas for Bank Action

The document identifies four priority action areas for the Bank. Derived from accumulated experience, these action areas are not identified with specific institutions or determined branches of the state. On the contrary, a transversal definition is opted for, based on thematic objectives, whose achievement requires a more systematic and integrated logic and long-term vision. This focus is justified, in the first place, because the larger objectives of sustainable economic growth and the fight against poverty and the promotion of social equity have an essentially transversal character. In the second place, institutional weaknesses also have marked transversal characteristics that have blocked the efforts of the countries to achieve these larger objectives, such as the deficit of legal predictability, corruption, insufficient protection of rights and freedoms, gender as well as other types of discrimination, weaknesses in macroeconomic management and other public policies and the limited capacity for regulation and supervision, among others. As a result, priorities should be established according to integrated goals for institutional development whose achievement involves different branches of the state, together with civil society and markets. Based on the above, the following areas for action have been identified: A) Democratic System; B) Rule of Law and Judicial Reform; C) State, Market and Society; and D) Public Management. For each of these areas, spheres of action are identified in which specific actions are suggested.

A. Democratic System: The achievement of sustainable and equitable growth in the region attains two interdependent objectives at the same time: on the one hand, a greater political democratic stability and, on the other, greater political inclusion that allows for an effective representation of large sectors of the population that are presently excluded or unequally represented. The strengthening of the democratic system therefore is crucial for the efforts of development. In this area the following spheres of action have been identified: a) strengthen the institutional capacity of the legislative branch and their support to the definition of policies for poverty alleviation; b) modernize the electoral and political party system and promote greater inclusivity in the political system; c) increase the neutrality and objectivity of public administration; d) strengthen inspection, oversight and supervisory agencies; e) support the processes of political-administrative decentralization and democratization of subnational governments; f) promote the participation of citizens through representative institutions in the design and implementation of public policies; and g) promote the democratic culture of citizens.

B. Rule of Law and Justice Reform: In order to develop sustainable and equitable growth, legal predictability with regards to goods, contracts and obligations, access to justice for the entire population

and the equality before the law of all citizens is necessary. Without a solid rule of law, it is difficult to have an efficient market economy. At the same time, while the lack of legal predictability affects the whole population, it affects in a relatively greater manner the poor. Bank action in this area should be targeted toward developing a justice system that is independent, efficient, reliable, agile and accessible. In this regard, programs and actions will be promoted to: a) support the independence of the judicial branch; b) widen access to justice as an essential mechanism to reduce the factors of social exclusion and transaction costs; c) strengthen the capacity of the judicial system in the fight against corruption; d) develop modern systems of management and administration of institutions and judicial processes; e) establish alternative conflict resolution methods; f) update the substantive legislative and procedural framework; and g) protect citizen security and ensure the legal control of the use of force.

C. State, Market and Society: The development of wider and more dynamic markets, that favor the inclusion of presently excluded sectors, but that are also more efficient and capable of competing in the global economy, requires that state action be conducive to an effective interaction among economic and social actors. The areas identified in this field are: a) support the professionalism of the economic management institutions; b) strengthen economic and social regulation institutions and the processes to protect consumers; c) support institutions that design and promote active and inclusive development policies; d) promote the establishment of socioeconomic partnership instruments; and e) improve institutions for environmental governance.

D. Public Management: A sustainable and equitable development also depends on the quality and efficiency of policies and public management. On occasion, well-conceived strategies and policies fail to achieve their objectives as a result of deficiencies in the state's administrative apparatus and in the management of the same. In this field the following areas for Bank action have been identified: a) develop and strengthen civil service systems under criteria of merit and flexibility; b) strengthen the fiscal capacity of the state and improve efficiency and transparency in expenditure management; c) improve the capacity for coordination of strategies and public policies, especially those that fight poverty; d) modernize public services management; and e) use the potential of the knowledge and information technologies in public management.

Options for Bank Services and Implementation Guidelines

The document reviews the different financial and non-financial instruments and services, with which the Bank can have an influence, as much at the national as at the subregional and regional levels. An effort has been made to identify those instruments and services that better serve reform and modernization of the State programs. It is recognized that various of these instruments have been the focus of recent endeavors to update and reconfigure them, for example the creation of flexible lending instruments and the adoption of new guidelines to formulate Bank strategies in each country, that are particularly useful for the efforts for change and institutional development.

For the implementation of the strategy, a set of actions has been proposed whose general objective is to strengthen the relationship between the priorities and criteria contained in the strategy and the Bank programming exercises in each country, as well as the design of Bank financial and non-financial projects. It is especially important to link this strategy with the country strategies whenever there is demand for Bank action and this should be done in accordance to individual country circumstances. In particular, the carrying out of activities such as the diagnostic of institutional capacity, the incorporation of the results of these diagnostics in the country strategies, the formulation of operational guidelines for each of the action areas identified in the strategy, the possible establishment of a Regional Policy Dialogue on Reform and Modernization of the State, the deepening of collaboration with other development agencies and the strengthening of the professional capacity of the Bank to work in this field is recommended.

Monitoring, Evaluation, and Performance Indicators

The monitoring and evaluation of the implementation of this strategy will be carried out through output, outcome and impact indicators. The document points out diverse output indicators such as the number and amount of loans and technical cooperation programs, elaborated institutional diagnostics and formulated operational guidelines, among others. The outcome indicators will come from the project evaluations. With regards to the impact indicators, it is advised that they comply with criteria of relevance, political acceptability and objectivity so that they can be applied with greater precision in the diagnostic studies and strategies to improve democratic governance. Finally it is pointed out that monitoring and evaluation are fundamental instruments for the implementation of the strategy and in the specific operations that are formulated accordingly. In compliance with existing policies and norms, specific loans and technical cooperation programs that are formulated within the scope of the strategy should specify clear goals and objectives and include measurable indicators that start from a baseline.

It is important to note, nevertheless, that the implementation of this strategy will depend on the priorities that the countries establish, the circumstances they face and available resources. As a result, the monitoring of the implementation of the strategy should distinguish between the action areas that are the Bank's responsibility and those that are the responsibility of the countries and/or exogenous factors. The evaluation of the strategy will be carried out five years after its approval.

1. OBJECTIVE

- 1.1 The Eighth Capital Replenishment establishes a mandate for the Bank to work with a more comprehensive approach to development that seeks to consolidate economic reforms while also promoting internal socioeconomic cohesion, regional integration, environmental protection, modernization of the state, and the strengthening of democratic institutions and of civil society, as the means to achieve sustainable economic growth, poverty reduction, and promotion of social equity. Based on this mandate, on March 13th, 1996 the Bank's Board of Directors approved the "Frame of Reference for Bank Action in Programs for Modernization of the State and Strengthening Civil Society" (GN-1883-5), that has served as the strategic channel for Bank action in this sector up until now.
- 1.2 The objective of this strategy consists in bringing up to date the cited document, adjusting it to fit with the requirements of the framework strategies related to sustainable economic growth, and poverty reduction and social equity and establishing the necessary connections with the sectoral strategies related to social development, competitiveness, regional integration, and the environment. The document reflects the lessons learned from the Bank's experience, the theoretical and practical advances in the subject, and the evolution of the needs and demands of the region in the last few years. This strategy establishes the basic criteria that should guide Bank programs in this field, defines the priority areas of action, and indicates the available financial and non-financial instruments. In addition, it defines the criteria for evaluating its implementation, proposing a collection of output, outcome and impact indicators.
- 1.3 In accordance with the mandate contained in the Eighth Replenishment, the strategic framework up to now in force as well as this document take the expression modernization of the state to mean state reform for the consolidation of democratic governance. Governance comprises the process through which authority is exercised in a given political community, including: (i) the form through which the holders of authority are elected, monitored, and replaced; (ii) the principles and norms guiding the interactions between the state, the private sector, and civil society organizations, particularly in respect to their responsibilities and functions; and, (iii) the capacity of the political authority to identify needs, collect resources, and define and implement policies. Governance is democratic when a series of requirements are met in respect to how authority should be exercised and under what socioeconomic conditions: first, the requirement of representativeness that legitimizes public authority through free elections; second, the existence of mechanisms for the effective constraint and division of power, for ensuring the accountability of public officials to citizens and respect for citizen rights and liberties; third, controls on arbitrariness so that authority is exercised in a manner consistent with the law and the constitution, with effectiveness and efficiency in the assignment of resources to social needs and with transparency and integrity in the behavior of public officials; and finally, democratic governance requires conditions in which the enforcement of the principles of solidarity and subsidiarity permit a consensual and effective relation between different social actors in a context of social cohesion.

- 1.4 The state, despite its weaknesses and imperfections, is the backbone of democratic governance. But, the quality of democratic governance is shaped not just by state institutions, but also by their interaction with market institutions and civil society. In this sense, a strong civil society participating in the design and implementation of public policies through representative institutions is an essential condition for the effective functioning of democracy and for achieving sustainable and equitable development. To that regard, and consistent with the requirement of social cohesion as one of the conditions for democratic governance, it should be taken into account that the principal foundation of a robust civil society, beyond its organizational dimension that is manifested in a large number of social organizations, is the existence of economic opportunities and democratic freedoms for all citizens. Therefore, the strengthening of civil society is linked to the set of economic and social policies that promote human development and broaden the possibilities for the full exercise of citizenship by all persons.
- 1.5 In this meaning, democratic governance not only refers to the attributes of a political and administrative regime, and the effective enforcement of the rule of law, but also the capacity of a society to face the challenges confronting it and create solutions based on a solid social consensus. A modernization of the state strategy, as development and improvement of democratic governance and defined by the same requirements, is therefore, a strategy for the construction of institutional capacity in the state and in the whole society. In other words, the development of democratic governance implies, therefore, a complementary and reciprocal process of strengthening the state and civil society in the way noted above.
- 1.6 This strategy has been formulated on the basis of the general and specific requirements of the overarching strategies related to sustainable economic growth and poverty reduction and promotion of social equity (Annex I). Sustainable and equitable development requires a democratic, modern and efficient state that promotes economic growth, establishes a regulatory framework conducive to the efficient functioning of markets, that guarantees a stable macroeconomic environment, that is capable of adopting social and economic policies appropriate for poverty reduction and environmental preservation, and that implements such policies in an efficient, transparent and accountable manner. In the development debate a consensus has formed that the quality of public institutions is an essential, and perhaps the most important ingredient for sustainable economic growth. Therefore, this strategy pays special attention to the institutional and political requirements of a solid strategy for economic and sustainable growth. On the other hand, there is a broad recognition that the consolidation of democratic systems, beyond strictly the electoral dimension, implies a reciprocal and complementary process of improving the situation of the poor in such a manner that increases their opportunities to have their interests represented in the process of formulating and implementing public policies. As a consequence, this Modernization of the State Strategy is formulated from the perspective of supporting a sustained process of poverty reduction and social equity promotion.
- 1.7 In the same manner, this strategy pays attention to the connections and interrelationships that can be observed in relation to the other basic sectoral strategies of the Bank. In relation to the social development strategy, it is taken into account that the effectiveness of efforts in

this area depend on the institutional capacity of public organizations and the existence of collaborative structures between different levels of government and a complementary relation between social actors and the market. In relation to the competitiveness strategy, the need for the state to ensure a solid and stable macroeconomic environment, to carry out necessary investments in social and economic infrastructure and human capital, promote competition and capacity for innovation, provide an appropriate regulatory framework, and guarantee the predictability and stability of the legal system and policy environment is emphasized. In relation to the regional integration strategy, the modernization of the state strategy takes into account the fact that the goal of regional integration depends on the institutional capacities of countries to define and implement commercial and customs agreements, develop an appropriate infrastructure for the exchange of capital, goods and services and labor, as well as common economic and social policies and progress in the convergence of legal and political systems of the countries. Finally, in relation to the environment strategy, it is recognized that political-institutional weaknesses that result in poorly designed, absent or ineffectively implemented policies constitute one of the principal causes of environmental vulnerability.

- 1.8 In the last few decades the Bank has supported the countries of the region, through a considerable quantity of financial and technical assistance operations, in the process of economic reforms oriented towards economic stabilization, consolidating the market economy, increasing trade openness, eliminating subsidies that distort competition and efficiency, and privatizing productive activities and service provision. These economic reforms, supported by the Bank, have resulted in an important transformation in the relationship between the state, market and different social actors. In addition to the institutional reforms directly associated with the economic reforms mentioned, the Bank has widened its activities to include operations aimed at supporting the countries in their efforts to consolidate the democratic system and the rule of law.
- 1.9 In fact, over the last decade a growing importance has been attributed to democratic governance for achieving the objectives of sustainable and equitable development. In the agenda of development policies of the countries and of the bilateral and multilateral cooperation organizations, the promotion of democratic governance (albeit with somewhat different emphases and nuances) has become one of the fundamental pillars to achieve and sustain the goals of development. A cumulative experience and academic knowledge has reaffirmed the conceptual framework adopted by the Bank, in the sense that the success of efforts to reduce poverty and achieve sustainable development requires a substantial increase of institutional capacity and a favorable political environment. The recognition of the positive contributions of democracy to development is now added to the recognition of its intrinsic value in respect to the promotion of freedom and human rights (see Box 1, for the mandates to this regard).

2. DIAGNOSIS

- 2.1 Historically, an inadequate relationship has existed between the state and the market, on the one hand, and between the state and citizens, on the other, that has translated into an erosion of the possibilities for sustainable and equitable development. The situation is not

the same in all the countries, and in the last few decades, a set of important processes have been implemented in the region that aims to address these areas of dysfunction. Nevertheless, from a historic perspective it is clear that there has been a democratic deficit occasionally expressed in the phenomena of authoritarianism, clientalism, corruption, and “capture” of institutions and public policies by particular interests. These political system features have resulted in state actions that discourage an efficient functioning of the market and instead promote rent seeking and speculation. At the same time, these same weaknesses have contributed to a policy-making process in which the resulting policies do not reflect the processing and aggregation of the demands of the majority of citizens but rather lead to the exclusion of broad sectors from the benefits of growth and to the delegitimation of the state. This democratic deficit is also responsible for the paradox of the region’s long periods of significant economic growth in the absence of reasonable degrees of social cohesion. A consequence of this inadequate relation between the state and society is chronic political instability and changing rules of the game that have discouraged saving and investment. The above analysis implies the necessity of promoting a state reform process oriented to overcome these dysfunctions in the relation between the state and citizens on the one hand, and between the state and the market on the other.

- 2.2 Nevertheless, there are important positive tendencies. It should be emphasized that with regards to the relationship between the state and citizens, in the last two decades, democratic regimes of government have been established in the countries of the region. This has brought significant improvements in terms of the protection of human rights, freedom of expression, exercise of individual political freedoms, and the expansion of the opportunities for the participation of citizens in public policy-making (See Graph 1).
- 2.3 In addition to progress regarding political freedom and the protection of human rights, the region as a whole has been carrying out important efforts to consolidate the rule of law and independence between the branches of the state, improve the regulatory capacity of the state, and provide macroeconomic management and monitoring and supervisory agencies with technical capacity and professional independence. Similarly, a wide process of decentralization that has deepened democratic tendencies and has brought the government closer to the population has been observed.
- 2.4 Nevertheless, there remain important weaknesses that call into question the political-institutional strength of these democratic regimes. Political institutions important to securing the legitimacy and trustworthiness of the democratic system in some cases suffer from important deficiencies: (i) The legislatures are typically characterized by operational, administrative, and resource problems that limit the fulfillment of their legislative, representative, oversight and monitoring responsibilities which affect the capacity to generate political and social consensus, the quality and consistency of laws, and the exercise of an effective and responsible oversight of the executive; at the same time, the mechanisms for the participation of citizens in legislative work are weak; (ii) the party system reflects great weaknesses, including the lack of capacity to process and aggregate citizen demands and represent general interests; (iii) in spite of the notable advance in the last couple of decades, in some countries more work is needed in perfecting electoral systems to ensure their effectiveness and credibility; (iv) equally, in some countries the

democratic civil control of the armed forces occasionally manifests important institutional weaknesses; (v) audit and other supervisory institutions do not always have the independence, objectivity, and technical capacity necessary for them to be able to oversee adherence to the law, integrity, and effectiveness of the actions of public officials and of transactions between the state and economic actors; (vi) finally, and despite a significant expansion in the number of organizations, civil society remains relatively weak because of the socioeconomic exclusion of vast sectors of the population. All of the above weaknesses can be related with indicators that show a low perception of political stability in the region and the lack of confidence of the population in politicians (Graph 2).

- 2.5 Another aspect of the relation between the state and citizens has to do with the institutional requirements of the rule of law. An assessment of the state of justice in the region reveals the persistence of problems, including: the lack of judicial independence, the obsolescence of laws and procedures, congestion in the court system; a scarcity of resources; the absence of modern systems of organization, information, and administration; barriers of access and the limits of the coverage of the system; the deficiency and poor state of the physical infrastructure; and the precariousness in the protection of fundamental rights. The result is justice with low credibility and inequality that denies or limits the access of broad segments of the population, without the capacity to reliably uphold and enforce rights and obligations or effectively impose sanctions to curb the growth in different forms of crime and other threats to citizen security. Comparison of the perceptions of the independence and integrity of judges, as well as the indicators of confidence in the justice system, illustrate the relatively unfavorable situation of the region in relation to the developed countries (Graph 3).
- 2.6 Even though it is difficult to identify a paradigmatic process of decentralization in the region, one can find some common deficiencies. Among these deficiencies could be included: the imprecision in the distribution of responsibilities; an imbalance between responsibilities and resources, larger fiscal deficits, the “capture” of subnational governments by local elites, scarce technical preparation of those who have been leading these processes, the lack of efficiency and effectiveness in the provision of decentralized services.
- 2.7 As a consequence of the institutional weaknesses noted above, existing indicators reveal levels of perceived corruption (Graph 4) that are incompatible with the legitimacy of public institutions, efficient operation of markets, an efficient management and allocation of resources, and the existence of a system of incentives consistent with the need to expand savings, investment and production. The prevalence of corruption is to some degree an expression of the weakness of the rule of law as a whole, but calls attention also to the weakness of the state’s financial administration, poor policy design, inefficient and deficiently transparent expenditure systems, the persistence of antiquated and inefficient procurement and public contracting systems, non-existing or inefficient regulatory capacities, absence of clear rules in the process of privatization, and the lack of a modern merit-based civil service.

2.8 The relation between the state and the market also has experienced very important changes derived from the economic reform process carried out over the last two decades. These reforms have resulted in gains in terms of macroeconomic stability, creating an environment more favorable for investment. In addition, entire sectors of productive activity, once dominated by inefficient state monopolies, have been opened to the market. In a similar manner, trade barriers and sector-specific regulations restricting internal and external competition have been dismantled. Nevertheless, the move towards an economy in which market forces play a more central role has not been sufficiently accompanied by the development of effective regulatory capabilities that promote competition, reduce rent seeking and protect the common good. In addition, the move to a market economy has been unequal, and in not a few cases, has been based on the capacity of organized interests to take advantage of or resist the opening. It is also important to note the absence of broadly inclusive social partnership mechanisms that include those interests that are positively or adversely affected by the reforms, in such a manner that the countries can have long-term strategies based on a wide social consensus. At the same time, as a consequence of the fiscal crises, policies and institutions established to promote and support productive sectors have been abandoned. Nor has there been sufficient progress in the adoption of fiscal reforms that broaden the tax base and share the tax burden in a more equitable manner. Confidence in respect to the basic economic rights indispensable for the promotion of investment and productive development continues to be absent (Graph 5). At the same time, in many cases the state's capacity to provide public goods and basic infrastructure necessary to promote social cohesion and the expansion of production activities has weakened. In this context, the necessary emphasis on the operation of markets should be accompanied by the recognition of the complementary and important role played by public policies and institutions. As shown by diverse studies, the countries that have benefited the most from economic reforms are those that have advanced more in implementing institutional reforms consistent with the requirements of democratic governance.

2.9 The relation of the state, both to citizens and to markets, is conditioned by the capacity of the public administration to make and implement public policies. During the last two decades, however, public administration reforms have not, for the most part, increased this capacity since in general they have been carried out under the pressure of severe fiscal crises and recurrent external shocks. More than administration reforms, they are more appropriately described as administrative consequences of fiscal adjustment whose effects have been the reduction of the public administration in the majority of countries (Graph 6). The 1990s have brought an advance of the reform agenda towards modernization projects oriented to achieving more effective and efficient administrations through new structures and procedures supported by new information and communication technologies. The balance of these projects has been uneven, with some advances achieved in fiscal and economic administration but deeper institutional reforms of the administrative apparatus remain pending in a majority of the countries, especially in the social sectors. It is not surprising that a regional comparison of the perceptions of the competence and professional independence of public officials is also unfavorable for the region. Finally, the delay in taking advantage of the possibilities of electronic government also clearly illustrates the deficits in relation to the modernization of the state in the region.

- 2.10 Thus, in spite of the advances in the region in respect to democratic freedoms, economic reforms, and state modernization, important institutional deficiencies remain which impede efforts to promote sustainable and equitable development. The consequence is a deep dissatisfaction of citizens with the functioning of state institutions and the political system in its entirety. The legitimacy of democracy as a system of government also shows signs of erosion (Graph 7). These tendencies are very worrisome.
- 2.11 All of the evidence and accumulated knowledge makes it clear that the solution to the outlined problems can only be found in institutions central to ensuring democratic governance. Only the consolidation and strengthening of the democratic system, the rule of law, and institutions that support competitive and inclusive markets, and the establishment of efficient public administrations, can guarantee the achievement of sustainable growth and the reduction of poverty. It is for that reason, that these priority areas of action for the Bank are included in scope of this Modernization of State Strategy. This conclusion needs special emphasis in light of the international trends in which the region is immersed. The opportunities and challenges presented by these trends, including those derived from globalization, the technological revolution, the consensus in respect to democracy and the market economy, as well as the cumulated deficits in terms of poverty, inequality, political and institutional weaknesses, insufficient development of productive capacity and the deterioration of the environment, require, on the one hand, to increase the efficiency of the relation between the state and the market, and, on the other hand, to strengthen the capacity of the state to act as an agent of progress and general welfare. State reform and modernization continues to lag in comparison with the progress of globalization processes, new technology, the requirements of competitiveness and the cultural transformation of society. Without strategies that contribute to overcoming the political-institutional weaknesses that prevail (although with variations depending on the country) in the region, it will not be possible to obtain sufficient progress in respect to development and the reduction of poverty.

3. LESSONS LEARNED

- 3.1 The Bank has experienced a considerable growth and diversification of its activities in the area of state modernization and reform, especially stemming from the approval of the Frame of Reference mentioned in paragraph 1.1. From the lessons learned from the Bank's experience (see Box 2 regarding a Bank special study on the topic) and that of other institutions, as well as the conceptual framework set forth in the preceding sections, and considering the conditions facing the countries of the region, a set of criteria for guiding the Bank's and countries' actions in state reform and modernization processes can be defined. This section presents a set of lessons learned, grouped into two categories, which result in criteria to guide interventions. First, those related to the conceptual framework, and second, those related to the process of design and execution of interventions.

Lessons related to the conceptual framework

- 3.2 *Conceive modernization of the state operations as a process of political reform.* The redesign of institutions and processes, in terms of their effectiveness vis-à-vis the relation

between the state and the market and in terms of the capacity of public policies to respond to the interests of all of the citizens, should form part of a broader process of consolidating the institutional requisites for democratic governance. The lessons learned in respect to sustainable economic growth and poverty reduction highlight the importance of democratic governance. On the one hand, there is a consensus between development agencies that the quality of public institutions – especially those related to the rule of law and the fight against corruption – is an essential ingredient, and perhaps the most important, for achieving sustainable economic growth. The recent experience in the region, in which the achievement of fiscal balance has tended to be given the highest priority, which combined with the notion that institutional reforms can be postponed until second and third generations of reform, has resulted in limiting the capacity of the state to undertake key public policy reforms and to accomplish some of its basic responsibilities in terms of the creation of economic infrastructure and the formation of human capital. On the other hand, under democratic governance conditions the poor are empowered, which tends to better ensure that growth is widely, inclusive, and participative. In solid democratic systems, there are more opportunities for the interests of the poor to be represented systematically in the process of formulating and implementing public policies.

- 3.3 *Take into account the reciprocal and complimentary relationship between state reform, on the one hand, and strengthening civil society and the expansion of the market on the other.* The combination of internal reforms with stimuli derived from a participative and competitive focus, can unleash a virtuous circle of incentives that support the reform process. The role of civil society (labor unions, political parties, non-governmental organizations, academic institutions, business associations, community organizations and other diverse types of society organizations) – for example, in demanding transparency and efficiency in public management in the advancement and consolidation of reforms, the accountability of public officials, and public policies that respond to the general interests of society – is central to the reform process. At the same time, the expansion of the market towards areas that were previously the state's responsibility requires a strengthening of business capacity and accountability to society, as well the development of the state's regulatory capacities in order to avoid inefficiencies and new types of distortions.
- 3.4 *Target the basic institutions that shape the incentives guiding the behavior of actors.* The projects that are limited to changing instrumental elements or simply strengthening technical organizational capacities, without altering the structure of incentives that affect the political will to apply them, are likely in general to have a negligible impact. Thus, institutional changes that condition the effectiveness of instrumental and organizational reforms need to be addressed at the same time. For example, it does little good to train public employees if their stability and career are not guaranteed through a merit-based civil service like that proposed below. In addition, it does little good to establish a financial management system without the development of a budgetary authority with the professional independence, power and capacity to enforce it.
- 3.5 *Avoid the uncritical application of models.* The uncritical application of models should be avoided and the specific circumstances of the recipient country should be considered. Even though institutional development historically came about more by imitation than by

invention, the success of the transfer of models depends on two factors: first, the consistency of the basic hypotheses regarding the functioning of the reforms within the two contexts; and second, the extent to which the reforms are adapted to the context in which they are applied. In some cases reforms identical to those followed in developed countries have been applied without considering the fact that in the particular countries of the region the minimal conditions necessary for their successful implementation are absent. This is particularly important, given the unequal institutional development existing between the countries of the region. For example, only the countries with more developed institutions, or that have historically incorporated certain attributes of rigor and professionalism, are in a condition to implement reforms that entail greater sophistication and formalization of their management systems; in those countries where de facto informal practices predominate, the approach needs to be more gradual and less ambitious. In these cases it is necessary to identify and give priority to critical institutions and processes whose reform can unleash sustained processes of change and institutional development in the whole state apparatus.

Lessons related to the process of design and execution of operations

- 3.6 *Ground the operations in ownership by the country, building necessary political will and consensus.* The principal problem diagnosed in the execution of the modernization of the state operations is their volatility derived from the lack of commitment of the borrower and/or the opposition of the community. The success of modernization of the state programs and projects requires a clear ownership and commitment of all the actors involved: the state, market and civil society actors, since state reform requires political backing in the whole of society and not only within the institutions that are the object of reform. In fact, experience indicates that the more successful projects are those that emerge from a window of opportunity derived from a crisis or change of government, and whose design has been clearly owned by the borrower. In other words, programs should be directed by demand and not by supply.
- 3.7 *Identify and design projects on the basis of a solid knowledge of the institutional situation of the country.* Given the technical difficulty of modernization of the state operations and the limited capacities available for their execution, it is indispensable to develop solid analytical foundations on the basis of which to identify and design projects. It is unlikely that the programs and projects will be successful if they do not take into account the complexity of the political situation and the real incentives affecting their implementation. Thus, various information and analytical resources should be available in the process of operation identification, design, and execution: (i) regional and global comparative diagnoses that provide relevant indicators of a country's institutional deficiencies; (ii) institutional diagnoses of countries to support the country strategy of the Bank and serve as an instrument for dialogue and programming; (iii) institutional diagnoses carried out in the course of designing projects that allow the detected problems to be related to proposed measures and the objectives to be obtained; and, (iv) evaluations of projects and country strategies that allow lessons to be learned from past experiences.
- 3.8 *Have a comprehensive and long-term conception of reform, but be selective in the definition of projects.* One critical aspect of a comprehensive approach is that state reform

should cover the entire institutional and legal environment that influence the social, economic and political activity of a country and should not be limited only to the executive branch. Reform processes should be developed in a comprehensive manner and on this basis the Bank's support should be structured in specific operations over time, prioritized according to criteria derived from the urgency of the problems, the viability of available solutions, the existing financial restrictions and particularly paying attention to those operations that can support processes of sustained institutional development within the whole state. At the same time, very large and complex operations that exceed the capacity for execution and the available resources of the countries should be avoided.

- 3.9 *Ground execution in specialized and permanent institutions with clear authority to implement the projects.* Recourse to ad hoc executing agencies can be unavoidable in conditions with institutional constraints and weaknesses. But, it is important to keep in mind that when such structures tend to multiply and endure longer than necessary they can have negative effects on institutional coherence. In particular, use of such structures in modernization of the state projects should be carefully analyzed, because they can compromise effectiveness in the long term, given that it is necessary for the new practices to be internalized by the permanent units of the state apparatus. In the case that the use of such ad hoc executing agencies proves indispensable, the projects should be designed in such a way that their functions are gradually transferred to regular state agencies.
- 3.10 *Design operations to have sufficient flexibility to be able to adapt them to changing situations and, at the same time, monitor them more closely during the implementation phase.* Institutional development responds to factors, including political will, the capacity of actors, and the environment in which they act, that are not easily adapted to the traditional schemes of investment and infrastructure operations, or also the rapid forms of disbursement used for supporting the financial situation of governments. In the majority of projects, for example, the uncertainties of the political-administrative context do not adjust well to the rigid separation between design and execution that conforms to the traditional project cycle. The strong dependence of modernization of the state operations on the socio-political environment means that they are subject to constant changes that require a reevaluation of the initial design (hypotheses) and the viability of its proposals for change. In other cases the uncertainty amounts to confronting new situations or those for which there exists little precedent, thus requiring flexibility and the capacity to make changes in midstream. Therefore, the design of operations should consider this flexibility since execution cannot be mechanical. This assumes the advisability of strengthening Bank capacity to carry out the monitoring and evaluation of operations, in close coordination with the borrowing countries and executing agencies, as much to detect unforeseen situations and correct courses of action as to learn from successes and mistakes.

4. AREAS OF ACTION FOR THE BANK

- 4.1 Given the theoretical and practical evolution described above of the diagnostic of development roadblocks as well as trends faced by the countries, of the lessons learned and of the necessity to coordinate the Modernization of the State Strategy with other basic Bank strategies, the framework document that was approved in 1996 needs to be updated. This

updated version maintains the prior conceptual framework, in the sense that democratic governance is a necessary condition for development, but at the same time adopts a new and important emphasis for Bank action.

- 4.2 In the first place, this strategy seeks to identify with greater clarity the link between each of the priority areas of action and the sustainable economic growth and poverty reduction strategies (see Annex I). In each of the areas that have possibilities for Bank action, actions that are coherent with that objective are identified.
- 4.3 In the second place, this strategy is different from the preceding version in the manner in which it defines the Bank's priority areas of action. Instead of associating the areas of action to specific institutions or branches of the state, it opts for a transversal definition, based on thematic objectives, whose success requires a more systematic and integrated logic and long-term vision. This focus is justified as the institutional weaknesses that hinder sustainable and equitable growth- such as the lack of legal predictability, corruption, insufficient protection of rights and freedoms, gender and other types of discrimination, weaknesses in macroeconomic management and other public policies and the limited capacity for regulation and supervision, among others- cut across multiple organizations. Priorities ought to be established in relation to the integrated goals of institutional development, whose success involves different branches of the state, together with civil society and the markets.
- 4.4 The cross-cutting nature of the proposed action areas does not entail simultaneous actions in all the branches and institutions of government, rather it means a comprehensive approach to the system that takes into account objectives which go beyond the strengthening of some institutions separately. At the same time, the crosscutting approach should not inhibit action at the level of specific institutions as long as they are inserted into a more comprehensive logic regarding the transformation of the state and its relation with the market and citizens. Nor does it assume that the fields of action should have the same importance in all of the countries of the region. The Bank strategies for each country, based on their needs and specific context, and of the comparative advantages of the Bank, should identify which of these fields ought to be identified as a priority and determine the appropriate sequence for programs to set forth advances in institutional development and democratic governance. As was stated in the lessons learned, it is important to combine a comprehensive approach to the reform process with selectivity and graduality in the definition of operations. Action should be focused on those institutions and critical processes capable of stimulating sustained and generalized processes of institutional development.
- 4.5 A caveat of a methodological nature: the strategy identifies in a disaggregated manner the action areas with the objective of maintaining the principle that reform and modernization of the state requires a comprehensive vision of citizens and the market. The Bank has been accumulating experience and professional qualifications in these areas, without reducing the need to work in coordination with other development agencies. The importance of appropriate coordination with other bilateral and multilateral agencies should be emphasized with the objective of implementing this comprehensive vision of state reform.

The special comparative advantages of the Bank in some fields should be complemented with those that other cooperation agencies have in other areas. The identification of the areas of action and their disaggregation, are a menu of options available to the Bank and the member countries. It is not a matter of doing everything in all the countries, rather at the country level, and in accordance with the services that the Bank offers and the particular needs and circumstances that each country faces, priorities for Bank action ought to be established. In this sense the country strategy and the implementation of Bank operational programming are instruments that coordinate this strategy and Bank activity in each country.

- 4.6 The strategy outlines, through its focus on priority areas of action, the basic institutional requirements of democratic governance in light of the general goals of sustainable growth and poverty reduction. These requirements are compatible with the different options that the countries can legitimately choose in respect to the role for their respective states in relation to the market and civil society. In other words, the strategy does not have as objective to identify in an a priori manner the role of the state, prioritizing some functions (for example, regulation) and rejecting others (for example, promoting investment or engaging in production). Experience demonstrates the desirability for states to maintain the option of as wide as possible a portfolio of possible functions, choosing those in which to concentrate based on their specific circumstances and institutional, economic, social, cultural and political factors. The following section describes these areas of action in greater detail and identifies the specific actions and programs that the Bank could develop to support the countries of the region: A) Democratic System; B) Rule of Law and Justice Reform; C) State, Market and Society; and D) Public Management.

A. Democratic System

The achievement of sustainable and equitable growth in the region depends on the simultaneous pursuit of two interdependent objectives: on the one hand, the attainment of increased democratic political stability and on the other, a greater political inclusiveness which permits an effective representation of large sectors of the population that are presently excluded or unequally represented.¹ Both aspects are closely related, as long-term democratic political stability cannot exist without the effective integration of all sectors of the population in the system of political representation, in such a way that excluded sectors influence the design and implementation of public policies so that they respond to the common good. Inclusion ought to avoid logics that increase the particularism and volatility of the political system, which entails strengthening representation based on the general interest. The Bank can support the countries with programs and projects in the following areas:

- 4.7 a) *Strengthen the institutional capacity of the legislative branch.* This should be carried out under the principles of contributing to an effective separation of powers and strengthening of democratic representation, especially for the excluded groups. The legislative branch is

¹ To that effect, all the structural factors of exclusion whether the result of gender, ethnicity, culture or of whatever other type, should be considered included in the strategy. They haven't been disaggregated in a specific fashion in order to avoid overloading the text and to facilitate reading.

one of the institutions that is most important to the interrelationship between the state and society. At the same time, it also carries out key functions, both in drafting and enacting legislation and in overseeing the executive. The Bank can contribute to the modernization of the legislative branch by supporting programs designed to: (i) strengthen technical assistance systems that will improve the quality of legislation and help ensure that budgetary, monitoring and oversight functions are performed based on objective and technical criteria; (ii) modernize legislation to eliminate obsolete laws, incorporate into the national legal framework commitments stemming from international treaties and conventions, address challenges resulting from technological change, globalization, new forms of delinquency and organized crime and overcome all types of exclusion; (iii) establish a professional parliamentary organization and administration, including systems that guarantee accuracy in the recording of legislative debates and laws and registering of roll call votes, as well as the installation of modern systems of public information, documentation and legislative reference, including electronic connection with other legislative libraries; (iv) develop channels for dialogue and communication between the legislative branch and the population, especially those that are designed to favor voice and participation of excluded sectors and to define policies for poverty alleviation; and (v) develop technical and policy training programs for political leaders and parliamentary groups with the objective of strengthening democratic political leadership and the political party system.

- 4.8 b) *Modernize the electoral and party system.* The objectives should be oriented toward the improvement of representation, avoiding the exclusion of sectors of the population, especially the poorest. Modern democracy requires effective electoral systems and political parties that serve as a link between the state and citizens, stimulating participation, articulating demands and aggregating different social interests. The Bank can support the following: (i) establishment of independent, reliable and technically capable electoral institutions, including support for voter registration and information systems. Special attention will be paid to information and outreach systems that promote the electoral participation of illiterates and communities that have traditionally been excluded; (ii) strengthening of political party systems through technical assistance to legislative agencies and electoral authorities to adjust the legal framework of their constitution, functioning and financing and for the development of democratic political leadership training programs.
- 4.9 c) *Ensure the neutrality and objectivity of public administration.* In addition to the powers of direction and supervision that correspond to democratically elected governments, an effective democracy requires a neutral and capable administration able to serve governments with different political orientations. In addition it should guarantee, from a professional perspective, the continued delivery of public services and attention to the permanent duties of the State. To this end the Bank could support: (i) fair, merit-based hiring and promotion practices within public administration, such as prohibiting the arbitrary removal of public officials; (ii) promoting an ethical code among the permanent civil servants to strengthen their commitment to the values of neutrality, objectivity and defense of the common good; (iii) the delineation of political and administrative functions, as well as the systems for the articulation between them, through planning and control mechanisms; (iv) the existence of systems that allow for the effective protection of citizen

rights before the actions and omissions of public administration, through judicial mechanisms or alternative, ombudsman-type mechanisms; and v) the transition processes between governments and the establishment of systems that guarantee the integrity, transparency and permanence of administrative information.

- 4.10 d) *Strengthen inspection, oversight and supervision agencies.* The objective should be to ensure transparency and honesty in the activities of government officials and in state transactions and management. In this context, oversight and corruption fighting institutions have acquired great importance. The Bank could provide support to: (i) increase the technical capacity and functional independence of institutions that oversee government performance, for example the offices of the comptroller general, court of accounts, auditor general, ombudsman, public defender, public prosecutor and attorney general; (ii) design and implement mechanisms for public management oversight by civil society organizations such as consumer advocates and civil auditors, with the objective of increasing transparency and avoiding bias; (iii) incorporate into national legislation international conventions and commitments that support the fight against corruption and review legal and administrative legislation with the objective of avoiding conflicts of interest and promoting greater transparency and information on the activities and transactions of the state, including implementing accountability, disciplinary and justice systems.
- 4.11 e) *Support the processes of decentralization of political power and democratization of subnational governments.* The objective is to bring representation closer to the citizens and the communities to which they belong. These processes ought to pay attention to overcoming the observed institutional deficiencies derived from the “capture” of subnational administrations by local interests, fiscal indiscipline, inefficiency in the provision of public services and the scarce coordination between community organizations and the decentralized levels of public management. In this framework, the Bank will support: (i) the development of decentralization processes, paying attention to fiscal implications and protecting the balance of authority and accountability between the different levels of government; (ii) the establishment of a normative and institutional framework for decentralization that clarifies the division of responsibilities between levels of government in order to promote the allocation of resources toward socially valuable ends; (iii) the promotion of the democratization of subnational governments, ensuring representation and oversight mechanisms that are in accordance with democracy, transparency and accountability. This entails the necessity of integrating marginalized zones and bringing decision-making closer to citizens, including support to political-administrative entities linked to indigenous communities in countries that have recognized them; and (iv) promotion of civil society incorporation in the elaboration and implementation of local policies through participation mechanisms that take advantage of their capacity to articulate public interests.
- 4.12 f) *Strengthen the participation of citizens in the formulation and implementation of public policies.* In coordination with the governments, as primary interlocutors for the Bank, citizen participation in public policy formulation and execution in the countries and in the development of projects and programs will be promoted. At the same time, the strengthening of the democratic system, which is one of the central objectives of this

strategy, will enable a greater role for citizen participation in public sector management. In this direction, the Bank can support: (i) implementing programs to strengthen the institutional capacity of relevant civil society organizations for project design and execution, especially with regards to technically weak organizations; (ii) designing operations with components that could be carried out by civil society organizations; and (iii) establishing participation channels for beneficiaries in the design, execution and evaluation of programs.

- 4.13 g) *Promote a democratic culture in the citizenry.* Consolidation of democracy requires a political culture based on ethics, values and a democratic civic culture. The Bank can support the: (i) incorporation of civic education programs in reform, expansion and strengthening of the formal education system projects; (ii) promotion of educational courses and reforms designed to encourage a culture of tolerance, freedom, participation, accountability and social solidarity.

B. Rule of Law and Justice Reform

It is not possible to advance sustainable and equitable growth without progress in legal predictability and equality before the law for all citizens. The development of investment and assumption of risk that form the basis of market economy development, are incompatible with the uncertainty or slowness that is observed in the region regarding the protection of rights and obligations. On the other hand, an important part of the population, especially poor and excluded sectors, lack legal predictability with regard to their assets, and therefore have limited access to credit and formal systems of work and production. Other manifestations of the weakness of the rule of law are the impunity with regards to corruption and the elevated rates of citizen insecurity. Bank action in this area ought to be directed towards developing a justice system that is independent, efficient, reliable, agile and accessible, without discrimination based on race, gender or of any other type, for which programs and actions could be oriented toward:

- 4.14 a) *Support the independence of the judiciary.* Judicial independence means that the availability of budgetary resources, appointments, recruitment and career development of judges and magistrates and cooperation with other judicial institutions are not exposed to interference by political or economic interests that can compromise the objectivity and independence of judicial decision-making. With this objective, the Bank can support programs that involve the following, among other activities: (i) creation or strengthening of institutions of the justice system to ensure their independence; (ii) establishment of systems for the recruitment, career development, training, disciplinary action, and remuneration of judges and magistrates that will guarantee the principles of equality and merit; and (iii) strengthening systems that promote the accountability of the judiciary to citizens.
- 4.15 b) *Widen access to justice.* The objective should be to widen access to justice for those segments of the population that are marginalized for geographic, socioeconomic, ethnolinguistic, gender and other reasons., and. Accordingly, Bank support may include: (i) the establishment of public defender systems and free legal aid services and other mechanisms that widen access to justice; (ii) modernization of judicial procedures to

decrease barriers and access costs, including normative simplification; and (iii) the design and execution of programs for outreach and training in basic citizen's rights.

- 4.16 c) *Strengthen the capacity of the judicial system in the fight against corruption.* As legal sanctions are the most effective form of dissuading corrupt behavior on the part of public and private actors, the Bank could support the: (i) creation of specific units to fight corruption in the attorney general and the public prosecutor's offices; (ii) adoption and implementation of necessary legal instruments by the countries, including conventions and international treaties for the fight against this type of crime; and (iii) the development of instruments for transparency that strengthen oversight by citizens and civil society organizations.
- 4.17 d) *Develop modern systems for management and administration of judicial institutions and procedures.* The ineffectiveness of judicial system management and processes, the weakness and limited coverage of the registry of property and people (there are wide segments of the population that lack property titles), are the causes of legal unpredictability, the denial of rights and socioeconomic exclusion, that limit the possibilities for a dynamic and equitable growth. Bank actions could include: (i) modernization of the administration of justice, including the design of new accountability frameworks in order to manage judge's offices and procedures more efficiently; (ii) reform of administrative structures, procedures and processes and the creation of modern methods of planning, human resource management, information systems, and training, and the establishment of an appropriate system of judicial statistics; (iii) expansion and modernization of the physical infrastructure of courts and tribunals to increase the coverage of the judicial system and to support its improvement; and (iv) development of programs that modernize and widen the coverage of the registry of people and property, including registry projects for urban and rural property, paying special attention to informal and excluded sectors.
- 4.18 e) *Promote alternative conflict resolution methods.* Alternative conflict resolution methods help reduce case backlogs and broaden access to justice. In this regard, the Bank may support: (i) the establishment of mechanisms to bring the law closer to the community to decrease the level of litigation and help reduce court congestion, including justices of the peace and other types of customary justice; (ii) the creation of opportunities to resolve conflicts through arbitration, mediation or conciliation; (iii) the promotion of basic civic and legal education regarding judicial institutions, court proceedings, and basic citizen rights, including training in alternative conflict resolution methods in schools and civil society organizations; and (iv) the capacity of special indigenous jurisdictions recognized in the legislation of some of the countries of the region.
- 4.19 f) *Update substantive and procedural legislation.* Actions in this field could include the: (i) elaboration of new laws and their regulation to respond to changing social needs; (ii) codification of existing laws prior to their simplification and streamlining; (iii) modification of procedures that would ensure an expedited exercise of rights and an effective and opportune compliance with obligations, such as a greater access to justice; (iv) modernization of judicial systems in order to promote convergence and coherence with regional norms to support the processes of economic integration.

4.20 g) *Protect citizen security, and ensure the legal control of the use of force.* In this area, Bank projects will seek to make human rights protection and procedural guarantees compatible with the need to combat violence, criminality and impunity that undermine the investment climate and impose a cost on citizens, especially the poorest. This section continues with the advice contained in the preliminary guidelines for project preparation for violence reduction in the countries.² Bank activities in this area can include: (i) strengthening the offices of the public prosecutor, ombudsman, and attorney general and formulating crime prevention policies; (ii) the establishment of rehabilitation and alternative sentencing programs to reduce recidivism; (iii) training, equipping and providing infrastructure to support forensic medicine and professional investigative practices; (iv) computerizing criminal statistics and establishing criminal information and record systems; and (v) strengthening executive branch institutions in charge of ensuring the state and legal monopoly of the use of force, as well as civilian control of the armed forces and the police.

C. State, Market and Society

The market is an area of the economy whose widening and improving depends on sustainable growth and an effective fight against poverty. Market development has been very uneven among and within the countries in the region: major segments of the population and property remain outside the market economy, and rent-seeking situations persist, which limit the development of productive capacity. It is necessary to develop government institutions and public policies that will provide the essential conditions and incentive systems conducive to the efficient and competitive operation of a market economy, which is a core requirement for dynamic growth and job creation, in a context of increasing worker productivity. For markets to function well, it is essential to guarantee a stable macroeconomic and financial framework that offers certainty to economic actors. At the same time, the reforms necessary to improve and widen markets with the two-pronged objective of increasing their efficiency and inclusiveness cannot be achieved without implementing wide partnership mechanisms between the different economic and social agents. The development of wider markets, that favor the inclusion of sectors of the population that are at present excluded, but that are also more efficient and capable of competing in the global economy, is the double objective of the policies and institutions that are referred to in this section. In this context, the following possibilities are open for Bank action:

4.21 a) *Support the professionalism of the economic management institutions.* As indicated in the Sustainable Economic Growth Strategy, the achievement of a stable macroeconomic framework requires the existence of institutions with sufficient authority, competency and capacity to obtain this objective. This assumes the need to support the development of legal regimes, personnel statutes and management instruments that allow the above-mentioned authorities to carry out their functions in a manner that is coherent with the objective of a stable macroeconomic framework. In particular, the Bank will support the institutional reform and development of: (i) monetary authorities; (ii) entities in charge of financial

² CP-2190-2 Preliminary Guidelines for the design of violence reduction projects

supervision and authorities responsible for pension system management; (iii) budgetary and tax authorities and iv) authorities responsible for statistic maintenance and census collection.

- 4.22 b) *Improve social and economic regulatory agencies.* In order to promote market competition and safeguard the public interest as well as vulnerable groups, it is necessary to strengthen and improve economic and social regulatory agencies. The institutions that regulate markets carry out at least the following crucial functions. First, they establish and ensure the effectiveness of property rights and contractual entitlements. Second, they help channel information on market conditions, actors, and participants, thereby ensuring a more informed and transparent decision-making process. Third, they increase market competition, which has an impact on the equality of opportunities, efficient resource allocation, and innovation. Lastly, they protect against negative externalities that can result from market forces, for example with regards to protection of the environment, vulnerable groups and consumer rights. In these areas, the possibilities where the Bank could provide institutional support include: (i) modernizing commercial, financial, and procurement legislation and streamline administrative regulations and procedures to avoid an adverse impact on competitiveness; (ii) promoting data instruments that ensure transparency; (iii) strengthening the independence and professionalism of the regulatory institutions, including their accountability mechanisms, supporting their consolidation when beneficial and developing complementary institutions necessary to be effective; (iv) modernizing economic regulation procedures, promoting transparent and efficient processes; and (v) developing norms and the institutions and procedures to protect consumers, including those that are supported by the participation of social groups.
- 4.23 c) *Support institutions that design and promote active and inclusive development policies.* In accordance with the Competitiveness and Social Development Strategies, the Bank will support the: (i) establishment of institutions and agencies that promote economic development, as much at the national as at the subnational levels, that widen opportunities for all sectors and regions, paying special attention to those that are most vulnerable and excluded; (ii) institutions in charge of promoting the expansion of physical infrastructure and increase of human capital; (iii) the institutions that support the formalization of economic activities, especially with regards to small and micro enterprises and simplify the recognition of contractual rights and obligations; and (iv) institutions for the development of collaboration mechanisms between the public and private sectors and civil society in the public policy formulation process.
- 4.24 d) *Support the establishment of socioeconomic partnership institutions and instruments.* For the design and implementation of the reforms necessary for the improvement and widening of markets, the Bank can support: (i) the establishment, reform or modernization of consultative forums that incorporate the different economic and social actors, and their institutional strengthening, and the design and implementation of horizontal and sectoral social partnership mechanisms to stimulate economic and other types of reform and; (ii) social partnership with communities and groups particularly those whose relation to and dependence on natural resources is critical for their subsistence and development.

4.25 e) *Improve environmental governance*. The institutional framework that the countries adopt is critical for the development and introduction of an environmental agenda geared toward an efficient and effective management of environmental resources. In this area the Bank could support: (i) the strengthening of intersectoral coordination in such a way that the dimension of environmental governance is included in the handling of the diverse productive sectors; (ii) the strengthening of central environmental protection institutions and the regional and local capacities for environmental management; (iii) the development, in accordance with the Environment Strategy, of regulatory instruments that establish a balance between the distribution of costs and benefits of conservation and environmental control; (iv) the participation of civil society, especially traditionally underrepresented groups, in the decision making processes for the use, protection and conservation of resources.

D. Public Management

Sustainable and equitable growth depends also on the quality and efficiency of public policies and management. As experience in the region has shown, without public policies that are fiscally responsible and sustainable, macroeconomic stability will be affected, undermining efforts for the development of production and poverty reduction. Strengthening accountability mechanisms provides incentives for efficiency in public policies and management and constitutes as much the best preventative measure against fiscal imbalances, as the only way to satisfy social and economic needs that are indispensable for promoting sustainable and equitable growth. A particular priority is to adapt resource allocation systems so that they respond to the needs of the disadvantaged and adapt public service provision systems, enabling participation and direct involvement. In order to achieve the above, it is indispensable to overcome the politization of public administration and its “capture” by particular interests, that results in the phenomena of clientalism and cronyism that are the causes of inefficiency, corruption and distortion of state actions and policies. Public administrations ought to form the institutional platform for the formulation and implementation of public policies that respond to the common good of society, with complete subordination to the law. In the area of the strengthening of public administration and the processes of design and implementation of public policies, the possibilities for Bank action are the following:

4.26 a) *Develop and strengthen civil service systems according to principles of merit and flexibility*. The Bank will support the development of policies, regulations, and institutions that support a modern and competent civil service, based on the principles of merit and equality. The Bank could support, among others, the following activities: (i) institutionalization of a merit-based and modern civil service, as a way to professionalize public administration, incorporating a modern legal system adapted to the current needs of public administration; (ii) development of modern and efficient human resource management policies and systems, including those regarding the selection, promotion and evaluation of personnel, adapted to the current needs of public services, with diverse methods of hiring and employment; (iii) coordination and coherence between public salary policy and fiscal policy, given the extraordinary interdependence between both due to the proportion of the cost of public employee salaries; (iv) development of information systems and human resource management that consolidate necessary information, allowing for a

responsible management of public employment integrated with budget management; (v) support to an appropriate dimensioning of the workforce in public administration, following the criteria and approach of strategic streamlining; (vi) modernization of pension systems of public employees; (vii) support to training of public employees, as long as it is tied to objectives that improve service provision or to well defined human resource policies; (viii) development of the management capacity of the governments through the institutionalization of a professional career path subject to a performance based system, with incentives of the same nature.

4.27 b) *Strengthen the fiscal capacity of the state and improve the efficiency and transparency of expenditure management.* It is necessary that the state have sufficient resources so that it can provide public goods that are essential to be able to finance a modern and competent public administration and strengthen the position of the countries faced with recurring external shocks. To this regard, and in accordance with the Sustainable Economic Growth Strategy, the Bank should focus its efforts toward aligning the fiscal capacity of the countries with their development needs according to the criteria of transparency, equity, sustainability, and non-distortion of market forces. At the same time, it is necessary to guarantee fiscal discipline and better management and oversight of government performance through proper transparency and by providing quantitative and qualitative information on the provision of public goods and services and the evaluation of expenditure efficiency. In this sense, Bank action can be oriented toward: (i) supporting reforms that increase revenue by strengthening collection agencies, procedures, and systems, including the modernization of customs agencies and simplification of legislation and tax procedures; (ii) strengthening the fight against tax evasion; (iii) supporting the development of the legal and institutional frameworks necessary for fiscal balances and accountability, including aspects such as tributary and expenditure monitoring; (iv) implementing comprehensive financial and accounting management systems and promoting the transparency of budgetary information; (v) developing comprehensive performance-based budgetary systems that permit the targeting of resources to more efficient activities and the focusing of policies on the neediest sectors and regions; (vi) supporting the decentralization of budgetary power to executive units or agencies that are closest to service provision, with the establishment of performance-based monitoring and evaluation systems especially with regards to those units and programs designed to impact poverty and inequality levels; (vii) strengthening the budgetary offices of the legislative branch so that they have sufficient technical capacity to elaborate and monitor budgetary norms; and (viii) developing modern public purchasing and hiring systems, that are integrated into budget management and allow for maximum transparency, rigor, and competitiveness in acquisitions, and use the potential that the new information and communication technologies offer.

4.28 c) *Improve the capacity for the formulation and coordination of public strategies and policies.* This should especially consider the protection of macroeconomic stability, the fight against poverty, and the promotion of equity and regional integration. The governments face growing challenges at a time when they must coordinate needs with available resources, especially in the above-mentioned areas where the coordination of a large number of governmental and non-governmental actors is necessary. The Bank can back the development of these capacities through support to the: (i) strengthening of the

institutional capacity to formulate public policies that are appropriately coordinated with each other, including the implementation of coordination systems between the legislative and executive branches; (ii) establishment of strategic evaluation systems, including the development of data collection and analysis capacity for the elaboration and evaluation of policies; (iii) implementation of instruments to prioritize investments; (iv) establishment of effective systems for monitoring and evaluating public policies, especially those that combat poverty; and (v) modernization of state institutions responsible for the coordination, planning and execution of poverty fighting policies, including their institutionalization as State policies.

4.29 d) *Modernize public services management systems.* This should aim to make public services more receptive to the demands of citizens, especially with regards to the sectors that have been traditionally excluded. Management of public services can be carried out under a varied range of institutional mechanisms. The role of the State (with its different levels of government), market, and civil society can be combined in the various functions of planning, regulation, financing and production. Given that there are no universally valid forms of service delivery, in each case the best alternative must be selected based on the existing circumstances. The Bank will support the countries in establishing management models that create the greatest incentives for quality and efficiency including the: (i) establishment of executive agencies and entities under a performance-based management system; (ii) creation of unified offices (one-stop windows) for the provision of services; (iii) improvement in the targeting and management of programs designed to eliminate poverty; (iv) use of the market and civil society organizations (contracting, concessioning and outsourcing) for the production and financing of services when this would provide the best results; (v) the strengthening of sectoral capacity to define policies in cases of decentralization or indirect provision of services; (vi) development of capacity to oversee service provision; (vii) transfer of power to subnational governments, development of horizontal and vertical intergovernmental instruments to promote economies of scale for the provision of services and correction of regional imbalances through the coordination of multi-sectoral actions; and (viii) development of the institutional capacity of subnational governments to provide public services effectively and efficiently, including the availability of a professional civil service, a strengthened fiscal capacity through the ability to collect revenue locally and the existence of a framework for budgetary discipline and fiscal co-responsibility on behalf of the regional entities.

4.30 e) *Use the potential of the knowledge and information technologies.* Modern information and communication technologies are closely linked to the process of state reform. On the one hand, there are instruments to carry out the transformation of the public sector. On the other, the growth of the so-called knowledge and information economy is becoming the focus of public policies. The majority of the countries of the region have still not adopted a model for the development of a comprehensive and duly articulated society that has broad technological capacity, incorporating the vision and needs of the state, the private sector and civil society. There are often widely disbursed initiatives in the sector, duplication of efforts and resources, and an absence of coordination between the public, private and academic sectors. Given this situation, institutional, regulatory and organizational conditions need to be established that will favor a participatory focus in the definition of

agreed-upon objectives and duly coordinated responsibilities. In this regard, the Bank will support: (i) the definition and implementation of strategies to develop an information society; (ii) the strengthening of public institutions governing the information society and e-government; (iii) the development of legal requirements and infrastructure to support the technological development and innovation, with emphasis on internal and external connectivity nationwide; (iv) placing public services online in order to achieve tangible improvements in accessibility, efficiency and transparency; and (v) the establishment of cooperation channels between the public and private sector to expand the information society and e-government.

5. OPTIONS FOR BANK SERVICES AND IMPLEMENTATION GUIDELINES

- 5.1 For implementation of the strategy, the Bank has several instruments at the level of each country and at the regional and sub-regional levels. Several of these instruments have recently been updated and reconfigured, such as the creation of flexible lending instruments, the adoption of new guidelines for country papers (now called country strategies), as well as the possible creation of new financing instruments currently under review. Although these instruments and services have not been exclusively designed for Bank action in the area of modernization of the state, these changes are positive for the implementation of this strategy. As will be demonstrated in the continuing section, the Bank presently has instruments available that are highly adaptable to the requirements of change and institutional development.
- 5.2 First, at the national level, Bank action will contribute to the formulation of development strategies and policy for the countries through the following instruments:
- i) The Bank strategies for each country, in which Bank operational strategy is defined in a country for a set period of time and programmatic guidelines for Bank dialogue with national authorities, are determined. As noted above, these strategies and the exercise of programming in each country are the most important instruments to articulate this strategy- with their wide and diversified supply of topics- with the particular needs and circumstances of each country. The criteria for prioritizing Bank action, as well as the identification of the areas in which the Bank has a comparative advantage should be deduced from the particular characteristics of each country. In the same manner, these country strategies should serve to identify those fields in which the Bank should work in closer coordination with other development agencies.
 - ii) The national strategies for poverty reduction, which, in addition to their intrinsic content, consolidate the groundwork for improved coordination and linkage with other multilateral financial institutions and bilateral aid agencies, in the countries in the region that most urgently need external support.
 - iii) The sectoral studies that support the formulation of Bank strategies for each country and for poverty reduction by analyzing critical problems and identifying priority areas of action in accordance with the individual characteristics of each country.

Within this topic, the critical importance of diagnostic studies of public sector institutional capacity has been recognized.

- iv) The institutional diagnostic studies, and in particular together with other international cooperation agencies, analytical work that results in a comprehensive vision of the institutional problems of the countries (like the Country Financial Accountability Assessments and Public Expenditure and Management Reviews).
- v) The policy dialogues at the national level, in as much as they help identify lessons learned, exchange experiences, structure specific development agendas, and build consensus.

5.3 Second, Bank financial instruments have gradually become more diversified, in such a way that investment loans, sector loans,³ and national technical cooperation programs have opened new opportunities to support institutional development. Below, it is suggested that the use of different types of instruments, in coordination with baseline sectoral studies and country strategies, will be of particular importance for the implementation of this strategy and for deepening and making more effective Bank action in this field.

5.4 On the other hand, at the regional level, the Bank has non-financial instruments that include regional technical cooperation programs, which address high priority issues in borrowing countries' agendas and allow research, dissemination, training, and consensus-building activities to be carried out. The Bank also has regional policy dialogues with policymakers in the borrowing countries help identify lessons learned, exchange experiences, and structure specific development agendas. Additionally, the Bank has non-financial instruments applicable to this field, such as the policy documents, sectoral guidelines, lessons learned and best practice studies, and sectoral analysis studies, among others.

5.5 A review of the instruments available to the Bank to implement the Modernization of the State Strategy led to the following observations:

- i) Strategy implementation will provide opportunities to strengthen diagnostic studies, regional and national dialogues, country strategies, and to coordinate the Bank's financial and non-financial products in the field of modernization of the state.
- ii) The success of this strategy depends both on the availability of necessary instruments and their proper selection in each situation and on how these instruments are coordinated with each other. For example, complex institutional modernization operations can be approached through initial stages of analysis, consensus building and the development of basic institutional capacities that can be financed through technical cooperation programs and through flexible lending

³ Within the investment loans, at present there are the "flexible lending instruments" that include: innovation loans, support to project preparation and execution facility, multiphase program loans and sectoral facilities among which there is a specific one for institutional development.

instruments⁴, allowing for subsequent traditional sectoral or multiphase loans of greater magnitude. In addition, given the nature of the institutional changes required by the countries, it is estimated that multiphase operations will be frequently used as a way to support the reform process and consolidate long-term Bank support.

- iii) The elaboration of modernization of the state operations tends to be more complex than other types of projects and frequently requires activities that are not considered in the “traditional” project cycle. Even though the Bank has a broad and expanding range of financial instruments, experience has shown that some of them have limitations. As a result, it is considered necessary to intensify the use of resources from trust funds. Similarly, use of funds from the Multilateral Investment Fund (MIF) is recommended when possible and consistent with its mission (as has been the case with the MIF operations to support the establishment of Arbitration and Alternative Conflict Resolution, or the establishment of regulatory frameworks appropriate for the private sector).
- iv) There is a need to evaluate the experience in the use of different Bank instruments in modernization of the state programs on an ongoing basis. The reform process tends to be complex and therefore often requires institutional, technical or management capacity for change, which is absent from the affected institutions. Consequently, it is necessary to combine traditional or sectoral loans, for example with technical cooperation programs, and draw general lessons from this critical aspect.
- v) The implementation of this strategy offers great opportunities to improve the methodology used in the preparation of projects, with the purpose of ensuring the evaluability of operations among other objectives.
- vi) In the implementation of the strategy, an effort will be made to ensure closer cooperation with other international development agencies that are working in the field of modernization of the state, in order to maximize joint efforts, avoid duplication and conflicts and strengthen synergies. The coordination of Bank action with bilateral donors, who have increasingly been incorporating democratic governance into their aid agendas, offers a great potential to increase the efficacy of projects in this field. To take advantage of this potential cooperation it would be useful to focus coordination efforts on the initial stages, such as in the preparation of analytical and diagnostic studies on institutional capacity.

5.6 To implement the Modernization of the State Strategy, a set of actions whose general objectives are to strengthen the relation between the priorities and criteria contained in the strategy and programming activities of Bank operations in each country, as well as with the design of the Bank’s financial and non-financial products. For reasons noted above, it is considered especially important to coordinate this Strategy with the country strategies since Bank action should be grounded in the demands of the countries, in accordance with their

⁴ Particularly with regards to the innovation, the project preparation and execution facility and the sector facility loans.

particular circumstances, and not with preestablished models. In particular the following activities are proposed:

- a) Analyze institutional capacity in the countries based on governance indicators that facilitate the identification of regional and national priorities and serve as a baseline for future evaluation.
 - b) Incorporate the institutional capacity studies in the country strategies with the objective of identifying priorities for Bank action and providing a baseline for evaluation purposes. This task is essential for enhancing coordination between this strategy and Bank action in each country.
 - c) Elaborate technical notes for identifying and improving pertinent outcome and impact indicators in the activity areas of this strategy in collaboration with other international institutions.
 - d) Elaborate operational guidelines to orient Bank action in the four activity areas identified. Each guide would incorporate the necessary methodologies, procedures to follow, decisions that need to be made and responsible public agencies.
 - e) Examine the possibility of a regional policy dialogue with those officials responsible for modernization of the State in the borrowing Bank member countries.
 - f) Deepen the cooperation of the Bank with other multilateral institutions and development agencies to exchange knowledge and experience on the topic of modernization of the state, as well as to implement joint initiatives in respect to diagnostic studies and evaluations of actions in this field.
 - g) Strengthen Bank participation in regional networks that work on the topic of modernization of the State.
 - h) Develop professional profiles in the Bank to generate the necessary capacity that the implementation of this strategy requires, through dissemination to Bank officials of the Modernization of the State Strategy. Special attention should be paid to the needs of country office staff, who have the responsibility of continuously monitoring projects and making adjustments when changes in circumstances require it.
- 5.7 The Bank has been strengthening its professional capacity to support the countries in the field of reform and modernization of the state. The establishment in the Regional Operation Departments of divisions specialized in the topic has been a significant step in this direction. Coordination and exchange of experiences between these divisions and with the Central Departments through thematic networks of specialists from the different action areas of the Strategy will be reinforced. At the same time, coordination with the Country Divisions will be strengthened so that the country strategies and the programming exercises reflect the institutional reform priorities in the countries. Likewise, cooperation between the

central departments of the Bank that carry out the activities of data collection, analysis and knowledge exchange regarding the topic of modernization of the state will be strengthened.

6. MONITORING, EVALUATION AND PERFORMANCE INDICATORS

- 6.1 Monitoring and evaluation of the Modernization of the State Strategy will be carried out through output, outcome and impact indicators. Monitoring and evaluation are fundamental instruments for this Strategy's implementation and for the specific operations that are formulated accordingly. In compliance with existing policies and norms, the loans and technical cooperation programs that are carried out within the scope of this strategy should specify clear goals and objectives and include measurable indicators fixed to a baseline.

Output indicators

- 6.2 These indicators measure Bank activity in the area covered by the strategy: (i) number and amount of loans for modernization of the state and each area activity defined in this strategy; (ii) number and amount of technical cooperation programs; (iii) number of institutional diagnostic studies carried out; (iv) number of country papers that include a diagnostic of institutions and governance; (v) number of best practices studies on Bank operations; (vi) number of events disseminating best practices; (vii) number of operational guidelines created; (viii) number of dialogue events with each country and with groups of countries in the region; and (ix) number of studies evaluating the final impact of Bank projects and actual achievement of the project objectives. In particular, it is proposed to complete the institutional diagnosis for all countries by December 2006.

Outcome Indicators

- 6.3 The purpose of these indicators is to evaluate the outcome of modernization of the state projects based on project execution reports, project completion reports, and project alert identification systems. To this end, projects following the methodology set forth in the logical framework should identify outcome indicators based on objectives connected to the activity areas identified in this strategy. As part of the work plan for implementation of this strategy, a technical note with outcome indicators in the strategy activity areas will be made available to the operational divisions. It should not be forgotten that in order to make this evaluation possible during the preparation of a project, it is necessary to carry out a baseline analysis that measures the country's situation in relation to these objectives.

Impact indicators

- 6.4 The purpose of these indicators is to evaluate the progress made in meeting the final objectives of the Modernization of the State Strategy in each of its activity areas. Impact measurement should be carried at the country level in accordance with the goals regarding governance and institutional development that have been included in the Bank strategy for each country. The intrinsic difficulty inherent in this type of evaluation should be taken into account however, since governance and institutional development in a particular country depend on a set of factors that go beyond the impact of the Bank's modernization of the

state projects. Given the importance of these exogenous factors, which frequently have a predominant effect, it can be hard to attribute observed changes in the action areas to which this strategy refers.

- 6.5 Additionally, the definition of relevant governance indicators is still in a very early stage of development. Only partial indicators compiled by different entities are available and although relevant, their reliability is very inconsistent. Among others, available indicators include Latinobarometer's confidence and satisfaction with democratic institutions, Transparency International's corruption perception indicators, and the indicators regarding the efficiency of public administration, the rule of law and quality of regulations and public environment for markets developed by the World Economic Forum, among others. The Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) is promoting the identification of second-generation governance indicators that will meet relevance, political viability and objectivity criteria that can be applied with greater precision to diagnostic studies and strategies designed to improve governance. The Bank is participating in the development of this effort through the multilateral coordination group with the objective of benefiting from the advancements on this topic. Notwithstanding their limitations, impact indicators are considered essential to assist countries and international development agencies with the monitoring of governance and institutional situations in the region's countries. In order to advance the work in this sector, a tentative impact indicator proposal corresponding to the activity areas defined in this Strategy will be made available to the Bank's operational Divisions.
- 6.6 The implementation of this strategy will depend on the priorities that the countries establish, the circumstances that they face and available resources. An evaluation of the implementation of the strategy that distinguishes between the action areas that are the responsibility of the Bank and those that are the responsibility of the countries and/or other exogenous factors, will be carried out after five years of being in effect.

ANNEX 1

MODERNIZATION OF STATE

**AREAS OF ACTION FOR THE BANK AND THEIR RELATION TO THE
SUSTAINABLE ECONOMIC GROWTH AND
POVERTY REDUCTION STRATEGIES**

MODERNIZATION OF THE STATE STRATEGY

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
A. DEMOCRATIC SYSTEM	Consolidation of the democratic system	Democratic system and political inclusion of the poor
<p>Objective: Greater political stability and a better environment for investment and growth. Better representation of the poor and excluded sectors in the formulation and execution of public policies.</p> <p>Sub-sections:</p> <p>a) Legislative branch</p> <p>b) Electoral and party system</p> <p>c) Public administration neutrality</p> <p>d) Supervisory and monitoring institutions</p> <p>e) Decentralization of political power</p> <p>f) Civil society</p> <p>g) Democratic culture</p>	<p>Objective: Political stability.</p> <p>Actions:</p> <ul style="list-style-type: none"> • Modernization of the legislative branch. • Modernization of the electoral system. • Stability, continuity and efficiency of public servants. • Effective functioning of supervisory and monitoring institutions. • Regional economic development. • Strengthening of economic actors. • Promotion of democratic values among social actors. 	<p>Objective: Political inclusion.</p> <p>Actions:</p> <ul style="list-style-type: none"> • Strengthening of internal mechanisms of parliaments to favor the voice and participation of marginalized groups and the definition of policies to reduce poverty. • Modernization of the electoral systems to include poor and excluded citizens. • Efficiency and continuity of policies and services for the poor. • Transparency in public management to improve allocation of resources. • Decentralization to integrate marginalized zones and bring decision-making closer to those affected. • Strengthening of the capacity of community organizations to fulfill their role in a decentralized context. • Promotion of values of democratic inclusion.

MODERNIZATION OF THE STATE STRATEGY

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
B. RULE OF LAW	Strengthening of the rule of law	Rule of law and the access of the poor to justice
<p>Objective: Greater legal predictability, indispensable for investment and growth, and greater coverage and access to justice, especially for the excluded sectors.</p> <p>Sub-sections:</p> <ul style="list-style-type: none"> a) Judicial branch b) Access to justice programs c) Anti-corruption programs d) Judicial management and administration e) Alternative conflict resolution measures f) Updating of legislation and procedures g) Citizen security 	<p>Objective: Legal predictability.</p> <p>Actions:</p> <ul style="list-style-type: none"> • Independence of the judicial branch. • Reduction of transaction costs. • Overcoming of institutional weaknesses that favor corruption. • Modernization of the justice administration. • Alternative conflict resolution mechanisms. • Modernization of commercial, fiscal, financial and procedural legislation. • Citizen security programs to improve the investment climate. 	<p>Objective: Effective acknowledgment of the rights of the poor and marginalized groups.</p> <p>Actions:</p> <ul style="list-style-type: none"> • Independence for the judges and magistrates for the protection of the effective rights of the poor. • Effective access for the poor. • Eradication of corruption as a cause of income redistribution to the detriment of the poor. • Reduction of the costs of access for the poor. • Alternative conflict resolution mechanisms, including justices of the peace. • Simplification of legislation to promote the access to rights of the poor and disadvantaged . • Citizen security to reduce the cost of violence for the poor.

MODERNIZATION OF THE STATE STRATEGY

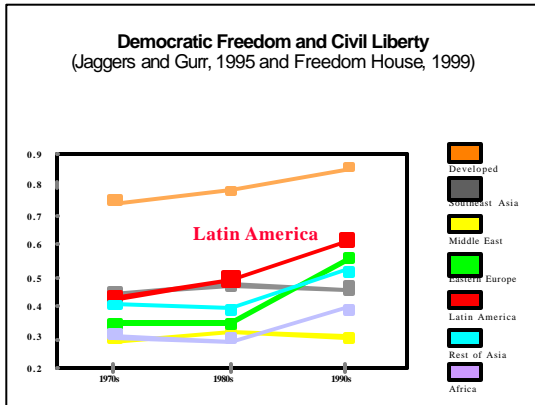
Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
C. STATE, MARKET AND SOCIETY	Strengthening of the linkages between the state, market and society	State, market and equity
<p>Objective: Improved institutions and policies to promote competition and development, indispensable for economic growth and widening opportunities for the poor.</p> <p>Sub-sections:</p> <ul style="list-style-type: none"> a) Professionalism of the economic management institutions b) Institutions for market regulation c) Institutions for the design of active and inclusive policies d) Socioeconomic partnership institutions and instruments e) Environmental governance institutions 	<p>Objective: Market competitiveness and efficiency.</p> <p>Actions:</p> <ul style="list-style-type: none"> • Institutions for macroeconomic and financial stability. • Strengthen institutions responsible for regulation and for promoting competition. • Institutions and policies that promote economic development. • Development of social partnership institutions for a more balanced representation of economic interests. • Development of markets under the criteria of environmental sustainability. 	<p>Objective: Widening markets and economic opportunities for the disadvantaged.</p> <p>Actions:</p> <ul style="list-style-type: none"> • Reduce the volatility of fiscal support to poverty reduction and support to market development. • Limit negative externalities to vulnerable groups. • Participation of excluded sectors in the formulation of public policies. • Social partnership policies and institutions that include and strengthen the interests of disadvantaged sectors. • Protection of minorities against factors of environmental vulnerability.

MODERNIZATION OF THE STATE STRATEGY

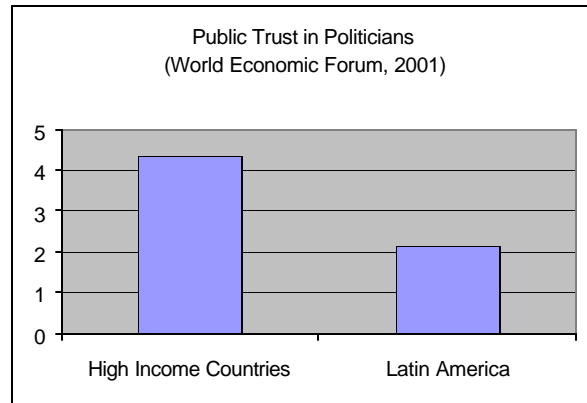
Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
D. PUBLIC MANAGEMENT	Modernization of public management	Public management for equity
<p>Objective: Greater efficiency in public management in the design and execution of public policies, necessary for growth and attending to the needs of excluded sectors.</p> <p>Sub-sections:</p> <p>a) Civil service</p> <p>b) Fiscal capacity, efficiency and transparency</p> <p>c) Elaboration and coordination of policies</p> <p>d) Public services management</p> <p>e) Greater use of information and communications technologies</p>	<p>Objective: Effectiveness and efficiency of services.</p> <p>Actions:</p> <ul style="list-style-type: none"> • Professionalization of economic management institutions. • Expansion of fiscal capacity, improvement of transparency and expenditure management. • Strengthening of the capacity to develop sustainable economic growth policies. • Modernization of public services delivery systems. • Application of new technologies to improve efficiency and transparency, for example, in public procurement. 	<p>Objective: Targeting policies and resources to the poor.</p> <p>Actions:</p> <ul style="list-style-type: none"> • Professionalization of state institutions responsible for poverty programs. • Greater fiscal capacity of the state to fight poverty, and greater transparency and efficiency to improve social equity. • Development of the capacity to fight poverty, including the targeting of programs. • Improvement in the management of public social expenditure and in the participation of community organizations in management. • Improvement in the access of the poor to services through new technologies.

GRAPHS AND BOXES

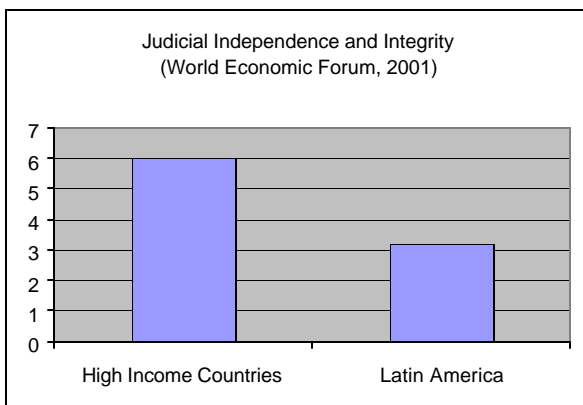
GRAPH 1



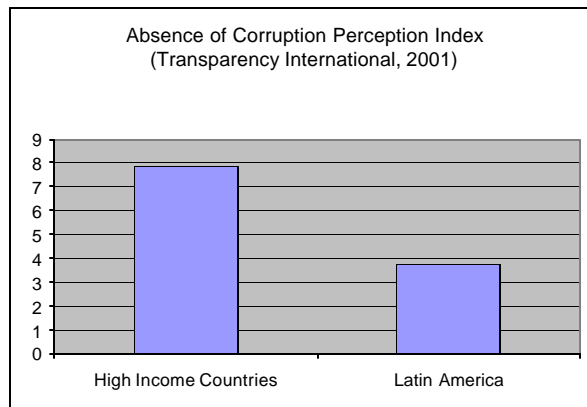
GRAPH 2



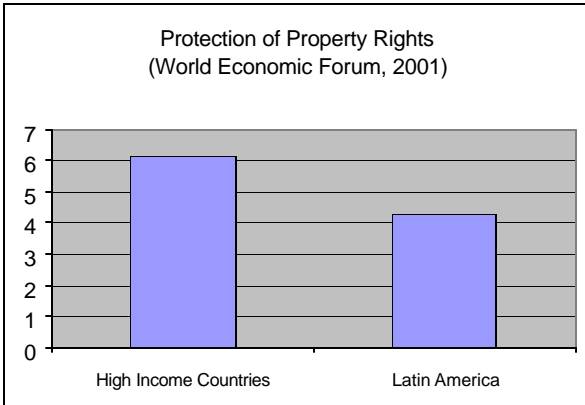
Graph 3



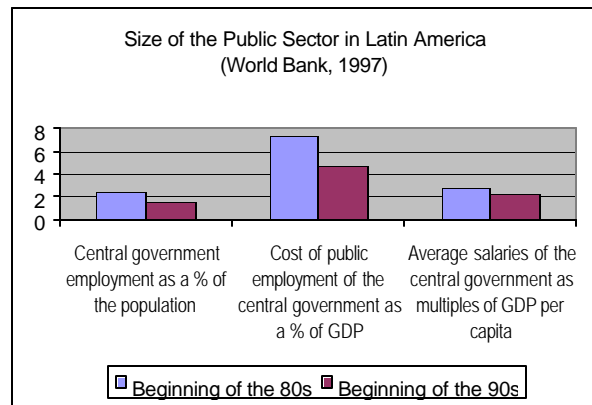
Graph 4



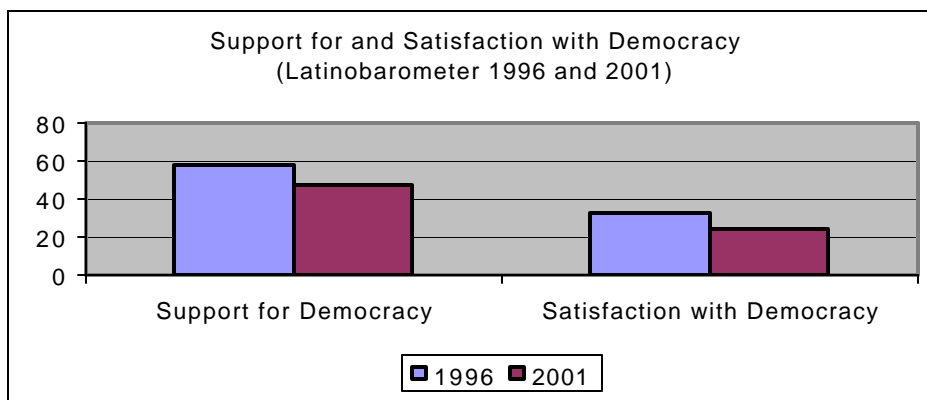
Graph 5



Graph 6



Graph 7



BOX 1: DEMOCRACY AND DEVELOPMENT IN THE MANDATES OF THE SUMMITS OF HEADS OF STATE AND GOVERNMENT

<u>Declaration of Miami, 1994</u>	<u>Declaration of Santiago, 1998</u>	<u>Declaration of Quebec, 2001</u>	<u>Declaration of European Union Summit - Latin America and the Caribbean, Madrid, 2002</u>
<p>Democracy is the sole political system which guarantees respect for human rights and the rule of law; it safeguards cultural diversity pluralism, respect for the rights of minorities, and peace within and among nations.</p> <p>Democracy is based, among other fundamentals, on free and transparent elections and includes the right of all citizens to participate in government. Democracy and development reinforce one another.</p> <p>.....</p> <p>Democracy is strengthened by the modernization of the state, including reforms that streamline operations, reduce and simplify government rules and procedures, and make democratic institutions more transparent and accountable.</p> <p><u>Plan of Action of Miami</u></p> <p>The strengthening, effective exercise and consolidation of democracy constitute the central political priority of the Americas.</p> <p>Governments will:</p> <p>Encouraging opportunities for exchange of experiences among member states' democratic institutions, particularly legislature-to-legislature and judiciary-to-judiciary..</p>	<p>The strength and meaning of representative democracy lie in the active participation of individuals at all levels of civil life. The democratic culture must encompass our entire population. We will strengthen education for democracy and promote the necessary actions for government institutions to become more participatory structures .</p> <p>.....</p> <p>Confident that an independent, efficient, and effective administration of justice plays an essential role in the process of consolidating democracy, strengthen its institutions, guarantees the equality of all its citizens, and contributes to economic development, we will enhance our policies relating to justice and encourage the reforms necessary to promote legal and judicial cooperation.</p> <p><u>Plan of Action of Santiago</u></p> <p>Governments will:</p> <p>Include in educational programs, whitening the legal framework of each country, objectives and contents that develop democratic culture at all levels, in order to teach individuals ethical values, a spirit of cooperation and integrity. To that end, the participation of teachers, families, students and outreach workers will be stepped up in their work related to conceptualizing and implementing the plans for shaping citizens imbued with democratic values.</p>	<p>We acknowledge that the values and practices of democracy are fundamental to the advancement of all our objectives.</p> <p>The maintenance and strengthening of the rule of law and strict respect for the democratic system are, at the same time, a goal and a shared commitment and are an essential condition of our presence at this and future Summits.</p> <p>Democracy and economic and social development are interdependent and mutually reinforcing as fundamental conditions to combat poverty and inequality. We will spare no effort to free our fellow citizens from the dehumanizing conditions of extreme poverty.</p> <p><u>Plan of Action of Quebec</u></p> <p>Make Democracy Work Better</p> <p>Recognizing the relationship among democracy, sustainable development, the separation of powers, as well as effective and efficient government institutions, and, noting that the transparency and accountability of electoral systems and the independence of bodies responsible for the conduct and verification of free, fair and regular elections are essential elements in ensuring support for and involvement in national democratic institutions.</p> <p>Share best practices and technologies with respect to increasing citizen participation in electoral process....</p>	<p>We consider it important to continue to strengthen democracy and consolidating democratic institutions that, inter alia, guarantee free, fair and participatory electoral processes based on universal suffrage and respect for the Rule of Law. We strongly support the principle that the national judicial systems should be independent and impartial.</p> <p>.....</p> <p>We believe that democracy, the Rule of Law and economic and social development are elements of fundamental importance for peace and stability</p> <p>We reaffirm our commitment for all human rights, civil political, economic, social and cultural rights, including the right to development, and fundamental freedoms taking into account their universal, interdependent and indivisible character in accordance with the UN Charter and the human rights instruments agreed internationally, together with the 1993 Vienna Declaration on Human Rights and the Programme of Actions.</p>

BOX 2: IDB EXPERIENCE WITH MODERNIZATION OF THE STATE OPERATIONS

At the request of the Board of Directors of the Bank, the Regional Operations Support Office (ROS) carried out a study of the Bank's experience in Modernization of the State operations. A total of 22 projects were analyzed that provided a representative sample of the different geographical areas, phases of implementation, and types of operations, whether technical cooperation programs, loans, or non-reimbursable funds. The study concluded that the majority of these operations had been executed successfully and that some of them represented valuable examples of good practices to follow in future operations of the Bank. Nevertheless, problems of design and execution were seen to have limited the achievement of the project's objectives in an important percentage of the cases.

Based on the accumulated experience the following lessons can be derived for achieving success in this type of operation:

- These operations depend on very favorable socio-political conditions and thus need to be associated with windows of opportunity that are opened in the political and economic cycles of the countries.
- Experience demonstrates that it is crucial to involve the key stakeholders in the processes of information gathering or participation in order to achieve a broad consensus.
- The availability of studies and previous analytical work has been shown to be of great utility for permitting a good knowledge of the country and for helping to correctly identify the areas for intervention and the rhythm and stages of the changes.
- The complexity of these projects and the incremental character of the changes to be carried out requires a long term perspective and a broad vision of the institutional and legal environment of the country.
- The more successful projects have been led by the borrower and implemented by a permanent and capable executing unit.
- Finally, it is clear that because of their characteristics these projects can require greater flexibility in Bank procedures and instruments.

ROS – Special Study IDB Experience with Modernization of The State Operations, March, 2002