

## **Modernizing The State**

Reflections on Next Generation Reforms to Strengthen the Capacity to Govern

Allen Schick

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1. Modernizers of the state have been busy during the past decade building new governance institutions and rehabilitating old ones in developing and emerging market countries. Modernization has been actively promoted and financed by multi-lateral institutions, including IADB, which have concluded that an effective state is necessary to combat corruption, encourage capital inflows, improve public services, promote accountability, nurture civil society, and foster other conditions favorable to development. Decades of disappointment have convinced the development community that a state which does not perform well and is not accountable to its people cannot make productive use of international assistance and cannot sustain social and economical improvement.

2. As sensible as this argument appears to be, it is appropriate to ask whether a modernization of the state (MOS) strategy can turn the tide when so many previous development initiatives have failed. Is MOS simply the latest grasping at straws in the hope that something might work when little else has? What would a modernized state look like, and how would a country (or international organization) know whether this objective has been reached? Can a state be truly modern if its markets and society aren't, if informal rules and relationships still predominate? Further, can a state be modernized if civil society remains disengaged or if political processes fall short of democratic ideals? Is modernization more than tinkering with the machinery of government?

3. These questions reflect deep unease that despite MOS' significant accomplishments, development still is impeded by serious inadequacies including embedded corruption, sub par public services, widespread mistrust of government, and reliance on informal institutions to

compensate for governmental shortcomings. As IADB and other development organizations plot future modernization strategies, it behooves them to consider why the buoyant expectations of a decade ago have not been fulfilled.

4. Unease about MOS has been stirred by Transparency International's latest (2003) corruption perception index. This annual survey found little improvement in the corruption scores and ranking of most developing countries.<sup>1</sup> Despite highly publicized anti-corruption campaigns, TI reported that most developing countries still have elevated levels of corruption. With the exception of Chile and Uruguay (which ranked 20<sup>th</sup> and 33<sup>rd</sup> among the 133 countries surveyed), all countries in the IADB region have scores below 5 (on a scale in which 10 represents a negligible incidence of corruption). Most were in the lower half of the rankings. The scores and rankings do not differ significantly from those reported in TI's first annual survey, published in 1995.

5. TI measures perceptions, which often lag changes in underlying conditions. It is certainly possible that the corruption percentage index fails to capture recent improvements in some countries. Moreover, corruption is only one facet of the MOS agenda; it is not a measure of all the governance deficiencies afflicting developing countries. It is certainly possible for corruption to persist at an elevated level even though various governance institutions have been significantly improved. Yet corruption is a relevant indicator because it tends to be correlated with other inadequacies in governance. In fact, governance indicators constructed by World Bank researchers have assigned most developing countries, including many in the IADB region,

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<sup>1</sup> Transparency International, [Press Release](#), 7 October 2003, posted at [www.transparency.org](http://www.transparency.org)

low scores on rule of law, accountability, and other relevant measures of government.<sup>2</sup> It should be noted, however, that governance indicators also rely in whole or in part on perceptions rather than objective criteria.

6. Despite the disappointing corruption and governance scores, MOS is an essential building block of modern society; countries with nonperforming states lag in development and experience other pathologies. Abandoning MOS is not a viable option, but broadening and refocusing it might be. The paragraphs that follow briefly discuss ways in which MOS might be more effectively built into an overall development strategy. The arguments summarized in these paragraphs are elaborated in the remaining sections of the paper. They argue for making MOS a more prominent part of the development agenda that is explicitly connected to other structural and policy reforms.

7. One reason for reorienting MOS is that the development community appears to be ambivalent about the fundamental role of the state in steering social and economic improvement. Although MOS strives to enable the state to carry out its functions more effectively, a significant amount of donor assistance is channeled to institutions that challenge the nation-state's authority and legitimacy. The state's rivals include NGO's, sub national governments, supranational institutions, administrative enclaves, and market-type arrangements. Perhaps even more important than the money given these alternative institutions, is widespread acceptance of the notion that they are better performers than the state. While the state is still powerful and commands immense resources and authority, the mixed messages—promoting modernization

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<sup>2</sup> See Daniel Kaufman, Aart Kraay, and Pablo Zoido-Lobation, Governance Matters!! The World Bank, Policy Development Working Paper 2772, February 2002.

and endorsing alternatives—may indicate that the role of the state as an engine of development will be less prominent in the new century than it was in the last.

8. MOS reforms stress the need to bolster accountability, but often give insufficient attention to the capacity of the state to perform. The emphasis on accountability may be due to the sense that the state is so powerful that it disregards the interests of its people and operates to the benefit of those who hold its reins. It may be, however, that a state, which is so powerful that it can thwart change, is nevertheless too weak to serve the people or promote development. It may be appropriate, therefore, to rebalance the MOS strategy by giving equal consideration to capacity, to the tools and resources needed by the state to transform society.

9. MOS is sometimes treated as an end in itself, and is not sufficiently linked to other development aims, in particular advancing political democracy and promoting pro-poor policies. It is unlikely that MOS can make much headway if it is regarded as a matter of governmental machinery rather than as a plank in the overall development strategy to improve the living conditions of ordinary people. A country that is poor and has weak democratic institutions, inadequate public services, and insufficient revenue will not have a modern state, no matter how much is invested in MOS initiatives. A state has to be modernized along with the rest of society; if it isn't, the state will continue to be hobbled by inefficiency, corruption, weak accountability, and other pathologies that retard development.

10. These challenges to MOS shape the argument of the paper. The first two pertain to the capacity and strength of the state, the third to the overall development agenda. At the end of the

day, the success of MOS depends principally on the strength of the state, the robustness of democratic political institutions, the rate of economic growth, the quality of services citizens receive, and the legitimacy of government. MOS is a means to building these essential elements of a good society. As elusive as these ambitious ends have been, MOS will come to naught if it does not make substantial progress toward them.

11. The reflections in this paper draw in part from several decades of work in reforming public management as well as from a review of more than a dozen MOS projects financed by IADB and visits by the author to Brazil and Uruguay, two countries which have had active modernization agendas managed at senior levels of government. In these countries, and I believe in many others as well, MOS appears to have been most successful in upgrading informatics and making government more transparent, but somewhat less successful in transforming the delivery of public services. In both countries, as in the region as a whole, modernization has been affected by the vicissitudes of the economy; in Brazil, it has also been impacted by a significant shift in political leadership.

#### 1. MOS Requires a Strong State

12. The development community is ambivalent about the future role of the nation-state. Although MOS explicitly aims to strengthen the state, other prominent development initiatives undercut the position of the state. Even when a weaker state is not the intended result, projects and assistance which bypass national government institutions, may have the cumulative effect of favoring rivals for public authority. I have argued elsewhere that the contemporary substitution of governance for government may reflect disinvestments in the state and thereby contribute to

the state's loss of the commanding position it held through most of the 20<sup>th</sup> century.<sup>3</sup> What is important is not the motive of those who seek alternatives to the state, but the effect of their reforms, which is to withdraw support and legitimacy from the state.

13. One challenge to the state comes from the popularity of NGOs, which now receive billions of dollars in donor aid each year. Although NGOs come in many forms and perform diverse functions, they all share one common-trait—they are not governments. It is truly remarkable that these entities are defined by what they aren't, but their “non definition” is a badge of honor that distinguishes them from the ineffectual states they purport to displace or influence. NGOs are most prominent in those countries where the state is weakest, especially in the least developed countries. In these venues, NGOs fill the void left by the absence of the state by delivering services to neglected communities, organizing the dispossessed, giving them voice in the political arena. In focusing on the good NGOs do, it is easy to lose sight of the plain fact that they speak to giving up on the possibility of rehabilitating the state.

14. Another popular alternative is found in the rush to decentralize public authority and the delivery of services. Decentralization is one of the key pillars of MOS, not only in large countries with diverse populations but also in small ones for which centralization was once deemed the most appropriate structure. The case for decentralization rests on claims that the state is too remote and uniformist, unresponsive to the interests of those it purports to serve and unable or unwilling to provide basic services that would ease misery and give people hope of a more promising tomorrow. Decentralizers acknowledge that the state is a superior tax collector,

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<sup>3</sup> Allen Schick, “The Performing State”, prepared for Organization for Economic Cooperation and Development, 2003.

but they argue that much of the revenue it produces should be turned over to sub national governments. In urging this division of public labor, decentralizers are unmindful of how fragile the state will become if it extracts revenues but does not accrue the political credit for providing services. It is doubtful that a state can long retain public support when cast in this role.

15. The nation-state has also been challenged by the expanded role assigned to regional and international organizations, which are reputed to be better providers of public goods which spillover national boundaries. The list of “international public goods” covers many responsibilities that once were unequivocally in the domain of the nation<sup>4</sup>. Once a function is labeled an international public good, a judgment has been made that a governing entity not confined within national boundaries should be made responsible for it. The new Constitution of Europe, which is now in the final stages of drafting, is a harbinger of the shrinking competence of the nation-state<sup>5</sup>. What is unfolding in Europe may be a template for the future relationship between the nation-state and supranational entities. While the transfer of authority to regional or international organization is not a central part of the MOS movement, modernizers are instinctively internationalist, for they seek to transplant avant garde practices and innovations from one venue to others. In a modernized world, national differences recede as countries mold themselves to the good or best practices promoted by reformers. The more countries are governed and managed alike, the more they are ripe for international structures that supplant the state.

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<sup>4</sup> See United Nations Publications, Global Public Goods: Taking the Concept Forward, Discussion Paper No. 17, March 2003.

<sup>5</sup> The Draft Constitution for Europe was approved by the European Convention in 2003 and is scheduled for final approval, subject to amendment, in 2004. It then will be open to ratification by each of the member countries.



16. The MOS agenda is conflicted on a contemporary innovation that has diminished the effective operating jurisdiction of some nation-states—the establishment of administrative enclaves that handle certain governmental functions, such as taxation and customs. Typically, enclaves are exempted from standard administrative rules governing personnel, procurement and other practices. In some IADB countries, enclaves have been assigned their own source of revenue, such as a fixed percentage of certain tax collections, freeing them from the financial and managerial constraints imposed on other departments and agencies. While modernizers generally regard enclaves as breaches of good governance, they nevertheless embrace enclaves in specific cases where administrative independence promises better performance. Moreover, international donors often insist that the money they supply be cordoned off in a separate agency or fund so as to assure that it is not diverted to other uses.

17. The final challenge to the state comes from privatizing or contracting out certain government functions on the ground that competition and market prices will generate efficiencies that elude government bureaucracies. This shift makes markets and governments rivals for resources and legitimacy, and transforms the relationship that prevailed through most of the 20<sup>th</sup> century. Although markets and governments are conventionally viewed as alternative means of organizing society and allocating goods, both flourished during the past century. Both now are vastly larger and more amply resourced than they were 50 or 100 years ago, and both are much more powerful. Apparently, expansion of one does not crowd out the other. Indeed, it is now understood that markets and governments are interdependent. Without big, effective public institutions markets would not prosper; and without productive markets, governments would lack

resources to provide public services. Interdependence also characterizes the relationship in poor countries where underdeveloped governments coexist with underdeveloped markets.

18. The fact that markets and governments are both impoverished in poor countries and robust in affluent ones is not happenstance. One implication is that government cannot be modernized if markets lag behind. Another is that MOS reforms which regard markets and states as antagonistic forms of organization may be misguided. There may be good cause for assigning certain work to markets, but any such transfer of power should be grounded on the nature of the work, not on efforts to curtail the scope of government.

19. The five governance alternatives discussed here have two common features. One is that they claim to provide better performance than the nation state can; the other is that they have a “democracy deficit,” they lack some of the representation and accountability mechanisms routinely used in democratic regimes. That this deficit does not tilt the argument in favor of the nation-state strongly indicates that MOS reformers value performance more than democracy. This is a troubling posture, for it runs contrary to the critical role attributed to democratizing institutions in promoting social and economic development. Each of the alternatives is deficient in some elements of political democracy, the processes by which citizens select leaders and hold them accountable. NGOs are self-appointed, accountable to themselves and funders, not to those they claim to represent; decentralization shifts resources and authority to sub national governments which, in most countries, are less transparent, attract lower voter turnout and are more likely to be infected by clientilism than the national government; supranational governments lack the machinery for representation and accountability that gives citizens voice in

democratic regimes; administrative enclaves have license to operate in ways that limit the authority of elected leaders; markets empower consumers, not citizens and make no claim to abide by the rules of political democracy.

20. Modernizers should reflect on what is lost when political democracy is compromised on the altar of performance. It may be that development itself is impeded, for the most developed countries have the sturdiest democratic institutions, and poor countries generally have inadequate ones.

21. Implications for multilateral institutions. It does not make sense that in the name of modernizing the state actions are taken that hollow out the state. Yet this may be an unintended side-effect of sectoral projects that prescribe or finance alternative institutional arrangements. Many sectoral loans have institutional components, even when their main focus is substantive policy. For example, educational projects often have conditionalities or elements that deal with management of schools, and health projects often dictate how clinics receiving donor assistance should be run. In fact, sectoral projects probably have greater impact on the structure and operation of the state than MOS activities. It would be appropriate, therefore, for IFIs to review the potential institutional impacts of all projects and to flag those that may impair the authority or capacity of the state. Such an arrangement would sensitize both donors and recipients to policies and reforms that may weaken the state.

22. IFIs have prodded governments to reform their civil service systems. They often demand that the civil service be downsized, arguing that financially-stressed governments cannot afford

the wage bill and that a leaner civil service will impel governments to operate more efficiently. The validity of this argument is challenged by data showing that the wage bill tends to be a significantly smaller share of GDP in poor and emerging market countries than in highly developed ones.<sup>6</sup> In many poor countries, overstaffing is accompanied by low pay, low morale, petty corruption, widespread absenteeism, and indifferent performance. But while there is a compelling need to modernize the public service, the emphasis on downsizing tends to be self-defeating for it fails to take account of the equally important need to improve the delivery of public services. In examining the deeply-rooted pathologies of urban slums, rural communities, squatter towns, and other areas where the truly poor are concentrated, it is the absence of government that takes the biggest bite out of development. Contemplating the wretched circumstances of the most disadvantaged, one can build a powerful case for more government, as well as for one that is more caring and efficient. What is the prospect of bringing order and hope to the “City of God” where Rio de Janeiro’s poor are trapped if government has fewer teachers, policemen, and nurses? While there is no assurance that an enlarged, empowered government would provide better services if it had more staff, one can be certain that a shrunken government will be even more noticed by its absence.

23. Concern about pressure to downsize emerged during missions to Uruguay and Brazil in 2003. In Uruguay, modernization projects have an agreed savings target based on reducing public employment rolls. To a considerable degree, success in modernization has been defined in terms of meeting the savings target. Government officials responsible for the modernization effort keep close track of estimated savings and the head count in the public service. Congress

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<sup>6</sup> See Nick Manning and Neil Parison, International Public Administration Reform, Figure 1, The World Bank, 2004.

passed legislation barring departments and agencies from hiring new permanent employees and the Government provided financial incentives for some employees to leave. As a result, there has been a modest decline in public employment, though Uruguay is still above the regional average.

24. But there is another side to Uruguay's oversized public service. Uruguay is reputed to have one of the best run governments in the region, as well as an array of public services that comes closer to the norms of developed countries than that of almost all IADB countries. Downsizing and recent economic difficulties may topple Uruguay from this lofty niche; if they do, government will be less effective. In fact, one effect of downsizing has been to induce government agencies to hire contract employees rather than tenured civil servants. When personal service contracts expire, they usually are rolled over, so that affected employees have de facto permanent status, though not with all the rights and protections normally provided civil servants. Employment contracts have brought some efficiencies, in particular, a lower wage bill, less clientelism, and the opportunity to retain and reward employees on the basis of performance. There also may be substantial downstream pension savings and somewhat greater flexibility in managing personnel. The downside has been disinvestment in human resources and in the state, evasion of the letter or spirit of rules intended to shrink the civil service, and (according to some observers) a graying government workforce. A large proportion of public employees, particularly in managerial ranks, are a decade or less away from retirement. With private employment depressed by the weak economy, the government currently has no difficulty recruiting skilled workers to fill its needs, but this situation may not prevail in the future.

23. It appears that (with some exceptions) departments and agencies have not used downsizing to retrain and motivate public employees. Personnel policies have been made in terms of the savings generated, not the public services delivered. Interviews with senior officials elicited mixed reactions to reliance on contract employees. Some insisted that contracts had made the public service more supple and efficient; others argued that many who work under short-term contracts lack a public service ethic. My limited observation of contract employees is that most behave as if they were public employees and are committed to probity and performance. It bears noting, however, that those who have part-time contracts may engage in private employment while they perform government work. Regardless of how the contract system is working, it is highly likely that reinvestment in human resources will be a focus of future MOS efforts, and that downsizing will recede in importance as future government strive to reinvigorate the public service.

24. In Uruguay, the future MOS agenda may seek to recapture the features that made the country a model for other countries in the region. In Brazil, by contrast, future MOS will concentrate on “completing” the state by enlarging its capacity, even if this entails an increase in public employment. In concrete terms, “completing the state” means providing public services where they are now lacking, upgrading the professionalism of public employees and changing their attitudes toward public service, making government more inclusive, accessible and responsive to ordinary citizens, especially, the excluded classes, and improving the everyday lives of the people. If this requires more government and a larger cadre of public employees, so be it.

25. Senior officials argue that the current size of the civil service is small relative to that of other countries in the region and to highly developed countries. They believe that deeply rooted social problems arise from the absence of government, not because there is too much government. They point to the favelas which lack basic services, as evidence of the compelling need to complete the state. They acknowledge that the civil service should be made more productive and responsive, but they see this reform as part of the process of bringing services to those who have been excluded from political participation and from the benefits of economic growth.

26. If Uruguay and Brazil are indicators of the direction that future MOS efforts will take, it is likely that they will consciously aim to strengthen the state. This strategy fits well with the theme expressed here: modernization and weakening the state are at cross purposes.

## 2. Enabling Government: The Capacity to Perform

27. An effective state is one that has the capacity to set and carry out objectives and is made to account for its actions and accomplishments. These vital attributes of good government are interdependent capacity without accountability risks irresponsible behavior—government wasting public resources and disregarding the interests of its people and power holders exploiting public office for private gain. Accountability without capacity yields impotent government that cannot deliver basic public services and is unable to spur socioeconomic advancement.

28. The interdependence of capacity and accountability is an old idea that is deeply rooted in both business management and public administration. Nevertheless, it runs counter to the

prevailing emphasis on accountability as the key to enhancing the development of poor countries and the performance of their public institutions. This imbalance is reflected in the World Bank's 2004 World Development Report which focuses on service delivery but defines both inadequacies and remedies in terms of accountability mechanisms.<sup>7</sup> It also is reflected in many conditionalities written in IADB projects as well as those of other IFIs. In my view, emphasizing capacity would establish a more balanced framework for development and enlarge accountability from an instrument that limits government action to one that contributes to improvements in public performance.

29. A balanced approach is especially needed in poor countries which tend to have weak political institutions and lack the strategic and operational capacity to surmount truly formidable obstacles to development. Yet these are countries for which the IFIs and the donor community habitually have subordinated, perhaps unwittingly, capacity to accountability. They stress the latter and say rather little about the former, and demand reforms that may further undermine the capacity to govern. Arguably, this skewed emphasis arises out of the disappointing progress of many poor countries in ameliorating poverty and putting international aid to productive use. IFIs and other donors feel they must be vigilant fiduciaries in providing assistance and monitoring results, for it is their performance that is called into question when resources and opportunities are squandered. But as fiduciaries, the development community tends to overestimate the capacity of governments to act. It sees the outward trappings of power, the military and police forces, an overbearing bureaucracy, unchecked political leaders. Donors see that all-powerful politicians and bureaucrats adroitly block reforms and hold onto power. What is not so apparent, however, is the absence of government, the lack of capacity to develop the country, the pervasive

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<sup>7</sup> The World Bank, Making Services Work for the Poor, World Development Report, 2004. 2003.



inability to get routine things done. Close examination might reveal that governing institutions that have the strength to repress public sentiment and civil liberties are too weak to uplift the country and bring basic services to the dispossessed.

30. In general, the poorest of the underdeveloped countries are weakly governed nations. Few have the political legitimacy, organizational skill, and intellectual capital to combat entrenched poverty, create genuine incentives and opportunities for growth or bring services to disadvantaged communities. As argued above, it is the absence of government, not only its overreaching, that entrenches poverty and defeats the noble aims of reformers. In simple terms, government must be present in order for it to be accountable, and it must be able to act in order for it to be responsible for the conditions under which its people subsist. Rebuilding capacity is a precondition for true accountability. Once authoritative institutions are enabled, it should be feasible to orient accountability mechanisms to matters of performance and effectiveness, in addition to the traditional focus on probity and legality.

31. It is not simple to define the essential capacities of government. One conventional approach is to structure capacity in terms of the basic organs of government(executive, legislature, etc) and to add civil society and other external parties on the periphery; another is to list various functions and activities of government and to identify the resources (skills, information, legal authority, and so on) needed to perform proficiently. Each approach has shortcomings; the first resembles an organization chart and says little about governing capacity; the second tends to be more an inventory of the activities contemporary governments conduct than a statement of how society should be governed. In my view, capacity should be defined generically, so that it pertains to all

democratic regimes, regardless of their particular structures. Once basic capacities have been specified, it should be possible to fit in the various organs of government, along with relevant elements of civil society.

32. The approach recommended here is to set out three capacities that may be common to all democracies: nation-building and maintenance, strategic guidance and development, and operational performance. The first is grounded on the constitutional system, it included the main organs of government, along with relevant elements of civil society order and political culture, the second pertains to the steering of society, and the third to the provision of services and the ongoing operation of government entities. In application, the three capacities are interlinked; effectiveness on one may be a precondition for performance on another.

33. Nation building and maintenance. Effective government begins with capacities that make civil society possible by vesting legitimacy in the institutions that exercise authority and by establishing checks and balances to safeguard civil liberty and assure that political democracy (parties, contested elections, open campaign, freedom to vote) can thrive. In most democracies, this framework is embedded in a written constitution, but it also must be enabled by a political culture that allows dissent and values human rights. Although essential, the constitutional framework is not sufficient to capacitate modern government. Public institutions also rest on the maintenance of law and order, protection against external threat, sufficient revenue to finance basic services, and the ability of the people to live in dignity. Social order breaks down and government decays or retreats when these conditions are missing. In other words, capacity must

be based not only on the formal empowerment of authoritative institutions, but also on social conditions that make democracy workable.

34. In countries where these conditions are absent, government is ineffective even if it has been modernized. Moreover, the inadequacies often reinforce one another; a government that cannot generate sufficient revenue to finance basic services, does not provide such services, leaving its citizens with little opportunity to escape abject poverty. Viewing enabling conditions as vital to nation building and maintenance leads to the conclusion that reforming governance in societies ravaged by anarchy or hopelessness neither improves government nor the lot of the impoverished. Authoritative institutions withdraw in these circumstances, allowing gangs or warlords to fill the void. It is the fortunate living in poor countries who have social order maintained by informal institutions; those who are less fortunate experience disorder and despair as ongoing facts of life.

35. Markets are an enabling condition of democratic government. Without them, public revenue will not suffice, individual liberty will be constricted by poverty, the demand for government improvement and openness will be weak, and authoritative institutions will have a limited role. As already noted, markets and democratic government are mutually supporting institutions. For MOS to succeed, markets must be modernized.

36. The main institutions of government contribute to nation building and maintenance: courts by upholding the rule of law, legislatures by giving voice to diverse interests, central government by unifying the country and mobilizing its resources, local and regional government by enriching

civil life. This is not a full inventory of their capacitating functions, for countless rules and tasks go into forging and keeping good government. As concepts of individual rights and interests have evolved, civil society has gained prominence as a builder and maintainer of effective government. One can expect globalization and the rise of international institutions to redefine and expand governing systems beyond national boundaries. One of the challenges of the 21<sup>st</sup> century government will be to devise new trans-national capacities while serving and responding to individual and local interests.

37. Strategic development. Effective governments have the capacity to steer society so that it adjusts to changing conditions and opportunities, and actively creates or facilitates a more favorable future than would otherwise occur. This capacity includes the making of intelligent, change-oriented policies, compiling and applying information on social conditions (such as the incidence of poverty, family structure, etc.) assessing public programs and the outcomes that derive from them, and mobilizing resources and support for policy change. In most countries, this capacity is difficult to fully realize, for it usually entails actions that would disadvantage certain interests. Even when society as a whole may be better off if change and development were promoted, strategic steering rarely works as a Pareto optimizing process, with winners compensating losers to gain acceptance of policy changes that would otherwise be blocked. Especially in underdeveloped countries, powerful interests gain from status quo policies, even though the country itself is thereby impoverished. There is some reason to believe that steering may be more effective when democratic checks and balances are weak, such as in contemporary Singapore and Pinochet's Chile's two of the few countries that have enjoyed significant development during the past several decades. The modernization of these countries suggests that

the absence of strong checks and balances may enable government to quash opposition to fundamental change.

38. Strategic capacity is vital in all countries, but arguably less so in highly developed countries that rely on firms and entrepreneurs to produce strategic change and put little (if any) stock in comprehensive national plans. In these countries, government promoted change tends to be incremental and tactical, not strategic and developmental. The market is a powerful engine of change, relentlessly engaged in the constructive displacement of old businesses and products with new ones. It may be, however, that inadequate capacity to shape their future will cause developed countries to lose much of their advantage in the decades ahead. The sunk cost of existing policies may weaken their capacity to adjust.

39. Transitional and emerging market countries are, by designation, states driving to become something other than what they have been. Some are “developmental states” that defer or neglect critical social and environmental issues and single-mindedly concentrate on growth-enhancing policies.<sup>8</sup> In the aftermath of the Asian financial crisis, some emerging market countries have awakened to the need for a more balanced approach to national development as well as to the need to modernize the state by making the government more transparent and accountable. Some emerging market countries have invested heavily in national planning and a few have broadened planning into a consultative process involving key stakeholders. The transitional countries of East/Central Europe have abjured national planning, but most nonetheless have been spurred to emphasize strategic development by the promise of accession to the European community.

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<sup>8</sup> See Meredith Woo-Cumings, The Development State, Cornell University Press, 1999.

40. Poor countries need but generally lack steering capacity. They lack the capacity to develop, to transform themselves into societies that are significantly more advanced than they are now. This incapacity is one of the main impediments to the effective use of international assistance. Many poor countries appear to have well-developed national planning processes, but all too often their plans are escapes from reality and are not accompanied by concrete actions to put them into effect. The plans are disconnected from the allocation of resources and from the realpolitik of national stagnation. They promise futures that will never materialize. Unfortunately, therefore, countries that need strategic capacity the most tend to have it the least. Unlike the developed world, they cannot rely on markets as engines of change; unlike emerging market countries, their plans are ineffective; and unlike transitional countries, they lack a medium-term vision of a better future.

41. Key governmental institutions are drawn into the change process, though the executive typically has lead responsibility. The legislature's role depends on the structure of government and its relationship to the executive. During periods of change, courts sometimes play a role in strategic development, though their principal window for doing so is legal rights not national development. Local governments typically have little involvement in strategic matters, though they are critical in implementing strategic change. In federal systems, and some countries that have introduced regional authorities, intermediate governments contribute to strategic development. Civil society's role is increasingly important, both in overcoming obstacles to change and in assuring that development benefits a broad swath of society, especially the disadvantaged.

42. Operational capacity. One of the popular truisms of new public management is that government should steer, not row. In fact, however, effective government encompasses both capacities, for as essential as steering is, government cannot fulfill its ambitions if it does not do a good job delivering public services. This is the overriding theme of the latest World Bank Development Report: services are not the bottom rung in the managerial ladder, but the point at which citizens connect with and experience government. Services are also the means by which citizens are raised up and given opportunity to escape poverty, as well as part of the infrastructure on which markets depend. Until recently, services were a neglected aspect of capacity in the development community; if the World Development Report is an indication, this may no longer be the case.

43. Operational capacity also includes the running of government. This facet has been the main focus of the “performance movement in many countries, though it rarely has advanced much beyond measuring outputs or other results. This writer is of the view that if a government lacks the capacity for efficient, prudential operations, introducing the language and mechanics of performance measurement will neither boost capacity nor improve the quality of services. It is highly probable that future efforts to build government capacity will focus on services and operations. Basic capacities, including timely information, caring public employees, access to services, and courteous relations with citizens, should be emphasized far more than avant-garde reforms such as the newest instrument for measuring employee satisfaction and state-of-the-art budget innovations.

44. Executives and the bureaucracy have lead roles in services and operations, though courts and legislatures have become increasingly active in some countries in setting minimum service standards and entitling citizens to certain services. The concept of good public services as an entitlement is also manifested in the “citizen’s charter movement” introduced in the United Kingdom in the late 1980s and tried in a few countries since then. Evidently, this form of entitlement has made little headway in underdeveloped countries where basic services are deficient and a remote national bureaucracy seems unable or unwilling to serve those who lack the material and political means to demand better from government.

45. To compensate for fundamental operational shortcomings, international organizations have promoted several of the alternatives discussed in the previous section. Decentralization has been the most widely applied; it has significantly enlarged the role of local and regional governments in delivering services, though these entities have sometimes been unprepared (and underfinanced) to handle the added responsibilities. NGOs are increasingly involved in serving the poor and advocating on their behalf. Apparently, international organizations find it easier to bypass unresponsive national governments than to reform them. There is much anecdotal evidence of the good work done by some NGOs, but not enough research on how they relate with or affect government or how responsive they are to the people they serve.<sup>9</sup> Reliance on markets is a third alternative to service provision by government, but it may not be practicable in

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<sup>9</sup> See Sarah E. Mendelson and John K. Glenn, The Power and Limits of NGOs: A Critical Look at Building Democracy in Eastern Europe and Eurasia, Columbia University Press, 2002.



countries where markets are underdeveloped and much of the populations lack money to purchase basic goods.

46. Implications for multilateral institutions. The three core capacities identified here have been accorded unequal prominence in the MOS agenda. Some aspects of nation-building and service delivery have been emphasized, but strategic development generally has received less attention. This is unfortunate because development does not just happen; it requires strategic capacity—a vision of a better future and mobilization of political, economic and social forces to surmount obstacles to achievement of that future. The relative neglect of strategic capacity arises, I believe, out of a combination of factors including: the difficulty of the task; the expectation that if the nation is well run and essential services are provided development will ensue; aversion to national planning and other developmental instruments; and the political obstacles to redistributing power and resources. This is not a complete list, but it suggests the hard work that formulating and implementing a development strategy entails. The two other tasks—nation building and improved services—also encounter obstacles, but the development community has been more willing to tackle them than the transformations required for steering a country in a different direction.

47. Nation-building is a slow, fragile process. It cannot be compressed into the few years that a typical MOS project spans. Few nations are fundamentally different five years later; when they are, it usually is because of revolutionary upheavals, not because of the measured changes promoted by MOS. Moreover, institutional change produced by MOS may wither in the face of the economic and political shocks that beset poor countries with disturbing frequency. In some

countries, MOS has invested in judicial capacity and independence, strengthening the rule of law and giving ordinary citizens fair treatment and rights that were previously denied them. Having courts that enforce property rights is a necessary condition for markets to develop and for society to be organized on a more formal basis. But citizen perceptions rarely change overnight; it takes years to wash away feelings of mistreatment and unfairness, and years for citizens and investors to gain confidence that they will be dealt with honestly by politicians and public officials. The state needs patient modernizers who are committed to stay the course and carry their work to fruition.

48. Legislative modernization has concentrated on adding staff and upgrading information resources in the expectation that these capacities would play a larger and more effective role in making policy and holding the government accountable. In some circumstances, however, legislative activism may get in the way of state modernization. An independent, active legislature with clientelist tendencies can be a formidable roadblock to reform.

49. Modernizers recognize that an adequate revenue base is essential for maintaining an effective state. Toward this end, in some countries, MOS has sponsored creation of independent revenue (or customs) agencies that have operating autonomy and are free from standard civil service and other administrative rules. The hope is that these agencies will be vigorous, corruption-free revenue collectors, and that the state will thereby have more money to finance essential services. Whatever their advantages, these enclaves may retard improvement in overall public administration. Moreover, the gains may be short-lived, for enclaves that are not continually nurtured may lapse into old habits.

50. There is much emphasis these days on improving public services, especially to the poor. Modernizers tend to the view that doing so requires more pliable, responsive providers who are not encumbered by rigid civil service rules or by uncaring, uniformed public bureaucracies. MOS has invested in a variety of reforms to deregulate public administration including market-like innovations, new managerialist arrangements, and improving the professionalism and performance of civic servants. My impression is that the market strategy (which includes outsourcing of public services, privatization, competition and citizen choice) has made relatively little headway in the LADB region. New public management has had somewhat more success, but it, too, has had limited application. Divestiture of administrative controls, which is one of the essential features of new public management, may be risky in countries where corruption is widespread and administrative performance is low. The third approach is to upgrade the operational efficiency of government by pruning the civil service, raising public sector pay, measuring performance, and introducing modern information technology.

51. Civil service centered reform characterizes MOS in both Uruguay and Brazil. Change tends to be slow and incremental in Uruguay; big bang reforms are not in tune with the country's sociopolitical temperament. Adverse economic conditions have led to belt-tightening, such as cutting the ranks of public employees, not to reconsideration of the costly welfare state or of the volume of public services. As discussed earlier, MOS has largely been defined in terms of savings targets, not in terms of aligning services with resources. There has been heavy reliance on informatics to drive management reform, and the most successful projects have been those where significant gains can be achieved through information technology. One successful project

computerized the issuance of national ID cards, another uses the internet to open the procurement process; a third, links the information systems of neighborhood health clinics. There is no denying the service and efficiency gains brought by these innovations, but there is as yet little evidence that reform has penetrated the behavior of public managers.

52. In Brazil, the Lula Government is mindful that to transform society, it will be necessary to tackle deeply-rooted bureaucratic pathologies, but thus far it has moved cautiously. It is aware of past failures, especially those of the Cardoso Administration, and its ties to the workers movement rules out a frontal assault on the civil service. It is likely that the Government will bring its “participation and inclusion” theme to management reform. The public management plan of the Lula Government is titled “Public Management Towards a Socially Inclusive Brazil”. It argues that past reforms failed because “they were established with little or no participation, which led crucial segments to reject their implementation”. This indicates “that democracy requires more appropriate and participatory strategies for the transformation of public management”.<sup>10</sup> To succeed, this strategy will have to rely more on the President’s popularity and interpersonal skills than on changes in civil service rules. The key challenge will be to institutionalize changes so that improvement in public services and in the performance of public employees can continue into future administration. The President will have to walk a tightrope between confronting entrenched interest and currying their support. Judging from his accomplishments thus far in office, President Lula may modernize that state without alienating key interests. If he succeeds, the tactics may be copied in other LADB countries.

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<sup>10</sup> Government of Brazil, Ministry of Planning, Budget and Public Management, Public Management Towards a Socially Inclusive Brazil, 2003.

53. As argued earlier, strategic development is essential for modernizing the state, but this capacity has had low priority on the MOS agenda. The annual budget is the main steering tool in most countries, but its incremental tendencies and the rigidity of public expenditure render it inadequate for societies in need of transformation. Extending the time frame to the medium-term (3-5 years ahead) does give the budget more capacity for strategic change. But the process still is dominated by fiscal constraints rather than by the government's social objectives, not by society's developmental needs and opportunities. National planning is an alternative path to development, but the multilaterals are wary of using it, partly because of the centralizing tendencies of these plans and partly because they tend to disregard fiscal realities. Thus, the budget is too encumbered by fiscal conditions to serve as a vehicle for change, and the plan is too indifferent to conditions to produce realistic change strategies. Some IADB countries (such as Columbia) have a strong planning orientation; some (such as Chile) have an embedded budget orientation.<sup>11</sup> Ideally, an MOS strategy that integrates planning and budgeting might correct for the developmental inadequacies of each process.

54. Indeed, this is the approach pioneered by Brazil in its pluroannual plan (PPA) prescribed by the Constitution. Rather than being divorced from the budget, as is the case in almost all planning-oriented countries, Brazil's planning process is intended to guide the annual budget. Toward this end, the PPA covers all programs for which public expenditures are made. The plan is framed within a budget constraint that is consistent with the Government's fiscal posture, and the annual budget during each of the four years covered by the plan is supposed to be based on the priorities set in the plan. To facilitate coordination of the two processes, Brazil merges

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<sup>11</sup> A planning orientation refers to countries in which planning is the dominant process for setting national objectives and priorities; a budget orientation refers to countries in which the budget is the dominant process.

planning, budgeting and management in a single ministry, but with a separate secretariat for each. Nevertheless, there is a tendency for the plan and the annual budget to diverge; as the next presidential election nears, the plan exercises only a weak influence over the budget.

55. The 2004-07 plan prepared by the Lula Government is titled Plana Brasil de Todos: Participacao e Inclusao to emphasize its aim to remake society during the next four years. While it is attentive to financial resources, the document clearly strives to be a strategy for development. Although it is premature to assess the Lula version of national planning, the Brazilian model may warrant consideration by countries that have significant development needs that are not addressed through annual, incremental budgeting. Developing countries need a strategic capacity that is realistic and informed by budget constraints, but is not locked into the routine and rigidities of conventional budgeting. Even if Brazil has not yet gotten the planning-budgeting relationship right, it has made an important contribution to the stockpile of strategic instruments.

### 3. Broadening the Modernization Agenda

56. Ideally, MOS should target each of the capacities (and sub-elements) identified in the foregoing paragraphs. After all, if these basic capacities are lacking, MOS cannot succeed, even if every conditionality is fulfilled and the state has modern information technology, an active and adequately resourced legislature, independent courts and accountability agencies, updated civil service rules, transparent procurement processes, a medium-term budget framework, and other gifts of modernization. Systems, strategic and operational capacities entail much more than the machinery of government; they are strongly affected by the social and political conditions under

which people live, economic activity occurs and power is exercised. To have lasting results, MOS must modernize socioeconomic conditions along with the machinery of government. MOS must be as much about development as about the state, for if society does not improve, the state will languish. MOS must be connected to reforms that alleviate poverty, improve access to basic health and education services, promote the conditions under which markets can flourish, and much more.

57. It would be useful to think of MOS as a key plank in an expanded Washington consensus that emphasizes social and economic change as much as it does economic issues. This would situate MOS as part of a broadened agenda centered on human development, economic reform, and political democratization. In fact, most of the IFIs have embraced this larger agenda, though they generally have not expressly linked social and economic transformation to MOS. It is important, to connect the major elements of transformation, if only to underscore that MOS alone will not work. A society that is not just cannot vest government with the legitimacy on which democratic governance rests. Democracies function well when a broad swath of the populations is included, when there is the prospect that collective action will produce social improvement, when basic human needs are met, when the political system distributes public goods and services fairly. These preconditions are lacking in quite a few countries targeted by MOS.

58. The confluence of an undeveloped economy and an underperforming state is well known in the development community. It underpins the Washington consensus and largely explains why MOS followed on the heels of economic liberalization. The predominant view is that a malperforming state is a breeding ground for corruption, poor services, opaque political processes, weak contract and property rights, a compromised judiciary, rampant informality, and other

pathologies of underdevelopment. The expectation is that these defects would recede if the state were modernized. My own sense is that cause and effect also run in the opposite direction, that poverty, social disorganization, immature markets, informality and cronyism are breeding grounds for an ineffective state that lacks the political and managerial strength to uplift its people by reshaping the social and economic conditions under which they live.

59. Modernizing society and the economy entails formalizing various relationships, transactions and roles that have traditionally been informal. De Soto is right that informality impedes the development of robust markets, but he may have erred in attributing pervasive informality solely to governmental mal-performance. In most underdeveloped countries, informality is rooted in the organization of society; it is the way social relations are handled and the way of small and medium-sized businesses as well. Informality also defines relations between citizens and government. After all, the norms and behavior which constrict markets and government are at their core norms of society. In countries where relations are based on interpersonal considerations, cronyism and conflicts of interest are widespread, not only in business, but in government as well. Government will be rife with petty corruption when payoffs are routine and expected. A key issue is whether MOS can purge government of these unwanted characteristics when they are extensive throughout society and regarded as proper.

60. While transforming society is difficult, improving the lot of the truly disadvantaged should be a key objective of modernization. The development banks exist to ameliorate poverty by developing and modernizing the country. Poverty reduction (along with other millennium development goals) should be viewed as the purpose of modernization, and a key test by which



its effectiveness is measured. It is widely accepted that easing poverty requires redistribution of political power, along with redistribution of income, robust markets along with effective government. The peaceful redistribution of money and power through democratic means should be a high priority of MOS.

61. A true anti-poverty agenda edges the IFIs close to political questions that they may be comfortable handling. A brief review of the MOS posture of key international financial institutions suggests they are inhibited in dealing with socio-political questions. This is certainly true of IMF; its macroeconomic perspective has limited its commitment to socio-political transformation. The IMF Board of Governors declared in 1996 that the Fund should “promote good governance in all its aspects...by ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption as essential elements of framework within which economies can prosper.”<sup>12</sup> Although the Fund subsequently expanded its work on governance, especially on matters pertaining to accountability and transparency, it has not been able to grow out of its macroeconomic roots. Guidelines adopted in 1997 specify that its “involvement in good governance should be limited to economic aspects of governance.”<sup>13</sup> This constrained perspective has been evident in its failure to adequately consider the social implications of its economic demands on Argentina and other countries.

62. The World Bank’s governance agenda has been significantly broader than the Fund’s, though it, too, has pulled back from overt involvement in political reform. The Bank has financed many projects concerned with public management systems, the judicial process and rule

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<sup>12</sup> See International Monetary Fund, Good Governance: The IMF’s Role, 1997.

<sup>13</sup> International Monetary Fund, Review of the Fund’s Experience in Governance Issues, 2001.

of law, legislative capacity and accountability mechanisms. Many of the projects have been part of the Bank's highly publicized anticorruption campaign, but the Bank is inhibited by its Charter, from openly addressing the political sources of corruption and mal-governance. IADB has been more willing than other regional development banks to deal with politically sensitive issues. Its MOS strategy includes the promotion of democratic institutions through reform of electoral systems and political parties. IADB has been particularly active in providing assistance to reform the administration of justice and to strengthen accountability. IADB's modernization policy first announced in 1996 and expanded in 2002 is a statement on the political economy of development. In implementing the policy, however, IADB generally defined MOS in managerial terms and does not integrate it sufficiently with its larger socio-political and economic agendas.

63. The narrowing of MOS' reach may be due to the inherent difficulty of organizing and mobilizing support for transformative projects that span a broad swath of socio-economic and political changes. But the structure of MOS projects also may limit the scope of modernization. IADB typically partners with a management-centered agency that is responsible for steering the country's MOS reforms. In application, IADB is much more involved in modernizing public management than it is the state. This tendency is reinforced by the conditionalities that specify the activities to be undertaken and the milestones to be reached.

64. Implications for multilateral institutions. MOS is not an appropriate vehicle for transforming society and the economy, but it can be linked to broad development initiatives that serve this end. Integrating MOS and development is not easy, however, especially as regards

managerial aspects of the modernization agenda. If MOS were treated as a subset of other development objectives, there is a strong probability that management and other aspects of governance would be neglected. But making MOS a free-standing initiative runs the risk that it will be divorced from socioeconomic development. There is no sure way out of this conundrum, but the problem would be eased if modernizers took a broad perspective on their work and expressly consider how MOS connects with other development objectives. It would be desirable to build governance indicators into the MDG process and to undertake research on how social and institutional developments reinforce one another.

65. This linkage is apparent in both Uruguay and Brazil, in the former because deterioration in socioeconomic conditions may be taking a toll in the quality of governance, in the latter because the Lula Government views modernization of society and modernization of the states as interdependent means of boosting Brazil into the ranks of developed countries.

66. Uruguay's standing as one of the most advanced countries in the region rests on the quality of governance and the structure of society. Its bloated civil service notwithstanding, Uruguay is reputed to do a much better job delivering social services than almost all other IADB countries. One may argue that the scope of services is beyond the means of the state, but there can be no denying that ordinary citizens get reasonably fair, courteous public services. The quality public services were mirrored in development of markets and society. With a large middle class and robust economic activity, Uruguay sometimes saw itself as the Switzerland of Latin America. However, my 2003 mission uncovered widespread concern that the quality of both government and society is eroding under the onslaught of economic difficulty. Income distribution is no

longer equitable as it once was, the sense of opportunity has been lost, poverty is visible as is widespread economic decline. Hopefully, these are passing ills that will fade away when the economy recovers, but the fact that governance and society have been adversely affected points to the dependence of MOS on conditions that go well beyond the modernization agenda.

67. Brazil's pluroannual plan for 2004-2007 expressly links social change, economic improvement, and participatory government. Government cannot become more inclusive if society and the economy aren't; democracy will have a hollow ring if large inequalities persist. The White Paper that defines how public management reform will support the plan links political, social, and economic transformation. One cannot advance without the other. In promoting fiscal stability, the Lula Government clearly has taken the position that robust markets are a precondition for social change. As the Lula reforms inch closer to the political and social arenas, they will undoubtedly encounter opposition. It is much too early to assess the probability that the Government will realize its ambitions. If it does, MOS will be one driver of change; if it doesn't, MOS will not amount to much.

#### 4. Concluding Thoughts

68. Broadening the MOS agenda requires that the concept and content of conditionalities also be broadened. From the perspective of IFIs, conditionalities are means of assuring that external aid is used for intended purposes, as well as milestones for measuring progress in achieving project aims. Conditionalities form the dialogue between the IFIs and client countries. They structure the discussion in the early stages of project development, when the parties to the relationship put price tags on the activities that will be carried out, during periodic supervision missions when IFI

staff visits to determine whether the project is on track, and after the funds have been disbursed to assess what the project has accomplished.

69. As important as conditionalities are to donors, they are equally important to recipient countries which know they have to promise action in order to get the assistance. Recipients line up the activities they want funded, keep checklists or promises and progress, decide which spending should be charged to which project, report on the extent to which they have met the conditionalities, and occasionally seek waivers. Conditionalities become the four walls of the project, boundaries within which decisions are taken and action unfolds. In running the project, it is hard for either donors or recipients to break out of the boundaries to reflect on larger developmental issues. Even when exploring follow-up projects they are confined by the language of conditionalities

70. In an ideal world, IFIs would dispense with conditionalities and ground projects on shared commitments to do good. But the world is not ideal, for donor funds are both fungible and divertible; weak accountability and severe money shortages in poor countries provide ample incentive to use external aid for mischief. For this reason alone, conditionalities must continue to occupy a prominent niche in donor-recipient relationships. But in view of disappointing progress on the development front and the pervasive emphasis on performance, it would be appropriate to expand conditionalities along the lines suggested in the previous sections of this paper so as to incorporate an assessment of changes in relevant governmental capacities. For example, a project designed to improve a government's financial management system might have conditionalities that pertain to the timeliness and accuracy of financial reports, consistency

of budgetary and accounting information, variance of actual expenditure from budgeted levels, estimates of unreported arrears, comprehensiveness of the budget, seepage of public funds due to corruption, and other means of rectitude and efficiency in financial management. Appropriate measures could be introduced for virtually all political and managerial aspects of governance. Some of these might be based on governance and management work already underway; some might have to be constructed from scratch.

71. It would be highly desirable for IABD to work with other development institutions to devise governance measures that would be incorporated into project agreements and conditionalities. There is a risk that each institution, as well as professional associations, will go its own way and that the resulting plethora of measures would stir up confusion and discredit efforts to obtain agreement on the indicators most appropriate for assessing development.

72. The aim of next generation MOS should be to link projects to development of the country. Rather than assume that good government will spur development, actual progress should be measured and compared to project targets. If it is true that only a state that performs well can be deemed to have been successfully modernized, then MOS should focus on changes in performance. These should be targeted, built into projects, and monitored. Doing so for all sectors of public sector development is an enormous task, but it can be done.