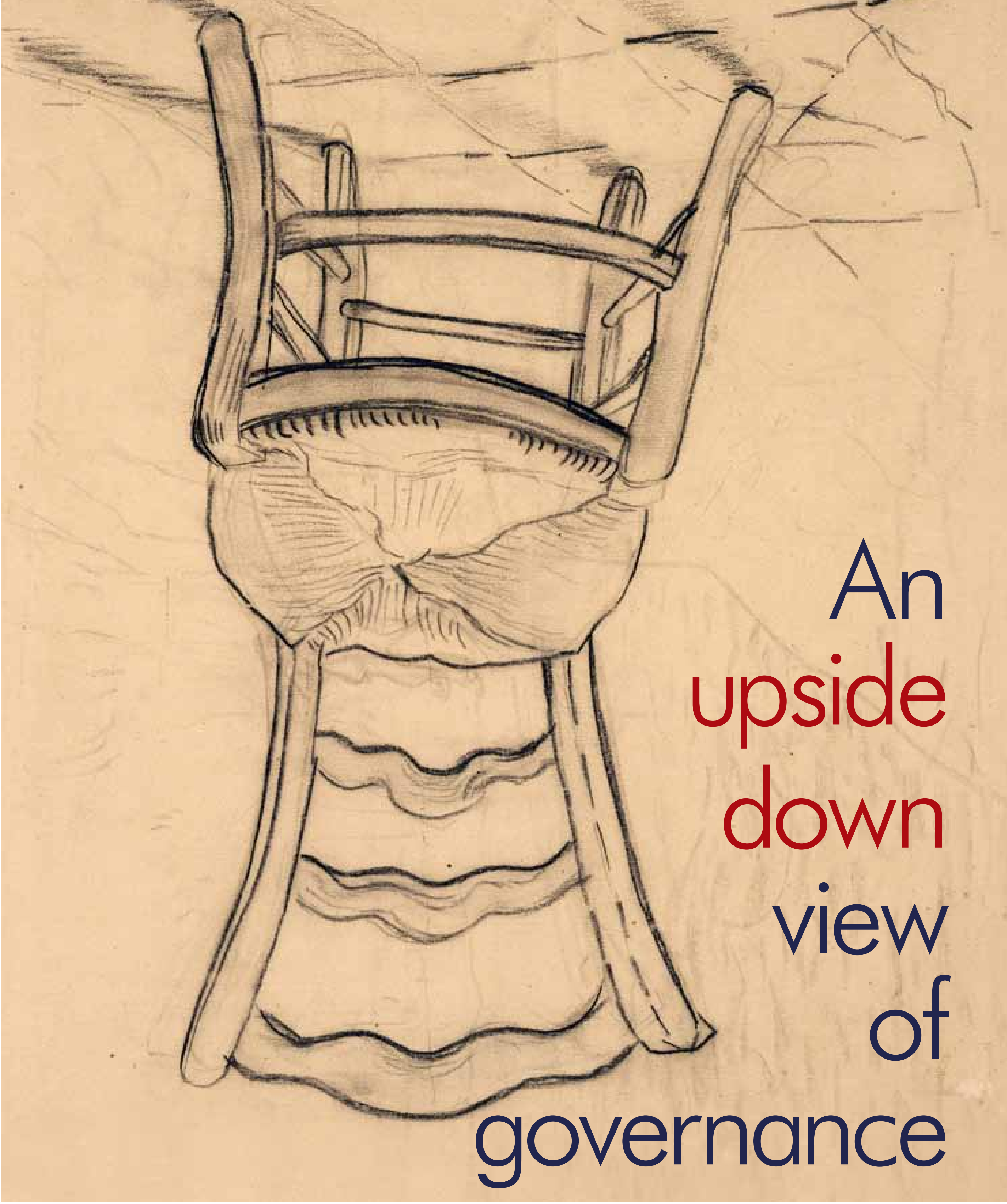

An upside down view of governance

CENTRE FOR THE FUTURE STATE

IDS Institute of Development Studies

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Contents

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Acronyms

AGI	Association of Ghana Industries
BJP	Bharatiya Janata Party
BRIC	BRIC countries: Brazil, Russia, India and China
CEBRAP	Centro Brasileiro de Análise e Planejamento
CFS	Centre for the Future State
DAC	Development Assistance Committee of the OECD
DEDA	Dongli Economic-Technological Development Area
ILGIs	Informal local governance institutions
IPA	Investment promotion agency
LUMS	Lahore University of Management Sciences
MIDS	Madras Institute of Development Studies
PDS	Public Distribution System
RTI	Right to Information
SME	Small and medium-sized enterprise
TEDA	Tianjin Economic-Technological Development Area
UBA	United Business Association

Executive summary

New art students are often advised to close off their pre-existing knowledge about the objects they are trying to draw, and instead focus on angles, spaces, lines, proportions and relationships. Development practitioners similarly need to close off their mental models about governance and development that are rooted in OECD experience. Instead of prioritising reform of formal institutions, they should look at the structures, relationships, interests and incentives that underpin them. This does not mean rejecting the longer-term goal of helping poor countries to build inclusive, rules-based public authority. But in the short-to-medium term it may be more useful to explore whether relationship-based arrangements could offer a way to make progress.

This paper draws together findings from a five-year research programme by the Centre for the Future State. It explores in an open-minded way how elements of public authority are being created through complex processes of bargaining between state and society actors, and the interaction of formal and informal institutions. For example, a study in Egypt shows how informal relations between politicians and investors that build on common interests can compensate for weak formal property rights and contract enforcement, and boost investment in the short-to-medium term. Studies of successful public sector reform in São Paulo suggest that formal participatory mechanisms may be less important as channels for policy influence than informal networks and relationships. Research in South Asia shows that informal village-level councils remain very influential, and can complement or undermine formal institutions. Studies in Ghana, Kenya and Ethiopia show how governments' need for tax revenue has driven implicit or explicit bargaining with citizens, with the potential to enhance accountability.

Informal institutions and personalised relationships are usually seen as governance problems, but the research suggests that they can also be part of the solution. All the findings have implications for policymakers. For example, they should prioritise international action to improve financial regulation and constrain criminal activity, thus counteracting perverse incentives for political elites to perpetuate fragile states. Instead of focusing exclusively on improving the formal investment climate, they could do more to facilitate dialogue between politicians and investors and support collective action by business associations. Policymakers should be more alert to ways in which the design of public programmes influences opportunities and incentives for collective action to demand better services. Efforts to improve local governance need to take more account of informal village-level institutions. Tax reforms should prioritise equity, transparency and improved collection.

But the value of this research for policymakers does not reside only – or even primarily – in a list of policy messages. It makes a more important, broader point. Programmes to improve the investment climate, strengthen the rule of law, or fight corruption do not fail just for lack of 'ownership' or attention to politics. They fail because they make the wrong starting assumption: that progressive change consists in, and can be achieved through, strengthening formal, rules-based institutions that reflect a clear division between public and private spheres of life. The key to making progress in the short-to-medium term may not be direct external intervention to orchestrate and support rules-based reform, but more indirect strategies to shift or influence the incentives and interests of local actors.

With this in mind, the research suggests a list of questions that seem particularly salient in understanding causes of bad governance and identifying ways of supporting more constructive bargaining between public and private actors. They are likely to be relevant in a great variety of circumstances. What is shaping the interests of political elites? (Sources of revenue are likely to be critical.) What is shaping relations between politicians and investors, and might they have common interests in supporting productive investment? What might stimulate and sustain collective action by social groups to demand better services? What informal local institutions are at work, and how are they shaping development outcomes? Where does government get its revenue from, and how is that shaping its relationships with citizens?

This way of thinking about governance and development implies that donors need to reassess their own role in the process, and their traditional approaches to managing 'donor-recipient' relationships. But the first step is for them to change their mental models, and to stop viewing the world through an OECD lens. Without this they will not make the necessary investment in understanding local political dynamics, or make the (often uncomfortable) changes needed to their own organisation, values, practices and behaviour.

Introduction

> **“Development practitioners need to close off their existing assumptions and mental models about governance and development.”**

One of the first things new art students are taught is to close off their existing knowledge about the objects they are trying to draw. They know that a chair has a back and a seat of roughly equal proportions, and four legs of identical length. But this knowledge is distinctly unhelpful in trying to capture a three-dimensional image of a chair in a two-dimensional medium, and to deal with the challenges of perspective and foreshortening. Instead, they are instructed to look at what is in front of their eyes, to forget their mental model of a chair, and to draw exactly what they see.

Development practitioners similarly need to close off their existing assumptions and mental models about governance and development. Their default position is to look at the world from the perspective of a ‘developed’ country, aspiring to introduce governance reforms that would align the institutions of poor countries in the South more closely with those of an OECD state. The goal includes an elected executive and legislature, a rules-based bureaucracy, an independent judiciary, a security apparatus under civilian control, and a regulated market economy – in short, effective, accountable public institutions that can support a broad range of civil, political, economic and social rights. The conventional donor approach to governance has been to analyse problems in developing countries in terms of deficiencies when compared to this ideal model.

Like an inept artist who seizes a pencil and draws a chair as she expects it to look, without pausing to consider the relationship between lines and angles and spaces, so Western policymakers too often view governance and development challenges in terms of their model of a developed state, and rush to find solutions without stopping to ask themselves what they can actually see.

The drawing metaphor works only up to a point: development practitioners, after all, seek not just to capture an accurate image of a society and polity, but also to change it. But for both art students and donors what sounds like simple advice – to close off their existing models and preconceptions – is surprisingly difficult. Students of drawing are sometimes advised to stop naming things as they draw: to stop thinking about a chair, an arm, a back, a leg, and to think instead about the angle of one line in relation to another, or the ‘negative space’ surrounding an object. One well-known teacher (Edwards 2008) advocates an initial exercise of copying a drawing that has first been turned upside down, so that the brain switches off pre-existing knowledge about specific objects and focuses instead on angles, spaces, lines, proportions and relationships.

Western policymakers increasingly recognise that improving governance involves far more than transferring formal institutions from rich to poor countries. Yet they find it very hard to discard developed country models.

They mostly come from or live in OECD states; they are driven by normative values (rights, democracy, poverty reduction); they work for organisations that are supply-driven and have short time horizons; and many have hard-won professional knowledge. Such knowledge – about the law, or private investment, or public expenditure management, or delivery of water, health and education services – is entirely valid and indeed essential in certain contexts. But it can get in the way of attempts to understand what is really driving behaviour and development outcomes in poor countries and fragile states.

Another set of assumptions that gets in the way is about the role of donors. Implicit in much Western policy relating to developing countries is still that West is best, that developed countries have the answers, that they need to take the lead in finding solutions, and that aid is a primary engine of development. But power is shifting away from OECD countries, and their fiscal situations mean that their governments will be less important in future as either sources of capital to poor countries or influence at a global level. China has global influence and offers an alternative model of development, as well as alternative sources of public and private capital. The traditional approach to managing donor-recipient relations, with DAC (Development Assistance Committee of the OECD) member states in the lead, is rapidly becoming history (Harris *et al*. 2009).

“Instead of viewing informal arrangements as a major part of the governance problem, they could also be part of the solution.”

This paper draws together findings from a five-year research programme[1] by the Centre for the Future State (CFS) located at the Institute of Development Studies, University of Sussex. The central research question is how to increase effective, accountable public authority in poor countries of the global South. The paper offers development practitioners a fresh perspective – an upside-down view of governance – in two senses. It focuses less on the destination – formal, rules-based democratic and market institutions – and more on the means of getting there, preferring an open-minded exploration of how elements of effective public authority are actually being created in a variety of ways. And it suggests that instead of viewing informal arrangements as a major part of the governance problem, they could also be part of the solution. This does not mean rejecting the longer-term goal of helping poor countries to build inclusive, rules-based public authority. But in the short-to-medium term it may be useful to explore whether relationship-based arrangements could offer a better way to make progress.

1 This is the second phase of a research programme led by the Centre for the Future State, running from 2005–2010. Findings from the first phase (2000–2005) were reported in ‘Signposts to More Effective States: Responding to Governance Challenges in Developing Countries’ (IDS 2005).

This means looking much more carefully at the structures, relationships, institutional spaces, interests and incentives that underpin the creation of formal institutions. Returning to our drawing metaphor, the good news is that students who do manage to close off unhelpful models and focus on what they can actually see produce surprisingly good results. Most people can learn to draw.

1 A fresh look at governance

1.1 The governance puzzle

Over the past two decades, 'governance' has come to be seen as a core development problem. There is widespread concern – stimulated by the plight of so-called fragile states – that many governments of poor countries are unable to exercise effective, accountable public authority. They are unable to control their territories and populations, often ceding ground to armed groups and criminal networks. They are unable to deliver basic public goods and services. Where authority does exist, it may be coercive and lack legitimacy. Power is concentrated in relatively few hands. Governments are unresponsive to large populations: poor people, women, and specific regional, ethnic or linguistic groups are politically excluded.

OECD governments are now spending over US$10 billion a year on governance interventions. There has been an explosion of research, actors, initiatives and approaches. Yet practitioners still have little reason to be confident that they know how to improve governance. Evaluations have shown the limitations of programmes designed to strengthen rules-based approaches through civil service reform, anti-corruption measures, rule of law programmes, democracy support, or attempts to improve the investment climate (World Bank 2008a; Norad 2009). There is growing recognition that institutional models cannot be transferred into very different social and political environments and be expected to take root and function as they do in OECD countries.

1.2 A new conventional wisdom?

There are therefore good reasons for taking a fresh look at governance. And indeed a new conventional wisdom is emerging. The Paris Declaration and Accra Agenda for Action reflect this in calling for local ownership and country-led development strategies – although they have little to say about what these might involve or how they could be negotiated. There is increasing donor rhetoric about the importance of politics, and the need to 'look behind the facade' of formal institutions to detect the 'real' location of power (DFID 2009a; Netherlands Ministry of Foreign Affairs 2008). Extensive work by the DAC and others on fragile states is highlighting the political fundamentals of state building (OECD/ DAC 2010). There is growing enthusiasm for using political economy analysis to help better identify and manage the risks associated with particular policy reforms and to identify more politically feasible strategies for implementing them.

Much of this is positive. It represents a move away from crude governance conditionality and 'best practice' approaches. Donor statements increasingly recognise that local political dynamics matter, and that outsiders should aim to facilitate and support change, rather than demand or try to enforce it. Some donors underline the need to understand country context, historical trajectories, the interests of key stakeholders and the factors that are shaping them. They recognise that the dynamics of a reform process may itself create new opportunities (World Bank 2008b, 2009; DFID 2009b).

But such approaches have their limitations. The core objective of the analysis is usually to improve the effectiveness of aid operations. The aim is to find practical solutions – often to development problems identified by donors. There is a tendency to attach labels to problems, and to see political patronage, rent seeking, and vested interests as 'pathologies' to be addressed through reforms that promote accountability, transparency and rules-based behaviour (World Bank 2008c). This risks over-simplifying a very complex reality, and can induce unwarranted optimism about the ability of donors to facilitate and support reform coalitions.

"It can be difficult to reconcile the implications of political analysis with the institutional incentives of donor agencies."

Moreover, there is often a gap between donor rhetoric and the reality of what they do. Competing objectives, including urgent national security concerns, can get in the way of more nuanced, incremental approaches. It can be difficult to reconcile the implications of political analysis with the institutional incentives of donor agencies. Their instinctive response is to 'manage' the local politics rather than see them as integral to finding a way forward. The default position of thinking in terms of Western models all too readily kicks back in.

This matters because it risks limiting the menu of options or – to return to our drawing metaphor – it risks *stopping the artist seeing things she does not expect to see*.

Two examples may help illustrate this:

- A now-familiar case – that has inspired one of the CFS research streams – comes from China, where transitional, unorthodox, informal relations between investors and local government officials effectively substituted for more formal property rights in the early stages of market-led growth, in quite unexpected ways (Qian 2003). It seems very unlikely that conventional governance or political economy analysis aimed at improving the investment climate would have picked up on these informal but deeply influential relationships.

- A less familiar but very topical example comes from Afghanistan. Recent research shows how supply-driven approaches to state building and development led donors to overlook very local customary village-level organisations that provide a range of public goods including local security and dispute resolution. The National Solidarity Programme largely ignored these informal arrangements and instead created over 18,000 Community Development Councils (CDCs), complete with social organisers to mobilise community participation and facilitate the delivery of donor-funded projects. The CDCs have provided funds for badly needed infrastructure, but are not accountable to villagers. The research found that in many instances they had a negative impact on the provision of public goods (such as dispute resolution) by customary village organisations, and could disrupt local patterns of decision-making and cooperation. There is potential for productive cooperation between externally funded programmes and customary organisations, but the latter can be undermined by state-building interventions that fail to take account of them (Brick 2008).

1.3 Centre for the Future State: framing the research

The CFS research has been framed in response to the following.

i) A belief that effective, accountable public authority matters for development. The approach is not ‘anti-state’ or ‘governance-sceptic’. But equally, in company with many other scholars, the research questions the primacy accorded by ‘institutionalists’ to a specific set of formal arrangements (for example laws to protect property rights, or enforce contracts).

ii) Building effective, accountable formal institutions in poor countries has proved much harder than many people expected. Experience suggests that ‘skipping straight to Weber’ will not work. Practitioners need alternatives. It therefore seems worth investigating whether

“There is huge diversity between and within poor countries and multiple possible paths towards creating effective public authority.”

transitional arrangements that build on existing interests and relationships might offer a better way forward than strategies that seek to disrupt or change them in preconceived ways.

iii) There is huge diversity between and within poor countries in the global South, and multiple possible paths towards creating effective public authority. This underlines the need to focus on the function not the form of institutions, to be open to novel arrangements and unexpected outcomes, and to look for ways of better understanding and explaining diversity.

iv) The world has changed significantly in the last 30 years, reshaping both the global environment for poor countries, and state-level structures. Decentralisation, privatisation, democratisation, citizen participation, the increasing involvement of non-state actors in service provision, public-private partnerships – all these have created new challenges. Traditional Weberian ideas about state capacity look out of date, even for OECD states. They can no longer rely on hierarchical, ‘command and control’ approaches; instead they need the capacity to manage multiple linkages and networks that cross the public-private divide (Ansell 2000).

Moving away from the security of Western state models can be destabilising for policymakers. The CFS research does not offer clear alternative models, or a menu of policy options (which need to be context-specific). But – returning to our metaphor of the struggling artist – it does offer two main kinds of help.

i) It sets aside preconceptions that distort the policymaker’s view of the world, and can get in the way of seeing what is actually there. One very practical starting point (equivalent to turning the picture upside down) is to change or challenge the language we use.

ii) It offers some new drawing skills: some working hypotheses, some ways of thinking about development challenges, some questions to ask, some angles to explore – all of which can help better identify the underlying causes of development problems, and the scope for finding common interests in addressing them.

In short, the CFS research is deeply interested in progressive outcomes. But it is open to unorthodox ideas about how these might come about. The argument is not that states do not matter. But they do not need to do everything. Moreover, while building more formal, rules-based democratic governance is a valid long-term goal, focusing exclusively on that may not offer effective strategies for helping poor countries with very weak institutions to improve security, encourage investment or deliver public services in the short-to-medium term.

1.4 Watch your language

A standard vocabulary has emerged among donors for discussing governance issues, and this can be unhelpful. Scrutinising it more carefully can help challenge unexamined assumptions, false dichotomies and ideological biases that get in the way of seeing 'what is actually there'. The following examples illustrate the kind of changes in language that have proved useful in framing the CFS research. They are not intended to be exhaustive.

"Instead of 'state building' and 'state capacity', think about 'public authority'."

- Instead of 'state building' and 'state capacity', think about 'public authority'. 'State building' tends to evoke the historical experience of Western countries, notably France and Germany in the eighteenth and nineteenth centuries. We prefer to talk about creating 'public authority', i.e. institutions (both formal and informal) that can undertake core governance functions: protection from external threats, and managing external relations; peaceful resolution of internal conflicts; and providing or facilitating the provision of a range of collective goods and services. The terms 'state building' and 'state capacity' can be unhelpful for the following reasons.
  - They imply a sequence of steps[2] leading to the creation of a set of formal institutions resembling those of a Western, Weberian state (monopoly of violence, a rules-based bureaucracy and representative institutions, and clear distinctions between public and private spheres). It is unrealistic to look for the recreation of these 'ideal' models in many poor countries in the short-to-medium term.
  - Moreover, as noted above, the model itself may no longer be so relevant. Governments today have to negotiate with a much greater diversity of actors, including: an expanded private sector with transnational links; diverse political parties and movements; sub-national governments; armed opposition groups; and a proliferation of multilateral and bilateral donors, and national and international NGOs. This implies a different set of state 'capacities', with more emphasis on influencing, networking and regulating other actors than on traditional, top-down capacity to formulate and implement policy.
  - States are not the only sources of public authority. In most poor countries the boundaries between 'state' and 'society' are unclear, and the task of organising collective action to create public goods

2 Some concept of sequencing is helpful, starting with the creation of institutions to control a given territory that are superordinate to other institutions claiming to exercise public authority, and the establishment of institutions of rule that depend less on coercion and force, and more on legitimacy, consent and negotiation. Progress in accomplishing these earlier tasks creates the conditions under which institutional arrangements to create a range of other public goods can be developed. However, the idea of any kind of rigid sequencing or state-building model is unhelpful.

may be shared between a great variety of state and non-state actors.
- ‘State building’ can evoke strong ideological biases that distort the picture. Some people, for example, emphasise the need for effective authority to aggregate power and resources and provide order and security; others are more inclined to see state power as a threat to citizens, and emphasise the need for legal and constitutional arrangements to limit state power.
- ‘State building’ has come to be associated with externally driven processes, and ‘state capacity’ with donor-led programmes of financial support and technical assistance.

In short, ‘public authority’ focuses on functions rather than on form, and is more neutral about the processes and actors involved – inside or outside the formal state, and across the public-private divide.

“Instead of ‘political will’ think about the institutional incentives that drive the actions of political and economic elites.”

- Instead of ‘political will’ think about the institutional incentives that drive the actions of political and economic elites. The term ‘political will’ is often used in a catch-all sense to avoid unpacking the complex factors at work in shaping a policy response. It can also encourage donors to pin their hopes on individual reform ‘champions’. While individuals clearly make a very important difference, they come and go – so it may be more useful to think in terms of the structures and institutions shaping their interests, and those of other elite groups.

- The term ‘vested (elite) interests’ is often used in a pejorative sense to imply venal or dishonest/selfish, leading to assumptions that such interests should be opposed (for example by creating a reform coalition). But elites are central to creating effective public authority, so it may be more helpful to think about the potential for their interests to overlap with a progressive agenda, or about more indirect strategies that could help shift their interests over time. These ideas are explored further in CFS work on the underlying causes of state fragility (Chapter 2).

- Instead of lionising civil society, think about state-society interaction. This helps to avoid the assumption that ‘strengthening’ civil society is always worthwhile: whether this is so depends on whose interests are being strengthened, and on the context. Stimulating collective action without considering the capacity of the state to negotiate and respond can lead to demand overload, or policy fragmentation. Sustaining effective ongoing collective action requires an adequate state response.

  A focus on state-society interaction underlines the need to look at both sides of the relationship, and avoids an over-simple dichotomy between the ‘supply’ and ‘demand’ sides of governance. It emphasises the way in which state and society can help build each other: bargaining between state and society actors is critical to stimulating collective action, aggregating and channelling demands, identifying common interests, and enabling the state to build consensus and respond effectively.

- Instead of prioritising formal institutions and equating informal institutions[3] with corrupt or collusive practices, take more account of how the two interact. For example, CFS research (Chapter 3) suggests that relations between public policymakers and private investors that are initially personal and exclusive can provide 'proxy' governance measures to encourage investment in the short-to-medium term.

"Informality is just a fact of life."

In exploring 'informality' the research seeks to avoid ideological positions. Informality is just a fact of life. 'Informal' is not equated with 'traditional' which can itself be unhelpful terminology if used to imply 'unchanging', and which tends to evoke strong pro or anti biases. Despite the CFS preoccupation with informality, there is no implied bias, either in favour or against 'working with the grain' of informal institutions. These need first to be understood within a specific context, and then evaluated for positive and negative consequences.

- More generally, it seems useful to avoid (1) general-purpose labels that blur important distinctions, and (2) value-laden language that embodies unexamined assumptions. An example of the first is '(neo)patrimonialism', often used in juxtaposition to rules-based, rational-legal systems of authority, and sometimes as a synonym for corruption or bad governance (Pitcher *et al.* 2009). People who use the term in this way miss an important aspect of patrimonialism as originally conceived by Max Weber, namely the existence of reciprocal relations between rulers and ruled. This is not just an academic quibble: labels can pre-empt a more discerning inquiry into the circumstances in which patrimonialism may be compatible with progressive change.

The second point – the need to avoid value-laden language – is probably more obvious. Democratic governance, rights, and rule of law are conventionally seen as both morally good and beneficial. Such associations can inhibit investigation of the very challenging processes involved in creating them. The words also imply a specific form as well as a function, which can get in the way of more open inquiry. For example, rather than thinking of political representation only in terms of democratic elections, the CFS research examines more unorthodox ways in which representative governance may be emerging in unlikely circumstances, including informal customary village councils in Karnataka, India (Chapter 5), and participatory governance structures in São Paulo, Brazil (Chapter 4).

3 By informal institutions, we understand 'socially shared rules, usually unwritten, that are created, communicated and enforced outside officially sanctioned channels' (Helmke and Levitsky 2004).

1.5 New drawing skills for policymakers

Having metaphorically turned the picture upside down, what new drawing skills can the research offer?

"The causes of and solutions to poor governance lie principally in patterns of state-society relations."

The first is a core theoretical insight that underpins both phases of the CFS research. It is widely accepted among political scientists but until recently has been unfamiliar to many development practitioners.[4] It is that the causes of and solutions to poor governance lie principally in patterns of state-society relations. Progress in creating effective, accountable public authority comes from bargaining among social groups and between social groups and the state. This can produce exclusive benefits for a privileged few, and low levels of public goods. But it can also lead to a broader range of public goods and more inclusive benefits. The Phase 1 research put it this way:

> Historically this [bargaining]... has often involved violent conflict, but it can also produce positive sum outcomes, if the parties involved can identify common interests and negotiate arrangements to pursue them. Over time this may lead to more civic ways of managing competing interests, and result in the creation of legitimate, stable institutions: arrangements which are valued – and thus become institutionalised – because they are seen to serve a common purpose. (IDS 2005)

Building effective, accountable public authority requires striking a balance between the need for states to have 'autonomy', and the need for them to be 'embedded' in society (Evans 1995). States need coercive power to impose basic order – but they also need 'buy-in' from societal actors to provide the legitimacy that transforms raw power into less coercive political authority. States need bureaucratic capacity to raise revenue and organise public goods, including security and dispute resolution – but they also need compliance and collective action by societal groups so that individual interests can be aggregated, common demands can be formulated, and policymakers can obtain the information and support they need to design and implement good public policy. Elements of public authority are also created outside the state, for example through self-regulation by private businesses to resolve disputes and enforce contracts, or when customary village councils organise the provision of public goods.

In summary, effective, accountable formal institutions evolve through complex, long-term interaction between state and society, public and

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4 This is now starting to change with increasing attention to the political dynamics of state building in fragile situations, for example by the OECD/DAC International Network on Conflict and Fragility (OECD/DAC 2008, 2010).

private actors, formal and informal institutions. So the first critical drawing skill is for policymakers to switch their attention away from formal institutions (the destination), towards mapping and understanding those complex interactions.

The problem for policymakers is how to link big theoretical insights of this kind to short-term practice. It is often easier to see how dysfunctional relations and informal arrangements cause governance problems than it is to find ways of fixing them. The CFS research reveals enormous diversity of contexts and circumstances that shape different outcomes: it is therefore very hard to detect broad patterns that could have policy implications (and researchers have been alert to the risks of drawing unwarranted generalisations from particular cases).

However, the research does provide a basis for moving beyond the broad proposition that informal institutions and relationships matter, and offers practitioners a way of starting to investigate the very messy, complex reality that confronts them. Drawing on and adding to the insights of other scholars, the research offers help in four main ways.

i) It points to some factors and relationships that seem particularly salient, and suggests some questions to ask that are relevant in a great variety of contexts. What is shaping the interests of political elites? (Sources of revenue are likely to be critical.) What is shaping relations between politicians and investors, and might they have common interests in supporting productive investment? What might stimulate and sustain collective action by social groups to demand better services? What informal local institutions are at work, and how are they shaping development outcomes? Are they supporting or undermining formal public authority? Where does government get its revenue from, and how is this shaping its relations with citizens?

ii) Large-scale comparative surveys – for example the research into informal village-level institutions in South Asia (Chapter 5) – can suggest explanations of diverse outcomes that may have wider relevance (in this case, linking them to the origins of informal institutions in different patterns of colonial rule). Smaller-scale comparative studies can suggest new hypotheses for future research – for example into state-business relations (Chapter 3).

iii) Individual case studies provide evidence of exactly why and how informal processes and relationships can derail well-intentioned policy reforms, or conversely can offer insights into factors that contributed to successful reform (Chapter 4). These cases do not offer examples that can be replicated, but they do stimulate questions and fresh ways of thinking about development issues that are relevant across a range of different contexts.

iv) Many of the findings have proved of direct interest to local policymakers. For example, research into informal village-level governance in Pakistani Punjab has been taken up by officials in the provincial planning department; research into collective action around service delivery has attracted the attention of local authorities in São Paulo and Delhi.

"Good 'drawing skills' consist of asking useful questions, directed towards understanding the underlying, informal processes that encourage or inhibit constructive relationships."

Essentially, good 'drawing skills' consist of asking useful questions, directed towards understanding the underlying, informal processes that could encourage or inhibit constructive relationships and bargaining between key actors. The CFS research helps to identify, fine tune and validate such questions.

More broadly, as explained in Chapter 7, the research points to a different aid model. It shifts attention away from donor-driven reform initiatives, and towards local capacity and incentives to address core development problems. This suggests doing much more to empower local policymakers (including through good-quality research), while looking for indirect ways in which external actors could help create a better enabling environment. This might include action to limit the damaging impact of OECD governments and businesses on local incentives and capacity for progressive change, and helping to convene and manage partnerships between multiple stakeholders, including public and private actors, North and South.

1.6 Outline of the chapters

Chapters 2–6 below set out the core findings from the research.

Chapter 2 looks at the factors shaping the global environment within which poor countries in the South are struggling to create effective public authority. It explains how changes in the global economy have provided exceptional incentives for political elites in poor countries not to create effective states and public institutions, resulting in distinctive patterns of persistent conflict, and state fragility. It explores effective policy responses that might shift the institutional incentives driving elite behaviour.

Chapter 3 explains why relations between holders of political power and holders of economic power are so central to the process of creating effective and accountable public authority, and why conventional approaches to improving the investment climate have had limited impact in poor countries. Case studies in Egypt, Indonesia and China explore the potential for informal relationships between politicians, policymakers and private investors to compensate for weak formal governance arrangements, and to boost investment in the short-to-medium term. Findings from Egypt suggest that these played a critical role in unleashing the profit potential of specific industrial sectors, thus leading to higher investment than in other sectors with less potential.

Chapter 4 explores the circumstances in which poor people, or collective actors working on their behalf, can be effective in demanding accountability and improved performance from service providers. Based on a cross-country comparative study of reforms of healthcare and social assistance programmes in São Paulo, Brazil and Delhi, India, it finds that different types of public sector reform can substantially influence opportunities for collective actors, as can involvement at critical stages of policy reform. It also explores new forms of representation emerging among collective actors in São Paulo.

Chapter 5 raises the question of how to view so-called 'traditional' institutions: are they part of the governance problem, or part of the solution? The CFS has undertaken extensive research into informal local governance institutions in Karnataka, Rajasthan and Pakistani Punjab. It finds that they remain surprisingly influential and diverse, and interact in significant ways with formal institutions. In Karnataka, customary village councils are adapting to a more competitive democratic environment, are becoming more representative and pluralist, and interacting synergistically with formal institutions. By contrast, in Pakistani Punjab informal local governance institutions remain hierarchical with authority concentrated in landowning families and kinship groups. These differences can be related to whether such institutions had their origins in indirect or direct systems of colonial rule, as well as to more contemporary factors. These different origins help to explain persistent differences in the quality of development outcomes between neighbouring villages, and offer some practical ways of starting to improve the targeting of public programmes.

Chapter 6 picks up on a major theme of the Phase 1 research, namely the links between taxation and accountability. Detailed studies cover the political economy of taxation and its relationship to accountability in Ghana, Kenya and Ethiopia. Findings from all three countries show clear evidence of a broad causal relationship linking government reliance on taxation with pressures for increased accountability and responsiveness. They also reveal some more specific processes at work, including direct tax bargaining leading to specific episodes of political reform, and more indirect pressures for change driven by citizen resistance to taxation. This chapter also picks up on the implications for governance of natural resource revenues. A case study from Peru shows how huge increases in natural resource revenues fuelled dysfunctional relations between local governments, mining companies and activist movements, resulting in conflict and poor governance. It provides a clear warning that standard remedies can backfire when they take insufficient account of local context and political dynamics.

Chapter 7 examines the operational implications of these findings for local policymakers, international donors and the current aid and development model.

2 State-society relations and state fragility

2.1 Introduction

This strand of the CFS research applies the lens of state-society relations to exploring the causes of conflict and state fragility in very poor countries of the global South.

Western policymakers have become increasingly preoccupied with the challenges posed by weak or 'failing'/'fragile' states – states where no group or party has been able to establish effective control over the territory and provide security and basic services and where weak governance and continuous internal conflict have become routine. In thinking about the reasons for state fragility, policymakers often cite historical or structural factors, including colonial legacies of artificial boundaries and institutions that lack local legitimacy. These are valid parts of the explanation but are not very amenable to policy interventions. More often policymakers point to weak institutions and high levels of corruption as critical features of fragile states that need to be 'addressed'. But finding effective strategies has proved elusive.

2.2 Perverse incentives for elites

Key findings

- *The global environment creates perverse incentives for political elites to perpetuate fragile states because it gives them access to unearned sources of income from natural resource rents and criminal activities.*
  This weakens their incentives to engage with citizens, build public institutions and nurture the economy.

(Moore *et al*. 2009)

“A critical underlying cause of state fragility is the lack of elite incentives to create effective public authority.”

The CFS research suggests that a critical underlying cause of state fragility is the lack of elite incentives to create effective public authority. A major reason is that the global environment has provided unprecedented opportunities for elites with transnational connections to profit from weak governance and ongoing conflict. Effective policy interventions therefore need to focus on ways of shifting these perverse incentives.

The core problem of states that lack effective public authority is widespread, has almost certainly worsened in recent years (in the sense of affecting an increasing number of people), and in some places is becoming normalised. Governments in Somalia, Sudan, Haiti, Democratic Republic of Congo, Côte d'Ivoire, Central African Republic, Guinea, Iraq, Afghanistan, Liberia, Sierra Leone, Angola and Chad among others have suffered significant, apparently long-term shrinkage of authority and capacity. Actual power has shifted to unofficial, non-state actors, often financed by criminal or resource extraction activities, and reliant on nonofficial armed force. Historically, following war, conquest or revolution, one party has emerged dominant, or public authority has been re-established through compromise between leading contenders. A distinctive feature of the current fragile state phenomenon is the absence or slowness of such processes. Failing governments have not been ousted militarily and the international consensus – supported by the UN and African Union – against changing international boundaries by force has reduced the chances of this happening. Weak governance and continuous internal conflict have become routine.

The end of the Cold War was the immediate trigger for so many cases of state weakness and failure. But a combination of globalisation, and big increases in wealth and income inequality between rich and poor countries, are also driving the process. Changes in the global economy from the 1970s onwards, spurred by the reduction in costs of long-distance transport and communications, have had a fundamental impact on elite incentives in poor countries. In the list that follows, the first two are the most important.

i) Elites with political and military power face huge financial incentives to enrich themselves by: gaining control of rents from the export to much richer countries of oil, minerals and natural gas; smuggling diamonds and other mining products; and illegal trade in narcotics. (The latter has particularly corrupting effects on officials and politicians in transhipment areas).

ii) Global financial liberalisation has made it increasingly easy to transfer large financial assets abroad, and to store them in tax havens with (until recently) very few questions asked.

iii) Elites can protect themselves at home by hiring military force on global commercial markets, thus relieving them of the need to organise local manpower and to build the political legitimacy and administrative capacity to support a domestic military capability.

iv) Where public institutions are already weak, they can be further undermined by high aid inflows. These can reduce incentives to increase economic growth in order to expand public revenue, and weaken the need to bargain with citizen taxpayers. More specifically, international humanitarian assistance to refugees and displaced persons can provide valuable resources to armed groups, and thus incentives to leave military and political conflicts unresolved.

v) The globalisation of arms production is an exacerbating factor, widening loopholes in regulatory systems to control the international arms trade.

All of these factors have weakened elite incentives to create effective public institutions, to nurture the economy and to invest in public services. Elites include people with formal power (businessmen, politicians, wealthy professionals or religious leaders) but also people with informal power (as warlords, or leaders of narcotics or other criminal networks). They matter because it is elites – people with high levels of political, bureaucratic, military, financial and economic power – who can make crucial policy choices to support or undermine public authority.

2.3 Scope for international action

Globalisation itself is not the culprit, and indeed has some positive effects. The close contemporary interaction between very rich and very poor countries has brought strong pressures for more democratic, rules-based governance. It has contributed to public awareness of global challenges – an obvious example being climate change – that in turn creates reputational pressure on business and governments. It supports the organisational power of international NGOs to mobilise action and public opinion, and offers new opportunities for communities of experts to share experience, facilitate learning and coordinate action. Transnational corporations can play a useful role as vehicles for introducing more effective and transparent systems of accountancy, commercial law and corporate governance. There is a growing role for multi-stakeholder partnerships that bring together governments, business and local and international civil society to tackle global issues including trade, the environment, human rights, crime prevention, security and medicine.

In particular there is scope for international action to address a range of issues that are central to changing the perverse incentives described above. Some are already well advanced, including action on international tax evasion, money laundering, stolen asset recovery, corruption and terrorist financing. A range of multi-stakeholder initiatives are also ongoing (with mixed results), designed to mitigate the negative impact of natural resource revenues. They include the Kimberley process to prevent trading in conflict diamonds; the Extractive Industries Transparency Initiative (EITI) to encourage transparency about revenues paid by oil companies to producer governments; and international action to control illegal logging. There is scope to make all these work better. One of the most significant gaps is the failure to reform the international regulation of narcotics, although political support for change may be growing. Meanwhile new challenges are in prospect: an example is the proposal for a mechanism under the post-Kyoto climate regime to pay compensation to countries for 'avoided deforestation', thus motivating them to protect tropical forests (the so-called REDD initiative – Reducing Emissions from Deforestation and forest Degradation). Depending on how the mechanisms are designed, such revenues might add to the problems of perverse incentives currently associated with large incomes from oil, gas and minerals.

2.4 Conclusions and policy messages

"Applying a different lens to thinking about state fragility points to a change in strategy."

There are some broad implications of these findings for policymakers, notably the way changes in the global environment are transforming aid relationships. These are examined in more detail in Chapter 7 below. The main point here is that applying a different lens to thinking about state fragility points to a change in strategy: less of a focus on direct action to build formal institutions, eliminate corruption or supply external sources of security; and much more of a focus on action to address the sources of perverse incentives that undermine elite interests in building effective public authority. Given how difficult it is for outsiders directly to influence internal political dynamics in poor countries, they should do much more to address aspects of their own behaviour that have a damaging impact, and prioritise action that can be initiated and managed by OECD countries.

3 How can public action stimulate productive private investment?

3.1 Introduction

For years, developing countries have been on the receiving end of well-intentioned advice from international donors about how to increase economic growth. As is often the case, the prescriptions have fluctuated widely according to prevalent donor fashions: enthusiasm for state-led development gave way to urgent advocacy of liberalisation, privatisation and retrenchment of government, followed by a rediscovery that public institutions matter for growth. This was accompanied by a stream of advice about how to improve the investment climate by strengthening legal arrangements to protect property rights, facilitate contract enforcement and improve regulation (with an emphasis on reducing the role of government in decision-making) (World Bank 2005). The problem with this approach is that (1) reforms have proved very difficult to implement in poor countries with weak institutions; and (2) it now seems clear that they may do little on their own to improve prospects for growth. China in particular – but also Vietnam – have achieved astonishing growth without many of these formal, legal arrangements in place.

"China in particular achieved astonishing growth without many of these formal, legal arrangements in place."

So a rethink is underway, stimulated by the work of Dani Rodrik among others (Rodrik 2005). It is increasingly accepted by development practitioners that comprehensive, best-practice reforms of public sector institutions have had limited impact. There is some recognition that what matters is the function, rather than the form of institutions: while certain high-level principles (protection of property rights, rule of law, market-oriented incentives, sound money, sustainable public finances) all matter for growth, they can be delivered in different ways, allowing for more country-specific variation and experimentation. More recently the World Bank and DFID among others have taken an interest in bringing together political economy analysis with growth diagnostic frameworks to identify the 'binding constraints' to growth in particular contexts, and to identify targeted, politically feasible solutions.

Much of this rethink is positive, and the CFS research programme into ways of stimulating productive private investment through public action builds on the insights of Rodrik and others. But donor thinking – even when directed towards more politically sensitive, targeted approaches – is still heavily coloured by the experience of OECD countries. This is unhelpful in two main ways.

i) It significantly underplays the importance, in poor countries, of the relationship between people who control political/military power and those who control economic power. This relationship is fundamental to creating and sustaining public order.

ii) It limits the menu of options because – despite acknowledging the need for some local experimentation – donors still tend to look for solutions based on formal rules that have (mostly) worked well in OECD environments. This underplays the potential for very informal relations to support productive private investment, through deals struck between politicians and investors, and through 'self-help' arrangements between business people (to arbitrate disputes and share information about credit-worthiness, for example – with reputational risk as a sanction).

The CFS research seeks to reframe the debate about how to stimulate productive private investment in poor countries by looking at relationship-based rather than rules-based approaches (Moore and Schmitz 2008). While rules-based arrangements remain a valid long-term goal, experience suggests that these are very difficult to implement and may be ill suited to helping poor countries with weak institutions to increase investment in the short-to-medium term. There are of course legitimate concerns that informal relationships often result in monopoly, privilege and corruption (so-called 'crony capitalism'). But it is unhelpful to slap this label on all informal arrangements between government and business without a closer examination of how they actually work out in practice.

3.2 Interdependence between politicians and business

People who hold political/military power and people who hold economic power need each other and stand to benefit from cooperation; but they also face considerable risks in doing so. Politicians need private capital to provide state revenue, finance political parties and invest to create prosperity that supports political order. Holders of private capital need public authority to provide security and public order, physical and financial infrastructure, and credible assurances that they will be able to retain the profits from their investments.

But in practice in poor countries the relationship is often fraught and competitive. Politicians are tempted to predate on private capital (legally through heavy taxation or illegally by confiscating assets or extracting protection money). Holders of capital may use their economic power to organise violent opposition or extract exclusive benefits through monopolies and restrictions on competition. Public authority and private capital are often fragmented and lack organisational capacity, which makes productive cooperation more difficult. Moreover, as seen in Chapter 2 above, politicians may have limited need for bargaining with private capital if they have alternative sources of revenue.

By contrast, in OECD countries, competition between public authority and private capital takes place primarily within widely accepted formal rules, and relationships are relatively indirect and impersonal. Governments depend on general taxation for revenue, which depends on economic growth. This makes it essential to negotiate with private capital, which can use its structural power to withhold or slow down investment if dissatisfied with government policy. Electoral democracy and high levels of welfare spending give governments legitimacy and capacity to bargain effectively with private capital. It is relatively easy to build political coalitions based on common interests between major economic and political actors, and to formulate economic policies to support growth. In short, institutions of market capitalism, liberal democracy and welfare states are mutually reinforcing.

“Advice about how to ‘improve’ the investment climate based on an OECD model is likely to be inappropriate and potentially damaging.”

But these arrangements are the product of a long history of political conflict and socioeconomic change, and cannot easily be replicated. Advice about how to ‘improve’ the investment climate based on an OECD model is likely to be inappropriate and potentially damaging, because it significantly underestimates the fundamental challenge of negotiating a bargain between politicians and business.

If building best-practice institutions in poor countries is not a short-term option, and if relationships between private investors and public authority are likely to remain highly personalised and informal in the medium term, the question becomes in what circumstances might such relationships lead to productive investment rather than crony capitalism? That is the issue addressed by this stream of the CFS research.

3.3 Relationship-based investment

Conventional thinking about the investment climate conflates two distinct ideas about things that governments can do to improve the environment for business investors. They can:

- reduce the *costs* of doing business, including the availability, reliability and cost of public infrastructure and skilled labour, the costs of complying with government regulations, and the burden of heavy taxation;
- reduce the *risks* of doing business – i.e. the degree of uncertainty faced by investors about their ability to profit in future from investment decisions made now. Particular problems of uncertainty arise from poor governance, including arbitrary taxation, inability to enforce contracts, and lack of government protection against theft.

The CFS research focuses on the risks of doing business, and especially the reality or perception of risks that arise from relationships between business and those who hold political power.

Clearly context matters, because it fundamentally affects the interests of economic and political elites, and therefore the way the relationship between them plays out. At the macro level, Chapter 2 above highlighted how recent changes in the global environment have undermined elite incentives to nurture economic growth or improve governance. The structure of the domestic economy is also significant: mineral or fuel wealth invites looting because it generates high levels of surplus that are easy to control. By contrast, governments dependent on revenue from specialist export enterprises with the freedom to move elsewhere will have a strong interest in providing them with support and protection. Formal institutions matter: decentralisation can create space and incentives for bargaining between officials and business at a sub-national level, and between different levels of government. The CFS research attempts to hold constant at least some contextual factors by looking at variations in investment performance between sectors or regions within a single country, to explore how far relatively short-term relationships between politicians and investors – often of a transitional kind – played a part in explaining different outcomes.

These relationships are not highly visible and are often deliberately covert, and therefore difficult to research. However, their potential importance is illustrated by a number of cases that have provided the inspiration for the CFS research. One already mentioned is China, where informal relations provided investors with confidence that they could retain their profits despite very weak legal protection of property rights (Qian 2003). Many of the same factors explain significant economic growth in Vietnam despite weak formal legal protection of property rights. A different but equally striking case comes from the experience of

Mexico where some sectors of the economy thrived during a long period of political instability and civil war between 1876–1929, based on very local bargains between politicians and business (Haber *et al.* 2003).

The CFS research programme has built on such insights, undertaking detailed investigation of the way relations between public actors and private investors have influenced investment outcomes at the national level in Egypt, and at local level in Indonesia and China. The following section gives highlights from the cases.

3.4 Detailed findings

Egypt: Common interests in productive investment

Key findings

- *A new government in 2004 triggered positive changes in relations between officials and business.*
- *A common understanding of problems and common interests in addressing them facilitated targeted solutions that boosted investment in sectors with good profit potential.*
- *These relations were initially informal and exclusive, but became more institutionalised and inclusive over time.*

(Abdel-Latif and Schmitz 2009)

Egypt has generally been perceived as having a poor investment climate at the national level. For most of the last three decades it has recorded declining levels of investment and growth. This is despite carrying out significant legal reforms to end expropriation and give equal treatment to local and foreign firms, as well as structural adjustment measures and intellectual property and labour laws.

However, there has been significant improvement in overall levels of private investment since 2004, with especially strong increases in particular sectors including food and communications. This coincided with a change of government in 2004, and the appointment of businessmen to ministerial positions for the first time since 1952. The government introduced a number of important regulatory changes, long demanded by the business community, including simplification of customs and taxation.

It seems unlikely, however, that these legal and regulatory changes go very far in explaining the increase in investment, given the failure of such changes in the preceding 30 years to have much impact. Moreover, formal changes do not explain why some sectors (notably communications) saw a significant increase in investment from the late 1990s, why investment after 2004 was so much higher in some sectors than in others, or how important remaining constraints in the ‘investment climate' were overcome, including inconsistent legislation and weak contract enforcement.

The CFS research explored whether, and if so how far, informal relations between policymakers and private investors played a role (alongside regulatory and other changes) in increasing the levels of productive private investment. It looked at two long-established, traditional sectors – food and furniture – that showed different investment trends: a sharp increase in investment in the food industry, but only in one sub-sector of the furniture industry. It also looked at two newer sectors – communications and IT: both started development in the mid-1980s but took different paths, with the communications industry growing much more rapidly.

The research was based on statistical data and 61 key informant interviews with government and business leaders. It traced in detail the development of informal relations between them, from initial contacts (often rooted in prior social or professional relationships), through building a common understanding of problems and interest in addressing them, to the development (first informally, later publicly) of sector-specific policy measures. In some cases these resulted in a 'tipping point' when investment started responding, and there were knock-on effects as local investment pulled in foreign direct investment, and confidence spread to other sectors.

> **"The most critical change was not so much in improved government regulation, as in changes in perceptions and attitudes."**

Overall the research found that the most critical change that occurred in 2004 was not so much in improved government regulation, as in changes in perceptions and attitudes. However, informal relations between policymakers and investors became effective only when there was a common understanding of the problems and a common interest in addressing them. This provided space to find sector-specific solutions, thus reducing obstacles and risks for investors and increasing their chance of reaping a profit, while enhancing the reputation of policymakers associated with boosting growth and job creation. Such mutual interests were particularly clear in the food sector (which contributed to industrial output, employment and exports). They were less evident in the furniture sector, although investment was high in one sub-sector that was focused on exports. In the communications and IT sectors the big companies were willing to invest because they saw the gains to be reaped from being first movers in new markets. Policymakers negotiated deals with these companies because they saw the potential of the new technologies and welcomed the prestige that came from being associated with the new industries. A shared professional background facilitated understanding and cooperation between the two sides.

Other findings of interest include the following.

- Informal state-business relationships were not the sole direct cause of an increase in private investment, but played a critical role in unleashing the profit potential of specific sectors. They can unblock the way forward in the short-to-medium term in cases where governance is weak. In the food sector, for example, the direct reason for the increase in investment was favourable demand, but informal relationships played an important part in overcoming general supply constraints and facilitating effective investments.
- Informal state-business relations operated by providing a broad level of trust and credibility in government, and by offering proxy governance benefits through policy changes of particular relevance to a sector or sub-sector. They facilitated difficult, politically sensitive decision-making, for example the removal of restrictions on access of big investors in the food sector to reclaimed desert land, and the removal of the energy subsidy. In particular, informal relations played a critical role in helping to establish the communication and IT industries virtually from scratch, overcoming initial barriers to entry and helping to surmount institutional deficiencies and lack of experience. Early investors were able to make a major contribution to drafting the new telecommunications law.
- In both the old and new sectors, the close alliance between high-level policymakers and big investors extended into the Cabinet, and in the case of the communications and IT industries, up to the President. This helps to explain why a willingness to take action translated into a capability to take action.
- Although informal state-business relations initially offer exclusive benefits, they can have a subsequent inclusive and positive impact, but only where the private sector has effective leadership and broad-based organisation (this applied, for example, to the food sector, but not to most of the furniture sector). And while initial interactions are informal, they can become institutionalised over time.
- Although effective state-business relations are often rooted in informal social or professional relationships, these are not a precondition for the development of common understanding of problems and common interests in resolving them.
- Finally, it is hard to establish whether informal state-business relations had a temporary effect, or were more enduring. The answer is clearest in the case of the communications and IT sectors, where a new industry was established. A tentative assessment is that the communications industry and the export-dominated sub-sector of the furniture industry had embarked on a new dynamic: the jury is still out on the IT industry and the food industry. What is clear is that informal state-business relations have provided an effective transitional arrangement in initiating investment and growth. The broader political and economic context in Egypt was significant in helping to ensure that exclusive

“Although informal state-business relations initially offer exclusive benefits, they can have a subsequent inclusive and positive impact.”

benefits were targeted on sectors with the potential for productive investment, and that the more negative effects of 'crony' relationships were avoided. Ministers had incentives to deliver on a range of public goods, and were subject to media scrutiny.

Indonesia: A tale of two cities

Key finding

- *Exclusive, personal relations between government leaders and business reduced the risks to key investors and were more important in boosting investment in the short term than formal governance arrangements.*

(Patunru *et al.* 2009)

Another strand of the research also challenges the conventional wisdom that impartial, rules-based economic governance is a precondition for investment. A study of the political economy of two cities in Indonesia shows that relationship-based, rather than rules-based, cooperation between government leaders and local firms can provide an effective mechanism to boost investment even where governance is weak, although it also suggests that the creation of rules-based institutions may be necessary to sustain growth in the medium term.

The study was carried out between 2007 and 2008, and explored the factors driving investment performance in Manado in North Sulawesi, and Solo in Central Java. They are broadly similar in terms of population and size of their economy, but display significant differences in the quality of local governance.

Surveys of small and medium-sized enterprises (SMEs) revealed that in Manado the regulatory environment was perceived as complex and confusing, and provided considerable room for rent-seeking. Over 80 per cent of SMEs surveyed saw the licensing process as corrupt, with the majority using informal intermediaries (mostly government officials) to obtain licences. By contrast, in Solo, perceptions of the regulatory environment were much less negative, and licensing procedures had been streamlined through the establishment of an effective one-stop shop.

Overall, relations between municipal authorities and business are much more inclusive in Solo than in Manado. In Manado, large businesses well connected to government receive preferential treatment. Small businesses lack channels of influence, and struggle to comply with the complex, corrupt and unclear regulatory environment. In Solo, there is a wide range of business associations that include different sectoral, ethnic and religious interests. Competition between them restricts rent-seeking. The mayor has active contacts (both formal and informal) with a wide range of businesses, and is not perceived as favouring particular groups.

Sectoral business associations are able to voice policy concerns.

In Manado economic development has been led by a small number of private sector actors rather than government, which lacks a coordinated plan. Solo, by contrast, has an active development plan resulting from high levels of inclusiveness in policymaking.

The outcome for investment has not, however, reflected these differences in local governance. Investment flows have increased significantly in both cities in recent years. In Manado, despite its high levels of rent-seeking, exclusive relationships between government and key economic actors, and minimal public planning, investment grew rapidly during the three years prior to the study, and included growth of micro, small and medium-sized enterprises.

“Local policymaking influences investment primarily by reducing the risks faced by key investors, rather than by reducing the costs of doing business for all.”

External factors were important in explaining the economic performance of both cities, including the general health of the national economy, and big increases in commodity prices, which particularly benefited Manado. But qualitative evidence from in-depth interviews underlines the importance of relationship-based, rather than rules-based, cooperation between government leaders and local firms in boosting investment. In Manado investments took place because specific permissions were given to large individual investors; in Solo an improved sense of security on the part of the private sector was the trigger for increased investment. These findings challenge assumptions about the importance of the broader investment climate, and confirm the idea that local policymaking influences investment primarily by reducing the risks faced by key investors, rather than by reducing the costs of doing business for all.

However, the highly personalised, exclusive relations that encouraged investment in Manado in the short term may not be sustainable in the longer term. After completion of the fieldwork, Manado’s mayor was being detained for alleged misappropriation of government funds for personal enrichment, and his vice mayor faced a court allegation for corruption. So in the medium term, the instability caused by corruption and rising inequality may undermine the effectiveness of exclusive, informal relationships in boosting investment, and progress in Solo may prove to be more sustainable.

Local government investment promotion in China

Key finding

- *The superior performance of one investment promotion agency is explained by informal personal and political relations and alignment of interests between local and higher level officials.*

(Hampton 2006)

Another comparative study – this time between two government investment promotion agencies in the northern coastal city of Tianjin in China – also provides evidence of the importance of personal relations and alignment of interests between public and private actors in explaining differences in investment performance.

China has been outstandingly successful in attracting foreign investment, despite its lack of formal 'best-practice' rule of law institutions. However, there are huge variations in investment levels within the country, and even within the coastal region. The CFS research sought to explain differences in investment performance between two neighbouring investment promotion agencies – the Tianjin Economic-Technological Development Area (TEDA) which has been highly successful in attracting foreign direct investment, and the Dongli Economic-Technological Development Area (DEDA), which has not.

Investment promotion agencies (IPAs) act as a bridge between the interests of the Chinese government and the Communist Party (in economic growth, tax revenues, job creation and management skills – all of which can enhance personal reputation and advancement), and the needs and interests of foreign investors. IPAs provide potential foreign investors with information (especially critical at early stages of engagement), access to land, specific investment opportunities and preferential policies, and ongoing support for implementation. All this can contribute to establishing credible levels of trust with investors.

The study found that TEDA provided: extensive, accessible and reliable information, including responses to specific queries within 24 hours; flexibility in meeting investors' needs for land and preferential policy packages; a one-stop administrative centre for all permits; and proactive ongoing support. This contrasted with the much less effective role of DEDA which provided poor, inconsistent, outdated information, was slow in responding to inquiries and ineffective in putting together credible policy packages.

The main explanation for the differences lay in the fact that TEDA was very well connected through personal networks linking its officials to party and government at sub-national and national levels. It had close links with the municipality of Tianjin (three of its recent former directors were promoted to become members of the Standing Committee of the Communist Party of China (CPC) of Tianjin, and a fourth became vice mayor). These links benefited both sides: TEDA got policy support, extra resources and freedom to provide preferential policies to investors; the Tianjin municipality got growth, revenues, and enhanced domestic and international status. Very high-level support from the Tianjin-born Premier Wen Jiabao allowed TEDA to extend its boundary and circumvent new land laws. Its political connections and bargaining power enabled it to generate capital (from retention of tax revenue and access to bank loans), and to build new infrastructure.

By contrast DEDA had weak political links, meaning it was less able to recruit high-quality staff. It had lower incentives to perform well, and lacked financial and political resources to secure bank loans to invest in infrastructure, and overcome restrictions on access to land.

In summary, the critical success factors explaining TEDA's superior performance were its ability to align its interests with those of potential private investors, which was in turn linked to its favourable positioning within the political system. The establishment of an IPA alone was insufficient to provide an administrative or regulatory 'fix' to attract investment. It also needed political and personal relationships in order to forge alliances within the public sector, and thus obtain the clout for constructive deals with the private sector.

Fee extraction by local governments in China

Key finding

- *The potentially damaging impact of arbitrary fees levied on business by local governments is mitigated by informal bargains that give well-connected businesses preferential access to state loans and other resources.*

(Choi 2009)

In China, sub-national governments extract significant amounts of money from businesses through a wide variety of 'fees'. Fees are different from regular taxes. In particular, they appear arbitrary and unpredictable. Fees are much resented, and frequently cited as a major obstacle to investment and enterprise. If the Chinese economy were doing badly, fee extraction would almost certainly be cited as a cause. It conforms exactly to the standard image of the predatory state suppressing private enterprise. Yet private investment continues to boom in China. Fee extraction cannot be as damaging as it first appears. The CFS investigated this issue, using both national-level firm surveys and in-depth interviews with local officials and entrepreneurs. Fee extraction is less damaging than we tend to assume because it is not simply what it first appears to be. It is actually part of a set of exchange processes between economic and political actors that allow each to achieve their immediate objectives while maintaining a positive investment climate. Businesses pay fees and in return obtain access to scarce resources controlled by officials of sub-national governments. Local officials use fee collection to obtain the cooperation of business in helping them to meet their objectives.

It is not very surprising that larger enterprises pay lower proportions of their business turnover in fees. They are in a better position to bargain with local officials. Larger businesses not only pay lower fees (in relation to turnover), but also obtain privileged access to scarce credit, that is still to a large extent allocated through official channels. They obtain what is termed 'selective protection'; in addition to normal duties, individual local officials have special relationships with and responsibilities for individual large firms. In return, larger companies help local officials achieve their objectives by, for example, complying willingly and quickly with government policies, or by helping local officials in their relationships with higher-level officials. The more surprising finding was that, taking firm size into account, the businesses with better political connections to the ruling communist party paid higher fees in relation to turnover. A high proportion of business people are members of the ruling party and hold positions within it. Business people who were party members paid higher fees than those who were not party members. Members who were also elected delegates to intra-party bodies paid more in fees than ordinary members. This pattern is contrary to conventional expectations of the abuse of political power to predate on private business in an authoritarian political system. Again, the politically well-connected businesses had privileged access to credit, but in return helped local officials achieve their objectives. These privileged relationships were stronger in economic sectors in which success was especially dependent on good relationships with local government: real estate, finance, transport, mining, electricity and gas, education and culture, and irrigation construction.

There is little doubt that fee extraction is a problem; the central government has long been struggling, with increasing success, to make sub-national governments reform and regularise their revenue-raising activities. The system is distortionary in the economists' sense of the term. But it represents a workable compromise, consistent with high levels of private investment, in an institutional context in which there is a persistent possibility that political power will be used in ways that would undermine the confidence of private investors. Policymakers need to understand such relationships not in order to recommend or emulate them, but to appreciate that they may be far less problematic in reality than they appear in the light of standard, rules-based ways of thinking about these issues.

3.5 Conclusions and policy messages

These findings illustrate the power of ' turning the picture upside down' – of closing off conventional assumptions about what constitutes a 'good' investment climate, and looking instead in a more open-minded way at what is actually driving investment in a given context. The results are counter-intuitive. In each of these cases what boosted productive private investment was not rules-based governance but personal, initially exclusive, often covert arrangements and relationships that allowed public and private actors to reach a common understanding of the

“Policymakers should focus on how to facilitate productive engagement between government and business.”

problems they faced, and to identify common interests in addressing them. This turns conventional wisdom on its head and suggests that instead of prioritising new rules-based arrangements as the main way of improving the investment climate, policymakers should focus on how to facilitate productive engagement between government and business, and consider whether informal arrangements offer a way forward.

This is not an either/or choice between formal institutions and informal relationships. There is a constant interplay between them. The wider political and institutional context clearly shapes the way informal arrangements play out, as does the organisational capacity within both the government and the private sector. Moreover, while informal relationships and exclusive bargains can help boost investment in the short term, more inclusive and institutionalised arrangements are almost certainly needed to sustain it over the longer term. But informal relationships may be able to pave the way for more rules-based governance, and in the meantime facilitate productive cooperation.

For policymakers, the finding that informal arrangements can offer effective transitional ways of increasing productive investment is important because it is potentially actionable. There may be things that can be done in the short-to-medium term to help shift incentives and increase productive dialogue between public and private actors. But the findings also suggest that external actors should view with some modesty their ability directly to influence these very informal processes.

What they can do is to develop new ‘drawing skills’: they can make different starting assumptions, and ask a different set of questions. Instead of focusing on how to remedy perceived deficiencies in rules-based governance, they should ask what is actually driving the interests of political and business leaders, whether there is scope for productive bargaining between them, and how far this might overlap with a progressive agenda. Such questions are likely to offer useful starting points in virtually any context.

4 Mobilising for better public services

4.1 Introduction

Improving the coverage and quality of basic services for poor people is an enduring development challenge. Poor people, more than any other group, rely on public services to provide them with the skills, healthcare and livelihood support needed to fulfil basic human rights and to succeed in the labour market. Access to education is the main route for escaping poverty, while lack of healthcare is one of the main reasons why households fall into poverty. The CFS research on service delivery looked at the impact of public reforms on the ability of poor people to mobilise and make demands on the state, against the background of major shifts over the past two decades including decentralisation, the creation of participatory institutions, and big increases in the number and types of service providers.

A major stream of the research explored in depth three cases of successful reforms of public services that are now contributing to large-scale poverty reduction – the universal provision of healthcare and conditional cash transfers in Brazil, and the passage of Right to Information legislation in India and its use to monitor the Public Distribution System (PDS). A fourth case looked at major reforms that changed approaches to women's reproductive health in India. The research focused on the complex interaction between state and society actors that underpinned these reforms to investigate:

- what role collective action by poor people, or those working on their behalf, played in achieving the reforms; and,

- how different kinds of public sector reform and models of service delivery affected the ability of poor people, or those working on their behalf, to organise *collective* action that influenced policy and subsequently ensured its effective implementation.

Local policymakers and international donors have spent years looking for ways of improving service delivery. Once again, development fashions have come and gone. Support for public service reform to improve direct provision of services was followed by New Public Management approaches in the 1990s that sought to change incentives of providers by giving service users more choice. There was a big expansion in the number and types of providers as services were decentralised, contracted out and privatised. By contrast, the 2004 World Development Report (World Bank 2004) emphasised the importance of strengthening direct accountability of service providers to users through arrangements to encourage the participation of poor people, and to strengthen their 'voice' through computerised complaints systems, citizen charters and other mechanisms. However such approaches to enhancing 'direct accountability', which focus on action by *individual* consumers may do little to help poor people who have no access to services in the first place, and are too vulnerable to undertake the effort and risks involved. Even in modern cities such as São Paulo and Mexico City, only a very small minority of poor people raise complaints or make demands on public officials about public services or infrastructure (either directly or through third parties) (Houtzager and Acharya forthcoming).

“Effective collective action involves ongoing action that engages with the state, not just *ad hoc* protests or self-help initiatives.”

The CFS research has been particularly concerned with the capacity of poor people – or those acting for them – to engage collectively with policymakers at national and city-government levels and (to ensure implementation of policy) with service providers at the community or neighbourhood level. Effective collective action involves organising around broadly shared goals, not just narrow, exclusive interests; and ongoing action that engages with the state, not just *ad hoc* protests or self-help initiatives. Establishing formal mechanisms for participation and/or 'strengthening' civil society groups with money and skills are important but not sufficient to make this happen. The research focuses on how to get constructive and ongoing *interaction* between public and private actors to achieve two main goals: to extend the coverage of public services to under-served groups, and to strengthen incentives for improved performance at the local point of delivery. The latter we call 'social accountability'.

Phase 1 of the CFS research[5] advanced the broad proposition that what the state does, how it is organised, and how public policy is designed and implemented all have a bearing on the ability of poor people or those working for them to mobilise and make demands on elected officials and government agencies. A prime example given was the Employment Guarantee Scheme in Maharashtra which was carefully designed to stimulate the mobilisation of potential beneficiaries, and encourage the engagement of political activists (Joshi 2009). The key point was that there is more room for stimulating collective action than is often supposed. How institutions are designed, and what models of service delivery are adopted, can have an impact on collective action by poor users. The Phase 1 research also questioned the common assumption that engagement with the state inevitably leads to a loss of autonomy (often seen as the key to effective civil society action). A survey of civil organisations in São Paulo showed that it is very often organisations well connected to governments and political parties that give poor people a voice in policymaking, without sacrificing their ability to engage, when needed, in more contentious ways of pressing for government action (Gurza Lavalle *et al.* 2005).

Phase 2 of the research uses new data-gathering methods, extends the findings to the point of service delivery, and deepens them to identify the role of issue-based networks that link advocates for better services to reformist public officials. It focuses on critical cases of reform in the health and social assistance sectors in São Paulo and Delhi. Using network analysis, case studies and a survey of service providers and community leaders, it asks how service delivery reforms inspired by New Public Management on the one hand, and increasing democratic participation on the other, affect the ability of poor people to mobilise and make claims on the state. The objective is to identify and compare the underlying processes at work in different contexts and sectors. There is a specific focus on how collective action to demand 'social accountability' from service providers is likely to emerge and be effective, given the weakness in many poor countries of formal mechanisms of accountability.

5 See 'Signposts to More Effective States' (IDS 2005: 20–33).

4.2 Detailed findings

Key findings

- *Different types of public sector reform, adopting different institutional models for designing and implementing public services, substantially influence the opportunities for collective actors to organise, influence policy, and hold service providers accountable.*
- *When citizen/user groups take part in negotiations over reform, it is more likely that the institutional models that emerge will enable collective actors to organise, influence policy, and hold service providers accountable.*
- *When formal accountability mechanisms are weak, social accountability activities by local collective actors can play an important role in improving services. Local collective actors are more likely to undertake social accountability activities when they participate in policy reforms and/or are part of networks linking them to public actors.*
- *Relationships and alliances across the public-private divide are diverse and critical to influencing policy and organising effective collective action. It is the way that networks of relationships between public and private actors are configured that shapes their ability to influence reforms, not the characteristics of individual actors.*

“A striking contrast between the design of health reforms and social assistance programmes created different opportunities for collective action.”

Different types of reform influence opportunities for collective action

The way services are reorganised or delivered can lead to the emergence of new actors and institutions, strengthen or weaken existing actors, and create opportunities for new alliances – between public and private actors, or across class divisions. The research highlights a striking, broad contrast between the design of health reforms and social assistance programmes in Brazil and Mexico that created different opportunities for collective action. Health reforms provided mechanisms to give collective actors a role in ongoing monitoring, while social assistance programmes involved direct cash transfers to families, thus bypassing civil society intermediaries (Houtzager and Joshi 2008).

The Brazilian constitution of 1988 created institutional mechanisms for direct citizen participation in the design of public policy, resulting in a proliferation of participatory institutions at federal, state and municipal level. In particular, the public health movement in São Paulo has a long history of engagement in reform, and has been active in negotiating the design of mechanisms – such as the health policy councils – that have given collective actors guaranteed seats. In Mexico, the Inter-Institutional Group on Reproductive Health gave the women’s movement privileged access to forums for policy design and monitoring. In these two cases, the actors were able to negotiate the creation of participatory bodies that facilitated their access to health decision-making centres over the medium term – thus providing them with a good ‘institutional fit’.

By contrast, cash transfer programmes for poor people (Renda Minima in Brazil and Oportunidades in Mexico) were deliberately designed to bypass civil society intermediaries that were seen as corrupted and politicised. Both the nature of the programmes and arrangements for implementing them provided little opportunity for collective actors to mobilise or demand accountability (there are complaints mechanisms for individuals, but these are of limited use to poor people). These programmes have been successful in helping poor people, and show that collective action is not the only means of improving service delivery. But cash transfers are not always appropriate; moreover it may be problematic over the longer term to exclude collective actors who could play a role in ensuring that eligible families get onto the cash transfer list, monitoring implementation, negotiating improvements, or simply facilitating effective local communication with beneficiaries.

Data from São Paulo show that levels of social accountability are much higher for health than for social services, reflecting in part the different institutional models that have been adopted. For health there are lots of physical points of contact between citizens and agents of the state, including local health posts and participatory councils, the regional coordinating body, and the municipal health council. By contrast, for cash transfer programmes there are fewer physical or organisational contact points around which people can mobilise.

Research in India also found that different types of service provision resulted in different levels of collective action, and different strategies. In Delhi, collective actors are more intensively engaged in pressing for accountability and reform in relation to the Public Distribution System (PDS), which provides subsidised basic food grain, than they are in relation to health services. Health reform over the last two decades has emphasised decentralisation, contracting out and public-private partnerships. Reforms have been carried out top-down, and provision is fragmented, with over 70 per cent of healthcare financed by individuals. By contrast, the PDS operates through a single point of provision – fair price shops, which are run by licensed private owners. This provides a clear focus for collective action and makes it easier to solicit support from local bureaucrats, since shopowners rather than officials are the main targets of such action. Since 2001 civil society groups in Delhi, organised under the Right to Food movement, have actively campaigned for PDS reform. Compared to collective actors around health issues, those targeting the PDS were more actively engaged, made more demands for public information (linked to the Right to Information movement), made more use of administrative and legal channels, and held more public demonstrations (Chowdhury, forthcoming).

Another strand of the research into neighbourhood associations as collective actors in Chennai, Bangalore and Delhi (Kamath and Vijayabaskar 2009; Coelho and Venkat 2009; Chakrabarti 2008) found that poor neighbourhoods shift their modes of making claims in response to reforms. Part-privatisation of service delivery, and formal recognition of neighbourhood associations in urban areas, have legitimised direct links between the associations and the bureaucracy. This has made poor citizens more likely to pursue claims by making demands on public officials through their neighbourhood associations, rather than through approaching political parties or patrons (as they did prior to the reforms).

“Formal links to enhance citizen ‘voice’ do not always operate in the wider public interest.”

However, formal links to enhance citizen ‘voice’ do not always operate in the wider public interest. Participatory mechanisms established under the *Bhagidari* programme in Delhi were initially restricted to the better-off ‘planned’ areas: this assisted resident welfare associations in those areas to capture increased amounts of public spending, and to make demands based on narrow class interests that disadvantaged the urban poor (Chakrabarti 2008).

Participation in policy reforms enhances subsequent collective action

The research shows that where collective actors are involved during significant moments of public reform, they are more likely to be able to influence the design of institutional mechanisms, and this allows them to remain engaged in monitoring implementation. This finding is important because it is often assumed that involvement by collective actors in policymaking will result in their co-optation by the state.

In Brazil, medical professionals including doctors and nurses from the Sanitarista public health movement pursued a long campaign for health sector reform, working with and within the public sector, and pushing for universal access, decentralisation and community participation. This allowed them to influence the design of institutions that gave them continuing access to reform processes, and facilitated their involvement in monitoring implementation. In Mexico, the women’s movement for reproductive health similarly drove the reform process from the start, and was thus able to help shape participatory mechanisms.

In India, the Right to Information (RTI) campaign was one of the main authors of the Right to Information Act that was passed in 2004. Once in effect, the legislation was used by an advocacy NGO in Delhi that had been part of the RTI campaign to demand accountability for failures of the PDS. This NGO was subsequently invited to take part in policy discussions over reforming the PDS. It remains to be seen whether they will be able to play an effective ongoing role, given that they were not involved during the initial stages of programme design (Pande 2008). In

Delhi, NGOs involved in lobbying for the Right to Education were invited to participate in the design of a universal elementary education programme (Mehtta 2008). This enabled them to play a role in implementation and monitoring, and gave them the detailed knowledge and legitimacy they needed to hold government accountable.

Social accountability can work for poor people

Efforts to improve service delivery through formal mechanisms of accountability – including elections and institutional checks and balances – often fail. Politicians may face weak electoral pressures to improve services; citizens have poor information about performance; policymakers lack effective ways of holding service providers accountable; horizontal channels of accountability through the legislature or an ombudsman work poorly. In such circumstances, collective action by or on behalf of poor people to demand accountability from policymakers and service providers may be effective. Groups exercising this kind of 'social accountability' lack the ability to impose formal sanctions, but they can have an impact by making the failures of government and service providers public, thus imposing reputational and political costs, and in some cases triggering formal accountability mechanisms (for instance through the courts, or an ombudsman). To be effective, such action needs to be targeted and sustained over a period of time, and groups need leverage – for example through access to information (Joshi 2008).

Social accountability works for poor people because collective action makes their numbers count, and demands can be framed in terms of legal or moral rights. It can offer a sharper, more targeted form of accountability than elections. It can also help address the issue of what standard of services ought to be provided, by highlighting deficiencies in existing provision or entitlements. Unlike formal accountability mechanisms that emphasise process and access to existing rights, social accountability can also focus on whether the outcomes are satisfactory, and press for improvements in standards of provision.

“Where collective actors are less engaged in social accountability there is little impetus for reform and delivery remains poor.”

Research in Delhi has highlighted the role of social accountability activities by local collective actors in helping to improve services. For example, mobilisation of poor people around the PDS and the exposure of corruption through public hearings has reduced corruption at the local level, and institutionalised some transparency within the system. Moreover, successful mobilisation in one locality has spread to other neighbourhoods through connected networks of collective actors. Where collective actors are less engaged in social accountability – for example, in relation to healthcare in Delhi – there is little impetus for reform and delivery remains poor.

Networks linking public and private actors are critical to shaping public policy, and network structures influence the way they interact with the state

Much of the debate about how to strengthen the capacity of poor and marginalised people to shape public policy has focused on formal institutions for citizen participation, either individually or collectively. These participatory institutions are often seen as key to providing a way of connecting under-represented groups in society with policymakers, and giving them a ‘voice’. Donor programmes tend to prioritise financial and management support for particular organisations. State and societal actors (including social movements and advocacy NGOs) are often portrayed as distinct, relatively autonomous entities (Houtzager and Castello 2009).

The CFS research calls into question important aspects of this narrative. Rather than focusing directly on participatory mechanisms and particular civil society organisations, the research starts with a detailed analysis of the networks of relationships within which public policymakers and civil society leaders operate. It finds that how state-society interaction plays out depends not just on the nature of public sector reform or on opportunities to participate through formal mechanisms, but on complex networks linking public and private actors. Moreover, the nature of civil society networks shapes the way they interact with the state.

Civil society networks and public-private relationships and alliances are very diverse, and rooted in both context and history. For example, the health movement in São Paulo goes back to the early 1980s, well before the ending of military rule: this helps to explain both its success in permeating state institutions (Houtzager and Dowbor 2010), and its strongly rights-based commitment to social and political reform (Dowbor 2008). The health network in India appears to have two distinct strands, with origins respectively in narrowly defined population programmes, and movements to promote general health and reproductive rights (Narayanan, forthcoming). The nature of networks is also influenced by broader political, social and cultural environments: Phase 1 of the CFS research, for instance, highlighted the different orientations of civil society organisations in São Paulo and Mexico City, linked to different configurations of state, church and political parties (IDS 2005: 24). In India, networks tend to be elite-led rather than organisation-led (Pande, forthcoming).

Researchers in São Paulo interviewed key individuals involved in debates on health and social assistance policy, and constructed the ‘issue networks’ of which they were the most important part. These networks were composed of people claiming to represent low-income service users, professionals and experts, trade union leaders, service providers and public officials.

The research found that:

i) People who occupied seats on the formal participatory councils covering health and social assistance were relatively marginal players in their respective issues networks. Although the councils have legally mandated budgetary oversight and decision-making powers, they were not found to be a critical channel for policymaking, or a space within which key players in health and social assistance networks operated.

ii) This did not result in a lack of connection between the state and actors representing poor and marginalised groups. Instead, the two issues networks permeated the state: members of the networks held key positions within the state – in municipal secretariats, the city assembly, and in state and federal government. This provided them with multiple formal and informal channels through which to influence policy. However, while the networks gave people access and influence, they did not capture decision-making processes; nor did they become clientelistic.

iii) Who is able to influence policy, and the strategies they adopt, depend on the internal structure of the networks. The health network in São Paulo is relatively horizontal and inclusive, providing multiple links between societal actors and policymakers. By contrast, the social assistance network is hierarchical, and bifurcated: a small number of well-positioned service providers control access to some parts of the state, while a distinct group of social assistance experts enjoys a high level of access to another part. User groups barely feature in this latter network at all.

"Professional groups played a strong role in influencing reform."

iv) Professional groups – public health professionals in the case of health, and economists in the case of social assistance programmes – played a strong role in influencing reform. This is unexpected as such groups are often portrayed as having vested interests in opposing public sector reform.

CFS research in Delhi also emphasises the importance of networks linking public and private actors, not just formal participatory mechanisms, in shaping reforms. In Delhi, research found that local actors who are linked into broader city-wide or national policy networks are more likely to engage in collective action, because they are better informed about policies and programmes, and better able to use networks to support their mobilisation and monitoring activities. As noted above, for example, in the PDS sector local organisations were able to use Right to Information legislation effectively because they were well connected to the RTI movement.

Moreover, just as different structures of health and social assistance networks in São Paulo affect their impact and strategies, so in India the nature of networks influences how they interact with the state. For example, the food security network in India has a very narrow policy interface with the state (limited to a handful of individuals), despite having a large mass organisation at the grassroots level. So the creation by the Supreme Court in 2002 of 'Commissioners' to monitor the implementation of interim orders relating to public nutrition programmes provided a key (formal) mechanism through which the small number of top leaders of the Right to Food movement could influence policymakers. This contrasts with the relatively marginal importance of health policy councils in São Paulo, where dense networks of civil society actors had multiple points of access to policymakers, and therefore less need of formal mechanisms.

Finally, the structure of networks, and the way they are linked to policymakers means that their influence is enhanced or diminished according to the changing fortunes of political parties. In India, for example, the health network linked to international organisations with a focus on narrowly defined programmes had more influence when the coalition led by the Bharatiya Janata Party (BJP) was in power; the network focusing on the right to health, by contrast, gained influence when the Congress-led coalition returned to power in 2004.

4.3 Conclusions and policy messages

The main research reported here was restricted to two sectors, and two large cities, employing common analytical frameworks and methodologies to maximise the chances of making some valid generalisations. However, these would need to be tested to see whether they hold in very different contexts – for example in rural areas, smaller cities, or in countries with lower levels of economic development and weaker political and institutional environments.

Nevertheless the research does offer some useful pointers for policymakers that may have wider relevance. Firstly, it underlines one of the core messages from the Phase 1 research: the importance of avoiding normative preconceptions, and of conducting open-minded, detailed inquiry into which collective actors are engaging in policy reform, and what factors enhance or impede their effectiveness. Even a comparison limited to two specific sectors in two big cities, both located in BRIC countries (Brazil, Russia, India and China), highlighted the complexity and diversity of state-society relations around service delivery, and the importance of history and context in shaping the way policy networks are structured and the opportunities for collective actors to influence them.

The second policy-relevant finding is that the way public programmes are designed clearly affects opportunities for collective action. This underlines the need to think about the impact of all public policy interventions on the ability and incentives of different groups to mobilise. For example

"Collective action that benefits poor people does not arise automatically from strengthening civil society organisations."

'choice' reforms such as the cash transfer programmes in Brazil and Mexico can undermine opportunities for collective action. Top-down reform, or very fragmented provision (for example, health sector reform in India) can also impede collective action. By contrast, the existence of the private licence-holder in the PDS case enabled public officials in Delhi to demand better performance without publicly criticising their own colleagues.

In São Paulo, participatory mechanisms which were an integral part of health and social assistance reforms have been important in shaping opportunities for collective action, although the issue networks that brought together civil society actors and policymakers in multiple, formal and informal ways proved to be more influential. This suggests the need for some caution, especially on the part of external actors, about their ability to engineer quick institutional fixes. What the research does emphasise is that collective action that benefits poor people does not arise automatically from strengthening civil society organisations – existing networks of actors will greatly influence whether (or how) strengthening particular organisations translates into greater capacity to shape policy, and on whose behalf. For example, strengthening organisations that are located on the margins of the network and have few relations to agents of the state is likely to have limited impact, whereas strengthening those central to the network and well connected to state actors is likely to produce far greater impact. Facilitating the formation of linkages between existing actors, and between them and agents of the state, may be particularly important. Investing in strengthening networks that have a strong vertical reach (from policymakers to the grassroots) might be a good strategy for achieving improvements in social accountability.

Finally, what is clear from all the examples of successful reform examined by the research is that fiercely protecting civil society autonomy is not the answer. In every case, broad-based alliances that crossed the public-private divide and brought together a range of key actors around common interests in reform – constructing a form of 'embedded autonomy' – were critical to success. One of the clearest examples comes from health sector reforms in Brazil during the early 1980s. These were underpinned by common interests between the military (supporting expansion of social rights), progressive technocrats in the bureaucracy (supporting rationalisation of services as a response to fiscal crisis), and the public health reform movement. Another example comes from the Right to Information movement in India that brought together a broad coalition across class and caste, including labourers, farmers, journalists, bureaucrats, lawyers, and social activists.

The research prompts more questions than it can answer, and some that it can only partially answer. For instance, the research does show that civil society organisations that are party to policy negotiations can also act as effective watchdogs of implementation; but it does not explicitly address the question of why in some cases they become co-opted and demobilised, and in others manage to retain their capacity to act independently. The research shows that the service delivery and social accountability roles of NGOs are not mutually exclusive, but not exactly why or under what conditions this is so. In some cases – for example health and social assistance in São Paulo – contracting out service delivery creates a new lobby of providers with an interest in pushing for more contracts, bigger budgets and higher wages, and thus in pressing for expanded coverage and greater benefits for their clients. But engagement in service provision could dampen the enthusiasm of collective actors for monitoring and accountability – this seems to have been the case with NGO health providers in Delhi. While further research can throw light on these questions, it seems likely that detailed answers and policy recommendations will have to be developed in a context-specific way.

“Who do civil organisations speak for when they are invited to participate in policy dialogue?”

One particularly critical set of questions arises from this strand of the research: who do civil organisations speak for, and with what authority, when they are invited to participate in policy dialogue or when they engage in social accountability?[6] What are policymakers to make of their claims to ‘represent’ the people they are working with and for? For example, in São Paulo, civil organisations often claim to ‘represent’ the interests of lower-income groups, when they speak or negotiate on their behalf in participatory governance fora. But (in contrast to political parties or labour unions) most of these organisations have no formal membership or mandates, and no accountability mechanisms based on elections. Their claims to representation are founded on their physical proximity to the groups they work with, their openness to participation, the fact that they are providing tangible benefits to those they claim to represent, and their mediating role in connecting excluded segments of the population to the state and political-electoral arenas (Houtzager and Gurza Lavalle 2010).

Such claims to representation should not be rejected out of hand. Where a poor minority has little relation to the state, associations do help to connect people to public officials and to providers of public services. Policymakers should be prepared to consider, in an open-minded way, how these kind of informal arrangements are really working before assessing their compatibility with democratic norms and processes. But they might want to encourage active participation in associations, and to pay more attention to ways of strengthening the accountability of civil society organisations to their constituencies (for example through formal membership arrangements and mechanisms for debating and adopting

6 This was also addressed during Phase 1 of the research: see ‘Signposts to More Effective States’ (IDS 2005: 31–2).

policy positions). This could help increase the accountability of civil society organisations when they engage in policy negotiations, increase their credibility and their access to policymaking processes (because they can 'deliver' their publics), and increase the potential for poor people, operating as citizens, to gain access to the state and to public services.

5 'Traditional' local governance: problem or solution?

5.1 Introduction

The abolition of 'traditional' authority[7] was a major objective of independence movements in much of the developing world. 'Traditional' institutions – including individual chiefs in much of Africa, chiefs, kings or traditional councils in the Pacific, and landlords responsible for collecting land revenue in most of South Asia – had been powerful intermediaries between ordinary citizens and colonial rulers. 'Modernisation' and 'development' meant bringing ordinary citizens into a direct relationship with modern government bureaucracies and political parties.

Many of these 'traditional' authorities were indeed outlawed or significantly weakened. But their influence has proved surprisingly persistent. And in recent years the ideological pendulum has swung back. 'Traditional' authorities in Benin, Bolivia, Cameroon, Congo, Côte d'Ivoire, Fiji, Ghana, India, Mozambique, Namibia, Niger, Rwanda, Somaliland, Tonga, Uganda, Zambia and Zimbabwe have been legally recognised and given consultative or administrative roles, especially at local government level.

7 The quotation marks around 'traditional' are used to indicate that claims by leaders and institutions to be traditional should not be taken at face value: traditions may be re-invented to bolster legitimacy and are continually being reshaped by interaction with 'modern', formal institutions.

In some cases, the immediate motive has been the need to placate particular ethnic groups. But the main factor underlying this official revalidation of 'traditional' authority has been prevalence of broad governance problems. As governments based in capital cities have struggled to establish legitimacy and authority, they have seen cooperation with 'traditional' institutions as a way to bolster their own position and to co-opt potentially powerful opponents. In situations of violent conflict and state collapse, international actors have also viewed 'traditional' authorities as a useful source of local political stability. DFID supported efforts to re-establish the authority of 'traditional' chiefs in Sierra Leone during the conflicts there. In contemporary Afghanistan, Western forces have tried to recruit 'traditional' tribal militias (*arbakai*) to provide security at the local level.

“Is active support for and cooperation with 'traditional' authorities a sensible policy?”

Is active support for and cooperation with 'traditional' authorities a sensible policy? Does it help create effective, legitimate and accountable public authority? Or does it empower exploitative local elites, violate basic principles of modern citizenship and accountable, representative government, and ultimately impede the task of state building? In situations of crisis, like contemporary Afghanistan or Sierra Leone in the 1990s, these questions become urgent. But a large number of contemporary governments actually face similar choices on a routine basis. Should they ignore 'traditional' authorities, try to repress them, or actively use and collaborate with them?

In practice, governments often do all three. For example, in rural India, the police liaise with informal village councils over the treatment of crimes, while the courts occasionally prosecute those same village councils for illegally sanctioning wrongdoers, and most official agencies pretend that they simply do not exist. Development agencies adopt similarly contrary positions when they condemn 'traditional' institutions for their gender and other sociocultural biases, but simultaneously support their activities under the label of 'alternative dispute resolution mechanisms'.

Much of the time, the actual relationships between traditional authority and modern state institutions are determined informally and locally, with a strong bias toward continuity. The explicit debates that do impact on the occasional formal policy change often polarise around conflicting attitudes, ideologies and world views, and are rarely grounded in research. The case for tolerating or actively supporting traditional authorities may range from a pragmatic acceptance of reality to a militant belief in their unique capacity to represent and protect local culture. Opponents tend to view them as a step in the wrong direction: the antithesis of contemporary norms of governance and citizenship.

"There is no right, general position for or against 'traditional' institutions."

There is no right, general position for or against 'traditional' institutions: policy recommendations have to be very context-specific. But there are ways of reframing the debate to make it more objective and policy-relevant. Above all, the language of 'traditional' institutions/authority is counterproductive. It is diversionary because it immediately elicits prejudices for or against the opposed concepts of 'tradition' and 'modernity'. It is misleading because so-called 'traditional' institutions vary widely in the depth of their historical roots and in the extent to which they have adapted to – and are compatible with – other political institutions, including formal state institutions.

These conclusions emerge from a comparative research project that the CFS has undertaken over the past seven years on the workings of 'informal local governance institutions' (ILGIs) in Karnataka and Rajasthan in India, and in Punjab province of Pakistan (Mohmand *et al.* forthcoming). The research explores the social value of ILGIs: how are they structured, how do they interact with the formal state, and what are the outcomes for poor people? And it asks how their performance is shaped by their history – both the extent to which they are rooted in institutions of direct or indirect colonial era rule, and whether they are changing in response to a changing social and political environment.

Key findings

- *ILGIs in South Asia are persistent, and influential. Efforts to improve local governance need to take account of them.*
- *They can provide public goods and services, and connect the rural poor to the formal state. But they can also entrench the interests of dominant groups and perpetuate poverty.*
- *They can work in ways that complement and/or compete with the formal state.*
- *Although ILGIs are universally termed 'traditional' by the people to whom they matter, the extent to which they are rooted in history varies widely.*
- *Current differences between ILGIs are closely related to their origins in colonial era institutions of direct and indirect rule. The more directly they are descended from systems of indirect colonial rule, the worse they govern today. The more they have been reshaped in interaction with more pluralistic, democratic, inclusive formal institutions, the more likely they are to meet acceptable governance standards.*

5.2 What are informal local governance institutions?

ILGIs are less prominent in South Asia than in sub-Saharan Africa, where indirect colonial rule was more extensive, and formal authority was almost always delegated to individual chiefs, including the authority to allocate land rights. Most ILGIs in South Asia receive no formal recognition from the state, and villagers themselves are often reticent about their activities. Yet in the areas covered by the CFS research ILGIs clearly play an important day-to-day role in the lives of villagers, as well as influencing public policy.

ILGIs in Karnataka, Rajasthan and Pakistani Punjab take different forms. In Karnataka, for example, village councils are composed of leaders of local caste groups, while in Pakistani Punjab an individual landowner often exercises informal authority. But they share some broad characteristics. They resemble states in that they exercise authority over an entire locality, including the whole locally resident population, and undertake a broad range of activities including resolving disputes and organising social and development activities. Unlike states they do not have revenue-raising powers, but do collect funds for particular purposes. Their relations with the formal state are ambiguous, variable and often contested. However, they play an important mediating role between ‘their’ populations and the outside world, and this role is becoming more important with the extension of local electoral democracy, and increasing availability of local development funds.

Typical ILGIs in Karnataka contrast particularly strongly with those in the Pakistani Punjab. Sections 5.3 and 5.4 below give more detail on each case. In Karnataka, where colonial rule was relatively direct, post-independence governments implemented progressive policies including land reform and local electoral democracy. ILGIs have been substantively reshaped through interaction with more pluralistic, democratic formal governance institutions. By contrast, in Pakistani Punjab, while ILGIs have evolved to some extent, they remain largely rooted in colonial practices of indirect rule, with authority concentrated in landowning families and kinship groups.

5.3 Informal local governance in Karnataka

The research built on CFS Phase 1 work[8] in 30 villages in three districts of Karnataka, and extended it to a further 26 villages (Ananth Pur and Moore 2010). It confirmed that informal village councils are actively engaging with formal, elected councils (*Gram Panchayats*). They are moving beyond traditional roles of resolving disputes and regulating social relations within the village. They are becoming more active in seeking access to public funds, influencing decisions about development projects, and raising matching contributions. They are also influencing elections to the Gram Panchayats: leaders and members of the informal village councils are standing for election or seeking to influence nominations. Far from being eclipsed by the elected panchayats, informal councils appear to have been stimulated by them: the research shows, for example, that informal councils tend to be more active when they are

8 For a summary see ‘Signposts to More Effective States’ (IDS 2005: 25–7).

located close to Gram Panchayat headquarters.

This increased activism could be negative if it were merely a way of furthering elite interests. But the evidence suggests that, while informal councils can be repressive and exclusionary – especially when dealing with affairs internal to the village – they are playing effective roles in representing the needs of villagers to higher levels of government, in negotiating and mediating interests with the Gram Panchayats, and in monitoring their performance. For instance, in villages where informal councils are most active, the levels of awareness and satisfaction with Gram Panchayat programmes are also relatively high. Women are more enthusiastic about informal village councils than men, and illiterates more than literates.

> **"Women are more enthusiastic about informal village councils than men, and illiterates more than literates."**

Informal village councils are also widening their basis of recruitment. Elected male members of the Gram Panchayats have been co-opted to sit on the informal councils in most of the study villages, reflecting the emergence of a new type of younger leader, whose power is rooted in their education and ability to mediate between villagers and outside actors, sometimes independently of their caste identities. However, Dalits are still mainly excluded, and women completely so. Though rooted in caste, decision-making of informal village councils is mostly consensual and transparent; meetings are public and follow clear procedures.

A number of factors help explain this broadly positive picture. Informal village councils do not control access to land and other valuable assets, so their opportunities for abuse of power are limited. Indeed informal councils are highly accountable over financial issues, presenting detailed accounts annually to a general village assembly. Moreover, informal councils face a pluralistic, competitive environment in which villagers have options: for example, they can take disputes to the police or formal courts if dissatisfied with informal dispute resolution mechanisms. When they attempt to influence the membership of Gram Panchayats by organising uncontested elections, they do so partly to save on the high costs of contested elections. They may have to compete with local representatives of national political parties, who favour electoral contests. The research shows that those informal village councils that invest the most effort in organising local meetings to achieve consensus on nominees are the most successful in having their nominees elected. Leaders and members of informal councils need to work hard to earn the trust of villagers, and actively retain their support. The increasing shift towards a more collective, externally oriented role for informal councils is also helping to make them more pluralistic and inclusive.

5.4 Informal local governance in Pakistani Punjab

Punjab province in Pakistan has high levels of social and economic inequality. ILGIs there are dominated by a landowning elite established during colonial land settlement processes in the late nineteenth and early twentieth centuries. They have remained powerful despite land reform legislation and local government electoral reform. Politics in Punjab is less competitive than in Karnataka, and heavily based on personal connections. ILGIs in Punjab revolve around the village head: this can be an individual large landowner, a group of men from landowning lineage groups, or an informal council of male heads of socially dominant families. They mediate relationships between villagers and the state, facilitating access to services, government departments, police and the courts. Authority is exercised in highly personalised, non-transparent ways. Compared to Karnataka, ILGIs in Punjab are more inward-looking, focusing on internal village affairs, including controlling access to jobs, regulating relations between different groups, and resolving disputes. They do however play a major role in influencing voting patterns.

Overall, while they have evolved to some extent, ILGIs in Punjab remain largely hierarchical and exclusionary, and relations with the formal state are competitive rather than complementary. But the research did identify important differences among them (Cheema and Naseer 2010). Within Sargodha district these differences are closely related to different land tenure systems established under colonial rule, with resulting differences in socioeconomic structures and informal governance (details in Section 5.5 below). Especially striking is the impact of such differences on economic mobility. The research looked at educational attainment across three generations as an indicator of economic mobility, and found it closely related to a household's historic social position, with historically depressed social groups doing much worse than the rest and continuing to diverge from them. Moreover, historic village-level institutions and socioeconomic structures affected inter-generational mobility. Mobility was higher across all social groups in villages where land inequality was less and authority was more horizontally distributed, compared to villages with greater historic inequality, a larger proportion of landless tenants, and more hierarchical social and governance structures.

> **"The more closely ILGIs remain rooted in the practices of indirect colonial institutions, the worse they govern."**

5.5 Explaining the diversity of informal local governance in South Asia: the legacy of direct and indirect rule

As already noted, the research found considerable diversity among ILGIs in terms of their structure, process and outcomes. There are broad and quite stark differences between Pakistani Punjab at one extreme and Karnataka at the other (with Rajasthan somewhere in between). There are also significant variations within states, provinces and districts, and even between ILGIs in neighbouring villages. There appears to be a close correspondence between the form of colonial era rule (more direct rule in Karnataka, and more indirect rule in Punjab) and the nature of contemporary ILGIs. This suggests a broad hypothesis: the more closely ILGIs remain rooted in the practices of indirect colonial institutions, the worse they govern (judged by their ability to provide valued collective goods and services, and to operate in relatively pluralistic, consensual and transparent ways). Conversely, the more they have been reshaped in interaction with more pluralistic, democratic, inclusive formal institutions, the more likely they are to meet acceptable governance standards.

A more detailed look at the impact of direct and indirect rule in British India provides evidence to support this hypothesis, and helps to explain the causal mechanisms involved. CFS research findings are also in line with those of other scholars who have studied the impact of colonial era rule in Africa and elsewhere.

Indirect rule was characterised by a small bureaucratic central state that had very limited capacity to control the territory. Colonial rulers governed through a chain of hierarchical relationships, giving sub-national elites extensive, largely unchecked authority over local populations. This included rights to collect taxes, maintain law and order, adjudicate disputes and (especially in Africa) allocate land. Indirect rule created a system of decentralised petty despots, organised along patrimonial lines but with little accountability to local people, and with limited supervision by the central state.

By contrast, *direct rule* involved an integrated state more on West European lines, with centralised, bureaucratic, legal-administrative institutions directly controlled by colonial officials. Scholars of British colonial rule (notably Lange 2009) demonstrate that direct rule had a much more positive effect on broad-based development than indirect rule. Direct rule created bureaucratic capacity, 'infrastructural' power to provide developmental goods throughout the territory, and more inclusive state-society relations.

In South Asia there was a broad distinction between 'directly ruled' British India, and the 'indirectly ruled' princely states. But there was also considerable variation within British India, with more direct/indirect rule rooted in the land revenue system. This ranged from very indirect systems (common in Punjab) where responsibility for collecting revenue was delegated to local notables, to surprisingly direct systems where the agent of the formal state was charged with collecting land revenue from individual owners – based on detailed, written land records (common in South India).The less direct the revenue relationship, the more the overall governance system was 'indirect'.

In Sargodha district of Pakistani Punjab current variations between ILGIs correspond closely to different land tenure and revenue systems established under colonial rule. There are two main types.

Land revenue systems in British India

These varied significantly between locations and over time, the core models including:
- *Indirect systems, where revenue collection was delegated to local notables (often known as the* zamindari *system).*
- *Indirect systems, where land was allocated to groups with total or partial revenue exemption, and where cultivators had no direct relationship with the state.*
- *Direct systems where the state bureaucracy collected revenue direct from the owner (often known as the* ryotwari *system).*
- *Intermediate systems, where the obligation to pay land revenue was attached to rights in land and assigned jointly to members of a group, typically a lineage or family. Depending on the composition of the group (ranging from a collective of cultivators to an individual), these arrangements could be more or less direct (resembling ryotwari or zamindari systems respectively).*

i) So-called 'proprietary villages' where rights were granted to an individual or family, with all authority vested in landlords to mediate the relationship between cultivators and the state. Here contemporary ILGIs are hierarchical, hereditary, and narrowly based on the authority of an individual or family (although there have been limited changes).

ii) So-called 'canal colony' or 'crown estate' villages, where authority was vested in the semi-formal office of a village headman (or *lambadaar*) chosen among larger established landowners, with relatively direct relations with villagers. Here there is a lower level of land inequality, and authority structures are more horizontal.

Current variations between ILGIs in Karnataka also reflect their origins in different systems of direct and indirect rule. Out of the 26 villages that were studied under the Phase 2 research, 19 are formerly *ryotwari* (direct revenue systems) and 7 are formerly *zamindari* or *jagirdari* (indirect). The ILGIs in the ex-ryotwari villages are less successful in tapping external funding sources, but function in a more pluralistic way and are much more active in undertaking self-funded development activities.

5.6 Conclusions and policy messages

ILGIs in South Asia are persistent, influential and have an important impact on the daily lives of poor people in rural areas. Efforts to improve local governance need to take account of them. But how? Echoing the broader question underlying all the CFS research programmes, should policymakers see such informal institutions as part of the problem, or part of the solution?

"Whether ILGIs should be valued because they offer benefits to poor people or opposed because they perpetuate poverty depends on what the alternatives are."

The research moves discussion away from the emotive issues associated with 'traditional' institutions, and offers a more neutral approach to thinking about the bewildering diversity of informal local governance. In terms of our drawing analogy, it helps close off unhelpful models and assumptions. The hypothesis – that ILGIs' performance today is linked to their colonial era origins and subsequent history – chimes with the findings of other scholars about the negative impact of indirect forms of colonial rule on subsequent development outcomes in Africa and elsewhere. It provides an objective basis for undertaking an initial assessment of the characteristics and likely impact of very different kinds of informal local governance arrangements.

There is no easy or automatic link between such an assessment and specific policy recommendations. Whether on balance particular ILGIs should be valued because they offer benefits to poor people in their area, or opposed because they perpetuate poverty depends on what the alternatives are. However the finding that current, unequal development outcomes in Punjabi villages are strongly influenced by historic land settlement patterns does help explain a long-standing development puzzle in Pakistan: the persistence of very poor human development indicators despite relatively good economic growth and high levels of development aid. The findings also point to the need for more intelligent targeting of development efforts and offer a practical starting point: the Punjab planning department has commissioned follow-on research with the specific objective of better understanding 'backward' villages and addressing their needs.

More tentatively, the research provides insights into how democracy actually works at a very local level in Punjab, which might indicate ways to improve the impact of the 2001 local government reforms. Instead of relying on electoral competition at the union level to improve effective allocation of development resources, there may be a case for more targeted approaches supported by evidence-based planning to give greater weight to equity considerations.

The research findings can also help policymakers follow 'Do no harm' principles. For example, there is a real risk that superficial assumptions about so-called 'traditional' institutions will lead to them being incorporated into formal governance arrangements in inappropriate ways. The 1996 Panchayats (Extension of the Scheduled Areas) Act in India formally recognises 'traditional tribal institutions' as the lowest level of formal governance in areas populated mainly but not exclusively by members of Scheduled Tribes. The implementation process remains fraught, not least because this legislation formally excludes from participation or representation in local government the significant proportion of people not registered as 'tribal'. Similar risks apply to proposals to incorporate traditional institutions into formal governance structures in Afghanistan without detailed, objective assessment of how they actually operate and affect the daily lives of poor people.

To end on a positive note: while research findings from Punjab and Rajasthan highlight how persistent institutional legacies can be, the findings from Karnataka show that ILGIs can change relatively rapidly if the external political and administrative environment changes. Post-independence reforms in Karnataka (which included early moves towards decentralisation, reinforced by the 1992 Panchayati Raj legislation) have shifted incentives and opportunities for informal village councils. They are providing an effective link between poor rural communities and the formal state, and actively contributing to building new forms of public authority.

6 Tax bargaining and managing the resource curse

6.1 Introduction

Phase 1 of the CFS research argued that taxation matters fundamentally for governance: tax bargaining between the state and its citizens to create a social fiscal contract is central to building effective and accountable public authority (Moore 2007). The research has sparked widespread interest among international donors, NGOs and (most strikingly) politicians and senior tax officials in Africa.

The Phase 1 findings were based on the historical experience of countries in Western Europe, some contemporary evidence from developing countries, and evidence that countries not dependent on citizens for taxation govern badly (the so-called 'resource curse'). Phase 2 of the research has tested these findings in finer detail, tracing the links between taxation and government accountability and responsiveness in Ghana, Kenya and Ethiopia. It has also looked at the reverse situation, where governments enjoy 'windfall' revenues from the export of oil, gas and mining products. Specifically, it has compared the recent experience of governments in Ecuador, Bolivia and Peru in managing huge increases in non-tax revenues.

Development policymakers have long seen public financial management as central to economic and social development – albeit with an emphasis on expenditure rather than revenue-raising. The CFS research highlights the importance of both for governance. It shows: how sources of revenue shape the interests of political elites; how processes of bargaining with taxpayers can increase government accountability and responsiveness; how pre-existing institutions and the political context shape the way governments manage booms in natural resource revenues; and why formal mechanisms (such as decentralisation and revenue-sharing arrangements) will not work well if they take insufficient account of that context.

6.2 Taxation and accountability in Ghana, Kenya and Ethiopia

Key findings

- *The contemporary experience of Ghana, Kenya and Ethiopia provides clear evidence of a broad causal mechanism linking government reliance on taxation with pressures for increased responsiveness and accountability. Within this broad mechanism, three more specific causal processes were identified:*
  - *i) direct **tax bargaining** with citizens, which led to particular episodes of political reform;*
  - *ii) **tax resistance** by citizens in response to unpopular governments, which created more indirect pressures for change and subsequent reform;*
  - *iii) **taxation as a catalyst** for strengthening civil society organisations, and encouraging mobilisation around broader common interests.*
- *Political context and other contingent factors shaped these processes. In Ghana, a more open political system facilitated direct bargaining over taxation. In Kenya and especially in Ethiopia, overt public action was much more muted but resistance to taxation by unpopular governments created indirect pressures for change*

(Prichard 2009 and forthcoming)

The history of Western Europe, and especially of Britain in the seventeenth, eighteenth and nineteenth centuries, provides the clearest evidence that state-society bargaining over taxation helps strengthen government capacity, accountability and responsiveness to citizens. The British monarch faced a direct challenge from taxpayers and bondholders who sat or were represented in parliament. The situation in poor countries today is very different and much less clear-cut. Governments do not face the kind of external threats that historically gave rulers and ruled strong common interests in bargaining over taxation. Taxpayers are more diverse, with fewer shared interests; and taxpayers are commonly also beneficiaries of government spending or employment. Many governments have alternative sources of revenue from natural resource rents and aid.

Nevertheless, the research shows that in all three cases – even in the very closed political environment of Ethiopia – government reliance on taxation has created pressures for greater accountability and responsiveness to citizens.

Ghana

A review of the period 1981–2008 shows that people's willingness to pay tax was closely linked to their perceptions of government. Governments were able to expand taxation with little overt political opposition while they enjoyed broad public support. Examples include the PNDC government in the early stages of the revolution, despite coercive tax collection, the NDC government after the ending of an opposition boycott of parliament in 1996, and the newly elected NPP government in 2000, which achieved dramatic increases in public revenue. Conversely, taxation became more contentious and difficult when political conflict peaked following contested elections in 1992, and when the NDC government lost political support in the late 1990s.

"There were clear episodes of explicit bargaining around taxation which strengthened government accountability."

In addition to this implicit bargaining, there were clear episodes of explicit bargaining around taxation which strengthened government accountability and helped fuel the movement for political liberalisation. These included tax protests by small traders which were an early sign of popular resistance to the PNDC regime. Most tellingly, two critical political moments for the first NDC government both centred on taxation. A public outcry over petroleum tax in 1993, and major protests that forced the government to withdraw the introduction of VAT in 1995 both helped to provide the impetus for a more inclusive and open parliament after 1996.

Tax bargaining also directly increased government responsiveness. Government moves to increase VAT rates in 1999 and 2003 caused strong public protests. In both cases government responded by agreeing to commit all new tax revenues to specific, popular social programmes, leading to the creation of the Ghana Education Trust Fund and the National Health Insurance Scheme. The result was some increased oversight of the funds (despite limitations and controversies surrounding earmarking as a fiscal practice).

Conflicts over taxation catalysed the formation or strengthening of civil society groups which have contributed to improvements in governance more broadly. The Committee for Joint Action, founded in the aftermath of the 1995 anti-VAT protests, subsequently broadened its focus to become an organiser of mass public mobilisation around issues of political liberalisation, corruption and poverty reduction. The primary driving factor in the expansion of the Association of Ghana Industries (AGI) after 1991 was an effort to get tax-compliant firms exempt from upfront payments of VAT. The new political assertiveness of the AGI persisted far beyond the initial advocacy campaign.

Kenya

The story in post-independence Kenya is much more complex than in Ghana. There has been relatively little overt conflict over taxation, and even less evidence of specific episodes of tax bargaining. This is surprising because the tax take in Kenya is the highest in the region, and Afrobarometer surveys show that Kenyans are more hostile to unfair taxation than Ghanaians.

There have been some examples of direct tax bargaining and conflict over taxation. There was a failed attempt by transport operators to mobilise against the Road Maintenance Levy (first introduced in 1994 and earmarked for roads, thus attracting some public support). The United Business Association (UBA) led opposition to the introduction of electronic tax registers in all VAT-registered shops, but the government made no concessions (and the UBA attracted the label of 'Asian tax evaders' despite being led by an African). There was some narrow elite bargaining through which MPs won concessions from government over the introduction of capital gains tax and taxation of MPs' benefits.

Overall, however, what is striking is the lack of resistance to the introduction of highly visible income and corporation taxes, and to broad-based taxes on fuel and VAT (this despite the fact that VAT was introduced during a period of considerable political turmoil prior to the 1992 election).

There are several reasons why tax bargaining in Kenya has been so muted. One is that, until 2003, Kenyan politics were relatively closed and repressive. Yet there are no major examples of tax bargaining after 2003 despite big increases in revenue collection. This suggests another explanation – that Kenya has a long tradition of relatively effective tax collection, and successive governments have employed careful political strategies in introducing new taxes, implementing gradual 'reform by stealth'. A further factor has undoubtedly been the racial divisions in the country: the economically dominant Asian and European minorities are excluded from politics and unable to mobilise widespread political support. They have therefore pursued narrow, exclusive interests in relation to taxation.

"The popularity and perceived legitimacy of successive governments has shaped their ability to raise revenue."

Yet the absence of discrete episodes of tax bargaining does not mean that taxation has not stimulated increased responsiveness and accountability. As in Ghana, the popularity and perceived legitimacy of successive governments has shaped their ability to raise revenue. The fiscal weakness of unpopular regimes has added to the pressure for change. For example, from the mid-1980s onwards the Moi government had increasing difficulty in raising revenue. However the 1992 elections increased its legitimacy, leading to a dramatic period of tax reform and a big surge in revenue collection. But in the late 1990s revenue fell rapidly following a controversial election in 1997. Although much of the decline was due to an economic crisis, it was also the result of explicit efforts by businesses aligned with the opposition to evade existing taxes, resist new taxes and weaken the fiscal position of the state. This helped precipitate the defeat of the Moi government in the 2002 election. The new NARC government increased political openness and made tax reform a major priority, seeking explicitly to link improved tax compliance to success in increasing political freedom and expanding popular social programmes.

There is also some evidence that taxation has provided an important basis for the development of business associations, including small and medium enterprises (notably the United Business Association) and the informal sector. More recently, the Centre for Governance and Development in Kenya (CGD) decided to participate in founding the National Taxpayers Association, with the explicit goal of linking tax advocacy to expenditure monitoring. The message that paying tax can be a basis for making claims on government has resonated well with the public, notably in relation to monitoring expenditure under the Community Development Fund.

In summary, while political debate and conflict around taxation has been relatively rare in Kenya and there are few examples of explicit tax bargaining, it seems clear that taxation has been a significant (if not decisive) indirect stimulus for the expansion of responsiveness and accountability. A telling recent example of the way government reliance on tax revenues shapes its behaviour came with the 2007–08 post-election crisis, the economic costs of which were directly felt by the political elite. The business community used its status as taxpayers to call for an early resolution of the political impasse, and explicitly threatened to withhold tax revenues if the government failed to comply.

Ethiopia

Ethiopia presents a sharp contrast to Ghana and Kenya. It offers strong evidence historically of the importance of tax bargaining in broader state building. During the imperial period (1855–1972) conflict over taxation became a catalyst for political change; systems of feudal administration were replaced by central bureaucracies. But the experience of Ethiopia had more in common with that of Eastern Europe than of Western Europe. Landlords and the church retained authority at a local level, and resisted taxation; coercive administration through the landed nobility became entrenched and the central state had only an indirect relationship with the majority of the population. The outcome was not a tax bargain leading to broad-based accountability, but revolution.

Today Ethiopia remains autocratic, lacking political openness and competitive politics. Under the Derg (1974–91) government control was so strong that public opinion had little bearing on revenue-raising (although fiscal weakness did contribute to its collapse). Under the successor EPRDF government there was a degree of political liberalisation, especially between 2001 and 2005, and the nationalised economic system was dismantled. The government undertook tax reform, and there was a rapid increase in revenue. Yet there was little public response: this was especially striking in relation to the introduction of VAT that affected the majority of the population. Nor was there significant public reaction to enforcement of trade, income and sales taxes.

One exception – and a rare example of tax bargaining – was the introduction of a presumptive tax on business, which provoked public outcry, especially in the Amhara region. Government responded by setting up a commission to study the broader fairness of the tax. Following the contested 2005 elections, government reduced rates for the presumptive tax, expanded participation in the assessment process, and created new forums for public consultation about tax collection and expenditure. It also relaxed compliance more generally, resulting in a rapid decline in the overall tax take.

Yet public discussion of taxation is still rare. There is no organisation of business associations or civil society groups in response to taxation. The political opposition claim that tax was not a major issue, either before or after the 2005 elections. While the government's retreat over taxation in 2005 suggests that they saw it as significant in shaping public opinion, the resulting fiscal squeeze did not lead to a change of regime. From 2008, as political turmoil subsided and with the opposition weakened, government stepped up the revenue effort accompanied by more aggressive enforcement – with no overt public reaction.

So the picture presented by Ethiopia is mixed. It is clear that taxation offers no easy, short-term route to increasing government accountability and responsiveness, especially in a closed political environment. There is also some evidence that high levels of aid to Ethiopia have helped erode government's incentives for revenue bargaining. Nevertheless, public perceptions of government have shaped its ability to raise revenue; and recent moves to increase consultation and transparency of tax collection represent significant gains, given the broader context. As was the case in both Ghana and Kenya, reliance on taxation has indirectly shaped the behaviour of government, even without overt public protest or explicit bargaining. This could contribute to quiet political change over the longer term.

“Reliance on taxation has indirectly shaped the behaviour of government. This could contribute to quiet political change over the longer term.”

In summary, these three case studies present clear evidence of:

i) explicit tax bargaining leading to increased accountability and responsiveness from government (notably protests over VAT in Ghana, and over presumptive tax in Ethiopia);

ii) tax resistance that indirectly created pressures for change, and incentives for further reform (notably following the 1997 elections in Kenya, contributing to a fiscal crisis and a change of government in 2002);

iii) taxation as a catalyst for broad civil society mobilisation. Here the role of taxation in mobilising business associations could be particularly significant, if tax provides a basis for mobilisation away from exclusive rent seeking to more broadly-based engagement around common interests, with the potential for productive outcomes.

6.3 Implications for tax reform and aid management

There is already substantial, ongoing work among international donors (notably within the DAC) to consider the links between taxation and state capacity, accountability and responsiveness. The broad message is to recognise that taxation is not just a fiscal issue, but is of central importance for governance. More specifically, the work on tax-governance linkages has stimulated donor support for the African Tax Administration Forum, contributed to debate about the impact of aid on domestic accountability, and stimulated a more detailed look at priorities for tax reform (OECD forthcoming, a).

The ongoing DAC work on tax reform, partly inspired by the CFS research, provides a good example of the practical implications of 'turning the picture upside down'. The overall message is to pay much more attention to the political dynamics of tax reform and tax collection, with sensitivity to the particular country context. Moreover, recommendations emerging from the CFS research suggest that instead of going for technocratic, politically low-key approaches aimed at increasing revenue mobilisation in the short term, policymakers should be bolder in addressing politically difficult issues that can contribute to more productive bargaining, increased tax compliance and improved accountability and responsiveness in the longer term.

"Policymakers should be bolder in addressing politically difficult issues."

Specifically, equity is seen to be a key issue, including more focus on personal income and property taxes as well as more equitable enforcement – all of which could increase public perceptions of fairness, and therefore improve compliance. How tax is collected matters, not just how much: efforts to reduce arbitrary and coercive collection, including at a local level, deserve priority, as do measures to increase public awareness and transparency over collection and use of tax revenues, and improved taxpayer services. Stronger linkages between taxation and public expenditure are critical, and could include earmarking in some circumstances.

Constructive tax bargaining requires effective mobilisation by civil society actors pursuing broad-based common interests rather than narrow, exclusive benefits. So support for more inclusive business associations to organise around collective tax concerns could be important, as could support for taxpayer associations pursuing a broad-based agenda. Finally, international donors in particular should prioritise action at a global level to curb the use of tax havens, and tax evasion by OECD individuals and businesses.

6.4 Managing natural resource revenues

Many poor countries have seen huge increases over the last decade in revenues from the export of oil, gas and minerals. This provides a significant opportunity to reduce poverty and inequality, but spending has often been unproductive, while competition for resources can unleash new social and economic conflict.

The CFS research explored the contrasting experiences of Ecuador, Bolivia and Peru in managing the boom in natural resource revenues (mainly from oil, gas and minerals respectively) between 1995 and 2008. It looked at the formal political and institutional arrangements in place before the commodities boom and analysed their impact on the strategies adopted for allocating and managing natural resource revenues.

Key findings

- *Effective formal state institutions (including functioning political parties, and effective decentralised governments) can help mitigate the 'resource curse', but introducing mechanisms for managing natural resource revenues (through decentralisation, earmarking or independent oversight bodies) will not work well if they are not embedded in the political and institutional context.*

(Arellano-Yanguas 2008; Mejía Acosta forthcoming; Albornoz and Mejía Acosta forthcoming; Barrantes *et al*. forthcoming; Laserna *et al*. forthcoming; Prichard 2009 and forthcoming)

In Peru the commodities boom started shortly after the country's return to democratic politics in 2001. Peru adopted orthodox policy prescriptions advocated by the international financial institutions (IFIs) and others, including an ambitious programme of political and fiscal decentralisation. Revenue-sharing formulas automatically transferred a significant part of mining tax revenues back to mining and non-mining areas. However, at the local level, politics were competitive but fragmented, lacking strong political parties or well-defined regional interests. Although there was competent central management of public finances, poor coordination between national, regional and local levels undermined attempts to improve revenue management – for example through decentralised participatory budgets. Public-private partnerships with mining companies created new political actors and interests at local level, making coordination more difficult and giving rise to new sources of conflict. Local governments lacked the capacity to manage the huge increases in revenue resulting from the system of automatic transfers

> **“In the case of Peru, following ‘best practice’ advice exacerbated pre-existing political, social and institutional problems.”**

(some mining districts saw a tenfold increase). So, in the case of Peru, following ‘best practice’ advice exacerbated pre-existing political, social and institutional problems, and appears to have resulted in patterns of poor-quality spending, growing socioeconomic inequalities between regions, and the spread of social conflicts both in mining and non-mining areas.

By contrast, Bolivia had a long tradition of managing natural resource rents from the mining sector, pre-dating the advent of the current commodities boom by several decades. This consolidated the role of the state as the main provider of goods and services to citizens. The predominance of the central state was reduced after 1994, when a new Popular Participation Law gave sub-national governments – including elected municipal councils – a substantial degree of fiscal and administrative autonomy from central government.

Fiscal revenues (mainly from the export of gas) more than doubled between 2003 and 2008, and triggered immediate demands for redistribution from well-organised regional political actors, including municipal and regional governments. Although in 2006 president-elect Morales had a majority of the popular vote, a cohesive Cabinet, majority support in Congress and at provincial and municipal government level he nevertheless had to engage in bargaining with local authorities over the allocation of natural resource revenues (for example to establish a national cash transfer programme). So in this case the potentially damaging effects of large natural resource revenue inflows were mitigated by a system of vertical checks and balances that reduced the space for corrupt, discretionary spending.

Ecuador has been an oil exporting country since the 1970s. In the late 1990s it undertook important decentralisation reforms, including the transfer of 15 per cent of government spending to sub-national governments. However, there was no explicit provision to include oil revenues as part of these transfers. The boom in oil prices led to dramatic increases in fiscal revenues (by 167 per cent) between 2001 and 2008. In the absence of an explicit revenue-sharing formula, presidents were able to re-centralise control over the new streams of revenue, and to establish central government as the main gatekeeper for accessing public funds. Preliminary findings suggest that municipalities largely escaped the negative effects of large revenue transfers, but became increasingly dependent on central government transfers for political survival. There appears to have been good investment at the municipal level but at the national level the negative effects of the resource curse, including discretionary and inefficient spending patterns, are more apparent.

6.5 Implications for policy on resource revenue management

"Policymakers should adapt their advice on natural resource management to take account of a country's pre-existing political and institutional arrangements."

The case studies show that formal political institutions and mechanisms for revenue management matter and can improve the governance of natural resources. But they also highlight the ways in which a resource bonanza can change the underlying configuration of political interests around the distribution of these revenues. The case studies show how standard remedies for mitigating the resource curse can backfire if they take insufficient account of pre-existing political and institutional contexts.

More specifically for policymakers, the research suggests that they should adapt their advice on natural resource management to take account of a country's pre-existing political and institutional arrangements; the institutional fit matters. Without this, formal mechanisms for managing natural resource revenues (for example through earmarking or revenue-sharing formulas) may exacerbate underlying problems.

7 Conclusions and implications for policymakers

7.1 Introduction

> "There is still a big gap between donor rhetoric and actual behaviour."

There is mounting evidence that many reforms to improve governance by strengthening formal, rules-based institutions have had limited impact. Donors have responded by recognising the need for more politically intelligent, context-specific approaches, and more local 'ownership'. But overall there is still a big gap between donor rhetoric and actual behaviour, and for the most part development practice remains donor-driven and aid-centric.

There are some familiar reasons for this gap between research and practice, rhetoric and reality. Research tends to produce either high-level advice that is difficult to translate into aid-financed operations (for example 'politics matters'), or detailed findings from case studies that are not widely applicable. There are also powerful institutional barriers within aid agencies that reinforce the status quo. It is difficult for donors to come to terms with the consistent message coming from research and evaluation reports that as outsiders they have far less influence over local development processes than is often assumed (Unsworth 2009).

However, the CFS research points to a more radical explanation for the mismatch between research and practice. Development practitioners, and especially Western donors, have mental models of development and of their own role in the process that get in the way of accepting and applying research findings. Programmes to improve the investment

> **"Programmes to improve the investment climate, strengthen the rule of law, or fight corruption fail because they make the wrong starting assumption."**

climate, strengthen the rule of law, or fight corruption do not fail just for lack of ownership or attention to politics. They fail because they make the wrong starting assumption: that progressive change consists in, and can be achieved through, strengthening formal, rules-based institutions that reflect a clear division between public and private spheres of life. This paper advocates a different starting assumption: that effective public authority is created in a variety of different ways, through bargaining between public and private actors, and that 'informality', instead of being the main problem, could also be part of the solution. It follows that the key to making progress may not be direct external intervention to orchestrate and support reform, but more indirect strategies to shift or influence the incentives and interests of local actors.

This is not to argue that donors should completely switch their attention from strengthening the capacity of formal institutions, to trying to modify the evolution of 'patrimonial' systems. The former is still important, if skilfully executed, and the latter is sheer hubris. But they do need to focus less on the long-term destination of rules-based governance, and more on incremental ways of making progress in the short-to-medium term through coalitions and relationships between key actors. Like our aspiring artists, they need to start by 'turning the picture upside down' so as to challenge a whole raft of preconceptions and often implicit assumptions that underpin current development practice. The CFS research illustrates vividly why this is important, and suggests some new – and sometimes counter-intuitive – ways of making progress.

7.2 Summary of research findings

The overarching finding is that ***informal institutions and personalised relationships are pervasive and powerful and can contribute to progressive outcomes in poor countries.*** Creating formal democratic government and market institutions remains a valid long-term aim. But in the short-to-medium term informal arrangements and relationships can help stimulate investment, improve services, connect citizens to the state and facilitate the transition to more inclusive, rules-based governance.

Key findings from individual streams of the research include:

i) ***The global environment creates perverse incentives for political elites to perpetuate fragile states*** because it gives them access to unearned sources of income from natural resource rents and criminal activities. This weakens their incentives to engage with citizens, build public institutions and nurture the economy. The policy message is to prioritise international action to change such incentives through better financial regulation, multi-stakeholder partnerships, and reform of the international narcotics regime.

ii) ***Relations between holders of political power and holders of economic power are central to creating effective, accountable public authority***. Informal relations between politicians and investors that build on common interests can compensate for weak formal property rights and contract enforcement, and boost investment in the short-to-medium term. External policymakers might have a role in facilitating dialogue and supporting collective action by business associations.

iii) ***Different types of public sector reform can influence the opportunities for collective actors to shape policy and organise effective monitoring of service delivery.*** Involvement at significant moments of policy reform can enhance opportunities for effective ongoing engagement. Formal participatory mechanisms may be less important as channels for policy influence than informal networks and relationships. Policymakers should be alert to ways in which the design of public programmes influences the scope for collective action.

iv) ***Informal ('traditional') local governance institutions are persistent, influential and very diverse. The extent to which they exercise effective and acceptable public authority reflects both their origins, and the contemporary institutional context in which they operate.*** Efforts to improve local governance need to take account of this diversity. Some informal local governance institutions can work synergistically with formal institutions; in other cases they may undermine or weaken them. Looking at the origins of ILGIs might provide a useful guide for better targeting of development programmes.

v) ***Case studies from Ghana, Kenya and Ethiopia provide evidence about the relationship between taxation and accountability that indicates the type of tax reform that should enhance the quality of governance.*** Governments' need for tax revenue has driven implicit or explicit bargaining with citizens; tax compliance has been greater under more popular governments whereas deep unpopularity can starve governments of revenue, and in some cases hasten their demise. Tax reform should prioritise equity, transparency and improved collection.

vi) ***Formal mechanisms for managing natural resource revenues (for example through fiscal decentralisation, earmarking or revenue- sharing formulas) will not work well if they take insufficient account of the political and institutional context.*** Policymakers need to take account of pre-existing institutions and sub-national political dynamics before offering advice on the management of natural resource revenues.

vii) ***Evidence from São Paulo and Mexico City suggests that new concepts of political representation are emerging from the activity of civil society actors, operating within participatory governance***

mechanisms rather than formal electoral channels or membership organisations. These should be explored on their own terms before assessing their compatibility with democratic norms and processes. All these findings have policy implications. In some cases (for example, in relation to tax reform) they are quite detailed and have already stimulated significant policy action. However the value of this research for policymakers does not reside only – or even primarily – in a list of policy messages. Indeed, reducing the findings to such a list would be to miss the point that all of them underline the need for a fundamental reassessment of existing assumptions and preconceptions about governance and development. That is what the next section is about.

“The value of this research for policymakers does not reside only in a list of policy messages. All of them underline the need for a fundamental reassessment of existing assumptions and preconceptions about governance and development.”

7.3 An upside-down view of governance

The meta finding – that informal institutions and personalised relationships are pervasive and powerful and can contribute to progressive outcomes – is itself an illustration of the benefit of closing off mental models based on OECD experience. But each of the research streams reveals more specific benefits in terms of reversing or challenging conventional assumptions, or identifying unexpected actors or processes at work. For example:

- Chapter 2 shows how the current global environment is quite different from the one in which Western state building took place, creating a new and historically unprecedented set of challenges, which have until recently been neglected by international donors (this is starting to change, partly in response to the Phase 1 CFS research).

- Chapter 3 challenges conventional assumptions about the importance of legal arrangements to protect property rights and enforce contracts, and highlights the unexpected role of personalised arrangements in building trust and common understanding, thus reducing risks and facilitating targeted problem solving.

- Chapter 4 calls into question the importance of autonomy for civil society actors, and shows that creating participatory mechanisms will not necessarily result in collective action. It also identifies some unexpected reformers.

- Chapter 5 challenges biases for or against ‘traditional’ institutions.

- Chapter 6 reinforces Phase 1 messages that tax should be seen not just as a fiscal issue but as a governance issue, and that *how* tax is collected matters, as well as how much.

Turning the picture upside down has been fundamental in identifying the original CFS research questions, and prompting detailed investigation of very informal arrangements, networks and relationships. This in turn has revealed angles, processes and dynamics at work, the importance of which might well not otherwise have been evident.

7.4 New drawing skills

Returning to our drawing metaphor, the research goes beyond telling policymakers to close off their mental models of development, and look at what is actually happening. It offers new 'drawing skills' – by providing some pointers to the kind of relationships and informal arrangements that seem particularly important in creating more effective, accountable public authority, the circumstances in which they may emerge, and the ways in which they can support a transition to more inclusive, formal arrangements. This guidance is captured below in a list of questions that policymakers will find relevant in a great variety of circumstances, and that in turn prompt more detailed inquiry. These are, of course, not the only questions worth asking, but they do cover many of the strategic issues bearing on development practice. In particular, all the questions relate in one way or another to the critical issue of how to get more effective collective action among societal groups, and more constructive bargaining between public and private actors. The answers to the questions provide important insights into the underlying challenges of creating effective public authority in a given context, and suggest priorities for action and possible strategies for external actors. The questions draw on the findings of many other scholars; their significance has in turn been validated and illustrated by the CFS research.

"All the questions relate in one way or another to the critical issue of how to get more effective collective action among societal groups, and more constructive bargaining between public and private actors."

How are history and context (political, institutional, economic, cultural) shaping formal and informal institutions, interests and relationships?

All CFS research streams highlight the importance of context and history – at the global, national and sub-national levels. Particularly striking is the way political and institutional context and historical trajectories have shaped networks of collective actors in São Paulo and Delhi (Chapter 4), help explain the very different performance of ILGIs in Karnataka and Pakistani Punjab, constrain the scope for tax bargaining in Kenya and Ethiopia, and contribute to the contrasting experiences of Peru, Bolivia and Ecuador in managing the recent boom in natural resource revenues. Most political economy frameworks used by donors highlight these issues, but the implications for development policy are often not pursued.

What is shaping interests of political elites? (Sources of revenue are likely to be critical.)

This question, as vividly illustrated in Chapter 2, is central to understanding the phenomenon of weak/'fragile'/'failed' states. It is also critical to understanding underlying causes of weak economic growth (Chapter 3), and the prospects for more constructive tax bargaining and better management of natural resource revenues (Chapter 6).

Are there common interests, among and between public and private actors, which could produce 'win/win' outcomes? In particular, what is shaping relations between politicians and investors, and might they have common interests in supporting productive investment?
Chapters 2 and 3 both illustrate why relations between holders of political power and holders of economic power are fundamental to creating and sustaining effective public authority. The power of bargaining around common interests is highlighted in accounts of how very informal arrangements between politicians and private investors stimulated productive investment in Egypt, Indonesia and China (Chapter 3), in cases of successful health and social assistance reform in São Paulo and Delhi (Chapter 4), and in accounts of tax bargaining and tax resistance in Ghana, Kenya and Ethiopia (Chapter 6).

What might stimulate effective collective action by societal groups to demand better services, or to support or resist public policy?
Chapter 2 illustrates how the absence of elite interest in engaging with citizens results in a lack of collective action, which fundamentally undermines attempts to create public authority. Chapter 3 notes that the way the private sector is organised influences how effective it is in supporting more inclusive engagement with public officials. Chapter 4 highlights the fundamental importance of collective action around policy reform and social accountability in improving service delivery, and investigates the processes involved. Chapter 5 shows how collective action through informal local government institutions in Karnataka (to access development funds and contest elections) was stimulated by the activities of elected local councils. Chapter 6 highlights the potential for business associations to mobilise their members around broad-based, common demands relating to taxation rather than exclusive, narrow interests. All these cases reconfirm the broad finding of Phase 1 of the research: how public programmes are designed and implemented shapes opportunities and incentives for collective action by citizens.

What informal institutions are operating (especially in rural areas), and how are they interacting with formal institutions? Are they competing with or undermining effective public authority?
This issue is most directly addressed in Chapter 5, which reveals the persistent influence of informal village institutions in Karnataka, Rajasthan and Pakistani Punjab, and their very diverse outcomes. However, the question is relevant in most poor countries where governance is problematic, particularly in Africa where 'traditional' institutions (with origins in systems of indirect rule) remain prominent, and in 'fragile' situations where state authority and legitimacy is weak.

Is the government reliant for revenue on taxing citizens, and how is that shaping their behaviour? Is there scope for productive bargaining around taxation?

Chapters 2 and 6 specifically address this question, which was also a major focus of the Phase 1 CFS research. Over the last five years policymakers have increasingly recognised the importance of links between taxation and the quality of governance. This has stimulated a new and growing stream of work on taxation and accountability within the OECD DAC Govnet (OECD 2008), linked to work by the OECD Committee on Fiscal Affairs to promote a more transparent, international tax environment. It is also stimulating new bilateral programmes to support tax reform. Perhaps the most important and interesting initiative has been the establishment of the African Tax Administration Forum which brings together senior African tax officials with the aim of facilitating cooperation between tax administrations, and which has attracted the support of African heads of state. It explicitly recognises that efficient and effective tax administration is central to creating capable states, as well as to economic development and good governance.

“Informal processes have the potential to pave the way for more rules-based arrangements in the longer term.”

Asking these questions provides a way for policymakers to start identifying the kind of state-society dynamics at work in a given situation that might produce constructive short-term outcomes. It may also suggest ways in which informal processes have the potential to pave the way for more rules-based arrangements in the longer term. The CFS research provides examples that are of interest not because they offer models to follow but because they stimulate thinking and useful questions. In Egypt the research shows how relationships that initially offered exclusive benefits subsequently had a positive impact on a whole business sector, and became more open and institutionalised over time. In Ghana tax bargaining has contributed directly to political reform. In São Paulo new, unorthodox forms of representation are emerging informally through the engagement of civil society organisations in participatory governance mechanisms. In Karnataka the interaction of elected village councils with very informal institutions is contributing to more effective and accountable local governance.

7 .5 Implications for policymakers

Taxation is a relatively unusual example of the CFS research directly stimulating and informing practice by international donors. It reflects the fact that there are common interests around tax reform: developing country governments are keen to increase revenue and reduce aid dependency; African tax officials have professional interests at stake; donors see an opportunity to increase finance for development and improve governance; in the wake of the financial crisis, OECD governments are increasingly concerned to improve international financial regulation and reduce opportunities for tax evasion and avoidance. There is also a good institutional ‘fit’ with current donor practice: donors can readily see ways of using money and technical assistance directly to support reform.

Most other examples of direct policy influence relate to links with local policymakers interested in using context-specific findings to inform policy interventions. For example, findings from the research around the right to food and the public distribution system in Delhi have been shared with policymakers and civil society activists working on new Right to Food legislation in India. CFS research on health in Delhi is of direct interest to policymakers concerned with urban health issues. The CFS partner organisation in São Paulo, the Centro Brasileiro de Análise e Planejamento (CEBRAP), has organised large-scale training programmes for NGOs, members of participatory councils and municipal councils in Brazil, drawing on research findings about the new forms of political representation and accountability that are emerging within participatory governance mechanisms. Officials in both Karnataka and Pakistani Punjab have picked up on CFS research into informal local governance institutions.

However, it is much less clear that the central messages from the research are informing donor policy thinking and practice more broadly, despite extensive dissemination of the Phase 1 findings, and ongoing discussion of the emerging Phase 2 findings. Donors are not routinely asking the kind of questions set out in Section 7.4 above, or following through on their implications. This is not because the importance of such questions is actively disputed, or because they have no practical implications for policy. But they do not offer a good institutional or ideological fit with the organisational culture of most development agencies.

“The search for improved aid effectiveness needs to start with a much better understanding of the local social, institutional and political dynamics with which aid programmes are interacting.”

Taking such questions seriously implies a change in how donors see their role – from being experts with responsibility for ‘delivering’ on the millennium development goals, to at best being effective facilitators of local political processes. It means letting go of implicit assumptions that aid can buy reform and ‘good’ behaviour, and that the interests of donors and aid recipient governments are generally well aligned around an OECD vision of development. The search for improved aid effectiveness needs to start not with improving delivery mechanisms, but with a much better understanding of the local social, institutional and political dynamics with which aid programmes are interacting. This in turn implies big (and uncomfortable) changes in the organisational culture and incentives of development agencies.

None of this is very new. The same story emerges repeatedly in one form or another from development research, policy papers and donor evaluations. Recent papers for the DAC International Network on Conflict and Fragility, for example, all emphasise that development and ‘state building’ are endogenous processes, that state-society relations are key to improving security and delivering public goods, that local perceptions of legitimacy are fundamental, and that donors need to be much more alert to the impact of aid (positive and negative) on local capacity and incentives for progressive change (OECD/DAC 2010 and forthcoming, b). There is also growing recognition that global shifts in economic and geopolitical relations have fundamentally changed the operational context for Western donors, and that traditional models of donor-recipient relationships need to change.

"The good news is that, if donors do 'turn the picture upside down' they will see new opportunities as well as challenges."

This paper has argued that donors cannot make significant progress in improving development outcomes and aid effectiveness without changing their mental models of how development happens. However, the good news is that, if they do 'turn the picture upside down' and investigate in a much more open-minded way what is actually happening in a given context, they will see new opportunities as well as challenges. For example they could do much more to:

- value country knowledge and invest in acquiring it;
- empower local actors at all levels through good-quality research and support for data collection and policy analysis;
- play a role in facilitating local dialogue and debate;
- prioritise action on things that external actors can directly influence, and that are fundamental to shaping elite interests in poor countries. In particular, they should prioritise a small number of strategic global initiatives that are central to regulating global financial flows, oil revenues and the narcotics trade;
- ensure they are alert to ways in which all their actions can impinge (positively or negatively) on opportunities for constructive state-society bargaining. Issues around tax reform and aid dependency are particularly salient and are already on the DAC agenda (although there has been disappointingly little effective action to address the long-acknowledged problems arising from aid fragmentation);
- reassess their strategies for supporting civil society, with less focus on pursuing a specific rights-based agenda, and more on the capacity of different groups to take effective collective action. This would involve extending engagement to a broader range of actors, who may not share a conventional view of governance and development but who have overlapping interests, for example in promoting economic growth;
- overall, show less concern with micromanaging aid, and much more with the political dynamics that influence its effectiveness.

There are powerful factors that are already prompting Western donors to re-examine their role and practices, including the very different approach to aid adopted by China (Brautigam 2009), growing recognition of the interdependence of rich and poor countries in an increasingly globalised world (DFID 2009a), and mounting concern about the security and development challenges posed by fragile states. But it is not clear that, despite the significant pressures, Western donors are seriously reappraising their understanding of development and in particular of the processes involved in creating more effective and accountable states.

Hence the central message of this paper – that donors need to turn the picture upside down, and develop new drawing skills. Unless they do so, they will not make the necessary investment in understanding local political dynamics, or make fundamental changes in their own organisation, values, attitudes and behaviour. In short, they will find it very difficult to resist the temptation to revert to the default position of viewing the world through an OECD lens.

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Informal institutions and personalised relationships are usually seen as governance problems. However the research presented in this synthesis paper suggests that they can also be part of the solution. Donors have had limited success in trying to improve the investment climate, reform public services and fight corruption in poor countries by strengthening formal, rules-based institutions. They need to stop thinking about governance and development challenges in terms of models based on OECD experience, and instead pay much more attention to the informal institutions, relationships and interests that underpin formal arrangements.

Informality is a fact of life. Policymakers seeking to better understand this messy, complex reality might start by asking themselves:

- What is shaping the interests of political elites? (Sources of revenue are likely to be critical).
- What is shaping relations between politicians and investors, and might they have common interests in supporting productive investment?
- What might stimulate and sustain collective action by social groups to demand better services?
- What informal local institutions are at work, and how are they influencing development outcomes?
- Where does government get its revenue from, and how is that shaping its relationships with citizens?

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