Rethinking the Role of the State in LDCs — Towards Development Governance

Chapter

1

A. Introduction

The current financial crisis has given added urgency to a reconsideration of the potential for new roles and functions for the State in the current global context. This chapter examines what this might mean in general terms for the least developed countries (LDCs). Its central argument is that the LDCs should pursue good development governance and that with this in view they should seek to build developmental State capabilities.

Development governance is about creating a better future for members of a society by using the authority of the State to promote economic development, and in particular to catalyze structural transformation, create productive employment opportunities and raise living standards.

Development governance, or governance for development, is about creating a better future for members of a society by using the authority of the State to promote economic development, and in particular to catalyze structural transformation, create productive employment opportunities and raise living standards for present and future generations. In general terms, governance is about the processes of interaction between the Government — the formal institutions of the State including the executive, legislature, bureaucracy, judiciary and police — and society. Development governance is governance that is oriented to solve common national development problems, create new national development opportunities and achieve common national development goals. This is not simply a matter of designing appropriate institutions but also a question of policies and the processes through which they are formulated and implemented. Which institutions matter is inseparable from what policies are adopted. Development governance is thus about the processes, policies and institutions that are associated with purposefully promoting national development and ensuring a socially legitimate and inclusive distribution of its costs and benefits.

Drawing principally on existing literature, this chapter examines possible approaches to effective development governance in LDCs. It argues that neither the current good governance institutional reform agenda, nor the old developmental State, including successful East Asian cases, are entirely appropriate now. What is required is a new developmental State that: (a) is adapted to the challenges of the twenty-first century; (b) creates and renews the micro-foundations of democratic practice to harness local, bottom-up problem solving and opportunity-creating energies; and (c) embraces a wide range of governance modalities and mechanisms within a mixed economy model to harness private enterprise, through public action, to achieve a national development vision. The chapter considers how this concept of the new developmental State can be adapted to provide a viable and useful model for development governance in LDCs.

Neither the current good governance institutional reform agenda, nor the old developmental State, are entirely appropriate now. What is required is a new developmental State.

The chapter is organized in four main sections. Section B discusses the good governance institutional reform agenda from a developmental perspective, whilst sections C and D focus on the governance practices within developmental States as an alternative approach to development governance. These sections examine in particular the economic governance practices that made some developmental States more successful than others and also how lessons about development governance in successful developmental States may be adapted to be relevant for the twenty-first century. Section E discusses how LDCs can use these insights to build developmental State capabilities, including the implications for development partners of LDCs. The conclusion summarizes the major messages of the chapter.

B. The good governance reform agenda and development

1. The imperative of good development governance

Within this Report, governance will be broadly understood as "the processes through which individuals and State officials interact to express their interests, exercise their rights and obligations, work out their differences and cooperate to produce public goods".

What good governance means is essentially contestable. Firstly, the term "governance" is not readily understood. Some academics and practitioners use it as a synonym for "Government", whilst others refer to a broader set of the structures and processes through which individuals and institutions manage their common affairs (for example, Weiss, 2000). Secondly, the "goodness" of governance necessarily rests on values and ethical judgments. At the most basic level, some base the goodness of governance on outcomes (for example, is governance effective for economic development?), whilst others base the goodness of governance on procedures (for example, is governance transparent and accountable?).

Within this Report, governance will be broadly understood as "the processes through which individuals and State officials interact to express their interests, exercise their rights and obligations, work out their differences and cooperate to produce public goods" (Brinkerhoff and Goldsmith, 2005: 200). This covers both what Governments do (the nature of policies) and how they do it (the nature of institutions).

One list of the core principles of good governance that has been suggested (Court, 2006) and is useful because it is universal rather than culturally specific, is the following:

(a) Participation: the degree of involvement by affected stakeholders;

(b) Fairness: the degree to which rules apply equally to everyone in society;

(c) Decency: the degree to which the formation and stewardship of the rule is undertaken without humiliating or harming people;

(d) Accountability: the extent to which political actors are responsible for what they say and do;

(e) Transparency: the degree of clarity and openness with which decisions are made; and

(f) Efficiency: the extent to which limited human and financial resources are applied without unnecessary waste, delay or corruption.

Core principles of good governance include: participation, fairness, decency, accountability, transparency and efficiency.

These principles, together with the predictability of rules and policies, can be realized through a variety of institutions or institutional configurations.

It must also be recognized that the goodness of governance is not simply a matter of processes and procedures of governing, but also a question of effectively achieving outcomes. It would be a curious type of "good governance" if the governance processes in themselves were considered to be perfect according to the valued principles, but the outcomes were poor. For a country concerned with promoting development, good governance should thus also encompass governance that effectively delivers development. Here the key question is whether the governance system creates the conditions for increased investment, innovation and structural transformation and thus leads to increased employment opportunities and rising and widely shared prosperity.

LDCs should aspire to a kind of good governance in which the practices of governing are imbued with the principles of participation, fairness, decency, accountability, transparency and efficiency in a non-culturally-specific way. They should also aspire to a kind of good governance that delivers developmental outcomes, such as growing income per capita, structural transformation, expanding employment opportunities in line with the increasing labour force and reduced poverty. In short, they should aspire to good development governance.

Over time, the development dimension has evaporated from many definitions of good governance.

2. The scope, content and propagation of the good governance reform agenda

Whilst good development governance in the sense defined above is essential for LDCs, a narrower understanding of what "good governance" means has come to dominate efforts to promote institutional reforms in LDCs.

The idea of "good governance" was initially introduced into international policy debates in the late 1980s following the realization that "getting the institutions right" was as important as "getting the prices right" to the success of policy reforms. At first some definitions of governance had an explicit developmental dimension. Thus World Bank (1992: 3) states that: "Governance is the manner in which power is exercised in the management of a country's economic and social resources for development." The European Commission similarly defined "good governance" as "the transparent and accountable management of all a country's resources for its equitable and sustainable economic and social development" (quoted in Landman and Hausermann 2003: 2). But over time, the development dimension has evaporated from many definitions of good governance. In World Bank (2006: 2, paragraph 4), for example, governance is defined as "the manner in which public officials and institutions acquire and exercise the authority to shape public policy and provide public goods and services". The pursuit of "good governance" has also increasingly focused on processes and procedures as a good in themselves, rather than on outcomes. In this way, "good governance" has been seen as a developmental end in itself rather than an important means for achieving economic development.

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The precise content of the current good governance institutional reform agenda in LDCs is implicitly rooted in a dichotomy between a formalized "good governance" system and an informal, personalized, "bad governance" system (table 1). Both these governance systems are "ideal types", that is to say they are abstractions from the way in which governing actually happens in individual countries. However, the good governance systems are stereotypically understood to be typical of developed countries, whilst the bad governance systems are stereotypically understood to be typical of very poor countries.

Good governance reforms have sought to introduce a particular style of public administration and management, namely the methods of new public management.

Within the good governance reform agenda, the task of turning bad governance systems into good governance systems has involved introducing particular types of formal institutions into LDCs. This is a complex agenda with different agencies emphasizing different issues (Weiss, 2000; Doornbos 2001). However, the typical vision of good governance reforms has usually included both the practices of public administration and the political processes through which Governments gain their authority and people are ruled.

Table 1
"Ideal types" of governance systems: good governance versus bad governance

Good governance	Bad governance
Authority is institutional, resides with official roles	Authority is personal, resides with individuals
Political leaders share power with others and are accountable for actions	Political leaders monopolize power and are unaccountable for their actions
Leaders hold onto power by providing collective benefits that earn support of large segments of society	Leaders hold onto power by providing personal favours that secure the loyalty of key followers
Policy decisions are taken in the open after public discussion and review	Policy decisions are taken in secret without public involvement
Decision-making standards are explicit and procedures are transparent	Decision-making standards are tacit and procedures are indecipherable
Political parties are organized around stated programs that affect large numbers of beneficiaries defined by universalistic or generic categories	Political parties are organized around personalities and the distribution of individual benefits
Political campaigns are financed by many small, unconcealed donations	Political campaigns are financed by a few large, secret donations
Elections are free, fair and open	Elections are marked by intimidation, vote buying and fraud
Civil engineering projects are disbursed to serve the interests of large portions of the country's citizenry	Civil engineering projects are geographically targeted to serve the interests of small portions of the country's citizenry
Administrators are recruited and promoted in competitive processes that judge their merit and expertise	Administrators are recruited and promoted as reward for personal connections with political leaders
There is an authorized administrative hierarchy with clear division of labour, specific standards for output and well-defined reporting channels	There is an unspoken administrative hierarchy, with little specialization or specification of output and uncertain reporting channels
Administrators can only be dismissed with cause	Administrators can be dismissed for no reason
Administrators are prohibited from supplementing their salary	Administrators supplement their salary with bribes and kickbacks
Administrators' actions are predictable, based on objective methods and follow uniform procedures	Administrators' actions are arbitrary, based on subjective reasoning, and follow ad hoc procedures
Rules are applied with neutrality and all citizens receive equal treatment	Rules are applied with partiality, and people with close ties to Government get preferential treatment
Binding legal contracts are used in Government procurement and sales	Verbal agreements are used in Government procurement and sales
Internal controls are strict, thorough records are maintained and regularly audited	Internal controls are lax, documentation is spotty with sensitive matters left off the books
Citizens have appeal channels if given poor service	Subjects have little recourse for poor service

Source: Brinkerhoff and Goldsmith (2005).

With regard to the former, good governance reforms have sought to introduce a particular style of public administration and management, namely the methods of new public management (NPM). This approach advocates that Government should be run according to private sector styles with an active, visible, "hands on" approach, using market mechanisms, client orientation and performance management to increase productivity, often favouring the unbundling of monolithic organizations into corporatized units and decentralization (table 2). With regard to political processes, good governance reforms have been particularly concerned with promoting liberal democracy. As Leftwich (1993:611) has put it:

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> good governance implies a State enjoying both legitimacy and authority, derived from a democratic mandate and built on the traditional liberal notion of a clear separation of legislative, executive and judicial powers. And, whether presidential or parliamentary, federal or unitary, it would normally involve a pluralist polity with some kind of freely elected representative legislature, subject to regular elections, with capacity at the very least to influence and check executive power and protect human rights.

An important aspect of the current good governance institutional reform agenda is that it also defines a particular role for the State. This is to support markets. World Bank (2002: 99), for example, states: "Many of the institutions

Table 2

Seven core principles in new public management reforms

"Hands-on" management	Active, visible control of organizations by identifiable professional managers who are free to manage using private sector styles of management
Unbundling	Disaggregation of formerly monolithic organizations into corporatized units around specific products and services
Productivity	Do more with less. Public service provision with lower resource use
Marketization	Use market mechanisms and competition to overcome pathologies of traditional bureaucracy.
Performance orientation	Define, preferably quantitatively, goals, targets, outputs and indicators of success based on explicit standards. Deliver what is promised. Link resource allocation and rewards to measured performance to enhance accountability
Service orientation	Improve Government-customer relations so as to improve the satisfaction of the latter
Decentralization	Place policy decisions as close as possible to the people who will be affected by those decisions

Source: Therkildsen (2008).

that support markets are publicly provided. The ability of the State to provide these institutions is therefore an important determinant of how well markets function. Successful provision of such institutions is often referred to as 'good governance'." Khan (2006a; 2006b) has identified the key governance goals of such market-supporting governance as: (a) achieving and maintaining stable property rights; (b) maintaining good rule of law and contract enforcement; (c) minimizing expropriation risks; (d) minimizing rent seeking and corruption; and (e) achieving transparent and accountable provision of public goods in line with democratically expressed preferences.

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Within LDCs, the good governance reforms that were initially undertaken in the 1990s were closely linked to policy conditionality attached to aid inflows. Governance-related conditionalities were particularly prevalent in African LDCs. Kapur and Webb (2000) analyze the conditionalities contained in International Monetary Fund (IMF) Letters of Intent, Policy Framework Papers and Memorandum of Economic Policies during the period 1997 to 1999 and find that in sub-Saharan Africa, 40 per cent of the conditionalities in the form of quantitative performance criteria and 72 per cent of the more loosely-defined conditionalities were governance-related. Since 2000, the nature of conditionality has been changing. There is now less emphasis on externally imposed conditions and more attempts to align conditionality with nationally produced policy documents. However, as shown in UNCTAD (2008), the efforts to enable country ownership of national policies and institutional reforms in the LDCs have not been completely successful and conditionality in relation to governance practices continues to be important.

Governance should be assessed for its instrumental value as well as its intrinsic value. Good governance is not simply an end in itself but also a means to an end.

A significant feature of the second generation reforms that are being formulated and implemented by LDC Governments is the importance they themselves now attach to "good governance". The Poverty Reduction Strategy Paper (PRSP), prepared in consultation with civil society, has been adopted as a key mechanism for achieving poverty reduction goals as well as allocating aid, and it is also used in external assessments as an indicator of good governance. By the end of 2008, 26 LDCs had prepared a second full PRSP. Good governance is a strategic pillar in most of these documents, with particular emphasis being placed on decentralization, improving the efficiency of public administration and reducing corruption (table 3).

3. The mixed evidence on developmental impact

It is difficult to disagree with the intrinsic value of some key institutions being promoted through the current good governance reform agenda. However, as Rodrik (2007) argues, governance should be assessed for its instrumental value as well as its intrinsic value. Good governance, from this perspective, is not

Table 3

Governance priorities in second-generation PRSPs in LDCs

LDC	Year	Key governance priorities	Strategic pillar[a]
Afghanistan	2008	Strengthen democratic processes and institutions, human rights, the rule of law, delivery of public services and government accountability. Goals: reduce gender inequality, reduction of corruption.	Yes
Bangladesh	2005	Promoting good governance: improving implementation capacity, promoting local governance, strengthening anti-corruption strategy, reforming critical justice and access to justice by the poor, improving sectoral governance.	No
Benin	2008	Promotion of good governance: acceleration of administration reform, strengthening the rule of law and individual liberties.	Yes
Burkina Faso	2004	Promoting good governance: democratic governance, improving economic governance, local governance.	Yes
Burundi	2006	Improving governance and security: promoting good governance: (a) strengthening the culture of democracy; (b) promoting effective public administration; and (c) strengthening the entities in charge of planning and economic management.	Yes
Cambodia	2006	Good governance: Fighting corruption, legal and judicial reform, public administration reform, armed forces reform and demobilization.	Yes
Democratic Republic of the Congo	2006	Promoting good governance: Administrative governance, political governance, economic governance, improving the quality of statistics.	Yes
Ethiopia	2006	Open, transparent and democratic governance: strengthening the rule of law, institutions, civil society organizations; decentralization; human rights.	No
Gambia	2007	Enhancing governance systems and building the capacity of local communities and civil society organizations to play an active in economic growth and poverty reduction. Decentralization.	Yes
Guinea	2008	Improving political and economic governance (promoting human rights, boosting the capacities of institutions, strengthening civil society), strengthening economic governance (strengthening macroeconomic analytical and forecasting capabilities, strategic planning capabilities, statistics). Local governance, administrative governance, corruption, gender and equality.	Yes
Guinea-Bissau	2006	Modernizing the public administration and building capacities, strengthening the rule of law and the judicial apparatus, supporting decentralization.	No
Haiti	2007	Justice and security.	Yes
Lesotho	2006	Improving legislative efficiency of the parliament, strengthen the Directorate of Corruption and Economic Offences. At the local level: strengthen human rights and decentralization.	No
Madagascar	2007	Responsible governance.	Yes
Malawi	2007	Improved governance: fiscal management, fighting corruption, corporate governance, peace and security, effective legal system, human rights.	Yes
Mali	2006	Promotion of democratic governance: rule of law, strengthening public administration, fight against corruption, coordination of national and regional governments.	No
Mauritania	2007	Governance and capacity-building: the rule of law, public administration, management of public funds, decentralization, capacity-building for civil society.	Yes
Mozambique	2007	Good governance: corruption, the rule of law, decentralization.	Yes
Niger	2008	Promotion of good governance: entrenching the rule of law and ensuring effectiveness and transparency in economic and financial management.	Yes
Rwanda	2008	Governance: control of corruption, strengthening decentralization, enhancing public sector capacity and accountability.	Yes
Senegal	2007	Good governance: improving the quality of public service and economic governance, judicial governance, local development and decentralization, developing secondary hubs, promoting social dialogue.	Yes
Sierra Leone	2005	Promoting good governance: public sector reform, decentralization of state governance, public financial management and procurement reform and anti-corruption "empowerment with information".	Yes
Uganda	2005	Good governance: democratization; justice, law and order; managing the public sector; public expenditure priorities for governance.	Yes
The United Rep. of Tanzania	2006	Good governance and the rule of law, accountability of leaders and public servants, deepening democracy, political and social tolerance, sustaining peace, political stability, national unity and social cohesion. Addressing corruption, equitable allocation of public resources, decentralization, reducing political and social exclusion.	Yes
Zambia	2006	Total adherence to the principles of good governance by 2030: administration of justice, constitutionalism, democratization, human rights, accountability and transparency.	No

Source: UNCTAD secretariat compilation, based on PRSPs.

a By "strategic pillar", what is meant is that governance is a crucial element in the PRSP.

simply an end in itself but also a means to an end. In the present context what is important, as argued above, is whether or not the good governance institutional reforms support economic development. As Meisel and Ould Aoudia (2007) have provocatively put it: "Is 'good governance' a good development strategy?"

This is a very controversial subject that inflames passions. It is now clear that institutions matter for growth and economic development. But the question then is: which institutions matter?

Some recent broad reviews of all the evidence linking the good governance agenda to development reach very mixed conclusions. Indeed they suggest that the links between the good governance reform agenda and development are weak. Thus:

Recent broad reviews of all the evidence linking the good governance agenda to development reach very mixed conclusions, suggesting that the links between the two concepts are weak.

(a) The Committee for Development Policy finds that "there is some empirical evidence to suggest that weak governance reinforces poverty" but the relationship between governance and poverty reduction is not yet decisively proven and "in the absence of conclusive evidence, it is plausible to suggest that the link sometimes exists, but that at other times, there is no link" (UNDESA, 2004: 68). This is particularly "in the light of the superior economic performance for some countries that are not ranked very highly with respect to good governance";

(b) Grindle (2007: 571) argues that whilst cross-country statistical studies "tend to find a strong linkage between governance and development", "those who focus on the particular conditions of specific countries frequently find reason to question this relationship and put forward arguments that link the impact of governance to those particular conditions";

(c) Gray (2007: 6–7) states that:

> Over the last decade, the gradual accumulation of indicators and research based on them has provided broad support for the arguments and institutions such as property rights, stability, reducing corruption, transparent and accountable public sector, democratic government, rule of law and rent-free markets to achieve sustainable growth in developing countries. A closer look at the debate, however, reveals important areas of contention and significant doubts about the validity of the data and evidence presented so far. Beyond the discussion on data quality and methodologies of measurement another more fundamental debate is also building steam which suggests that other governance criteria, not covered by good governance are in fact the crucial institutions for growth;

(d) Kurtz and Schrank (2007b: 552) conclude that:

> The balance of the evidence to date leaves us with two imperfect conclusions. Either we cannot reasonably conclude that improvements in governance produce meaningful increases in the rate of economic growth, or the absence of such an observed connection implies that our conceptualization and measurement of governance is as yet quite imperfect. We remain agnostic as to which (or perhaps both?) is true, but we have sought to make the case that the oft-asserted connection between growth and governance lies on exceedingly shaky foundations.

Kurtz and Schrank regard this as a very dangerous situation because "potentially flawed indicators of governance quality are being utilized by policy makers to condition development aid and to shape development efforts" (ibid: 552).[1]

This literature has resulted in a much greater understanding of the conceptual and technical limitations of indicators that assess the goodness of governance. It has been shown that indicators of good governance, such as the World Bank's Worldwide Governance Indicators (WGIs), have a number of serious limitations that need to be taken into account in interpreting results when efforts are made to interrelate governance with various developmental outcomes. Thus, for example, examination of all the potential pair-wise comparisons that can be made amongst the LDCs on the six governance dimensions using the WGI data set shows that 60 per cent of the differences in governance quality between LDCs were too small to be statistically significant (box 1).

Box 1. Measuring the goodness of governance — some methodological problems

Within recent years there has been an explosion of different types of indicators that seek to measure the quality of governance (see, among others, Landman and Hausermann 2003; UNDESA 2007; UNDP, 2006; World Bank, 2006; Court, Fritz and Gyimah-Boadi, 2007; Kaufmann and Kraay, 2007). These indicators are based on both objective measures and subjective perceptions. Given the complexity of the notion of governance, they are often aggregated into composite indicators, and the technical procedures of what is selected and how they are aggregated into an overall indicator have important effects on determining where a country stands in terms of the goodness of governance and what inference can be made from the data.

This issue can be exemplified by the World Bank's Worldwide Governance Indicators (WGIs). These define governance as the set of "traditions and institutions by which authority in a country is exercised" (Kaufmann, Kraay and Zoido-Lobaton, 1999: 1), and the goodness of governance in each country is measured on three different dimensions, each of which is measured by two indicators, as follows:

(a) The political dimension of governance refers to the process by which those in authority in a country are selected and replaced:

- (i) *Voice and Accountability* — measuring the extent to which a country's citizens are able to participate in selecting their Government, as well as freedom of expression, freedom of association, and a free media;
- (ii) *Political Stability and Absence of Violence* — measuring perceptions of the likelihood that the Government will be destabilized or overthrown by unconstitutional or violent means, including political violence or terrorism;

(b) The economic dimension of governance refers to the capacity of the Government to formulate and implement policies:

- (i) *Government Effectiveness* — measuring the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation and the credibility of the Government's commitment to policies;
- (ii) *Regulatory Quality* — measuring the ability of the Government to formulate and implement sound policies and regulations that permit and promote private sector development. This includes measures of the incidence of market-unfriendly policies such as price controls or inadequate bank supervision, and the perceptions of the burdens imposed by excessive regulation in areas such as foreign trade and business development;

(c) The institutional dimension of governance deals with the respect of the citizens and the State for institutions that govern interactions among them:

- (i) *Rule of Law* — measuring the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police and the courts, as well as the likelihood of crime and violence;
- (ii) *Control of Corruption* — measuring the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the State by elites and private interests.

The level of "good governance" is proportional to the country's score, as measured by the given indicator (the higher the indicator's score, the higher the quality of governance).

These indicators have been very influential. But close analysis of their methodological basis suggests that the information that they provide can easily be abused (Arndt and Oman, 2006). Amongst the problems Arndt and Oman note are:

(a) The aggregation procedure assumes non-correlation between the errors amongst different sources. But there is a high likelihood of correlation of errors in practice among different sources and this means that the regression results on which the aggregation is built is spurious. As they put it: "Significant violations of the assumption of non-correlation of the sources' errors have significant negative implications for the reliability of the indicators" (ibid.: 67);

(b) The average value of the indicator across all countries, worldwide, is always zero and its standard deviation is also one. As a result of this technical feature, the indicators "cannot reliably be used for monitoring changes in levels of governance over time, whether globally, in individual countries or among specific (e.g. regional groups) of countries (ibid.: 61).

Box 1 (contd.)

(c) The aggregation procedure brings in a sample bias in the underlying indicators in favour of business surveys and expert assessments.

It is also clear that there is a conceptual bias in terms of a particular role for the State in these indicators. For example, the ability of the Government to formulate and implement sound policies and regulations is assessed through the incidence of market-unfriendly policies such as price controls or inadequate bank supervision, and the perceptions of the burdens imposed by excessive regulation in areas such as foreign trade and business development.

Regarding the comparability issue, the problem of statistically significant margins of error means that the indicators are most reliable if there is a very large difference between countries. Analysis of potential cross-country comparisons amongst LDCs on the six governance dimensions in WGI for 2006 showed that only 40 per cent of 14,700 comparisons were statistically significant. That is to say, 60 per cent of the differences in governance quality amongst LDCs were too small to be statistically significant. These indicators therefore pick up very coarse differences in the quality of governance. Donors must take great care if they use them for aid allocation.

For poor countries such as LDCs, a particular problem with these indicators is that they are not absolute indicators of the goodness of governance but rather relative indicators: they show the goodness of governance relative to other countries. The problem here is that there is close correlation between the indicators and GDP per capita. Thus there is a strong probability that the poorest countries will always rank towards the bottom. Also governance can be improving but this will not show up if other countries are also improving their position.

Leaving aside these technical problems, one critical insight from cross-country statistical analyses is that the quality of governance is closely associated with *levels of per capita income*. That is to say, according to the indicators high income per capita is associated with good governance practices and low income per capita with the absence of good governance practices. This pattern is illustrated with regard to the "government effectiveness" indicator in the WGI data set in chart 5A. The quality of government effectiveness is measured here through assessments of the quality of public services, the quality of the civil service and its degree of independence from political pressures, the quality of policy formulation and implementation and the credibility of the Government's commitment to policies. As is evident from the chart, the countries with the highest income per capita stand out with the best quality of government effectiveness whilst the countries with the lowest income per capita stand out with the worst quality according to this assessment.

Cross-country statistical analyses shows that the quality of governance is closely associated with levels of per capita income. Thus the countries with the highest income per capita stand out with the best quality of government effectiveness ...

Whilst there is a close relationship between the quality of governance (according to these indicators) and levels of per capita income it is much more difficult to identify a close relationship between the quality of governance and *growth of per capita income over time*. Thus, for example, Knack (2006: 9) finds a statistically significant but weak relationship between the quality of governance and growth, but states that "this finding does not rule out the possibility of mutual causation, or of a 'halo effect' by which growth affects expert perceptions of the quality of governance". Rodrik (2008: 2) is more skeptical, stating that: "I am not aware of any strong econometric evidence that relates standard governance criteria to *growth* (all the evidence is about *income levels*)." This result arises because some countries are growing rapidly even though they do not have "good governance" according to the standard criteria.

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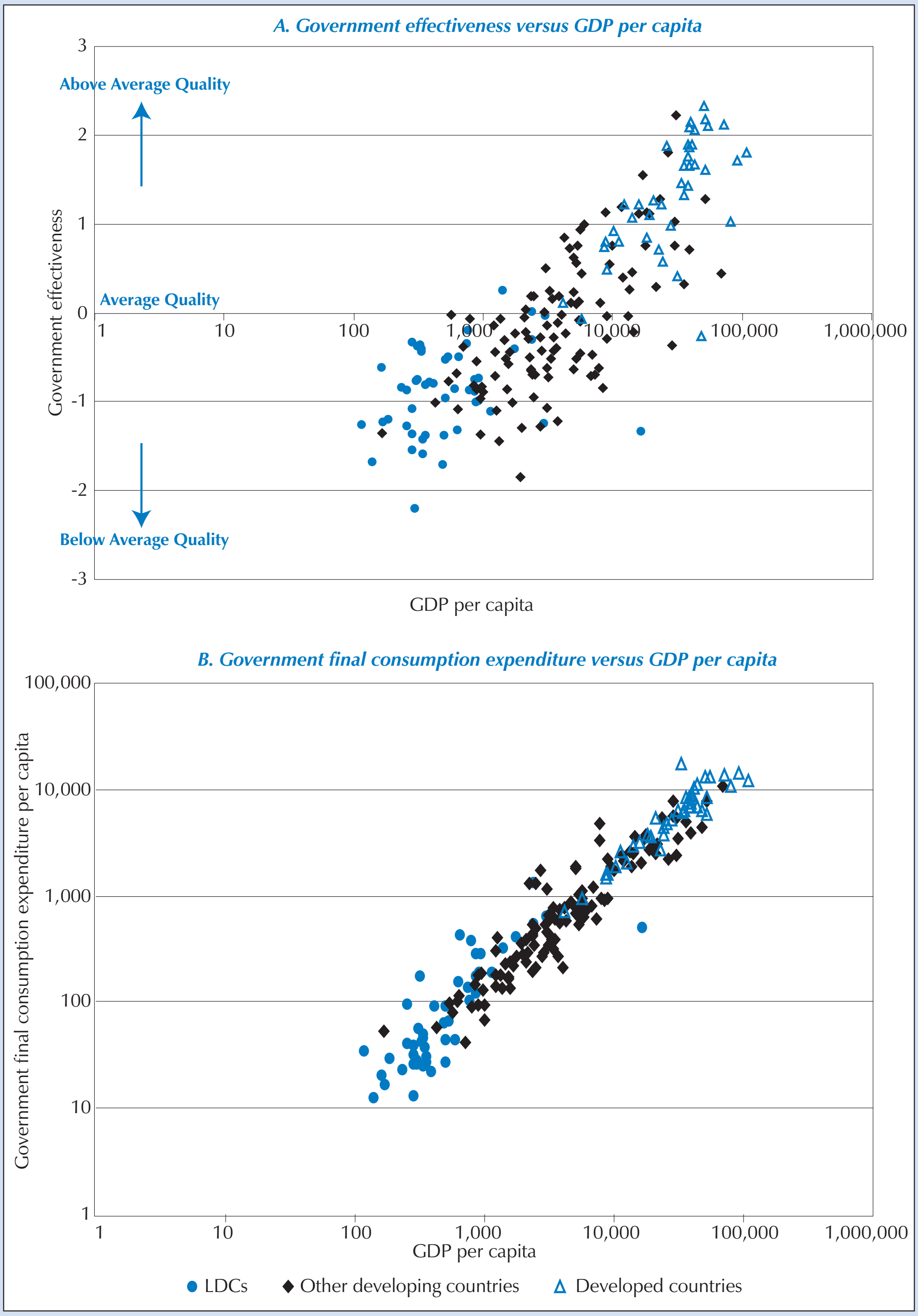
In a series of papers, Khan (2004a; 2004b; 2006a; 2006b) has gone even further in specifying the nature of the relationship between governance and the economic performance of developing countries. This work has underlined the point that some features of governance that are not covered in the current good governance institutional reform agenda may be crucial when the developmental efficacy of governance is a central concern. He divides developing countries into those with a good economic performance in the sense that their gross domestic product (GDP) per capita is converging with developed countries and those that have had bad performance in the sense that their GDP per capita growth

Chart 5

GDP per capita, Government effectiveness and Government final consumption expenditure per capita in LDCs, other developing countries and developed countries in 2006

(Current $)



Source: UNCTAD secretariat calculations based on GlobStat, and World Bank, *Worldwide Governance Indicators* (WGI) 1996–2007, online, May 2009.

Notes: Data on GDP per capita and Government final consumption expenditure per capita are in log scale.

a Government effectiveness represents one of the six dimensions of governance identified in the World Bank *Worldwide Governance Indicators*. It is measured through assessments of the quality of public services, the quality of civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of a Government's commitment to policies.

b Government final consumption expenditure includes all Government current expenditures for the purchase of goods and services (including compensations for employees).

is slower and they are thus diverging from developed countries in terms of their past economic growth record. Khan then examines differences in their quality of governance according to selected indictors in the WGI data set. He finds that with regard to the control of corruption and the protection of property rights there is actually no significant difference between the converging countries and diverging countries in terms of the quality of their governance. However, he notes that this does not mean that there are no important differences in the governance characteristics between the countries that have performed relatively well and those that have performed relatively badly. Rather, he argues that "the important differences in their governance characteristics are not identified by the good governance analytical framework" (Khan, 2006b: 8).

Some countries are growing rapidly even though they do not have "good governance" according to the standard criteria.

From this perspective, Khan has identified two potential routes for governance reforms in poor countries. The first route — the good governance institutional reform agenda — is to implement institutional reforms that will transform their institutions into copies of those in advanced countries. The second route is to discover and implement specific governance changes, including both policies and institutions, which enable a country to accelerate its growth rate over an extended period of time and achieve structural transformation. This latter route would undertake governance reforms that are directly geared to transform it from one diverging in per capita terms from developed countries to one experiencing "catching-up" growth. The expectation is that as average income per capita increases the governance practices of the developing country will progressively conform to those in developed countries.

Good governance reforms should not simply be supporting markets. Rather, they should build "growth-promoting governance".

The latter route involves the adoption of a different set of institutional reforms from the good governance reform agenda. In short, these reforms should not simply be supporting markets. Rather, they should be building what Khan calls "growth-promoting governance" (Khan, 2008). This type of governance reform focuses on the effectiveness of institutions for accelerating capital accumulation and the transfer of assets and resources to more productive sectors, accelerating technological learning and maintaining political stability in a context of rapid social transformation. For Khan, such governance reforms involve transforming States that are currently experiencing socio-economic marginalization in the global economy into developmental States. This idea is very similar to the notion of development governance advocated in this chapter, and the possibility of using the developmental State as a model for development governance in LDCs will be taken up later in the chapter.

4. The problem of good governance reform overload

The good governance institutional reform agenda demands a complex set of reforms across many institutions which has led to reform overload in a number of countries.

The developmental impact of the good governance reform agenda is not simply an abstract issue but it is also related to how well the content of the reforms are fitted to the context where they are being implemented. In this regard, an important and problematic feature of the good governance institutional reform agenda is that it demands a complex set of reforms across many institutions. As Grindle (2004: 525–6) argues:

> Getting good governance calls for improvements that touch virtually all aspects of the public sector — from institutions that set the rules of the game for economic and political interaction, to decision-making structures that determine priorities among public problems and allocate resources to respond to them, to organizations that manage administrative systems and deliver goods and services to citizens, to human resources that staff government bureaucracies, to the interface of officials and citizens in political and bureaucratic arenas.

Implementing this agenda has led to reform overload in a number of countries. Thus institutional outcomes have diverged from expectations in implementing the good governance agenda on the ground. Brinkerhoff and Goldsmith (2005) have suggested that one tendency has been the emergence of institutional dualism, in which there is a double character to the way that things work, with elements of both the good (formal) governance systems and bad (informal) governance systems interacting. This may involve a tendency for the formal systems to be a façade within which informal practices continue to prevail, or sometimes it could involve a new productive synthesis of practices.[2] However, the reforms themselves are sometimes so ambitious that they can undermine the very possibility of good governance in very poor countries because officials are simply swamped by a constant round of reforms. In effect, the drive to implement an overambitious, unrealistic good governance agenda can in itself be incapacitating.

Regulatory reform, in which specific agencies are established to provide specific pro-market enabling roles, has often been strongly constrained, reflecting inappropriate transfer of models of regulation from developed to developing countries.

There is no comprehensive survey of how good governance reforms are working in practice in the LDCs. However, the experience of public administration reforms, even basic ones, implemented in some African LDCs has generally been very mixed so far (box 2). There have been particular weaknesses with reforms associated with the NPM. Performance enhancement reforms, which are central to NPM, have often failed in these countries because the basics — predictable multi-year funding, reliable measures of performance, rewards sufficiently large to make a difference and credible commitments to reward actual performance and not patronage — are not in place. It has also been noted that Performance Improvement Funds, which have been strongly promoted by donors, are "building without foundation" (Stevens and Teggemann, 2004: 70). Similarly, regulatory reform, in which specific agencies are established to provide specific pro-market enabling roles, has often been strongly constrained. This, it is argued, reflects an inappropriate transfer of models of regulation from developed to developing countries, with insufficient sensitivity to context (Therkildsen, 2008).

Box 2. Public sector reforms in LDCs: some lessons from experience in African LDCs

Two distinct waves of public sector reforms have occurred during the past twenty-five years. First generation reforms focused on redefining the roles of the public sector, reducing its size, bringing order to inappropriate structures in public organizations and their mandates, and controlling the activities of public sector workers through retrenchments, pay reform and payroll control. Second generation reforms started around the mid-1990s and were much broader in scope than the first generation reforms. Recent reforms seek to improve Government performance by building managerial capacities, developing positive organizational cultures and providing incentives for performance at the individual, organizational and country levels.

The World Bank supported the following types of initiatives: (a) pay reform, but shifting from across-the-board attempts to decompress and raise salaries towards more strategic increases for selected groups of staff ; (b) a renewed effort to focus Government on its "core" functions — law and order, regulation of the private sector, economic management and the provision of social services — to "reverse the relentless expansion" of programmes during the era of the developmental State; (c) creating executive agencies to enhance performance for specific functions; (d) pushing service delivery down to the local level — decentralization; (e) specific performance enhancing measures directed at ministries, local Governments and executive agencies; and (f) efforts to modernize budget and financial management and to strengthen audit institutions. New forms of State organization have emerged, inspired by the new public management and good governance. These include public–private partnerships in infrastructure development, (partial) privatizations of utilities and performance contracting arrangements between purchasers and providers. A particularly notable but underresearched trend in African LDCs has been the creation of many semi-autonomous executive agencies.

Reviewing major elements of this experience in African LDCs, particularly Uganda and the United Republic of Tanzania, Therkildsen draws the following lessons:

Pay reform: adequate pay is essential for the motivation, performance and integrity of public officials but pay reform has been conducted within an "iron triangle" of conflicting priorities: the size of the public sector, pay levels and budgetary wage limits. The latter have predominated. Uganda and the United Republic of Tanzania succeeded in improving pay in periods in the 1990s and early 2000s, but in Benin, Burkina Faso, Senegal and Zambia the civil service has experienced long-term pay deteriorations. The general situation is one in which average real pay is lower than at independence, even

Box 2 (contd.)

in countries where it has improved recently. Recent efforts are focusing on Selective Accelerated Salary Enhancement, which aims to raise the salaries of key technical and professional staff, but the economic and political sustainability of these measures remains doubtful. Allowances are increasingly used and middle-level public servants interviewed in 2006 in Uganda and the United Republic of Tanzania said that these were as or more important for their take-home pay than salaries.

Human resources management reform: in the 1980s and 1990s, human resource management reforms were dominated by attempts to increase pay to correspond to "living wages" and to fund the reduction of public sector employment. Employment reductions were politically resisted, costly, often hastily implemented and generally unsuccessful. Experiences from Uganda show that where pay increases were made they were financed by increased tax revenue generated by economic growth and better tax collection rather than savings from retrenchment. More attention is now paid to reforming personnel management systems. There has been a shift from an old career system towards a position-based system in which merit is related to the specific position. There is also a move towards performance management with managers and staff working towards performance targets and output objectives that define individual tasks. Thus in Uganda and the United Republic of Tanzania there has been a push for strategic plans, action plans, client service charters, carrying out of service delivery surveys and self-assessments, staff appraisals and the establishment of results-oriented monitoring and evaluation systems. These are very ambitious undertakings and it is difficult to assess the outcomes of these systems where they have been introduced. The available studies indicate that progress has been slow. The conditions for introducing performance management are generally not in place and until basic administrative and budgetary requirements exist, such NPM-inspired reforms will not work well.

Performance-enhancement reforms: the United Republic of Tanzania and Zambia have experimented with performance improvement funds (PIFs) to encourage willingness to adopt new ways of doing things and also success in meeting performance targets. However, once again this model seems to be "building without foundations" (Stevens and Teggermann, 2004: 70). If incentives for performance are limited, uncertain and/or transaction cost-intensive then PIFs are unlikely to succeed. If, on the other hand, incentives are substantial and predictable and given without too many strings attached, then strong administrative capacities are needed to utilize them efficiently.

Regulatory reforms: systematic evidence of what works and does not work in terms of regulatory reform in poor countries is scarce. But it is clear that regulatory agencies need substantial capacity to meet their pro-market regulatory and enabling roles. Market conditions and incentives must be understood and assessed continuously, information must be collected and analyzed to help to make appropriate regulatory decisions, and there must be some arms' length distance to and protection from political and business self-interests. Batley and Larbi (2004) found that business support services were most responsive to business needs when there was some degree of autonomy from the Government, some resource dependency on the firms to be supported (payment for services) and some institutional relations such as representation on boards.

Executive agency reforms: executive agencies are semi-autonomous contracting units that operate to achieve particular objectives under administrative accountability mechanisms. Such an agency can potentially recruit and offer appropriate incentives to qualified professionals. However, effective government management is needed to hold the agencies accountable to deliver the required services. Executive agencies have typically been established through the conversion of Government departments, previously operating in a hierarchical civil service, into semi-autonomous contracting units operating under administrative accountability mechanisms. This has been occurring in English-speaking African countries in particular. In the United Republic of Tanzania, 20 agencies were established in 2004 and more since. Uganda has around 75 agencies. Zambia has 40 agencies established by an act of Parliament. Examples of well-performing agencies are found in all countries, particularly when they have access to private finance. However, literature reviews suggest that performance has been mixed and there have been difficulties to hold agencies to account.

Source: Therkildsen (2008).

A particular constraint on the introduction of good governance institutions typical of advanced countries into LDCs is that the financial resource base of LDCs is very weak. Chart 5B shows the relationship between average government final consumption expenditure per capita and average GDP per capita for all countries in the world for which there are data in 2006. Government final consumption expenditure per capita covers all government current expenditures for purchases of goods and services (including compensation of employees). It is clear from the chart that there is a very close relationship between the ability of countries to finance governance and their GDP per capita. Moreover, the relationship between average government final consumption per capita and GDP per capita closely follows the relationship between government effectiveness as indicated by the good governance indicator and GDP per capita (chart 5A).

A constraint on the introduction of good governance institutions of advanced countries into LDCs is that the financial resource base of LDCs is very weak.

The average government final consumption per capita in LDCs in 2006 was just $60 per capita, compared with $295 per capita in lower-middle-income countries, $1,051 per capita in upper-middle-income countries and $6,561 per capita in high-income countries. The central question is: how can the institutions of advanced countries be expected to work in LDCs with this very low level of government expenditure per capita?

The average government final consumption per capita in LDCs in 2006 was just $60 per capita, compared with $295 per capita in lower-middle-income countries, $1051 per capita in upper-middle-income countries and $6,561 per capita in high-income countries.

Khan (2008) argues that the structural weaknesses of LDCs are such that an attempt to implement the ambitious institutional changes of the good governance reform agenda is simply doomed to failure. Thus, he suggests that the tax base for protecting all property rights as a public good simply does not exist in most poor developing countries. Most assets are in low-productivity sectors with production organized through households, such as in peasant agriculture or the informal sector. These assets generate an insignificant surplus that is insufficient to pay for their protection either through taxation or the purchase of private security. Similarly, electoral democracy in LDCs remains fragile because conflicts over resources are intense. Fiscal constraints often mean that it is difficult to deliver public goods to everyone and political stability then depends on the ability of the political system to deliver to powerful factions through networks of patron–client relations.

This does not mean that the values embodied in the good governance reform agenda are inappropriate for LDCs. However, it does imply that the specific content of the institutional reforms to achieve those values should be more realistically calibrated to country circumstances and developed over time.

The rest of this chapter examines how it may be possible to inject a more explicit development dimension into governance practices. It focuses in particular on governance practices within the developmental State. It considers what governance practices made some developmental States more successful than others and how the governance practices of developmental States need to be adapted to play a key role in economic development and social transformation in the twenty-first century. In discussing the former issue, particular attention is paid to East Asian models, but the discussion of the latter issue draws on a broader range of models, including Nordic models and Ireland, as examples of developmental States. Just as with the good governance reform agenda, it is clear that LDCs cannot simply transplant institutions from other countries and expect success. Attention will thus also be given (in section E) to the issue of building developmental State capabilities in LDCs.

The specific content of governance reforms should be more realistically calibrated to country circumstances and developed over time.

C. What makes some developmental States more successful than others

Like good governance, the concept of the developmental State has been conceptualized and defined in different ways by different people (box 3). A particular problem, as Mkandawire (2001: 291) argues, is that there is a danger that the developmental State is "deified into some kind of omnipotent and omniscient leviathan that always gets its way". This arises because a State is defined as developmental if the economy is developing, economic success is equated to State strength, and the latter is measured by the presumed outcomes of policy.

It is possible to avoid this tautological view, in which outcomes are used as explanations of the phenomenon in question, by recognizing that the Governments in developmental States are certainly developmentalist in their vision, their priorities and their ideology, but they may fail to achieve their objectives. From

Box 3. Different types of State: developmental States, regulatory States and enabling States

Developmental States

The idea of the developmental State has been applied in a number of contexts, including Latin America (Cardoso and Falletto, 1979; Schneider, 1999) and the late industrializing European countries such as Austria and Finland (Vartiainen, 1999). However, the original impetus to analyze the theory and practice of developmental States came from the work of Chalmers Johnson on Japan (Johnson, 1982) and the subsequent application of the concept as part of the explanation of East Asian development (Woo-Cummings, 1999; Johnson, 1999). Johnson distinguished between socialist developmental States, such as the Soviet Union before the fall of Communism, and capitalist developmental States which he found in East Asia. He defined the latter as existing when: "(i) there is a developmentally-oriented political elite committed to break out of the stagnation of dependency and underdevelopment and for whom economic growth is a fundamental goal, (ii) such an elite is not committed first and foremost to the enhancement and perpetuation of its own elite privileges, and (iii) the elite sees its primary leadership task to discover how, organizationally to make its own development goals compatible with the market mechanism and the private pursuit of profit" (Johnson, 1987: 140).

Generalizing from this work, different authors have defined the concept in different ways but all emphasize the Government's commitment to developmentalism and the translation of this commitment into policies and institutions designed to achieve national economic development. Thus:

(a) Fritz and Menocal (2007: 533) understand a developmental State to exist "when the state possesses the vision, leadership and capacity to bring about a positive transformation of society within a condensed period of time";

(b) Bagchi (2000: 398) defines a developmental State as "a state that puts economic development as the top priority of government policy and is able to design effective instruments to promote such a goal"; and

(c) Chang (1999: 183, 192) defines a developmental State as "a state which can create and regulate the economic and political relationships which support sustained industrialization. … This State takes the goals of long-term growth and structural change seriously, 'politically' manages the economy to ease the conflicts inevitable during the process of such change (but with a firm eye on the long-term goals), and engages in institutional adaptation and innovation to achieve these goals."

One important insight from Johnson's work is that the activities of the developmental State, which involve harnessing the energies of the private sector for private economic development, comprise a complex task in which the Government may constantly be threatened with failure. It is wrong to deify the developmental State into "some kind of omnipotent and omniscient leviathan that always gets its way" (Mkandawire, 2001: 291).

Within this Report, the developmental State is therefore understood, following Mkandawire (2001), as a State whose ideological underpinnings are developmental and one that seriously attempts to deploy its administrative and political resources to the task of economic development.

Regulatory States and enabling States

The understanding of the idea of the developmental State can be sharpened by contrasting it with two other types of State currently discussed in policy analysis — the regulatory State and the enabling State.

In his initial work, Johnson distinguished between the developmental and regulatory State, and he noted that the latter differs from the developmental State in that its fundamental role is not to shape outcomes but rather to provide regulatory frameworks, i.e., to set the rules of the game. Regulation is the central role of the regulatory State. On top of this, the regulatory State has been closely associated with privatization and the subsequent need to correct the market failures caused by monopoly suppliers, to create competitive markets and to achieve public service objectives that cannot be delivered by market mechanisms. Typically, the emergence of the regulatory State is marked by the creation of new and autonomous regulatory institutions, such as independent central banks. The main role of the State is not to regulate but to set up the regulatory agencies and oversee these agencies. For this reason, the regulatory State is associated with an increasingly technocratic and juridical approach to economic governance and a "depoliticization" of economic management (Phillips, 2006; Minogue and Carino, 2006).

Regulation is certainly one policy mechanism of the developmental State. But it would be too restrictive to confine the policy mechanisms of the developmental State to regulation. Moreover, it is particularly restrictive in light of the important role of the developmental State to act in an entrepreneurial manner to nurture new activities (for example, Lazonick, 2008).

Another type of State that is talked about is the enabling State. This concept is particularly related in the literature to the transformation of the welfare State in rich countries. Taylor (2008) writes that "the notion of the enabling State gained currency in the [United Kingdom] in the 1990s as an alternative to the providing or welfare State. It reflected the process of contracting out in the [National Health Service] and compulsory competitive tendering in local Government in the 1980s, but was also associated with developments in the 1990s in health, social care and education in particular." These developments were particularly focused on the creation of an internal market in the National Health Service and attempts were made to provide users with more opportunity to influence provision. Similarly, Gilbert (2005: 6) affirms that the enabling State is a State "whose role is to provide social protection through public support for private responsibility".

Box 3 (contd.)

This involves in particular the shifting of responsibility for social protection that aims to limit the direct role of the State and to increase private activity in the financing and delivery of social benefits. With these associations, it is clear that the notion of the enabling State is an inappropriate substitute for the developmental State.

Page and Wright (2008: 4) associate the enabling State with a particular modality of governance in which the main role of the State is "enabling other organizations — whether private, voluntary, semi-public, regional and local Government or judicial bodies or arm's length government agencies — to provide services and to exercise hands on control over the application of regulation". In the enabling State, senior officials become network managers rather than wielders of authority and there is a move from the direct application of hierarchical authority through Government to the mobilization of networks through governance.

As with regulation, such a mode of governance can certainly be an element of the practice of developmental States. Indeed, an argument later in this chapter is that these modern forms of network governance need to be adopted as a key element of the new developmental State. But reducing the policy mechanisms of developmental States only to such enabling forms of action would be unnecessarily restrictive.

The concept of the developmental State is thus more encompassing as a basis for reconsidering the role of the State. Neither the regulatory State nor the enabling State can capture the entrepreneurial nature of the developmental State or its commitment to structural transformation as a means to provide employment for people and improve their living standards.

this perspective a developmental State is defined in this chapter as "a state that puts economic development as the top priority of government policy and seeks to design policies and institutions to promote this goal" (Mkandawire, 2001: 291). With this definition, it is not assumed that that the developmental State inevitably achieves developmental outcomes, but rather that there is a constant commitment, effort and orientation to achieve developmental outcomes. This is a very complex process that requires policy experimentation, policy learning and institutional adaptation and innovation. Thus in developmental States, policies and institutions are constantly evolving and being adapted to new external circumstances and changes in internal structures, and policy-makers are always in danger of failing.

A developmental State is defined as "a state that puts economic development as the top priority of government policy and seeks to design policies and institutions to promote this goal".

With this broad definition, there are a wide range of developmental States. These include the successful East Asian developmental States, notably the initial four Asian tigers — Hong Kong (China), the Republic of Korea, Singapore and Taiwan Province of China — and also more recent successes — Malaysia, Thailand and Viet Nam — as well as China. But beyond this, there are socialist developmental States such as the Soviet Union before the fall of communism (Johnson, 1982), the developmentalist States of Latin America in the 1940s and 1950s (Cardoso and Falletto, 1979; Schneider, 1999), late industrializing European countries such as Austria and Finland (Vartiainen, 1999) and early post-colonial African developmental States and also the democratic developmental States of Botswana and Mauritius (Mkandawire, 2001).

There are a wide range of developmental States. A central issue is what makes one type more successful than others.

The central issue that then arises is what makes some developmental States more successful than others. Various possible conditions for success have been identified in the literature. These include firstly, initial conditions — most notably, the length of experience a country has in terms of its manufacturing experience (Amsden, 2001); secondly, international economic relations, including the existence of policy space (Chang, 2008b) and supportive political allies in rich countries (Cumings, 1987); and thirdly, political prerequisites, in particular cohesive rather than fragmented multiclass States (Kohli, 2004). However, a critical factor that has distinguished more successful from less successful developmental States has been the nature of development governance.

The rest of this section identifies key features of development governance in successful developmental States. It discusses both policies (what Governments did) and also institutions (how they did it), as both areas are important aspects of good development governance. The section draws in particular on the experience of development governance in successful developmental States in East Asia, as these have been studied the most and UNCTAD has made a particularly strong contribution in this area.

In the successful developmental States of East Asia, policies sought to develop the productive capacities, expanding employment opportunities, stimulating structural transformation and increasing living standards.

1. What Governments did[3]

In the successful developmental States of East Asia, policies were production-focused. They sought to develop the productive capacities of a country with a view to expanding employment opportunities and labour productivity, thereby increasing living standards. In all successful cases, except the city States, policies have encouraged structural transformation, a process in which the relative importance of agriculture and primary commodity extraction has declined within the economy while that of manufacturing industries has increased, and in which production processes have progressed from less to more skill-, technology- and capital-intensive activities. At the macro level, structural transformation has been driven and facilitated by a rapid pace of capital accumulation that depends on increased domestic savings, investment and exports (both in absolute terms and as a share of GDP), linked together in a virtuous circle of cumulative causation. At the enterprise level, this process is founded on imitation, learning and adaptation of internationally available technologies in order to reduce costs, improve quality and introduce goods and services not existing in a country, and on the diffusion of best practices from more advanced to less advanced enterprises within a country, including from foreign owned to locally owned firms (Gore, 2000).

Policies to develop productive capacities involved a combination of macroeconomic, mesoeconomic and microeconomic policies. Thus economic governance invariably involved the adoption of some form of industrial policy.

An important aspect of policies to develop productive capacities is that they did not simply involve macroeconomic policy or getting the overall investment climate right (a framework approach). Instead they involved a combination of macroeconomic, mesoeconomic and microeconomic policies. Thus economic governance invariably involved the adoption of some form of industrial policy or what ECLAC has more generally called productive development policy (ECLAC, 1996; 2004). This includes a range of measures, coordinated with macroeconomic and trade policies, designed to improve the supply capabilities of the economy as a whole and also specific sectors, and to help the private sector to identify and acquire competitive advantage. These measures, which evolved over time as the economy developed, were founded on a dynamic interpretation of comparative advantage. In this forward-looking approach, the opportunities of current relative cost advantages are exploited to the full, but efforts are made at the same time to promote investment and learning in economic activities where comparative advantage can be realistically expected to lie in the immediate future as the economy develops and as other late industrializing counties catch up.

Successful developmental States decided the timing, speed and sequencing of opening on the basis of how they support the national interest in promoting economic growth and structural change.

Successful developmental States managed their integration into the world economy. This involved neither de-linking and closing the economy to the rest of the world, nor cross-the-board opening up of the economy to imports and external capital. Rather there was a process of strategic integration with the rest of the world, in which the timing, speed and sequencing of opening in relation to different types of international flows was decided on the basis of how they support the national interest in promoting economic growth and structural change.

Finally, successful developmental States also paid attention to distributional issues to ensure that the dynamic benefits of growth were socially acceptable. This was achieved through a production-oriented approach rather than redistributive transfers. Thus, a significant fact about successful developmental States is that they are not high “tax and spend” countries (Sindzingre, 2007). The main bases for a more equitable growth process were wide asset ownership, including though land reform and investment and education, and the expansion of productive employment, as well as a business elite committed to investment rather than conspicuous and luxury consumption.

Successful developmental States also paid attention to distributional issues to ensure that the dynamic benefits of growth were socially acceptable.

2. How Governments did it: the role of the State and the market

Successful developmental States were based on a mixed economy model in which the Government worked in partnership with the private sector to achieve national development goals. This did not mean that public ownership was avoided in successful developmental States. Indeed it is an often ignored fact that some of the successful East Asian newly industrializing economies (the Republic of Korea, Singapore and Taiwan Province of China) made use of public ownership (Chang, 2008a). However, the commitment to public ownership in successful developmental States was pragmatic (i.e., does it contribute to the national economic development goals?) rather than ideological. Moreover, the major function of the State was not seen as being to replace the private sector but rather to design policies and institutions that harness private ownership, the animal spirits of entrepreneurs and the drive for profits, to achieve national development goals.

In successful developmental States, market failures have been understood in relation to the ability of the market mechanism to achieve the goals set by the Government.

Whilst the idea of market failure has been important within successful developmental States, there is a different understanding of this concept than in mainstream economic theory. In the latter context, market failure is defined as occurring when the market economy fails to allocate resources efficiently, which is understood as a deviation from the general equilibrium that is expected in perfectly competitive markets.[4] But in successful developmental States, market failures have not been understood in this way but rather in relation to the ability of the market mechanism to achieve the goals set by the Government. For example, Kato et al. (1993: 28) defines market failures as arising “when the goods and services deemed necessary by society cannot be easily or adequately provided through the dependence on only the free economic activities of private sectors motivated by private profit”.

The possibility of Government failure does not foreclose public action. Rather it points to the need to build up the organizational and institutional capabilities of governance required for the implementation of a national development vision.

This developmentalist view of market failure has, in successful developmental States, also been embedded within a broader notion of system failure, which arises when the economic system as a whole fails to achieve the developmental goals set by the Government. This view rests on the fact that development depends on market institutions and non-market institutions. Market institutions in a capitalist system include the firm as the basic institution of production, but also various producer and consumer groupings such as conglomerations of firms, producer associations, trade unions, purchasing cooperatives and subcontracting networks (Chang, 2003a). The idea of systems failure is particularly important in developing economies at the early stages of development because, as Yanagihara (1997: 11) puts it, markets actually “are created and developed through an interactive process of decision-making and action-taking by economic agents in an attempt to establish and reform interrelationships among them”. This means that development efforts cannot be limited to “freeing markets”; rather an important role of Government should be to create and develop the capabilities of non-market institutions and promote the relationships between them so that markets are created and develop.

The notion that the problem that must be tackled is the failure of the whole economic system also brings government failure into the picture, as the Government is a key institution in the system. As Yanagihara (1997: 22) states:

> The overall role of the Government is to facilitate the evolution of the economic system so that goals of economic development could be achieved.

… At a most general level government failures may be defined in relation to the attainment of this task. The extent to which the Government will be able to carry out this task will hinge on its own organizational/institutional capabilities. In cases of serious government failure the Government itself may turn into the source of system failure.

But from the systems failure perspective, the possibility of government failure does not foreclose public action. Rather it points to the need to build up the organizational and institutional capabilities of governance required for the implementation of a national development vision and facilitation of the development process.

The four major functions of successful developmental States are: (a) providing a vision; (b) supporting the development of the institutional and organizational capabilities; (c) coordinating economic activities; and (d) managing conflicts.

3. How Governments did it: functions of the State

Against this background, in which the Government is working with a mixed economy model in partnership with the private sector, it is possible to identify four major functions of successful developmental States: (a) providing a vision; (b) supporting the development of the institutional and organizational capabilities of the economic system, including the Government's own capabilities; (c) coordinating economic activities to ensure the co-evolution of different sectors and different parts of the economic system; and (d) managing conflicts.

Providing a vision for the future of the economy is the most basic function of the State. The five-year development plan has been an important mechanism for this. It represents an indicative forecast of where the economy should and can develop and also provides basic guidelines that shape the expectations underlying household and business decisions. But as well as this general vision, more specific visions may be drawn up for the various sectors. The importance of such visions is that they lead "private sector agents into a concerted action without making them spend resources on information gathering and processing, bargaining and so on" (Chang, 2003b: 53). In providing the vision the State is acting like an entrepreneur and its vision may well be wrong. But what is necessary is not to dismiss State entrepreneurship as risky but to minimize the risk of promoting the wrong vision by "building a mechanism that will enable the State to put together and prepare different visions that exist in society and to create a consensus out of them" (ibid.: 54).

Realizing a vision requires policy and institutional innovation. Because it is through the private sector that the vision is realized, a central role of the State is to strengthen the capabilities of economic agents.

Realizing the vision requires policy and institutional innovation. Because it is through the private sector that the vision is realized, a second central role of the State is to strengthen the capabilities of economic agents. This is not simply a matter of strengthening capabilities at the firm level but also of deepening inter-firm relationships and networks.

Coordination is essential as factors of production are interdependent in use but dispersed in ownership.

The third essential role is coordination. This is essential as factors of production are "interdependent in use but dispersed in ownership" (Abramovitz, 1986: 402) and there are also many complementarities between investments such that one investment alone is unprofitable whilst a cluster of related investments can be profitable. There is also a need to ensure the co-evolution of different parts of an economic system so that supply bottlenecks (for example, caused by underinvestment in infrastructure), resource scarcities (such as particular types of human capital) or institutional scarcities (such as technology centres) do not arise.

Finally, a critical role of the State is conflict management. The societal transformation involved in structural transformation is massive and there are inevitable social conflicts as different people gain and others lose in the "creative destruction" of activities and institutions. Conflict management involves ensuring that the benefits, or expected benefits, of the transformation are widely shared. This is necessary for economic dynamism, but at the same time it is important that methods of conflict management do not have adverse effects on efficiency and productivity.

Governance in successful developmental States was founded on technically competent bureaucracies.

4. How Governments did it: institutional capabilities

An important lesson from governance in successful developmental States is that it was founded on technically competent bureaucracies. Investment in higher education was vital for this. But coherent governance for development was typically achieved through the establishment of a pilot agency that shaped development initiatives. Examples are the Ministry of International Trade and Industry in Japan, the Economic Planning Board in the Republic of Korea, the Economic Planning Board in Singapore and the Council on Economic Planning and Development in Taiwan Province of China.

The economic bureaucracy established close Government–business ties to enable the implementation of policies that supported the needs and general interests of business.

In successful developmental States, the economic bureaucracy also established close Government–business ties to enable the formulation and implementation of policies that supported the needs and general interests of business. This was not a situation in which bureaucrats worked in their own world, with textbook economic models or with donor blueprints. Rather as Evans (1998: 76) has put it: "Effective Government–business relations depended on large volumes of high quality information flowing between Government and corporations and on mutual confidence that predictions and commitments were credible. Neither could be generated by exchanging position papers and publicity releases." A variety of institutional forms enabled effective information flows between Government and business, with Japan's Deliberation Councils as an archetype in East Asia. Often, they were designed at the sectoral level.

A critical feature of successful developmental States is that incentives and resources that Governments provided to private sector activities were contingent upon performance.

A further critical feature of successful developmental States is that incentives and resources that Governments provided to animate and guide private sector activities were contingent upon performance (Amsden, 2001). Thus, for example, access to cheap credit depended on investment in new machinery, or access to duty-free imports was tied to 100 per cent exporting. The results-oriented performance standards adopted were particularly related to production and trade objectives that could be monitored at the firm level. Other important features of government support were that it often involved contests or competition amongst firms, and that it was time-limited. This was a way of reducing misuse and guarding against capture. For example, firms would compete for technology licenses that would give them exclusive access to the domestic market for, e.g., a five-year period. Another mechanism of ensuring effective use of government support was that firms were gradually made subject to the discipline of competition through international markets.

The incentives and resources provided by Government included the creation of rents for inducing new investments and innovative activity.

The incentives and resources provided by Government included the creation of rents. That is, policies were devised to ensure that private companies would secure profits above normal market conditions. Such rents were particularly important for inducing new investments and innovative activity. The management of rent-seeking was thus an essential part of governance in successful developmental States. In this model, rent-seeking was not in itself bad. But the key governance issue was to ensure that rents were derived through activities that had social as well as private returns and that the rents, when earned as profits, were reused in a way that supported national development.

Finally, a key feature of successful developmental States was that they designed a bank-based financial system that ensured that long-term finance was available for productive investment by the private sector. This often involved either quite strong administrative guidance by the Government or State ownership of key financial institutions.

D. Adapting the developmental State to the twenty-first century

These lessons about development governance in successful developmental States are drawn from the experience of developmental States from the 1960s to the 1990s. An important recent area of thinking has been to consider how the developmental State can be adapted so that it can continue to play a key role in economic development and social transformation in the twenty-first century. This draws upon a broader range of models than East Asian developmental success, including Nordic models and Ireland, the "Celtic Tiger".

In the 21st century, the developmental State should give greater emphasis to the role of knowledge in processes of growth and development...

It is possible to identify six major types of adaptation that would constitute features of a forward-looking developmental State:

(a) Giving greater emphasis to the role of knowledge in processes of growth and development. This is because "growth is driven more by ideas and information (both as a means of production and objects of consumption) than by the physical transformation of nature" and "profits increasingly depend on intangible assets (ideas, brand, images) and the protection of those assets through intellectual property rights" (Evans, 2008). This directs attention to the important role of knowledge systems and national innovation systems, alongside financial systems, as critical institutional complexes in the development process;

(b) Considering how to shift from economic activities that are characterized by decreasing returns to those characterized by increasing returns (Reinert, 2007). This would promote economic growth and structural transformation through a type of diversification that does not solely rely on the expansion of manufacturing industries. In this regard, more attention may be given to services (Evans, 2008);

... and it should make better use of the opportunities of interaction between domestic and foreign capital by increasing the developmental impact of FDI and upgrading through links with global value chains.

(c) Exploring how to make better use of the opportunities of interaction between domestic and foreign capital by increasing the developmental impact of foreign direct investment (FDI) and upgrading through links with global value chains. This was particularly important for Ireland (O'Riain, 2000);

(d) Adopting a regional approach to developmentalism that increases policy space and exploits the potential for joint action to create the conditions for structural transformation (UNCTAD, 2007);

(e) Building democratic rather than authoritarian developmental States (Robinson and White, 1998; Kozul-Wright and Rayment, 2007); and

(f) Drawing on new thinking about modern governance approaches that focus on new forms of interaction between Government and society and between the public and private sectors, and the associated diversification of policy mechanisms and policy instruments to apply this to the task of governance for development.

Some of these issues — notably the increasing importance of knowledge, the interaction of domestic and foreign capital and the potential of increasing returns through activities other than manufacturing industry – will be taken up later in this Report (in particular, chapter 4). However, the rest of this section looks at some recent thinking on the democratic developmental State and modern governance practices that involve new forms of public sector/private sector interactions.

Democratic deliberation is critically important to build societal consensus around a national development project and to develop effective policies and institutions.

1. The democratic developmental State

In recent discussions of the new developmental State, an important concept to emerge is the notion of the democratic developmental State. This idea is important because one principal objection to the desirability of the developmental State model is that many of the successful cases have had authoritarian regimes. Thus, some have admired the ability of the autocratic developmental State to deliver developmental results whilst regretting the price involved in terms of loss of democratic freedom, considering the latter too high (Kohli, 2004). Moreover, in the wake of the wave of democratization that has occurred since the early 1990s, in which the LDCs have certainly participated (UN-OHRLLS/UNDP, 2006), the idea of the authoritarian developmental State has much less societal support. In this new context, the potential for building democratic developmental States, and the nature of the democratic developmental State, are the key issues.

The relationship between democracy and development is a very complex issue.[5] From those thinking about the nature of democratic developmental States, two key insights are noteworthy.

In successful developmental States the ideological commitment to development is not simply held by a small cadre of political leaders and bureaucrats, but more widely shared in society.

Firstly, it has been observed that electoral democracy with competitive political parties has yet to play an important role in fostering democratic developmental States. Randall (2007: 633) writes that “on the available evidence, parties make a very limited contribution to the emergence of new democratic developmental States, in terms of either democracy-building or policy-making, recruitment, ensuring accountability or policy implementation”. She argues that this is due to weak institutionalization and the prevalence of “clientelism”. However, it has also been noted that within some democracies with hegemonic and quasi-single ruling parties, these parties have sometimes played a significant developmental role. An example is the Botswana Democratic Party. In some cases, what has worked is that there is a single dominant party but there is frequent renewal of the leadership and elected representatives through the democratic process.

A democratic developmental State is one that not only embodies the principles of electoral democracy but also ensures citizens’ participation in the development and governance process.

Secondly, it is clear that democratic deliberation is critically important to build societal consensus around a national development project and also to develop effective policies and institutions in what is necessarily an open-ended and uncertain development process. Kozul-Wright and Rayment (2007: 258) argue that democratization helps because “problem-solving involves experimentation, processes of trial and error, tolerance and encouragement of open criticism and willingness, or at least incentives, for Government to change direction as a result of that criticism”. But there is a need to promote “thicker” forms of democratic decision-making than simply holding regular elections. This means greater emphasis on deliberative democratic approaches in which people and their organizations interact to solve common problems and create new opportunities. Kozul-Wright and Rayment (2007: 260) argue that “by strengthening the local and micro-foundations of democracy, Governments can be helped to design more effective strategies for reform and to build a broad coalition for societal change”. It is through this mechanism that it is possible to deploy local knowledge and local interests to ensure that policies are contextually appropriate. From this perspective, it has been argued that “a democratic developmental State is one that not only embodies the principles of electoral democracy but also ensures citizens’ participation in the development and governance process” (Edigheji, 2005: 5).

The most basic insight of recent thinking on democratic developmental States is therefore not that there should be a commitment to a particular type of democratization but rather to harnessing citizens' participation in governance for development purposes. Looking to the past it is clear that a feature of successful developmental States has been that the ideological commitment to development is not simply held by a small cadre of developmentally determined political leaders and bureaucrats but is also more widely shared in society. A national developmental vision is particularly effective when it becomes a shared national project and there is a societal mobilization behind the goals of this project. To the extent that a particular form of democratization supports this, both society-wide and in the local identification of development problems and development opportunities, democratization can make the developmental State more effective. But to the extent that the form of democratization undermines societal cohesion behind a shared development project, it will detract from this effectiveness.[6]

Harnessing citizen's participation in governance for development purposes is more important than commitment to a particular type of democratization.

2. Modern governance for development

A second area that is relevant to the new developmental State is the application of modern forms of governance to the task of development. From the earlier discussion, it is clear that successful developmental States in the past did not use simple top-down control but rather worked through public–private partnerships of various kinds. In recent years there has been much greater thinking and analysis on how such an approach to governance can work (for example, Kooiman, 1993; Rhodes, 1996; Peters and Pierre, 1998; Pierre, 2000). This thinking and analysis has been conducted in literature on the nature of modern governance and what it means for what Governments do. There is much scope now for application of these new ideas about modern governance to the task of development, and this can provide further ideas for the new developmental State.

Governments cannot resolve societal problems or create societal opportunities alone, but governing is rather a matter for both public and private actors, and in particular interactions between them.

The basic insight of the modern governance approach is that Governments cannot resolve societal problems or create societal opportunities alone, but that governing is rather a matter for both public and private actors, and in particular interactions between and amongst them. This changing role of Government is related to "the development of governing styles in which boundaries between and within public and private sectors have become blurred" (Stoker, 1998: 17). One elegant and much quoted metaphor to describe this shift is to say that the principal feature of emerging forms of governance is that Governments are giving up "rowing" (through direct service provision and State owned enterprises), which will now be undertaken by private sector actors and local communities, and focusing on "steering" (leading, thinking and guiding) — Osborne and Gaebler (1992). Kooimann (1993: 34) conceptualizes the shift as "away from 'one-way steering and control' to 'two-way or multi-way designs' in which people in a variety of roles and circumstances are engaged in mutual problem-solving"; whilst Pierre (2000: 242) characterizes the shift as:

In emerging forms of governance Governments are giving up "rowing", which will be undertaken by private sector and local communities, and focusing on "steering".

> a shift from a centripetal to a centrifugal model of governing. In the centripetal model, the political centre was the undisputed source of political power and institutional capabilities. In the centrifugal model of governing, however, the state seeks to increase its points of contact with its external environment as a means of conveying its objectives to the surrounding society.

Putting this into practice can be expected to be a key feature of governance in the new developmental State. This will involve attention to modalities of coordinating societal activities, types of policy instruments and sources of administrative effectiveness.

In terms of modalities of governance, an important new strand of thinking relates to what is called "network governance". As Jessop (1998) emphasizes, this modality of governance does not work through the formal and impersonal procedures of the market, or the top-down, ex ante goal-setting of hierarchical governance, but rather through continuing reflexive procedures, in which different actors in the network identify mutually beneficial joint projects, refine and redefine them as they monitor how far they are being achieved and respond to changes in the external environment. This involves continued negotiation of goals, cooperative mobilization of resources controlled by the different actors involved to achieve their interdependent goals and also continuing dialogue to establish the ground rules for negotiated consent, resource sharing and concerted action. Such networks can include a range of organizations, both State and non-State actors.

The new developmental State is likely to use a judicious mix of different modalities of governance (hierarchy, markets and networks) and also to adopt a wide array of policy instruments.

The new developmental State is likely to use a judicious mix of these different modalities of governance and also to adopt a wide array of policy instruments. These instruments may be designed to influence outcomes or processes through which outcomes are achieved and to do so through a variety of "governing resources", namely giving information, using State authority to make laws and regulations, deploying financial resources through taxation and government expenditure, and employing the public sector in direct action (table 4). For the different instruments, the State is more or less involved, with different degrees of compulsion and voluntary action in the way in which outcomes are achieved (chart 6).

Second generation theories of policy choice have moved beyond good and evil and focused more on why a particular combination of procedural and substantive instruments is utilized in specific contexts.

Modern governance involves matching the policy instruments to the task. First generation theories of policy instrument choice, Howlett (2004: 1) argues, were stuck in a "one size fits all" perspective and what he calls "a struggle between 'good and evil' in which an existing range of instrument used is condemned and the merits of some alternative single instruments trumpeted as the embodiment of all that is good in the world". The unfortunate consequence of this approach, which pitted the vices of State dirigisme against the virtues of privatization, markets and deregulation, was to wield the policy instrument "less like the scalpel of a careful surgeon working on the body politic, and more like the butcher's cleaver, with little respect for the tissue of the patient falling under the knife" (ibid.: 1). Second generation theories of policy choice, which are associated with the modern governance perspective, have moved "beyond good and evil" and focused much more on why a particular combination of procedural and substantive instruments

Table 4

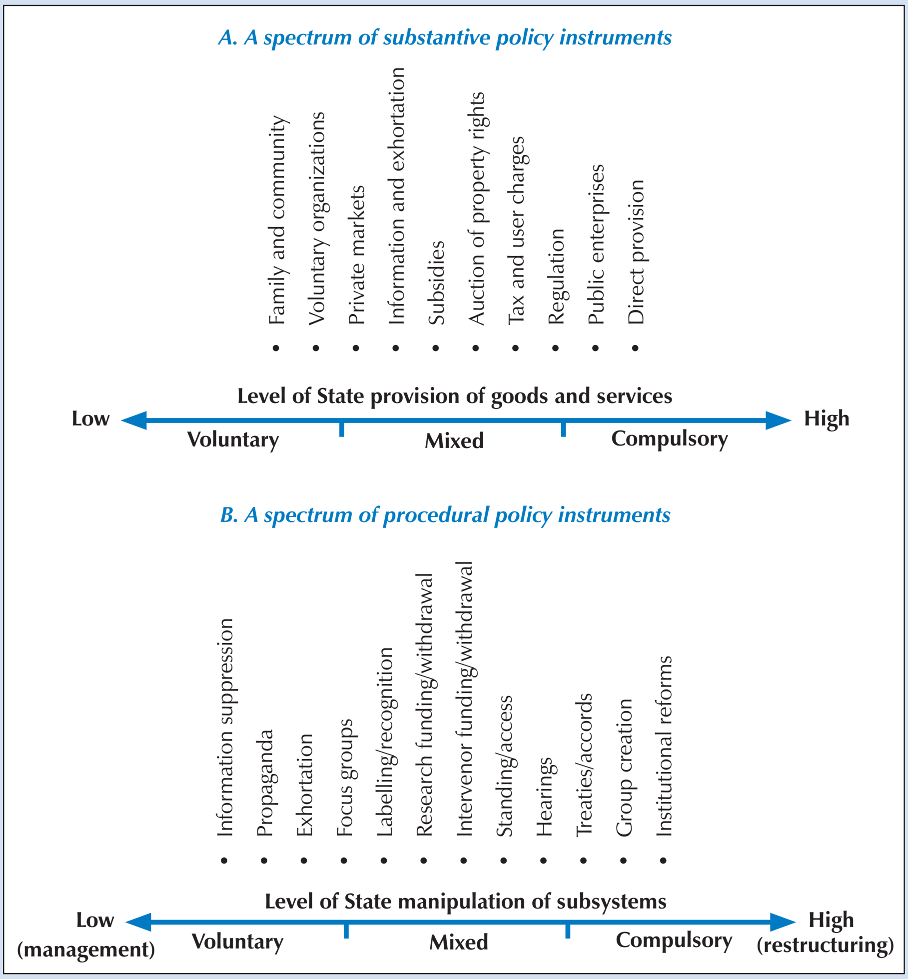
Taxonomy of substantive and procedural policy instruments

Principle use	Governance resource			
	Information	Authority	Finance	Organization
A. Substantive policy instruments				
Effectors	Advice Training	Licences User charges Regulation Certification	Grants Loans Tax Expenditures	Bureaucratic Administration Public enterprises
Detectors	Reporting Registration	Census-taking Consultants	Polling Policing	Record-keeping Surveys
B. Procedural policy instruments				
Positive	Education Exhortation Advertising Training	Agreements Treaties Advisory-group Creation	Interest-group funding Intervenor-funding	Hearings Evaluations Institutional- bureaucratic reform
Negative	Misleading information propaganda	Banning groups and associations	Eliminating funding	Administrative delay Information suppression

Source: UNCTAD secretariat, adapted from Howlett (2004).

Chart 6

The spectrum of substantive and procedural policy instruments



Source: Howlett (2000).

is utilized in specific contexts. What matters here is the employment of "a mix of policy instruments carefully chosen to create positive interactions with each other and to respond to particular context-dependent features of the policy sector" (Howlett, 2004: 8). This type of approach is likely to be an important aspect of new developmental States.

The new developmental State is likely to draw on a "hybrid approach" to ensure administrative effectiveness, based on bureaucratic capacity, market signals, and bottom-up democratic accountability.

Finally, the new developmental State is likely to draw on what Evans (2005) has called a "hybrid approach" to ensure administrative effectiveness. This approach would balance three basic modes of ensuring effectiveness: bureaucratic capacity, built on meritocratic recruitment, professional norms, predictable rewarding careers and coordinated organizational structures; market signals, which convey costs and benefits, facilitate the efficient allocation of resources and provide fiscal discipline to make sure that goals remain consistent; and bottom-up democratic control in which, through deliberative participation as well as transparency and accountability, the goals pursued by the State would reflect the needs and desires of ordinary citizens (Evans, 2005). Whereas the old developmental State was founded on bureaucratic capacity, and the NPM reform agenda has particularly emphasized the disciplinary power of the market on State actors, the new developmental State would seek a better balance between these ways of guiding public administration and also seek to inject bottom-up citizen participation.

E. Can LDCs build developmental State capabilities?

When East Asian developmental States embarked on their development process, the technical capacities of their Governments were not particularly advanced...

1. Yes they can!

It is necessary to be quite sanguine about the task of building capable developmental States in LDCs. However, although we must leave aside those few LDCs where internal conflict has left State structures weak and unviable, there are a number of factors that suggest that it would be possible to build developmental State capabilities in many LDCs.

Firstly, an important lesson from the experience of successful East Asian developmental States is that when they embarked on their development process, the technical capacities of their Governments were not particularly advanced. As Evans (1998: 71) puts it:

> Public bureaucracies capable of fostering effective public performance in global markets were not some kind of natural resource, immediately available to East Asia following the Second World War. Modern bureaucracies were constructed through intense prolonged struggles for reform and endless experimentation over the course of the post-Second World War period.

... they were built up over time, through policies of meritocratic recruitment, continuity of personnel and rewards commensurate with those that capable individuals could attain in the private sector.

They were built up over time, through policies of meritocratic recruitment, continuity of personnel and a career structure that produces rewards commensurate with those that capable individuals could attain in the private sector (Evans, 1998). Significantly, even in successful developmental States all the bureaucracy was not necessarily super-efficient. Policy learning was an integral aspect of the process of building developmental State capability, and this occurred over time.

Secondly, it is clear that there was a deliberate strategy to build a few strategically important agencies rather than to improve government effectiveness across the board and all at once. Thus, an important lesson of the East Asian experience is that "a substantial share of the benefits of superior bureaucratic performance may be obtained by focusing reforms on a relatively small set of economic agencies" (Evans, 1998: 73). Rodrik has also found in a cross-country analysis of the relationship between institutions and growth that "large-scale institutional transformation is hardly a prerequisite for getting growth going. … The initial spurt in growth can be achieved with minimal changes in institutional arrangements. … Countries do not need an extensive set of institutional reforms in order to start growing" (Rodrik 2007: 191).

There was a deliberate strategy to build a few strategically important agencies rather than to improve government effectiveness across the board and all at once.

Thirdly, one should not be overly pessimistic about the potential for public sector reform to build developmental State capabilities by looking at recent experience. Perhaps the major lesson of past experience with public sector reform in LDCs is that weak country ownership has undermined sustainability and success. Therkildsen (2008: 46) states that "there is no doubt that many reform initiatives have grounded to a halt because donors push too hard on issues that had a limited domestic constituency". This has been a particular feature of past efforts to build general State capacity. It has been observed that the types of capacity development that donors are likely to do well normally do not lead directly to significant improvements in State capacity (Teskey, 2005). The reason is that improvements can be real at an individual organizational level but they do not have significant capacity impacts as they do not spill over into affecting inter-organizational relations and the rules of the game. The key lesson of many decades of donor assistance is that if such interventions are not domestically owned they will not have much impact. To the extent that a developmental vision and approach is country owned, building developmental State capabilities should be easier.

Institutional innovations do not travel well. It is necessary to look at successful models and identify which principles and practices provide a "good fit" with the circumstances of each LDC.

2. A pragmatic approach to building developmental State capabilities

One major lesson of efforts at institutional reform is that "institutional innovations do not travel well" (Rodrik, 2005: 994). As noted above, this is clear in the implementation of the good governance reform agenda, but it is also clear that LDC Governments should not imagine that they can simply take policies and institutions from successful developmental States, for example in East Asia, and transplant them for guaranteed success.[9]

In building developmental State capabilities in LDCs, what is necessary is to look at successful models and then identify which principles and practices provide a "good fit" with the circumstances of each LDC. This is different from the wholesale transfer of best practice. What constitutes a "good fit" to particular country circumstances will change over time. It is necessary to have an evolutionary approach in which policies and institutions are adapted to the level of development of both productive capacities and governance capabilities.[7] This should build on what exists within a country rather than identifying what does not exist when its institutions are compared with some external norms of best practice — either as set out in the good governance agenda or provided by the models of successful East Asian newly industrializing economies. Models transferred wholesale from the newly industrializing economies are likely to be as unsuccessful as models transferred from advanced countries.

It is necessary for Governments to have an overall development vision.

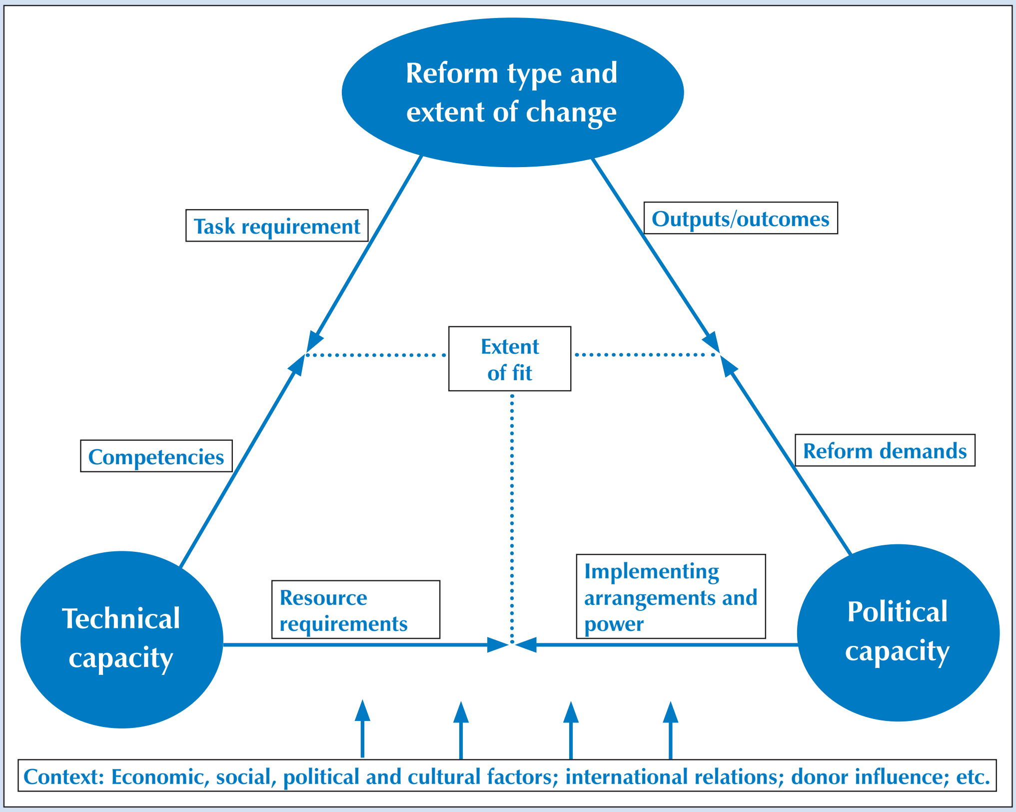
A pragmatic approach to building developmental State capabilities in LDCs would involve the adoption of a small number of institutional reforms that fit well within the existing context. Chart 7, drawn from Therkildsen (2008), shows the factors that need to fit well for any type of public sector reforms to work. In short, reforms will progress: (a) if their outputs and outcomes are well matched with political demands; (b) if there is a good fit between the political capacity and technical capacity for specific reforms; and (c) if technical competencies fit the requirements of the reform tasks. This is a matter of fitting the types and extent of the reforms both to technical and political capacity. There is a high degree of country specificity in this activity. As Therkildsen (2008: 45) puts it, "the bottom line is that reforms, to succeed, must be tailor-made to country and specific conditions".

State capabilities should be built up over time through a strategic incrementalist approach.

In applying this approach to building developmental State capabilities, both technical and political capacities matter. It is necessary for Governments to have an overall development vision that maps where they are going. But developmental State capabilities should be built up over time through a strategic incrementalist approach,[8] building on islands of excellence in public administration or executive agencies, promoting policy learning and nurturing growth coalitions (chart 8). Particular effort should be focused on building the governance requirements to address factors that are slowing down capital accumulation, technological upgrading, sectoral diversification and structural change (Khan, 2008). Box 4 (p.44) illustrates this idea for the Bangladesh garments sector.

Chart 7

Schematic representation of fit requirements in public sector reform



Source: Therkildsen (2008).

(a) Political capacity

In terms of political capacity, a defining characteristic of successful developmental States is the existence of a developmentally-oriented elite, often consisting of "a small cadre of developmentally determined senior politicians and bureaucrats, usually close to the executive head of Government who was instrumental in establishing the development regime and its culture" (Leftwich, 1995: 405). This elite provides vision and leadership for the achievement of national development goals. Unless it exists, there is no possibility of creating developmental State capabilities. If the elite is simply committed to personal enrichment and perpetuation of its own privileges rather than national economic development, the latter will be impossible.

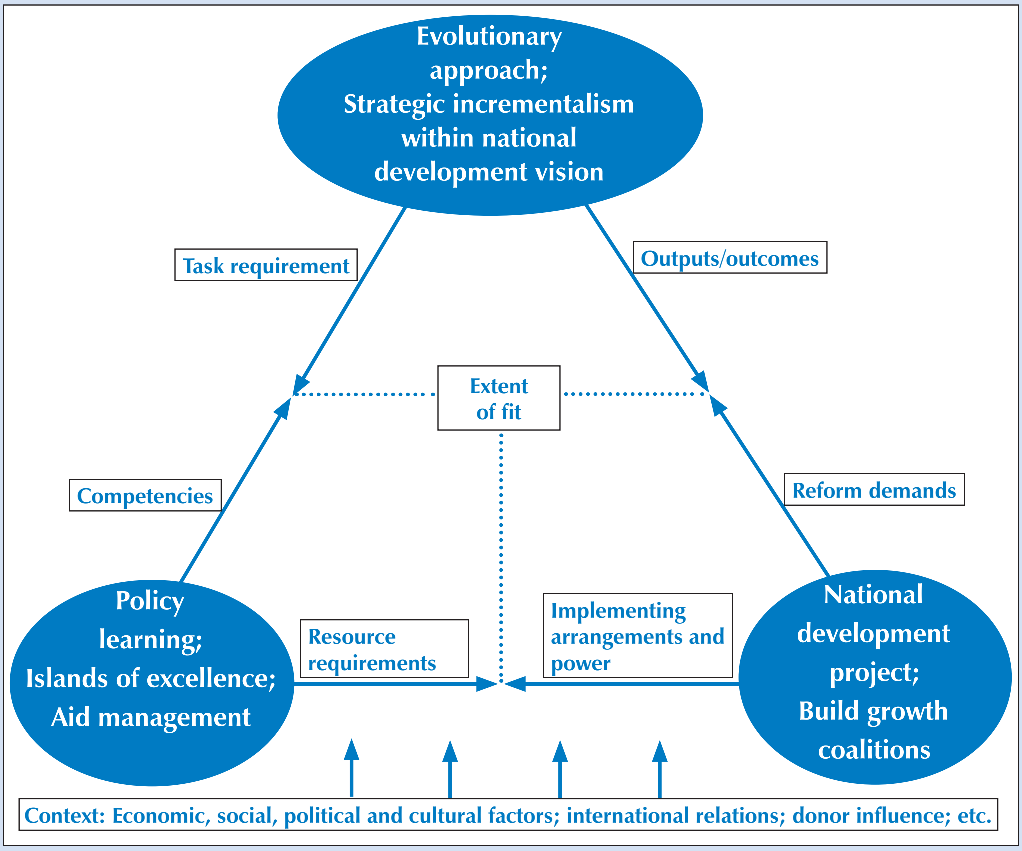
A defining characteristic of successful developmental States is the existence of a developmentally-oriented elite committed to national economic development rather than personal enrichment.

As noted earlier however, the developmental elite cannot carry out a national development project in isolation. Solving development problems and creating development opportunities requires the participation of a wide range of informed and interested stakeholders. As indicated earlier, democratic processes, which might take various forms, can provide the basis for a more inclusive societal mobilization behind a national development project. However, it is likely also that there is a need to forge growth coalitions.

Growth coalitions arise when relations between business and Government elites take the form of active cooperation towards the goals of fostering investment

Chart 8

Building developmental State capabilities in LDCs: an approach to public sector reforms



Source: UNCTAD secretariat, based on Therkildsen (2008).

and increasing productivity. They have not been deeply studied. However, research on business associations in poor developing countries (Brautigam, Rakner and Taylor, 2002; Garforth, Phillips and Bathia-Panthaki, 2007; Moen, 2003; and Arthur, 2006) suggests that growth coalitions are most likely to form:

Growth coalitions arise when business and government elites cooperate to foster investment and increasing productivity.

(a) When the business class has matured in number and experience and broadened to the point when it represents a sizeable portion of the productive economy;

(b) When its associations broadly represent the range of business interests in the country (possibly with a peak association) and have technical capacity, credibility and a resource base; and

(c) When the government and business associations have institutionalized regular consultation.

The creation of mechanisms for business–Government cooperation through business associations should be an important element of building developmental State capabilities.

From this perspective, the creation of mechanisms for business–Government cooperation through business associations should be an important element of building developmental State capabilities.[10] However, although business associations are important institutions, "there is no clear evidence that strong business associations or democratization on their own further growth coalitions. They require active state nurture." (Therkildsen, 2008: 21) Thus, sustaining growth coalitions depends on State leadership, ideology, capacity, and the actual choice and sequencing of the chosen policies. A national policy of developing productive

Box 4. Mushtaq Khan's approach to building growth-promoting governance capabilities: the example of the Bangladesh garments sector

In general terms, Khan suggests that building governance capabilities should focus on sectors where growth is already present but could be accelerated or where there is a challenge to move up into higher value products or up the value chain, or to increase the productivity and competitiveness of machinery. There are likely to be a number of obvious growth sectors. If success is achieved in one sector, the capabilities and lessons learned can be transferred to strategies in other sectors. In making the selection, it is necessary that "the priorities for capacity-building are selected in such a way that the political capacity for exit is assured if results are not satisfactory" (Khan, 2008: 15), and the potential for linkage effects that promote policy learning are maximized.

The ready-made garments sector in Bangladesh is an example. It has been very successful but the sector faces significant competition both from countries higher up the value chain with higher productivity and quality and better links with buyers, and also countries with lower wages that are aggressively seeking to enter the same markets as Bangladesh. Through discussion with entrepreneurs, efforts were made to identify market failures in the allocation of key resources — namely investment funds, labour skills and land — and which governance reforms might help resolve these problems.

With regard to investments, banks were willing to lend to producers so access to capital was not a problem, but the conditions attached to loans (high level of interest rates and collateral requirements) meant that investors were reluctant to borrow for investments in new technology that were inherently more risky. The governance challenge then was for "the government and the private sector to develop feasible governance capabilities that allow existing financial instruments or strategies or one similar to those used in other developing countries to be implemented to allow risk-sharing investments" (Khan, 2008: 20).

Two possibilities are discussed. The first is Bangladesh's Equity and Entrepreneurship Fund, which was set up in 2001 to address precisely this market failure. With this instrument, the Government buys up to a 49 per cent stake in companies engaging in investments in new areas, relieving the entrepreneur of immediate and onerous interest payments, with an option to buy back the equity in three years at face value or after eight years either at face value or at a vaguely defined break-up value to be determined from the balance sheet by accountants. But projects were poorly chosen and the fund has not been dynamic, with projects being adopted that were often straightforward and could have been financed in the traditional way and still have been viable. The governance challenge is, according to Khan, to create compulsions for firm management to perform and deliver a return on equity. This could be done through measures to improve the design of the fund in relation to the claims of the lender on subsequent profits and also the buyback option, and to be successful would need a dedicated agency that would monitor and enforce the terms of the specific funding arrangement under its remit.

The second possibility is a direct subsidy for the capital cost of acquiring pre-specified technologies. An example is the Technology Upgradation Fund Scheme in India in which investments in pre-specified machinery (deemed necessary for improving productivity in the Indian textile sector) are given a 5 per cent reimbursement on the interest charged on the purchase loans. Khan argues that scarcity of budgetary resources makes this more difficult to envisage in Bangladesh, but a more targeted interest rate subsidy may be possible. But this again would require the development of governance capabilities in the agency charged with monitoring the use of disbursed funds. There is a need "to start with very modest programmes with a small well-resourced agency charged with monitoring and implementation of a narrowly defined programme".

With regard to labour skills, the problem is that employers are unwilling to pay much for training their workforce because they are afraid they will later leave the firm, but if worker skills could be improved in a few critical areas this could provide an important boost to productivity growth. Khan suggests "relatively small subsidies for employers sending critical personnel to accredited private training institutes" (Khan, 2008: 24). But "this would only work if governance capabilities could be developed to provide accreditation to programmes in association with employers' associations", to ensure "maintenance of quality" and "to ensure exit from programmes that fail to deliver".

With regard to land, it was found that the acquisition of large pieces of uncontested land is a long and complex process that is a serious constraint on new projects and the achievement of economies of scale. The good governance solution to this is try to improve the land market as a whole by improving land records, the operation of the court system and fighting corruption, so that land transactions take place smoothly. The incremental approach would focus on the specific problem of land availability for the expansion and achievement of economies of scale in the garment industry. This would require the development of governance capabilities in agencies seeking to resolve the land acquisition problems faced by the sectors. One approach could be to prioritize the acquisition of land for a large industrial zone with adequate infrastructural amenities where the highly dispersed garment sector would be given incentives to relocate. In the mean time, "intermediate steps may be necessary to facilitate temporary expansion of critical facilities in firms who apply for assistance" (Khan, 2008: 26). This would require a land agency dedicated to the task and given powers to facilitate a temporary solution by negotiating the renting and acquisition of contiguous land (Khan, 2008: 26). As with other cases, the essential point is focusing on limited things that can be done, ensuring that the highest quality personnel with clear political support is made available for these agencies, and, as with the other cases, "the ability to change the policy and exit from strategies that are not working is critical for improving the chances of success" (Khan, 2008: 26).

Source: Khan (2008).

capacities would require the formation of growth coalitions, but also could be a key first step for their formation. This requires that the political and bureaucratic elites are able to articulate a vision and a viable and credible strategy to support growth. Economic crises may offer an important opportunity for building growth coalitions if it is possible to devise credible policies to deal with the crisis in a way that promotes unity. Dealing with the impact of the global financial crisis should thus be seized as an important opportunity to build growth coalitions in LDCs.

Building developmental State capabilities in LDCs requires not only political support but also resources for design and implementation, including funds, staff and skills.

(b) Technical capacity

A pragmatic approach to build developmental State capabilities in LDCs not only requires political support but also resources for design and implementation, including funds, staff and skills. Skilled staff is in short supply. But as noted above, it is not necessary to have bureaucratic excellence everywhere. In building developmental State capabilities, it is important there is a pilot agency that is close to political power and that can provide overall vision and coordination. An institution dedicated to aid management is also critical. More emphasis should also be put on improving bureaucracies in ministries concerned with production sectors (chapters 3 and 4 of this Report).

Creating islands of excellence and spreading their ways of doing things to other parts of the public sector could be a viable approach to improving governance capabilities for development.

Islands of excellence within the ministries and executive agencies of LDCs can provide lessons about what works and does not work in particular contexts and also models for spreading these practices. Such islands of excellences are hidden by the countrywide indicators of governance quality. But the few in-depth studies, based on interviews with civil servants, that have focused on this issue have found such islands of excellence in a number of LDCs including in Central African Republic and the United Republic of Tanzania (Grindle, 1997) and in Uganda and the United Republic of Tanzania (Therkildsen and Tidemand, 2007). These studies find that what makes these institutions work well are: (a) leadership and management — in well-performing organizations, staff have a clear sense of purpose, management gives clear signals about expected work effort and quality and rewards accordingly, and there is some degree of participation, flexibility, team problem–solving and equity; (b) prestige, professionalism and a sense of service to the country; and (c) merit in recruitment, promotion, demotion and dismissal. The effort to build ministries of finance under structural adjustment programmes also shows that deliberate political decisions to create capacity in key parts of the public sector bear results. Creating islands of excellence and spreading their ways of doing things to other parts of the public sector could thus be a viable approach to improving governance capabilities for development.

Policy learning is also important. There should be sequential experimentation as policymakers learn what works and what does not.

Policy learning is also important. Learning occurs by doing and in stages. As Therkildsen (2008: 44) states: “Learning what works precedes learning how to be efficient; and learning how to be efficient precedes learning how to expand what works to organizations beyond a limited number.” Errors will be made at all stages, but this is a key aspect of learning to improve. A focus on policy learning also implies a different style of planning. Rather than a linear planning approach to policy in which formulation precedes implementation, there should rather be sequential experimentation as policymakers learn what works and what does not (Justman and Teubal, 1995). Development projects that are undertaken should thus be chosen not simply on a static cost–benefit analysis but in terms of the new information they generate, the capabilities they develop and their demonstration effects. As Lall and Teubal (1998:1381) have put it: “Frequently, any one of several choices may work: what is important is not to identify the unique optimum but to assemble a smaller set of reasonable choices and implement them comprehensively and systematically. Since mistakes are inevitable (as with firms), the Government has to be flexible and responsive to evolving characteristics — policy has to allow adjustment and learning".

Therkildsen (2008) also notes the potential of an old reform tradition in some African LDCs, which existed before the public sector reform agenda became strongly donor-driven. This was done in campaign style with politicians mobilizing civil servants and the public to seek to bring significant change. This short-term intensive mobilization of resources and political energies invigorates technical capacities, focuses energies for short periods of time and also provides the basis for policy learning. The financial crisis could also be the basis for such societal mobilization.

Building developmental State capabilities will depend on political commitment by LDC elites, but also by their development partners.

3. The critical role of donors

Building developmental State capabilities will not only depend on political commitment by LDC elites, but also by their development partners. Brautigam, Rakner and Taylor (2002) and Mkandawire (2001) point out that African States have in the past often failed to allow local business classes an effective voice in policy–making. Brautigam, Rakner and Taylor (2002: 540) relate this phenomenon to the belief by political leaders that growth coalitions could undermine their political and social power, beliefs that "are likely to be complicated by aspects of race, class and ethnicity". However, a further factor in many cases has been the way in which Governments have been more responsive to donors' demands than to the interests of the local business class. Mkandawire (2001: 309) has suggested that the weakness of development of the domestic private sector has been one of the basic contradictions, and a major irony, of the practice of structural adjustment policies. As he puts it:

The weakness of development of the domestic private sector has been one of the basic contradictions, and a major irony, of the practice of structural adjustment policies.

> Wanton liberalization of markets without careful consultation with business classes, privatization that provides no special privilege to local capitalists, cessation of directed credit or "development finance", high interest rates, all these underscore the distancing of the State from local capitalist interests and the preeminent position of IFIs' [international financial institutions] interests and perceptions in policy-making.

More recently, the PRSP process has continued this marginalization of the business perspective in policy formulation and implementation. The shift from aid to support production sectors towards aid to support social sectors, noted in earlier *LDC Reports*, is an aspect of this marginalization. More broadly, the effort to mobilize the voices of civil society in the PRSP preparation process has not sufficiently incorporated a domestic business perspective.

The shift from aid to support production sectors towards aid to support social sectors is an aspect of the marginalization of the business perspective.

A further problem that all LDCs face, as mentioned earlier, is their very weak financial resource base. A simple indication of this is provided in table 5, which shows a number of indicators of the challenge of financing governance in a number of LDCs. One general indicator is the domestic resources available for financing governance and investment (DRAF). The scale of these resources is estimated by subtracting household consumption expenditure per capita from GDP per capita. What is left covers all the domestic resources available for financing investment and running vital public services, including the public administration. In 2006, the DRAF in the LDCs, when measured at current prices and market exchange rates, was on average 41 cents per capita per day. There are quite large variations amongst the LDCs in the sample. But the median value is equivalent to 18.4 cents per capita per day. In other words, half the LDCs had less than 18.4 cents a day available per capita to spend on private capital formation, public investment in infrastructure, the running of vital public services such as health, education

Table 5

The challenge of financing governance in LDCs: GDP per capita, Government current expenditure and domestic resources available for financing governance and investment (DRAF), 2006

	GDP per capita *(in current 2006 $)*	Government final consumption expenditure *(as % of GDP)*	Government final consumption expenditure per capita	DRAF per capita	DRAF per capita per day *(in cents)*
Total LDCs	**462.1**	**12.9**	**59.8**	**150.5**	**41.2**
LDCs: Africa and Haiti	***493.7***	***15.5***	***76.6***	***180.7***	***49.5***
Angola	2 998.7	21.2	636.3	2 050.5	561.8
Benin	537.9	12.1	65.0	127.6	35.0
Burkina Faso	418.9	21.1	88.3	105.0	28.8
Burundi	117.3	29.4	34.5	21.8	6.0
Central African Republic	346.3	10.6	36.8	40.5	11.1
Chad	634.0	24.0	152.3	481.5	131.9
Democratic Republic of the Congo	140.9	8.8	12.4	16.7	4.6
Djibouti	940.4	29.4	276.4	389.1	106.6
Equatorial Guinea	16 747.5	2.9	494.0	15 106.5	4 138.8
Eritrea	258.1	35.6	92.0	53.6	14.7
Ethiopia	164.0	12.4	20.3	32.8	9.0
Gambia	305.3	9.3	28.3	60.8	16.6
Guinea	357.8	7.5	26.9	59.4	16.3
Guinea-Bissau	185.0	15.6	28.8	40.3	11.0
Lesotho	749.2	18.1	135.3	23.2	6.4
Liberia	170.9	9.5	16.3	14.8	4.1
Madagascar	287.9	8.7	25.2	52.0	14.2
Malawi	234.6	9.6	22.6	5.6	1.5
Mali	511.6	17.3	88.4	177.4	48.6
Mauritania	874.3	19.5	170.8	333.2	91.3
Mozambique	325.8	13.0	42.2	59.7	16.4
Niger	258.9	15.4	39.8	67.3	18.4
Rwanda	312.5	18.0	56.3	52.4	14.4
Senegal	767.7	13.1	100.8	168.5	46.2
Sierra Leone	288.2	13.3	38.2	43.5	11.9
Somalia	299.8	8.7	26.0	82.8	22.7
Sudan	1 163.9	16.2	188.7	353.1	96.7
Togo	342.8	13.4	45.9	15.1	4.1
Uganda	339.8	14.3	48.6	74.4	20.4
United Republic of Tanzania	339.5	7.3	24.9	59.5	16.3
Zambia	930.7	20.0	186.4	382.7	104.9
Haiti	503.7	8.5	43.0	-3.5	-1.0
LDCs: Asia	***406.5***	***7.4***	***30.2***	***100.2***	***27.5***
Afghanistan	285.2	10.9	31.0	-28.9	-7.9
Bangladesh	386.6	5.5	21.4	99.7	27.3
Bhutan	1 421.9	22.0	312.8	728.3	199.5
Cambodia	512.4	5.3	27.0	97.5	26.7
Lao People's Democratic Republic	605.1	7.3	44.2	263.9	72.3
Myanmar	284.0	4.6	13.0	56.2	15.4
Nepal	357.8	8.4	30.2	63.7	17.4
Yemen	878.0	13.8	120.8	343.3	94.1
LDCs: Islands	***927.1***	***32.5***	***301.0***	***318.2***	***87.2***
Comoros	492.6	12.6	62.1	-6.8	-1.9
Kiribati	659.3	64.3	424.0	-60.0	-16.4
Maldives	3 020.0	37.9	1 145.4	2 120.5	581.0
Samoa	2 425.1	22.1	537.1	199.5	54.7
Sao Tome and Principe	788.0	46.3	364.7	176.1	48.2
Solomon Islands	877.0	31.9	279.8	451.7	123.7
Timor-Leste	316.5	53.8	170.3	24.4	6.7
Tuvalu	2 427.4	54.2	1 316.6	216.4	59.3
Vanuatu	1 763.1	22.7	400.3	625.5	171.4
Low-income countries	*673.0*	*11.0*	*73.7*	*248.6*	*68.1*
Lower-middle-income countries	*2 167.4*	*13.6*	*294.5*	*1 165.4*	*319.3*
Upper-middle-income countries	*6 571.0*	*16.0*	*1 050.9*	*2 736.6*	*749.7*
High-income countries	*36 048.0*	*18.2*	*6 561.1*	*14 007.4*	*3 837.7*

Source: UNCTAD secretariat calculations based on data from GlobStat database (April 2009).

Notes: General Government Final Consumption Expenditure (formerly general Government consumption) includes all Government current expenditures for purchases of goods and services (including compensation of employees). It also includes most expenditures on national defense and security, but excludes Government military expenditures that are part of Government capital formation.

DRAF is the amount of domestic resources available for financing governance and investment, which is calculated as the difference between GDP per capita and household final consumption expenditure per capita.

Countries' classification by income groups follows the standard criteria set by the World Bank. Economies are divided according to 2007 GNI per capita (Atlas method), and the groups are as follows: low income, $935 or less; lower middle income, $936 – $3,705; upper middle income, $3,706 – $11,455; and high income, $11,456 or more.

and public administration, as well as the provision of law and order. For the sake of comparison, the average sum of domestic resources available for financing development in lower–middle income countries in 2006 amounted to $3.2 per capita per day, whilst in high–income countries it was $38.4 per capita per day.

In 2006, half the LDCs had less than 18.4 cents a day available per capita to spend on private capital formation, public investment in infrastructure, the running of vital public services and public administration, as well as the provision of law and order.

Data on government revenue and expenditure is very patchy. But as indicated in past *LDC Reports*, the general pattern is that in terms of GDP share, government revenue and final consumption expenditure do not appear to be significantly different from what they are in other developing countries (UNCTAD, 2002). But because their GDP per capita is lower than that of other countries, the levels of government expenditure per capita are also inevitably much lower. This has been discussed earlier in the chapter, but it is worth repeating that the average annual government final consumption expenditure per capita in LDCs in 2006 was just $60 compared with $295 in lower–middle income countries. This difference occurred even though as a share of GDP, government final consumption expenditure in LDCs is not significantly different from that of lower–middle income or high–middle income countries (13 per cent and 16 per cent respectively). The $60 has to cover all government current expenditures for purchases of goods and services (including compensation of employees). This is equivalent to 16 cents per person per day.

In 2005–2007, on average 20 per cent of aid disbursements to LDCs were for Government and related purposes.

From all this it is clear that an important priority for LDC Governments in building developmental State capabilities should be to improve domestic resource mobilization (UNCTAD, 2007). However, in the immediate future donors will be vital in the building developmental State capabilities in most LDCs.

In fact, donors are at present heavily involved in supporting the process of building State capabilities in LDCs. In 2005–2007, on average 20 per cent of aid disbursements to LDCs were for Government and related purposes (table 6). Out of the almost $5 billion disbursements for Government and related purposes,[11] 63 per cent went to government administration and policy management, with policy management and administration in social sectors, infrastructure and production sectors receiving 16 per cent, 8 per cent and 7 per cent respectively. Sixteen per cent of the gross official development assistance (ODA) disbursements for Government and related purposes went to political development and 15 per cent to conflict prevention, peace and security. Less than 1 per cent went to building statistical capacity, creating a major gap in policy-making capacities in LDCs (table 6).

Aid for improving governance capabilities should be refocused from the current good governance reform agenda to supporting good development governance and building developmentally capable States in LDCs.

Those LDC Governments that are seriously committed to building developmental State capabilities should be supported in this task. This would mean that aid for improving governance capabilities should be refocused from the current good governance reform agenda to supporting good development governance and building developmentally capable States in LDCs. Building developmental State capabilities should be the central thrust of a proactive response to the financial crisis.

Table 6
Gross aid disbursements to LDCs for Government and related purposes by main categories in 2005–2007

	Average annual disbursement 2005–2007 *(constant 2007 $ millions)*	Share of total aid disbursed *(%)*	Share of total aid for government and related purposes *(%)*
A. Policy management	**2 426.63**	**9.83**	**48.79**
General	*762.71*	*3.09*	*15.34*
15110: Economic and development policy/planning	553.24	2.24	11.12
15120: Public sector financial management	175.10	0.71	3.52
16062: Statistical capacity building	34.37	0.14	0.69
Social sectors	*785.55*	*3.18*	*15.80*
11110: Education policy and administration management	281.46	1.14	5.66
12110: Health policy and administration management	343.61	1.39	6.91
13010: Population policy and administration management	86.48	0.35	1.74
16020: Employment policy and administration management	70.81	0.29	1.42
16030: Housing policy and administration management	3.20	0.01	0.06
Infrastructure	*382.72*	*1.55*	*7.70*
14010: Water resources policy/administration management	90.32	0.37	1.82
21010: Transport policy and administration management	213.67	0.87	4.30
22010: Communications policy and administration management	8.77	0.04	0.18
23010: Energy policy and administration management	69.96	0.28	1.41
Productive sectors	*329.63*	*1.34*	*6.63*
31110: Agricultural policy and administration management	201.83	0.82	4.06
31210: Forestry policy and administration management	27.96	0.11	0.56
31310: Fishing policy and administration management	37.81	0.15	0.76
32110: Industrial policy and administration management	4.41	0.02	0.09
32210: Mineral/mining policy and administration management	7.53	0.03	0.15
32310: Construction policy and administration management	4.08	0.02	0.08
33110: Trade policy and administration management	36.93	0.15	0.74
33210: Tourism policy and administration management	9.08	0.04	0.18
Environment	*132.54*	*0.54*	*2.66*
41010: Environmental policy and administration management	132.54	0.54	2.66
Financial sector	33.48	0.14	0.67
24010: Financial policy and administration management	31.01	0.13	0.62
24020: Monetary institutions	2.47	0.01	0.05
B. Government administration	**716.13**	**2.90**	**14.40**
15140: Government administration	716.13	2.90	14.40
C. Legal and judicial development	**299.10**	**1.21**	**6.01**
15130: Legal and judicial development	299.10	1.21	6.01
D. Political development	**797.96**	**3.23**	**16.04**
15150: Strengthening civil society	314.29	1.27	6.32
15161: Elections	285.36	1.16	5.74
15162: Human rights	127.94	0.52	2.57
15163: Free flow of information	21.10	0.09	0.42
15164: Women's equality organisations and institutions	49.27	0.20	0.99
E. Conflict prevention and peace building	**733.56**	**2.97**	**14.75**
15210: Security system management and reform	69.25	0.28	1.39
15220: Civilian peace-building, conflict prevention and resolution	362.55	1.47	7.29
15230: Post-conflict peace building (United Nations)	122.14	0.49	2.46
15240: Reintegration and Small Arms and Light Weapons control	43.39	0.18	0.87
15250: Land mine clearance	127.38	0.52	2.56
15261: Child soldiers (prevention and demobilisation)	8.85	0.04	0.18
Total ODA disbursement for government and related purposes	**4 973.38**	**20.14**	
Total ODA disbursement	**24 691.30**		
of which:			
Bilateral from DAC countries	*19 481.22*		
Multilateral	*5 210.08*		

Source: UNCTAD secretariat calculations, based on OECD/CRS database, online (June 2009).

F. Conclusions

There is a need to move beyond the good governance institutional reform agenda now and to institute good development governance.

The developmental State model can be adapted to provide a viable and useful approach to development governance in the LDCs if lessons about development governance are adapted to the twenty-first century.

Adapting the developmental State to the twenty-first century involves redefining the nature of developmental States away from the authoritarian forms that have been more typical of East Asian developmental success.

Building developmental State capabilities in the LDCs will take time and public sector reforms oriented to this end should be adapted to actual technical and political capacity.

This chapter has five basic messages.

Firstly, the role of the State in many LDCs is currently being defined through the good governance reform agenda. This involves the introduction of a particular set of institutional reforms, notably private sector styles of public administration (including using market mechanisms, client orientation and performance management to increase efficiency), electoral democracy and a limited role for the State. The key role of the State in these reforms is to support markets rather than to promote economic development directly. There is a need to move beyond this institutional reform agenda now and to institute good development governance. This means injecting a much stronger and direct developmental dimension into governance reforms to enable a more active role of the State in promoting development.

Secondly, the developmental State model can be adapted to provide a viable and useful approach to development governance in the LDCs. However, not all developmental States have been successful. The developmental State model can provide a useful and viable model for LDCs if lessons about development governance are drawn from successful developmental States in the late twentieth century and if these experiences are adapted to the twenty-first century. This is not a return to “old style” development planning.

The main lessons from development governance in successful developmental States are that national policies were oriented to promoting structural transformation, and this was achieved through a mixed economy model that sought to discover the policies and institutions that would harness the pursuit of private profit to the achievement of national development. This was achieved though a mix of macroeconomic and sectorally specific productive development policies, including an industrial policy. These policies aimed to promote capital accumulation and technological progress as the basis for dynamic structural change. In the language that UNCTAD has used in past *LDC Reports*, they were geared to develop productive capacities, expand productive employment and increase labour productivity with a view to increasing national wealth and raising national living standards. Success was achieved through the construction of competent bureaucracies in a few key strategic agencies and policy learning. Governments also devised policies in close cooperation with the business sector.

Adapting the developmental State to the twenty-first century involves redefining the nature of developmental States away from the authoritarian forms that have been more typical of East Asian developmental success. This can draw on other types of developmental State, including for example the Nordic model or the Celtic Tiger. Building democratic developmental States should involve, in particular, ensuring citizens’ participation in development and governance processes. The twenty-first century developmental State will also apply new knowledge on modern governance practices that promote multiple forms of interaction between public and private actors.

Thirdly, building developmental State capabilities will take time and public sector reforms oriented to this end should be adapted to actual technical capacity and also actual political capacity. Developmental State capabilities can be built incrementally through policy learning and institutional experimentation, focusing initially on extending the experience of islands of excellence within the public administration and executive agencies and aiming to build the governance capabilities required to relax binding constraints on the development of productive capacities. Policy space is necessary to allow policy pluralism and experimentation.

Fourthly, building developmental State capabilities in LDCs will only be possible if there is a developmentally-oriented elite of politicians and bureaucrats. Moreover, it will be most successful if this elite establishes a social compact through which broad sections of society support the development project. This should include both rural and urban interests and thus developmental policies should be directed to include both developmental agricultural policies and developmental industrial policies. The financial crisis should also be used as an opportunity to build growth coalitions between Governments and the domestic business community.

The developmentally oriented elite of politicians and bureaucrats should establish a social compact through which broad sections of society support the development project, including both rural and urban interests.

Finally, it will be very difficult to realize a domestically–owned developmental vision and programme without the support of donors. This is due to domestic financial resource constraints on governance and the potential for aid to undermine the formation of domestic growth coalitions. LDC Governments must focus more on domestic resource mobilization. But development partners can best support genuine country ownership in LDCs, and also achieve mutual goals, by supporting the realization of national developmental aspirations. Approximately 20 per cent of aid to LDCs now goes to improving government capabilities. This should be refocused from the broad good governance agenda to support development governance and building developmentally capable States in LDCs.

Notes

1 For a reply to this analysis and also subsequent response to the reply, see Kaufmann, Kraay and Mastruzzi (2007a) and Kurtz and Schrank (2007a), and for a broader response to critiques see Kaufmann, Kraay and Mastruzzi 2007b).
2 For a discussion of the implementation of the good governance agenda in island LDCs see Roberts, Wright and O'Neill (2007).
3 For UNCTAD's analysis of the bases of East Asian success, see: UNCTAD (1994), UNCTAD (1996) and also Akyuz, Chang and Kozul-Wright (1998). Gore (1994) provides a detailed discussion of the Japanese model of "catch-up" growth.
4 There are various sources of market failure, including externalities, goods that have characteristics that make private suppliers unwilling to supply them (e.g., non-rival and non-excludable public goods, monopolies and asymmetric information), and these different types of market failure lead to different kinds of public intervention.
5 Refer, for example, to Leftwich (1993).
6 For the importance of societal cohesion, see Kohli (2004).
7 For an important discussion of the role of the state in an evolutionary approach, see Moreau (2004).
8 Strategic incrementalism – between big bang and "muddling through" – is also advocated in World Bank (2005).
9 LDCs which are rich in mineral resources, for example, felt difficult context-sensitive development governance challenges. See Jourdan (2008).
10 For discussion of some experiences in some African LDCs see Kalema and Nsonzi (2008).
11 Between 2005 and 2007, ODA disbursements averaged almost $5 billion in constant 2007 dollars.

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