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Chapter 5

Good governance scripts: Will compliance improve form or functionality?¹

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The past decades have witnessed the rise of a new development paradigm as academics and donors have embraced the idea that governance matters to social, political and economic development. Political and administrative reforms in many countries are directly shaped by the scripts informing good governance indicators. Countries apparently buy into the story that ‘this is what good government looks like’.

Countries and organizations comply with scripts like these all the time, understanding that legitimacy and support are often conditional on such. This behaviour reflects a theory called isomorphism. It posits that organizations exist within fields – ‘those organizations that, in aggregate, constitute a recognized area of institutional life’ (DiMaggio and Powell 1983: 148) – and face pressure to conform to the externally defined ‘belief systems and related practices that predominate’ such fields (Scott 2001: 139). If organizations do not yield to these isomorphic pressures, they lose legitimacy and jeopardize their external support and survival.

Governance indicators constitute defined ‘belief systems and related practices’ in the development field. Isomorphic pressure to comply with the requirements of such indicators could lead countries to adopt governance reforms that help improve functionality and advance development. One can expect this where we have proof that the ‘belief systems and related practices’ embodied in governance indicators actually facilitate development. Isomorphic pressures could also foster compliance with forms that make countries look better but do not necessarily help them function better. This is likely where we cannot show that the ‘belief systems and related practices’ embodied in governance indicators actually facilitate development.

This chapter asks if isomorphic compliance with governance indicators will improve form or functionality in developing countries. Put another way, will countries that follow scripts informing indicators just look better or actually be better (facilitating development)?

The first section examines the development community's story of good governance and argues that we have cause for concern. Developed countries that score high points on governance indicators do not follow the good governance scripts in the same way. Put another way, functional states do not share the same governance forms. The second section analyses this issue in depth, asking whether fiscal rules, a common form expected in 'good governance' models, are uniformly in place in more functional governments. It finds that they are not. There is thus reason to believe that governments may adopt such forms without any improvement in functionality. We should question the functional contribution of good governance scripts to development.

THE DEVELOPMENT COMMUNITY'S STORY OF GOOD GOVERNANCE

At its most basic, 'governance' refers to 'the general exercise of authority' (Michalski, Miller and Stevens 2001: 9) or, as the World Governance Indicators (WGIs) developers put it, '[T]he traditions and institutions by which authority in a country is exercised' (Kaufmann, Kraay and Zoido-Lobaton 1999: 1). Built ostensibly on this general definition, the WGIs have emerged as, arguably, the most influential governance measure (Arndt and Oman 2006). They combine various stand-alone elements into aggregate indicators of six governance concepts, including 'rule of law' and 'government effectiveness'. These mix outcomes (like effective health care statistics) with processes and structure (like meritocratic hiring and the degree of decentralization) and policy choices (about the size of government, for example, and the extent to which a government exhibits a pro-business orientation). The various elements are aggregated into indicators that apparently reflect how well authority is exercised, by concept area, in a country (aka governance).

Most indicator sets spotlight structural characteristics of governments and associated outcomes considered important for development; for example, the WGIs name a measure 'Government Effectiveness' (Kaufmann *et al.* 1999; Kaufmann, Kraay and Mastruzzi 2007). The indicators (WGIs and others) arguably underlie strong isomorphic influences on

thinking about what effective government is (for discussion, see Arndt and Oman 2006 and Goldsmith 2007). Academic work, lending engagements and reform proposals gain legitimacy by identifying with the ‘myth’ or ‘story’ that formal structures reflected in the indicators provide a rational means to attain desirable ends – in this case development itself (Meyer and Rowan 1977: 346). The following description captures the contents of such myth:

An effective government is small and limited in its engagement, formalized in mission and process and drawing limited revenues primarily from domestic sources. High-quality personnel devise and implement needed programs and deliver efficient and effective services via participatory processes and through formalized, disciplined, efficient and targeted financial management. Responsiveness to the citizenry’s changing needs is high, effected through transparent, decentralized and politically neutral structures; consistently, even during political instability, without impeding (indeed supporting) the private sector.

The ‘story’: Developed countries are governed like this

Many might find this word picture appealing – the kind of government we would all imagine is ‘good’. The message implied in these indicators is that these are the common characteristics of a good government that developing country governments should attempt to reproduce. The message is often presented like this: developed countries do it this way ... you should copy them. Figure 5.1 provides some support for this message. The figure shows scores for 184 countries on the ‘government effectiveness’ element of the WGIs. These scores range from –2.5 to +2.5. Negative scores reflect less-good governance. Countries are organized to show the relationship between GDP per capita in 2005 and government effectiveness scores in 1998 and 2008. Note simply how positive the relationship is between these two pieces of data. If a country is more developed (with a higher GDP per capita), it also seems to have better governance (with a higher government effectiveness score). What the figure shows graphically is also evident in statistics, with a strong correlation existing between WGI dimension scores like ‘effective government’ and per capita income figures (0.76 in the 184 countries shown in Figure 5.1, significant at 0.00).

Figure 5.1:
WGI government effectiveness scores and GDP per capita

Such evidence also emerges if one looks at individual countries. Which ‘examples’ might lower and middle countries look up to as models of ‘good governance’ – where social authorizing structures have facilitated development? Many would agree with the following kind of country set: Denmark, Singapore, Canada, Sweden, Australia, the Netherlands, the United Kingdom, Hong Kong, the United States, Belgium and Germany. Coincidentally, these countries make up the ‘top 10 per cent’ in Figure 5.1’s score for 184 countries (all scoring above 1.5 on the WGI effective government indicator). They are all developed countries and tend to have better outcomes, such as more sustained growth rates, stronger business environments and better social indicators.

The reality: Developed countries are governed differently

But evidence does not show that these countries reached this development nirvana by complying with the governance story embodied in the WGIs. Indeed, evidence shows that these kinds of countries do not comply with this story today.

The institutional characteristics of governments in these countries – the core of governance structures – vary a great deal among these countries.

While one may argue that all the governments exhibit formal bureaucratic systems with disciplined budgetary processes, for example, differences in the details of how these systems work are quite significant (Curristine 2005; Hallerberg, Strauch and von Hagen 2007; Joumard *et al.* 2003). For instance, the degree of political influence on appointments, promotions and performance assessments varies significantly across governments, as do basic civil service structures (see OECD 1999 for a dated comment, and for more recent discussion, Choi and Witford 2008 and Matheson *et al.* 2007). The use of arms-length agencies also varies, as does the degree to which these agencies are subject to formal rules governing the rest of government (Matheson *et al.* 2007).

There are even more prominent differences when one considers the limits and size of government and the degree to which it is engaged in the economy (Handler *et al.* 2005; OECD 1999). The good governance paradigm suggests the importance of limited governments, which it measures in terms of legal checks (rule of law) as well as institutionalized constraints on government scope and fiscal size.² While the rule of law is central to all the 'good governments', it is much more limiting in some than others. For example, an OECD survey of budgeting practices found that the United States legislates processes in all 11 areas considered, but the United Kingdom only legislates 4 of the 11, implying different levels of discretion in the latter.³

Furthermore, government revenue and spending as a percentage of GDP ranged in these governments from about 35 per cent to about 55 per cent in 2004 (Hauptmeier, Heipertz and Schuknecht 2007: 298).⁴ A government like Sweden uses this money to fund extensive engagements across the economy, and plays a dominant role in financing and providing social services (also providing 'bakeries, gyms and garden centers' (Henrekson 2005)). The US government is more restrained in its social activities, and the private sector actually plays a bigger role in financing and providing key services like health care. Comparing the two reveals that the governments actually differ a lot, in size and scope, which are two variables organizational theorists find foster all sorts of other structural variations.

Literature shows that governance structures in the model countries differ in other areas as well. The governments exhibit different levels and types of decentralization, politically, administratively and fiscally (Mosca 2007; Stegarescu 2004). Also, while economic and administrative regulatory burdens tend to be lower than in other countries, they are still highly variable across the sample (Malyshev 2006; OECD 2005). Different regulatory mechanisms underpin different relationships between the government and the private sector, an important aspect of governance.

Commonly good governance functionality comes through different forms

Governance indicators thus identify governments that look commonly good in terms of the outcomes they produce – or functionality – but seem to vary in regard to other institutional characteristics – the forms they adopt. Perhaps we should not be surprised at this, given that the indicators generally reflect perceptions of governance and are not measures of actual institutional characteristics. The bottom line, however, is that the ‘good governance’ story presented in these indicators seems quite limited: good governments can look very different in terms of their forms but achieve similar functional results. Forcing them to look the same in terms of form may not yield improvements in functionality.

The following section provides a more rigorous argument for this proposition by examining the key characteristics of a particular aspect of good governance, that is, public financial management (PFM).

FORM VERSUS FUNCTION IN PFM SYSTEMS

Critics might claim that the differences mentioned above are random, or that countries with good governments probably vary less on core ‘best practice’ characteristics than other countries. They might argue that relative convergence around good governance criteria is higher in countries with good governments than in countries with less-good governments, and that my observations fall short in providing rigorous evidence otherwise. I attempt to respond to these critics here, providing more rigorous evidence that governance functionality does not imply common forms.

I do this by analysing one small dimension of the ‘good governance’ script in development: the use of fiscal rules to ensure budgetary discipline. Development organizations frequently recommend fiscal rules as fundamental mechanisms to facilitate strong PFM. Strong PFM systems are important because, as Kettl (1992: 1) says, ‘Nearly everything we want government to do requires money.’ International organizations like the IMF and OECD identify institutional features of strong PFM systems, considered necessary ‘to effectively control public expenditures.’ Top-down, structured budgeting techniques like fiscal rules are one such feature.

Anyone reading work on fiscal rules in the mid-1990s would have believed that all leading governments had similar top-down mechanisms and that these rules offered a one-best-way solution to fiscal problems.

Figure 5.2:
When countries adopted fiscal rules, according to recent studies

Source: Data drawn primarily from CESifo (2007), IMF (2009) and Scartascini (2007). The data show initiatives after the 1970s, which means that earlier reforms in places like Germany and Japan are not included. Some countries shown above – including the United States – have also departed from using fiscal rules.

The fiscal rule concept was quickly picked up in Latin America and other regions as a best practice mechanism to facilitate expenditure control and management. It is now part of the dialogue in reform throughout the world, manifest in terms like ‘deficit rule’, ‘expenditure rule’ and even in the more operational ‘budget limit.’ Figure 5.2 shows detail from recent studies on a number of countries that have adopted these rules. It illustrates that fiscal rules are fairly new (note the adoptions began only after the 1980s in this list) and that a variety of countries have adopted them. Countries in bold are OECD countries and countries in *italics* are non-OECD countries that are largely developing or transitional.

It should be interesting to note that the number of non-OECD developing countries shown in Figure 5.2 is at least as high as the number of OECD countries. The implication is that developing countries with less functional governance systems may be more likely to adopt the fiscal rule ‘form’ than more functional OECD countries. Figure 5.2 is not comprehensive, however, so we should be careful not to read too much into this. The study below goes beyond such data, however, to examine data from the 2007 OECD Budget Practices and Procedures Database about which countries do and do not have these forms in place. The database provides common quantitative data on 89 detailed questions about PFM systems in 38 countries.⁵ A subset of these speak to the issue of fiscal rule adoption.

Good governments have commonly functional PFM systems

Deficits are the only PFM outcome measure commonly available across countries. These are also a vital PFM outcome measure given current struggles with economic downturns and fiscal management.⁶ Figure 5.3 shows average deficits across the 38 countries included in the OECD database for 1990–2006. Governments considered more effective on the WGI indicators are at the right with deficit averages below 2.5 per cent of GDP over this period, compared with higher averages for many of the other governments. The figure thus suggests a convergence around lower average deficits for the more effective governments. In other words, good governments have similar outcomes, or are similarly functional in managing budgetary issues.

All the good governments were responding to higher, problematic deficits in the 1970s and 1980s. Economic and political pressure to control these deficits is credited as the dominant influence in favour of recent more disciplined financial management (Blondal 2003). Most of the nine governments actually recorded material decreases in expenditure in the mid-to-late 1990s as a result of such pressures. The pressure was not just for control and lower spending, but also for lower and better spending. Various authors suggest a high level of consistency in the way the more effective governments dealt with this pressure (see Blondal 2003; Joumard *et al.* 2003, for example). As noted, one argument is that they all introduced fiscal rules to achieve functionality.

Figure 5.3:
Average deficits for 1990–2006

Source: World Development Indicators (accessed December 2007); OECD 2007.

Good governments were not more likely to adopt the fiscal rule 'form'

Evidence in the OECD database shows that this is not, however, the case. Scores on fiscal rule adoption here range from 0 to 4, indicating the number of different rule types a country has in place (including budget balance, debt, expenditure and revenue rules). The scores are graphically related to different WGI effectiveness scores (as in Figures 5.1 and 5.3). Figure 5.4 shows that higher fiscal rule adoption is not reserved for the more effective good government models to the right. Indeed, three of the four governments in the sample scoring below 0 on the WGI government effectiveness indicator (Venezuela, Peru and Argentina) have scores of 3 on the fiscal rule adoption measure. Only one of the five governments scoring above 2 on the WGI indicator has a fiscal rule adoption measure of 3 (the other four scoring below this level).

The ten countries scoring lowest on the government effectiveness indicator (all below 0.5) have the highest fiscal rule adoption measure average (2.2) as compared with the ten countries scoring between 0.5 and 1.5 on the WGI (averaging 1.9) and the 17 countries scoring between 1.5 and 2.5 on the WGI (with an average of 1.47). However, *t* tests indicate that none of these differences are significant, showing that good governments are not more likely to exhibit this good government characteristic than others.

Figure 5.4:
Fiscal rules and government effectiveness scores

Source: 2007 OECD Budget Practices and Procedures Database.

Good governments achieve functionality with different forms

Table 5.1 details the variation in fiscal rule adoption in the nine so-called good governments identified earlier in this chapter. This illustrates that these governments look very different in terms of the rules they adopt to facilitate budgetary discipline. The first column in Table 5.1 shows that two of the nine governments (Australia and the United States) do not actually have fiscal rules.⁷ The other seven have different types and combinations of rules.

Table 5.1
Fiscal rules in the more effective governments

<i>Country</i>	<i>Fiscal rule</i>	<i>Expenditure rule</i>	<i>Limits for spending requests</i>
Australia	No rules		No
Belgium	Budget balance rule		For some types of expenditure at a chapter level
Canada	Expenditure, budget balance, debt rules	Targets nominal growth rate, covers central government only, dependent on political commitment of government	For all expenditure at chapter level
Denmark	Expenditure, revenue, budget balance rules	Targets real growth rate, covers entire government sector, dependent on political commitment of government	For some types of expenditure at organizational level
Germany	Debt rule		For all expenditure at line-item level
Netherlands	Expenditure, revenue, budget balance rules	Targets real expenditure ceiling, dependent on formal agreement of parties in government	For all expenditure at organizational level
Sweden	Expenditure, budget balance rules	Targets nominal expenditure ceiling, covers central government only, based in legislation	Other
United Kingdom	Budget balance, debt rule		No, but indicative limits
United States	No rules		No, but indicative limits

Source: 2007 OECD Budget Practices and Procedures Database.

Column two shows that the mix of expenditure rules looks quite different in the four countries that have them. In some cases, the rule targets expenditure levels, while in others, it targets growth rates, covering central government only in some cases and the entire government sector in others, and relying on political commitment for influence in some cases, agreement among ruling parties in others, and legislation in one country. The third column features information about whether governments provide limits for budgeting entities prior to these entities submitting spending requests (often called ceilings). These are not macro-fiscal rules, but certainly are budget rules and contribute to the top-down formal budget structure. Again, there is a range of experience, from no limits at all to indicative limits only, to limits on some kinds of expenditure, to limits for all expenditure types.

This range of experience creates problems for advocates of a model of the appropriate 'form' of good PFM. Some may disagree and argue that the general experience is to have rules. However, the institutional literature so readily referenced in good governance work emphasizes the importance of institutional detail, making even differences in the mix or the specifics of rules very important. These differences lead to different influences on behaviour. Consider, for example, the different ways offside rules impact behaviour across sporting codes like football, field hockey and rugby. In some instances, these rules prohibit an attacking player exceeding the last line of defence, but in others, they prohibit passing a certain point in the field, while in others, they constrain players to points behind the physical presence of the opposition. The different implications of such different rules on budgeting behaviour would be amusing to consider!

Different forms work differently in different contexts

Different fiscal rule influence is in evidence across the governments. For example, Sweden has found the rules (based in legislation) quite influential, and is one of the governments actually maintaining fiscal discipline in recent years (at least at the national level and when looking at expenditures in a strict sense).⁸ However, economic challenges associated with unification and a prolonged recession made it very difficult for Germany to strictly adhere to rigid rules in the European Stability and Growth Pact.⁹ The United States actually had fiscal rules from the late 1980s and formally still has some on the books, but these are not reflected in the OECD database, partly due to their perceived lack of presence and influence.¹⁰ In both the

United States and Germany, social and economic challenges (the Iraq war, unification and economic pressures) were partly to blame for undermining the influence of rules.

Other governments in the effective government sample are also experiencing pressure in this regard as they face the challenges of other 'special costs' associated with aging populations and, more recently, the 2008 global economic downturn.¹¹ These costs contribute uncertainty to the PFM agenda and make rigid rules less appropriate devices for fiscal management. One could also argue that they redefine the role of fiscal deficit measures as PFM outcome indicators; in the face of spending challenges or economic downturns, some governments might find it less appropriate to rigidly control deficits in some years, rather allowing some slack to accommodate new policies or demands.¹²

Identifying how uncertainty influences the appropriateness of fiscal rules assists in understanding why different governments have different PFM forms. Hallerberg *et al.* (2007: 338) underscore the importance of this kind of understanding in their direct reference to unanswered questions about adopting fiscal rules themselves: 'While rules seem attractive and straightforward to contain the spending and borrowing bias of profligate governments, it is by no means clear what institutional design they need and how they should be embedded into the government budgeting process to be effective.' Hallerberg *et al.* (2007) suggest other political process influences on fiscal rule adoption, identifying two institutional approaches in countries attempting to enhance top-down budgetary influence – delegation and contracts. Delegation involves a minister of finance using rules to enforce his or her influence, while contracts involve actual contractual agreements about fiscal behaviour within the executive and between the executive and legislature. The authors argue that delegation is appropriate for single-party governments where ideological distance and political competition are small in the party, while contracts are appropriate for coalition governments and for single-party governments where ruling party ideological distance and political competition are significant.

The authors emphasize the significance of these differences: 'The European framework [of rigid rules] may be less effective in countries whose budget process is shaped by the delegation approach ... [and] ... the two are not easily interchangeable for a given country' (Hallerberg *et al.* 2007: 339). The story of PFM systems, related to fiscal rules, thus emphasizes context and the need to embrace contextual variation in thinking about governance forms. Different forms accommodate functionality differently in different contexts.

CONCLUDING THOUGHTS

This chapter asks if isomorphic compliance with governance indicators will improve form or functionality in developing countries. Do we have any reason to believe that countries following good governance scripts will look better or actually become better (facilitating development) as a result?

I tackle the question by looking for evidence that ‘forms’ implied in good governance indicators are linked to better functionality – do developed countries really have these forms in place? The first section raises doubts about such, providing secondary evidence that the more functional governments of this world actually look very different. They are different in size, for example, and have varying levels of decentralization and de-politicization.

The chapter then goes beyond secondary sources to examine a more discrete dataset showing which countries adopt fiscal rules – a staple ‘form’ in discussions about good PFM. The evidence suggests that while more functional governments commonly have better outcomes (lower deficits) they do not all have the good governance form (fiscal rules) and actually achieve their functionality in different ways that seem to be contingent on contextual factors.

This evidence causes me to question whether the ‘forms’ implicit in good governance – and good PFM scripts in particular – facilitate more functional government. It appears that countries exhibiting good outcomes – or functionality – can have very different governance structures – or forms. This evidence should challenge the current predilection for one-best-way models of PFM systems and government structures in general. These models are being foisted on developing countries with the implied promise of development but without evidence that the developed countries themselves uniformly adopt the model elements. Countries that come out reflecting ‘good government’ – according to the influential good governance indicators – actually look very different, varying on the very dimensions that indicators imply are central to good government.

Therefore, the development community should pay more attention to this variation. Such attention will require closer focus on the importance of context in shaping governments. Instead of building an ever-growing list of good governance characteristics we would like developing countries to adopt, researchers should focus on better understanding what structures governments actually do adopt and why.

It is important to note that elements of the good government picture painted by governance indicators are already fixtures in global public

sector reform programmes, and context appropriateness is not a strong point in most development engagements. A recent study of 31 African countries' PFM reforms finds governments commonly pursuing multiple 'best practice' constructs in the form of a model: like multi-year budgets (29 of the 31); programme, activity or performance budgets (25 of the 31); external audit and legislative reform (28 of the 31); and internal audit (25 of the 31) (Andrews 2010). One should note the cross-country variation in this sample: about half had Francophone histories (where external audit did not exist in the modern guise), 7 of the 31 countries had experienced serious social and political upheaval in the previous five years, 6 had not produced an annual budget in at least one of the previous three years, at least half had major discrepancies in the line-item classification scheme they used, and most had only 20 and 50 qualified accountants in the country (private and public sector, the numbers present in the United States in the 1880s). Surely, the variation in countries should have led to varying types of reform proposals, composed of different mixes of best practice constructs (and perhaps some constructs that are not best practice). Surely, the major differences between these contexts and those in which new ideas were hatched should raise red flags to those advocating replication.

The stories of replicated 'best practice' reform designs abound, as do tales of failed reforms. The latter are partly to blame (I believe) for the fact that effective government elements underlying reforms resemble the principles of administration Herbert Simon decried as problematic proverbs over 60 years ago – quotable and convenient constructs for rationalizing past behaviour or justifying future decisions, but defective in providing serious theoretical explanation or practical advice. Simon (1947: 53) argued that, as with all proverbs, the principles of administration of his day stood well when applied alone and in the right context, but poorly when considered in tandem with others: 'For every principle one can find an equally plausible and acceptable contradictory principle.'

The discussion of variation in 'good governance' structures suggests that leading world governments do not treat these sets of potentially conflicting principles (or proverbs) as elements of one strict model but rather as items in a menu. Put metaphorically, Sweden 'chose' to have a large but decentralized government system for providing its health care because it 'fit' the context.¹³ The United States has a system dominated by the private sector perhaps because it 'fit' that context as well. The two governments and societies adopted different menu selections of different practices to achieve similar objectives (provide world-class health care). Interestingly, there is evidence of 'choice', even within governments and

over time. While authors like Wehner (2007) show that wealthier, more developed countries are also more transparent in their PFM systems, most wealthy governments 'choose' lower levels of transparency in certain sectors – like defence.

Conceptualizing governance forms as menu items to be chosen, rather than essential elements of a one-best-way model, is an important step to better understanding why good government looks different in different settings. However, it will be a helpful step for developing country governments, especially if linked to thoughts on how governments should 'choose' from the menu. The development community could start addressing this question by asking why the world's more effective governments exhibit different combinations of better practices. What current cross-country characteristics and/or historical factors led to these menu choices? What internal factors lead governments to adopt different governing solutions? How can function drive form in the governance domain, rather than form driving function?

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