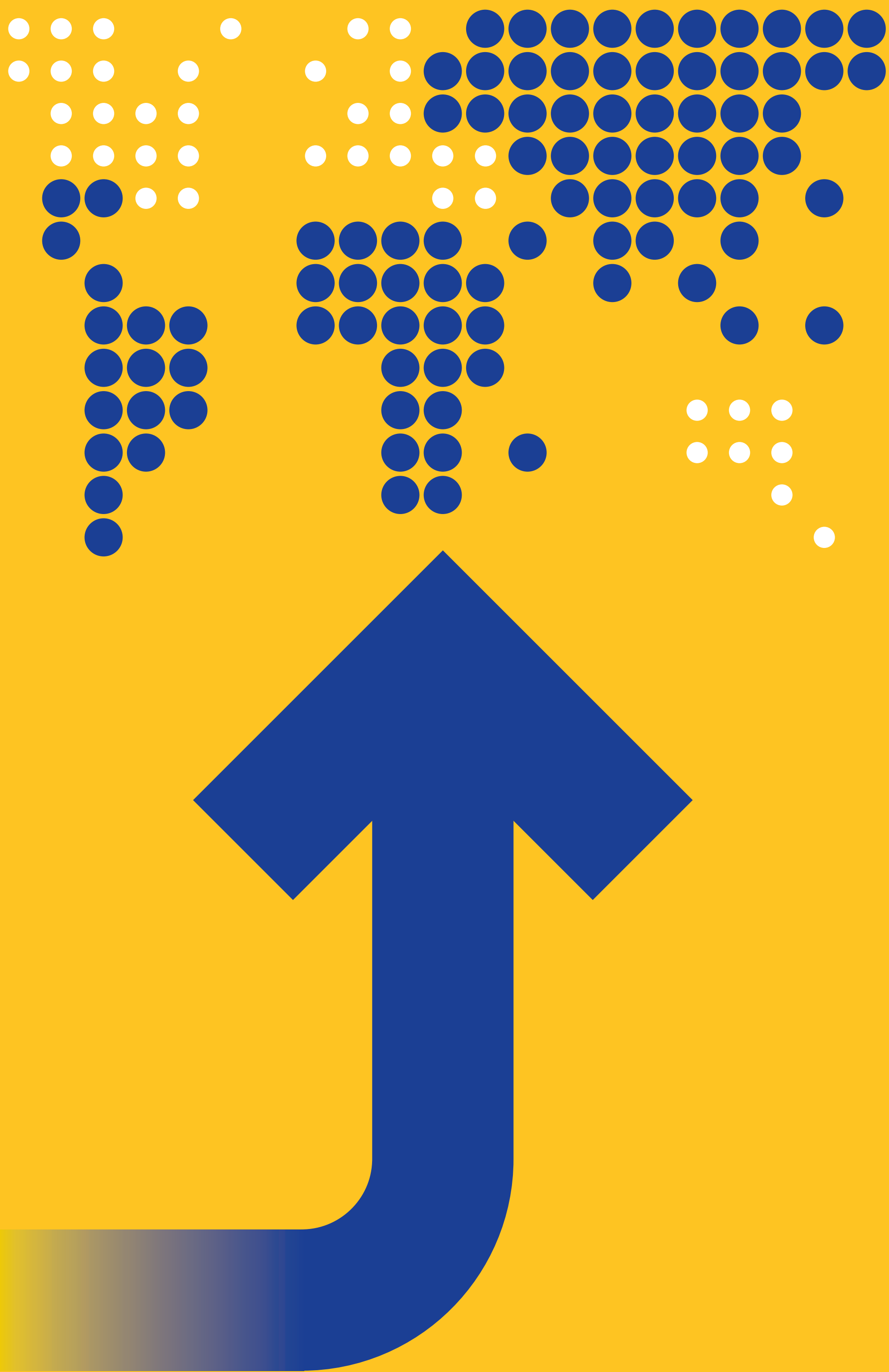

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EMERGING MARKETS FORUM

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BACKGROUND PAPER

GOVERNANCE CHALLENGES IN EMERGING MARKETS: FROM HERE TO DENMARK

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Overview

"Here" is a hypothetical construct of a place where governance is poor, rule of law is not respected, justice is often denied, and people lead lives deprived of basic human dignities.

"Denmark," at the other end of the spectrum, is another hypothetical construct of a place where good governance prevails, people are treated fairly and live in security and under the rule of law.

Quite obviously, Denmark is the place to be. Here is not.

The big practical question faced by almost all developing countries, then, is how do we get to Denmark from Here? *That question is the subject of this paper*.

It is a matter of some satisfaction that over the past century, particularly over the past several decades, the vast majority of countries in the world have improved their economic and social wellbeing. However, they have not all shared equally in the growing prosperity of the world. Indeed, in a large number of countries internal disparities have risen over time, and overall "Here" and "Denmark" may have drifted even further apart.

Why do these disparities endure? Why, in so many cases, are they growing within countries?

In our work and travels over the years around the developing world, be it in Asia, Africa or Latin America, we have spoken to hundreds of the intended beneficiaries of "development" work: the poor. What has been striking about these conversations is that the poor seldom talked about poverty. Instead, they all talked about governance, or the lack of it, in one way or another. To understand fully what they said, it is necessary to revert to what the latest "theories and concepts" on governance say.

In its most basic sense, governance is the process of how a society steers itself. It is the process of how a society manages its affairs for the overall good of its citizens.

From the many technical definitions of governance, four basic elements of good governance can be identified: predictability, transparency, participation and accountability. These four basic elements have to work in tandem to produce good governance. They mutually reinforce each other, and the absence or dilution of any one of them undermines the entire structure of governance.

But what is the relationship between good governance and development?

Several studies over time have confirmed a positive relationship between good governance and development. Note, for example, that high-income and more developed OECD countries all score higher on governance measures than less developed, poorer countries.

But does good governance lead to development, or vice-versa? Perhaps the two are mutually reinforcing: good governance results in more efficient and effective use of scarce national resources, providing a greater impetus to growth, resulting in greater incentives for better governance, triggering a virtuous cycle leading to higher growth.

But good governance in turn requires that the right institutional frameworks be in place and that national leaders wisely leverage them. In short:

Institutions matter

In their most basic form, institutions are rules governing social interactions; "rules of the game in a society, or more formally, the humanly devised *constraints* that shape human interaction" (North 1990). According to Rodrik et al (2002), "the quality of institutions 'trumps' everything else" in determining income levels around the world, even geography and international trade.

In their seminal 2012 book, *Why Nations Fail*, Daron Acemoglu and James Robinson essentially boil down their answer to the title question to institutions (or, more correctly, the lack of them).

At the risk of oversimplifying their comprehensive and very important work, Acemoglu and Robinson distinguish between inclusive and extractive institutions in determining the economic fate of a nation. Inclusive institutions create the incentives and opportunities for people in a society to aspire to and achieve prosperity. Extractive institutions do not; on the contrary, a small group of "elites" capture (extract) the benefits of growth to their advantage. Inclusive institutions include the population at large in the process of governing in a predictable, transparent, and accountable manner, thereby reducing—if not entirely eliminating—the process of exploitation by a few.

Institutions matter, but how to improve them?

The importance of good governance and sound institutions is widely accepted; the question is how to achieve them. In approaching this question, it is critical to think not only of building new institutions, but also (and perhaps more importantly) of nurturing and strengthening existing ones. In this regard, five aspects stand out.

1. Contextual settings of institutions: limited access order and open access order societies

Institutions are context-specific: institutional experiences in one country cannot be easily transplanted elsewhere.

North et al (2007) suggest that human society has devised only two significant orders of organizing itself so far:

Limited access order (LAO), where powerful individuals (the elite) possess privileges and means to "create limits on access to resources and economic functions to generate rents… privileged individuals have privileged access to social tools enabling them, and only them, to form powerful organizations" (North et al 2007).

On the other hand, *open access order (OAO) societies* "rely on competition, open access to organizations, and the rule of law to hold the society together" (North et al 2007).

In the LAO, elites actively manipulate the social order to regulate access and economic competition, thereby creating economic rents which they enjoy. The elites also use these rents to create social order, control violence and establish social cooperation for their own, rather than the larger polity's, advantage and welfare. By contrast, in the OAO, all citizens are empowered to form economic, political, and social organizations to pursue any activity (except violence). They can pursue their own interests, and rents, if any, are dissipated due to open entry, which induces competition.

In OAO societies, transactions (political and economic) are impersonal and based on transparent and predictable criteria. In the LAO, transactions are personal: "the logic of the LAO creates incentives such that the delivery of government services always depends on whom the recipient is connected to" (North et al 2007).

Seen through the lens of limited and open access orders, it becomes clear why many proposed institutional reforms fail: not because the proposals are inappropriate prescriptions in and of themselves, but because they are grafted onto limited access orders when in fact they would work only in open access systems.

It would be useful to pause here to ask if the extractive or inclusive institutional construct proposed by Acemoglu and Robinson is somehow different from that proposed by North et al in their articulation of limited or open access systems. We argue that these two constructs are answering different (though related) questions. Acemoglu and Robinson are asking: what type of institutions will lead to good governance and good development? Their answer: inclusive institutions rather than extractive institutions. North et al are asking: how will such inclusive institutions evolve in a society? Their answer: when the society moves to an open access state.

The logical question then is how to transition from limited to open access order? Effecting such a transition is neither quick nor straightforward. Societal changes from the LAO to the OAO take generations, and best practices cannot be transplanted from one institutional context to another. Moreover, dynamics of local politics, culture and social norms drive behavior and are hard to change—and when they do, they take time and do so in response to internal driving forces rather than external demands.

Encouragement can be drawn from a number of historical examples, starting with Denmark itself.

Denmark's institutions and governance were in very poor shape in the 1600s, but eventually they improved. The United Kingdom, United States and Japan are other examples of countries which moved from limited access to open access order societies and prospered. More recently, the experiences of South Korea, Botswana, and Singapore offer good evidence that "history is not destiny" (Acemoglu 2008).

The speed of institutional development and transformation is also a critical challenge. Speaking of Lee Kuan Yew, father of modern Singapore and an icon in developing strong institutions at a rapid pace in his own nascent country, Kissinger (2000) has observed that "tasks which in the West were accomplished over centuries [had to] be completed in a decade or two under much more complex circumstances".

How would such a process of institutional growth play out in much larger and more complex societies, say in India or Brazil?

One common feature of all historical breakthroughs in the evolution of strong and sound institutions has been an enlightened national leadership (for example, King Frederik III and his successors in Denmark, Lee Kuan Yew in Singapore). But what else is required for societies to transit from limited to open access order? Is an exogenous shock (such as the Danish loss of almost a third of its territories to Sweden in the war of 1658) always the tipping point for the changes? What are the "doorstep" conditions for the transition? How does good leadership emerge?

2. Are institutions immutable, or should they also adapt to changing circumstances and stages of development?

All aspects of governance need not be equally important at all stages of development. Economic aspects, such as government effectiveness and regulatory quality, may be more important in the early stages of development than, say, voice and accountability. The experience of the East Asian economies over the past five decades would be a case in point. And, while institutional quality is obviously an important factor driving good governance and good development, it is also relevant to consider that institutions well-suited to one phase of development may become inadequate for another. One may need to think, therefore, of the quality of institutions not in an absolute sense, but relative to the level of development.

3. The role of government, markets and citizens: the three pillars of delivering good governance

The government obviously plays a key role in delivering governance by designing sound, growth-oriented, and inclusive economic and social policies. But designing policies is only a start: implementation is what matters. To facilitate implementation, the government must devise enabling institutional and regulatory frameworks that are rules-based, predictable, equitable, accountable, and applied equally and fairly to all citizens. But the government cannot and must not be the sole institution concerned with and responsible for good governance; it has to create an enabling environment in which markets can operate. The role of civil society and the average citizen is also key. Emergence of stronger civic societies together with a vibrant and freer press bodes well for better governance in more and more countries in future.

4. Fighting corruption

Corruption, broadly defined as misuse of public office for private gain, is at the core of bad governance. Its pernicious effects are felt by all, though the incidence of such ill effects is borne disproportionately by the poor.

Bardhan (1997) observes that economists tend to focus on efficiency, growth, institutions and incentives for fighting corruption and "promote market inspired solutions such as competition, liberalization, deregulation and privatization". But, noting the scant evidence that such anticorruption measures have achieved much, Mungiu-Pippidi (2006) argues that such measures fail "because these initiatives are non political in nature, while most of the corruption in developing countries are inherently political". No wonder then that anticorruption strategies based on legal measures often fail in developing countries because of the ease with which elites subvert the rule of law.

There is a rich literature (Olson 1971, Sen 1967, Rothstein and Teorell 2015, Persson et al 2012) which argues that corruption can be better understood as a "collective action" problem rather than a "principal-agent" relationship: members of a society may all agree that corruption is bad; they also may know that, as a group, they are worse off with existing corruption and it is therefore in their interest to support anticorruption measures. Yet given the high short-term costs of, say, refusing to slip the policeman a bribe to avoid being charged with jumping a red light, individuals continue to engage in corrupt behavior themselves.

5. Promoting transparency, enhancing participation and empowering citizens

Just as the old adage goes "sunshine is the best disinfectant", transparency is a key enabler for good governance. The best-designed and even perhaps best-intended rules of law will not mean much if citizens don't know about them or can't readily find out about them. If information is power, it needs to be widely disseminated and easily available to all in order to avoid this power being abused. Knowledge of government rules and regulations and awareness of citizens' rights and responsibilities are powerful tools to complement and reinforce predictability.

But transparency is undermined by asymmetries of knowledge and hence power. Those who generate and apply the rules governing a society know much more about them than the ordinary citizens who are affected by them. This asymmetry can be misused by the information keepers to control what information is provided and when. Citizen access to information should therefore be a matter of right rather than a favor granted by the state. The role of an open media becomes very important in this context.

Conclusions

At this point, we have reached five key conclusions:

i. Governance matters: good governance is a necessary condition for good development.

ii. Institutions matter: sound, inclusive institutions are needed to deliver good governance.
iii. Most leaders and policy makers around the world accept the above two premises, but need help building sound, inclusive institutions.
iv. Institutional development is arduous and unpredictable; it cannot follow a "how to do manual" with a streamlined cookie cutter approach in all countries. Local context matters and institutional reforms cannot be easily transplanted. Essentially, there are no silver bullets.
v. Experiences in various parts of the world and at various times have proven that "history is not destiny". Enlightened national leaderships combined with national emergencies caused by external factors have often led to major institutional improvements. In other words, when unexpected opportunities arise, local leaders can make a huge difference: change can happen in nonlinear ways. Such opportunities combined with enlightened national leaders led to nonlinear changes in countries as diverse as Denmark, Japan, Singapore and South Korea.

We are persuaded that in the future there will be many more Denmarks and Japans even in the absence of national emergencies caused by external shocks. Instead, countries throughout Asia, Latin America and even Africa will enjoy improvements in governance at a pace faster than we have seen in the past thanks to a combination of mega-trends that are now beginning to affect emerging economies worldwide.

We see five drivers (major mega-trends) coming together almost simultaneously during the next few decades which will create strong societal pressures for good governance. They are: (i) the demographics of a young population in emerging economies, particularly in South Asia and Africa; (ii) a fast-growing middle class; (iii) rapid urbanization; (iv) the ICT revolution and an explosion in communications through social media, allowing people to see how the rest of world lives and is governed; and (v) globalization of not only trade but also ideas and expectations.

Demand for good governance will in turn create demands for better, stronger institutions. Each country will make its own unique journey to "Denmark", but the above mega-trends make us more hopeful about the future.

Governance Challenges in Emerging Markets: From Here to Denmark

Rajat M. Nag and Harinder Kohli

1. Introduction

"Here" is a hypothetical construct of a place where governance is poor, rule of law is not respected, and justice is often denied. Here people suffer the consequences of a capricious and corrupt ruling elite, do not reach the potential of their capabilities and often lead a life deprived of basic human dignities, marked with fear and insecurity.

"Denmark", at the other end of the spectrum, is another hypothetical construct and perhaps what Tagore dreamt of when he sang the praises of a place "where the mind is without fear and the head is held high". "Denmark" is where good governance prevails, people are treated fairly and live in security and under rule of law.

People in "Denmark" enjoy high social development indicators, including incomes and quality of life. Those "Here" do not.

Quite obviously, Denmark is the place to be. Here is not.

The big practical question faced by almost all developing countries then is how do we get to Denmark from Here?

That is the fundamental objective of this paper. We also note that this is a work in progress.

It is a matter of some satisfaction that over the past century, particularly over the past several decades, the vast majority of countries in the world have improved their economic and social wellbeing. However, they have not all shared equally in the growing prosperity of the world. Indeed, in a large number of countries the disparities have risen over time, and "Here" and "Denmark" may have drifted even further apart. Section 2 notes these issues as evidence of the two diverging faces of the world we live in.

While several factors contribute to economic and social development (physical and human capital, appropriate policies and prices, for example), it is now widely recognized that good governance is a principal enabler of development. Governance matters, and that is the subject of Section 3. Along with the thesis that governance matters, we will note (perhaps optimistically) that some drivers (demographics and greater penetration of technology, for example) will push countries on a trajectory of good governance, though not necessarily all to the same degree.

However, it is also equally true that even if the right drivers are in place, they will result in good governance and good development only if the right institutional framework is in place. Societies need to proactively leverage these drivers, rather than merely react to them. In other words, institutions matter, and are discussed in Section 4.

Sound, inclusive institutions are needed to deliver good governance. This is generally well accepted in the literature and by policy makers; the challenge is how to build such institutions to help countries in their journey from "Here" to "Denmark"? Section 4 identifies some of the possible "hows" and the principal issues influencing them.

Section 5 concludes.

2. The world we live in

At the turn of the twentieth century, almost three quarters of the world's population lived in extreme poverty. By 1970, that proportion had come down to less than half and even more dramatically to less than a twelfth today. This achievement has been fueled in large part by reductions in poverty in China and India, where the estimated incidence of extreme poverty[1] has fallen to 0.2% and 2.8%, respectively (World Data Lab 2019).

Incomes have also risen. In 1970, the global average per capita income was slightly less than $6,000. By 2017, it had increased by more than two and a half times to over $15,000.

Social indicators have improved as well, often dramatically. Over the past hundred years, the global average life expectancy has more than doubled to over 70 years. All countries in the world today have a life expectancy higher than the best in 1800.

1. People living in (extreme) poverty are defined as those living on a daily income of less than $1.90, measured at 2011 Purchasing Power Parity prices.

In 1960, every 5^{th} child born that year would not live to see her 5^{th} birthday. That rate has now come down to every 25^{th}.

Education levels have also improved. The global adult literacy rate is now over 80%, up from 56% in 1950.

The world is now richer, healthier, and more literate than it was just a generation back. These are all very significant achievements and there is much to celebrate.

However, the average global profile we paint above hides (as averages often do) the grim reality of the two faces of the world. It hides the fact that there are still almost 600 million people in the world who live in extreme poverty today. It also hides the steadily increasing concentration of the world's poor in Africa. Though only an estimated 8% of the world's population lives in extreme poverty, more than 70% of the world's poor live in Africa—up from just above 60% in 2016 and 40% in 2010 (Kharas et al 2018, World Data Lab 2019). This phenomenon is best viewed through the lens of Africa's long-term economic decline: the average African's income relative to the world average has declined in every decade since 1950, while the average Asian's income has risen just as consistently (Varathan 2018); per capita GDP in sub-Saharan Africa declined almost 11% between 1974 and 2003 (Artadi and Sala-i-Martin 2003). As a result, Nigeria, with nearly half of its 200 million-strong population living in extreme poverty, is home to more than twice as many poor people as India, whose population is seven times larger (World Data Lab 2019).

While a Norwegian earned a per capita annual income of over $68,000 in 2017, a Nigerien earned just $900 that same year—a staggering 75-fold difference. While a Nigerian earned over five times more than a Nigerien, it is striking that he earned only one thirteenth that of a Norwegian, though both of their countries have bountiful oil wealth. If he were instead a she, the difference would be even more stark.

A girl born in Japan in 2017 could expect to live over 87 years while her counterpart in South Asia could expect to live almost a fifth (or about 16 years) less.

And the list goes on.

Why are there such glaring and often increasing differences between countries? Why are some nations rich and others poor? Why, in spite of the dramatic improvements in healthcare around the world, do more than 500 mothers still die in childbirth (per 100,000 live births) in sub-Saharan Africa compared to 3 in Finland?

These obvious questions have occupied many. Philosophers, politicians, policymakers, academics and private citizens have all wrestled with these issues through the ages.

These concerns became particularly dominant with the dismantling of colonies around the world starting in the mid-20^{th} century. The general consensus at that time was that the principal and immediate cause of the continued stark poverty in the world was lack of adequate capital.

If only these poor countries could have easy and ready access to financial and physical capital (machinery, infrastructure, etc.), so the thinking went, their economies would grow and all would be well. The quick and dramatic success of the Marshall Plan in reconstructing Europe, particularly Germany, after the ravages of the Second World War was considered robust evidence that that prescription worked.

It soon became evident however that while obviously important, physical capital by itself could not adequately engender sustainable economic growth; human capital was also needed. A skilled, educated and healthy labour force was necessary to leverage the available physical capital and produce and sustain growth.

Hence, the importance of human capital.

But even with substantial resources employed to enhance the stock of physical and human capital, progress on the economic and social fronts in many, if not most, developing countries was not satisfactory enough, as evident from the selected statistics quoted earlier.

By the early 1980s, the thinking in the development field started to explicitly recognize that the country's macroeconomic environment also matters. Policy and price distortions in the economy cause misallocations of resources and result in their inefficient use. Economic growth and the distribution of its benefits would both be detrimentally affected in such a distorted macroeconomic milieu. Getting the prices and policies right became the mantra encapsulated in what became known as the Washington Consensus.

But it soon also became apparent that it was not only a question of devising the right and appropriate policies. Equally and perhaps more important was how such policies would in fact be implemented. Difficult as crafting the right policies might be, it was considerably more challenging to implement them and make them work.

Increasing tax rates paradoxically resulted in reduced tax revenues, but perhaps that should not be so surprising. Higher tax rates increased the incentives to cheat and bribe the tax officer rather than pay the higher taxes. Corruption came in the way of enforcing policies, no matter how good their design might have been. Additionally, a recalcitrant bureaucracy had the potential to undermine policies in implementation.

Thus, governance matters, and this is the next focus of our discussion.

3. Governance matters

3.1. What is governance?

In our work and travels over the years around the developing world, be it in Asia, Africa or Latin America, we have spoken to hundreds of the intended beneficiaries of "development" work: the poor. What was striking about these conversations was that the poor seldom talked about poverty. Of course, it was a concern, but often not the principal challenge they faced in the daily grind of their lives.

They talked instead of the feeling of helplessness and of disempowerment. They often recounted the daily humiliations they faced in their interactions with the police at the street corners (recall Tunisia) or the petty bureaucrats at the local administration offices or the primary health center where they had gone to get some urgently needed healthcare.

They talked of travelling for hours by bus and often on foot to collect the necessary papers and permissions to take advantage of the government programs due to them only to be told to be back the next day as the "dealing officer" was away or, in this age of digital progress, "the system was down".

They talked about their daily battles with rules, regulations and processes which they did not understand but which ground them down. They talked of the feeling of being supplicants and at the mercy of others more powerful (official or otherwise) when in fact they were asking for no favors and nothing more than was already their due (access to healthcare and education, for example).

And while there often was the unstated message that perhaps the system could work faster and in their favor if some money was offered, it was not necessarily always so either. The challenges were much deeper than "corruption" alone. They were a combined effect of biases and prejudices, of processes and procedures not clearly defined and certainly not transparent. Often, the intended beneficiaries did not know (and would not be told) which pillars and posts they were supposed to run between. And, worst of all, no aspect of the systems that failed them could be held to account.

Essentially, they all talked about various aspects of governance, or the lack of it.

In a strikingly moving and powerful book, Deepa Narayan (2000) and her colleagues at the World Bank recount similar conversations as ours.

They note the "commonality of the human experience of poverty across countries. From Georgia to Brazil, from Nigeria to the Philippines, similar underlying themes emerged: hunger, deprivation, powerlessness, violation of dignity, social isolation, resilience, resourcefulness, solidarity, state corruption, rudeness of service providers, and gender inequity" (Narayan 2000, p. 3).

Contrary to what many might think, governance is not a recent concern for society. Going back more than two millennia, Chanakya's *Arthashastra*, Plato's *Republic* or his disciple Aristotle's *Politics* all reflect wise ruminations and advice, simultaneously deeply philosophical and practical, on how a society could best govern itself to enhance its citizens' welfare.

It is not surprising therefore that the word "governance", derived from the Latin "gubernare" is itself originally derived from the Greek word "kubernaein", meaning "to steer".

In its most basic sense, governance is the process of how a society governs (steers) itself. It is the process of how a society manages its affairs for the overall good of its citizens.

As a matter of fact, it is not hard to imagine that even the first human habitants on earth must have, even if instinctively, realized that they needed to evolve "rules of engagement" with each other to coexist and "steer" their affairs. Fundamentally, these rules of engagement define governance.

But just articulating rules and regulations, passing laws and statutes, and making policy declarations are not enough to assure good governance. Rules, laws and policies have to be implemented. How they are applied to enhance the welfare of citizens matters!

Governance then needs to be looked at through a wider prism of social justice.

In this context, we have found it useful to draw on two Sanskrit words which Amartya Sen uses often in his discourses on social justice. The first is "niti" and the second is "nyaya". Both mean justice in a sense, but the nuanced difference between the two is critical. "Niti" refers to organizational propriety, behavioral correctness, the rules and regulations—how you ought to behave. "Nyaya" on the other hand refers to realized justice. "Nyaya" recognizes the role of "niti"—the rules and the organizations, the importance of institutions—but considers the world as is (Sen 2010, pp. 21-22).

The context in "nyaya" is the world we live in, not some idealized state of society. Nyaya recognizes the role of niti in shaping institutional frameworks but focuses on implementation. It takes into account the context while using the rules, norms and legal measures to ensure that justice is implemented in a fair manner to govern the society.

Niti is a necessary condition to achieve nyaya, but ultimately it's nyaya which a society aspires to achieve. Good governance has to concern itself with both niti and nyaya. Niti alone is not enough.

In this context, there is another very relevant Sanskrit word, "matsyanyaya", which means justice in the world of the fish. Justice in such a world allows a big fish to devour the small fish at will. Such a situation is obviously a fundamental violation of human justice, no matter how well laid out the rules, regulations and institutional structures might be. A key element of good governance is thus ultimately about assuring and ensuring justice, or at least the reduction of patent injustices which many of the "voices of the poor" had spoken of.

In his seminal work, *Development as Freedom* (1999), Sen distinguished between the "intrinsic" (also called primary or constitutive end) and "instrumental" (also called principal end) values of freedom. He argued that human freedom (to choose, to express views, to live as one wishes, for example) is of value by itself to be cherished as an important, indeed inevitable, metric of development itself. Freedom is an intrinsic and primary end of development in its own right: "This fundamental point is distinct from the 'instrumental' argument that these freedoms and rights may also be very effective in contributing to economic progress" (Sen 1999, p. 37).

Following the above logic, the value of good governance as discussed so far may be termed its "intrinsic value". Good governance is good in its own right. It recognizes and restores, even if partially, human dignity and gives people a sense of empowerment. However, the intrinsic value of good governance as a desirable end in itself does not in any way diminish the instrumental value of good governance in contributing to economic development. To the latter concept we now turn.

Governance is a broad, multidimensional concept meaning different things to different people. While many instinctively think of good governance as implying honest government (i.e. absence of corruption), that is only one of many aspects of governance which we have to be concerned about.

The developing world is full of examples where technically sound projects fail due to poor project management and inadequate supervision; where much-needed policy and institutional reforms are sabotaged by vested interests; where laws are improved but simply remain on the books due to intentional (or unintentional) road blocks put in the way of administration of justice; where improvements and simplification of government processes (to enhance efficiency and access) are negated by lack of awareness among the people who such changes are supposed to benefit. Desired improvements in public expenditure management may not materialize if the government's accounting systems are weak. Efforts at enhanced tax collection efforts to bolster government revenues may not bear fruits if tax collection officers can strike deals under the table with unscrupulous taxpayers. Poorly monitored procurement systems and complicity with fraudulent suppliers would encourage corruption even if improved procurement management policies were adopted.

All these cases are examples of failure of governance. Good governance leads to sound development management; bad governance does not. In the examples above, good governance implies that the desired effects of the reforms and changes could be achieved, even if not perfectly.

Interest in governance has increased dramatically in recent decades. Be they politicians or policymakers or bureaucrats, be they academic researchers or development practitioners, or be they ordinary citizens, people all over the world are concerned about governance, particularly the lack of it, as it affects the wellbeing of all.

But, though we all talk about governance, what is it? Is there any standard definition? The answer, alas, is no. As a matter of fact, there are multitudes of definitions and descriptions of governance, depending on who is doing the defining.

Note that we had started off by describing governance, in a very broad sense, as the process of how a society governs (steers) itself. This is easily said, but governance is actually a complex amalgam of multidimensional and multidisciplinary considerations. Legal, political, social, anthropological and economic aspects all have a bearing on how we understand governance and how we define it.

Consider only a few of the many definitions of governance in the literature.

Kaufmann et al (2009, p. 2) describe governance "as the traditions and institutions by which authority in a country is exercised. This includes political, economic, and institutional dimensions of governance. Specifically, how governments are selected, monitored and replaced, the government's capacity to effectively formulate and implement sound policies and provide public services; and the respect of citizens and the state for the institutions that govern economic and social interactions among them".

Notice that this is an eloquent and exhaustive expression of "how a society governs (steers) itself", but notice too the fact that the citizens and the state must respect the institutions which will deliver governance. Essentially, governance in this definition involves setting the rules of the game and then ensuring that society also plays by those rules.

Similar in vein to Kaufmann et al (2009), Francis Fukuyama (2013, p. 3) defines governance "as a Government's ability to make and enforce rules, and to deliver services, regardless of whether that government is democratic or not".

Not only is governance multidimensional, but it also involves multiple stakeholders (members of society) who all have to somehow come together to decide and choose how they would like to steer themselves. Cárcaba et al (2017, p. 1) thus define governance as being about "the interaction between governments and other social organizations, the relationship with citizens, decision making and accountability. Governments have a key role in this network, since good governance implies managing public affairs in a transparent, accountable, participatory and equitable manner".

In a very similar vein, Bovaird and Löffler (2002, p. 16) define governance as "the negotiation by all the stakeholders in an issue (or area) of improved public policy outcomes, and agreed governance principles, which are both implemented and regularly evaluated by all stakeholders".

That such a process of negotiation will not always be easy has been explicitly recognized by Rotberg (2004, p. 71), who defines governance as "the tension filled interaction between citizens and their rulers and the various means by which governments can either help or hinder their constituents' ability to achieve satisfaction and material prosperity".

As is apparent from the above, different definitions and interpretations of governance focus on different aspects of governance. While they all are in one way or another appropriate and relevant, they may broadly be classified in three buckets: political, state capacity to implement, and legal.

Some have emphasized the political aspects of how a society chooses to govern itself and the process of arriving at that configuration. As Quibria (2014, p. 3) notes, from this perspective "political contestability and election processes, political liberties, and the legitimacy of the Government… democracy, human rights, political rights, and freedom of the press are critical elements of good governance".

Another perspective emphasizes legal aspects of governance: the laws, rules and regulations which would govern the behavior of, and the interactions between, various members and groups in society: the citizens, businesses and the government. Under this consideration, governance is about defining the rule of law, enforcing contracts and securing property rights. This definition equally emphasizes the importance of "rule by law" and the necessary institutional arrangements (an independent judiciary, for example) to ensure that.

Yet a third grouping focuses on state capacity for efficient economic management, a la Fukuyama. Governance is about the performance of agents in carrying out the wishes of the principals, not how the principals are selected. Note that Fukuyama specifically includes in his definition the phrase "regardless of whether the government is democratic or not". Governance from this perspective is about execution to improve the lives of citizens through "improvement of the provision of public services, and in efficacious management that helps avoid delays of execution, malfeasance and corruption" (Quibria 2014, p. 3).

Though trying to incorporate all the above aspects in defining governance does tend to get a bit overwhelming, it is also obvious that all these aspects (political, execution and legal) are relevant. However, all aspects need not be considered simultaneously or given equal importance in each definition.

International development financing organizations (the World Bank, ADB, etc.), for example, can only consider economic aspects of development and are actually prevented by their charters to get into political issues in any member country. These institutions have thus cast governance in the mold of sound development management and defined it as "the manner in which power is exercised in the management of a country's economic and social resources for development" (ADB 1995).

Good governance is to be valued because it would lead to sound development management and thus contribute to "creating and sustaining an environment which fosters strong and equitable development, and it is an essential complement to sound economic policies" (World Bank 1992, p. 1).

It is obvious from the above that a wide variety of definitions of governance are possible. Some are rather broad and others narrowly focused on public sector management, but suffice it to say that governance is ultimately the "manner in which power is exercised in the management of a country's economic and social resources for development" (ADB 1995).

3.2. Four basic elements of good governance

The various definitions of governance we have laid out above all touch on one or more aspects of governance: political, economic, state capacity, legal, social justice. Each aspect is relevant in some way or another, but they can indeed get overwhelming in the breadth of their coverage. But a closer reflection on the various definitions reveals that four basic elements of good governance can be identified: predictability, transparency, participation and accountability. (ADB 1995, p. 8).

Members of a society need to know in advance the laws, rules, and regulations that apply. They need to have the assurance that they will indeed be applied **predictably** and **transparently** to all, not capriciously and unfairly with irrelevant but pernicious considerations of a person's station in life or access "to higher ups". Citizens must have the confidence that their **participation** in efforts to demand good governance, as agents of change and development, will be encouraged and not be ignored (or worse). People (the governed and those governing) must be held **accountable** and bear consequences for their actions.

Needless to emphasize, these four basic elements of governance have to work in parallel to produce good governance. They mutually reinforce each other and the absence or dilution of any one of them undermines the entire structure of governance.

Having clearly defined rules and regulations makes the expectations of social behavior (and the consequences thereof) by all citizens, both the governed and the governors, **predictable**.

But without **transparency** in knowing what such rules and regulations are and, more importantly, how they will be applied, the "rule of law" will not translate to "rule by law", which is what good governance demands.

Active citizen **participation** is critical to holding public officials **accountable**, drawing on the predictability of the functioning of the legal framework and information available through the practice of transparency. Weaknesses in any of these elements will dilute the practice of good governance.

3.3. Measures of governance

If defining governance is complex, measuring it is much more so. Governance is a multidimensional phenomenon and thus must be seen and measured in that context.

No single measure (or even combination of measures) will either be perfect or comprehensive. The best that can be hoped for are indicators which collectively will provide an approximate sense of what may be summed up as the core concept of governance: "the importance of a capable state operating under the rule of law" (Kaufmann and Kraay 2008, p. 4).

Over the last three decades, as interest in and concern about governance rose around the world, there has been a proliferation of governance indicators. Most of them are outcome-based, as there is much greater interest (and indeed relevance) in actual conditions on the ground (or, more accurately, perceptions of conditions on the ground, but perceptions matter). Various commercial risk rating enterprises, international development agencies (such as the World Bank), and civil society organizations (such as the World Economic Forum and Transparency International) regularly publish such indicators, each looking perhaps at different aspects of governance, though understandably corruption often takes much of the attention.

Many governments and multilateral organizations also assess the status of their governance for internal diagnostics and policymaking purposes. For almost all bilateral and multilateral development organizations, good governance is a key performance measure in determining allocation of aid funds.

For our purposes in this paper, it would perhaps suffice if we culled from the many governance indicators available and focused on only one: the Worldwide Governance Indicators (WGI), produced by the World Bank.

Starting in 1996, the World Bank has produced annual updates of the WGI covering over 200 countries. Six dimensions of governance are included: voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption. These are not listed in any particular order of importance, but note that corruption, or the control of it, is only one of the six dimensions considered to assess the state of governance.

3.4. Why governance matters?

In a seminal study undertaken almost two decades back (and which has withstood the test of time), Kaufmann et al (1999) concluded that "governance matters, in the sense that there is a strong causal relationship from good governance to better development outcomes such as higher per capita income, lower infant mortality and higher literacy" (Kaufmann et al 1999, p. 1).

Using cross-sectional data drawn from 150 countries, they conclude that a one standard deviation improvement in governance causes "between two and a half fold (in the case of voice and accountability) and a fourfold (in the case of political instability and violence) increase in per capita income" (Kaufmann et al 1999, p. 15). It is even more encouraging that their study confirms impressive impacts on social indicators as well. They note: "Improved governance has a strong negative impact on infant mortality, of proportionally the same magnitude as for per capita incomes… and between a 15 and 25 percentage point improvement in (adult) literacy" (Kaufmann et al 1999, p. 17).

Several studies over time have confirmed that there is a positive relationship between good governance (notwithstanding the challenges in measuring what is good governance, a topic we do not get into in this paper in any depth) and development. Note, for example, that high-income and more developed OECD countries all score higher on governance measures than less developed, poorer countries.

Some have questioned the causality: does good governance cause development or does development lead to good governance? Perhaps the process is mutually reinforcing. Good governance results in more efficient and effective use of scarce national resources, providing a greater impetus to growth, resulting in greater incentives for better governance, triggering a virtuous cycle leading to higher growth.

It is indeed quite possible to see economic growth in a country even without good governance (Nigeria in the oil boom period, Indonesia in spite of well-recognized governance deficits in the Suharto era) but we believe that such growth is not sustainable. Such episodes of growth happen as spurts, which then fade away and do not last over a sustainable period.

But what about China? The country does not score too well on several of the Worldwide Governance Indicators, and yet its economic growth over the last three decades has been stellar. China has also done phenomenally well in reducing poverty and improving many of its social indicators.

The Philippines and Vietnam also provide interesting contrasts, again challenging the conventional wisdom on governance. Vietnam has more closely followed Chinese-style reforms (limited deregulation, financial repression, absence of private property rights, for example) while the Philippines has adhered more closely to conventional expectations of good governance (as summarized in the six components above). And yet, Vietnam is growing at a much healthier clip than the Philippines, which seems to show many of the telltale signs of getting caught in a middle-income trap.

Would it then not follow from the examples of China and Vietnam that the above standard framework of governance does not matter for economic and social development?

Quibria (2006) provides a valuable insight. He argues that measures of governance such as the WGI are "too coarse to capture the nuances of governance-growth interactions" and suggests that all these indicators are not each equally important for growth at all stages of development (and in all societies).

The miracle economies of East Asia, for example, initially put much greater emphasis on economic aspects of governance such as government effectiveness and regulatory quality, rather than on the political aspects of governance, such as voice and accountability. In addition, they had above-average quality institutions (and resultant implementation capacity) given their stage of development. That allowed them to concentrate on economic growth (including by attracting foreign investment and knowhow), for example, ahead of other countries with weaker institutions (and poorer implementation capacity). Nonetheless, as they moved up the development ladder most East Asian countries also moved toward better governance in its other aspects, reiterating a correlation, if not proven causation, between development and governance.

Good governance encourages growth because it encourages investments. Investors (both domestic and foreign) are encouraged if they can reasonably predict the consequences of their actions in an environment of good governance. By the same token, bad governance is bad for growth, but more importantly, bad governance has a disproportionately higher negative impact on the poor. The poor have less ability to deal with corruption or to work their way through an opaque system or a maze of bureaucracy. So, good governance is good for growth, but perhaps more importantly, bad governance has a more deleterious effect, particularly on the poor.

3.5. Future drivers of governance

Evidence around the world indicates that societal pressures for good governance will increase in the coming decades through a combination of the following five drivers (mega-trends) in many, if not all, developing countries to the same degree.

First: demographics. The young are much less patient with bad governance; they are much less willing to accept the status quo and the explanation or excuse that "this is how things are". They demand change and accountability, and the growing young population in developing countries over the coming decades will speak its mind on bad governance and demand and bring changes on this score.

Second: a fast-growing middle class. As with the youth, middle class people have greater aspirations for a better life for themselves and their children and are willing to work hard to achieve it. And, when they see bad governance thwarting that process, they are willing to stand up for better governance. It is no coincidence that the Arab Spring had its first spark in Tunisia (currently a lower-middle income country by the World Bank classification, and not a poor country), or that the citizens of Delhi (largely on the back of the city's large and growing middle class) overwhelmingly elected a political party promising good governance a few years back.

Third: urbanization. Partly because of their higher education levels than those of the rural population, and partly because of their greater access to information, urban populations usually are more demanding of better governance and better access to public services, as well as accountability of public officials. Just China, India and Nigeria, for example, will together have an extra billion people in their urban centers by 2050.

Fourth: the ICT revolution. This revolution has allowed people to see how the rest of world lives and is governed and facilitated an explosion in communications through social media. It has connected people more readily with the rest of the world and is often a major driver for better governance at home. The rapid spread of the Arab Spring was fueled in no small part by social media.

Five: globalization of not only trade but also of ideas and expectations. The world has become a much smaller place with the rise of instant communication and knowledge of what's happening in other parts of the world. People in different corners of the world can thus aspire to better lives and more accountable governments at home if they know what's happening elsewhere.

It can be argued that the above drivers would create the demand pressures for good governance. But even with the right drivers, they will only result in good governance if the right institutional frameworks are in place and if national leaders wisely leverage these drivers. It is equally important to recognize that rising inequalities, increasing youth unemployment (again, particularly in Africa) and climate change could lead to social upheavals and weaken the credibility of existing institutions. Essentially, the thesis is that institutions matter, a topic we now discuss.

4. Institutions

4.1. Institutions matter

In its most basic form, institutions are rules governing social interactions. They evolve over time, reflecting the history, culture and politics of a society. They sometimes become formalized and sometimes not, but they essentially become rules of engagement in society, "rules of the game" as they were.

Douglass North, a principal protagonist of New Institutional Economics, which recognized the key role institutions play in delivering good governance and good development, actually uses this phrase in his definition of institutions "as the rules of the game in a society, or more formally, the humanly devised *constraints* that shape human interaction" (North 1990, p. 3).

North expands on this concept by observing that institutions are "a set of rules, compliance procedures, and moral and ethical norms designed to *constrain* the behavior of individuals in the interests of maximizing the wealth or utility of principals".

A key feature of any definition of institutions (and there are many variations, though essentially along similar lines as above) is "constraints". Members of a society, the governors and the governed, all have constraints placed on their behavior for the overall welfare of others. These constraints can be codified in a country's constitution, in laws, or in generally accepted norms of behavior even if not formally articulated in legal provisions. Rights, for example, embedded in legal provisions would constrain the state from expropriating private property or violating rules of law.

Adam Smith (1902, p. 502) had articulated this as such (even if he did not use the word "institution") more than two centuries back in his seminal work, *The Wealth of Nations*:

> *"Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government".*

It is important to recognize that institutions are not just organizations. They are that, but more importantly, institutions are the rules that govern and shape economic and political life. Institutions are shared beliefs; they are norms and rules. They can be formal or informal, but are essentially social rules of the game.

Over the last three decades, particularly with the resurgence of interest in the role of institutions, there has been renewed attention to the query of why some nations remain poor and others can move on?

Several factors, individually or in combination, have been considered to explain the phenomenon of the two faces of the world as described in Section 2, and there have been very rich contributions by renowned academics.

Among these is a widely referenced work by Rodrik et al (2002) which telegraphs its conclusions in a precise sound-bite title "Institutions Rule". Considering geography, international trade and institutions (particularly the role of property rights and the rule of law) as possible determinants of income levels around the world, Rodrik et al (2002, p. 1) conclude that "the quality of institutions 'trumps' everything else".

In their seminal 2012 book, *Why Nations Fail*, Daron Acemoglu and James Robinson essentially boil down their answer to the title question to institutions—or, more correctly, the lack of them.

Taking several striking examples of countries all over the world (including neighbors such as the Koreas), some of which have prospered and others which have not, Acemoglu and Robinson (2012) convincingly conclude that it is man-made institutions, not geography or culture, which make the difference to determine whether a country will enjoy sustained prosperity or not.

It would be an incomplete, perhaps even misleading conclusion, however, if we just stop at saying "institutions matter". Yes, institutions matter, but which ones remains an important query.

Bardhan observes that most of the literature focuses primarily on security of property rights, whereas "in general, economies at early stages of development are beset with coordination failures of various kinds…and in dealing with (such) failures…there are all kinds of collective action problems" (Bardhan 2005, p. 499-500). Asymmetry of political power between citizens makes resolving distributive conflicts difficult and "may be at the root of a great deal of institutional failures that are so common in poor countries" (Bardhan 2005, p. 499-500).

In a similar vein, Acemoglu and Robinson (2008, p. v) argue that while differences in prosperity across countries are driven by differences in economic institutions, they in turn "depend on the nature of political institutions and the distribution of political power in society".

It is often not in the interest of the political elite to redistribute power or transform the political institutions, and hence reforming economic institutions is often rather challenging. The situation is further exacerbated by the fact that some in society may in fact enjoy *de facto* political power (say, by access to arms, mercenaries, and political agents) which political institutions (the government, for example) might not have granted them *de jure*.

At the risk of oversimplifying their comprehensive and very important work, Acemoglu and Robinson distinguish between inclusive and extractive institutions in determining the economic fate of a nation. They argue that rich countries are rich because they have inclusive economic and political institutions, while poor countries are poor because their economic and political institutions are extractive.

Inclusive institutions create the incentives and opportunities for people in a society to aspire to and achieve prosperity. Extractive institutions do not; on the contrary, a small group of "elites" capture (extract) the benefits of growth to their advantage. Inclusive institutions include the population at large in the process of governing in a predictable, transparent, and accountable manner, thereby reducing—if not entirely eliminating—the process of exploitation by a few.

It is important to note that a society can experience growth even under "extractive" institutions, at least for a while. But such growth will not be sustainable in the long run, since innovation and creative destruction do not thrive under such an arrangement. Inclusive institutions, on the other hand, enable innovation and renewal, leading to sustainable growth as they provide the necessary incentives and the right enabling and nurturing environment where efforts earn their just rewards.

4.2. Institutions matter, but how to achieve them?

Most leaders and policymakers in developing countries have heard and know enough about the importance of good governance and sound institutions. For the well-intentioned and serious leaders and policymakers who actually want to effect change, the challenge is more "how" rather than "why". What are some necessary, initial conditions? Time, history, and culture have important roles to play, as does leadership. The interplay of the state, the market and the community at large (the "third pillar" described by Rajan [2019]) in any society forms a very important part of any enquiry into how that society could build inclusive institutions and thus deliver inclusive development to its people. It is also important to note that in seeking answers to the "how", we need to think not only of building new institutions but also (and perhaps more importantly) how to nurture and strengthen existing ones. Thus, our analyses and examination would need to focus on both existing and new institutions.

Ours is a report of work in progress. We list below five areas of further work which we are currently engaged in and on which your thoughts and suggestions would be most welcome.

1. Contextual settings of institutions: limited access order and open access order societies

Institutions are context-specific: thus institutional experiences in one country cannot be easily transplanted elsewhere. The social dynamics of countries differ and how societies actually behave has a very significant influence on how they develop.

In some fundamental and far-reaching ways, North, Wallis, Webb and Weingast have proposed a new conceptual framework of interpreting recorded human history to better understand "how developing societies structure their economic policies and polities in order to solve the universal problem of violence and disorder" (North et al 2007, p. 2). And reducing the dangers of violence and disorder is, of course, an essential condition for good development.

According to this framework, human society has devised only two significant orders of organizing itself (a third one, the primitive order, consists of hunter-gatherer societies and is not very relevant for our discussion here), namely:

Limited access order (LAO), where powerful individuals (the elite) possess privileges and means to "create limits on access to resources and economic functions to generate rents… privileged individuals have privileged access to social tools enabling them, and only them, to form powerful organizations" (North et al 2007, p. 3). This order is also sometimes referred to as the natural state, since the bulk of the world still live in this state.

By contrast, a much smaller proportion of the world (North et al 2008, p. 10) live in *open access order societies*, which "rely on competition, open access to organizations, and the rule of law to hold the society together" (North et al 2007, p. 4).

In the natural state or LAO, elites actively manipulate the social order to regulate access and economic competition, thereby creating economic rents which they enjoy. The elites also use these rents to create social order, control violence and establish social cooperation for their own, rather than the larger polity's, advantage and welfare.

In the open access order, by contrast, all citizens are empowered to form economic, political, and social organizations to pursue any activity (excepting violence). They can pursue their own interests, and rents, if any, are dissipated due to open entry, which induces competition.

By their very construct, transactions (political and economic) are impersonal in the open access order and based on transparent and predictable criteria: a driver's license is issued based on the results of a road test and some clearly laid-out criteria. In a limited access order, transactions are personal. As North et al note: "the logic of the LAO creates incentives such that the delivery of government services always depends on whom the recipient is connected to" (North et al 2007, p. 26).

What is important to note is that it is not that the formal organizations (of the bureaucracy or the judiciary) don't exist in the LAO, but that the game is played differently: "rules of the game" (the institutions) are different. North et al (2007, p. 26) continue in that vein: "the administration of welfare programs, business licenses, and judicial services all require personal exchange—and often bribes—in limited access orders".

Seen through the lens of limited and open access orders, it becomes clear why many proposed institutional reforms do not work. They do not work not because the proposed institutional forms (i.e. property rights, rule of law, legal and judiciary structures) are inappropriate prescriptions in and of themselves; they do not work because they are grafted onto limited access orders when in fact they would work only in open access systems. As North et al note, for example, that "it is one thing to create courts and justices and another to ensure that they can sustain the independence necessary to produce the impartial delivery of justice" (North et al 2007, p. 44).

It would be useful to pause here to ask if the extractive or inclusive institutional construct proposed by Acemoglu and Robinson is somehow different from that proposed by North et al in their articulation of limited or open access systems. We argue that these two constructs are answering different (though related) questions. Acemoglu and Robinson are asking: what type of institutions will lead to good governance and good development? Their answer: inclusive institutions rather than extractive institutions. North et al are asking: how will such inclusive institutions evolve in a society? Their answer: when the society moves to an open access state.

The logical question then is how to transition from limited to open access order? On this, North et al (2008, p. 16) pull no punches: "There is no easy answer to this question, no magic bullet".

Instead, they counsel that one needs to assess where an individual country is on the trajectory of natural states: whether it is fragile, basic, or mature or at the tipping point (doorstep). Efforts need to be made to help countries move up this value chain and "focus on institutions and organizations that help reduce the threat of violence and disorder" (North et al 2008, p. 16).

Similar advice on paying attention to the context also comes from Rodrik (2008, p. 22). Observing that "what works will depend on local constraints and opportunities", he adds that "designing appropriate institutional arrangements requires local knowledge and creativity... in a second best (i.e. real) world, the nature of the binding constraints and their interactions with other distortions will influence the desirable arrangements".

Acemoglu (2008, p. 3) also cautions that "there is no general recipe for improving institutions", adding that "institutional reforms must have internal driving forces and what types of reforms can be successful will vary from country to country". Local context matters and institutional reforms cannot be easily transplanted. Institutions need constant nurturing as their destruction can be fairly rapid, even though building them takes time and is often a multi-generational process.

At first glance, the above makes for depressing reading for those hoping to find a way of going from Here to Denmark. Societal changes from natural states (limited access orders) to open access orders take time (generations); best practices cannot be transplanted; dynamics of local politics, culture and social norms drive behavior and are hard to change—and when they do, they take time and do so in response to internal driving forces and not to external demands.

However, our conclusion need not be so negative. Experiences in various parts of the world and at various times have been more encouraging. Denmark itself is a positive example. Its institutions and governance at one time (in the 1600s) were in very poor shape: many things were indeed "rotten in the state of Denmark". But they improved. The United Kingdom, United States and Japan are other examples of countries which moved from limited access to open access order and prospered. In more recent times, the experiences of South Korea, Botswana, and Singapore would be good evidence that "history is not destiny" (Acemoglu 2008, p. 3).

The speed of institutional development and transformation is also a critical challenge. Speaking of Lee Kuan Yew, father of modern Singapore and an icon in developing strong institutions at a rapid pace in his own nascent country, Kissinger (2000) has observed that "tasks which in the West were accomplished over centuries [had to] be completed in a decade or two under much more complex circumstances". How would such a process of institutional growth play out in much larger and more complex societies, say in India or Brazil?

One common feature of all historical breakthroughs in the evolution of strong and sound institutions has been an enlightened national leadership (for example, King Frederik III and his successors in Denmark, Lee Kuan Yew in Singapore). Can the past successes of the miracle economies in East Asia be attributed to strong and decisive political leadership in those countries? Is such decisive national leadership the necessary spark to leverage the societal drivers in order to create sound institutions and improve governance? More importantly, how does such leadership emerge? If it's fortuitous, what can a society do other than hope?

This then is our first broad area of further work. How do societies transit from limited access to open access order? Is an exogenous shock (such as the Danish loss of almost a third of its territories to Sweden in the war of 1658 or the threat of Commodore Perry's attack on Japan in 1853 as the trigger for the Meiji Revolution some fifteen years later) always the tipping point for the changes? What are the "doorstep" conditions for the transition? What lessons may be learnt from the experiences of countries to prove that "history is not destiny"? How does good leadership emerge?

2. Are institutions immutable, or should they also adapt to changing circumstances and stages of development? Is democracy a necessary condition for getting to "Denmark"?

We had observed earlier that all aspects of governance need not be equally important at all stages of development. Economic aspects of governance (such as government effectiveness and regulatory quality) may be more important in the early stages of development than, say, voice and accountability (political aspects of governance). The experience of the East Asian economies over the past five decades would be a case in point.

China and Vietnam, for instance, have seen high growth in recent times even though they have relatively low institutional quality in an absolute sense; however, they have above-average quality institutions given their stage of development. That allows them to attract foreign investment, for example, ahead of other countries with similarly low wage levels but weaker institutions. As per capita incomes rise and the economies become more complex, the pressure on these countries to improve their institutions will only increase. In fact, we are already seeing moves in that direction in countries as diverse as China, India and Vietnam.

While the quality of institutions is obviously an important factor driving good governance and good development, it is also relevant to consider that institutions well-suited to one phase of development may become inadequate for another. One may need to think, therefore, of the quality of institutions not in an absolute sense, but relative to the level of development (Nag 2017, p. 123).

In this context, two interrelated, vexing (but unavoidable) questions come up: is democracy a necessary condition to create strong and sustainable institutions? Is democracy a necessary institutional arrangement for good development or a hindrance to it?

These questions could be looked at from two different perspectives. One could be the instrumental value of democracy as a necessary institutional arrangement to achieve good development. The other perspective is the intrinsic value of democracy to be cherished, no matter how chaotic and even burdensome the resulting governance system may appear to be. Supporters of the latter view would argue that to even couch this question in economic rather than political terms ignores the value of democracy as a way of life.

But it is also appropriate to recognize that political institutional arrangements can evolve. Perhaps at early stages of economic development, more authoritarian institutions work more effectively.

Our work will assess this hypothesis more deeply, recognizing that no large country has ever reached advanced economy status under an authoritarian regime.

3. The role of government, markets and citizens: the three pillars of delivering good governance

The government (the first pillar) obviously has a key role to play in delivering governance. Governments have to design sound, growth-oriented, and inclusive economic and social policies. But designing policies is only a start: implementation is what matters. To facilitate implementation, the government must devise enabling institutional and regulatory frameworks that are rules-based, predictable, equitable, accountable, and applied equally and fairly to all citizens. But the government cannot and must not be the sole institution concerned with and responsible for good governance; it has to create an enabling environment in which markets (the second pillar) can operate. The role of civil society and the average citizen (the third pillar—more on this in Item 5 below) is also key.

4. Fighting corruption

Corruption, broadly defined as misuse of public office for private gain, is at the core of bad governance. Its pernicious effects are felt by all, though the incidence of such ill effects is borne disproportionately by the poor. The ills of corruption and the economic costs (by some estimates exceeding $6 trillion “in poor countries between 2001 and 2010 with devastating impacts on the livelihoods of ordinary people”) have been extensively documented in the literature (i.e. Kar and Freitas 2012) and will not be repeated here. What concerns us is how corruption ought to be fought.

Bardhan (1997) observes that economists tend to focus on efficiency, growth, institutions and incentives for fighting corruption and thus “promote market inspired solutions such as competition, liberalization, deregulation and privatization”.

But, noting that there is little evidence that such anticorruption measures have generally achieved much, Mungiu-Pippidi (2006) argues that such measures fail “because these initiatives are non political in nature, while most of the corruption in developing countries are inherently political”.

Most assessments of corruption and the consequent design of anticorruption strategies make an implicit assumption that corruption is a deviation from a norm of “universal ethics”. The state is assumed to operate under some norm of universalism where all citizens are treated equally and fairly, which may occasionally be infringed by favoritism (because of connections or bribery, for example). Corruption in such a state is thus an exception and anticorruption strategies are designed on this assumption.

Unfortunately, the reality in many, if not most, societies is different. Rather than universalism, these societies may be considered to be practicing “particularism”, where people are treated differently depending on their social status and economic power. Unequal treatment is the norm in particularistic societies: “a culture of privilege reigns in societies based on particularism” (Mungiu-Pippidi 2006, p. 88).

Note that particularistic and universalistic societies are much akin to the limited and open access societies (a la North) which was discussed earlier.

It is no wonder then that many anticorruption strategies based on legal measures have not worked in particularistic societies which encompass the bulk of developing countries. The balance of power is so tilted in favor of the elite in such societies that they can easily subvert the rule of law and thus negate the possible consequences of, say, anticorruption legal measures.

Another feature of most anticorruption strategies is their treatment of corruption as a typical "principal-agent" problem. Under such a situation, it is the principal who has to be protected from the agent's possible nefarious activities since he (the agent) has the informational asymmetry in his favor. But the truth may be just the reverse. The principal, as an elite actor who holds the levers of power, benefits from the rent-seeking activities he indulges in and has all the incentives not to let anticorruption measures work.

There is a rich literature (Olson 1971, Sen 1967, Rothstein and Teorell 2015, Persson et al 2012) which argues that corruption can instead be better understood as a "collective action" problem rather than a "principal-agent" relationship.

In a collective action problem, person 1 will pursue a suboptimal option A even when she knows that she would be better off pursuing option B, but only if everyone else also pursued option B. But she also knows that she would be worse off if she chose option B while others chose A. Thus, since she has no confidence that her fellow citizens will do the right thing (choose option B), she and all others end up choosing option A, and everyone is worse off as a result.

In thinking of corruption, a similar phenomenon exists. Members of a society may all agree that corruption is bad. They also may know that, as a group, they are worse off with existing corruption and it is therefore in their interest to support anticorruption measures. Paradoxically, however, they will (individually) still slip the policeman a bribe to avoid being charged with jumping the red light. As Persson et al (2012, p. 9) note: "the short term costs of being honest are comparatively very high since this will not change the game. Hence: why should I be the sucker?"

This phenomenon of collective action has a very corrosive influence on society's attitude towards corruption. It dilutes trust within a society when "without norms of trust, the tragedy of the commons is unavoidable" (Rothstein 2000, p. 477). Rothstein accurately captures the social dilemma that follows when trust is in short supply: "I would pay taxes if I knew others were paying too, and the tax authorities were not corrupt"; but since I cannot assume either of these two conditions to hold, I evade taxes, as do others, and all suffer: a classic result of collective action pushing the system to a suboptimal equilibrium. Once the system gets there, it stays there (stable but suboptimal), caught in what is often referred to as a "Corruption Trap".

Building on the above aspects, our work will focus on how to nudge the system out of the Corruption Trap.

5. Promoting transparency, enhancing participation and empowering citizens

Just as the old adage goes "sunshine is the best disinfectant", transparency is a key enabler for good governance. The best-designed and even perhaps best-intended rules of law will not mean much if citizens don't know about them or can't readily find out about them. If information is power, it needs to be widely disseminated and easily available to all in order to avoid this power being abused. Knowledge of government rules and regulations and awareness of citizens' rights and responsibilities are powerful tools to complement and reinforce predictability.

Transparency ensures that decision makers and custodians of citizens' welfare will always know that their decisions and actions, no matter how high and powerful their office might be, cannot be kept in the dark indefinitely. Transparency reduces uncertainty and makes for better decision making by both the governors and the governed.

While the above may give an impression that transparency enables better governance by making bad governance more difficult (by instilling the fear of getting caught in the minds of the perpetrators), it is equally important to recognize that transparency enables good governance directly.

Greater clarity on and knowledge of the laws, rules and regulations, as well as better understanding of the process by which a regulator works, instill greater motivation for staying within the law.

Transparency in the process of policymaking and implementation creates a more conducive environment for doing business. No wonder then that transparency is a major consideration in all measures of "ease of doing business".

A major challenge in ensuring transparency is the asymmetry of knowledge and hence power. Those who generate and apply laws, rules and regulations governing a society (i.e. the legislators and executive) know much more about them than those who are affected by them (i.e. the ordinary citizenry).

This asymmetry can often then be misused by the information keepers who decide what information they will provide, and when they will provide it, to information seekers. But citizen access to such information should be a matter of right rather than a favor granted by the state. The role of an open media becomes very important in this context. It may therefore be necessary for societies to make legal provisions for such access through Right to Information Acts, a very significant and powerful example being the one India enacted in 2014.

Concerns are often raised about whether limits need to be placed on the principle of transparency and whether the possibility of full disclosure of sensitive and confidential matters will inhibit full and free internal discussions of relevant issues. These are valid concerns. However, the presumption in favor of disclosure has always served society well. Sensible safeguards against misuse of transparency requirements and expectations rather than blanket restrictions on disclosure and transparency seem a wiser course to pursue.

Nobody has a greater stake in the successful outcome of development efforts than the intended beneficiaries of such efforts themselves. But the intended beneficiaries (i.e. the citizens) must not be seen only as passive recipients of such a process. Instead, they are also the agents of development. As such, they need to be actively involved in determining what the best development interventions, initiatives, programs or projects might be.

Granted, for obvious reasons of practicality, all citizens cannot always be directly and individually involved in all such deliberations, discussions and decision making processes. Such participation would, of necessity, have to be intermediated through various institutional arrangements (a la Tocquevillian traditions, chosen representatives, local chiefs, civil society organizations, for example), but the key point is that the beneficiaries would have a forum to express their voice.

5. Conclusions

At this point, we have reached five key conclusions:

i. Governance matters: good governance is a necessary condition for good development (understood in a broad sense of a better quality of human life rather than increased per capita incomes alone).

ii. Institutions matter: sound, inclusive institutions are needed to deliver good governance.

iii. Most leaders and policymakers around the world accept the above two premises (and nothing much can be done anyway if they don't), but need help building sound, inclusive institutions.

iv. Institutional development is arduous and unpredictable; it cannot follow a "how-to manual" with a streamlined cookie-cutter approach in all countries. Local context matters and institutional reforms cannot be easily transplanted. Essentially, there are no silver bullets.

v. At first glance, the above conclusion makes for depressing reading for those hoping to find a way of going from Here to Denmark. However, experiences in various parts of the world and at various times give us reason to be more hopeful. Denmark itself is a positive example, as are the experiences of the UK, USA and Japan. In more recent times, the experiences of South Korea, Botswana, and Singapore are further evidence that "history is not destiny". Enlightened national leaderships, combined with national compulsions caused by external factors, have often led to major internal (institutional) reforms. In other words, when unexpected opportunities arise, local leaders can make a huge difference: change can happen in nonlinear ways.

Such opportunities combined with enlightened national leaders led to nonlinear changes in countries as diverse as Denmark, Japan, Singapore and South Korea.

We are persuaded that in the future there will be many more Denmarks and Japans even in the absence of national emergencies caused by external shocks. Instead, countries throughout Asia, Latin America and even Africa will enjoy improvements in governance at a pace faster than we have seen in the past thanks to a combination of mega-trends that are now beginning to affect emerging economies worldwide.

We see five drivers (major mega-trends) coming together almost simultaneously during the next few decades which will create strong societal pressures for good governance: (i) the demographics of a young population in emerging economies, particularly in South Asia and Africa; (ii) a fast-growing middle class; (iii) rapid urbanization; (iv) the ICT revolution and an explosion in communications through social media, allowing people to see how the rest of world lives and is governed; and (v) globalization of not only trade but also ideas and expectations.

Demand for good governance will in turn create demands for better, stronger institutions. Each country will make its own unique journey to "Denmark", but the above mega-trends make us more hopeful about the future.

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