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COMMENTS ON "DEMOCRATIC GOVERNANCE IN THE ASIA-PACIFIC"

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COMMENTS ON DEMOCRATIC GOVERNANCE IN THE ASIA-PACIFIC

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Let me begin by thanking the Chair for the opportunity to speak today. I would like to talk about two main things. One is a rather specific, and perhaps somewhat narrower approach, to issues of democratic governance. The second refers to a broader set of issues concerning the idea of governance. This second view refers to what I might call "the political market" or "the political industry" in developing countries.

Resources

Before I turn to these matters, as a person from the multilateral banking sector and formerly from AusAID, the Australian development agency, I want to say something about money and resources.

Throughout my career in various parts of the aid industry I have been acutely aware of the need to watch how we use scarce aid resources. And to emphasize this, there is one key statistic -- a crucial statistic -- that I find very sobering. I say this because we all attend many conferences where we often talk about grand programs but, for myself, I find that there is one key statistic that serves to remind me of how limited international aid resources really are. Consider the following. Total global official foreign aid -- official development assistance (ODA) -- is currently running at a level of around \$ 60 billion. On average, on a world-wide basis, this goes to around four billion people. Sixty divided into four is fifteen, so global aid flows amount to around \$15 per person per year in recipient countries -- which is (and this is the truly significant figure) around \$1 per person per month in developing countries.

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That's it! That's what global foreign aid, from all rich countries to all poor countries, amounts to each month -- \$ 1 per person per month at the recipient end. That is what the rich world is contributing to tackle the huge programs of poverty, environment, women and all other gender issues, children, peace building, human rights, democracy, rule of law, humanitarian crisis, refugees, and the rest of it -- \$ 1 per person per month in developing countries. So in all our meetings, when we discuss ambitious goals, we need to bear in mind that we are all really facing an acute shortage of resources. When we are discussing our ambitious goals, we need to remember that many of the institutions that we come from are really very badly overstretched in what we are trying to achieve. All too often, our resources are stretched almost to breaking point. We often don't really have the resources that we need to do the job. So we really should be careful what we promise to do because, too often, we just don't have the resources to deliver on our grand promises.

Asian Development Bank

Having made this point, I want to, first, talk about the Asian Development Bank, and then later, about some wider issues. At the broadest level, one of ADB's key goals is to tackle poverty in the Asia-Pacific region. ADB's President Chino, has given great emphasis to this goal. Traditionally, ADB has approached the task of tackling poverty using mechanisms such as support for good economic policies and for individual projects in developing countries. However, like many other international agencies, in recent years we have been urged to pay more attention to newer, non-traditional issues such as governance. In response, using the limited resources that we have -- and stretching them a bit further -- we have been giving more attention to governance issues. In discussing these governance programs supported by ADB I can provide you extensive lists of activities in individual countries which may, perhaps, sound rather impressive. But the truth of the matter is that if you look at the amount of money that we have been able to spend, then the impact has sometimes been less impressive because the resource constraints are very real indeed.

Nevertheless, it may be useful if I sketch out a few general details of ADB's work in the governance area. (Additional details are available at the following ADB website: <http://www.adb.org/Governance/default.asp>.) Like other institutions, we focus on some main principles. The current emphasis gives special attention to the four areas

of (1) accountability, (2) participation, (3) predictability, and (4) transparency.

In developing our programs under these four headings we have tried to be practical. In operational activities, therefore, we have focused on seven types of work. (Additional information is at http://www.adb.org/Governance/gov_practices.asp). These are:

- public administration,
- public financial management,
- sub-national and local governance,
- corporate regulatory frameworks,
- legal and justice reform,
- participation of civil society, and anticorruption programs.

Let me say a few words about each of these types of work.

Public administration and financial management

As I say, in implementing these programs we try to take a realistic and practical approach. We are aware, for example, that the resources available to support good in developing countries are often stretched. Public servants are often grossly underpaid and the facilities available to help them carry out their duties are often very poor. Often public officials don't have access to the kinds of excellent facilities that we take for granted in rich countries. In addition, we have focused on public financial management in an effort to improve the financial mechanisms of governments.

Sub-national and local governance

We have also been very aware in recent years of the importance of sub-national and local governance. Looking across the Asian region it is very clear that there has been a significant trend in many countries towards decentralization. Perhaps the most dramatic recent example of decentralization has been in Indonesia but in there are similar developments in other countries as well. As an example, the ADB Institute here in Tokyo is supporting a major study on decentralization in Philippines. These changes can impose considerable strains on the process of government. In Indonesia, recent reforms have introduced large changes into government arrangements at both the central and regional level. I doubt that many of the people in rich countries who are so willing to be critical of countries like Indonesia appreciate the scope of reforms that many developing countries are grappling with.

Corporate regulatory frameworks

Both the Asian Development Bank in Manila and the ADB Institute here in Tokyo have done considerable work on corporate regulatory frameworks. Across the international donor community we have all been aware of problems with weak supervision of financial institutions in rich countries. Doubtless we all remember the consequences of the collapse of Barings Bank in the mid 1990s. It is clear, then that good corporate governance of both financial and non-financial institutions is very important because the costs of failure can sometimes be very high.

Legal and justice reforms

Another area of attention in the governance agenda has been the need for legal and justice reforms. These days we hear a lot about the need to develop good legal systems in developing countries. It is, of course, very desirable to strengthen legal systems in poor countries. But -- and here I speak as an economist who has an eye on costs -- I should mention that one aspect of these legal reform discussions that surprises me is that one hears little about the likely financial costs of reform programs. Indeed, to listen to some commentators the costs involved are not a key issue at all. Some commentators talk as if reform of the legal system was a free good. But it is not. I would therefore like to see more discussion about the costs of reforming legal systems. I would like to see a more explicit recognition of the fact that we cannot have good legal systems in developing countries unless the resources are available. And bearing in mind what I said earlier about shortages of resources, I am obliged to conclude that in many developing countries legal systems are unfortunately going to remain very weak for decades to come. To believe in anything else -- to believe that we can improve and progress for free -- is wrong.

It is useful in this context to look at legal system costs in rich countries or in the international system. It is not unusual for just one major United Nations commission in a developing country, or one major Presidential inquiry in a rich country, to report total budgetary costs of around \$10 million or \$20 million -- or even \$100 million -- over the course of an inquiry. The truth is that the full costs of legal systems in developing countries are likely to be extremely expensive. We therefore need to face up to the difficult implications of a situation where developing countries themselves do not have the financial resources to guarantee good law, and where donors are also unable to provide adequate resources because of the many competing calls on foreign aid

budgets. In any case, one cannot hope to get much justice on a figure of \$1 per person per month.

Participation and anticorruption programs

In addition to these areas of work on governance, ADB also has projects to strengthen participation of civil society and a range of specific anticorruption programs designed to help reduce and eliminate malpractice in government in official agencies across the region.

Political Markets

The second issue I want to take up is the broad topic of political markets. As noted earlier, the Asian Developing Bank has numerous specific activities designed to strengthen governance in the Asia-Pacific region. But the broader environment is important as well. And at this broader level, issues of governance become quite difficult because of the wide scope of the problems that need to be faced.

Political industry

It is useful, I suggest, to bear in mind that a country -- any country -- needs a good and effective political industry. I put it this way -- referring to an "industry" -- because this is the way that economists such as myself think of different sectors of an economy. Countries surely need a domestic political industry that both (1) operates in an effective way, and that (2) provides satisfactory outcomes. But when we look across the Asia-Pacific region we see many developing countries that have political industries which clearly do not, first, operate in a very effective way nor, second, provide satisfactory outcomes. Thus, in looking at the topic of governance in a broader way, we can see that there are some quite difficult structural issues of governance that need to be addressed.

Consider these two issues relating to operations and outcomes. What does it mean to say that the political industry should "operate in an effective way"? I suggest that one main thing that is needed is a balance -- a balance between, on one hand, proper opportunities for civil society institutions to participate in decision-making and reflect the interests of citizens, but on the other hand, a reliable stream of good decisions. It is finding this balance that is difficult. If politicians and civil society organizations talk endlessly about any single issue without reaching a decision then it is unlikely that there

will be good governance. Decisions are needed to keep the processes of government moving along and to ensure that timely reforms are introduced and implemented. Thus finding the right balance is a key issue for good governance. Unfortunately, looking across the Asia-Pacific region, it seems that the political industry in many countries is not arriving at a good balance.

Good and effective operations are not enough in themselves. We also need good outcomes. But what do we mean, precisely, when we speak of "good outcomes"? Good outcomes seem to involve, perhaps, three things -- good decisions, that are well implemented, and which yield good outcomes. Decisions; implementation; and outcomes. Putting all of these things together is very difficult. And what we observe in many developing countries is that at the broadest level, the political processes -- that is, the political industry -- do not seem to be putting these things together well.

There is an important contrast here between the way the political industries operate in most rich countries and the way they operate in many poor countries. In most rich countries, broadly speaking, political industries operate in a satisfactory way. But broadly speaking, this is not true in many developing countries. This is surely an important phenomenon for the topic of good governance. What can we say about this? Why is this so?

Industry characteristics

Let us first clarify why the political process might usefully be seen as an "industry". What are the characteristics of an industry? An economist would say that an industry is composed of elements such as firms, entrepreneurs, revenue flows, strategies, and inputs and outputs, and that industries are most likely to function well when there is "healthy competition". Considering these elements, it seems clear that one can consider the process of formal politics in most countries as being part of an industry. For example, political leaders such as George W. Bush, Tony Blair, and Junichiro Koizumi are certainly entrepreneurs par excellence. They take risks, play for high stakes, and they lead parties that are, effectively, large and well-known firms in the national political industry. There are strategies, outputs and revenue flows within the industry -- and indeed as we all know, revenue and expenditure flows are a key part of the political industry in most countries. And most voters in most rich countries would hope that there is healthy competition within the political industry, especially close to election time.

Furthermore, in practice, the political industry in most rich countries is relatively well regulated. As a general rule, in rich countries both the formal and informal rules of the political game are well known and are generally adhered to by most players. Of course, the existing rules are challenged from time to time, but when this happens there is generally a process for settling disputes in an orderly way. An example of this process of dispute resolution occurred when the results of the presidential election were challenged in the United States in 2000. Although there was some controversy between the Republican and Democratic parties over the final results of the contest between candidates Bush and Gore, in the end the process of resolving differences was -- broadly speaking -- accepted across the political industry. Much of this is in sharp contrast to the situation in developing countries. In many developing countries local political markets are chaotic, often operating in an uncertain and rapidly evolving regulatory environment, where the formal and informal rules are not especially well-known or understood by local actors in the industry.

My own impression -- and I merely put this forward for consideration -- is that just as many agricultural and industrial and labor markets in developing countries are chaotic and in need of reform, so are many of the political markets in developing countries. To illustrate this point, it is useful to consider reforms that might be undertaken in three areas: competition arrangements, selection of the chief executives of the organizations (CEOs) in the industry, and rules of the game.

Competition

As far as competition arrangements in political markets are concerned, what seems to be needed is not just competition but "healthy competition". One main problem with the competitive arrangements in many developing countries at present is that too often, there is either very little effective competition (consider Indonesia during the Soeharto era) -- or too much (consider Indonesia since the Soeharto era)! When there is too much competition -- when there are, say, more than 20 parties contesting national elections -- the process tends to become chaotic. In contrast, in quite a few Western countries markets, which are essentially duopolistic in nature (with two main parties, or at least two main sides to the political industry), seem to have worked quite well. In countries with a Westminster system, such as the United Kingdom, Canada and Australia, the structure of having a formalized government and opposition has generally worked quite well. In the United States, the two main parties, Republicans and

Democrats, essentially dominate the formal political market in a duopoly. In these duopolistic markets there are often a number of small parties that serve to pose a potential threat to the dominance of the two largest parties. The smaller parties constantly try to improve their market share. If they are successful in this attempt (as seems to be occurring in the United Kingdom), the two main firms in the duopolistic market come under strong pressure to improve their performance.

Of course, a duopoly is not the only market structure that exists in political industries in rich countries. In some countries that are generally regarded as having good government arrangements (the Netherlands is an example) there are a number of parties. It is thus clear that a duopoly is not necessarily the best model to ensure that "healthy competition" exists.

CEO Selection

A second area where, perhaps, reforms are needed in some developing countries is in the process by which the CEOs of the political firms are selected. This, really, is a very important process. It is very important for the governance of a country that good CEOs are selected in political firms because it is these CEOs who often become the President or Prime Minister of the nation. If the CEOs are inexperienced at government, and if they cannot manage board meetings (that often the Cabinet meetings of the nation) well, then the governance of a country is likely to suffer. However, when we look across the developing world it seems clear that the processes for the selection of the CEOs of political firms are often poor. One thinks of President Estrada in the Philippines and President Gus Dur in Indonesia, for example, as CEOs who surely appeared unsuitable even before they took office. In contrast, in most (although not all!) rich countries, the process of selecting CEOs for political firms is more rigorous. In the highly competitive Westminster parliamentary system, for example, it is unusual for a person to climb to the top and become Prime Minister without many years of experience and without being subjected to close scrutiny in the national media over a long period.. One way or another, it would seem that in many developing countries, the processes for the selection of CEOs in the political industry need to be improved.

Rules of the game

A third area where improvement would be very helpful is in defining and enforcing both the formal and informal rules of the game. In other words, there needs to be reasonably clear regulatory rules for the political industry, and the rules need to be

enforced. This is very difficult, of course, when legal systems are weak but it is at least useful to consider the directions that reforms might take. Effective electoral commissions are needed to conduct free and fair elections, and to take action when there is abuse of the electoral process. And it seems clear that it would be highly desirable to establish reasonable procedures for monitoring financial flows within political industries. Firms in the political industry should be required, just as firms are in other industries, to maintain audited internal accounts and publish proper annual financial reports. In this context, it is worth noting that the current chaos that exists in pricing arrangements in the political industry in many developing countries does not seem conducive to good government. Better regulation of prices is needed. It is quite obvious, for example, that the actual annual incomes that many parliamentarians have are far higher than their official parliamentary salaries. One reason for this -- not the only reason, but one reason -- is that the nominal official salaries are well below reasonable comparable living standards for people in the political industry. It would be a step towards reality if it were recognized that trying to regulate (and suppress) nominal salaries in this way leads, in effect, to political and administrative "black markets". Just as it became widely realized during the 1970s that attempts to suppress the price mechanism in foreign exchange markets led to black markets for currencies, so it needs to be recognized that attempts to set incomes in political markets that are well below equilibrium prices encourage the growth of black markets in political activities.

With these observations, I thank the Chair for the chance to speak today. I have spoken, mainly, about two main things. I have provided a summary of some of ADB's work in the area of good governance. And I have suggested that specific activities designed to strengthen good governance need to be considered within the broader framework of the operations of the political industry in developing countries. Thank you.