A Focus on Policy Effectiveness

How can we make policies for security, growth and equity more effective?

Why do inefficient, unequitable, or ineffective policies often persist?

Why are technically sound policies often not adopted or implemented?

Why are some ‘second best’ policies more effective than ‘first best’ policies?

Governance for Development

The WDR 2017 digs beyond proximate factors to uncover the underlying determinants, related to governance.

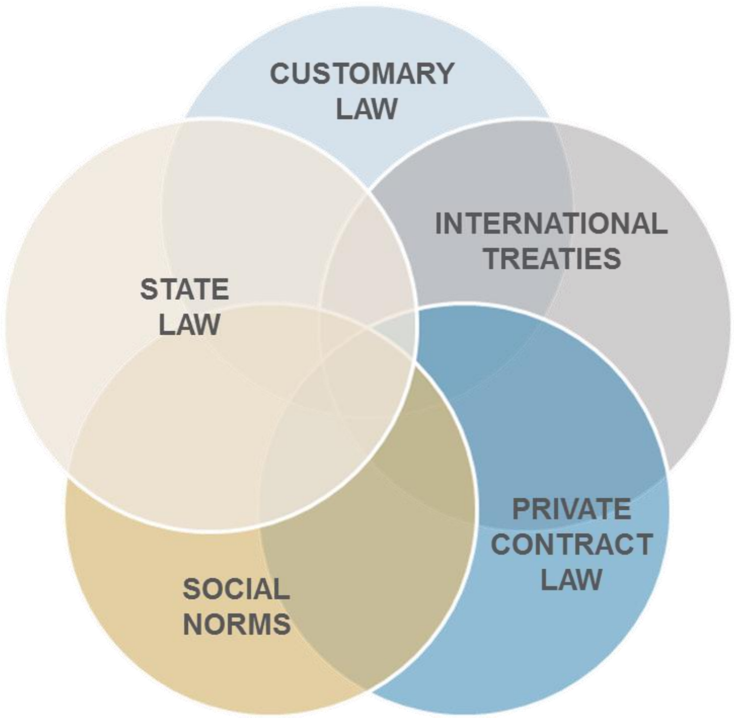
1. Governance is about how actors (state and non-state) reach and sustain agreements

2. Institutions and policies are the outcome of those agreements

3. This bargaining process among actors takes place within the policy arena

The Role of Law

A complex system of rules shapes the policy arena.
Formal state law interacts with a range of alternative legal, social and informal rule systems, in complementary and/or competing ways to play three roles



LAW ORDERS BEHAVIOR
by inducing individuals and groups to act in certain ways so as to convert policies into outcomes

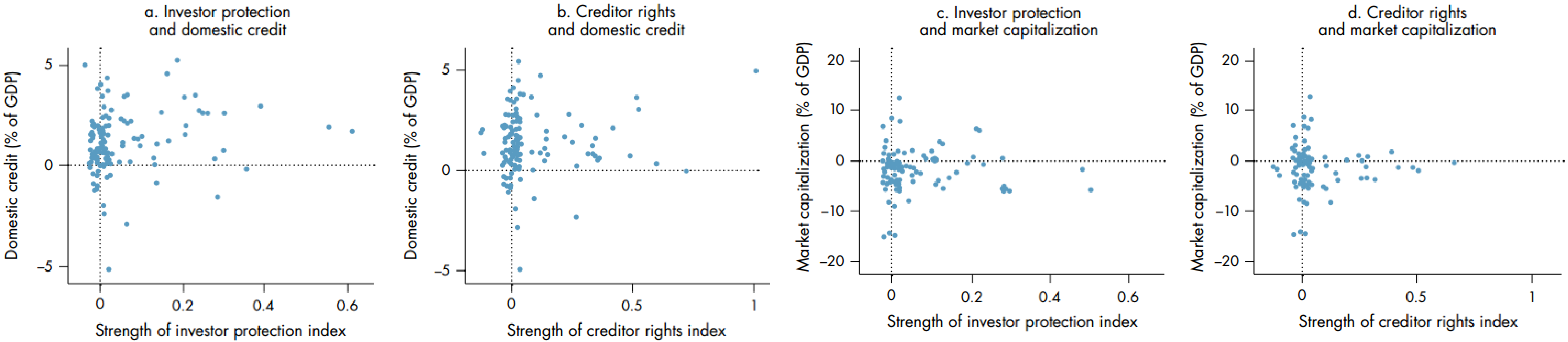
LAW ORDERS POWER
by establishing and limiting de jure authority among government actors and between the state and citizens

LAW ORDERS CONTESTATION
by enabling actors to challenge prevailing dynamics of power to achieve better outcomes

Form vs function

While many countries have reformed their legal system to improve rules for investor protection and creditor rights, there is a lack of systematic effects on changes in economic outcomes

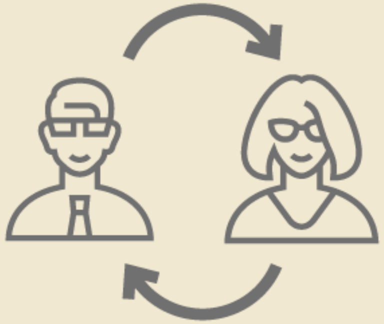
Effects of changes in legal indexes on financial indicators



Determinants of Policy Effectiveness: The Three Cs

How can agreements among actors in the policy arena effectively change outcomes?

COMMITMENT



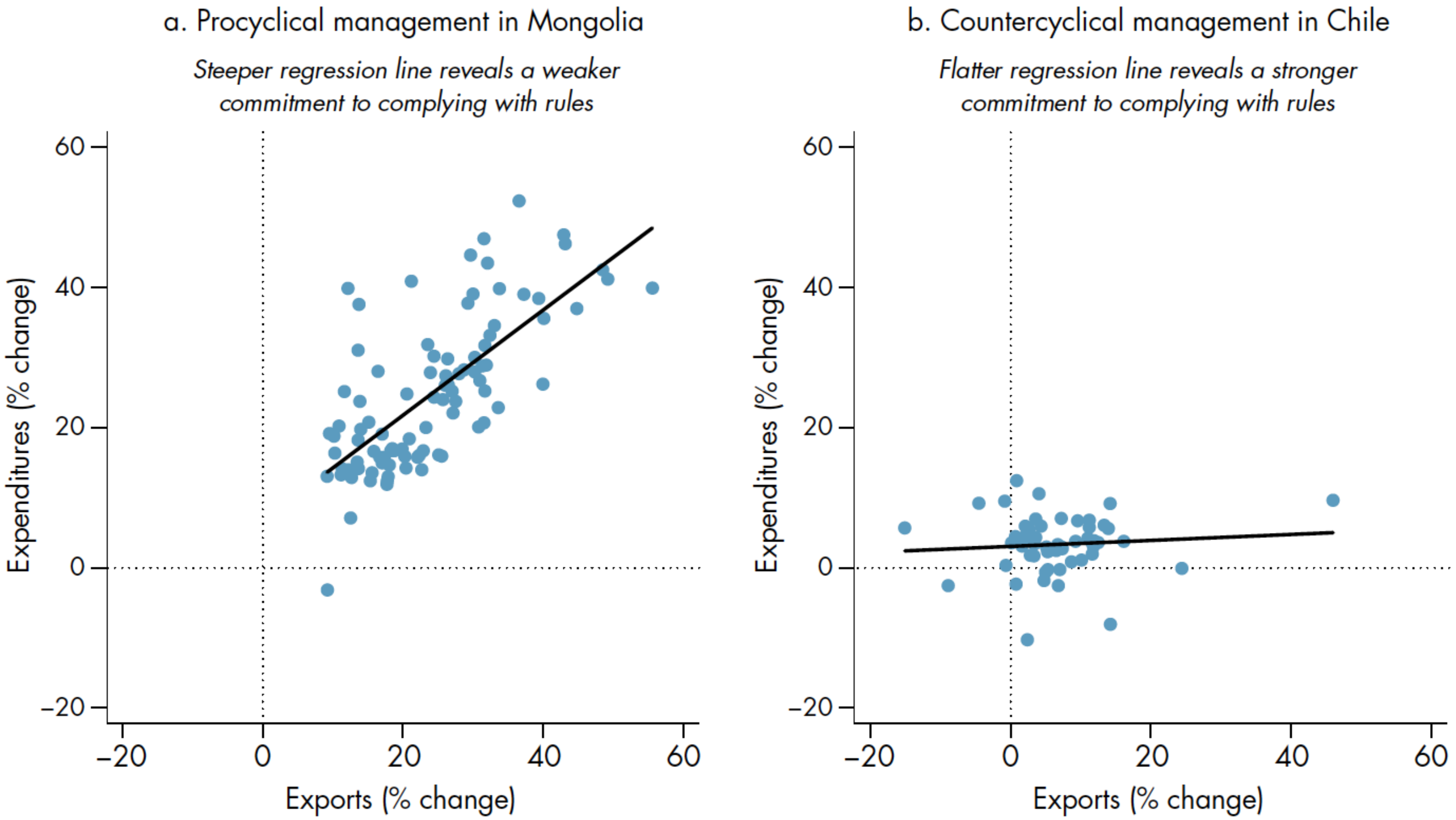
COORDINATION

COOPERATION

These are the functions that institutions need to perform

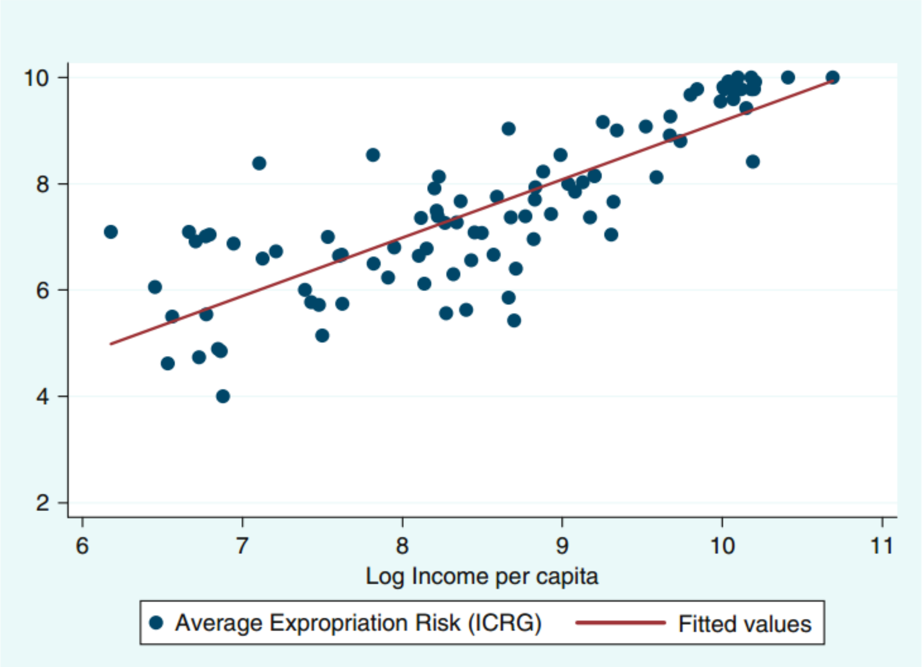
Same rules, different outcomes

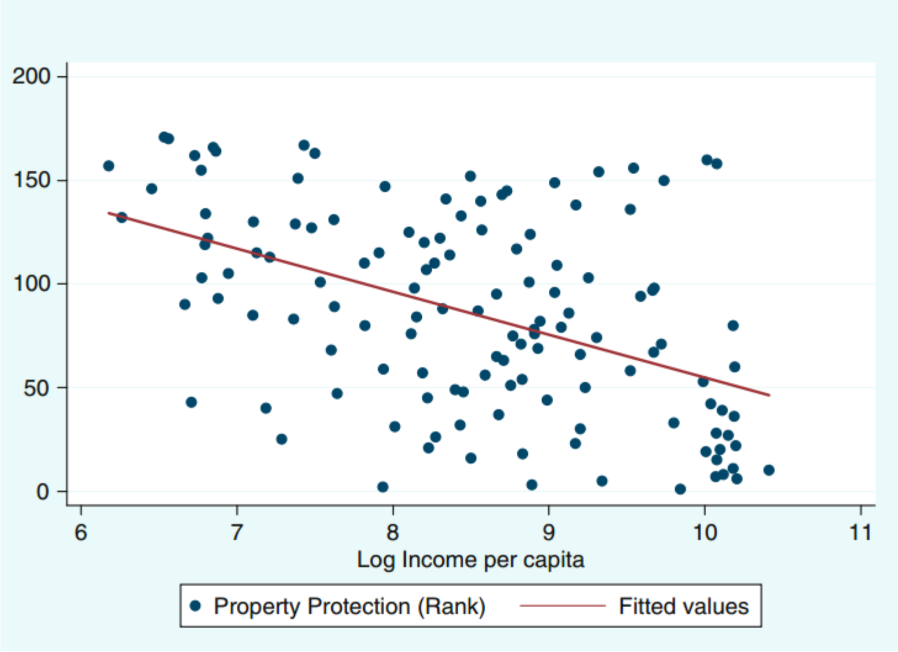
Despite similar rules for the management of natural resource revenue in Mongolia and Chile, Chile's expenditure patterns reveal a stronger commitment to compliance



Commitment and growth

Credible commitment to security of property rights, contract enforcement, consistent regulation of product and labor markets, and policy certainty incentivizes investment and permits efficient market transactions





Source: Besley and Ghatak (2010). Property Rights and Economic Development. Figures 1 and 2.

Coordination and cooperation

“The disparity in the performance of economies and the persistence of disparate economies through time have not been satisfactorily explained by development economists. . . What has been missing is an understanding of the nature of human **coordination** and **cooperation**”

-Douglas North, 1990

Collective action: A game theoretic approach

Coordination

If $x<2$:*assurance game*. Actors' incentives are aligned, but their action depends on expectations about what others will do.

Cooperation

If $x>2$: *prisoner's dilemma game*. Actors' incentives are not aligned, and actors are not taking action to maximizing the group payoff.

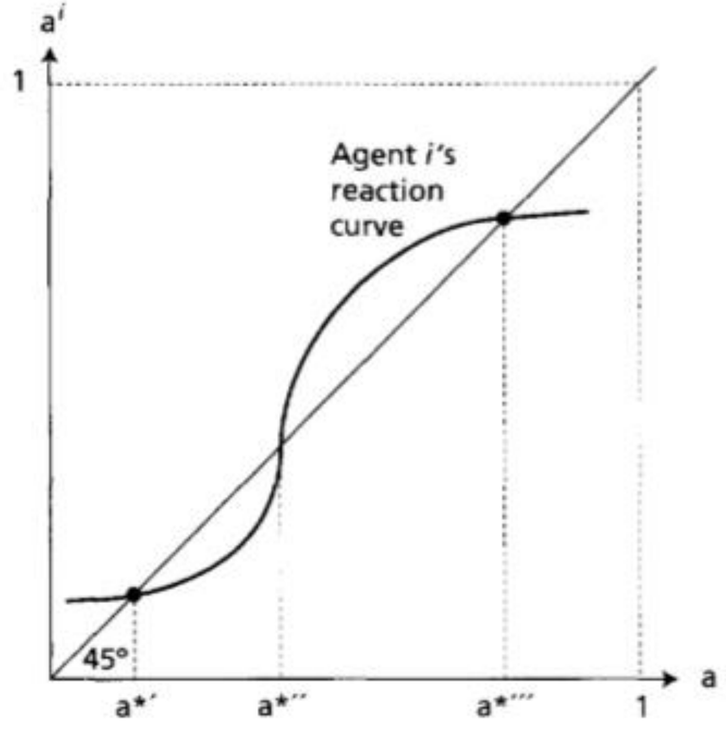
		Actor 2	
		Take Action A (A)	Do not take action A (NA)
Actor 1	Take Action A (A)	**2 , 2** *(A,A)*	**0 , X** *(A,NA)*
	Do not take action A (NA)	**X, 0** *(NA, A)*	**1, 1** *(NA,NA)*

Multiple equilibria and coordination failures

In the presence of strategic complementarities, coordinated actions can lead to better outcomes for all

- Institutions can help solve market failures by coordinating investment decisions and the expectations of market participants
- While classic coordination problems relate to industrialization (Rosenstein-Rodan 1943, Murphy, Shleifer, and Vishny 1989), they can occur in a range of contexts (i.e. innovation, adoption of technology, finance, etc)

Figure 2. Multiple Equilibria in a Model with Symmetric Agents



Source: Hoff (2001)

Coordination vs Cooperation: Tax compliance

Tax morale: Coordination problem

i.e. Under-reporting of taxes as a *norm* under Berlusconi (Raitano and Fantozzi 2015)

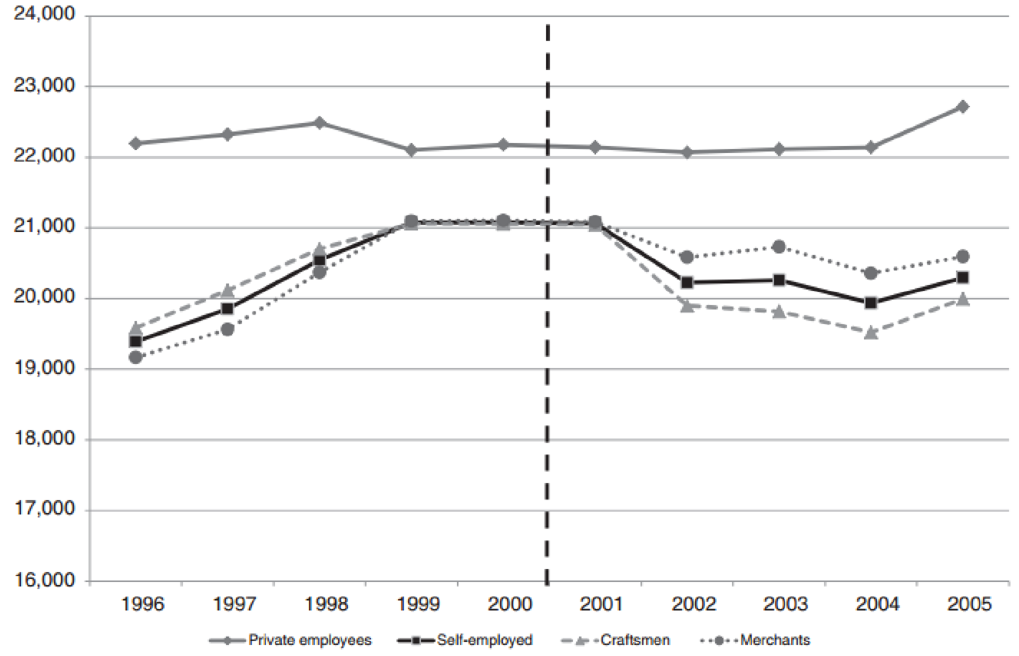


Fig. 2. Trend of mean gross yearly real earnings 1996–2005 (constant prices; Euro 2010). Source: Elaborations on AD-SILC data.

Tax evasion: Cooperation problem

i.e. Higher informality and lower willingness to pay taxes (Torgler 2003)

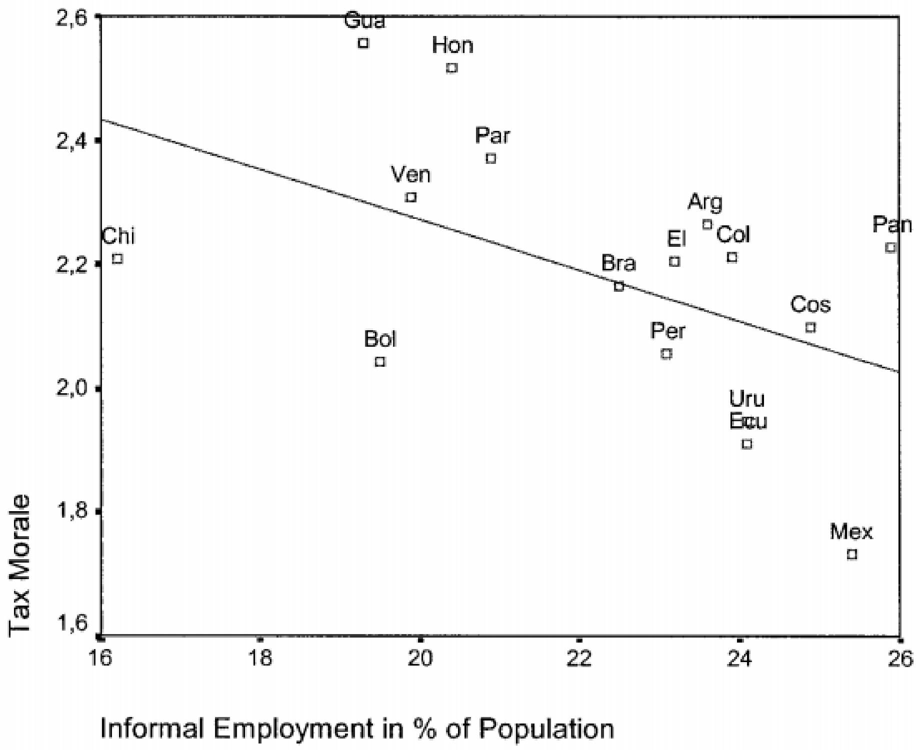
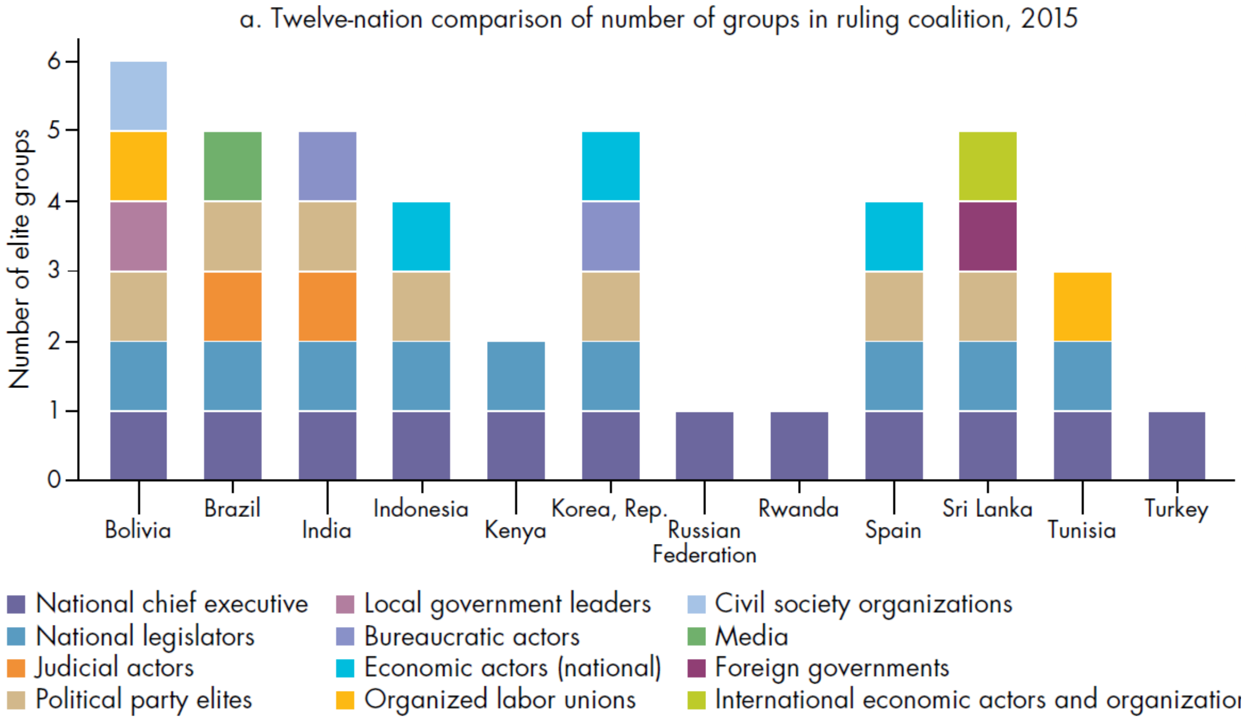
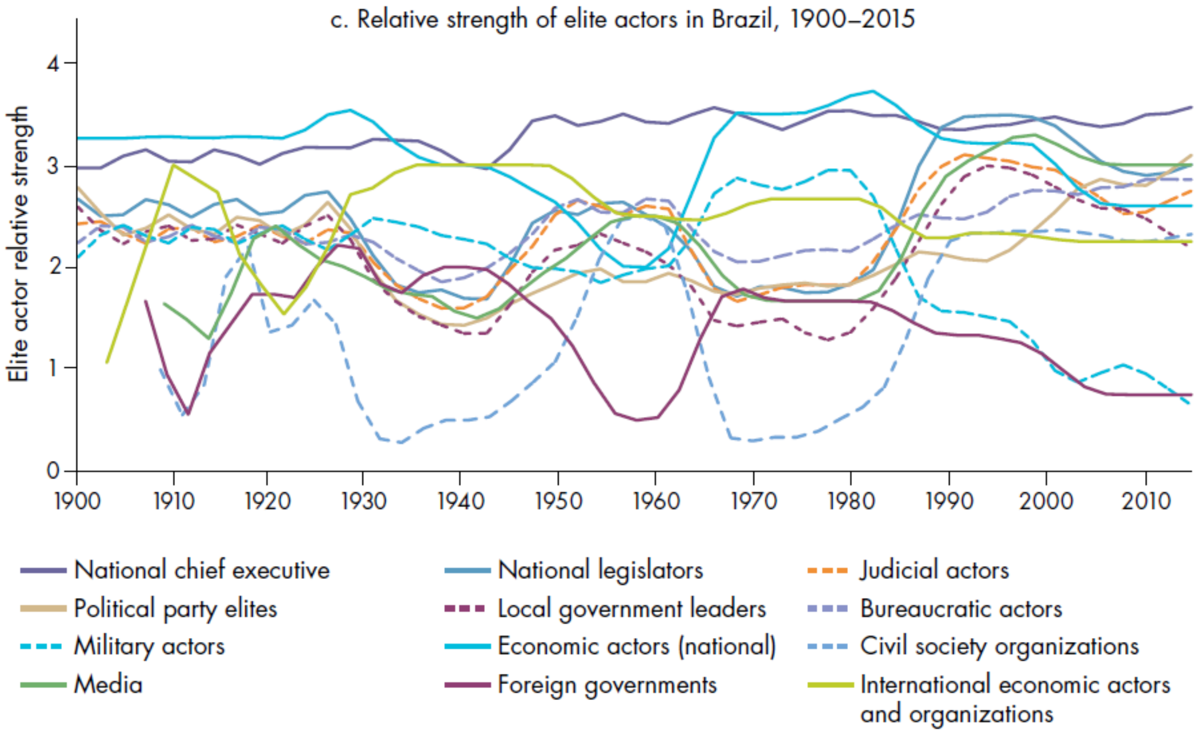


Figure 1. Correlation between tax morale and the size of shadow economy

Manifestations of power asymmetries (capture, clientelism, and exclusion) can undermine commitment, coordination, and cooperation

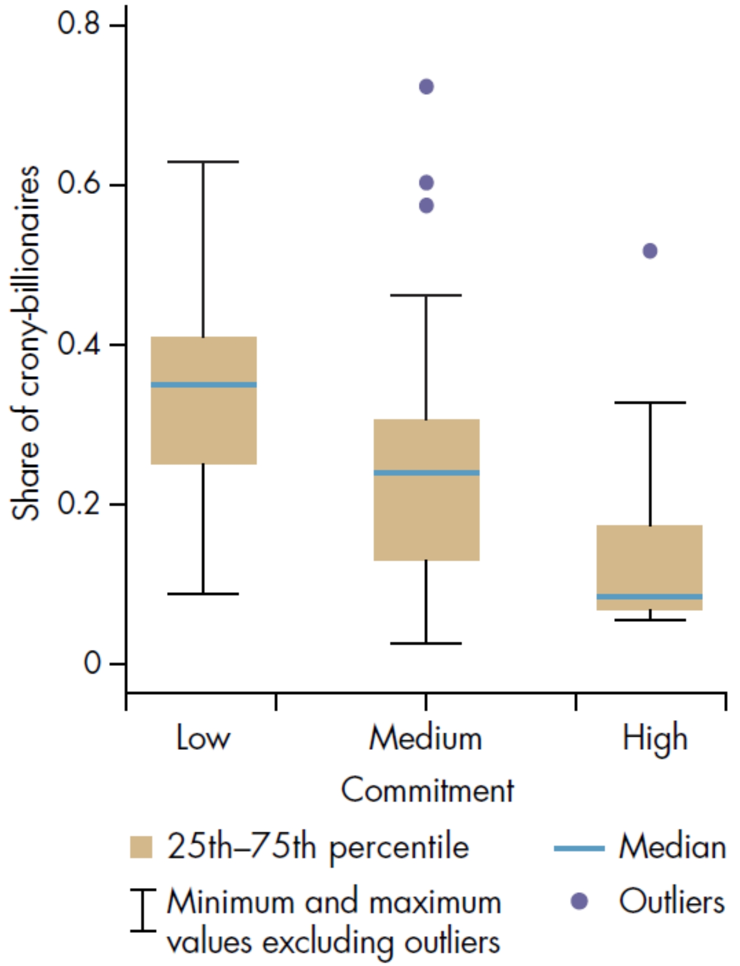
The distribution of power among actors in the policy arena varies greatly across countries and over time.





Capture can lead to a breakdown of commitment

Figure B6.2.1 Capture is associated with lower levels of commitment



Capture and Competition IN the Market

Capture during policy design and implementation, can give powerful firms an undue advantage even in competitive markets

Diverting credit

E.g. In **Pakistan** (1996-2002) politically connected firms borrowed 45% more and had 50% higher default rates than other firms (Khwaja and Mian 2005).

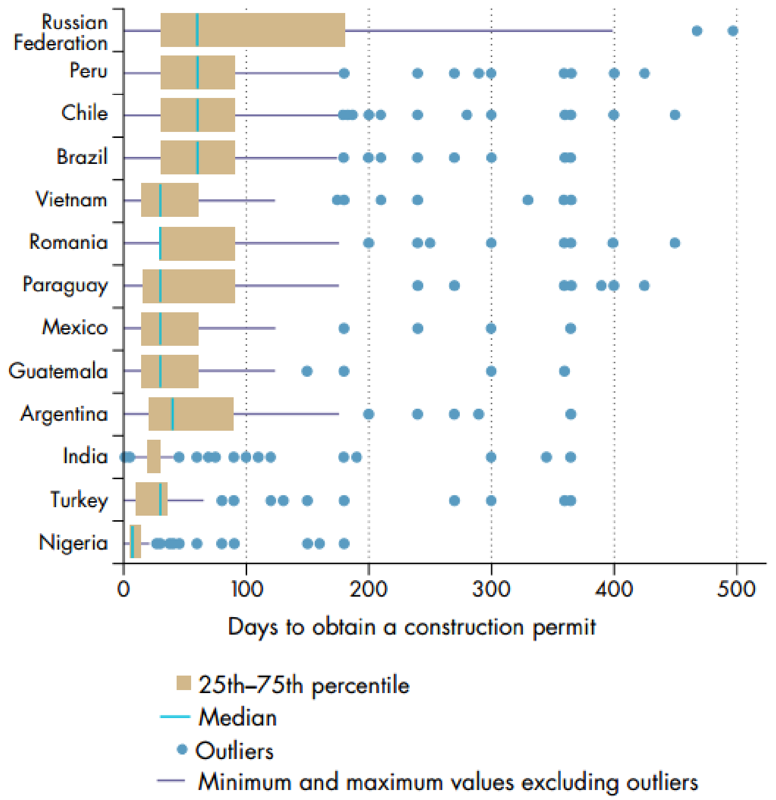
Granting import licenses to favored firms

E.g. In Suharto-era **Indonesia**, being politically connected tripled the likelihood of receiving a license relative to a firm's competitors.

Using market regulations to favor firms

E.g. In **Tunisia** under Ben Ali, politically connected firms accounted for a disproportionately high share of total private sector profits – and the gap was higher in more regulated sectors (Rijkers, Freund, and Nucifora 2014).

Figure 5.1 Length of time needed for firms to obtain a construction permit varies widely



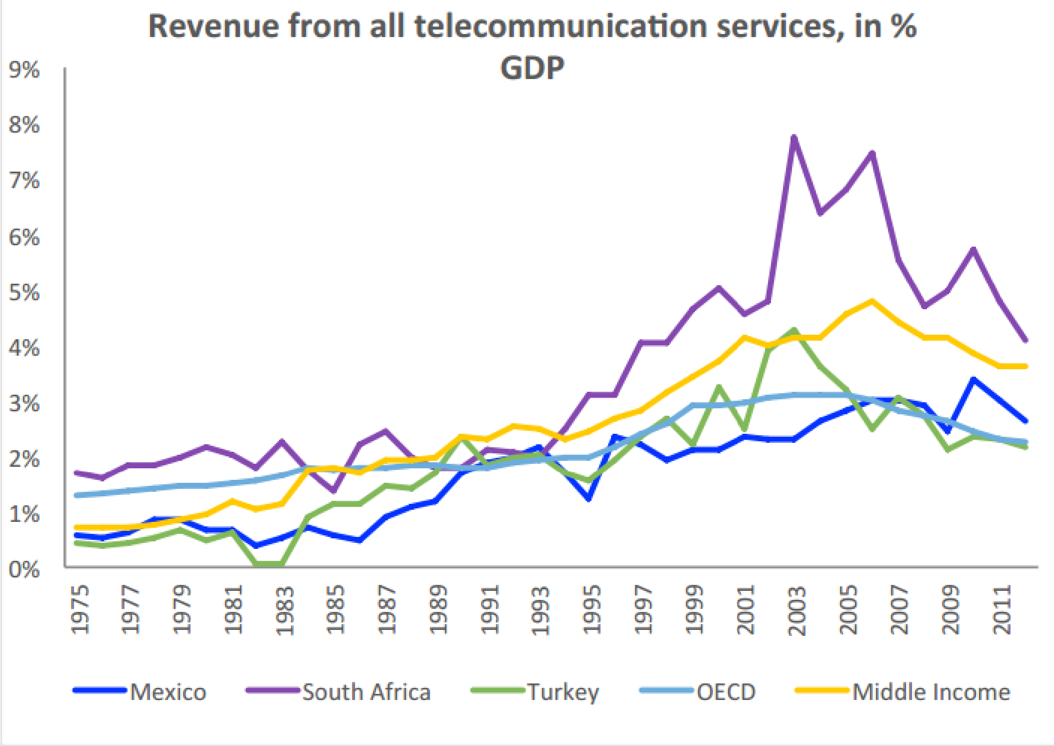
Capture and Competition FOR the Market

In the case of regulated markets with natural monopolies, there is risk of capture by the regulated firms in collusion with the regulating agencies

- Role of information asymmetries
- Role of power asymmetries
- Solutions to the commitment problem:
  - In many cases: Public ownership

Potentially superior option:

- Regulated private ownership (Willig, 1993)

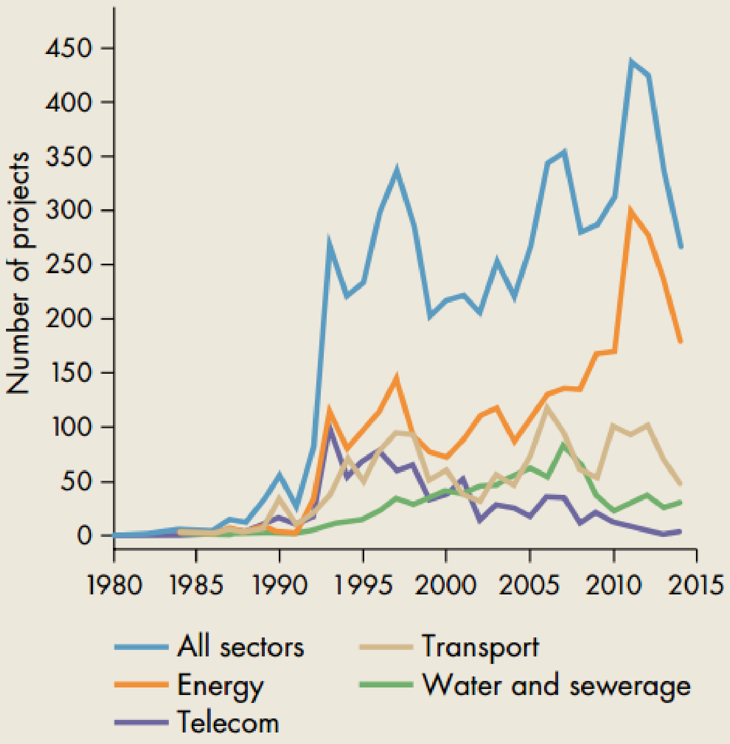


Source: Walton, Levy, Atiyas (2016) Figure 8.

A Look at Public Private Partnerships (PPPs)

- Private firms can introduce competition in markets characterized by the features of natural monopolies
- BUT PPPs face a commitment problem because they allocate risks between the contracting parties over a long period of time, when circumstances often change
- In the absence of a commitment device, contracts are frequently renegotiated in favor of the private contractor, with considerable government spending often allocated in questionable, noncompetitive ways
- E.g. 8% of the 1,700 PPP projects financed in LAC from 1990 to 2013 were renegotiated just one year after the contract award, on average (Guasch and others 2014).

Figure S7.1 Private participation in infrastructure projects in developing countries remains limited



Source: WDR 2017 team, using data from World Bank, Private Participation in Infrastructure Database, 1980–2014.

Economic costs of capture

- The most obvious cost of policy capture is the **inefficient allocation of public resources**

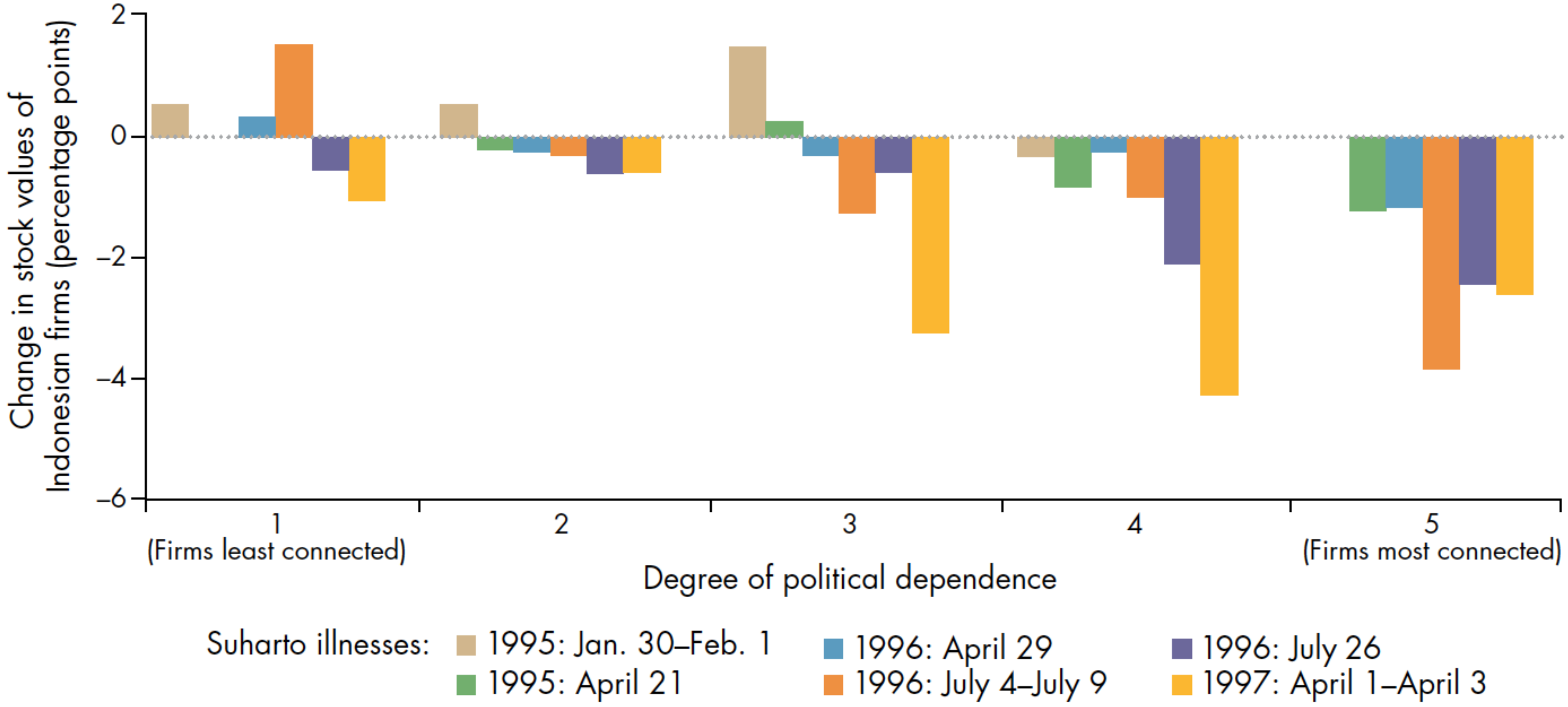
- Such misallocation could also have a long-term impact on growth through its **detrimental effects on the process of creative destruction**— that is, the entry of new firms, investment by existing firms to become more productive, and the exit of unproductive firms

- **Entrepreneurship is likely to be discouraged** in an environment in which firms with political influence earn rents at the expense of more efficient or more innovative firms that lack influence.

- By tilting the playing field, such capture can also **make growth less inclusive**

Example: Estimating the costs of capture

The closer that industrial groups were to the president, the more the value of their stock fell as rumors about the president's health circulated



A Middle Income Trap?

Transitioning from a growth model based on factor accumulation to a growth model based on productivity and innovation may require a different set of institutions.

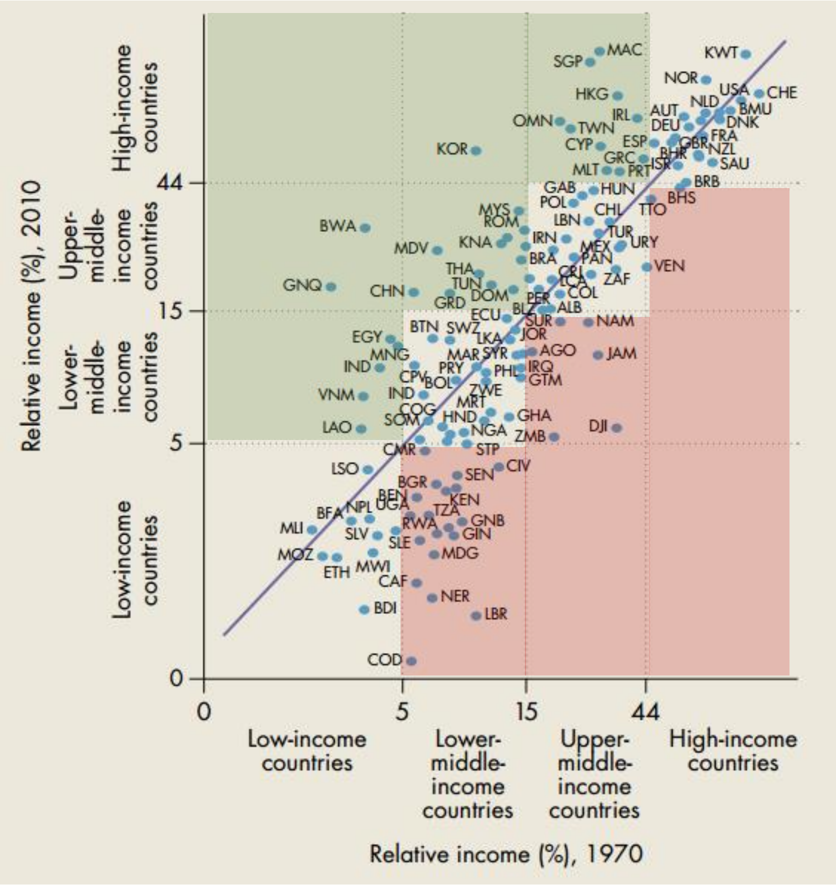
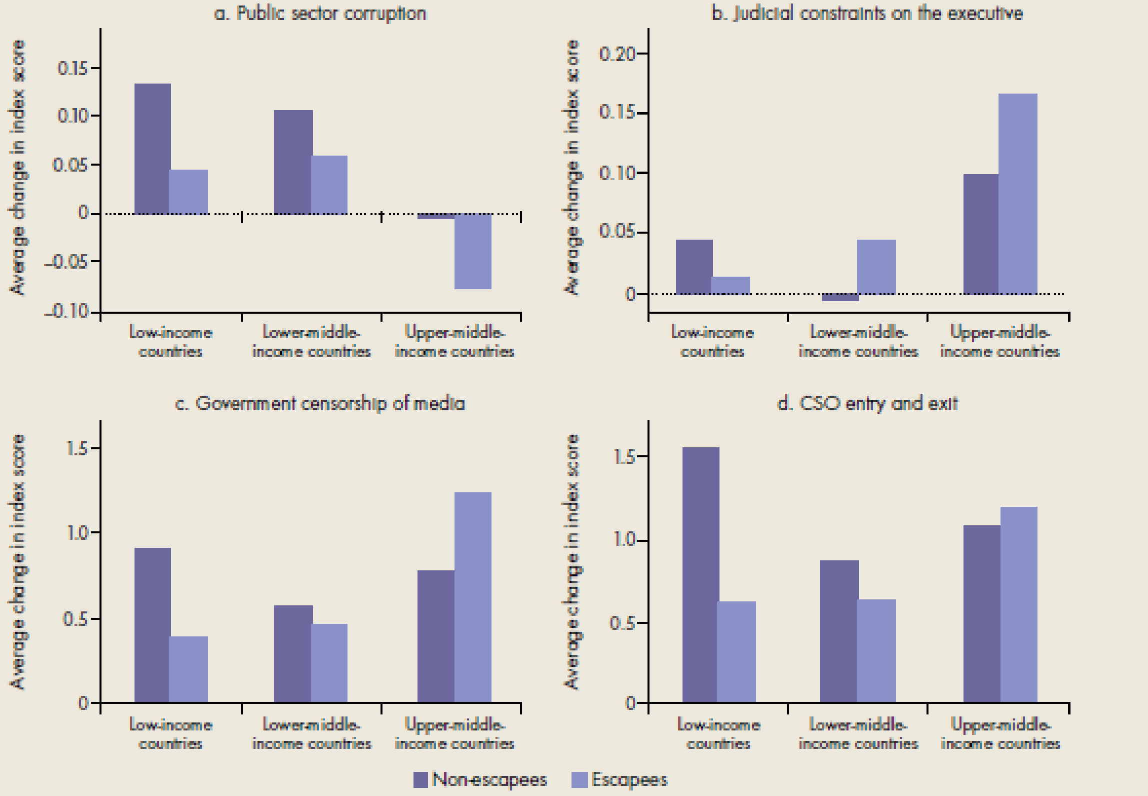
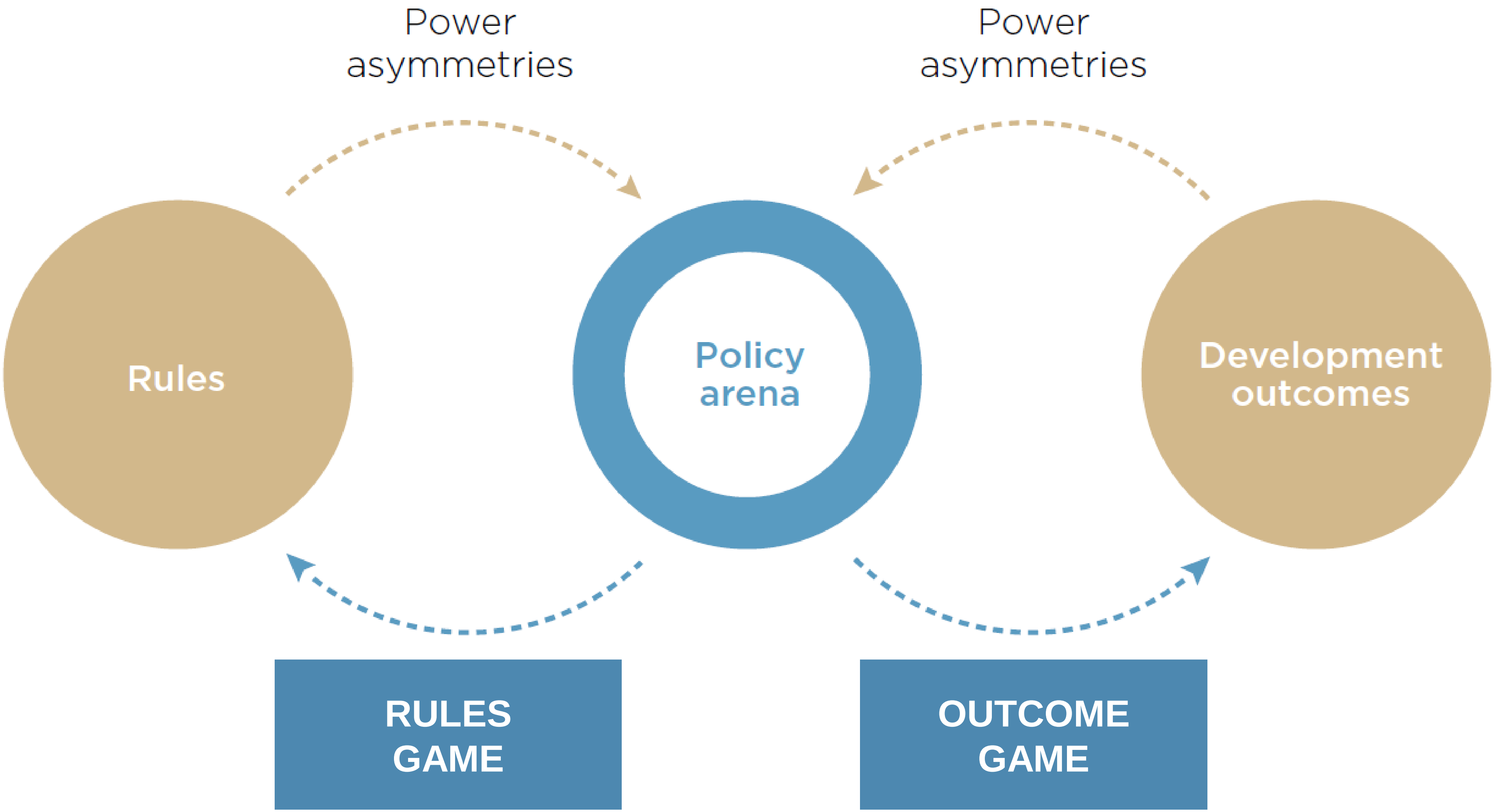


Figure S6.2 Checks on corruption and accountability institutions improve more in countries that escape upper-middle-income status to achieve high-income status than in countries that are "non-escapees"



Visual Synthesis of the Conceptual Framework



Shifting the equilibrium: Law as a lever of change

WHAT ARE THE ENTRY POINTS FOR CHANGE?

Change incentives
Change the cost of action or inaction

Reshape preferences and beliefs
Change objectives of actors

Increase contestability
Reduce barriers of entry in policy arena

WHAT KIND OF RULES CAN BE CHANGED?

R1 (Low-level rules)
Specific policies

R2 (Mid-level rules)
Organizational forms

R3 (High-level rules)
“Principles and rules about changing rules”

Incentives and Horizontal Accountability

Horizontal oversight of regulatory agencies by other government branches can help prevent or invalidate regulatory decisions that are not in the public interest

- Across countries, the strength of judicial independence and constitutional review is associated less regulation of firm entry (La Porta and others 2004).
- In the US, the delegation of decision-making authority to bureaucratic agencies and of arbitration authority to the courts has helped make regulatory policies more consistent (Spiller and Tommasi 2005)

Table 1: Relevant checks and balances institutions

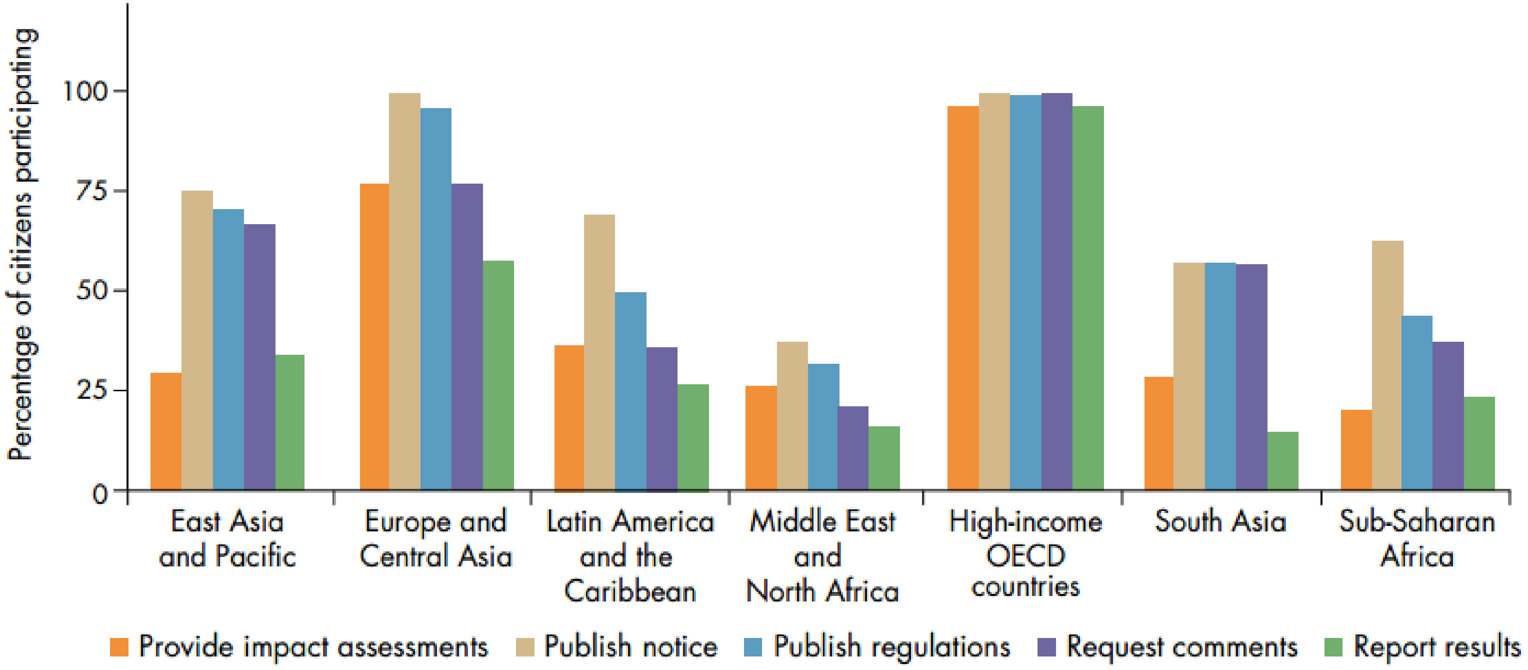
	Mexico	South Africa	Turkey
Sectoral regulator	Federal Telecommunications Commission (COFETEL), formally under the Ministry of Telecommunications (SCT) 1996-2013. From 2013 the Federal Telecommunications Institute (IFT)	South African Telecommunications Regulatory Authority (SATRA), 1996; merged 1997 with the Independent Broadcast Authority to become the Independent Communications Authority of South Africa (ICASA)	Information and Communication Technologies Authority
Competition Authority	Federal Competition Commission (CFC)	Competition Commission	Competition Authority
Courts	Appeals courts; Supreme Court.	Magistrates courts (district level); High Court (provincial level); Supreme Court	The Constitutional Court; The Council of State (appeals court for administrative decisions)

Source: Walton, Levy, Atiyas (2016)

Contestability and Vertical Accountability

Mechanisms of vertical accountability that facilitate contestability by citizen (or consumer) groups can help balance influence in the policy-making process

Figure 5.6 Formal avenues for broad-based participation in regulatory decision making are limited in low- and middle-income countries



Source: WDR 2017 team, using data from World Bank, Global Indicators of Regulatory Governance, various years.

Note: OECD = Organisation for Economic Co-operation and Development.

Example: "Bulldozer Initiative" in BiH

- In 2002 Bosnia and Herzegovina implemented the "Bulldozer Initiative" to promote more inclusive public-private dialogues

- The reform facilitated better information flows and accountability in the design and implementation of reforms of the business climate

- By mobilizing local business communities to suggest reforms and to become more engaged with the monitoring of authorities during implementation the initiative successfully reduced the influence of narrow interest groups.

REFORM RECOMMENDATION AND IMPLEMENTATION PROCESS

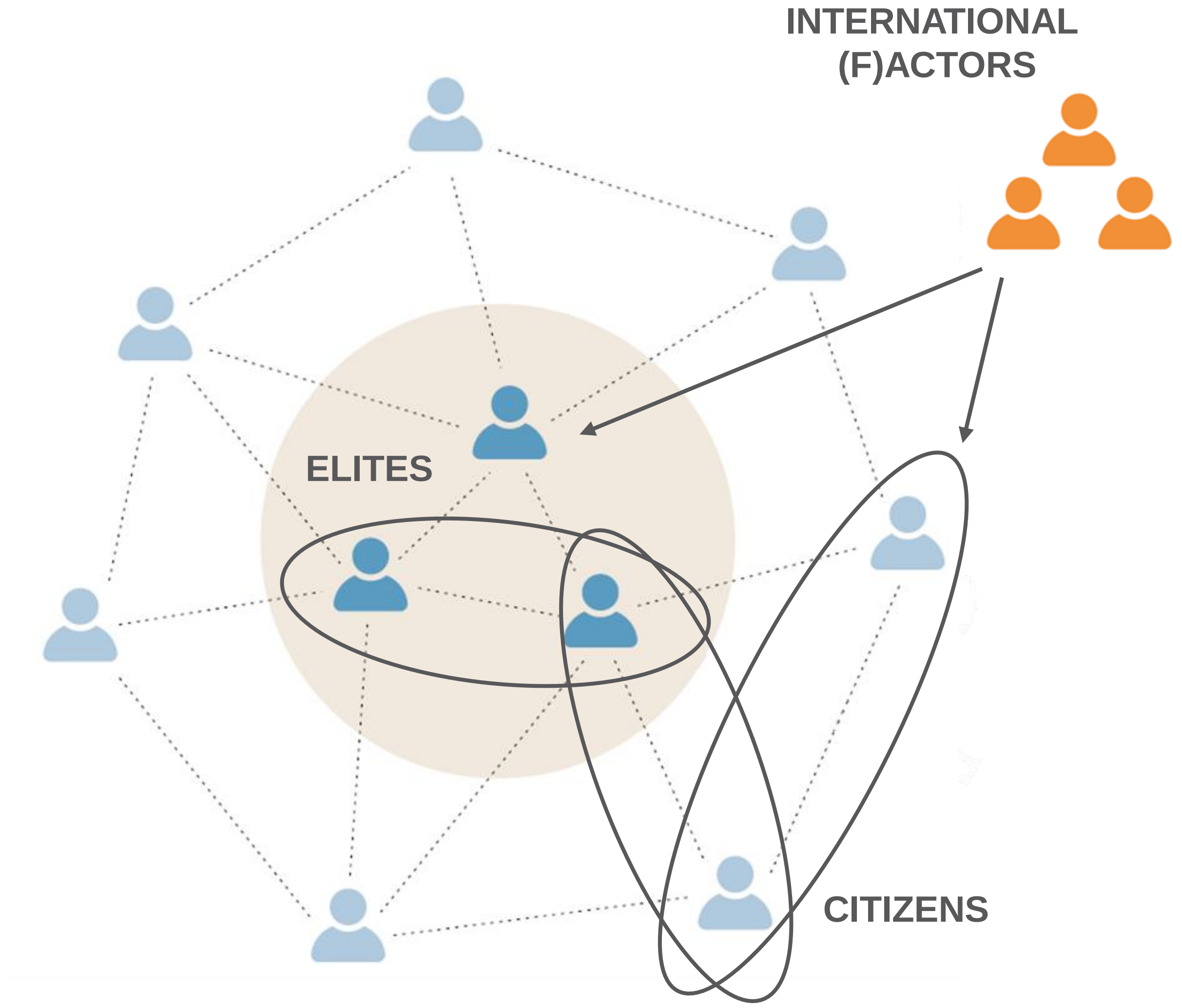
Source: Herzberg (2007).

Drivers of change: A focus on actors

Elite bargains
Agreements among decision makers to restrict their own power

Citizen engagement
Coalitions to change the incentives of those who make decisions

International influence
Indirect influence to change the relative power of domestic reformers



Implications for development approaches

Governance depends on actors

Abstract idea of "**institutions**" → How **actors** reach and sustain agreements

Governance is a process

The "**right**" policies → The policy **process**

Countries can only be compared to themselves

Benchmarking across countries → **Country-specific** historical trajectories

Countries are constantly adapting to new tensions

Large-scale change and 'critical junctures' → **Incrementalism** and change at the margin