INTERNATIONAL MONETARY FUND

Review of the Fund's Experience in Governance Issues

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In consultation with other departments

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Contents Page

Figures

Annexes

Annex Table

Executive Summary

Background

- The Fund's 1997 Guidance Note on Governance (GN) was prepared in recognition of the importance of good governance for macroeconomic stability and growth. The GN called for a more comprehensive treatment of governance issues and a more proactive approach in advocating policies that promote good governance. This paper responds to the Board's request at that time for periodic reviews of experience.

- At the time of the GN, the Fund (and the international community more broadly) was still feeling its way regarding the approach to governance. The emergence since then of a global consensus on the importance of good governance has provided strong support and a more conducive environment for the Fund's work.

Experience

- The Fund's approach to governance issues includes initiatives to promote good governance and specific measures to address particular instances of poor governance and corruption. The further development of instruments to promote good governance—including standards and codes of best practice and other policies to encourage transparency and accountability—has moved substantially beyond expectations at the time of the GN. Key factors have been the response to successive emerging market crises and the focus on strengthened public resource management in HIPCs.

- Specific remedial measures may also be needed, either in the surveillance or program context, to address governance issues that have significant macroeconomic implications. The review indicates increased recourse to such advice, but also points to the difficulty of precisely defining macroeconomic significance in many cases—for example in transition economies, where all elements of the transformation may have potentially important macroeconomic ramifications; or in cases where the macroeconomic effects of poor governance may, like termites in the woodwork, remain hidden for a lengthy period. Careful judgments are also needed when addressing governance issues that require action in areas outside the Fund's expertise, especially when the appropriate agencies are not in a position to provide the needed advice.

Issues for Discussion

- The paper asks Directors if they agree that: the strengthening of the Fund's instruments to promote good governance has been appropriate and that prevention should be at the center of the governance strategy looking forward; the pragmatic approach to involvement in particular cases within broad boundaries should be maintained and that the scope for narrowing these boundaries should be considered on the basis of further experience; the Fund should follow up on OECD-led initiatives on the two-sided nature of corruption; and this paper should be published.

I. INTRODUCTION

1. **At the time of the approval of the 1997 Guidance Note on Governance (GN, attached), the Executive Board requested periodic reviews of the Fund's experience with governance issues.**[1]

2. **The Guidance Note was prepared in recognition of the importance of good governance for macroeconomic stability and growth, and hence for the Fund's activities.** In 1997, the Fund and the international community in general, was nevertheless still feeling its way in its approach to governance. Reflecting this, the GN eschewed precise guidelines and was cast in relatively general terms. Its central message was a call for greater attention by the Fund to issues of governance:

"in particular through: (i) a more comprehensive treatment in the context of both Article IV consultations and Fund-supported programs of those governance issues that are within the Fund's mandate and expertise; (ii) a more proactive approach in advocating policies and the development of institutions and administrative systems that eliminate the opportunity for rent-seeking, corruption, and fraudulent activity in the management of public resources; (iii) an evenhanded treatment of governance issues in all member countries; and (iv) enhanced collaboration with other multilateral institutions, in particular the World Bank, to make better use of complementary areas of expertise," (GN, paragraph 3).

3. **The broader environment in which the Fund approaches governance issues has changed radically in recent years and in particular since the Board's 1997 discussions.** Above all, a global consensus has emerged on the importance of good governance for key dimensions of economic performance, including growth, poverty reduction, resilient economic and financial systems, and the effectiveness of aid and private capital inflows.[2]

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[1] "The Role of the Fund in Governance Issues: Guidance Note" (approved by the Executive Board, July 27, 1997). The Board requested that subsequent reviews be folded into the biennial reviews of surveillance: see *Concluding Remarks by the Chairman: The Role of the Fund—Governance Issues—Guidance to the Staff*, (SUR/97/48, 5/21/97).

[2] This has been accompanied by a growing body of empirical research on the economic effects of governance and corruption. See for example, P. Mauro, "Corruption and Growth," *Quarterly Journal of Economics*, August 1995; C. Van Rijckegham and B. Weder, "Corruption and The Rate of Temptation: Do Low Wages in the Civil Service Cause Corruption?," IMF Working Paper 97/73, 1997; S. Gupta, H. Davoodi, and R. Alonso-Terme, "Does Corruption Affect Income Inequality and Poverty?," IMF Working Paper 98/76, 1998; D. Kaufman and S-J. Wei, "Does 'Grease Money' Speed up the Wheels of Commerce?," NBER Working Paper 7093, National Bureau of Economic Research,

(continued…)

This process began in the aftermath of the end of the Cold War and was significantly moved forward with leadership of the international financial institutions, notably in the context of the 1996 Annual Meetings of the Fund and the World Bank.[3] It has by no means been confined to the international community: there has been an increasing intolerance of poor governance and corruption within member countries, with civil society becoming more vocal in support of good governance and many authorities demonstrating increased commitment to addressing governance issues. The increasing broad-based recognition of the importance of governance is also likely to have contributed to greater country ownership of good governance measures.[4]

4. **As part of this overall movement, the Fund has increased its engagement in governance issues in many ways, and in response to new issues, that were not anticipated by the GN.** These are represented schematically in Box 1; they include the development and use of standards and codes of best international practice in a wide range of policy areas, policies to encourage transparency and accountability in member countries, and

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Cambridge, Massachusetts; C. Leite and J.Weidmann, "Does Mother Nature Corrupt, Natural Resources, Corruption and Economic Growth?" IMF Working Paper 99/85, 1999; E. Gurgen and T. Wolf, "Improving Governance and Fighting Corruption in the Baltics and CIS Countries: The Role of the IMF," IMF Working Paper 00/1, 2000; and World Development Report 2000/2001—Attacking Poverty, 2000, World Bank, Washington.

[3] The Interim Committee declaration of September 26, 1996 on *Partnership for Sustainable Global Growth* attached particular importance "to promoting good governance in all its aspects."

[4] To cite but a few examples of initiatives in various regions: in Africa, The West African Monetary Union (WAEMU) Code of Transparency adopted in June 2000, the Libreville Declaration of the Summit of African Heads of State and Government on the Economic and Social Agenda for Africa at the Dawn of the Third Millennium, January 2000 that affirms the determination to fight corruption, the Global Coalition for Africa (GCA)—in particular, the 1997 Policy Forum on Corruption and Development in Africa; in Latin America, RICOREP—Network of Institutions to Combat Corruption and Rescue Public Ethics, PFC (Journalists Against Corruption), De Frente al Pais—Programa Presidencial de Lucha Contra La Corruption—presidential program in Colombia against corruption; in Asia, the GOA Right to Information Website—a citizen's initiative in India highlighting the importance of open and clean governance, in Japan, "Expel Political Misfits"—a civic movement to drive out the abuse of authority, greed and corruption; and in the transition economies, the Anti-Corruption Network (ACN) for Transition Economies—which includes government, private sector, and civil society participants.

Box 1. Fund Activities to Promote Good Governance

SURVEILLANCE
FUND-SUPPORTED PROGRAMS
TECHNICAL ASSISTANCE

Data Dissemination
Special Data Dissemination Standard (SDDS) started 1996,
General Data Dissemination System (GDDS) started 1997

Reports on Observance of Standards and Codes
started April 1999

Fiscal Transparency
Code of Good Practice
issued April 1998

Monetary and Financial Policy Transparency
Code of Good Practices
issued September 1999

Financial Sector Assessment Programs
started May 1999

Guidelines on Misreporting
Strengthened policy
introduced July 2000

Safeguards on the Use of Fund Resources
Strengthened policy
introduced July 2000

Monitoring Use of Debt Relief for Poverty Reduction
Part of Enhanced HIPC Initiative
(1999)

Internal Governance
Staff Code of Conduct
(July 1998),
Staff Financial Disclosure Statement
(April 2000)
Executive Board Code of Ethics
(July 2000)
Evaluation Office
(2001)

strengthened safeguards on the use of Fund resources. As discussed further in Section II, these initiatives have brought concreteness to key elements of the Fund's approach to governance within the broad framework set out in the GN.

5. **This greater global emphasis on good governance thus provides important context for the review of post-GN experience presented in this paper.** The review concludes that the Fund's involvement in broad initiatives geared to strengthening economic aspects of governance has laid a firm foundation and that this emphasis on prevention should be the main plank of the Fund's governance strategy looking forward. The paper also considers more difficult issues—notably the nature of appropriate boundaries—raised by the Fund's involvement in particular cases, as well as how the Fund could help tackle the two-sided nature of corruption. The review draws upon a broad survey of the attention given by the Fund to governance (Annex I), and illustrative country cases of the Fund's involvement in particular areas (Annex II). The review does not address issues relating to conditionality, which will be considered by the Board in a separate discussion. [5]

II. THE FUND'S INVOLVEMENT IN GOVERNANCE ISSUES

6. **The Fund's involvement in governance derives from its mandate to promote macroeconomic stability and sustained noninflationary growth, which it seeks to fulfill through surveillance, programs of financial support, and technical assistance**. Accordingly, poor governance is an issue that falls within the Fund's mandate when it is an obstacle to achieving these objectives, or when it raises questions about the adequacy of safeguards on Fund resources. At the same time, good governance broadly defined has many dimensions that go beyond the narrowly economic (including, for example, political processes), and drawing the line was (and still is) not straightforward. While the GN specifically eschewed the political dimension (GN, paragraph 7), defining the scope of the Fund's involvement consistent with its mandate proved difficult to do with precision, and the GN set out relatively general boundaries.

7. **The GN thus limits the Fund's involvement in governance issues to those that would have a significant macroeconomic impact, and the scope of its intervention to the economic aspects of governance.** The GN defines good governance in terms of: the effective

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[5] These issues are considered in *Conditionality in Fund-Supported Programs—Preliminary Considerations* (SM/01/60, 2/20/01) and background papers—*Structural Conditionality in Fund-Supported Programs* (SM/01/60, Supplement 2, 2/16/01) and *Trade Policy Conditionality in Fund-Supported Programs* (SM/01/60, Supplement 3, 2/16/01); see also *Streamlining Structural Conditionality in Fund-Supported Programs—Interim Guidance Note*, (9/18/00). Annex II of the present paper provides factual information on the use of conditionality in the country case studies.

and transparent management of public resources; and a stable economic, regulatory and legal environment conducive to the sound management and efficient use of private and public resources. The GN provides broad guidance (the wording of which was the subject of lengthy discussion in the Executive Board) on the definition of a significant macroeconomic impact, both in general terms:

"staff should be guided by an assessment of whether poor governance would have a significant current or potential impact on macroeconomic performance in the short and medium term and on the ability of the government credibly to pursue policies aimed at external viability and sustainable growth" (GN, paragraph 9);

and, in the context of possible individual instances of corruption:

"staff should continue raising these with the authorities in cases where there is reason to believe they could have significant macroeconomic implications, even if these effects are not precisely measurable" (GN, paragraph 10).

The GN also underscores the need to avoid involvement in the political aspects of governance and not to adopt the role of an investigative agency or guardian of financial integrity in member countries.[6] The GN states in addition that

"the IMF should focus its policy advice and technical assistance on areas of the IMF's traditional purview and expertise", and that in other areas policies and reforms could *"be part of the IMF staff's policy discussions and conditionality for the IMF's financial support where those measures were necessary for the achievement of program objectives."* (GN, paragraph 6).

In practice, the Fund's advice has been founded on transparency, accountability, and the strengthening of good practices and effective institutions. These elements, together with the effective rule of law, seek to limit the opportunities for rent seeking, corruption, and fraudulent activity. Examples of governance-related issues raised in Article IV consultation discussions and Fund-supported programs are given in Box 2.

8. **The Fund's approach to governance issues includes broad initiatives that seek to promote good governance across the membership.** These initiatives aim to strengthen

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[6] In the case of the use of Fund resources, the application of safeguard assessments of central banks is provided for under the Fund's Guidelines on Conditionality (3/2/79): *"a member may be expected to adopt some corrective measures before a stand-by arrangement is approved by the Fund, but only if necessary to enable the member to adopt and carry out a program consistent with the Fund's provisions and policies."*

Box 2. Examples of Governance-Related Reforms in Selected Article IV Consultations and Fund-Supported Programs

Fiscal and Public Sector Reforms •Strengthen revenue collecting agency. •Set up a quarterly monitoring system of tax arrears. •Improve coordination of spending decisions among all levels of government. •Reform state enterprise sector. •Improve policy-making capacity for, and institutional implementation of, macroeconomic reforms.	**Banking and Financial Sector Reforms** •Introduce uniform chart of accounts for commercial banks. •Strengthen the legal basis for central bank independence. •Introduce bank regulation to strengthen the capital position of banks. •Privatize four largest banks. •Enact laws and regulations to provide a legal framework for bank supervision. •Introduce new/strengthen/enforce prudential standards for banks and other financial institutions.
Legal and Judicial System Reforms •Approve regulations governing the functioning of an arbitration court. •Enact new commercial code. •Enact foreign investment law. •Adopt/revise labor code. •Implement an effective law on bankruptcy. •Prepare/implement strategy for breaking up monopolies. •Complete review of forest concession contracts and cancel concessions in violation of regulations.	**Statistical Data and Information Flow** •Enact law on statistics/improve statistics/establish statistical coordinating office. •Improve macroeconomic database and disseminate economic statistics on a regular and timely basis. •Publish quarterly indicators on public investment execution. •Improve data coverage in government budget subscription to the Fund's General Data Dissemination System (GDDS) and Special Data Dissemination Standard (SDDS).
Transparency and Accountability in Public Resource Management •Reduce extrabudgetary funds and consolidate into budget. •Strengthen public expenditure control. •Revise system of automatic advancement of civil servants/review public service rules. •Implement liquidation procedure for largest tax fraud cases. •Eliminate granting of extensive customs exemptions. •Remove/reduce/clarify tax exemptions. •Transfer management of public customs warehouses to private sector. •Implement regulations on procurement and contracting procedures.	

Sources: Chairman's Summings-Up of Article IV Consultation Discussions and IMF staff reports.

institutions and systems and the functioning of national and international markets in ways that reduce the economic rents and lack of accountability that create opportunities and incentives for poor governance and corruption. As detailed below, the Fund's involvement has covered the range of its core responsibilities but with a particular emphasis on those aspects of policy that help insure the integrity of financial institutions and financial markets. These broad initiatives typically feature most prominently in the Fund's surveillance activities, but in the context of programs they provide a broad framework on which remedial policy reforms directed at individual instances of weak governance can be based.

9. **In addition, the Fund has become involved with specific governance issues in individual country cases.** This involvement may entail a targeted remedy (for example, an audit to strengthen the accountability of a state-owned enterprise) and, as documented in Annex II, has featured in both surveillance and program cases. A key question (discussed below) is when it is right for the Fund to become involved, either in the context of surveillance or in helping member countries design adjustment programs.

A. Initiatives to Promote Good Governance

10. **Since 1997, the Fund has moved forward considerably in developing and expanding its role in promoting good governance.** Even before 1997, the Fund's involvement in governance issues was already considerable. This involvement was often in the form of policy advice and technical assistance that promoted sound public resource management and economic efficiency, albeit without an explicit recognition that such activities were related to good governance. But in the period since the issuance of the GN, the Fund has moved substantially ahead in developing and applying its instruments for achieving these goals, with a focus on those aspects for which it has core responsibilities and expertise. Impetus to these efforts was provided by a variety of factors, including: the successive financial crises in emerging market economies that prompted a search for more effective measures of crisis prevention; and the enhancement of the HIPC initiative with its increased emphasis on the effective use of debt relief for poverty reduction.[7] The Fund's initiatives have, moreover, formed part of a broad cooperative effort by the international community that involves many agencies, and addresses areas both within and outside the Fund's core responsibilities.[8] In fact, in recent years, several other multilateral institutions have also made good governance a more explicit policy objective (Annex III).

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[7] The survey conducted for this paper of the Fund's Article IV consultation discussions shows that governance-related issues have been addressed in an increasing proportion of the membership during 1994-99 (Box 3, Annex I, and Figure 1).

[8] These areas and agencies include: *securities market regulation*, the International Organization of Securities Commissions; *insurance regulation*, the International Association

(continued…)

11. **The main ways in which the Fund has itself strengthened these instruments since 1997 comprise the development and promotion of codes and standards of good practices, transparency and accountability; public resource management under the enhanced HIPC Initiative; and safeguards for the use of Fund resources.** These instruments (with the exception of safeguards) are being developed in close collaboration with the World Bank. Many of the specific tools, such as ROSCs, that have been developed subsequent to the 1997 discussions on the GN have provided the Fund with a set of instruments to better help members identify weaknesses in country institutions and regulatory frameworks that can be entrées for poor governance and corruption, as well as to support the design and implementation of remedial reforms. In the Fund's core areas of expertise—macroeconomic and financial policies and data—its efforts have increasingly focused on the dissemination and implementation of the standards now established. The Fund has undertaken assessments of compliance with standards, provided technical assistance, and is developing a framework for incorporating these assessments, together with those of codes and standards established and assessed by other bodies, into its surveillance activities.

12. **The successive emerging market crises of recent years pointed to the importance of *transparent policies and data* as elements of good governance and crisis prevention.** In response, the Fund has since 1996 developed standards for: data; fiscal transparency; and monetary and financial policy transparency.[9] In addition, the Basle Committee on Banking Supervision (BCBS) of the Bank of International Settlements (BIS), issued the Basle Core

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of Insurance Advisors; *corporate governance*, the OECD, World Bank, and Basel Committee; *payments and settlement systems*, the Committee on Payments and Settlements Systems; *insolvency regimes*, the United Nations Commission of International Trade Law, the IMF, and the World Bank; and *accounting and auditing*, the International Accounting Standards Committee and International Federation of Accountants.

[9] The Special Data Dissemination Standard (SDDS) was adopted in 1996 (and recently strengthened) to guide countries that have or might seek, access to international capital markets in the dissemination of economic and financial data to the public. The General Data Dissemination System (GDDS) was adopted in 1997 to guide countries in the development, and provision to the public, of comprehensive, timely, accessible and reliable economic, financial, and socio-demographic data. See *Third Review of the Fund's Data Standards Initiative,* (SM/00/55, 3/29/00) and *Amendments to the SDDS and the GDDS* (SM/00/195, 8/21/00). The *Code of Good Practices on Fiscal Transparency* was adopted in 1998 (followed in 1999 by a supporting document to guide its implementation—*Revised Manual on Fiscal Transparency* (SM/99/68, 3/11/99)) and the *Code of Good Practices on Transparency in Monetary and Financial Policies* in 1999; also see *Review of the Experience With Assessments of Implementation of the IMF Code of Good Practices on Transparency in Monetary and Financial Policies* (SM/00/269, 12/01/00).

Principles on Effective Banking Supervision in 1997 and more recently approved a methodology for reviewing adherence to the core principles.[10] Also, in collaboration with the Financial Stability Forum and the World Bank, experimental modalities for the Fund's approach to financial sector practices in offshore centers have recently been adopted, and are being reviewed with respect to financial system abuse, financial crime, and money laundering.[11]

13. **For the purpose of assessing and supporting members' compliance with standards and codes, in 1999 the Fund introduced, in collaboration with the World Bank, *Reports on the Observations of Standards and Codes* (ROSCs), as well as the *Financial Sector Assessment Program* (FSAP) and *Financial System Stability Assessments* (FSSAs).** These instruments, which help countries assess vulnerabilities and the need for corrective actions, incorporate assessments of relevant standards and codes promulgated by other bodies.[12] The modalities of this approach, including integration in the Fund's surveillance activities, are experimental and under review, and the participation of member countries is voluntary. Progress in carrying out assessments has, nevertheless, already been substantial.[13] Links between Fund technical assistance (in coordination with other institutions) and capacity-building needs identified in assessments of good practice are also being strengthened.[14]

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[10] See *Experience with Basel Core Principle Assessments* (SM/00/77, 4/12/00).

[11] See *Offshore Financial Centers—The Role of the Fund* (BUFF/00/190,12/14/00) and *Financial System Abuse, Financial Crime and Money Laundering—Background Paper* (SM/01/46, 2/12/01).

[12] For a review of the experience in implementing these codes and standards see *Financial Sector Assessment Program—A Review—Lessons from the Pilot and Issues Going Forward,* (SM/00/263, 11/27/00) and *Assessing the Implementation of Standards: A Review of Experience and Next Steps*, (SM/01/11, 01/12/01).

[13]As of December 4, 2000, 83 ROSC modules, including 11 on data dissemination, 18 on fiscal transparency, 18 on monetary and financial policy transparency, and 18 on banking supervision, have been produced for 32 countries, of which 67 have been published. Furthermore, as of January 2001, completed ROSC modules have been circulated as supporting documentation for the Article IV consultation for 27 members since September 1999.

[14] See *Ensuring Alignment of Technical Assistance with the IMF's Policy Priorities,* (SM/00/284, 12/20/00) and the *Annual Report on Fund Technical Assistance*, (SM/00/227, 10/05/00).

14. **The Fund's efforts to promote transparency and accountability, as elements of good governance, have not been confined to the work on standards and codes but cover also program design and the Fund itself.** For countries receiving financial support under the PRGF, the introduction of Poverty Reduction Strategy Papers (PRSPs) in 1999 strengthened transparency and accountability through a process of public participation. As regards transparency of the institution itself, the Fund in 2000 adopted policies on the publication of Fund country documents for Article IV consultations and the use of Fund resources, policy papers, and information about Fund financial transactions.[15] In parallel, the Fund has also promoted good governance in its own operations through, for example, a Code of Conduct and Financial Disclosure for staff, and a Code of Ethics for the Executive Board. In addition, an independent Evaluation Office will be established in 2001.

15. **Also prominent among the Fund's recent governance-related efforts is the program, recently initiated in collaboration with the World Bank, to strengthen public expenditure management in heavily indebted poor countries (HIPCs).** This program is motivated by the need for proper tracking of poverty-related spending in the countries receiving assistance under the enhanced HIPC Initiative.[16] It aims to develop systems to track the composition of overall government spending on poverty-related programs, and would entail other more general improvements in public expenditure management.

16. **Finally, the Fund has recently strengthened policies to safeguard the use of Fund resources and with regard to misreporting of information to the Fund.[17]** In March 2000, the Fund adopted a strengthened framework to safeguard the use of Fund resources, with the purpose of providing assurances that a central bank's control, accounting, reporting, and auditing systems for managing resources, including Fund disbursements, are adequate to ensure the integrity of operations. Safeguards assessments apply to all members with arrangements approved after June 2000, with transitional procedures for arrangements already in place at that date.

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[15] See *Review of the Pilot Project for Voluntary Release of Article IV Reports and Other Issues in Fund Transparency* (SM/00/190, and supplements, 8/10/00).

[16] See *Tracking of Poverty-Related Public Spending in Heavily Indebted Poor Countries* (SM/01/16, 1/19/01).

[17] See *Summing Up by the Acting Chairman on Strengthening Safeguards on the Use of Fund Resources and Misreporting of Information to the Fund—Policies, Procedures, and Remedies—Preliminary Considerations,* (BUFF/00/48, 3/30/00), *Strengthening the Application of the Guidelines on Misreporting,* (EBS/00/12, 06/29/00), and *Misreporting in the Context of HIPC Initiative Assistance—Preliminary Considerations,* (EBS/00/45, 11/29/00).

17. **In sum, since 1997 the Fund's initiatives to promote good governance across the membership have expanded and crystallized into a broad menu of operational instruments.** This evolution has had wide support, and a clear framework is now in place to guide the institution's work in the future.

B. Involvement in Particular Country Cases

18. **The Fund's involvement in specific governance-related issues has also developed and increased considerably since 1997.** This has been facilitated by member countries' greater acceptance of the macroeconomic importance of governance issues and the increased awareness on the part of political leaders of the need to address instances of poor governance and corruption—factors that have helped develop greater ownership of governance-related measures. While this involvement occurs both in surveillance and programs, it has played a particularly important role in the context of those program cases where achieving macroeconomic objectives and safeguarding Fund resources urgently call for specific remedies. The survey of program conditionality also indicates an increase in the average number of governance-related conditions per program, particularly for transition economies. The program conditions surveyed focused on economic aspects of governance, notably transparency and accountability in public resource management (Box 3, Annex I, and Figure 3). Box 4 summarizes preliminary lessons from the case studies (Annex II) for the formulation of policy advice to tackle poor governance and corruption.

19. **At the same time, issues have arisen in some program cases about the nature and scope of the Fund's involvement.** In the case of Indonesia, for example, the issue was whether the program's wide array of structural reform commitments (aimed at addressing governance concerns and thereby helping reestablish investor confidence) was actually needed to address the immediate financial crisis and whether it may have distracted the authorities from more pressing priorities. In the case of Cambodia, the question was the appropriateness of involvement of the Fund in reforms in a noncore area (the forestry sector) as part of efforts to halt the misappropriation of public resources (see Annex II). The country case studies in Annex II also provide numerous further illustrations that addressing

Box 3. Survey of Fund Involvement in Governance Issues in Member Countries, 1994-99[1]

- **The survey suggests that the Fund has increased its involvement in governance-related issues in recent years**. This is attributable to greater proactiveness of the Fund on these issues, as well as to the changing circumstances of member countries. As measured by the survey, the increase in involvement was particularly marked in terms of: (i) the increased proportion of the Board's Article IV consultation discussions in which governance issues were raised, and (ii) the increase in the average number of governance-related conditions that were incorporated in those Fund-supported programs that addressed governance issues.

- **In addition to the Fund's increased focus on governance, the changing circumstances of countries are also likely to have contributed to the greater attention to governance issues.** For the transition economies in particular, the policy agenda in the latter part of the 1990s gave heavy emphasis to structural issues including governance matters. Also, for program countries, there may be additional governance-related issues due to the need to safeguard Fund resources.

- **In general, system-wide (or indirect) issues tended to be raised in Article IV consultation discussions, whereas policy measures directed at specific instances of bad governance and corruption also played an important role in the context of Fund-supported programs.**

- **The survey suggests that overall the Fund's involvement in governance issues is primarily concerned with economic policy areas within its mandated responsibilities and expertise.** The main area of governance issues addressed in both surveillance activities and programs was that of transparency and accountability, especially in public resource management. Consultation discussions and programs have also taken into account policy areas where the Fund does not have the primary responsibility, such as legal and judicial reforms, but that are complementary to needed reforms in the sound management of public resources. This involvement has been limited—indeed legal and judicial reforms were raised the least frequently—and in most cases was complementary to the privatization of public enterprises.

[1] See Annex I and Figures 1-4 for a description of the methodology and results of the survey.

Box 4. Country Case Studies—Issues in Improving Governance[1] and Fighting Corruption

The country case studies highlight a number of issues relevant for the formulation of policy advice geared to remedying poor governance and corruption:

- **The establishment and enforcement by countries of accountability is essential for the effectiveness of procedures and rules aimed at promoting good governance, and for this purpose,**

  — *measures that promote transparency and encourage adherence to sound public resource management practices are important.* Such measures could include audits, public service codes of good conduct and ethics, reforms to promote the professionalism of the civil service (for example, merit-based recruitment and promotion), and the introduction and strengthening of anti-corruption tribunals and committees;

  — *the independence of officials and agencies responsible for ensuring compliance with good governance is essential* to reduce the possibility of political interference and the influence of vested interests and establish the credibility of the agencies. In this context, such agents and agencies should provide and publish regular reports on their activities, and on punitive actions that they have implemented or recommended;

  — *transparent enforcement of good governance can have an important demonstration and breakthrough impact.* In this respect, the strong expression of the authorities' commitment at a high level to good governance can play an important role. This expression should include a commitment to take measures against the culpable parties in revealed incidents of corruption. Also, exposed cases of malfeasance and remedial action could be given a high public profile.

- **Domestic ownership at all levels is important for the credibility of initiatives to promote good governance** and the even-handed application to, and adoption by, all individuals and groups of practices of good governance. In low-income countries, the introduction of PRSPs and the associated participatory preparation process, together with the involvement of civil groups in monitoring progress should encourage such ownership.

- **Significant sources of economic and financial rents that create incentives and opportunities for poor governance and corruption should be addressed.** Experience indicates that monopoly privileges in the energy sector, raw material extraction and processing, and commodity marketing and trading activities, as well as the absence of clear even-handed rules and regulations for such enterprises and the markets they operate in, are likely sources of significant incidents of bad governance and the misappropriation of public resources. Given the strength of vested interests that benefit from such rents and their ability to resist reform, the use of transparent audits can play an important role in eroding their influence on decision-making and promote broad-based support for their elimination. Regulatory reform and the application of codes of best practices are also important.

[1] See Annex II for detailed description of individual country cases.

governance issues can entail essential complementary measures in areas outside the sphere of the Fund's core responsibilities.[18]

20. **Experience indicates that there is a large range of possible sources of poor governance that can be viewed as having significant or potential macroeconomic impact, in the terminology of the GN, and could justify Fund involvement.** The question is whether it would be helpful to attempt to draw the boundaries for Fund involvement more narrowly than does the GN. The experience reviewed in this paper suggests that it would be difficult in practice to define a clearly calibrated yardstick for involvement. For example, in transition economies, it would be virtually impossible to quantify an appropriate threshold for the macroeconomic significance of governance-related reforms needed to establish a market-based economy. Moreover, while manifestations of the macroeconomic effects of poor governance and corruption are in many country cases clearly evident, in others the negative effects may for a long period of time be largely hidden—akin to termites that are causing unseen damage to the woodwork. An early attack on, for example, instances of "crony capitalism" might under an unduly precise criterion of significance be difficult to justify at a time when macroeconomic performance is still favorable, leaving the damage to emerge later on.[19] That said, the present approach under which judgement is exercised within relatively broad boundaries entails risk—for example, that the Fund could come under pressure from interested parties to intervene in a case of alleged corruption that does not have a macroeconomic impact. Such pressures would be more easily resisted with narrowly defined boundaries. However, considerable further experience and research would be needed to provide the basis for a more narrow definition. Nevertheless, in the absence of narrow boundaries, it is important that the rationale for Fund involvement be clearly presented in each case. The survey of country cases (Annex II) indicates that explicit discussion of the macroeconomic relevance of governance issues was presented in most, but not all instances.

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[18] For example: privatization and related issues of corporate governance in the context of improving financial discipline of state-owned enterprises in Bulgaria; civil service reform in Cameroon and Bolivia as part of efforts to strengthen revenue administration; the judicial/legal system in Kenya; and generally in transition economies, such as Bulgaria, Poland and Lao PDR, enforcement of contracts and property rights, effective bankruptcy regimes, and comprehensive anti-monopoly policies as part of a strategy to establish a well-functioning market-based economy.

[19] The GN indicates that the staff should continue raising individual instances of corruption, even if their macroeconomic effects are not precisely measurable, in cases where the amounts involved are potentially large or because the corruption may be symptomatic of a wider governance problem (GN, paragraph 10).

21. **Issues may also arise where the governance problem has a clear macroeconomic impact but lies outside the Fund's primary responsibilities**. In such cases, complementary measures in areas outside the Fund's responsibilities are key to the effectiveness of the Fund's efforts to help countries remedy poor governance. In these instances, the Fund has sought where possible to avoid mission creep by conducting its involvement in areas outside its primary responsibilities in collaboration with other multilateral organizations possessing the appropriate expertise (see Box 5 for discussion of collaboration with the World Bank and other multilateral organizations). Difficult choices may, however, need to be made in situations where the multilateral organization with the relevant expertise may not be in a position to provide the needed advice and assistance. In making such choices, Fund staff have been guided by the framework for Bank-Fund collaboration, which states that when the Bank is unable to provide the needed input, the Fund should do so in order to ensure that the country's program does not suffer.[20] The staff has applied the same principle with respect to inputs from other organizations. In this situation, Fund staff have consulted with counterpart staff on an informal basis and efforts have been made to help ensure that the Bank (or other institution) can provide the input needed for the program, if necessary at a later stage, through program reviews. The staff proposes for now to continue this approach, while exploring ways to reduce the need for Fund input in the context of the evolving framework of collaboration with the Bank.

22. **Finally, the GN called for greater attention to the two-sided nature of corruption**.[21] The OECD, through its 1997 Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, has taken a lead in promoting legislation that addresses the source of bribes (often in advanced economies) (Box 5). There may be scope for the Fund to play a supporting role in this initiative through the Article IV consultation process, for example by following up to see if signatory countries have modified the relevant domestic legislation in line with the convention, and to explore the attitudes of non-signatories to the convention.

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[20] See paragraph 13 of *Report of the Managing Director and the President on Bank-Fund Collaboration*, (SM/98/226, 9/4/98) and (SM/98/226, 9/4/98, Revision 1, Correction 1).

[21] See *Ensuring Alignment of Technical Assistance with the IMF's Policy Priorities,* (SM/00/284, 12/20/00) and the *Annual Report on Fund Technical Assistance*, (SM/00/227, 10/05/00).

Box 5. Collaboration with the World Bank and Other Multilateral Organizations

In governance-related areas outside its primary responsibilities, the Fund has sought the involvement of, and collaborated with, other multilateral organizations according to their expertise and regional affiliation (see Annex III for a description of the governance-related activities of international organizations).

1. **A review of four governance-related policy areas (financial discipline in state-owned enterprises, revenue administration, expenditure management, and corruption) in selected country cases (Annex II) shows that the broad terms of the Bank-Fund collaboration in these cases were in line with the two institutions' respective primary responsibilities and expertise, with the extent of collaboration in the country cases varying by policy area**. Involvement of other multilateral institutions in the policy areas and countries reviewed included the Asian Development Bank (AsDB) in Cambodia and Lao P.D.R., and the EU (through its PHARE program) in Bulgaria.

Surveillance Country Cases

- **In several countries (Lao P.D.R., Slovenia, and Tunisia), staff reports noted the World Bank's activities and collaboration in governance-related areas where the Bank has expertise**. The involvement of the Asian Development Bank (AsDB) was also noted in the case of Lao P.D.R. The coordination of advice and assistance was noted primarily with respect to issues closely related to the Fund's core responsibilities—financial sector, public expenditure management, as well as the budgetary implications of privatization in structural reforms.

Use of Fund Resources Country Cases

- In **Bolivia and Cameroon**, where the Fund was heavily involved in efforts to improve tax administration that were included in the Fund-supported programs, the World Bank provided input in areas complementary to improving tax administration. In Bolivia, the Bank advised the authorities in the governance-related areas of judicial and civil service reform. In Cameroon, Fund staff relied on the Bank's input on forestry policy reforms germane to strengthening revenue administration. In **Azerbaijan**, expenditure management reform was an important part of the Fund-supported program. Related to this, the Bank assisted the authorities in setting up a procurement agency. Privatization is a primary area of Bank responsibility and expertise, and in both **Bulgaria and Indonesia** the Bank was actively involved through its own policy loans, with close collaboration between Fund and Bank staff. As regards the handling of corruption in **Kenya**, the issues that arose in the Goldenberg scandal lie in the Fund's areas of responsibility and the Bank was not involved in the discussions between Fund staff and Kenya authorities. However, the Bank (and bilateral donors) also suspended lending activities pending the satisfactory resolution of the scandal. In **Cambodia**, Fund staff relied on the World Bank and AsDB for the formulation of a forestry management policy that could be the basis of prior actions to resume Fund financial assistance.

- **The experience with Fund-Bank collaboration was positive, with some variation across countries.** In the case of Bolivia and Cameroon, collaboration on governance and in general was extensive.[1] For some of the other countries, temporary issues arose from differences between the Fund's and Bank's timetables. In Indonesia, for example, clear understandings were reached (after some initial delays in the early stages of the crisis) on lead areas of responsibility between Fund and Bank staff and policy matrices under the two institutions program/loan support were closely aligned. In none of the eight cases were any collaboration issues considered by Fund staff to have significantly affected progress with the program.

Box 5 (concluded). Collaboration with the World Bank and Other Multilateral Organizations

2. **Two areas of the OECD's governance-related activities—corporate governance and the bribery of foreign public officials—are of particular interest**. The OECD and the World Bank are leading the development of principles of corporate governance and the monitoring of their implementation. In May 1999, OECD Ministers adopted the OECD Principles of Corporate Governance, and in mid-2000, the World Bank developed an assessment template as the basis for a ROSC module on corporate governance. The Fund commented on the template and subsequent country modules; as of end-2000, ROSC modules have been produced (and published) for India, Malaysia, Poland, and Zimbabwe. Corporate governance issues are also addressed more generally in the Fund's surveillance and program activities. For example, in the Fund-supported program for Korea, the World Bank's matrix on corporate sector reform was attached to the authorities' November 1999 Letter of Intent. Also, the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies deals with corporate governance.

As regards the bribery of foreign officials, Fund staff attended the preparatory meetings of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which was adopted in 1997. The convention commits 34 signatory countries, including industrial countries and several emerging market economies, to adopt the principles embodied in the Convention. As of end-2000, 26 countries, had changed their domestic laws in accordance with the Convention.

[1] Both countries were participants in the 1998 pilot program for enhanced World Bank-Fund collaboration.

III. Conclusions

23. **The review indicates that the Fund has given more attention to governance issues in recent years as called for in the 1997 Guidance Note.** Indeed, the Fund has developed and applied its instruments for promoting good governance to an extent well beyond what was envisaged at the time of the GN, and these instruments will be central to a prevention-oriented governance strategy looking forward. The work on standards and codes has advanced rapidly, including with regard to the development of implementation modalities, and it is expected that this work will be increasingly integrated into the Fund's operations over time. This process, especially with respect to the financial, monetary and fiscal sectors, will entail Fund involvement in governance across a wider range of the membership. Key innovations under the PRGF and enhanced HIPC Initiative (the participatory process underpinning the preparation of PRSPs, and improvements in tracking the use of aid flows for poverty reduction) should also help further strengthen members' focus on governance issues.

24. **The Fund has also gained valuable experience through its involvement in specific governance issues in a number of policy areas.** This involvement has been based on the broad criterion that the governance issue in question has significant macroeconomic implications. Nevertheless, difficult judgements have had to be made in each case to determine the appropriate scope of the Fund's involvement—in essence where to "draw the line." The present approach of applying judgement within broad boundaries could entail risks in terms of exposure to pressure from interested parties and also, more broadly, of mission creep. At the same time, narrower boundaries could unduly limit the Fund's involvement in individual cases, and defining such boundaries would require further experience. Given these considerations, the staff proposes to continue the present pragmatic approach to involvement in specific governance issues and, subject to Directors' views on this paper, to revisit this question in due course on the basis of further experience. The staff will ensure that each case incorporates a clear elaboration of the macroeconomic considerations on which it is based.

IV. Issues for Discussion

25. Do Executive Directors agree that the strengthening of the Fund's instruments to promote good governance, associated *inter alia* with architecture-related initiatives, has been appropriate and should be the centerpiece of the Fund's governance strategy?

26. What are Directors' views on the experience with the Fund's involvement in governance issues in specific country cases? Has the right balance broadly been struck? Do Directors agree that the present pragmatic approach of applying judgement, within the relatively broad boundaries set by the GN, should be maintained? Do Directors see scope for setting narrower boundaries and would they like to return to this issue on the basis of further experience?

27. Do Directors agree that the present approach to collaboration with other institutions should continue?

28. Do Directors agree that greater attention should be paid to the two-sided nature of corruption, following-up on OECD-led initiatives?

29. Do Directors agree that this paper should be published following the Board discussion?

A SURVEY OF THE FUND'S INVOLVEMENT IN GOVERNANCE ISSUES IN SURVEILLANCE AND USE OF FUND RESOURCES, 1994-99

Methodology

A survey covering 1994-99 was conducted to shed light on the comprehensiveness, proactiveness, and evenhandedness of the Fund's involvement in governance issues—areas in which the 1997 Guidance Note called for greater attention. Summings-Up of Article IV consultation discussions were examined for the presence of governance-related recommendations, and requests for use of Fund resources were reviewed to identify governance-related conditions they contained. For the purposes of the survey, conditionality included structural performance criteria, conditions for completing reviews, and structural benchmarks. All information on conditionality data was taken from the MONA database.[1]

Governance issues were grouped into five categories: fiscal and public sector reforms; banking and financial sector reforms; legal and judicial system reforms; improvements in statistical and information flows; and transparency and accountability in public resource management; examples of issues included are given in Box 2. The coverage of governance issues aims to encompass those issues related to economic aspects of governance to which the Fund Board has given attention. As a result, the coverage is broad and not restricted to areas within the Fund's primary responsibility.

The categories overlap somewhat in terms of policy area, especially transparency and accountability, and to a lesser extent, legal and judicial reform. For the purpose of the survey, decisions were made as to where reforms that fall in overlapping areas would be classified. For example, changes to the structure and organization of fiscal operations are covered under fiscal and public sector reform, while the elimination of exemptions, clarification of rules to reduce discretion by officials, budgetary consolidation, and strengthening incentives to officials for resisting corruption are covered under transparency and accountability.

The survey covered governance-related recommendations in Article IV Summing-Ups rather than in staff reports. The reason for this was to focus on the more important issues on which the Executive Board expressed its views (only recommendations supported by a majority of the Executive Directors were included). In the program cases, the focus on conditions served to ensure that the issues considered were both of macroeconomic relevance and important to achieving the program's objectives. Clearly the Fund's role in promoting good governance is

[1] The database for monitoring Fund arrangements (MONA) was established in 1992 to collect, in a systematic way, information about Fund-supported programs, including information on conditionality. The database covers stand-by, extended, and ESAF/PRGF-supported arrangements. Country teams report at the time of program approval and for each subsequent review.

much broader than captured by this approach. For instance, the dialogue between the Fund and a member during the Article IV consultation process goes beyond the Chairman's Summing Up of the Executive Board's discussion, and in program discussions many important measures are agreed that are not translated into formal conditions. In addition, while the staff and management may often raise governance matters in discussions with country authorities, they are brought to the Board's attention only when they raise significant macroeconomic or safeguard issues. Nonetheless, the approach provides useful insights.

Results

Surveillance

During 1994-99, the Executive Board held 822 consultation discussions covering 182 countries, including 56 programs for 28 countries.[2]

- **The most notable result of the survey is an increase in the proportion of Board consultation discussions in which governance was addressed** from 18 percent in 1994-95 to 62 percent in 1998-99. This increase occurred for all country groups (Figure 1).

- In Article IV consultations in which governance issues were raised, on average about three governance-related issues were raised per consultation Summing-Up.

- Transparency and accountability, in particular in public resource management, was the area of governance most frequently addressed; legal and judicial reforms came up the least (Figure 2). There was an increase in attention to financial and banking sector reforms during 1996-97.

- Within the category transparency and accountability, explicit references to corruption and/or fraud occurred on 48 occasions for 34 countries, amounting to 4 percent of all governance issues raised.

Use of Fund resources

The survey covered program requests and reviews. In total 158 program requests (arrangements) by 84 countries were reviewed, 26 of which did not include governance-related conditionality. Thus, in the end, 132 programs covering 77 countries were included in the survey database. About two thirds of programs were for developing countries, and one third for transition economies; there was one program with an advanced economy (Korea).

[2] Country groupings defined according to WEO. For 1994, the surveillance database covers only the second half of 1994.

- **The most notable result of the survey is the increase in the average number of governance conditions in programs that included such conditions, from 3 ½ in 1994-95 to 6 ½ in 1998-99** (Figure 3).

- The average number of conditions during 1994-99 was higher for transition economies, about six per program, than for developing countries, about four per program.[3]

- The proportion of programs which had governance conditions increased by a small amount during 1994-99, reflecting an increase in the coverage of transition economies.

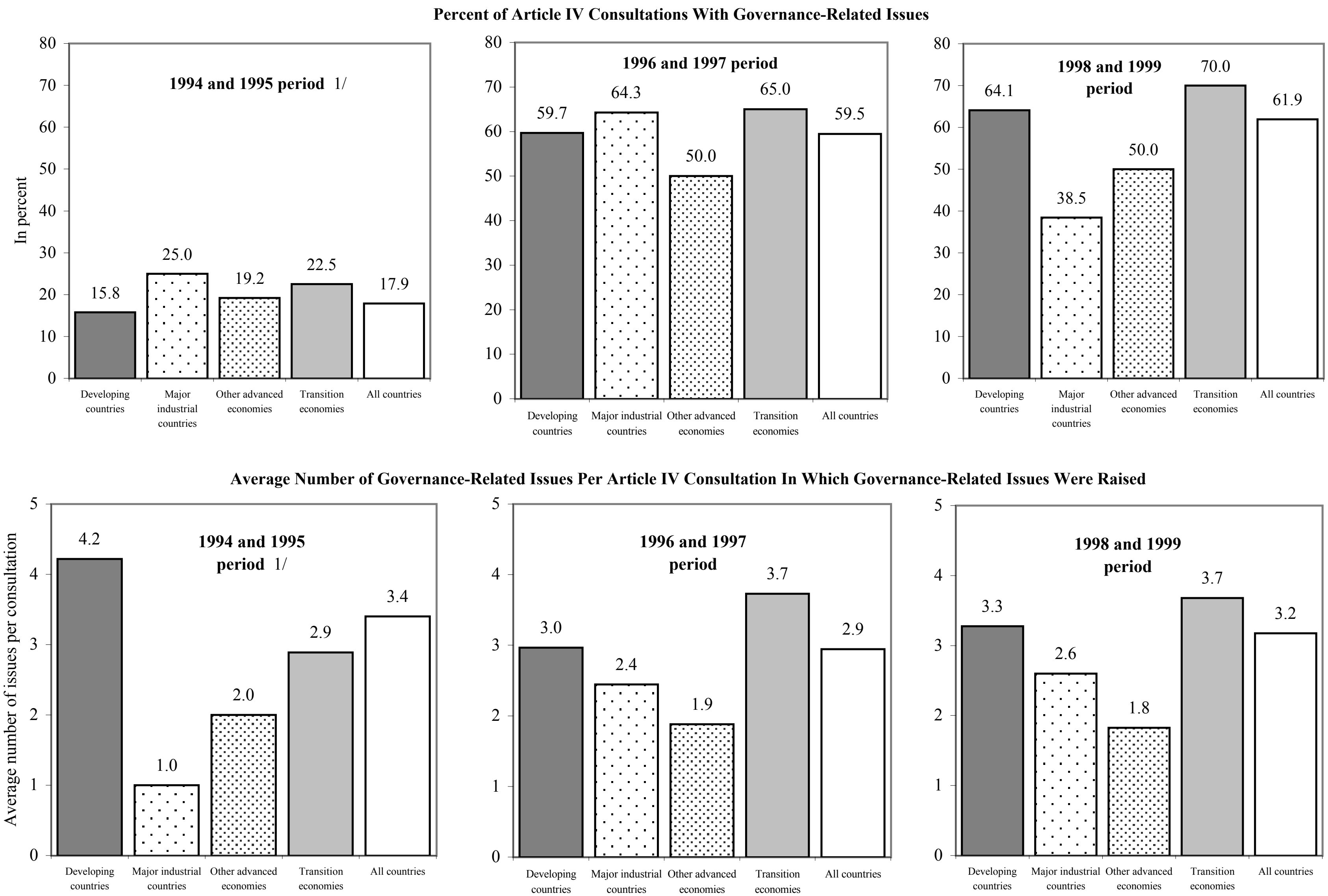
- The governance conditions most often addressed were transparency and accountability issues, notably in public resource management; financial and public sector reforms also commanded considerable attention (Figure 4).

- Within the category of financial sector reform, prudential supervision was most often addressed with conditionality, and increasingly so over time. Accounting/auditing, capacity-building and privatization accounted for most of the program conditions within the category of public sector reform. Within judicial reform, conditions appeared most frequently for market and anti-monopoly regulations, commercial codes and court processes, and property rights.

- Specific corruption and fraud-related conditions were included in nine programs for five countries.

[3] Korea, the only advanced economy with a program during this period, had nine governance-related conditions in 1996-97.

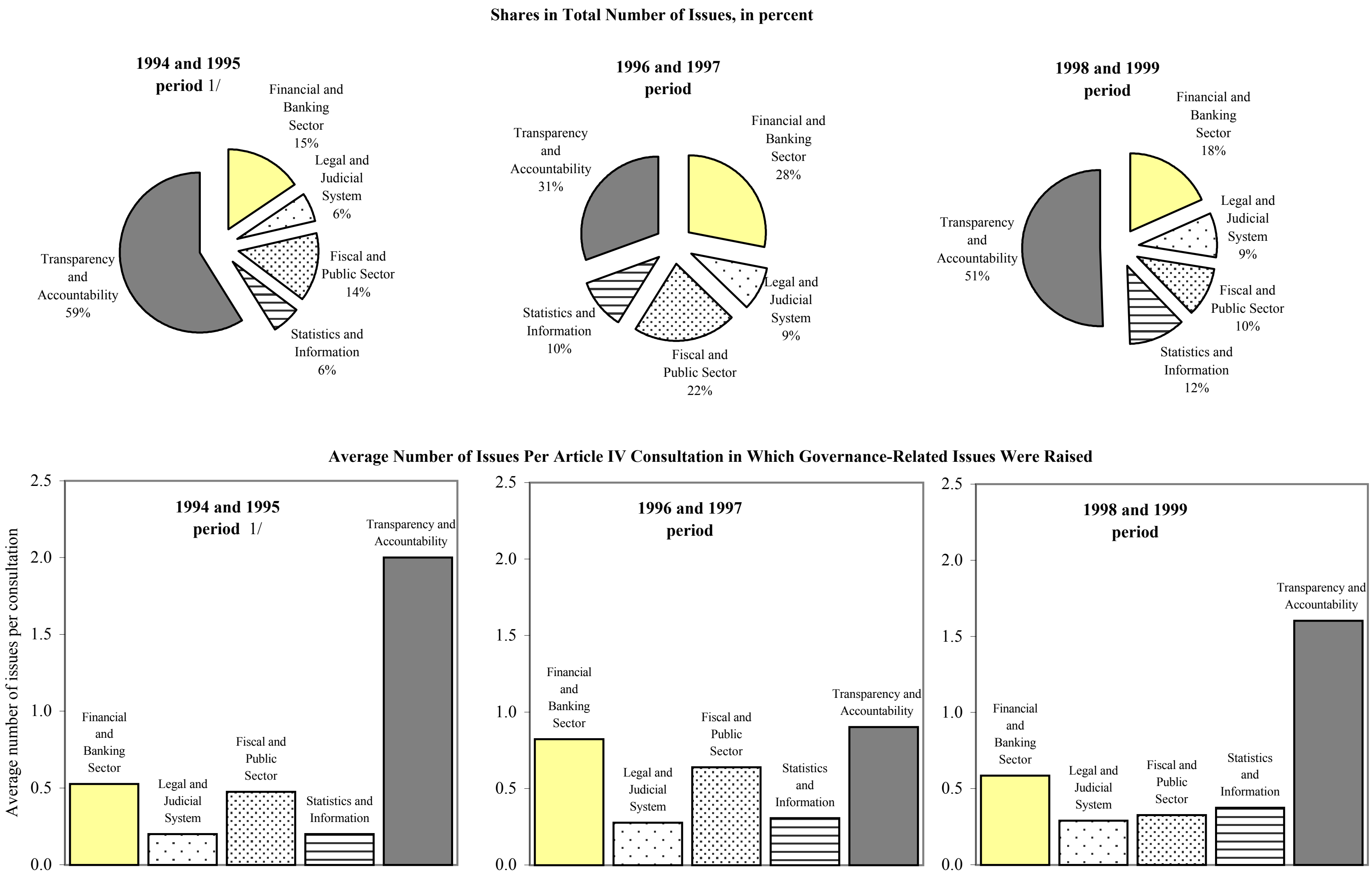
Figure 1. Article IV Consultations With Governance-Related Issues by WEO Country Group, 1994-99



Source: IMF Documents.

1/ Data for 1994 covers Article IV Consultations only from June to December.

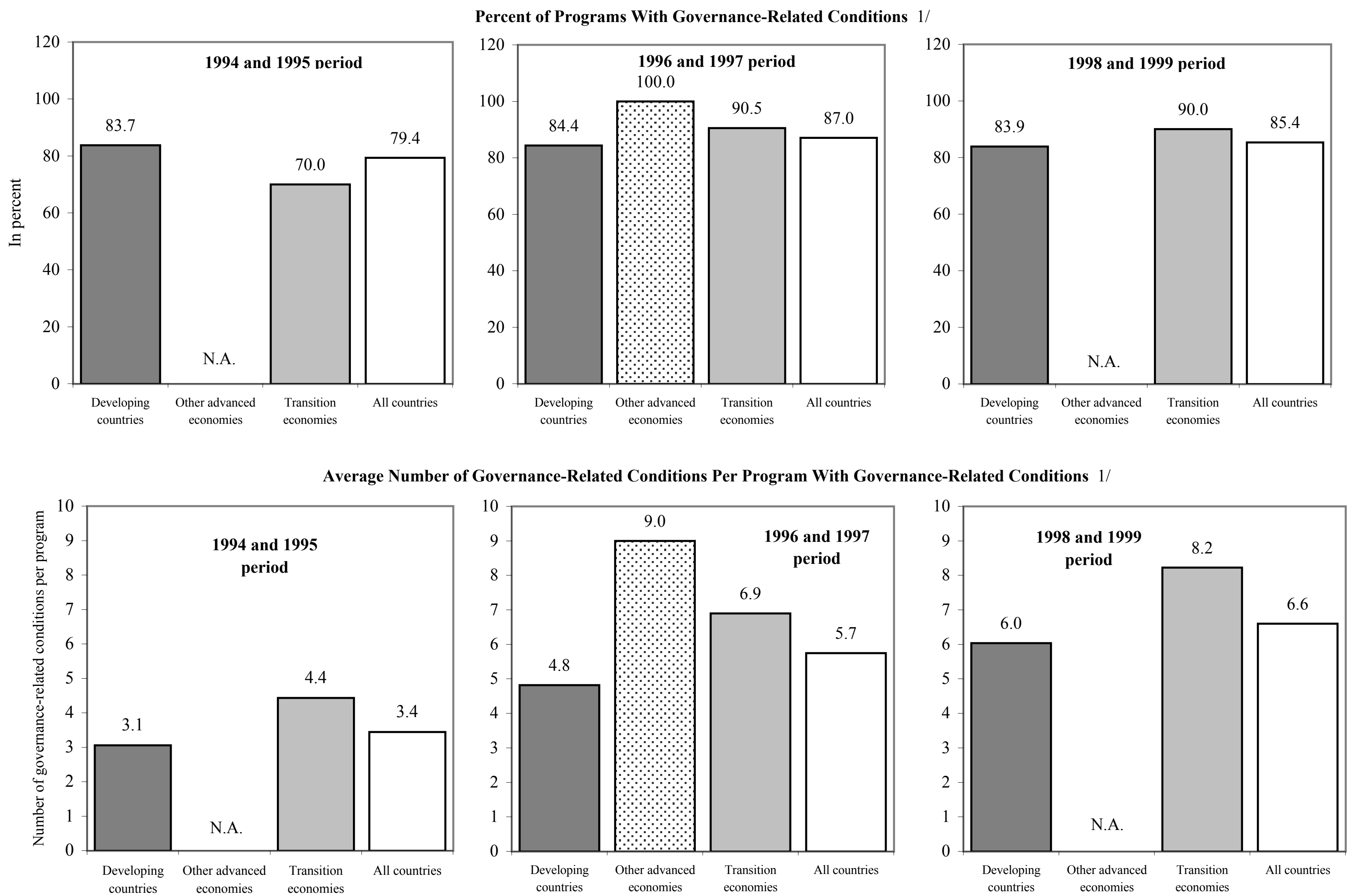
Figure 2. Article IV Consultations With Governance-Related Issues by Policy Area, 1994-99



Source: IMF Documents.

1/ Data for 1994 covers Article IV Consultations only from June to December.

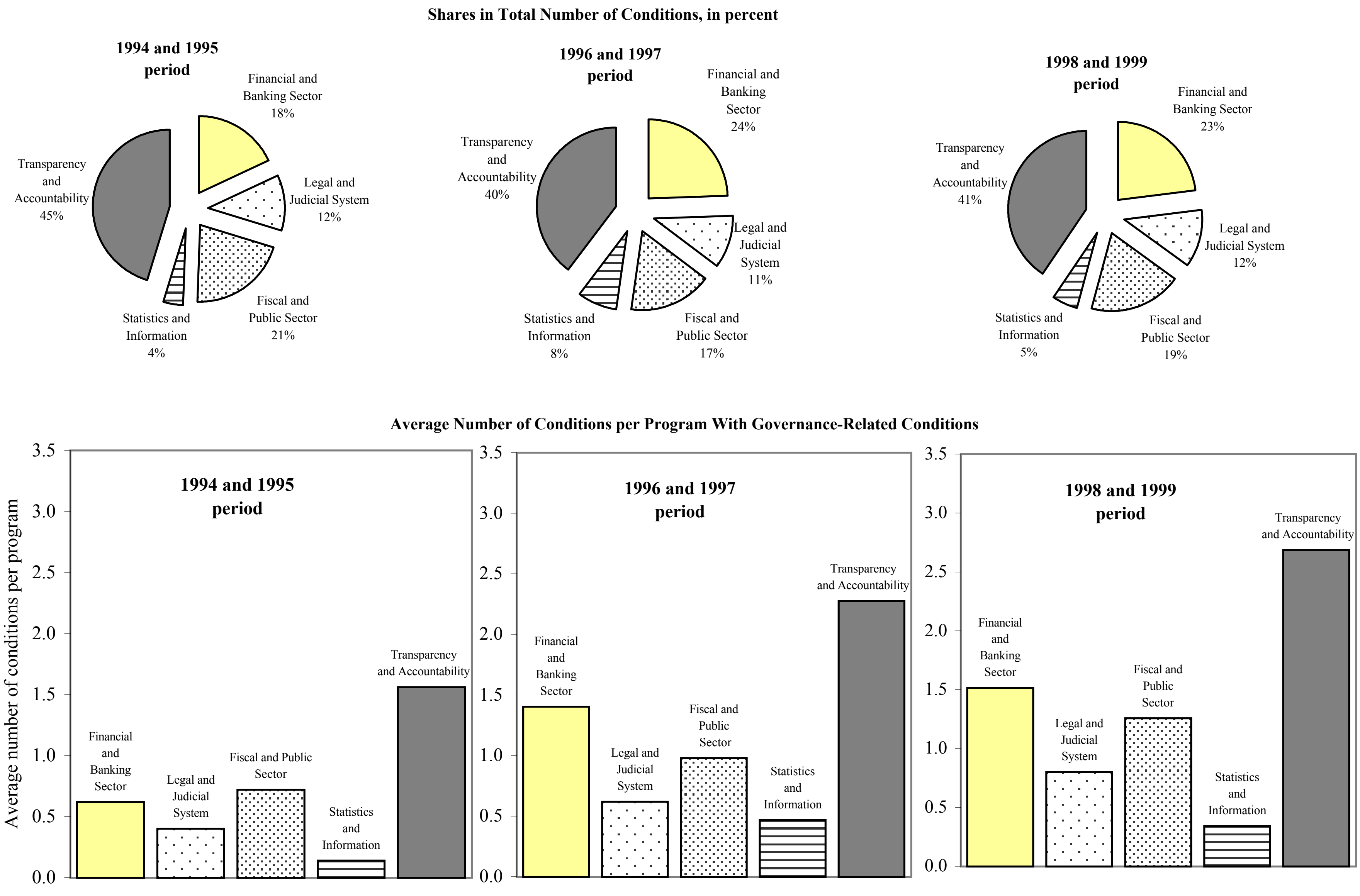
Figure 3. Programs With Governance-Related Conditions, By WEO Country Group, 1994-99



Source: IMF Documents.

1/ There were no programs for "other advanced economies" during the periods 1994-95 and 1998-99.

Figure 4. Programs With Governance-Related Conditions by Policy Area



Source: IMF Documents.

THE FUND'S APPROACH TO GOVERNANCE IN SURVEILLANCE AND USE OF FUND RESOURCES—ILLUSTRATIVE COUNTRY CASES

Surveillance

The Fund's approach to governance issues in the context of surveillance was reviewed in-depth in a sample of eight countries. The countries were selected not on the basis of judgment about the relative seriousness of any governance issues but rather to provide coverage of economies at different stages of development. The sample includes two advanced economies (Iceland and Italy), four developing countries (Botswana, Guatemala, Lao P.D.R., and Tunisia) and two transition economies (Poland and Slovenia). The review examined Article IV staff reports discussed by the Executive Board during the period 1997-99 subsequent to the issuance of the Guidance Note; typically there were two consultations. The Chairman's Summings Up of the Board's discussion were also reviewed. The review took account of governance-related issues mentioned by a majority of Executive Directors in the discussion or noted in the appraisal sections of staff reports. It should be noted that the definition of good governance in the Guidance Note that provides the framework for this analysis—improving public resource management, and supporting an environment conducive to efficient private sector activities—is relatively broad and as such covers many structural policy areas. The analysis does not distinguish issues raised first by the authorities in describing their policies from those mentioned by the Fund, and the fact that issues were discussed does not imply a negative judgement about governance.[1]

The issues discussed were predominantly within the area of Fund primary responsibility (see Box 6). In staff reports, fiscal, public enterprise (except in Iceland and Italy), and financial sector issues were mentioned in all cases. Data quality and dissemination issues were covered in many cases (Botswana, Guatemala, Italy, Lao P.D.R., and Tunisia). The following issues were addressed in relatively few cases: trade, civil service, legal, judicial, land, health and pension reforms, plus corporate governance. In almost all cases (except in Guatemala and Italy) the reports noted the macroeconomic relevance of the governance issues discussed. In some cases, quantitative estimates were given for specific issues, in others the relevance was phrased in terms of improving growth prospects through, for instance, greater efficiency and diversification of exports.

[1] Indeed, the countries in this sample are viewed in surveys (to the extent that they are covered) as better than average with regard to governance. Iceland, Botswana, Slovenia, Tunisia, Italy, and Poland all ranked (in that order) in the top (i.e. positive) half of the latest perceptions indicator compiled by Transparency International (Guatemala and Lao P.D.R. were not among the 90 countries for which the indicator was compiled); Botswana, for example, was the best-rated African country.

The attention and priority attached to governance issues in the Board Summings Up was selective. Issues in the Fund's core areas of responsibility tended to be picked up more than those in non-core areas. Most frequently cited were those in the areas of fiscal and financial sector reform (virtually in all countries), and data quality and privatization.

The Board's recommendations in the Summings Up were typically cast in general terms, for example, highlighting the importance of the issue and the need for reform. In staff reports, too, recommendations were usually phrased generally, but the reform needs were often specified more narrowly than in Summings Up. Specific corrective actions were mentioned only in one case (Lao P.D.R.) in the context of program negotiations and an extensive technical assistance effort by the Fund. For all of the sample countries, issues raised in the first staff report reviewed were followed up in subsequent consultation discussions and Summings Up. Staff reports described to varying degrees the progress made.

In several countries (Lao P.D.R., Slovenia, and Tunisia), staff reports noted the World Bank activities and collaboration in governance-related areas where the Bank had expertise, and in one case (Lao P.D.R.) also the involvement of the Asian Development Bank (AsDB). There were references to coordination of advice and assistance primarily on issues close to the Fund's core responsibilities (financial sector, public expenditure management, plus the budgetary implications of privatization).

Use of Fund resources

The Fund's involvement in governance-related issues in public sector resource management was examined in nine program cases. The choice of program case studies aimed to cover issues in public sector resource management that were important for achieving program objectives and, to the extent possible, provide a broad coverage of regions (including both developing and transition economies); the choice of countries does not imply a judgment about the quality of governance relative to program countries not included in the sample. The review covered primarily program involvement during the period 1997-99, and five areas of public resource management are covered: (i) financial discipline in state-owned enterprises (SOEs) in Bulgaria and Indonesia; (ii) revenue administration in Bolivia and Cameroon; (iii) expenditure management in Azerbaijan and Côte d'Ivoire; (iv) instances of corruption in Cambodia and Kenya; and (v) state monopolies in Mali and Indonesia.

Financial Discipline in State-Owned Enterprises (SOEs)—Bulgaria and Indonesia

Both Bulgaria and Indonesia pursued a strategy of broad-based privatization and deregulation to improve the financial discipline and efficiency of the state-owned enterprise (SOE) sector. SOEs remaining in the public sector would be subject to tighter financial controls and specific performance requirements. In Indonesia, efforts focused in particular on four large state agencies: BULOG, Pertamina, PLN and the Reforestation Fund (RF). In both countries, the SOE sector was a large component of the economy and, while comprehensive financial data were not available, it was clearly a source of inefficiency and a burden on the budget and banking sector. In an environment of lax financial oversight and soft budget constraints, serious concerns existed about the likelihood of widespread financial irregularities. As privatization is a primary area of World Bank responsibility, the Bank was involved in these areas in both of these countries, and there was close collaboration between the Fund and Bank staffs.[2] In Indonesia, after an initial delay in the early stages of the crisis, clear understandings were reached on lead areas of responsibility between the Fund and Bank staff, and policy matrices under the two institutions program/loan support were closely aligned.

At the outset, the lack of adequate information on the financial performance of SOEs, especially the largest, meant that the completion of audits was a critical first step. This inevitably delayed progress with restructuring enterprises. In Indonesia, it was only after special audits of BULOG, Pertamina, PLN and the RF had revealed large-scale losses and financial malfeasance that more narrowly focused investigative audits were initiated that could form the basis of targeted remedial actions.

As privatization took hold in Bulgaria, and as SOEs in Indonesia were scrutinized more intensely, it became apparent that to achieve effective financial discipline complementary reforms were required in areas that are not core Fund responsibility. In Bulgaria, programs incorporated measures to facilitate bankruptcy procedures, such as improving bankruptcy laws and expediting court processes. In Indonesia, the program contained similar measures but these were motivated by the need for corporate restructuring rather than SOE reform. In both countries, efforts were made to raise accounting and auditing standards to international levels to, *inter alia*, strengthen the quality of enterprise financial data available to shareholders, creditors, and the public (for example, Bulgaria introduced International Accounting Standards for SOEs and in 1999 prepared a ROSC module on the Implementation of Standards and Codes).

SOEs remaining in the public sector (in most cases pending privatization) proved adept in by-passing efforts to strengthen financial discipline. Moreover, this was made possible through political interventions, or weak enforcement on the part of civil servants. For example, in Bulgaria, SOEs accumulated tax arrears (as well as interenterprise arrears) as a substitute for bank credit which had been cut off. To help reduce the vulnerability of civil servants to vested interests, the authorities introduced a code of conduct, including dismissal for receiving bribes. In Indonesia, even with improvements in court procedures in place, the susceptibility of judges and other key personnel to bribery remained a serious concern.

Progress under the Fund-supported programs was monitored through program reviews, drawing on detailed lists of measures in the authorities' LOIs (Table 1). In the case of Bulgaria, SBMs and SPCs were introduced in 1999, designed with Bank input to help

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[2] In Bulgaria, the Bank had two FESALS (Financial and Enterprise Sector Adjustment Loans) in 1997 and 1999 to support the privatization of SOEs. In Indonesia, support for privatization was provided under the Policy Reform Support Loan (PRSL).

achieve the targets for the overall number of SOEs to be privatized. In Indonesia, there were few SBMs and SPCs directly connected to SOE reform but the program contained a large number of structural commitments in other areas.

Revenue Administration—Bolivia and Cameroon

Improvements in revenue administration in Bolivia and Cameroon were deemed necessary to raise budget revenues from relatively low levels. In both countries, the strategy was based on a comprehensive reform of tax administration with an emphasis on customs administration in Bolivia, and on the reform of the state oil company (SNH) in Cameroon. In both cases the revenue administration reform efforts drew heavily on Fund technical assistance. Collaboration with the World Bank was extensive with respect to the Bank's assistance in the related areas of judicial and civil service reform in Bolivia and forestry policy reform to strengthen revenue generation in Cameroon (see below).[3]

Establishing an efficient and more transparent tax system involved a wide range of micro-level reforms (such as the issuance of tax identification numbers). Technical assistance to complement domestic capacity was essential. To help sustain the pace of reform, the authorities' memoranda of economic policies contained large numbers of micro-level reform commitments. In light of the time needed to implement the reforms, interim stop-gap measures were introduced. In Cameroon, a large part of the responsibility for collecting customs duties and domestic taxes was delegated in 1995 to a private preshipment inspection company, Societe Generale de Surveillance (SGS), and in Bolivia (1999) customs personnel were replaced.

As improvements in the tax system were established, programs placed increasing emphasis on accountability and enforcement. In both countries, there was a focus on developing a more professional civil service that would be less vulnerable to corruption and fraud. For example, in Cameroon, the authorities in 1997 undertook to improve financial incentives for tax officials, and in 1999 introduced a code of conduct for tax and customs officials. In Bolivia, the absence of a professional civil service undermined reform efforts. Typically, the average tenure of each official was under two years. The system of political patronage, combined with very low remuneration and benefit levels, as well as the absence of a mechanism to punish malfeasance, contributed to poor governance. Since 1999, efforts to overhaul the civil service have been underway, including the introduction of transparent recruitment policies and a code of ethics for customs administration officials.

In Cameroon, the reform of the state oil agency (SNH) was protracted. In part this reflected the monopoly position and associated large rents of SNH, and the role of strong (connected) vested interests. Adequate and timely financial information critical for

[3] Both countries were participants in the 1998 pilot program for enhanced Bank-Fund collaboration.

successful reform was absent, and independent audits—even when they were resisted in the SOE—proved helpful in filling this gap. In 1997, an independent financial audit of the SNH was called for under the Fund-supported program as a basis for preparing an action plan. This was followed up by further operational and management audits, including one to assess implementation of the action plan. After some delays, the second round of audits—the operational and managerial audits of the oil sector—and the adoption of the international accounting standards—part of the initial 1998 action plan—were completed by end-2000. Cameroon completed a ROSC in 2000 on fiscal, monetary, and financial transparency.

Program monitoring in the area of revenue administration reform in both countries relied mainly on structural PCs (SPCs) and structural benchmarks (SBMs). In Bolivia, partial or non-implementation of reforms led to the rephasing of SBMs with the result of an increasing number of SBMs over the course of the programs. Only one SPC was established (for mid-1999), for the submission to Congress of draft legislation to strengthen the authorities' ability to enforce tax laws—previously a SBM—as an important threshold for the overall strategy. Cameroon's programs in 1998-99 contained specific review clauses but only for non-oil revenue performance. They also contained three SPCs and a number of SBMs for critical steps in the program. For example, given that forestry was an important source of revenue, an SPC called for the completion of an independent study (under the third annual program of the 1998 ESAF arrangement) as a basis for a tax reform plan.

Public Expenditure Management—Azerbaijan and Côte d'Ivoire

Establishing sound public expenditure management was a central element in the Fund—supported programs of Azerbaijan and Côte d'Ivoire since the credibility of the programs' fiscal targets depended on it. In both countries, there was sizeable off-budget and unauthorized spending and, as a consequence, sizeable expenditure arrears. In Côte d'Ivoire, other serious governance problems were ongoing (involving customs and tax administration, and the commodity price stabilization fund) and eventually caused the Fund-supported program to go off track.

The problems of poor expenditure management and their adverse consequences took some time to identify. Indeed, in the case of Côte d'Ivoire, staff were initially alerted by the private sector complaints about arrears and by the EU concerning improper use of aid resources. The approach in both countries sought to establish effective centralized control mechanisms as well as transparency and accountability in budget procedures. In Côte d'Ivoire, this required strengthening the existing budgetary framework, while in Azerbaijan the outmoded central planning budgetary spending framework had to be replaced in its entirety. The design and implementation of reforms was based on FAD technical assistance. In Azerbaijan the World Bank assisted in setting up a procurement agency.

In Côte d'Ivoire, a two-pronged strategy was adopted. One set of measures, reflecting the lack of adequate information, comprised the clarification of off-budget spending under the special accounts and an audit of expenditure commitments and government arrears. The second prong was the centralization of spending authority, for example, through the reintegration of special accounts within the budget, the introduction of monthly spending ceilings, and strengthened control of commitments. In addition, a new computerized expenditure management system was installed with FAD technical assistance. In Azerbaijan, a Treasury Central Unit (and its legal framework) was to be established as the anchor for expenditure management. Also, the bank accounts of budgetary institutions were to be merged into a single Treasury account. In addition to several interim measures such as daily cash management controls, elements of a full-fledged management system were gradually introduced.

Immediate, remedial measures were implemented, albeit with delays. However, compliance with monthly spending plans and the systematic recording of spending was uneven and eroded the effectiveness of reforms. In Côte d'Ivoire, this contributed to continued unauthorized spending and the further accumulation of arrears. In Azerbaijan, weak observance of interim measures and good practice procedures also led to the further accumulation of arrears, and the introduction of stop-gap measures to control expenditure commitments. In addition, in 2000 Azerbaijan prepared a ROSC fiscal transparency module.

The experience of the two countries shows that early attention to accountability and related enforcement mechanisms is important to help ensure the effectiveness of reforms. This was also borne out by the revenue administration reform described above. In this regard, the early elimination of opportunities for corruption through the simplification of existing systems can be helpful. For example, in Côte d'Ivoire while the number of links in the chain of expenditure management was reduced, the chain remained overly long.

The Fund-supported programs for Azerbaijan and Côte d'Ivoire relied on program reviews in addition to SPCs and SBMs for monitoring. In Azerbaijan, the LOI included a detailed list of measures. The 1998 Cote d'Ivoire program contained one SBM related to civil service reform, outside the Fund's core responsibilities but with a major impact on governance in expenditure management.

Large Instances of Corruption—Cambodia and Kenya

In Cambodia and Kenya, large incidents of corruption led to the suspension of Fund-supported programs. The Fund resumed support upon the implementation of satisfactory corrective action after a long delay and extensive discussions between staff and the authorities. In Kenya, two incidents of fraud during 1988-93 were revealed by the Attorney-General reports on the 1992-93 and 1993-94 government accounts: irregular fiscal payments under an export compensation scheme (amounting to over 1½ percent of GDP)—the so-called Goldenberg scandal—and payment by the Central Bank for foreign exchange that was not delivered (about 4½ percent of GDP). While some three quarters of the misused funds were recovered, the ramifications of the Goldenberg scandal led to the suspension of Fund support in 1997 which was not resumed until 2000.

In Cambodia, staff became aware of illegal logging, in part as a result of evidence published by the Global Witness group in 1996. In addition, there was tax evasion on legal logging. The government revenue foregone based on proper resource pricing was estimated to be 4 percent of GDP in 1997-98. Furthermore, the logging activities undermined the implementation of environmentally sound and sustainable forestry management. Notwithstanding generally good macroeconomic performance, the absence of a sound forestry policy was considered to put in doubt the medium-term sustainability of the fiscal and external position.

The incidents of corruption, in addition to threatening the successful implementation of the program, also put in doubt the purpose of the use of Fund resources. Given the seriousness of the incidents, continued support would have damaged the credibility of the Fund. Thus, Fund support of the authorities program was suspended or delayed and corrective measures were prior actions for its resumption. The prior actions sought to recuperate misappropriated funds, have sanctions implemented on the involved individuals, and begin the establishment of specific anti-corruption policies and institutions to prevent a recurrence. The latter was especially important as the exposed incidents were likely to be symptomatic of more widespread corruption, and the absence of effective remedial action could lower the perceived risk of corrupt practices.

The Fund's actions to suspend support took place against a background of broad donor approval. Indeed, the potential misuse of funds in Kenya, and environmental concerns in Cambodia, had already led many donors to reduce or suspend their aid (including the World Bank, in the case of Kenya). The resulting cutback in external assistance made it impossible to design a credible adjustment program that could be supported by the Fund. With Kenya, after ESAF negotiations had broken down in 1994, a new ESAF-supported program was eventually agreed in 1996. Agreed measures to prevent a recurrence of the incidents were not implemented, however, and the first review of the program could not be completed and the first annual arrangement elapsed. With Cambodia, lack of progress in improving forestry practices was cited as one of the main reasons why the Fund announced in November 1996 to cancel an installment under the second annual arrangement of the ESAF-supported program. Prior actions agreed for a third annual arrangement were not implemented and in August 1997, the ESAF lapsed.

The strategy to address corruption in both countries comprised four elements: investigation to verify the fraud and identify culpability, prosecution/removal from public office of guilty parties, recovery of funds, and remedial actions to prevent a recurrence. **In Kenya**, the key prior action was for the Attorney General to prepare a report to assess the potential liability of the involved public officials, publish the report, and commence promptly any civil or administrative actions that were to be recommended in the report. In addition, the Kenya Anti-Corruption Authority (KACA) was to be established. Initial drafts of the report were unsatisfactory to the staff and, amongst other things, raised doubts about the commitment of the authorities to improved governance. This state of affairs persisted until 1999, despite various adaptations to the prior actions. In July 1999, a new economic team came into office which proposed a comprehensive program to improve governance and counter corruption and implemented many measures up front. This track record re-established the credibility of the authorities' commitment in the assessment of staff, and led to the resumption of Fund support. Key was further progress in creating a climate conducive to good governance. The pro-active attitude of the authorities allowed a shift in emphasis to the forward-looking elements of the program. Hence, while the follow-through actions to the Attorney General's report that was eventually produced were still pending—and which was part of the original 1997 prior action—it was decided to resume Fund support.

The experience in Kenya highlighted the complications that may arise when governance issues involve the domestic legal system and court processes. The prior actions had to take account of the fact that criminal charges concerning the Goldenberg scandal were *sub judice*. Also, the outcome of court decisions and use of appeal processes contributed to delays in satisfactorily implementing the prior actions. Respecting the rules of the Kenya judicial system hence complicated the assessment of the authorities' commitment to achieving progress and restore credibility. Most recently, the Kenyan High Court has found that the KACA as currently formulated is unconstitutional, and Parliament has rejected the Code of Ethics Bill.

In the case of Cambodia, the emphasis was on adopting a transparent, monitorable, environmentally sustainable forestry policy. Fund staff relied on the World Bank and Asian Development Bank (AsDB) for the design of the policy. Eventually, the formation of a coalition government in November 1998 enabled headway to be made in putting in place such a policy. In early 1999, many prior actions had been met, and by the end of the year, Fund support was renewed, subject to the authorities' compliance with further prior actions on implementing the forestry policy. The new arrangement also required a review of the policy in consultation with the Fund, World Bank, and AsDB staff. Global Witness was appointed as an official independent monitor of Cambodia's forestry policy.

State monopolies—Mali and Indonesia

State monopolies in Mali and Indonesia were seen as having significant implications for economic performance and poverty. In Mali, cotton is the lifeline of the economy—it accounts for nearly half of export revenue, almost ten percent of GDP, and about six percent of government tax revenue. Furthermore, about a third of the population depends directly on cotton for its livelihood. The sector is controlled by a single, vertically-integrated, state-run cotton company, the *Compagnie Malienne pour le Développement des Textiles* (CMDT). The CMDT controls all aspects of the cotton sector in Mali, including: sale of seeds; purchase of seed cotton; ginning, import, transportation, sale and distribution of fertilizer, pesticide, seed cotton, and cotton fiber; crop financing; and marketing of cotton fiber. In addition, the company has built and maintained roads to facilitate the transport of cotton. However, the controlled CMDT procurement price for cotton is considerably below the procurement price in fully liberalized markets in other countries. This price difference levies an implicit tax on cotton farmers in Mali which remains significant even after taking into account the value of services provided free by the CMDT to farmers. The CMDT also contracts state-guaranteed loans every year with the banking system that absorb a substantial part of the overall bank credit to the economy (up to 17 percent of total credit in 1999), thus potentially crowding out other activities.

The Malian authorities' strategy for the cotton sector under the program supported by a PRGF arrangement features: an independent financial audit of the CMDT completed in July 2000; measures to strengthen the transparency and effectiveness of CMDT's financial management and reduce production costs; and a strategy for withdrawal of CMDT from provision of public services and preparation of the sector for competition.

In Indonesia, economic institutions under the Suharto regime featured a number of state monopolies, particularly in the agricultural sector. Fund-supported programs have included measures to address inefficiencies and distortions associated with these monopolies. One such monopoly with a significant poverty impact concerned clove marketing. In the past, most of the clove production in Indonesia was bought by a small number of domestic local cigarette manufacturers, and the clove market was *de facto* monopsonistic. In 1991, the Suharto government established a marketing board for cloves, the Clove Marketing and Bufferstock Agency (BPPC), with the stated rationale of strengthening the market position of Indonesia's 500,000 clove farmers. However, the introduction of the marketing board, which became the sole buyer of the crop from farmers and the sole supplier to cigarette manufacturers, weakened the market position of both farmers and manufacturers, and gave rise to significant rents accruing to BPPC and considerable inefficiencies. The price paid to farmers for their crop was below competitive market levels, thus distorting incentives in agricultural production, lowering output, and increasing poverty. Also the price paid by manufacturers was above competitive market levels, thus also impacting output. As a result of artificially high prices for cloves to be sold to cigarette manufacturers, BPPC accumulated excess clove inventories of up to 167,000 tons—equivalent to almost two and a half years' average production. In spite of BPPC's sizeable buy-sell price margin and an initial concessional loan of about $325 million dollars from Bank Indonesia—roughly half the central bank's annual budget for agricultural subsidies—the large excess stocks contributed to substantial losses, which were financed by state banks. The large depreciation of the rupiah that occurred during the 1997/98 financial crisis significantly improved the potential incentives for clove exports. However, the BPPC only partly passed the depreciation through to domestic prices, and hence did not permit farmers to fully respond to the change in relative prices. A fuller pass through also would have mitigated the negative effect of higher import prices on clove farmers.

An indicator of the impact of the BPPC is the effect on prices and the incomes of poor farmers of the removal of the marketing board. Six months after the removal of BPPC by the new government in May 1998, the price of cloves paid to farmers had nearly tripled, from Rp 2,500/kg paid by the BPPC in the fall of 1997 to Rp 7,000/kg in October 1998; the increase was well in excess of the depreciation of the Rupiah/US dollar exchange rate (slightly over 100 percent), while international market prices for cloves were broadly stable in US dollar terms over the same period.

Annex Table 1. Monitoring of Governance-Related Reforms in Selected Program Cases[1]

Country[2]	Number of Structural Performance Criteria (SPC)	Number of Structural Benchmarks (SBM)	Number of Prior Actions (PA)	Remarks
Privatization of State-Owned Enterprises				
Bulgaria	-	-		
SBA/STF (1994)	-	-	3, 9[3]	
SBA (1997)	8	7		•Completion of 3 SBMs was delayed and they were subsequently converted to SPCs.
EFF (1999)[4]				
Indonesia				
SBA (1997)	2	7	2	
EFF (1998)[5]	2	3	-	
Revenue Administration				
Bolivia				
PRGF I.1 (1994)		2		•Completion of the SBM on submitting new draft of customs law to Congress was delayed and rolled over as a SBM in successive programs
PRGF I.2 (1996)		3	-	
PRGF I.3 (1997)		9	-	
PRGF II.1 (1998)	-	17	-	
PRGF II.2 (1999)	2	8	-	•The 2 SPC's, on submission of amendments and legislation on tax system reform, were previously SBMs, for which completion had been delayed since PRGF II.1.
Cameroon				
PRGF.I.1 (1997)	2	3	-	
PRGF.I.2 (1998)	1	5	-	
PRGF.I.3 (1999)	1	3	-	
Public Expenditure Management				
Azerbaijan				
PRGF/EFF (1996-1999)	2	3	-	

Annex Table 1. Monitoring of Governance-Related Reforms in Selected Program Cases[1]

Country[2]	Number of Structural Performance Criteria (SPC)	Number of Structural Benchmarks (SBM)	Number of Prior Actions (PA)	Remarks
Côte d'Ivoire			-	
PRGF.I.1 (1994)	-		-	
PRGF.I.2 (1995)	2	-	-	
PRGF.I.3 (1996)	-	-	-	
PRGF.II.1 (1998)	-	-		•Expenditure measures regarding unauthorized spending and arrears were prior actions in the negotiations for a second annual arrangement.
Corruption				
Cambodia				
PRGF I.1 (1999)	1	1	3	
Kenya				
PRGF I.1 (1999)	-	2	4	
State Monopolies				
Mali				
PRGF I.3 (1998)	1	1	-	
PRGF II.1 (1999)[6]	1	1	2	
Indonesia	-	-	-	•Liberalization of the clove market and abolition of the Clove Marketing and Bufferstock Agency (BPPC) were a government commitment during first review of SBA (1998).

Source: IMF Board documents.
[1.]Includes only SPCs, SBMs, and Pas directly related to the particular aspect of governance reviewed, and does not include those associated with other governance-related reforms in complementary areas.
[2] Year of approval of arrangement is shown in parenthesis. For PRGF, annual arrangements are shown separately, e.g., PRGF I. 1, 2, 3.
[3] Includes first, second, and third program reviews.
[4] Three PAs for approval of SBA, and nine conditions for completing the first, second and third program reviews.
[5] Includes first, second, third, and fourth reviews.
...[6] Includes first and second reviews.

Annex II. Box 6: Governance-Related Discussions in IMF Article IV Consultations, 1997-99—Illustrations from Eight Countries[1]

Developing countries

Botswana
Public resource management: Strengthening of tax administration. Restructuring and privatization of state enterprises.
Trade, tariffs, and external sector: Further liberalization of the capital account and rationalization of tariffs; greater transparency regarding composition of the basket to which national currency is pegged.
Statistics: Improvements in timeliness and coverage of balance of payments, fiscal, and national accounts.
Macroeconomic relevance: Policies supporting diversification of an economy dependent on diamond production would benefit medium-term growth.

Guatemala
Public resource management: Improvement of revenue administration. Reduction of exemptions and deductions in VAT. Cessation of earmarking of revenues. Improvement of regulatory framework for public sector procurement. Acceleration of privatization. Reduction of size of the civil service and introduction of new rules for recruitment and promotion.
Financial sector: Introduction of prudential regulations and improvement of supervision of commercial banks. Evaluation of assets and solvency of financial institutions. Make the Central Bank autonomous. Specification of the terms and conditions of the Central Bank's role as a lender of last resort.
Legal and Judicial System: Improvement of justice system, land titling, and computerization of land records.
Statistics: Correction of delays and deficiencies in information on public revenue and expenditures, and banking sector.
Macroeconomic relevance: No explicit mention.

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[1] The sample of countries was chosen not on the basis of judgement about the relative seriousness of any governance issues but rather to provide coverage of developed, transition, and advanced economies; the countries in this sample covered by survey-based indicators are in fact rated relatively favorably (see text). Promotion of good governance is defined broadly as in the Guidance Note (improving public resource management, and supporting an environment conducive to efficient private sector activities). This box focuses on issues discussed in the context of Article IV consultations and does not distinguish those mentioned first by the authorities in describing their policies from those put forward by the Fund; it therefore does not constitute a report on steps that these countries have taken to improve governance. As examples, in Botswana all remaining exchange controls were abolished in February 1999; in Tunisia, the authorities have moved to increase policy transparency by committing to subscribe to the SDDS, agreeing to publish the Article IV staff report, preparing a new fiscal code and publishing monetary policy objectives.

Annex II. Box 6 (concluded): Governance-Related Discussions in IMF Article IV Consultations, 1997-99—Illustrations from Eight Countries

Lao, P.D.R.
Public resource management: Overhauls of tax administration, public investment program, and public enterprises. Improvement of budget coverage of military expenditures and revenues of companies conducting logging and other commercial activities.
Financial sector: External audits and restructuring of state-owned banks.
Trade, tariffs, and external sector: Greater uniformity of tariff rates. Elimination of informal barriers to trade and licensing restrictions.
Legal framework: Adoption of decrees on leasing, pensions, and negotiable instruments. Acceleration of implementation of previously adopted decrees, including Foreign Investment Law.
Statistics: Improvement of accuracy, coverage, and timeliness of critical economic data.
Macroeconomic relevance: These issues seen as critical for long-term growth, private sector development, and integration into regional and global economies.

Tunisia
Public Resource Management: Streamlining of tax exemptions. Steps to check proliferation of extra-budgetary funds. Formulation of plan for civil service reform. Accelerate privatization.
Financial sector: Consolidation, restructuring, and privatization of public sector banks. Upgrading of banks' risk management practices. Transparent take-over by budget of bad loans to public enterprises, combined with enterprise restructuring and strengthening of bank supervision. Reduction of moral hazard in write-off of nonperforming loans by ending repeated write-offs. Improvement of collection and liquidation procedures and of tax treatment of provisioning.
Macroeconomic relevance: Banks' bad loans to private sector equivalent to 20 percent of GDP.

Transition economies

Poland
Public resource management: Acceleration of a transparent privatization process. Simplification of income taxes. Establishment of clear goals for privatization of healthcare. Strengthening of oversight and regulatory capabilities for pension funds.
Financial sector: Improvement of performance of retail banks. Reduction of quasi-fiscal costs of rehabilitating troubled banks. Staggering of terms and thereby retirement of council members of the Central Bank to improve continuity.
Macroeconomic relevance: State enterprises on privatization list account for one-third of GNP.

Slovenia
Public resource management: Reform of personal and corporate income tax, VAT, and pensions. Installation of legislative framework for private ownership of socially-owned enterprises. Constraint on expansion of activities of Slovene Development Corporation.
Financial sector: Removal of obstacles to free determination of interest rates. Provision of modern legal framework for foreign exchange, banking, insurance, securities, and investment companies.

Annex II. Box 6 (concluded): Governance-Related Discussions in IMF Article IV Consultations, 1997-99—Illustrations from Eight Countries

Strengthen the functioning of markets: Reduction of importance of state-controlled prices.
Macroeconomic relevance: Governance issues are raised in the context of making the economy more efficient and flexible, and encouraging foreign direct investment. "…economic activity continues to be constrained by administrative hurdles that give room for bureaucratic discretion."

Advanced economies

Iceland
Public resource management: Reduction of economic rents in fishing either by explicit taxation or by auctioning rights. Greater transparency in government operations.
Financial sector: Introduction of legislation to strengthen supervision and regulation of private pension funds. Reform of home finance system by transferring risk from government to private lenders. Adoption of law granting central bank independence.
Trade, tariffs, and external sector: Reduction of high tariffs, especially those on agricultural products.
Macroeconomic relevance: Link between improvement in fishing quota allocation procedure and fiscal position.

Italy
Public resource management: Alignment of budgets on a cash and commitment basis. Reform of the budgetary process to increase accountability and transparency in budgetary documents. Steps to fight tax evasion, and avoidance of tax amnesties on tax compliance. Strengthening of regional accountability through fiscal reforms, combined with development of administrative capacity and introduction of incentives to comply with ceilings on spending.
Public administration, legal, and judicial reform: Steps to tackle key issues of governance in southern Italy, through the fight against criminality and the establishment of an effective judicial system.
Statistics: Improvements in transparency of fiscal data.
Macroeconomic relevance: No explicit mention.

Sources: Article IV Consultation Staff Reports; and Chairman's Summings-Up of Executive Board discussions.

GOVERNANCE ACTIVITIES IN OTHER INTERNATIONAL INSTITUTIONS[1]

A. African Development Bank (AfDB)[2]

1. **Scope**: Over the last few years, the AfDB Group has given due recognition to the issue of governance for two main reasons. First, from a broader perspective, good governance, which promotes accountability, transparency, rule of law and participation, is central to creating and sustaining an enabling environment for development. Second, from the Bank's perspective, sound development, including good governance, is inextricably related to the efficacy of the investment it helps to finance.

2. **Mandate**: The mandate of the AfDB is to contribute to the economic development and social progress of its regional member countries (RMCs). Given its importance to economic development, governance has emerged as a suitable and necessary area for AfDB Group intervention to achieve sustainable development in the RMCs. To this end, under the Seventh General Replenishment of the African Development Fund, good governance was introduced as a performance and resource allocation criterion.

3. **Operational Implications**: The AfDB's interventions seek to promote good governance across a range of activities, depending, *inter alia*, upon country circumstances and needs: (i) *accountability*—through the strengthening of the public sector, including public enterprise and public financial management, *corporate governance*, as well as public enterprise and civil service reform; (ii) *transparency*—through the improvement of information disclosure, the conducting of Public Expenditure Reviews (PERs) jointly with the Bretton Woods institutions, and the strengthening of capacity in public policy analysis and dissemination; (iii) *fighting corruption*—through the prevention and control of corruption related to AfDB-financed projects and programs, the reduction of opportunities for rent-seeking and corrupt practices, the support for research on the nature, origin, development and impact of corruption in African societies, the support of civil society capacity in investigating corruption matters, and the sensitization of, and assistance to, RMCs for combating corruption; (iv) *participation*—through enhancing the participation of beneficiaries and affected groups, reinforcing the cooperation with NGOs, community-based and civil society organizations, economic cooperation and regional integration, public sector/private sector dialogue and supporting decentralization processes at various sub-national levels; and (v) *legal and judicial reform*—focusing mainly on law reform, judicial reform and the legal framework for private sector development.

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[1] The description of involvement in governance has been reviewed by the respective institutions.

[2] See also the AfDB's website (www.afdb.org), and its 2000 policy paper: *African Development Bank Group Policy on Good Governance*, also available on the website.

4. The AfDB's activities to promote good governance are pursued through a combination of advocacy, policy dialogue, and consultation with the RMCs. Governance issues are now fully integrated in the design of lending activities. The AfDB's new Country Performance Assessment methodology includes issues such as political stability, anti-corruption policies and practices, property rights and rules-based governance, and accountability and transparency of the public service. The AfDB also participates in, and organizes, senior-level seminars, conferences and workshops on governance issues. Finally, the AfDB aims to further its agenda in the area of governance through its non-lending activities, in particular by expanding its cooperation and collaboration with civil society organizations and other development partners.

B. Asian Development Bank (AsDB)[3]

5. **Scope**: In 1995, the AsDB defined governance as "the manner in which power is exercised in the management of a country's social and economic resources for development" (*Governance: Sound Development Management, AsDB policy paper, 1995*). The AsDB's approach to governance is based on the "four pillars" of governance: accountability, participation, predictability (primarily through the rule of law), and transparency.

6. **Mandate**: The adoption of this approach was in reflection of lessons learned from AsDB's operations: that sustainable development depends not only on the quality of decisions made toward development and reform, but, equally, on the manner in which these decisions are taken and carried out. Article 36 (2) of the AsDB's Charter notes that "*the Bank…shall not interfere in the political affairs of any member, nor shall they be influenced in their decisions by the political character of the member concerned. Only economic considerations shall be relevant to [its] decisions*". However, the AsDB can take into account "*demonstrable and direct economic effects of non-economic factors*" as part of the economic considerations on which it must base its decisions. In 1999, the AsDB adopted poverty reduction as its overarching objective, and identified governance as one of the three pillars of poverty reduction. In February 2001, the Board of the AsDB is to consider a review of its governance-related activities, and adopt a medium-term governance agenda and action plan for the next five years which includes activities to: (i) elevate governance issues to the top level of the development agenda in the region; (ii) develop a consensus on regional benchmarks, codes of conduct, and best practices across the whole range of public and private sectors, and indicators of good governance; and (iii) enhance the quality of governance in individual Developing Member Countries (DMCs). The AsDB considers that the application of governance measures must be

[3] This section uses information posted on the Asian Development Bank's website (www.asdb.org), including the AsDB August 1995 policy paper: *Governance: Sound Development Management*, and provided directly by the AsDB.

country-specific, and grounded on the economic, social, administrative and implementation capacity realities of each country.

7. **Operational implications**: The governance policy adopted in 1995 became the basis for a cluster of good governance policies, which now includes policies on procurement, law and policy reform, civil society, and fighting corruption. Examples of the AsDB's activities across key governance-related areas include: (i) enhancing budget preparation and public expenditure management; (ii) public administration reform; (iii) legal system reform, especially developing legal information systems, enhancing DMCs capacity to implement and administer laws, and supporting legal reforms for private sector development; (iv) institutional development and capacity building aimed at improving the delivery of government services, particularly to the poor (this constitutes the largest segment of the AsDB's governance work); (v) improving public accountability, through strong anti-corruption measures in AsDB's investments, improvement of audit standards and capacities in DMCs, and activities to combat money laundering; (vi) improving governance at sub-national levels by supporting devolution; (vii) improving the public-private interface by helping to improve (a) disclosure and transparency in the financial sector; (b) the effectiveness of regulatory frameworks; and (c) corporate governance of state-owned and private enterprises, through improved laws and regulations; and (viii) the participation of civil society and NGOs, particularly in the AsDB's project work.

8. The AsDB seeks to ensure that its programs and projects raise the quality of governance, for example, through appropriate policy measures, project components, or technical assistance. In addition, the AsDB provides, on request, advisory technical assistance for specific governance-related policy studies, seminars and training. Governance issues are addressed in the AsDB's country assistance plan in order to ensure an integrated approach to governance issues across specific projects and sector programs.

9. In addition to anti-corruption activities under the governance policy—establishing anti-corruption commissions in various DMCs, strengthening procurement, audit and financial management, and anti-money laundering activity—*in 1998, the Board of the AsDB unanimously approved an anti-corruption policy* that deals with fraud and corruption in AsDB-related projects. In July 2000, full operational guidelines for anti-corruption procedures were finalized. These guidelines provide for the possibilities of suspending disbursements, accelerating the maturities of, or outright, cancellation of loans, along with blacklisting firms involved in specific instances of corruption.

10. For the AsDB's own practices, a Code of Conduct has been promulgated, and the Office of the General Auditor has been designated as the initial point of contact for investigating allegations of corruption in AsDB-financed projects or by AsDB staff.

C. European Bank for Reconstruction and Development (EBRD)

11. **Scope**: The EBRD is concerned with the political, legal, economic, and corporate aspects of governance (political aspects cover multiparty democracy, pluralism, and human rights issues).

12. **Mandate**: The purpose of the EBRD is to "*foster the transition toward open market-oriented economics, and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to apply the principles of multi-party democracy, pluralism, and market economies*". References to human rights are found in the Preamble. In May 1991, the Board of Directors approved a paper outlining procedures that the EBRD should adopt to implement the political aspects of its mandate. In particular, it proposes to assess political and economic progress together annually in the EBRD's country strategy papers (CSPs) rather than on a project-by-project basis.

13. **Operational implications**: EBRD activities in member countries are guided by the CSP, issued to the EBRD Board every two years and updated in the interim year. Attached to the CSP is an assessment of the country's political orientation, followed by the EBRD President's conclusion. In principle, a country's access to EBRD's resources can be suspended if the political orientation is not appropriate, that is, it does not comply with the principles of multi-party democracy. So far, no country has been found to be in violation of the political orientation for access to resources. However, there have been cases when concerns regarding compliance with the political aspects of the mandate had operational implications. In the case of Belarus and Turkmenistan, the Board of Directors has limited the EBRD's exposure (within a base case scenario approach) to private sector projects only, thus curtailing new public sector operations.

14. On the economic aspects of governance, the EBRD recognizes the critical importance of institution building and investment climate issues to the process of transition to market-oriented economics. As an investor, the EBRD requires a supportive and effectively enforced regulatory framework, limits to administrative discretion and corrupt practices, and fair and predictable taxation. Economic aspects of governance are taken into account in the EBRD's lending activities through two channels. First, conditions to be met before a project can be signed have included implementation of required legislation at the level of economic governance or required changes to corporate governance, while continuing project conditionality may be related to good governance practices. To strengthen its operations to promote good corporate governance, in July 2000 the EBRD established the function of Chief Compliance Officer. Second, economic aspects of governance in members countries impact the development of the EBRD's country strategies and assessment credit ratings. For instance, a poor investment climate and pervasive corruption would reduce the EBRD's ability to develop and implement operations in the country concerned.

15. In the legal area, the EBRD has focused on improving corporate governance in the transition countries through its Legal Transition Programme. In 1997, the EBRD published the "Sound Business Standards and Corporate Practices Guidelines that became one of the sources for the OECD's International Principles of Good Corporate Governance. The EBRD has participated in international efforts to promote good corporate governance through the OECD's Roundtables for Corporate Governance in Russia and in Eurasia as well as working with the World Bank and the OECD to establish the Global Corporate Governance Forum. Technical assistance has also been used by the Legal Transition Programme to help with the development of sound securities and company laws and the building of effective regulatory institutions such as security commissions and stock exchanges. The EBRD has provided such legal transition assistance to Azerbaijan, the Czech Republic, Romania, and Russia. In Russia, the EBRD has assisted with the revision of Russian economy and securities laws, helped develop a private sector corporate governance rating system and is helping to prepare a corporate governance code of best practice with the Russian Securities Commission.

D. European Union (EU)

16. **Scope**: Good governance in the EU is closely related to democracy, human rights, and the rule of law which are all important elements of cooperation with third countries. The European Union's (EU) approach to governance issues is set in the context of its development activities and cooperation with several regional groups (ACPs, Balkans, NIS, Asia, MENA, Latin America, and the Caribbean), and specifically in the context of its support to Central European Countries (CECs) and more broadly, candidate countries, in improving the quality of governance of their public administrations. In the context of its development activities, the EU defines good governance as: "*the transparent and accountable management of human, natural, economic, and financial resources for the purposes of equitable and sustainable development*." The EU also acknowledges the political nature of the problem of widespread poverty in developing countries. In the context of its relationship with the EU candidate countries, the EU is guided by the accession criteria established by the Copenhagen European Council in 1993, which require the candidate country to ensure "*stability of institutions guaranteeing democracy, the rule of law, human rights, and the respect for the protection of minorities, the existence of a functioning market economy and the capacity to withstand competitive pressure and market forces within the Union and the ability to take on the obligations of membership including adherence to the aims of political, economic, and monetary union*." The EU's activities to strengthen public administration in the candidate countries cover both political and economic aspect of governance, with a special focus on issues directly related to the implementation of the "*acquis communautaire*".

17. **Mandate**: In its *development policy*, as redefined in the recent Statement adopted by the Council and the Commission (Council Resolution, November 11, 2001), institutional capacity-building, particularly in the area of good governance and the rule of law, is one of the six areas identified as a priority to concentrate Community activities. These areas have been selected on the basis of their contribution towards reducing poverty and on the

added value provided by Community action. Good governance, which includes the fight against corruption and the rule of law, is considered decisive in strategies to reduce poverty. In its co-operation activities with the Africa-Caribbean-Pacific (ACP) States for example, in the framework of the new Partnership Agreement signed in Cotonou in June 2000, the European Union seeks to "*support the promotion of human rights, processes of democratization, consolidation of the rule of law, and good governance*."[4] The EU will provide support for political, institutional and legal reforms, and for building the capacity of public and non-government actors, including the private sector and civil society. The EU's mandate in its involvement with public sector reform in the candidate countries is to help them reform and reinforce their public administrations and institutions, so as to enable them to meet the accession criteria and function effectively.

18. **Operational implications**: The objectives of the EU's new approach to development are pursued through integrated strategies that incorporate economic, social, cultural, environmental, and institutional elements that must be locally owned. More specifically, these strategies aim at, *inter alia*, promoting institutional reforms and development; strengthening the institutions necessary for the consolidation of democracy, good governance and respect of human rights and for efficient and competitive market economies; and building capacity for development and partnership.

19. In the EU's activities to help the candidate countries reinforce their administrative structures with a view to membership, the twinning of administrations and agencies plays a central role. The vast body of Member States expertise is being made available to the candidate countries through the long-term secondment of civil servants and accompanying expert missions. In addition, the EU provides the candidate countries with targeted technical assistance, including through specific multi-country program. One of these is the SIGMA (Support for Improvement in Government and Management) program. This program is a joint initiative of the EU and the Organization for Economic Cooperation and Development (OECD) and seeks to assist the candidate countries in designing and implementing reform strategies in public management. The SIGMA program covers: public administration development strategies, policy making, coordination and regulation, budgeting and resource allocation, public service management, and audit and financial control.

20. Resources (grants) from the EU's various budget lines and the European Development Fund (EDF) are allocated on the basis of needs and performance. The criteria for evaluating a country's performance include, *inter alia*, the progress accomplished in implementing institutional reforms. These reforms relate to efforts of the country concerned in reforming its institutions to ensure respect for human rights and to

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[4] The Cotonou agreement signed on June 23, 2000, describes the development cooperation relationship between the 15-member states of the European Union and the 77 countries of the ACP states.

create a climate of democracy, rule of law and fight against corruption, and the country's performance in the use of resources and to ensure transparency and accountability. A new specific procedure has been put in place for serious cases of corruption. This procedure is to be applied in cases involving money from the EDF, and, more widely, in any country where the EU is financially involved and where corruption constitutes an obstacle to development.

E. Inter-American Development Bank (IADB)

21. **Scope**: The IADB is concerned with the economic, social, and political aspects of governance and the implementation capacity of the governing body. Special attention is paid to restructuring the State consistent with the economic reforms adopted in countries in the region during the 1980's, and the associated shift from excessive state intervention and sometimes authoritarian government to ensuring the effective functioning of democracy, competitive markets, and the rule of law. This involves the modernization of government and strengthening of civil society, transparency, social equity, participation, and gender equity.

22. **Mandate**: The objective of the IADB is to "*contribute to the acceleration of the process of economic and social development of the regional developing member countries*" (Article I, Section 1). In the context of the Eighth Replenishment agreement reached in April 1994, the IADB received a mandate to support the process of social investment and reform; to reduce poverty and promote equity; to incorporate the poorest members of the society into the production process; and to foster a new culture of work and investment. Priority would be given to efforts to modernize and integrate political and civil society, including actions to modernize the State and promote conditions for democratic government. In 1996, the IADB's Executive Board approved a framework for the role of the IADB relating to programs for modernization of the State and strengthening of civil society.

23. **Operational Implications**: Since 1990, the IADB has provided several loans and technical cooperation funding for institutional strengthening and reform of the State, many of them directed at the executive branch. In more recent years, the IADB has supported efforts by member countries to reform, modernize, and strengthen the judicial and legislative branches, as well as other non-traditional targets of reform, such as public records systems, agencies to oversee and audit the workings of government, and mechanisms for protecting citizens' rights. In addition, the IADB has helped strengthen civil society organizations and support political reform programs.

24. Based on the 1996 operational framework for reforms relating to the modernization of the State and strengthening of civil society, the IADB endeavors to: (i) include such issues in its country studies and for programming processes; (ii) involve all social agents concerned to ensure the long-run sustainability of the IADB's operating programs; (iii) consolidate mechanisms for cooperation with other multilateral organizations to modernize government and strengthen civil society, especially under those programs that

might fall outside the IADB's sphere of action; and (iv) provide resources from the IADB's Multilateral Investment Fund to strengthen the transfer of economic responsibilities from the State to civil society organizations and the private sector.

25. The IADB is currently engaged in a review of its approach to governance issues, and is working on a new frame of reference for its involvement in this area.

F. Organization for Economic Development and Cooperation (OECD)

26. **Scope**: The OECD's concern with governance reflects its commitment to economic development through, *inter alia*, the efficient use of economic resources. In 2000, governance was named as one of the OECD's eight priorities.

27. **Mandate**: A 1999 resolution of the OECD Council provided a mandate to the OECD's Public Management Committee (PUMA) for designing and implementing a program aiming to: "(i) *identify and help address the emerging forces and trends which constitute strategic governance challenges*; (ii) *assist OECD members and non-members to raise the performance of their public institutions so that they are better equipped to manage those forces*; and (iii) *to focus on key elements of a good governance framework including: developing capacities for more coherent and globalized policies, delivering on policy commitments in a changing world, institutionalizing transparency, honesty, and accountability in government, intervening effectively in society and markets to achieve public policies and promote competition as well as social cohesion*."

28. **Operational implications**: While governance issues permeate the whole range of the OECD's work, its main elements can be grouped under seven broad headings:

- *Establishing effective institutional and policy frameworks for markets*: this includes, *inter alia*, the OECD Principles of Corporate Governance, which focus on governance problems that result from the separation of ownership and control. These principles seek to help government establish the legal, institutional, and regulatory framework for corporate governance, and provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in developing good corporate governance. It also includes the development of policy recommendations, such as the 1995 Recommendation for Competition Policy, which deals with enhancing co-operation between the OECD's member countries on anti-competitive practices affecting international trade.
- *Managing across different levels of government*: this includes, *inter alia*, the OECD's Principles of Metropolitan Governance, which can be used as a benchmark in evaluating and improving governance of metropolitan areas.
- *Managing cross-cutting issues to build policy coherence*: in the development area, OECD countries have a pivotal role in improving the "developmental policy coherence" of their policies, so that developing countries can fully exploit the

- benefits of open trade and investment. This includes improving the framework for international trade and capital flows, addressing environmental concerns, and facilitating participation of developing countries in the global information society. Another example is trade policy, where the OECD's work demonstrates the importance of coherence between trade policy, and other policies, especially in the environmental and competition areas.
- *Fostering public sector capacities*: this is a large part of the OECD's work, notably through elaboration and dissemination of best practice policies. In the area of public sector management, priority activities include budgeting and financial, performance, and human resource management. The OECD also has a major program of fostering public sector management in central and eastern Europe, through the SIGMA (Support for Improvement in Governance and Management) program, which is a joint initiative with the European Union.
- *Fostering integrity and fighting corruption* : this includes: (a) the 1999 Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; (b) the 1996 Recommendation which committed all OECD Member countries to put an end to the practice of according tax deductibility for bribe payments made to foreign officials; (c) the 1997 Recommendation which invited OECD countries to adopt appropriate accounting and auditing requirements, and to deny bribing companies access to public procurement procedures; and (d) the 1996 Recommendation concerning Anti-Corruption Proposals for Bilateral Aid Procurement.
- *Managing relationships between government, business, and civil society*: this includes, *inter alia*, the strengthening government-citizen connections, which aims to support government efforts to strengthen public participation, transparency and democratic accountability, and policy effectiveness. *Governance and economic development*: In 1993, the OECD's Development Assistance Committee (DAC) established a set of "orientations" on participatory development and good governance . Following the operationalization of these principles, an exercise is underway to promote more systematic and locally-owned efforts to improve governance systems in six pilot countries (Benin, Bolivia, Burkina Faso, Mali, Mauritania, and Uganda). The May 2000 high-level meeting of the DAC recognized good governance as an essential building block for poverty reduction. In December 2000, the activities of the DAC networks on good governance and institutional and capacity building have been merged to form a new network on governance issues (GOVNET). Areas covered by the network include capacity development in the public sector, public sector financial management, democratization, and the rule of law. Through the GOVNET, the DAC aims to intensify efforts to effectively involve local civil society organizations, as well as other key development stakeholders, in governance issues.

29. Other major initiatives of the OECD include the Anti-Corruption Ring Online (AnCorR Web) and the Anti-Corruption Network for Transition Economies (ACN).

G. United Nations (UN)

30. **Scope**: For the UN, governance is a theme under which coherence and focus can be given to a variety of social, economic, and political development activities. It encompasses issues ranging from concerns about efficient government, including accountability and transparency, to human rights, social cohesion, equity on gender and income, democracy, participation, corruption, military expenditures, and political thought, culture, and discourse.

31. **Mandate**: Broadly defined, the UN's involvement in governance issues is through its mandate to support the implementation of national strategies and action plans for poverty eradication, in particular, with respect to social goals agreed upon at the 1995 World Summit for Social Development.

32. **Operational implications**: The UN seeks to foster aspects of good governance through the action of its various agencies. The United Nations Development Program (UNDP), which is the lead UN agency in this area, emphasizes participatory mechanisms, including process consultation, and facilitates dialogue and choice in decision-making, thus promoting a constructive engagement between the state, civil society organizations, and the private sector. The main areas of UNDP involvement in governance are: (i) the promotion of public sector reform; (ii) the strengthening of governing institutions, such as those related to the judiciary, elections, parliaments, and human rights; (iii) governance in special circumstances (crisis and transition countries); (iv) support for decentralization and local governance; (v) the development of leadership skills; and (vi) the enhancement of democratization and the political empowerment of the poor through strengthening civil society organizations. It does so by, *inter alia*, helping countries build capacity, providing policy support on the development dimensions of governance, gathering and sharing national and regional experiences and best practices in governance; partnering with other institutions to deliver technical assistance in governance, and helping countries mobilize and coordinate resources for improved governance. The United Nations Educational, Scientific and Cultural Organization (UNESCO) contributes to strengthening decision-making processes by developing human resources in education, science, culture and communications. The United Nations' Department for Development Support and Management Services (UNDDSMS) builds capacities for governance with programs of administrative reform aimed at improving government performance, accountability and transparency, and strengthening management systems for national programming. The United Nations Children's Fund (UNICEF) supports decentralization, especially in health care, education and other social sectors, and develops the abilities of community groups and indigenous NGOs to participate in the formulation and implementation of policies that affect their lives. Similarly, the United Nations Development Fund for Women (UNIFEM) promotes the dialogue between NGOs, government, and its UN partners with a view to bringing

women's voice into the policy-making process and to increase the accountability of governments to gender concerns. The United Nations Conference on Trade and Development (UNCTAD) provides technical cooperation to enhance the human and institutional capacities of developing countries and improve the necessary policy and institutional environment for development and enhance the ability of countries to participate fully in the world economy, particularly in international trade and investment. Other agencies indirectly contribute to governance as well; for example, the United Nations International Drug Program in the fight against money laundering.

33. In order to carry out its mandate, the UN is also seeking to improve the coordination among the various UN services involved in the governance area. This would include, *inter alia*, the elaboration of a common framework on governance to guide country-level programming and the preparation of best practices to illustrate the framework; and the incorporation of the issue of governance in existing country-level programming tools.

H. World Bank

34. **Scope**: The World Bank's concern with governance reflects its commitment to economic and social development, with poverty reduction as an overarching objective.

35. **Mandate**: The World Bank's involvement with governance issues stems from the recognition that successful pursuit of economic and social development depends on effective public sector institutions and a favorable legal environment. The Bank's involvement also derives from its fiduciary responsibility which requires it to ensure that the proceeds of each loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency (Article III, Section 5(b)). Governance emerged as an important focus in the Bank's work in late 1980s, prompting several discussions by the Board of Executive Directors. In 1991, the General Counsel of the World Bank provided an interpretation of the legal framework within which Bank operations could deal with governance issues.

36. **Operational implications**: The Bank's involvement in governance issues can be described as an effort to improve accountability, transparency, and capacity within the public sector and civil society through policy reforms and institutional development. Combating corruption in the public sector is an explicit and integral part of this agenda, including the prevention of fraud and corruption within Bank-financed projects. A summary of the Bank's governance-related activities is provided below.

37. The Bank's traditional lending programs (such as structural adjustment) have played an important role in its efforts to promote public sector reform. New approaches (such as adaptable and programmatic loans) are also being developed to allow for the longer timeframes required to achieve institutional change. Structural adjustment programs and conditions associated with a number of projects have supported reforms to eliminate unnecessary economic legislation, streamline cumbersome administrative procedures, and increase the scope of the market in economic activities. Although aimed primarily at

improving economic efficiency, these reforms contribute to improving transparency and accountability, by reducing the scope for administrative discretion and rent-seeking behavior. More directly, the Bank has contributed to improved governance by helping to: improve capacity and incentives in the civil service; strengthen public expenditure management; improve regulations and supervisory capacity in financial systems; develop legal and accounting frameworks for private sector development; strengthen judiciary systems; strengthen tax policy and administration; and provide economics training to parliamentarians and journalists. It has also encouraged community-based participation in Bank-sponsored programs, for example through social investment funds and decentralization. In November 2000, the Bank launched a public institutions reform strategy, with the explicit aim to strengthen governance.[5] The strategy includes, *inter alia*, efforts to: establish clear criteria to ensure that institutional and governance concerns are adequately reflected in the Bank's country assistance strategies and lending programs; develop toolkits and survey techniques for governance analysis and assessment; and improve the quality of Public Expenditure Reviews—expand the institutional content, more clearly define the scope and function, and enhance the relevance and ownership.

38. The Bank views corruption as a symptom of underlying weaknesses in public sector institutions, therefore its anticorruption efforts are integrated into the broader strategy for reforming public institutions and strengthening governance. Its framework to combat corruption, adopted in 1997, has four main elements: preventing fraud and corruption in Bank-financed projects; taking corruption more explicitly into account in all aspects of Bank work; helping countries that request Bank assistance fight corruption; and supporting international efforts to combat corruption. These elements are operationalized through, *inter alia*, ensuring that procurement, disbursement financial reporting, supervision, and auditing procedures are adequate and followed; by helping countries design and implement anticorruption and governance programs through Bank loans and economic sector work; and bringing together various stakeholders—parliamentarians, civil society, households, private sector, and the media—to expose sources of corruption.[6]

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[5] *Reforming Public Institutions and Strengthening Governance: A World Bank Strategy,* World Bank, November 2000.

[6] The report *Helping Countries Combat Corruption: Progress at the World Bank since 1997*, published in June 2000, provides details on the progress made since the initial strategy was adopted. A more recent report, *Anticorruption in Transition: A Contribution to the Policy Debate*, identifies and compares patterns of corruption across transition countries in Europe and Central Asia, expands the earlier analytical framework, and explores options to tailor country strategies to specific realities and problems on the ground.

39. More information on the World Bank's work can be found in its governance and public sector reform website at *www.worldbank.org/publicsector*. This website has links to the many thematic areas and reports mentioned in this summary.