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# Governance for economic growth and poverty reduction: empirical evidence and new directions reviewed

## Discussion paper [or working paper, etc.]

# Governance for Economic Growth and Poverty Reduction: Empirical Evidence and New Directions Reviewed

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## 1. Introduction

The purpose of this paper is to provide a review of recent empirical literature on the links between governance and growth, to highlight the key contested areas and to draw out implications for policy and future work on evidence and indicators. Over the past decade governance has taken centre stage in the reform agenda designed to promote growth and poverty reduction in developing countries. The dominant view, both in research and policy making, is encapsulated by the 'good governance' agenda. This advocates property rights stability, reducing corruption, a transparent and accountable public sector, democratic government, rule of law and competitive (rent free) markets, not only to satisfy the popular aspirations of millions living in developing countries, but also as a means to promote growth and ensure sustainable poverty reduction.

While the links between institutions and growth were a central concern of classical political economy, the roots of the 'good governance' agenda lie in more recent theoretical developments within the field of neo-classical economics, notably New Institutional Economics initially developed by North (1974, 1990, 1994, 1995)[1]. According to NIE, all economic interactions involve transaction costs. Institutions provide the rules of exchange under conditions where transaction costs are an inherent part of human interaction. The level and types of transaction costs are determined by the dominant institutions in any given society. The good governance agenda is also informed by recent developments in the theory of competition that draws on theories of rents and rent seeking that date back to the work of Krueger (1974), Posner (1975) and Bhagwati (1982). The importance of governance can be elaborated either in terms of lowering the costs of transacting or alternatively in terms of reducing the possibility of creating wasteful rents and the associated waste of rent seeking.

The 'good governance' agenda transforms these theoretical insights into concrete recommendations for institutional reform in developing countries where growth is needed as a pre-requisite for sustainable poverty reduction. The policy package associated with 'good governance' includes efforts to; first, improve accountability through mechanisms such as the PRSPs, PGBS, decentralization, public financial management reform processes; second, to counter corruption and rent seeking through anti-corruption institutions and legislation, liberalization, WTO and IMF regulations on trade policy and fiscal management; and, third, to promote property rights stability through programmes such as strengthening the rule of law through judicial reform, limitation on expropriation risk, and formalizing property rights in the informal sector (Khan; 2006).

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[1] As well as others including Olson (1982), Williamson (1885),Milgrom and Roberts; (1992), and Bates (2001), to mention just a few.

The creation of quantitative measurements of institutions has been central to solidifying the consensus on the links between governance and growth. The development of indicators has also been welcomed by donor agencies and multilateral financial institutions that are accountable for development spending and have to demonstrate what is being achieved as a result of spending programmes. Earlier empirical work on institutions within the NIE paradigm primarily involved historical case studies (North and Thomas 1973, Hayami and Ruttan, 1984, Bates 2001). Serious quantitative analysis was limited by the fact that, as North points out 'we cannot see, feel, touch, or even measure institutions' (1990; 107). Nevertheless, since the mid 1990s economists have worked to overcome this problem by developing 'proxy' indicators of governance. Malik (2002) estimates that there are now around 150 measures of different aspects of governance in the public domain. This has also led to a new branch of research on institutions using these indicators as variables in econometric analysis, the vast majority of which provide support to the basic insights of New Institutional Economics.

The early work on indicators of governance involved attempts to harness 'objective' measures of institutions, such as the work by Barro (1991) on political instability, as well as 'subjective' measures by Mauro (1995) and Knack and Keefer (1995), who use survey data from credit risk rating agencies. Since then, these approaches have been expanded and refined to produce composite indices, using both subjective and objective measurements from a wide variety of sources. The most well known of these data sets are, arguably, the Corruption Perceptions Index produced by Transparency International and World Wide Governance Indicators produced by Kaufmann and his associates at the World Bank. As well as informing research, these indicators have a wide range of users, from international investors to donor agencies where they are used for monitoring and aid allocation criteria (Arndt and Oman; 2006). Measurement and indicators have thus been 'instrumental in putting governance at the top of donors' agendas' (Knack; 2006, 5).

Yet despite the fact that, as Knack (2006) points out, good governance has now achieved the status of 'conventional wisdom', significant uncertainty remains and key aspects of both the empirical evidence and theory have been contested in recent years by prominent economists and social scientists. These dissenting views are based on concerns about the quality of the data, reassessments of the cross national data on governance and detailed case studies of governance and growth in specific countries. In the second section of this paper, the main areas of research and methodologies of measurement used in the 'good governance' debate are set out. The third, fourth and fifth section provides a summary of the critique of the data and empirical evidence. The sixth section outlines the new approaches to the relationship between governance and growth from the work of Dani Rodrik, Douglass North et al, Mick Moore and Mushtaq Khan. The final section sets out some implications for future research emanating from this survey.

## 2. Empirics

Despite its relative recent genesis, the proliferation and profile of research on the links between governance and growth has led to some excellent thematic and methodological reviews of the evidence, including Aron (2002), Malik (2002) and Arndt and Oman (2006). This short review provides a topology of the research based broadly on method and data employed. While empirical investigation has always been central to the research agenda on governance in the social sciences, little of the data was amenable to the type of econometric modelling that is central to the mainstream economics discipline. Since the early 1990s, the rising profile of new institutional economics focussed economists minds on how to overcome the problem of quantifying what are essentially abstract concepts such as rule of law, efficient government etc. This has been achieved through the creation of indirect ‘proxy’ indicators for aspects of governance. The vast majority of studies on the links between governance and growth using these proxy indicators have employed cross-sectional regressions and much less research has been undertaken based on case studies, notwithstanding some recent narrative case studies of country experience (for example Rodrik; 2003).

Some of the earliest econometric work on political regime variables and growth was undertaken using the Freedom House indicators which rank countries in terms of their political rights and civil liberties based on a questionnaire that is completed by in-house experts (Arndt and Oman; 2006). Research using this index as a proxy for aspects of democracy has been widespread, for example Koremedi and Meguire (1985), Scully (1988) and Grier and Tullock (1989), to investigate growth and governance through various econometric models. They all find a positive relationship between civil liberties, taken to be a key component of democracy, and growth.

Aside from the Freedom House index, many of the studies on regime type and growth have attempted to use ‘objective’ descriptive features. A common source of data for the earlier research in this area was Banks’ Political Handbook of the World. More recent sources of data on characteristics of political regimes have been compiled in the Polity IV data set maintained by the Centre for International Development and Conflict Management which aims to measure the limits of executive power and the Database on Political Institutions developed by the World Bank.

Barro’s 1991 study is seminal in this area. He looks at the relationship between regime instability and growth where regime instability is used as a proxy for the security of property rights. He argues that his ‘objective’ measure, which involves counting the number of civil wars, coups, strikes and political assassinations, is an improvement on the earlier studies using Freedom House Indices. He finds that these variables are significantly and negatively related to growth rates and to private investment's share of GDP over the 1960-85 period. Different conclusions, however, are reached by Alesina et al. (1996), using similar variables to Barro. They find that political instability and growth are jointly determined[2].

As well as investigating political instability Alesina et al (1996) use the variables of civil and economic liberties and the competitiveness of elections to measure the impact of democracy on growth. They conclude that the relationship between democracy and growth is inconclusive. This has been echoed by other studies including Svensson (1999), Rodrik (2000), Przeworski et al (2000), Halperin et al (2004) and Ross (2006). One of the important shifts in the governance debate over the past five years has been a growing understanding of the complexity of the relationship between democracy and growth, while its intrinsic value to people over the world has been re-affirmed through survey data discussed below.

The studies discussed above have relied primarily on description of the features of institutions, but these say little directly about how well such institutions actually perform

[2] Earlier work by Londregan and Poole (1990, 1992) find that coups are caused by low growth, but they also find that more frequent coups do not reduce growth rates.

in terms of underlying theoretical assumptions that such institutions are advantageous to economic growth because they lower transaction costs. Doubts have also been raised in terms of how well these variables actually reflected the underlying governance structures. For example, the frequency of elections and number of parties may be a poor proxy for the essence of democracy in terms of accountability of government to the people. In order to capture more focussed economic notions of institutional quality (Aron; 2002), as well as to reflect the performance of different institutions, economists have turned to 'subjective' data sources based on surveys of businesses and citizens. Knack (2006) reports that advancements in this area were made simultaneously by Mauro (1995) and Knack and Keefer (1995). The main source of the subjective data was the International Country Risk Guide (ICRG), as well as the Business Environmental Risk Intelligence (BERI) and Business International (BI). Mauro (1995) found that corruption, bureaucracy and red tape, legal system and judiciary and political stability were all related to growth. Knack and Keefer (1995) construct an index based on the ICRG and BERI[3] data and find that security of private property and enforceability of contracts are strongly related to growth as well as private investment.

Firm level surveys, including the World Business Environment Survey (WBES), Firm Analysis and Competitiveness Survey (FACs), have become increasingly important in the research on governance and growth. These studies have been used to assess various aspects of the business environment, including the institutional constraints that firms in developing countries face. Business surveys have highlighted the problems of government regulation and corruption for firms in developing countries. The World Bank's Doing Business Survey provides measures of business regulation and protection of property rights which are used to compile comparable indicators for 175 economies. Countries are then ranked on the basis of the ease of 'doing business'. Djankov et al (2006) use these measures in a growth regression based on Barro's earlier work, to establish that countries with 'better' business regulation, in terms of less regulation, grow faster. Gelb et al (2006) use the Investment Climate Assessment survey on business climate to assess constraints on firm level productivity. They observe that that direct comparisons costs due to different productivity levels and wages show only a minor gap between poor performing African countries and better performing China and India. They find that it is, in fact, the indirect costs facing firms in many African countries that explain the higher costs of production. These indirect costs relate to various aspects of business environment and regulation. Detailed firm studies have come a long way in providing details of the types of costs that firms face and provide data which could be used to benchmark indirect costs as a target for reform (Gelb et al; 2006).

Surveys of individuals and households such as the Afrobarometer, the Latinobarometro and Gallup International's Voice of the People have been a relatively new growth area in the study of governance. These surveys have played an important role in highlighting that people around the world find intrinsic value in the types of institutions that the good governance agenda promotes. They also enrich our understanding of people's personal experience of the impact of governance. For example, in Nayaran et al (2000) study *The Voices of the Poor*, they find that poor people face arbitrary and corrupt bureaucracies while Gallup's survey finds that people want their governments to do more to protect human rights (Sprogard and James, 2000). These large surveys of citizens are much less useful in

3 These are constructed through measures of corruption in government, rule of law, expropriation risk, repudiation of contracts by government, quality of bureaucracy. With the BERI they construct an index from variables of contract enforceability, nationalization risk, bureaucratic delays and infrastructural quality.

terms of providing direct information about the relationship between different institutions and growth.

Nevertheless these subjective data sources play a crucial role in composite indices of governance that have become increasingly prominent in the research on governance and growth. Composite indices of data involve aggregating different measures of governance from various sources involving both 'subjective' and 'objective' information to produce a summary indicator of a specific aspect of governance. Perhaps the best known composite index of governance is the Corruption Perceptions index produced annually by Transparency International[4]. Transparency International's perceptions based data has played a crucial role in opening up the analysis of corruption to empirical analysis, given the difficulties of obtaining valid 'objective' data on corruption. Lamsdorff (2005) provides a summary of cross country research into the impact and causes of corruption, many of which use the TI index or the WGI discussed below. His survey of recent studies concludes that while higher corruption is clearly related to a low level of economic development, the direction of causation is still not settled. He argues that despite the uncertainty on causality with regards to growth the evidence from perceptions based indices supports the conclusion that corruption causes misallocation of government funds for public services and lowers foreign investment.

In terms of generating data for research on the links between governance and growth, Daniel Kaufmann, Aart Kraay, Paulo Zoido-Lobaton and later Massimo Mastruzzi work in developing the World Wide Governance Indicators (WGI) at the World Bank, has recently taken centre stage. Over the past five years the WGI has become the most frequently used measure of governance for academics and policy makers alike. The WGI indicators are composite indicators including six aspects of governance. These are voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, control of corruption. The indicators are based on an aggregation of perceptions data from 31 different data sources produced by 25 different organizations. Their data covers 200 countries from 1996. Kaufmann et al (2007) argue that WGI mark an important improvement in data on governance on a number of fronts. First, WGI provides a broad country coverage; second, it summarizes information from different sources by averaging the information, and they argue that this also means that some of the idiosyncrasies in the data are reduced; third, in a break from standard practice, they also publish margins of error that serve as a warning to researchers and policy makers about the unavoidable degree of uncertainty in measuring institutions. Kaufmann et al (1999) and their subsequent studies (2002, 2004, 2005, 2006) use the indicators to find 'a strong positive causal relationship from improved governance to better development outcomes' across the range of their indicators. This research has been backed up by a considerable number of other studies using their data sets, summarized in Thomas (2006).

Over the last decade, the gradual accumulation of indicators and research based on them has provided broad support for the arguments that institutions such as property rights stability, reducing corruption, transparent and accountable public sector, democratic government, rule of law and rent free markets are necessary to achieve sustainable growth in developing countries. A closer look at the debate, however, reveals important areas of contention and significant doubts about the validity of the data and evidence

[4] The CPI is constructed by compiling the surveys of perceptions of business people yet as Arndt and Oman (2006) point out, the CPI cannot be used as a measure of national performance in terms of reducing corruption. This is because of the year to year changes in methodology and the list of countries it covers.

presented so far. Beyond the discussions on data quality and methodologies of measurement another more fundamental debate is also building steam which suggests that other governance criteria, not covered by the 'good governance' institutions are in fact the crucial institutions required for growth. The next section summarizes the controversies over the quality of governance data and then sets out some of the arguments that suggest that we have to look to a different set of institutions to explain growth in developing countries.

## 3. Data Controversies

The proliferation of indicators and empirical research has generated an important debate on the role of measurement in governance. This is reflected in papers by Aron (2000), Knack (2006), Sudders and Nahem (2005), Malik (2002) and Basancon (2003). There has also been an important and informative debate specifically focussing on the World Wide Governance Indicators (WGI) which includes the critiques by Arndt and Oman (2006), Kurtz and Shrank (2006, 2007), Thomas (2006) and Knack (2006) and responses by Kaufmann, Kraay and Mastruzzi (2007, 2007) and the February 2007 World Bank Roundtable Discussion on Measuring Governance[5]. These frank debates, involving both the users and producers of this data, provide useful suggestions on to how to move forward on the issue of measuring governance.

The basic problem with measuring governance is how to accurately define and identify an abstract concept of governance and whether the proxies that have been used actually reflect the institution which they are supposed to represent. Thomas (2006) argues that 'The first question that should occupy potential users of any governance indicator is not the size of the measurement error, but whether the indicators are valid measurements of what they purport to measure' (2006; 13). This problem bedevils all of the research using proxy indicators of governance from Barro's early work using violence proxies for property rights instabilities (Knack; 2006) to the construction of the WGI data set. Thomas (2006) argues that WGI indicators exhibit 'concept vagueness' that makes the whole exercise of data construction problematic.

Kaufmann et al (2007) reject this criticism arguing that it is widely agreed that governance lacks an accepted common definition and that their choice of indicators are broadly in line with commonly used definitions. They also argue that without some agreement over concept definition, measurement of governance would fail to get off the ground completely. They suggest that problems of concept formulation are less apparent in the WGI indicators because of the high correlation between the different proxies they identify to measure particular concepts. While this may go some way to assuage fears that the data is unreliable (Kurtz; 2006) it does not necessarily imply much for the validity of the concepts. The issue of appropriate conceptual definitions therefore, undoubtedly requires careful and on-going review.

Knack (2006) highlights another area of definitional concern, echoed by Kurtz (2006) and Glaeser et al (2005), that there is not enough discrimination between outcomes and processes in the measurement of governance. Knack (2006) argues that this criticism applies to most of the 'first generation' indicators discussed above, while Kurtz (2006) makes the specific point that the WGI indicators combine institutions, policy preferences and policy outcomes into single indicators. Knack (2002) argues that a further general

5 http://info.worldbank.org/etools/BSPAN/PresentationView.asp?PID=1967&EID=907.

problem is that ‘first generation’ indices measure performance very broadly rather than specific aspects of performance. This limits the usefulness of the indicators in terms of policy advice and monitoring. Knack suggests that ‘existing research on governance ‘does not often point the way toward specific reforms, because it is based largely on very broad and aggregated indicators of institutional performance’ (2003: 294). He gives the example of corruption indicators which are rarely disaggregated between different types of corruption such as petty corruption and grand corruption or bureaucratic, legislative and judicial corruption. Such imprecision limits the use of the indicators to inform specific policy actions.

In terms of information sources, the fact that many of these indices rely on subjective views collected by public and private organizations for a range of purposes has been an important area of criticism of the data. This concern, expressed by Glæser et al (2004), Knack (2006), Kurtz and Schrank (2006) and Arndt and Oman (2006), is based on the fact that subjective data risks the possibility that ratings are affected by expert’s knowledge of recent economic performance, for example a country that has recently grown well will be assessed as having lower corruption than a country where the economy is stagnating. Kurtz and Schrank (2006) provide evidence that the Government Effectiveness measure in the WGI index, tends to have a significant partial correlation with two year average growth rates prior to the date of the governance indicator although their evidence is disputed by Kaufmann et al (2007). Lambsdorff (2004) defends the use of subjective data for analysis arguing that attempts at objective measures, such as the number of convictions for corruption used by Goel and Nelson (1998), are unlikely to give a true picture of the level of corruption.

Knack (2006) and Arndt and Oman (2006) make a related point that subjective indexes may be biased in favour of the interests of foreign investors who pay for the studies and that reports from one source may influence another. Arndt and Oman (2006) argue that while the list of sources appears to be diverse the fact that the aggregation procedure used to calculate the composite indicator assigns less weight to sources that differ from the majority means that there is much more weight given to expert assessments and enterprise surveys than to population surveys. Further, both Knack (2006) and Arndt and Oman (2006) point out that due to the aggregation process used in the formulation of the WGI composite indicators, the measurement errors that relate to measurement bias in subjective data are magnified. Arndt and Oman (2006) suggest that the likelihood of correlation of errors among the 37 sources from which the composite WBI indicators are constructed are high. Knack writes ‘this unknown but substantial degree of interdependence among many of the sources also obviates any claim regarding the ‘precision’ of these indicators’ (2006; 23).

The correlation of sources of errors does have significant negative implication as it means that each additional source used to produce a given composite indicator actually contributes less additional information to the construction of the composite indicator than the authors assume and the statistical significance and reliability of cross-country comparisons among country scores is lessened. This argument is strongly contested by Kaufmann et al (2007) who see the fact that their scores are based on diverse sources as one of the strengths of the WGI compared to earlier governance measures. Further, they argue that their data is explicit about the problems of errors in measuring as their aggregated figures allow calculations of margins of error, which are large for each individual measurement. Yet the rationale for aggregation is based on the presumption that different sources of errors are uncorrelated. They argue that the high degree of correlation between the numbers shown by some sources is not a reflection of a correlation of these sources' measurement errors but instead it is a reflection of their greater accuracy, compared to less closely correlated sources, in terms of the underlying reality of governance they are trying to reflect. Yet they concede that isolating the effect of correlated errors in driving the observed correlation amongst sources is extremely difficult and a challenge that remains to be addressed.

Arndt and Oman (2006) raise the issue of whether the WGI provides a suitable basis for ranking countries or to judge changes in governance performance over time. They argue that due to the fact that data sources can vary from year to year and that the change may just be a statistical artefact, caution should be exercised in using the indicators for these purposes. Kaufmann et al (2007) argue that change in governance performance over time can be assumed from their data. Their rule of thumb for judging change is that if over two years, the confidence intervals for the two different scores do not overlap, it can be stated that change has actually occurred in the country during that period. Arndt and Oman point out that there are actually a very limited number of countries where, on this basis, change in any direction can be reasonably inferred from the WBI indices. Ranking countries based on the WGI indices is put into doubt by Knack (2006) who argues that where country indices on measures such as corruption are based on two completely different sources, comparison is rendered less meaningful. Kaufmann et al (2007) argue that by aggregation they are creating common units of governance that can be compared across countries.

Nevertheless, both Kaufmann et al and Knack agree that this type of data is not very useful in terms of providing specific policy recommendations. Knack (2006) calls for the development of 'second generation' indices that are specific in measuring performance, pay greater attention to measuring government processes and institutions and not only performance, and are more transparent and replicable. Already there have been advances in these areas. The data sources for the WGI are all available publicly, apart from the data based on CPIA scores of the World Bank, African Development Bank and Asian Development Bank. Knack (2006) also points to work in developing 'objective' measures of performance. Proposals include measures of contract intensive money which Clague et al (1999) uses as a variable for the extent to which contracts are enforceable and property rights are more secure, budget volatility, civil service pay and measures discussed above to quantify business start up costs and difficulties of pursuing valid legal claims.

## 4. The Enduring Problem of Causality

Notwithstanding the strides that have been made in measuring governance, the enduring problem of causality hampers econometric analysis of the relationship between growth and governance. The methodological problems of cross country growth studies have been widely discussed in the literature in recent years (including Temple; 1999, Rodrik and Rigobon; 2004, Pritchett; 2002). The fact that rising incomes may improve the quality of institutions thus making institutional quality endogenous, causes problems of measurement error, reverse causation and spurious correlation. One way of reducing the problem of reverse causation is by going back as far as possible in time and measuring their dependent variables further forward in time. Yet, the fact that most of the data is only available for recent years, means that many institutional variables can only be measured from the end or close to the end of the period under investigation.

There is, of course, a wide body of economic literature which points out the links between rising incomes and improving governance. Econometric studies have proven inconclusive about the direction of causation, despite the fact that most of the literature covered in this review has attempted to deal with this problem through various econometric techniques. These include Mauro's two-stage estimations, Knack and Keefer's attempt to use longer periods of data and Rodrik and Rigobon (2004) use of Least Squares estimation. Even with more rigourous data tests, however, causality remains uncertain. For example Chong and Calderon (2000), apply a rigorous approach to causality, yet found strong evidence of causation running in both directions: from institutions to growth and from growth to institutional quality.

A solution to the causation problem is to find a valid instrument to include in the econometric model that is exogenous, correlated with the endogenous variable for which it is instrumenting and does not influence the dependent variable through any channel other than the relevant endogenous variable (Rodrik and Rigobon; 2004). For example, Mauro (1995) uses ethno-linguistic fractionalization of the population. Colonial experience has also been used to try to instrumentalize different institutional forms and remove the pervasive influence of rising incomes on the quality of institutions. Acemoglu et al (2001) work on colonial impact on property rights is perhaps the most well known attempt in this field and is credited (Glaeser; 2004) with reinvigorating the debate on governance and growth.

Acemoglu et al (2001, 2002) argue that where European colonizers settled, they brought with them institutions that protected private property and limited expropriation by the executive. Where European colonizers did not settle they introduced institutions of expropriation and arbitrary rule over the local population. They then argue that where a region was not densely settled by locals and where settler mortality was high, Europeans did not settle. They use this logic to argue that settler mortality and indigenous population density in 1500 can be used as instruments for modern day institutions that protect private property and constrain the executive. Their econometric results confirm that countries which exhibited this pattern of colonial settlement have experienced higher growth over time. Thus, their evidence purports to show that security of property rights and constraints on the executive lead to long term higher growth rates.

This article has attracted a great deal of praise for its innovative use of a colonial instrument to back up the good governance arguments. There are, however, a number of important critiques that undermine their conclusions. Glaeser et al (2004) point to the fact that while Acemoglu et al have shown that colonial history had an impact on growth they have failed to prove that it was the security of property rights that colonial settlers brought with them. Glaeser et al (2004) provide an alternative explanation, suggesting that colonial settlers may instead have brought aspects of human capital with them. Kurtz and Shrank (2006) and Khan (2006) both point out that the early colonial experience in countries where settlement was the norm actually involved a huge amount of expropriation of existing property rights. Khan (2006) argues that the rapid transfer of property rights can under certain circumstances, be a pre-requisite for growth, rather than the blanket property rights stability that Acemoglu et al presume to be at the root of divergent growth experiences.

A strong econometric rebuttal to the good governance evidence on the links between institutions and growth is provided by Glaeser et al (2004) and by Sachs et al (2004). Glaeser et al go so far as to state that 'the evidence that institutions cause economic growth, as opposed to growth improving institutions is non existent' (2004; 2). They doubt that the subjective data is capturing anything more than rising incomes. They find a strong correlation between economic growth over a period and the average assessments of institutional quality over that period while they find that constitutional rules for governance, which are one of the few variables that can be measured objectively, are not influenced. They conclude that the evidence supports the conclusion that higher income will improve governance, but not the reverse.

Sachs et al reach similar conclusions. They argue that while governance is a problem it is not as fundamental as other challenges that face African countries and that even if governance improved, in the conventional sense, this would not mean that growth would take off. They use Radlet's work (2004) where he regresses the WGI on GDP per capita and ranks countries according to the residuals of that regression. This standardizes the measurement of governance by level of income. They find that in fact many African countries are well governed according to their level of income. They also find that governance in Africa is not, on average, worse than in other countries once income has been controlled.

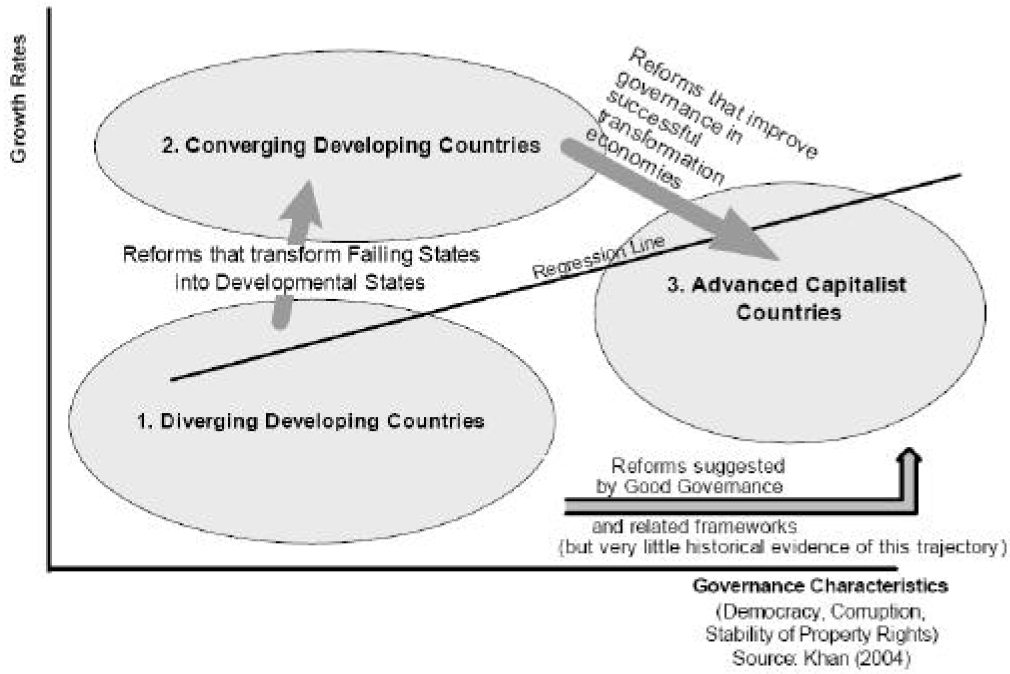
**5. Fast Growing and Slow Growing Developing Countries have Similar Governance Failures**

Mushtaq Khan's reassessment of the governance data from the WGI and the IRIS data set of governance indicators created by Knack and his team at the University of Maryland provide a different critique of the good governance evidence from that of Glaeser and Sachs above. Khan (2004) starts by dividing countries covered by the data set into three groups. In the first group are advanced economies with high income based on World Bank definitions (he leaves out countries that have had natural resource windfalls as they have not necessarily had capacities for producing wealth). The second group includes high growth developing countries which are developing countries whose per capita GDP growth is higher than the median advanced country average, these countries are classified as 'converging economies'. In the third group are low growth developing countries where per capita GDP growth is lower than the median for the advanced country group and hence these countries are 'diverging economies'.

He then calculates that there is virtually no difference in the median property rights index for converging and diverging developing countries and the range of governance across the indices almost entirely overlaps. Developing countries which lack the 'good governance' institutions dominate across both the low growth and the higher growth groups. He argues that the lack of clear separation of diverging and converging developing countries suggests that the econometric results based on the data that purport to show a strong link between good governance and growth are not robust.

Further, he argues that for all the composite indices of governance that he tests in this manner, the data suggests 'a very weak positive relationship between the quality of governance and economic growth' (2006; 18) and crucially, this positive relationship depends on the advanced country group having high governance scores. Looking solely at the group of developing countries, it is impossible to say anything conclusive about the direction of causality between growth and good governance. Importantly, the critical group of countries for ascertaining policy advice for other developing countries, the converging countries, don't have better good governance indicators.

He argues that this analysis has important implications for policy on governance. Unlike Sachs and Glaeser, he does not reject the idea that institutions do influence growth but instead argues that there are other dimensions of governance that fall outside the good governance agenda and are not being measured in the most used indices of governance. His argument is summarized in table 1 below. This evidence suggests that there may be important governance capabilities that are important both for setting off growth in poor countries, and other governance capabilities important for sustaining growth *before the conditions for achieving significant improvements in good governance have come about.*




## 6. New Directions

Over the past five years, there has been a proliferation measures and quantification of governance which has opened up the field of empirical analysis on institutions to mainstream economic techniques of research. Yet along with the proliferation of quantitative studies and measurement there is now an awareness that our knowledge about the relationship between governance and growth is perhaps more limited than we previously assumed. The data issues raised in the previous section and the challenges to the empirical evidence from reassessments of the data have generated a sense of caution and humility (World Bank; 1990) in terms of what we now claim to know about governance and particularly in regard to providing instruction on policy reform in developing countries. In parallel to the developments in empirical analysis that have broadly supported the good governance agenda, there has been a counter current of analytical dissent that has generated alternative hypothesis about the relationship between governance and growth. The main trends in this area are summarized in this section.

### 6.1 Dani Rodrik: Binding Constraints

Perhaps the most prominent and prolific critic of the good governance agenda has been Dani Rodrik at the John F. Kennedy School of Government, Harvard University. In various works (2002, 2003, 2004, 2005) has re-investigated the relationship between governance and growth. Along with the 'good governance' consensus he argues that 'institutional quality holds the key to prevailing patterns of prosperity around the world. Rich countries are those where investors feel secure about their property rights, the rule of law prevails, private incentives are aligned with social objectives, monetary and fiscal policies are grounded in solid macroeconomic institutions, idiosyncratic risks are appropriately mediated through social insurance, and citizens have recourse to civil liberties and political representation. Poor countries are those where these arrangements are absent or ill-formed.' (2004; 1).

His central intervention in the debate, and where he parts company with the conventional analysis, is to argue that institutional function does not uniquely determine institutional form, thus 'different contexts require different solutions to solving common problems' (2006; 6). For example he contrasts property rights stability in Russia and China. He argues that in Russia, investors have, in principle, the protection of a private property rights regime enforced by an independent judiciary, while, prior to the recent formalization of private property rights, investors in China did not receive the same formal recognition of their property rights and the courts were not formally independent. Despite these formal differences, investors consistently reported that their property rights were better protected in China than in Russia. Rodrik (2004) posits that this was a result of profit sharing arrangements between entrepreneurs and local government in China which ensured that it was not in the interests of government to expropriate private property rights.

Thus, property rights stability was achieved despite the absence of formal regulation in this area. He also argues that the broad objectives of economic reform e.g. market oriented incentives, macroeconomic stability and outward orientation do not translate into a unique set of policy actions (2006). There are a number of ways that these policies can be used and different contexts demand different solutions. The strong conclusion from this analysis is that 'the empirical literature on institutions and growth has pointed us in the right direction, but that much more needs to be done before it can be operationalized in any meaningful way. Many of the policy implications drawn from this literature are at best irrelevant and at worst misleading.' (2004; 1)

Rodrik draws out some important conclusions for growth policy in developing countries. He argues that reform efforts need to be selective and focus on the binding constraint on economic growth rather than attempt to tackle broad reform. The problem with large scale institutional reform, he suggests, is that it is inherently unfalsifiable and it leads to an open ended agenda that means that even the most ambitious institutional reform efforts can be faulted ex post for having left something out. For growth to take off in developing countries, he argues that a moderate move in the right direction can generate a big payoff. This conclusion is based on the neo-classical growth model where countries that are far from the 'steady state' rate of growth will grow more rapidly than those closer to the equilibrium growth rate. He argues that the main challenge to policy makers is to identify the 'binding constraint' where small reforms will have the largest impact on growth. The binding constraint will be specific to particular countries at particular points in time. Rodrik therefore presents an approach to institutions and growth that advocate caution and experiment. Diagnostic analysis is needed first to figure out where the most significant constraints on economic growth are in a given setting. This should be the basis for a creative an imaginative policy design to target the identified constraints appropriately. The process of diagnosis and policy response needs to be institutionalized to ensure that the policy does not run dry.

The impact of Rodrik's arguments is beginning to seep through to the policy audience. His influence is recognized and clearly evidenced in the World Bank Report *Economic Growth in the 1990s* (2005) which states 'An important realization of the 1990s was that the design of institutions can take a broad range of forms' (2005; 50). It is now acknowledged by the World Bank (2005) that merely adopting the institutions used in another country does not guarantee the same institutional performance and in fact different institutional arrangements can have the same outcome. They point to the very different ways that property rights of investors have been secured in India or China while in Indonesia property rights enforcement depended much more obviously on ones relationship with the ruling elite. The report says that the focus on efficiency gains was not very helpful and there is need to focus on the dynamic process of growth.

The 2005 Report admits that the relationship between democracy and growth is much more complex than was thought a decade ago. They argue that elected government are more likely to make narrow policy favouring certain sections of the population at the expense of the general population when citizens are ill informed or cannot trust commitments prior to elections or are deeply polarized. Thus information and credibility are the key factors in making democracy work for growth and poverty reduction. Further, elected governments are more likely to respect private property rights when they confront checks and balances in decision making. The report recognizes that there are many imperfections in political markets. Divergence in performance between rich and poor democracies depends on the extent of imperfections in political markets. They conclude by pointing out, along Rodrik's lines that democracy is not sufficient to ensure accountability. Importantly, they also point to the recognition of the prevalence of patron-client networks in politics and clientelism that has emerged in academic and policy fields over the past decade.

The implications of Rodrik's work for future research into governance are that more detailed country based analysis is needed to identify binding constraints and tailor institutional reform policy to the specific needs of countries at particular times. A suitable methodology for this kind of research requires analytical narratives as well as statistical research for detailed case studies. Rodrik's (2003) *In Search of Prosperity: Analytic Narratives on Economic Growth* provides an example into how meaningful research can be carried out in this area.

### 6.2 Mick Moore and Hubert Schmitz: Hand in Hand Arrangements

In a recent paper Mick Moore and Hubert Schmitz (2007) review the debate on investment climates and draw two important conclusions; first, more attention needs to be paid to the political relations between investors and those who exercise public power; second, temporary, heterodox, 'hand-in-hand' arrangements might have more impact on private investment where governance institutions are weak. They also investigate the implications for research that these insights suggest. Their paper starts by defining an investment climate as the unpredictable factors that affect the degree of uncertainty that investors face about their ability to profit in the future from investment decisions made now. Their definition excludes relatively predictable aspects such as changes in input prices or interest and exchange rates and instead focuses on variables such as the inability to enforce contracts and debt obligations with suppliers or customers or the unwillingness of the police to take action against large scale theft of goods in transit.

Thus, broadly, the investment climate reflects 'the extent to which private investors perceive that the holders of political power are on 'their' side' (2007; 7).

Moore and Schmitz agree with Dani Rodrik that the 'best practice' governance institutions common in OECD countries may not be a practical or useful guide for developing countries facing the urgent need to improve the investment climate. This is partly because of continued uncertainty over the historical evidence on the link between these institutions and growth in OECD countries themselves. Further, more recent experience of attempting to transfer institutions from rich to poor countries has had disappointing results. They review a number of studies that have assessed programmes to transfer legal structures to developing countries, promoted by the Law and Development approach. The generally disappointing results raise questions about 'the ease with which the general principle may be translated into specific, non-conflicting policies and institutions that will contribute to the general good.' (2007; 12). They argue that reasons for the difficulty in transferring institutions include ideological, organizational, political and structural factors and concur with Rodrik that forms and functions of institutions are distinct.

Rather than trying to create 'arms length' relations of institutionalised trust through universalistic, standardised legal mechanisms, they argue that reformers might do better to pay more attention to temporary, heterodox 'hand-in-hand' arrangements that could help boost private investment in weak governance contexts. The key focus in improving the investment climate should be on improving relations between owners of private capital and holders of political power. The investment relationship depends primarily, but not exclusively, on private sector relations with government. There are, however, other social agents who may also play a role in providing social co-ordination through forms of 'relational contracting'. These may not be a first best option, but suggest that more attention should be paid to non-state actors and to co-operation across the state society divide.

Moore and Schmitz point to the historical and structural reasons for the fact that across most developing countries the relations between those holding political power and private capital have often been fraught, including the colonial bureaucratic legacy that has led to over-developed states, sources of revenue such as aid and natural resources that have reduced the dependence of the state on productive capital, greater trans-national influence and therefore less space for nationally negotiated political settlements, low incomes and shorter historical trajectories of development compared to OECD countries. Moore and Schmitz argue that there needs to be more explicit recognition of the political processes through which productive relations develop between investors and holders of political power in developing countries as very little is known about the conditions under which these relationships actually work.

Developing countries that have been successful in improving the investment climate have relied on 'particularistic' relations between investors and the state. Yet, these 'particularist' relations can also lead to unproductive relations. Moore and Schmitz argue that explicit recognition of the political processes through which productive relations develop between investors and holders of political power in developing countries is needed. Little is known about the conditions under which these relationships actually work. They suggest that probably the two most important factors in determining whether particularistic relationships will lead to growth or not is due to sectoral characteristics and scope for rent taking. A research agenda to improve knowledge in this area require a richer vocabulary to distinguish between different types of relationships. Finally they call for more research on an intra country basis to provide some constant contextual factors that may aid the analysis of causation, however, they caution that whether such studies will provide generalisable and transferable findings is hard to predict.

### 6.3 Philip Keefer: Political Incentives

Philip Keefer's review of the political economy of governance (2004) suggests that while 'good governance' is required for growth, little is known about the political incentives and overarching political environment under which improvements to governance can be made. Keefer argues that moving forward in this area will require separate examination of the heterogeneous components of governance rather than aggregated concepts which may be analytically imprecise in a context where all good things may not come together. Instead, he recommends focussing on the determinants of good governance, the political and social conditions that lead to more secure property rights, greater voice and accountability or more efficient and honest bureaucracy. From a policy perspective, questions of the determinants of good governance are critical for the development of sustainable and effective reform.

Understanding of the political incentives and wider political environment under which governance operates requires a critical engagement with a broader political economy literature. There are two important areas of emerging research in political economy of sources of good governance. First, investigation into the structure of political institutions and competition which involves analysis of information accessible to voters, credibility of political competitors, the foundations of intra-party competition and incentives on government decision making processes. Research in this area suggests that political and electoral institutions as well as information directly impact on political incentives and can therefore improve governance. Second, there has been more specific research into the conditions under which secure property rights develop.

So far analysis has primarily been undertaken through rational choice or new political economy analysis. The comparative politics literature is limited as while it differentiates regime types by referring to historical and broad characteristics it does not consider the incentives of the actors that run them. Keefer argues that efforts to bridge these approaches can be rewarding. He suggests that 'the new political economy literature regularly makes explicit and often different assumptions about the credibility of political promises, but it rarely analyzes variation in credibility across countries as a key determinant of differences in development outcomes' (2004; 35). Keefer (2002) argues that variation in credibility itself depends on patterns of clientelism. Clientelism prevails when competing politicians can make credible pre-election promises to only a few people while clientelism will become less influential where pre-election promises are credible to the whole country. Institutionalized bases for credibility, for example political parties with deeper historical and ideological roots, are important in providing political competitors with incentives to prefer generalized and broad-based public good provision.

Keefer argues that this approach uses the detailed historical observations of clientelism in tandem with the quantitative tools, used by Persson and Tabellini (2000) for example, to study incentives facing individual actors. The most promising areas of future research according to Keefer relate to the specific conditions of political decision making and electoral decision making. These conditions include information, credibility and the nature of inter-personal relationships among politicians. He argues that checks and balances are important to government credibility and secure property rights but they are neither necessary nor sufficient. If governance failures are deeply rooted in the incentives of political actors these reforms may not translate into significant change in the way that government operates.

In terms of a role for those outside the political process in promoting 'good governance' this analysis suggest there can be potential to change the political equilibrium. This can be achieved by providing relevant information about candidate performance to voters and looking into political claims and mobilizing voters around service delivery issues. Keefer argues that there is a move in the literature towards the identification of key concrete political obstacles to good governance that, like the extent of voter information, are amenable to change.

### 6.4 Douglass North, John Walis, Steven Webb and Barry Weingast: Limited Access Orders in the Third World

Within the last year a new framework for considering the impact of governance on growth has been proposed by a team of researchers including Douglass North, Steven Webb, John Wallis and Barry Weingast. This research is important, not least, because it represents a radical new appraisal of institutions by Douglass North who is credited as one of the founders of New Institutional Economics. They start by admitting that development policy models are based on making developing countries look more like developed ones but that the social dynamics of developed countries are fundamentally different from those of developing countries, thus they propose that 'development tools based on first world experiences are ill-suited to the development goals in third world countries' (2007; 1). Their theoretical framework makes a break from Weberian analysis of the state as holding the monopoly of legitimate violence. Most approaches to the state are based on the assumption that the state can be modelled as a single actor and that the state has a monopoly of violence. They start from a different understanding: Violence potential is spread throughout society rather than concentrated and no one has a monopoly on violence. Thus, all societies structure their economies and polities in order to solve the universal problem of violence and disorder. The problem of providing powerful individuals with an incentive to be peaceful is common to all societies and all countries, rich and poor, possess institutions, organizations and beliefs that enable them to deal with violence with varying degrees of success. Standard development advice fails all too frequently because it conflicts with the social logic that maintains order.

Their conceptual framework categorizes three orders into which all human societies fit. The first is the primitive order which consists of hunter-gatherer societies. The second is the limited access order (LAO). The LAO creates limits on access to political and economic functions as a way to generate rents. Rents are created by limits on access to resources and functions like worship, trade, education and fighting and by limiting access to forms of social organization that the larger society will support. Rents are then redistributed in order to maintain social stability and limit violence. This is a potentially significant break with the previous analysis of rents coming from mainstream New Institutional Economics because it recognizes that some of this damaging rent creation can be *functional*. LAOs are not a malfunction of a disorder, but are rather the normal operating form of developing economies. This potentially has significance in developing a more appropriate research paradigm for assessing and identifying governance priorities for developing countries. The third order is the open access order (OAO). This order relies on competition, open access to organizations and the rule of law to hold the society together. These societies, which are basically limited to rich economies in the modern world, use competition and institutions to make it in the interests of political officials to observe constitutional rules, including political control over a consolidated military.

North et al call the 'first development problem' that of economic, political and social development within limited access orders, which includes the majority of developing countries today. The LAO is a general strategy for organizing society and not a specific set of political, economic or religious institutions, yet they all share the basic principle of manipulating the economy to produce stability and prevent violence. They argue that institutional change persists when it is compatible with the incentives and constraints of those in power. Governance reform fails because it is based on transplanting elements of the open access order such as competition, markets and democracy directly into limited access orders. These reforms threaten the rent-creation that holds the society together and challenge the very logic on which the society is organized. LAO's typically reduce violence by forming a dominant coalition containing all individuals and groups with sufficient access to violence that can, if they acted unilaterally, create disorder. The dominant coalition creates cooperation and order by limiting access to valuable resources – land, labour, capital or access and control of valuable activities such as contract enforcement, property rights enforcement, trade, worship and education – to elite groups. Typical LAOs exhibit rent creation in various forms including state-controlled industries, problematic licensing regimes for new entrants and 'corrupt' patron-client networks.

The rents that elite groups receive by restricting access are magnified by restricting support for organizations only to elite groups. For example, LAOs enable only elite groups to form contractual organizations with third-party enforcement which limit access to organizational forms and contract enforcement. Such restrictions are the key to the limited access order as it creates rents through exclusive privileges and directly enhances the value of the privileges by making elites more productive through their organizations. As elite rents are reduced by violence, the existence of rents can provide credible commitments among elites that they will not fight each other as maintaining the rent requires stability of the current coalition. Limited access orders must carefully balance the distribution of elite interests within the dominant coalition. A shift in the incentives facing a major player that leads him to defect or use violence will produce instability.

They further define three types of LAOs that are common amongst developing countries today. The first is the fragile LAO where the state can barely sustain itself. Each faction in the dominant coalition has access to violence and violence potential is a principal determinant of the distribution of rents and resources. Commitments are not credible and elite organizations cannot be formed. A step up from this is the basic LAO where the state is well established compared to the fragile LAO but the state is the only durable organization and elite rights and privileges are closely identified with it. An individual or group who wishes to pursue a complicated activity requiring a more sophisticated organizational structure must use the state itself as the vehicle for organization. In such a state civil society activity is limited but there are opportunities for dispute resolution within the state. In basic and fragile LAOs the integration of politics and economics is complete and the state is relatively undifferentiated.

The third type is the mature LAO where the government supports a large variety of organizations outside the government. This allows the state to limit competition and create rents to maintain the dominant coalition. The presence of better organized private elite organizations takes this LAO closer to the open access order. In a mature LAO, some actors come to specialize in political or economic activities, violence specialists will have more distinct and often separate organizations. In the modern world in order for countries to follow the example of countries that have become OAOs they have to achieve certain 'doorstep conditions'. These include rule of law for elites, support for perpetually lived elite organizations and increasing centralization and consolidated control of violence.

For most LAOs the most important development issue is to understand how the state can solidify itself and maintain or improve its control of violence and eventually to create a legal framework for non-state organizations. The actual distribution of coercive power is the decisive factor that will determine the pace and path of development. Fragile LAOs should focus on creating the possibilities for moving towards basic LAOs. This would include the creation of more specialized governmental agencies and services. The problem of moving from being a LAO to an OAO is made easier by the fact that there are countries that can provide examples of how an OAO is structured, however, North et al counsel that it is not simply a matter of transplanting the institutions from OAOs to LAOs as the logic of maintaining social stability is completely different. Further, a certain amount of growth on the basis of technological upgrading and copying does not necessarily shift a country to OAO status, nor does simply opening up to firms from OAOs, which instead of changing the underlying social logic, merely leads to dualistic economic structure.

The Limited Access Order paradigm is of course very new and requires detailed historical case studies to flesh out examples of how different LAOs have achieved stability and, in some cases, growth and progress towards OAO status. The concrete policy implications remain to be explored.

### 6.5 Mushtaq Khan: Growth Enhancing Governance Capabilities

In a number of books and papers (2001, 2004, 2005, 2006) Mushtaq Khan argues that the good governance agenda has failed to identify the key governance capacities that are critical for maximizing the pace of growth in developing countries. Khan (2006) argues that the institutions identified by the 'good governance' agenda relate essentially to improving market efficiency. He classifies market enhancing governance capabilities as institutions which make markets more efficient by reducing transaction costs, including secure property rights, enforceable contracts, efficient bureaucracy etc. Khan's analysis of the data on governance discussed in section 5 above shows that neither rapid growing nor poorly growing developing countries have strong market enhancing institutions. Instead, he argues that the distinction between these two groups of developing countries is in another set of institutions, which he terms 'growth enhancing' institutions.

Growth enhancing institutions deal with some of the specific structural constraints that face modern developing countries that are attempting to improve growth and poverty reduction. These structural conditions cover three main areas. First, weak property rights are a structural feature of late development. This is due to the fact that there are limited public resources available to adequately define and protect property rights across the board. Constructing a functioning property rights system is extremely expensive and Khan points out that 'advanced countries only achieved significant stability in their property rights at a relatively late stage of their development when most assets had achieved high levels of productivity' (2006; 31).

Khan argues, therefore, that the establishment of stable property rights prior to the achievement of more productive capitalism is almost impossible to achieve. Instead, the governance challenge for developing countries governance capabilities is to manage non-market asset transfers in ways that created incentives for productive investment and allows productive investors to have stable expectations about their future rewards, as well as maximizing social justice. Khan points to cases where countries have achieved this non market transfer of assets in a way that generated productivity growth over the medium to long term. These were the creation of the chaebol in South Korea in the 1960s using transfers of public resources to these privileged groups; the creation of the Chinese TVEs using public resources in the 1980s and their privatization in the 1990s; and the allocation and appropriation of public land in Thailand.

The second structural feature facing today's developing countries is that markets alone cannot achieve sufficient technological catch up. Khan explains that 'efficient markets can only attract capital and technology to countries where these technologies are *already profitable* because the requisite skills of workers and managers already exist' (2006; 36). Developing countries have lower levels of productivity, not primarily because of lower levels of education, but, more importantly, in terms of the time and effort needed to achieve labour discipline, tacit knowledge and learning by doing. Overcoming these constraints on productivity incurs costs. Closing the technology gap and competing effectively on the international market therefore requires public or private rents and complementary support by states with the governance capabilities to ensure that rent management can be effectively enforced (Aoki, et al. 1997; Khan and Jomo 2000).

The governance capabilities for success in this area require state capabilities that allow the state to adapt strategies to acquire technologies and learn new ways of organizing work and using knowledge. This is not simply a question of setting up infant industries. Instead, it involves establishing institutional compulsions that ensure that effort involved in learning is achieved. The common feature of successful learning by doing countries was that failure led to corrective action that was effective. Khan points out that even countries that are following largely market-driven growth strategies have elements of formal or informal strategies to promote technology acquisition and to maintain discipline in these processes.

The third structural constraint facing developing countries is the difficulty of maintaining political stability in a context where patron-client politics is structural and difficult to change in the short run. Counter to the good governance argument that patron-client networks can be limited by democratic accountability, there are structural forces which drive political corruption. Structural political corruption is due to the difficulty of managing political stabilization using transparent fiscal processes. The critical constraints facing developing countries are limited fiscal resources and the social dislocation caused by the social and economic process of development. Within this structural context, the logic of patron client politics dominates. Khan (2006) writes 'patron-client politics makes sense because it allows the governing group to identify the most critical, the best organized, the most troublesome, or simply the most dangerous constituencies and buy them off selectively'.

The identification of political instability as being generated by structural constraints is, at some levels, similar to North's framework discussed above, although the structural features identified by the authors are different. For Khan the governance challenge in this area is to 'understand how in specific contexts, the management of political stability is being achieved using the historical endowments of institutions and power structures, and whether feasible changes in political institutions and political organizations can assist in strengthening political stabilization.' (2006; 53). Success in this area depends on the compatibility between institutional structures and the political structures which encompass political organizations and patron-client networks that describe the political settlement.

## 7. Some Implications for Future Research

This review has set out the major areas of advance in research on governance and growth in recent years. The most dramatic change has been in the proliferation of quantitative measures of governance and the subsequent econometric research that such data has permitted. With the expansion and growing importance of governance indicators for policy and research, the debate over data quality has also taken on new importance. Frank and vigorous debate on the merits of different measurements has undoubtedly enriched and furthered the task of data production. The main challenges in this area remain to design more robust, specific and policy relevant measures. Notwithstanding the improvements in data, the last five years has seen significant challenges to the empirical evidence and theories that the good governance agenda is built on. Some of the most prominent advances in this area such as Rodrik and Moore, build on the basic insights of New Institutional Economics. Others, such as North et al and Khan challenge some of its basic assumptions and relevance for growth in developing countries. They suggest that there are significant structural differences that mean that the governance requirements to promote growth in developing countries involve very different challenges from those identified by the good governance agenda. The challenge that these new directions in thinking on governance pose to research and policy is that before we can reach conclusions on the debate on how to improve measurement, more discussion is needed on *which* are characteristics of governance that are central to growth. Agreement on this will point to what is most important to measure, either in general or in particular developing countries, and how to best use the expertise that has emerged over the past five years in measuring governance.

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