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An Age of Divergence in Countries’ Economic Performance

In the last two centuries the ratio of real per capita income in the richest countries to that in the poorest countries has jumped from about two to over thirty-five. The share of global inequality caused by differences between countries—as opposed to differences within countries—increased from less than 15% at the beginning of the 19th century to about 60% in the post-World War II period. Since then, some parts of the developing South have started catching up with the richer North. After 1980 in particular, a number of emerging-market economies gained ground on the more mature advanced economies, with growth in some, especially India and China, lifting hundreds of millions of people out of poverty.

Most of the poorest economies, however, were unable to increase their real incomes significantly over this period, and the gap between the richest and the poorest economies has widened since 1980. The gap narrows when development is measured by broader yardsticks such as the Human Development Index (HDI) because life expectancy and school enrollment have converged more than income, but huge gaps remain in these broader indices as well. Today, our world remains one of great income divergence between the richest and poorest countries, as is documented in the United Nations Department of Economic and Social Affairs’ (UN DESA) latest World Economic and Social Survey. One should add that within-country inequality has been increasing in most of the world over the last three decades. Another major problem is that the causal link between growth and decent work, which should be an extremely important ultimate policy objective, has weakened over the recent past, as documented for example by the ILO.

Explaining Divergent Economic Performance: The Role of Institutions

Economists and social scientists have long sought to explain the tremendous differences in economic performance that have created this world of divergence. Global and comprehensive answers still elude us. But we have found ample evidence that institutions and economic governance strongly influence economic performance, as reiterated in the latest World Economic and Social Survey.

The institutions that enable growth and development are those that encourage investment, ensure the rule of law, and lead to overall social stability and a sense of ‘legitimacy’ about economic outcomes. Institutions are not only determinants of economic performance; that causality also runs in the other direction, since prosperity increases demand for strong institutions and enhances the conditions that sustain them. But the differing quality of
institutions is certainly an important part – the key, in many instances – of the explanation for the divergent development between countries that we see today.

**Governance Reform for Embedding Markets in Political and Social Institutions**

There is today wide agreement that both efficiency in resource allocation and the drive for innovation require markets and entrepreneurial activity. We have also learned, however, that development demands an enabling state that allows markets to function, ensures adequate competition and pursues redistributive policies to make market outcomes more acceptable to all. Unregulated markets can’t provide efficient outcomes because a number of market failures must be addressed. These include abuse of monopolistic positions, externalities and the existence of public goods, and information asymmetries. At the same time progressive taxation as well as the provision and/or subsidization of public services to the poorer segments of the population help to legitimize the market economy.

Thus, private markets require building state capacity for regulation, providing public goods, ensuring the fairness of rules, enabling consensus building and avoiding social conflict. We can see that in today’s most successful advanced countries, the development of competitive markets and vigorous entrepreneurial activity driving innovation and growth has gone hand in hand with the establishment of a strong and effective state that reflects the interests of and is legitimized by the consent of its citizens. As expressed by Karl Polanyi, markets have been embedded in social and political institutions.

Embedding market systems in these institutions requires strong and effective governance structures. While appropriate governance is intrinsically difficult to design fully and in terms applicable to all countries, it always involves creating well-functioning, legitimate public institutions supportive of development.

**Challenges in Implementing Governance Reform**

Capacity development in public administration is a crucial part of governance reform. Election support and anti-corruption measures often take the limelight, but a democratically elected and honest government may still fail to deliver services if it is not able to attract and retain qualified employees, or if teachers and doctors fail to be present at schools and hospitals. Neglecting the need for an effective public administration and civil service often represents a weak link in overall efforts to enhance governance and economic performance. In some cases, for example in Afghanistan, the reluctance of many donors to channel support through the new national administration has seriously weakened overall progress.

Public-administration reform and the need to strengthen the civil service have been perennial concerns for development strategies. The results of efforts in the past, both at the national level and at the level of the international community, have been mixed at best. While specific challenges differ among countries and evolve over time, three common, interrelated issues emerge again and again in hindering the effectiveness of public administrations in the developing world.
Striking the right balance between politics and autonomy

Too often public servants are forced to respond to purely partisan political demands and are chosen on political criteria rather than on merit. A public administration with these characteristics will not have the professional competence and the longer term perspective that is crucial for effective regulation. Good economic governance also requires the ability to credibly pre-commit to certain stability and growth enhancing policies. That is why the most successful modern economies, in addition to a professional civil service, have non-partisan and to some extent autonomous regulatory bodies and central banks. At the same time one has to be careful not to separate these agencies from the hopefully democratic and legitimizing political process. Good economic governance must be politically legitimate. There is need for the right kind of balance, therefore, involving laws that guarantee objectivity, competence and the ability to pre-commit, with strong accountability and transparency in the regulatory and decision making process, including regular reports to parliaments, open debates with civil society and public access to the information that leads to particular decisions as well as the explanation for the rationale underlying the decisions taken.

Incentives and compensation

Poor incentives sap the motivation of civil servants to do their jobs well and adhere to high standards of integrity. They also inhibit the attraction and retention of qualified and talented staff. Merit-based appointment and career-progression policies, for example, seem to bring higher levels of performance and integrity, as noted, for example, in UN DESA’s World Public Sector Report 2005. But they are still a rarity in many developing countries.

One major drag on performance in education and health public services is absenteeism. A recent study in a sample of developing countries for the World Bank found that on average, 19% of teachers and 35% of health workers were absent from their workplaces. Further, the study found that absences were most frequent among the highest-ranking providers, with older, more educated and head teachers, as well as doctors, more frequently missing work. Better incentives would seem to reduce absenteeism, including more reasonable expectations – for example, asking health workers to cover a smaller geographical area – better monitoring of attendance, and more effective reward/penalty structures.

The salaries of civil servants in most developing countries are very low, in some cases barely providing enough income to subsist. In almost all instances, compensation for highly skilled professionals is not competitive with the private sector, though public- and private-sector wage differentials vary widely between and within countries. Civil-service pay is also often dramatically lower than the compensation paid by international donors to consultants. International consultants may earn as much as US$200,000 a year, a large multiple of what top civil servants are paid, according to the 2005 OECD DAC’s Development Co-operation Report. This same report shows that about 25 percent of all development assistance is in the form of technical cooperation and a large portion of the funds are spent on foreign experts who may often be very competent and naturally demand compensation commensurate to income levels in their home countries. The question arises, however, whether much of that money should not be spent
on truly building and sustaining the domestic capacities of the public administration in recipient countries.

Inadequate compensation is not only reflected in average salary levels. The salary structure in the public administration of developing countries is often compressed, which makes it difficult to adequately compensate better qualified, more experienced or more senior civil servants. A salary-compression ratio of 2 or 3 (calculated as the ratio between the mean of the highest salary grade and the mean of the lowest salary grade), which is not uncommon, means that employees with major managerial or leadership responsibilities, often charged with making key strategic decisions, can earn only slightly more than workers with the most routine tasks. These inadequacies in compensation further aggravate the problem of motivating civil servants to perform at a high level, and with integrity.

*Emigration of Skilled Professionals*

The emigration of skilled professionals from developing countries further depletes the already limited pool of highly qualified people upon which the public sector relies, as emphasized by the recent report of the UN Secretary-General on international migration and development. In some developing countries, as many as two-thirds of highly educated citizens live abroad, with several countries seeing more than 20 percent of highly skilled workers living as expatriates. The situation is particularly dire in some sectors such as health where research carried out by the Center for Global Development shows that about 28% of sub-Saharan Africa-born physicians live in developed countries.

There are, of course, advantages to having citizens living abroad – remittances and, often, the added experience, exposure, and contacts acquired by expatriates. It helps if developing countries are able to tap into the skills and experience that their expatriates have gained abroad. But in reality, developing countries are often unable to compete with the appeal emigrants see abroad. The net effect of this “brain drain” in depleting the country’s human capital – the product sometimes of significant domestic investment over many years – makes public service delivery much more difficult.

*Governance Reform and the United Nations*

Developing countries can face great difficulties and setbacks despite markets strengthening if governments remain weak and under-staffed. A weak public administration will threaten market development itself, as a grossly enfeebled state will not be able to uphold the very conditions that sustain free and productive economic activity. Such weakness also frustrates expectations for public service delivery, leading to a perception that governments are being irresponsible to the needs and concerns of citizens, breeding instability and insecurity.

This is why support for governance is a priority within the United Nations family, including UNDP. This fits with the UN experience of and focus on the “software” of development rather than the financing of physical infrastructure or the balance of payments support provided by other development partners such as the multilateral banks. At the core of
the work of the UN and its funds, programmes and agencies are wide ranging governance capacity development programmes. These include democratic governance and support for elections, as is currently the case in the Democratic Republic of Congo. But elections are only the first step in a longer-term process of strengthening state capacity and legitimacy.

Now that the importance of improving governance and reducing corruption is so widely accepted and is the focus of so much energy and so many resources, it would be disappointing to see reforms fail to work because of a failure to address the fundamental issues of public service reform. It is, therefore, crucial to imbue efforts for public service reform with a new impetus and new resources to make them progress so that effective economic governance, appropriate to the specific circumstances of each country, can embed and legitimize the indispensable working of markets.