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Two Aspects of Governance

Public Service Delivery and Corruption

Introduction

An exceptionally sociable, kind and gentle person, and a loving family man, Abid Hussain was an outstanding civil servant, a diplomat and an adviser to several Prime Minister's in his public life. He was also a person with a deep commitment to India and to high moral values. Sliding standards of governance, the rising incidence of corruption, adulteration of the idea of inclusive India and the erosion of moral values that he witnessed in the later years of his life seemed to cast a shadow over his otherwise cheerful demeanour.

I had the good fortune of knowing 'Abid Bhai', his charming wife Karki and their whole family over several decades. Fairly early in our relationship, Abid Bhai once asked me what price India paid for its endemic corruption. Could we say, for instance, that India lost x percent of growth because of corruption. This was long before a whole literature emerged on the relationship between corruption and growth. I had no answer for him, not to say that lost growth is the only possible price of corruption. However, the thought stayed with me as I progressed through my career of over four decades in the field of development, sometimes as practitioner and sometimes as researcher.

Placing corruption within the larger context of governance failure, I came to recognise that the question of more or less

1. I would like to thank Rana Hasan and Deepak Nayyar for inviting me to contribute this paper as my small tribute to Abid Hussain in this festschrift volume in his memory. I would also like to gratefully acknowledge the assistance of Satadru Sikdar in writing this paper.

successful development depends quite crucially, though of course not exclusively, on successes or failures of governance. I would maintain that this proposition is robust to varying contexts across different geographies and for countries in different stages of development.

This essay discusses some issues relating to two aspects of governance: a positive aspect, service delivery, and a negative aspect, corruption. In section 2 we develop the concept of governance as service delivery and a metric for measuring the quality of governance, so defined, particularly in the context of competitive sub-national governments in India. Section 3 presents the case for dealing with the supply side of corruption in the interface between business and government, and spells out an approach towards the establishment of an ethical business institution to curb the incidence of corruption. Section 4 concludes.

Governance as Service Delivery

Conceptions of governance have ranged from a narrow definition that governance is what governments do to a much wider definition that governance is the way in which individuals, groups, and institutions, both public and private, manage their affairs and resolve conflicts of interest in an orderly manner (Weiss 2000, DARPP 2009). The narrow definition, what governments do, is obviously the most appropriate if our purpose is to assess the performance of governments, national or subnational.

Given that definition of governance, what is the criterion that enables us to distinguish between good and bad governance or to establish a metric for assessing the quality of governance? In a recent paper Fukuyama (2013) has described the quality of governance as "a government's ability to make and enforce rules and to deliver services." The authority-service duality embedded in this concept of good governance can be traced back at least two and a half millennia. Kautilya's *Arthashahstra*, the authoritative treatise on India's traditional concept of good governance dating back to the 4th century BCE, states that the king must have coercive authority, *danda*, but also outlines the principles for its fair application to serve the common good, Dharma.[2] Around the same period of history we find in different parts of the world remarkably similar conceptions of good governance as the need for authority and an order preserving government to ensure peace, security and prosperity of the people. It is a view shared by the Shang emperor of China in the East and Plato, with his concept of the ideal Athenian state in Greece, then the centre of civilisation in the West (Spengler 1969, Shome 2012).

This core concept of good governance as the duality of authority and service, adapted to changing times and conditions, has survived over the centuries through Machiavelli (1515),[3] Hobbes (1651), Adam Smith (1776) among other philosophers. In our own times, the duality in Fukuyama's definition resonates with many similar formulations (Arrow 1974; La Porta et al. 1999; Besley and Persson 2011, Acemoglu and Robinson 2012). It is important to note that in this historically robust concept of good governance authority, the ability to make and enforce rules, is not an end in itself but a means to an end, i.e., the delivery of services. This distinction is key in developing a metric for rating the quality of governance.

Fukuyama lists four possible approaches for assessing the quality of governance: procedural measures, capacity or input measures, output measures and measures of bureaucratic autonomy. Stating that as bureaucratic capacity increases bureaucratic autonomy should also increase, he goes on to define an optimal path of good governance. It is a path that moves from a combination of low levels of bureaucratic capacity and autonomy to high levels of bureaucratic capacity and autonomy.

While this specification of a good governance path is interesting, it has little operational value. Fukuyama does not provide any metric for measuring either bureaucratic capacity or bureaucratic autonomy, nor does he provide any functional rule relating capacity to autonomy, i.e., the so-called optimal good governance path. He also does not specify how the two variables, bureaucratic capacity

2. See the translation by L.N. Rangarajan. (Kautiliya 1992)

3. See the introduction by George Bull to the Penguin edition of Machiavelli's treatise on statecraft (1969). The original Italian version was probably completed in 1515.

and autonomy relate to his own core concept of good governance, i.e., authority and service delivery.

Of the four measures that Fukuyama lists, only the output measure of service delivery is compatible with the concept of good governance discussed above. As explained earlier, in the authority-service delivery duality, authority is not an end in itself but only a means to an end. We are thus left with an unambiguous measure of good governance, namely, the quality of service delivery.

However, governments deliver not just a service but a multiplicity of services. These can range from infrastructure services such as transport, connectivity, water, and power to social services like education and health, to fiscal performance, to maintenance of law and order, to justice delivery, etc. So the first challenge that arises in empirically assessing the quality of governance, defined as service delivery, is to develop a credible metric that can aggregate indicators of the quality of all these services into a comprehensive index of the overall quality of governance.

Before turning to this empirical question it is necessary to address two prior issues. The first issue is that service delivery outputs such as the quality of infrastructure, education etc., may depend on factors other than public action. This concern has led Fukuyama and others to reject service delivery output as a measure of the quality of governance.

This view is based on a misconception that outputs of service delivery are functions of governance along with other determinants. In the definition adopted above, service delivery outputs are not functions of governance and other determinants. They are themselves the constitutive elements of governance, whatever their determinants. As such, the fact that these outputs are functions of multiple determinants is quite irrelevant.

Further more, let us grant for the sake of argument that these outputs are not in themselves constitutive elements of governance but only a function of some undefined element called governance, along with other determinants. Multiple determinants are not a problem for isolating the impact of governance on these outcomes. Econometric techniques enable us to do that decomposition.

Governance quality can then be estimated as the residual-analogous to the measure of technical progress in the Solow (1957) aggregate production function.

The second issue is the close correlation between service delivery outputs and the level of development, represented by per capita income, that has been widely observed over time and across geographies (Besley and Persson 2011; Evans and Rauch 1999; La Porta et al. 1999; Rodrik et al. 2004). In an earlier paper Mundle and associates also reported such correlation at the sub-national level in India (Mundle et al. 2012). Wilson (2016) has recently reported similar correlation at the sub-national level in China.

These 'development clusters', as Besley and Persson have called them, may appear partly because of underlying determinants that drive both development and public service delivery, and partly because of mutual inter-dependence between service delivery and development. Thus two countries, or subnational jurisdictions, with the same level of governance inputs such as capacity, process efficiency, autonomy, and transparency may have different levels of service delivery if they are at different levels of per capita income. So we need to control for the differences in per capita income if we are interested in assessing the pure impact of governance inputs on service delivery outputs.

Turning to empirical assessments of the quality of governance, most of these have been undertaken at the national level. Broadly, two approaches have been adopted. Some follow the 'big data' route. All available data on a wide range of indicators, bearing on one or another aspect of governance, are processed and aggregated into five or six major dimensions of governance.

These may include but are not limited to service delivery outputs. They could include data from official as well as private sources, secondary data as well as survey data, objective data as well as perception data, data from large random surveys as well as the opinions of some individual observers, and so on. The best known exercise in this genre is the World Bank's *World Governance Indicators*, a series that is regularly revised and updated (Kauffman et al. 2007, Kauffman and Kray 2015). Another similar exercise is the Mo Ibrahim

Foundation's *Index of African Governance* (Rottberg and Gisselqucst 2009, Rottberg et al. 2014).

The other, parsimonious, approach is to assess governance on the basis of a few carefully selected key indicators that best capture different dimensions of the quality of governance, or some aspect of it. Thus, Transparency International focuses on the corruption aspect and produces the annual *Corruption Perception Index* (Transparency International 2014), UNDP produces the *Human Development Index* (UNDP 2014), Freedom House assesses governance from a libertarian perspective (Freedom House 2015) and so on.

The study by La Porta and associates (1999) and Besley and Persson (2011) are probably methodologically the most rigourous in this genre. Both assess the overall quality of governance based on aggregating a small set of key indicators, mainly objective data drawn from official sources, not perception surveys and individual observer opinions.

Assessments of governance at the sub-national level are rare.[4] India is an exception with half a dozen studies now available.[5] While some assess the overall quality of governance (Mundle et al. 2012; 2016), others focus on specific aspects such as infrastructure and social service delivery (Bhandari 2012) or economic freedom (Debroy et al. 2013).

All these studies adopt the parsimonious approach, basing their assessments on aggregating a selected list of variables. The study by Mundle and associates, for example, chose 14 indicators that capture service delivery across 5 broad classes: infrastructure, social services, fiscal performance, delivery of justice, law & order, and quality of the legislature. Most of these studies, though not all, are also based on objective data drawn from official sources. The studies also vary in their choice of indicators and in their methods of aggregation.

4. See however the earlier cited paper by Wilson (2016) which analyses the relationship between the quality of governance and growth at the sub-national level in China,

5. Mundle et al. (2012; 2016), Bhandari (2012), Debroy et al. (2013), Malhotra (2014), Tan and Rao (2015), World Bank (2015), Mathew et al. (2016).

A comparison across six of these studies of the rankings of states[6] shows there is a remarkably high degree of consistency. This is particularly so in their assessment of the best and worst performers clustered at the top and bottom of the rankings.

Thus, Gujarat, Tamil Nadu and Andhra Pradesh are the three best performers in both the Mundle et. al (2016) study and the Debroy et al. (2013) study. In fact Gujarat and Tamil Nadu are among the top six performers in five of the six studies, while Andhra Pradesh and Karnataka appear among the top six in four studies (Table 9.1).

Table 9.1

Six Best Performing States Comparison of Different States' Performance Estimates

Public Service Delivery	*Economic Freedom*	*Competitiveness*	*Ease of Doing Business*	*Policy Effectiveness Index*	*Public Affairs Index*
Mundle et al. 2016	*Debroy et al. 2013*	*Tan & Rao 2015*	*World Bank 2015*	*Malhotra 2014*	*PAC 2016*
Gujarat	Gujarat	Maharashtra	Gujarat	Punjab	Kerala
Tamil Nadu	Tamil Nadu	Tamil Nadu	Andhra Pradesh	Himachal Pradesh	Tamil Nadu
Andhra Pradesh	Andhra Pradesh	Karnataka	Jharkhand	Karnataka	Karnataka
Kerala	Haryana	Gujarat	Chhattisgarh	Haryana	Maharashtra
Punjab	Himachal Pradesh	Andhra Pradesh	Madhya Pradesh	Maharashtra	Gujarat
Karnataka	Madhya Pradesh	Uttar Pradesh	Rajasthan	Tamil Nadu	Punjab

Source: Mundle et al. (2016)

At the lower end, Assam and Bihar appear among the six worst performers in all six studies. Odisha and Jharkhand appear among the bottom six in four of the six studies, with Uttar Pradesh, Madhya Pradesh and West Bengal also appearing among the bottom six in three studies (Table 9.2).

6. Only those states that are common to all six studies are compared

Table 9.2

Six Worst Performing States: Comparison of Different States' Performance Estimates

Public Service Delivery	*Economic Freedom*	*Competitive-ness*	*Ease of Doing Business*	*Policy Effective-ness Index*	*Public Affairs Index*
Mundle et al. 2015	*Debroy et al. 2013*	*Tan & Rao 2015*	*World Bank 2015*	*Malhotra 2014*	*PAC 2016*
Assam	Odisha	Himachal Pradesh	Punjab	Kerala	Uttar Pradesh
West Bengal	Uttar Pradesh	Bihar	Himachal Pradesh	West Bengal	Madhya Pradesh
Odisha	West Bengal	Assam	Kerala	Assam	Assam
Jharkhand	Jharkhand	Uttarakhand	Bihar	Madhya Pradesh (+Chhattisgarh)	Odisha
Bihar	Assam	Chhattisgarh	Assam	Bihar (+Jharkhand)	Jharkhand
Uttar Pradesh	Bihar	Jharkhand	Uttarakhand	Odisha	Bihar

Source: Mundle et al. (2016)

In the absence of a rigorous theory of governance, and constraints of available data, a great deal of judgement is involved in the preparation of these empirical assessments of governance. Moreover, these studies also differ in their objectives, their consequent choice of indicators, and their methods of aggregation. Hence, the robustness of clusters of good and bad governance performers identified in these studies is very important. It points to the objective reality underlying the identification of these clusters.

This is a good point at which to return to the question of development clusters raised earlier. It was mentioned that governance quality and the level of development are closely correlated. Therefore, to estimate the pure impact of governance inputs on governance outputs, it is necessary to control for the level of development. Mundle et al. (2016) have done this in their earlier cited study, and compared the Governance Performance Index (GPI) of Indian states with their Development Adjusted Governance Index (DAGI).

It turns out that some of the states in the middle or lower end of the GPI rankings such as Madhya Pradesh, Chhattisgarh, Bihar and Uttar Pradesh move up significantly in their DAGI ranks, implying that in service delivery per se they are performing much better than would be expected at their level of development. Others like Assam unfortunately slip down further. Some states at the upper end of the GPI ranking such as Gujarat and Kerala also slip down significantly in the DAGI ranking, suggesting that the high quality of service delivery in these states is partly a legacy effect arising from their high level of development.

After adjusting for the impact of development, the functional relationship between DAGI scores and governance inputs such as bureaucratic capacity, autonomy, transparency and processes can be estimated once suitable metrics are developed for quantifying these inputs. This function will in turn point to the interventions required to strengthen the quality of governance. Such interventions will have resource costs. This is obvious in the case of improving bureaucratic capacity. But changing processes or bureaucratic autonomy will also require resources since all such changes will entail initial adjustment costs. The DAGI function should enable us to calculate the trade-offs between these alternative interventions, thereby identifying the cost effective combination of interventions for strengthening the quality of governance.

A Business Institution Against Corruption

From a positive aspect of governance as service delivery, we now turn to a negative aspect, corruption. Media reports and assessments produced by institutions like the World Bank (*Ease of Doing Business*) and Transparency International indicate that corruption is endemic in many countries around the world.

A large number of studies on corruption have been published, especially since the 1980s, when multilateral agencies like the International Monetary Fund (IMF) and World Bank started focusing on corruption as a major factor adversely affecting growth in developing and transitional economies. Some of these studies are empirical and some theoretical.[7] Among other issues, they have addressed the question why corruption has remained endemic despite the fact that governments in many countries have set up institutions to investigate and prosecute those involved in corruption.

In this context Avinash Dixit (2015) has explained in a recent theoretical paper why this is not surprising. There is a major problem of incentive compatibility in leaving it to governments to deal with corruption since, typically, it is politicians in power and bureaucrats who are among the main beneficiaries of corruption. They constitute the demand side of the market for corruption (bribery). He has suggested it could be more effective to address the supply of corruption, i.e., the individuals or businesses who pay the bribes.

A distinction needs to be made here between big corruption and petty corruption where officials demand bribes to perform tasks that they are supposed to perform in the normal course of their duties, e.g., make pension payments. This kind of petty corruption is really extortion by public officials, who can exercise power by not performing their duties in a proper and timely manner. Basu (2011) has suggested that in such cases punishment should be handed out only to those seeking the bribe. Not those who are forced to pay it to get a service which is there's to receive as a right. Those paying the bribes will then have no disincentive to blow the whistle, and knowing this should dissuade many potential bribe seekers from seeking a bribe.

Big corruption consist of cases where officials bend the rules or procedures to favour an individual or business entity in return for a bribe. In all such cases, the entity paying the bribe obviously benefits, but other stakeholders lose, e.g., competing businesses, consumers, or government and society at large as in cases of tax evasion or padding up the price in government contracts. Analysing the phenomenon of corruption in a game theoretic framework, Dixit has shown that it should be possible through collective action, in which businesses cooperate, to ostracise their corrupt peers. And the threat of such ostracism and sanctions could help deter businesses from pursuing corrupt practices.

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7. See among others Mauro 1997, Aidt 2003, Rose-Ackerman and Palifka 2016.

This theoretical insight is confirmed by many real world cases of businesses regulating themselves and monitoring their own compliance with an agreed code of behaviour, without recourse to formal courts of law, official law enforcement agencies or the police. The earliest recorded case of such self-regulation is among the Maghrebi traders who operated in the Mediterranean trading area in the 11th century (Greif 1993).

In more recent times such self-regulation is noted among the Jewish, Indian and Arab diamond traders operating between New York, Antwerp, Amsterdam, Ramat Gan and Dubai, among other places (Siegel 2009). Self-regulation to enforce their internal ethics, along with sanctions for violation, have also been noted among trading communities operating in global markets for products other than diamonds.

Further, such self-regulation is not limited only to communities engaged in global trade. Until recently, the local Mafia or Cosa Nostra had a vice like grip in Sicily, extorting protection money from some 80 per cent of the island's businesses. It now finds its business crumbling. This is all thanks to Addio Pizzo, a civil society movement that was started in 2004 by an intrepid group of young volunteers. The name literally means 'Goodbye to Pizzo', Pizzo being the protection money hitherto extorted by the Cosa Rostra. Today some 800 businesses in Italy, including corporates like Benetton, supermarket chains, nightclubs, travel agents, architects and others have signed up on a code against paying the pizzo. These members of the movement enjoy widening support from consumers, clients, civil society, the media and others while the Sicilian Mafia is in retreat.

These real world illustrations of the feasibility of businesses self-regulating their compliance with a code of behaviour is encouraging. At the same time, the incidence of such self-regulation seems to be limited to close knit business communities operating under challenging conditions. The Maghrebi traders operated across markets in different jurisdictions, under conditions of information asymmetry, and limited means of enforcing contracts. This is also true of the global diamond traders today. The Sicilian businesses were totally at the mercy of the Cosa Nostra, and individually could do little to resist the extortion.

What is common to these experiences is the essential dependence of individual businesses on the material and moral support of the relevant community, and the development of relationships of trust based on a shared culture within the community. This is backed by the implicit threat of a high penalty, sanctions and loss of all support, in case the trust is betrayed. Replicating such conditions, or creating conditions that substitute for them, to establish a broad based business community institution against corruption, cutting across different industries, trades and ethnic communities may be quite challenging.

One of the key conditions of success for a self regulating business community institution seems to be a relationship of trust embedded in shared ethnic or cultural bonds of an ethnic/religious group such as the Jews, Arabs, Gujarati or Sindhi Indians, Chinese, etc. Absent that, a broad based institution would have to be built around a different model, e.g., an institution led by eminent citizens respected by all in a given society.

A second key condition seems to be the urgent need of an individual business for the support of other members of the institution, by way of financing, contracts, and preferential treatment in business transactions. The corollary is the heavy penalty of losing such support in case the ethics code is violated. The design of any such institution would have to address this question of benefits, why would a business want to be a member of such an institution?

The core elements of such a broad based business community institution are briefly discussed below, i.e., an ethics code, a 'good and clean' business rating system, a code compliance assessment office (back office), a communications and external relations office (front office) that serves as the interface between the institution and other stakeholders, especially businesses, and a governing council that leads the institution.[8]

8. The following section draws on the author's presentation at the conference "Towards a Business Community Institution Against Corruption" organised by the World Bank in Mumbai, 30-31 March 2016.

The foundation for such an institution, it's raison de'tre, would be an ethics code for good and clean business. Business associations the world over and many corporations have such ethics codes. The specific feature of this code would be a list of do's and don'ts for doing business without corruption.

Based on this code, the institution would have to develop a rigorous 'good and clean business' rating system. This system would start with a scrutiny of audited accounts available in the public domain in the case of publicly quoted companies. Other companies that want to be rated would have to make their accounts available. Established techniques of corporate forensic analysis would provide the first layer of assessment, drawing attention to oddities and outliers where they appear. Successive rounds of further scrutiny, and more detailed investigation where warranted, e.g., for firms that seem to be politically connected, would lead to a rating.

The rating system would be somewhat analogous to a credit rating system. All quoted companies, and others which wish to be rated, would be rated annually. However, only the names of firms with high ratings would be made public. Naming and shaming of those with poor ratings can be left implicit to avoid a hostile pushback, especially during the formative phase of the institution. To undertake this forensic analysis, along with monitoring, investigation and detection of bribery complaints, the institution would have to have a Code Compliance Assessment Office (the Back Office) staffed with appropriately skilled personnel.

The other major arm of this institution would be the Communications and External Relations Office (Front Office). The main task of this office would be to develop and implement an effective strategy to communicate the mission, activities and benefits of this institution to all stakeholders; build the institution brand, its influence and voice; and grow the membership of the institution. The larger the membership of the institution, the more effective it will be.

The larger and more prestigious the membership, the greater would be the demand for membership of the institution. However, there are many concrete benefits of membership which the front office can also leverage to grow the membership. Thus, business to business transaction benefits would include improved standing in debt and equity markets, lowering the cost of capital to the firm. Well rated members of the institution would constitute a safe, hygienic, platform in which to do business and strike deals with other members. The members could also agree on a system of preferential treatment in business dealings with other members. There would also be the collective security of the institution in whistle-blowing against corrupt practices, cartels, etc.

Benefits in business to consumer transactions would include enhanced brand value. It would also include media and civil society driven consumer preference for products of well rated firms and greater competitiveness. Business to Government transaction benefits would include the enhanced reputation of well rated firms in dealing with government, stronger collective lobbying power vis-á-vis government in matters of corporate law, regulation, governance, etc.

Among its other activities, the front office would organise the publicity campaign, including the announcement event, for the best rated companies each year. It would liase and build relationships with all stakeholders including businesses, consumers, media, government, education institutions and civil society organisations to build up societal movement against corruption. These will be critical but challenging tasks for the success of the institution. The front office would have to have staff who are appropriately skilled to undertake these tasks.

To lead the organisation and coordinate its activities, the institution would have to be headed by a governing council, supported by a secretariat. To ensure the credibility and reputation of the institution, the council should consist of eminent persons widely known for their standards of probity. Business leaders themselves should not become members of the council, no matter how committed they may be to the institution, to protect the institution from becoming, or perceived as becoming, a cartel of insiders. In some sense, the institution would be a referee of competing businesses, so there would be an obvious conflict of interest if the heads of one or more of these businesses were to become members of the council.

Concluding Remarks

This paper has discussed some issues relating to two very different aspects of governance. On the positive side of governance, it has discussed the concept of governance as service delivery, and proposed a metric for rating governance performance based on this concept in the specific context of sub-national governments. On the negative side, the paper has addressed the issue of corruption, and proposed that effective action to contain corruption might actually have to be initiated outside government, by a business institution against corruption. The paper has discussed what might be the core elements of such an institution.

In both aspects, the success or failure of the proposals contained here will depend very much on the prevailing sociopolitical context and prevailing values. Performance rating of governments, national or sub-national, can be a powerful tool in promoting better governance. However, that can only happen in democratic societies ruled by elected governments, where parties compete on the basis of their governance performance rather than identity. Similarly, the 'good and clean business' rating of businesses can be an important tool to curb the 'supply' of corruption provided market conditions, consumer preferences, and prevailing social values enable such ratings to be translated into better bottom lines for business.

It is encouraging that of late political parties in India, particularly at the sub-national level, have started competing on the basis of performance in addition to traditional identity politics. This has also been facilitated by the greater fiscal autonomy of states, following the award of the 14th Finance Commission, since the state governments are now primarily responsible for the selection, design and delivery of social and economic programmes in addition to justice, law and order.

It is possible to take the view that such changes notwithstanding, identity politics based on caste, religion and ethnicity will continue to trump performance. Similarly, with regard to corruption, one can take the view that when corruption is endemic, initiatives to curb it whether by government, business or civil society are bound to fail. However, against that cynical view we also have the heartening experience of tipping points, of how small initiatives have sometimes culminated in dramatic change (Gladwell 2000).

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