CENTER FOR GLOBAL DEVELOPMENT

GOVERNANCE MATTERS:
NEW WORLDWIDE INDICATORS OF GOVERNANCE

with

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and

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With Comments by

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Discussing Implications for the Millennium
Challenge Account

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P R O C E E D I N G S

MR. RADELET: Welcome. My name is Steve Radelet. I'm a senior fellow for the Center for Global Development and we're very excited to have all of you here today. I must say that I am absolutely astonished how many people want to come out and listen to three economics nerds talk about data. It is pretty amazing, but we're very happy to have such interest and such a good turn-out today.

We've very excited to have with us the three authors of a new paper called "Governance Matters: New Worldwide Indicators of Governance." Danny Kaufmann, Aart Kraay and Massimo Mastruzzi, who is sitting here in the second row--wave your hand--they have just released as of last week the newest edition of their governance indicators. They go back to 1996, released every two years--1996, '98, 2000, 2002, and now the latest data for 2004 covering 209 countries around the world and providing six different indicators of governance. In my opinion, it's the best data set there is on governance around the world and has many different applications.

What we'd like to do today is spend a little time having them present to you the newest data, what it means, what it doesn't mean, trends and changes since last time both in how they put together the indices, but also in terms of worldwide trends in governance and some of the issues that have come up around that.

So the two of them will speak and then I will provide a little bit of short commentary for a few minutes and talk about one application of these governance indicators, which is their use in selecting countries for the Millennium Challenge Account. That's the main focus of our discussion today, but I will show you some very preliminary results of how the changes in these governance indicators might affect the next round of selection for the Millennium Challenge Account countries, which probably won't take place until October, so it's a little bit speculative, but shows one application of this.

This event is part of our new program at the Center for Global Development called the MCA Monitor, in which we are more formalizing the work that we have been doing and are continuing to do on the Millennium Challenge Account. You can find a new dedicated website as part of the CGD website called the MCA Monitor which posts written analyses, events. We've got a blog--everybody has to have a blog these days--for discussion purposes of some of the key issues on the MCA--the data, lots of other links, where we hope can be a place where you can find anything and everything on the MCA, and links to not only what we're doing, but what other people are doing as well. So I would invite you to visit that website if you're interested in the Millennium Challenge Account.

Let me introduce our two speakers today. Aart Kraay is going to lead off and give the first presentation and then Danny will follow. Aart is the Lead Economist in the Development Research Group at the World Bank, where he has been since 1995. I've known for Aart for several years now and he's one of the best economics researchers that I know.

He has his Ph.D. in economics from Harvard, which he received in 1995, and his bachelor's from the University of Toronto. Besides his work in the Research Department, he has worked on China issues at the World Bank and was a team member for the 2001 World Development Report on building institutions. In his spare time, he has taught at Georgetown, at the Sloan School of Management at MIT, and at sites down the road here at Johns Hopkins.

So Aart will lead it off, and then he'll be followed by Danny, who is the Director of the World Bank Institute's Global Programs and one of the leading experts in the world on issues about governance, not only measuring governance, but thinking about issues as to how improve governance and its relationship with development and different development indicators. And he has been in charge of this process for several years now.

Before that, he had worked in Latin American on capacity-building. He was the lead economist at the Bank for economies in transition in the Research Department and he was the first chief of mission to Ukraine when the Bank opened up operations there. He was also an author of one of the World Development Reports on challenges of development.

Danny and I have known each other for a long time, as well. He was a visiting scholar at Harvard University when I was on the faculty there back several years ago, and it's great to be able to reconnect on this work as well.

So it's my pleasure to introduce these guys. We'll start with Aart and then have Danny follow. Thank you.

MR. KRAAY: Thanks, Steve, for those kind words of introduction. It's a real pleasure to be here, speaking for Danny and Massimo and myself. It's always nice to get outside the four walls of the World Bank and talk to people in the real world, and I think that's squarely where we are right now.

The paper that we're talking about today is actually the continuation of some work that's been going on for quite a while. Danny and I first started working on these cross-country aggregate governance indicators back in the late 1990s. This is now the fourth installment of this project.

We've been producing these governance indicators for several years and hopefully learning some things along the way, and we'd like to share with you the things that we think we've learned about what one can and cannot do with these types of governance data.

Before I launch into the presentation, I'd like to just give you a quick overview of sort of the main lessons that I think we've learned from this kind of work that we'd like to share with you.

As mentioned, we have this sort of updated data set. We now cover 209 countries and territories around the world. We essentially cover all countries with six dimensions of governance that I'll talk about in just a minute.

I'd like to stress that what we've continually tried to do in producing and in refining these governance indicators is to draw on larger and larger sets of data that we have available to us. For this round of the governance indicators, we've drawn on a total of 352 different individual data sources that we have mapped into these different dimensions of governance and used to construct composite indicators.

An important consequence of having large amounts of data, and also increasing amounts of data relative to past years is that we can say with some confidence that the precision of our governance indicators has improved over time.

That said, we do still continually emphasize the importance of margins of errors that are involved with comparisons of governance both across countries and over time within countries. These margins of error that we emphasize, however--and I'm going to show you several slides as we go along that graphically visualize these, or help you to graphically see these--we also want to emphasize that these are not unique to our perceptions-based measures of governance.

We in this project rely exclusively on subjective data for a number of reasons. This is not the only kind of data that one can use for measuring governance. There are a variety of indicators out there. The point, though, that we want to convey is that any effort to measure such a tricky and sometimes slippery concept as governance is going to be fraught with measurement error. And in order to be able to use the data intelligibly and intelligently, it's important to take the consequences of this measurement error into account.

We also want to share with you a little bit about what we think we can say now with our expanded data about changes in governance over time. The bottom line here, of course, is that governance--and consistent with many of our sort of gut notions, is governance is something that changes relatively slowly over time.

As the time period covered by our data set is expanded--we now cover from 1996 to 2004--we're starting to become increasingly confident that we can say something about changes in governance across countries.

And what we have seen is that in some countries there have been marked and even statistically significant, to drop into the nerdy economist language that Steve referred to, improvements or deteriorations in governance. But it's important also to notice that, you know, these improvements and worsenings more or less go hand in hand.

And when you look across countries and you ask sort of what's happening to governance in the world, the somewhat sobering conclusion we come to is that there is no really apparent evidence of trends, for better or for worse, in most dimensions of governance.

Then I'm going to turn things over to Danny and he's going to talk a little about some of the analytical issues that we've been working on in the context of this round of the data. One--and this is a recurring theme in our work--is our defense of the usefulness of perceptions-based measures of governance, and we'd like to share with you some results which we think capture very nicely the extent to which perceptions-based measures of governance add some value or add additional insights that wouldn't get from looking at sort of de jure or very legalistic, very objective measures of governance or institutional quality.

We also want to talk a little bit about what we refer to, and what many others, I think, also refer to as the development dividend of good governance, thinking about the causal impact of governance on per capita incomes and what that means for thinking about governance and mis-governance particularly in poor countries. And then we'll also share some of policy implications that we think are relevant here.

We construct these six composite governance indicators that are motivated by a definition of governance that we've actually, with remarkable time consistency, have stuck with for the last six or seven years. We refer to governance as the set of institutions and traditions by which authority in a country is exercised.

And underneath this, we have sort of three sub-components, each of which have two indicators corresponding to it, for a total of six indicators. We have two indicators--voice and accountability, and also political stability and absence of violence, including politically-motivated violence such as terrorism, that is intended to capture how well the processes that work that select and replace people who are in authority in a country.

We have two indicators that are more focused on what governments do. We have a government effectiveness measure, whose name is rather self-explanatory and really tries to focus on the procedures followed by governments in arriving at decisions--are they clear, are they transparent, and so on--as well as a regulatory quality measure that captures the outcome of this government policymaking process and tries to capture various dimensions of the regulatory environment which may help or hinder business.

We also have in our last indicators measures of rule of law which one can think of as essentially protection of property rights, and control of corruption which is also fairly explanatory in its name and captures the very sort of traditional definition of corruption as the use of public office for private gain, both at the small-scale level as well as at the level of large-scale corruption.

The data that we use to build these indicators come from a wide variety of sources. In this round of the governance indicators, we rely on 37 different sources that are produced by a total of 31 distinct organizations. Twelve of these data sources are new ones that we have come across over the past two years since we last released the governance indicators.

Although these sources are new to us, not all of them are completely new and some of them have data going backwards in time. So we've also done some backwards revisions of our data for earlier years. I mention this only as a caution to those of you who have used our data in the past. We recommend that you re-download the data set. The changes aren't large, but some of the historical data has changed slightly in our data set.

The data comes from broadly a couple of categories or types of data sources. On the one hand, we have surveys, and let me show you what some of these look like. We have a number of cross-country surveys of firms. The Global Competitiveness Survey is one of the best-known ones; so is the Global Competitiveness Report. There are also some firm surveys done by the World Bank and by other organizations. We also rely on several surveys of individuals, cross-country surveys of individuals done by Gallup by Latinobarometro, Afrobarometer, and a number of other sources.

This is sort of the one distinct set of sources we have, surveys, where basically people are asked what they think about various dimensions of the environment that pertain to governance.

Our remaining sources--and this is a somewhat larger number--are what we refer to as expert assessments of one sort or another. These expert assessments break down into three categories. We have expert assessments from commercial risk-rating agencies. These are places like the Political Risk Services, Economist Intelligence Unit, a number of other ones. By the way, I should mention all the sources that are italicized here are new sources that we've added in the 2004 round of the governance indicators.

We also rely on a number of expert assessments that aren't produced for profit, in effect, which is what the first group are, but are produced by a number of NGOs and think tanks, and so on, ranging from Reporters Without Borders, Heritage Foundation, Freedom House, with which I'm sure many of you are familiar, also some other studies being done by universities and other think tanks.

Some of the data that we rely on is even closer to home for us coming from the World Bank. What we've tried to do is to systematically collect from all the major multilateral organizations their own internal assessments of policy performance of countries.

The World Bank has its country policy and institutional assessment. The EBRD, the African Development Bank, the Asian Development Bank, the UN Economic Commission for Africa all produce similar ratings of countries that we rely on. We also have a rating that's produced jointly, or that draws jointly on data from Amnesty International and the State Department in their human rights report.

To make this slightly more concrete--and, you know, I can't list for you all 352 questions on which we rely, but it's useful to have a look at what some of these ingredients are that go into the governance indicators.

The little acronyms at the end there indicate which governance indicator we map these questions to. So, for example, we have a survey that asks people their opinions. Does the government interfere with private investment? That would go into regulatory quality. How fair and transparent is the legal system? This is something that we would map to rule of law, and so on.

I'm sorry. These are the expert assessments. The survey responses are the ones that are on the bottom half of this slide, and here again these come from cross-country surveys of firms or individuals where very specific questions about things like corruption and government effectiveness are asked. You know, how likely is it that bribery is required in order to get things done is a particularly clear question relating to corruption. How transparent is the information given by government as a component of government effectiveness?

So we have these many, many, many questions, a total of 352 questions, as I've mentioned. An obvious question to ask ourselves, you know, before embarking on doing something with this data is to ask why we should aggregate these governance indicators at all because, you know, one might reasonably think that it's useful just to look at these individual questions, like question about trust in the police or freedom of the press, policy consistency.

The reason we think it's useful to aggregate--and there's a couple of reasons. The first is a simple and common-sense one. It's simply too overwhelming to try to track countries' performance on 352 variables. It's just not something that can be done.

But more concretely, the reason that we think--there are sort of three main benefits that we think come from constructing aggregate or composite indicators. The first is--and this flows from the sort of premise through which we view the data. The basic premise through which we view the data is that all these different sources, say, that ask questions about corruption--if we put them all together, each one of those individual data sources gives us a tidbit, a signal, some kind of information about corruption in the country.

If we combine all these different signals, we come up with a more informative signal about what corruption is in the country, and that's the claim that we make and this is our first sort of main rationale for aggregation is that aggregation can give us more precise measures of the broader governance concepts which we're interested in than [TECHNICAL INTERRUPTION.]

A somewhat more prosaic, but nevertheless relevant justification for aggregation is that when we aggregate, we end up with a much larger set of data--a much larger set of countries that is covered in total; that is, not all of our sources cover the same groups of countries. By the time we put it all together, we cover essentially all countries and quite a few--I'm not sure what the politically correct term is--territories, I guess, who aren't quite countries. So we cover a very large group of observations.

And then the third main benefit of aggregation that we're going to see in a minute is that it allows us to be very precise about the imprecision of the governance indicators. And we think this is one of the main value-added features of our governance indicators. We're able to construct margins of error which essentially tell us that there's a certain probability or we can be so confident up to a certain point that governance is within a particular range for a country rather than fixating on particular numbers.

So let me show you a little bit how this looks, and I'm going to jump right ahead to a first slide which shows you selected countries, how they fare on our voice and accountability indicator. We have countries--hopefully, this is legible for many of you, at least--countries ranked from the worst scores on voice and accountability over on the left, to the best scores over on the right.

The countries that are highlighted--they are color-coded according to the ranks they fall in the distribution. So if you look at these red countries over here, these countries have the worst, in the bottom 10 percent. These dark green countries that you see on the far right are countries that fall in the top 10 percent, and then various gradations of [TECHNICAL INTERRUPTION] in between.

Just to state the obvious, this is not all 209 countries. We've just pulled out a subset of countries here so that you can get a sense of what country names look like without excessively cluttering the graph.

The other thing that's important to keep in mind here--and these are these margins of error that we've been stressing throughout--if you look on the top of each one of these bars for a country, you see these thin black lines here. These thin black lines extending, you know, down and above the score for each country are the margins of error. In technical jargon, these are the 90-percent confidence intervals.

The interpretation of these is that we can be 90-percent confident in a statistical sense that the true voice and accountability score for--this isn't working so well--the true voice and accountability score for a country is somewhere in the range that is covered by those black bands.

Those bands have important consequences once you start thinking about comparisons of governance across countries. So if you were to ask us, you know, listen, guys, you've produced these wonderful governance indicators, now tell me, do you think that voice and accountability is better in Denmark than it is in Norway, which are the two countries on the extreme right over there, the answer that we have to give you is that we have absolutely no idea.

For these countries, the statistically likely range covered by the governance indicators of these two countries overlap almost completely and we really can't say with any confidence that things are different.

Similarly, if you ask us the opposite question, do we think that things are particularly worse in Uzbekistan than they are in Syria, which are two of the countries over on the left here, the answer also would be that we really can't say.

What we can do, though--and we do have much more confidence in gathering countries up into broader groupings, somewhat along the lines of how they are color-coded here. Of course, at the margin, when you look at the margin between one group and another, there are always going to be countries where there is some ambiguity.

But we can certainly say with a great deal of confidence that, say, voice and accountability in Venezuela is probably somewhat--is worse than what it is in, say, Finland, Denmark, Norway, and it certainly is better than what it is in Uzbekistan or Syria, simply by looking at whether these 90-percent confidence intervals overlap or not.

Let me just walk you through another application of this data which I think is very topical and it's going to complement nicely with what Steve is going to talk about. As Steve mentioned, this data has been used as one of quite a few eligibility criteria for the Millennium Challenge Account.

What we've done here is try to illustrate in this slide and in the next slide both how margins of error matter when you starting thinking about how to classify countries, and also the consequences of the improvement in the accuracy of our governance indicators for making these classifications.

So what we've done here is we've taken 70 countries. These are the 70 countries that as of last fiscal year would have been eligible for the Millennium Challenge Account. I think Steve is going to show us results that are more updated for the sort of current fiscal year.

But for this group of 70 countries, we plot the control of corruption score. So countries are ordered by their percentile ranks on the horizontal axis. On the vertical axis, we have their scores, and so you see the countries sort of marching up here.

What's perhaps a little less visible to you, but hopefully sufficiently visible, are the 90-percent confidence intervals for each country, these thin vertical bars which give us the sort of 90-percent confidence range for the country.

Now, what we can back out from this is we can ask ourselves, well, clearly we can just by looking at this graph see which countries are above the threshold of the median of all countries for control of corruption, which countries are below. That, we can simply read off the graph by inspection. The heavy horizontal line there is the median.

But what we can also do is we can go a step further and we can say how confident are we that countries are above the median. And if you look at the countries on the extreme right, all the countries that have green dots above them, these are countries where we're at least 75-percent certain that these countries--75-percent or better certain that these countries are above the median. So from sort of a policy standpoint, we have a lot of confidence that these countries fall above the median.

Countries on the extreme left--all these red dots are countries where we think there's less than a 25-percent chance that these countries actually belong in the top half of the sample, given the uncertainties and the imprecision of the governance indicators. These are also countries that we can be quite confident that they fall below the threshold.

There's also, however, a non-trivial group of intermediate countries. There's 17 red countries, there's 20 yellow countries and there's 23 green countries. That gives you an idea of sort of how countries break down here. For those 20 in-between countries, the likelihood that they're in the top half of the sample is somewhat between 25 percent and 75 percent. So we're not quite so certain whether these countries are above.

And what we read in this, and a view that is also certainly shared by the folks at the Millennium Challenge Account who are using this data, is that these are countries that deserve special scrutiny. We should look more carefully at these countries, try to bring in other sources of data and see what else we know in terms of where they actually fall.

Let me show you also just as a hypothetical exercise--I think I have the same slide. No, I'm sorry. This slide is mislabeled and I apologize for that. No, this isn't mislabeled. The presentation has changed a little bit.

This slide--the following hypothetical exercise: What we're trying to do is illustrate the benefits of aggregation in terms of precision. What we've done here is we've done the following thought experiment. Instead of relying on our composite governance corruption indicator, suppose instead we used one single source of corruption data.

One of our sources, WMO, which stands for World Markets Observer, produces corruption ratings for all 70 countries that are in the MCA. The MCA could very well have chosen to rely on just that one indicator.

A side product of our aggregation procedure is that we can come up with margins of error not only for the aggregate governance indicators, but also for all the individual sources. So these margins of error are shown here and these margins of error are substantially larger than what they are for the individual governance--they are substantially larger than what they are for our composite governance indicators.

And as a result, you can see that this group of yellow countries that is in the middle is much, much larger, these countries where we would be less certain where they actually fall in a statistical sense. So we think that this highlights the benefits of aggregation.

In fact, something like fully one-third of countries, we can be at least 75-percent sure that they're in the top half of the sample if we rely on the composite governance indicators. That drops down to about 10 percent of the sample if we rely on the selected individual governance indicator.

Let me say briefly a few things about changes over time in governance and then I'll turn things over to Danny. We think it's useful that we now have a fairly long period covered by the data. From 1996 to 2004, this is an eight-year period. It's starting to get plausible that over this period we should see economically important and measurable movements in governance in some countries. And we do, in fact, see that.

So for roughly about 10 percent of the countries of our--of the 10 percent of our roughly 160 countries where we have data both in 1996 and 2000, we see statistically significant changes in governance in one direction in the other, improvements or declines.

To give you a sense of how those look, this shows you voice and accountability again, changes between 1996 and 2004. Over on the extreme left, we again have countries in red. These are countries where there have been large and statistically significant declines in voice and accountability. These are countries that range from Nepal--we have Zimbabwe, Cote d'Ivoire. Also, Russia, Cuba, Belarus are in this group.

On the other hand, over on the right we have a number of countries that have substantial improvements, ranging from Albania, Estonia, Serbia, Sierra Leone, to name a few. We have a number of countries where there are improvements. And then, of course, there's this middle ground where there has been significant change.

An important thing to notice from this graph is that this middle group of countries is actually the largest group of countries. We've suppressed them here just so that we can focus on the large changes. But if you look here, this graph gives you a sense of how the overall distribution of changes looks.

So here we have control of corruption 2004 scores on the horizontal axis, 1996 scores on the vertical axis. The black line there is the 45-degree--I'm sorry--the red line there is the 45-degree line. So we can just ask countries that are above are countries where corruption has worsened. Countries that are below the red line are countries where corruption has improved.

The countries that are highlighted and labeled are countries where we think there are statistically significant changes in this particular dimension of governance. And you see, you know, there's a non-trivial number. There's about 15 or 20 such countries on the graph, but there's a very large number of countries, another 150 or so, where there is no statistically significant change.

So the lesson we take away from this is that, yes, governance does change even over the short periods of time that we're looking at. It doesn't change by a great deal in most countries. And what is more, it does appear to be the case that improvements and declines sort of more or less balance each other, and this is something that Danny is going to confirm with us for a second when looking at some data on trends in global data, so that overall we have this picture of, you know--you know, it's a non-trivial churning. Some countries are getting better, some countries are getting worse. But governance as a whole in the world, we can't say is getting significantly better or worse.

So I'll turn things over to Danny to continue with this here.

MR. KAUFMANN: Thanks, and this is supposed to be seamless. So after having addressed the issue of changes for specific countries over time, I found the good news in one sense that some countries can improve and have improved, in fact, over six to eight years, even if it's not their norm. Then we get very quickly to the more sobering question--unsobering answer, what has happened worldwide, on average.

And very quickly, we will--I'll tell you the answer even before we go through the data. Unfortunately, the world has been stagnant, on average, even though, as we have seen the variation in all the major dimensions of governance.

It's very important to look at this question, and we start seeing here the stagnation in one dimension, which is in the case of rule of law where we see different lines, because we go back to the individual sources in each case. The reason we go back to individual sources is that our aggregated governance index is in relative units, benchmarked at the mean of zero, as Aart has suggested. So it has no absolute, cardinal content, and therefore we need to go back to individual measures to see, well, if the world has really improved in absolute terms, we need to take that into account because our measure is relative and implicitly we may be penalizing countries that are staying stagnant in relative terms, but they may be improving in absolute terms.

Unfortunately, the world is not improving in absolute terms, so benchmarking it an average of zero is still accurate whether it's in relative or absolute terms. And we see this for different individual sources, for rule of law; we see it here for other sources, for voice and accountability, a measure that Aart already covered. This is more in the political and civil liberties realm.

It's worth commenting that it's very insightful to look at these individual sources and to come from our aggregate data and see that sometimes one detects, even if it's not significant, some changes in some dimensions of one aggregate component. For instance, there are obviously more electoral democracies nowadays than there used to be in the past. But the same Freedom House index that rates some countries a little bit better sometimes on political liberties, in terms of freedom of the press it has remained totally stagnant.

In Africa, quite a few African countries are showing some improvement in terms of voice and democratic accountability, some dimensions; not so in freedom of the press in many of them. So it is also helpful in unbundling.

The bottom line: on aggregate, when we aggregate, we do not see a positive worldwide trend. But there are some trends for some countries and for some sub-regions that have been mentioned and as we will elaborate. We also get into tougher territory with the data. Thanks to collaboration with outsiders, there is an incipient database also for human rights. So transcending beyond the conventional approach of international financial institutions, which we have totally obsessed on the protection of property rights, we think that protection of human life and human rights is also very important.

And the voice and accountability indicator very significantly accounts also for human rights. We see here also not a very clear upward trend, which is quite sobering, even though in some countries there has been improvement. Very quickly, we see something similar, certainly no upward trend for control of corruption as another one. So this is the sobering evidence in balance.

We move quickly now to the next issue that was already a preview given by Aart, and this is on this whole issue of perceptions matter. There is a whole set of issues, and we have very quickly a set of eight or nine bullets in front of us. And for the lack of time because we want to get to the interactive part, I'm not going to go through all the arguments in favor of using with caution perception-based data.

But, basically, we want to suggest that we covered quite a few tricky methodological issues about that in our previous installment, "Government Matters III," published in the World Bank Economic Review and fully available. And in this issue, in this version, "Governance Matters IV," we cover an additional set of methodological challenges related to perceptions versus objective indicators.

Essentially, and very quickly, we find that sometimes perception-based indicators are the only ones available, like for corruption. A so-called objective indicator would not be available, but for many others there are both. And we acknowledge that it's important to always look at the objective indicators, as well.

But very often, as was already suggested by Aart, a perception-based indicator may at an a priori conceptual level capture more closely the broader concept of governance being measured, the objective indicator being very, very specialized, specific about one particular mini-dimension instead. And we will illustrate that.

The perception-based indicators relate much more to the de facto reality on the ground by asking firms what's happening on the ground; the objective indicators, maybe a lawyer or an official gathering data in an office and not so closely related to what's happening on the ground. We have found in our previous work, we codified that, the extent to which perceptions do matter. Of course, perception-based data has a margin of error. It's important to codify, but at the end of the day what the firms, the investors and others are saying and responding--

they do matter in their own decisionmaking. So it should not be discounted in that context.

Now, over time there has been significant improvement also in these perception-based type of questions, moving away from the very generic and full-of-noise type of question: In your view, your country is very highly corrupt or not so corrupt? That's not very useful. Nowadays, the questions are much more rigorous. They are experiential about experiences of the firm or others in terms of what's happening to them, and much more quantitative. So the fact that they are perceptual subjective questions does not mean that they are not quantifiable. Firms are asked how much do they have to pay in bribes nowadays for what kind of services--at the end of the year, on procurement; how much time they spend with public officials, and so on.

We have also addressed the issue of potential ideological biases, given the diversity of institutions and sources that we gather, and we have not found it that significant; or other such challenges--the concept of halo effects that in some countries, like in rich countries, there may be the fact that they have been so successful, that might paint the responses in being too positive, versus poorer countries; or the fact that some countries may be culturally more disposed to complaining, versus others that consider that everything is fine. Even in Latin America, we have a joke about neighboring countries, one where we tend to complain about everything, the other that everything is much rosier. We have controlled and have done tests for that. We do not find that there any significant biases in that context.

And then the last two points I want to cover a little bit more in depth, because it is in our present paper, is the issue already mentioned, that perception-based data has a margin of error and it is very important to know what it is and how, therefore, to use the data cautiously. It's not unique in that sense. Objective, other type of data has similarly significant margins of error as well, sometimes even more. And finally, the type of insights that come out from this objective data, in addition to objective data.

Let me take just as an illustration for the first point, which is the point on the margins of error. And very quickly, I'll go--I'm going through the whole slide for the sake of time, suggests--we'll take some examples, perceptions type of measures, like bureaucracy hindering business or the quality of public schools, are the type of questions that are asked. Versus objective type of measures: trade taxes as a share of total tax revenue, number of telephone --.

Neither of them, of course, will capture the totality of the concept of governance. We depart from the premise, from the notion that true governance is not observable. And therefore, all that we can do, and with a bit of humility, is try to come up with as many proxies as possible to try and approximate to the true and unobservable notion of governance. But a few points are in order here. First, by aggregating these perception-based indicators, as was already shown, one reduces significantly the margins of error. And secondly, one is very explicit about these margins of error, which we know what it is, we are transparent and precise about the degree of imprecision.

The margins of error for both perception individually--perception-based and individual objective indicators remained implicit and they are present in both cases. They are very significant, and we codified that for objective indicators as well. And to what extent subjective indicators then add additional information to what objective indicators can bring will give--even though here we present a couple of illustrations, I'll skip a slide or two to just illustrate it with one case.

That case is about business entry. We also do it for taxation. We go to the firms--and thanks to the collaboration with the World Economic Forum Global Competitiveness Survey, we know from the firms their reported tax burden, the percentage tax burden as they report it. We can consider that an element of subjectivity, but that's what they report. And we relate that, first, to objective data--about tax rate, but also about how easy is it to start a business. One objective data that is asked about doing a business report is number of days that it takes to start a business.

In this particular graph, in the horizontal axis, the x axis, we see the number of days to start business--that's the objective data--while in the y axis, vertical axis, we see their reported difficulty in starting business. Well, the good news is that there is some correlation. It's significant. It shows that none of these data should be thrown out of the window. But it's 0.4--a little bit above that, below 0.5, so it's far from being 1. So this real difference, then, in trying to figure out why just codifying the objective data of how many days it takes to start a business doesn't explain the whole story of how easy or difficult it is to start a business.

So we did the econometric analysis and tried to figure out the relative explanations of different factors in terms of how difficult it is to start a business for a company. On the left-hand side, we see the contribution of the objective indicator--number of days that it takes to do business. It is here, and in statistical terms it's not insignificant; it's significant. But compared with the additional kick that is given by the subjective indicator, which we put in, then, which is how high is corruption, the informality in the implementations of this rule, corruption fully dominates. And corruption is a type of subjective indicator, is a type of indicator that cannot be captured just by objective data.

This goes to show that one has to complement any type of objective data with other data, which may be perception-subjective based, to capture the informality, the de facto of what's happening on the ground, and not staying at too high of a de jure fact level.

One more last issue I would like to cover, and that's the question, well, does governance matter? After all that we have seen so far in terms of measuring governance, in terms of the assessing degrees of imprecision, changes over time, comparison across levels, the importance of aggregation and of perception and subjective data, there's the question does it matter. We'll cover that and then I'll conclude.

The bottom line is that it matters enormously. But there is a very significant debate, which we do address in this paper, and the way of looking at it is by the simple correlation. This is the data plot for the 200 or so countries and territories. And what we see here on the horizontal axis is income per capita; what we see in the vertical axis is a governance indicator--in this case, rule of law, the latest one. We see, obviously, a very significant correlation. That doesn't prove what is the -- direction, obviously.

We have plotted and put for illustration the country labels only for African countries, because there is a significant debate going on whether, in thinking ahead about evaluating how Africa is doing, whether one should discount the performance in governance of Africa, the level, by the fact that they are overall poor countries. Well, discounting it would imply that most of the action goes from higher incomes to improved governance. That's why it's crucial to disentangle the two -- directions, and in a recent paper with Aart we have done that. And not only us--this has also been done by other researchers. We summarize here the results of various research efforts, including ours, but also Roderick, et al., Johnson Robinson, [inaudible].

What we see, essentially--and these are the lines, this is the causal link, after having isolated causality, from governance to incomes. And we see a very significant causal link. Essentially it's what we call the 200 to 300 percent dividend of good governance, very, very large. One standard deviation improvement in governance--and what is one standard deviation improvement in governance, to illustrate, is improvement in rule of law. From Somalia to Laos or Laos to Lebanon, Lebanon to

Italy, or Italy to Canada, that will raise in the long run by two- to three-fold, incomes per capita. So we're talking about a very high payoff, and we see that the slopes are very similar to each other.

Well, then we look at the reverse causality question. Well, there may be still significant action in the reverse causality, from income to governance. Unfortunately, we do not find much evidence. We do not rule out that there may be some, but both in our study--which is the green--or in Roderick and Riegelbaum [ph], which is the right, we find that essentially the fitted line we saw at first in the correlation has become very, very flat. So at the end of the day, we're left with a very naked reality, that each country should be evaluating its level for where it is. A very different picture emerges, then, for African countries, with the exception of six or seven countries that are doing above the median for the world. Others are below the median.

So the challenge is enormous, and it suggests how crucial it is to redouble the efforts in this area. Not only in Africa, but this applies to other poor countries in this context.

Let me quickly conclude with four sets of conclusions now.

The first is that, obviously, by now you know our bias: Measuring global governance is extremely important. We have found that increasingly we see the importance ascribed to it by citizens, enterprises--investors follow that. But increasingly policymakers, and policymakers in countries that have challenges, but they are reformist-oriented, they are demanding more and more data, using it internally to promote reform, to monitor also governance trends. It also empowers civil society in powerful ways.

So we believe that these type of efforts--and it's not only ours, but many others that have joined--are extremely important for empowerment for civil society and not just for research. Obviously, it's very important for research as well, and so we know that. And it's very important, as was illustrated before, and I'm sure Steve will talk about it now, for assessing donor aid effectiveness.

Second, [inaudible] which is a message that comes out of this new report with the new data and the new methodology to assess changes over time--I'll get to that in a second--but first, very clearly, measuring governance is clearly feasible, and it's also something that should not be a surprise that we come out with that. We have the major expansion in the indicators, margins of error need to be taken extremely seriously for not only our indicators but from any other effort in governance, in investment climate, in institutional writing of this sort.

Subjective, perception type of data, we make the case that it does matter and it can be extremely valuable and insightful. It should complement other efforts, but it's important in itself.

And we highlight the importance of aggregation, as we suggested. But, as I was suggesting, one other innovation this time is that it is now possible to isolate, to identify which countries, over a relatively limited period of time--it's a very short time for institutional reform, six to eight years--are undergoing changes which can be regarded as significant and isolated from those that may be just elevator economics--a little change up or down which is not significant is not meaningful.

The third point refers to the development dividend. Governance matters significantly, and we saw the strong causal link. But unfortunately, the average on governance around the world is not improving significantly, at least not over the past six to eight years. And I must note that we have also data, which we don't show for the sake time, on other areas, like on inflation or infrastructure or new technology, where one detects an upward trend for many place, on an average. So it's possible for the world to improve, but in governance, on average, that's not happening. For every country that we found there's a significant positive change, there is another that has gone down.

Therefore, we put it for debate and discussion the one very generic, but, we feel, very important, policy implication, that it may be very important to rethink what we are collectively doing in this area. Obviously, there's been a much more focus and effort over the past few years on institutional governance and anti-corruption reform. We're not yet seeing the fruits. There may be many reasons, but maybe it's time for some rethinking.

One area we have been doing some is, for instance, on anti-corruption. And looking at the data very hard, we do not see high payoff for very traditional approaches like supporting anti-corruption commission, like supporting additional drafting and redrafting of anti-corruption laws--a lot of legalistic approaches. Every country in the world has decent anti-corruption laws nowadays. It's [inaudible]. So traditional, very traditional public sector management approaches may not be delivering the goods in the way that we expected, as opposed to areas where there may be a way forward in pushing more even if they are politically very difficult, like the whole issue of supporting or enhancing much more voice--the voice issues--devolution at the very local level, and the second generation of institutional reform in terms of transparency [inaudible] reform, which some countries in Latin America are undergoing already. There are many examples which I'm not going to get into, but we can discuss it later.

And that leads to the last two slides, for illustration, raising the question that comes out from the fact that there hasn't been as much progress as we would have hoped, number one. But having seen at the same time that some countries that get their act together can improve significantly in the short term, raising the question whether we shouldn't be a bit more impatient and not fall into the trap of translating the notion that is additional change a long-term phenomenon--of course it is--to thinking that one can only expect bold reforms, significant changes in generations. And for that there may be an issue of collective responsibility.

We see this in the summary slide, which summarizes what Aart showed earlier in terms of significant changes. Let's only focus for now on the green lines. The two green lines are countries that have undergone improvements; the reds are countries that have undergone deteriorations. The lower one, the continuous green line, is very significant improvement, at 90-percent-significant level. Not very high. We're talking about 10, 12 countries from '96 or '98. If you want to relax this, that high bar, and say, okay, how about at 75 percent confidence level that the country has undergone change? Then it's a dotted line, and we are talking about 20-25 countries that have undergone improvement. So it is clearly feasible, and one can learn from that.

Let's take a very powerful sub-region that has made significant progress. And let's relate it to the incentive, the carrot and the responsibility of the international community and the rich world in this context. These are two groups of countries, transition economies. The first, the high one, was told in the mid-'90s, you have a big chance in joining Europe if the homework is done right. The lower one--and that's what is obviously the Eastern European countries. Those are the EU countries that have made it, just made it, the new accession countries. You see a clear trend upward.

Lower down are the post-Soviet countries that were not given that opportunity. I was living in Ukraine at the time. Ukraine was told thank you, but no thanks, you've got no chance whatsoever. I think this speaks mountains. And it's no wonder that President Yushchenko is saying today to the whole international community, First, I know what we need to do; we need to do our own homework, governance, institutional reforms, and anti-corruption are our priority. But I need from you, Europe, some kind of sense that if we do do it and do it right, we can join you. And he knows when he's saying that, that if he gets that promise, he can push much more for significant reforms domestically.

Thank you.

MR. RADELET: Thanks to Danny and Aart for that presentation. There's obviously a lot there that we need to talk about. I for one was really, really glad that they concluded that measuring governance was important. Because if they would have, after all of that, concluded that it wasn't important, then we would have all been in trouble. So that was reassuring to me.

Let me just comment--I'll try to be brief, and comment a little bit on the governance indicators as a whole and then one application on the Millennium Challenge Account.

As I said earlier, I think this is the best set of governance indicators that are available, and I think that for a couple of reasons. One is that they used 37 sources of data. And they just bring in a whole lot more information than other individual sources do. They rely on a lot more information. So I think there's a lot more there.

Now, more information is not always better, but what these guys do that other sources of governance data, and other sources of data in general don't do, is bend way over backwards to tell you what they're doing, how they get the answers or the data that they get, the summary statistics that they get, and what the weaknesses are of their approach. And there are very, very few other indicators out there on corruption or on trade policy or freedom or economic freedom or whatever it is that go into the detail that these folks go into to tell you where the data come from, what the sources are, how they aggregated them, and what the errors are. You won't find too many other discussions like this where they focus as much as they did on the errors, and I think that's really important. So that gives me a lot more confidence about what's going on.

I must say--just one comment--I'm puzzled by the lack of trends in the world data. And I think that that should be--"sobering" is the word I think they use in their paper, and bit of a puzzle and troubling for all of us to think about what's going on. I had hoped to do a little bit of digging to find out if there were regional differences or other kinds of trends in sub-categories. I didn't have the opportunity to do that. I had wondered whether or not what we might be seeing is more dispersion around the world, where the average level of governance might not be changing but we, I don't know, might be separating into some groups that are improving and some getting worse, where the world might be separating a little bit.

The reason I say that is I tend to think to some extent that's what is happening in Africa over the last 10 years, where we're finding seven, eight, nine, ten, twelve countries in Africa where at least my perception is that governance has improved significantly over the last 10 or 12 years, but that there are other countries where things are clearly getting worse, which might suggest some increase in variation around the world. I don't know, it's just an idea. But I am quite puzzled by what's going on, and I think that finding in and of itself needs some more analysis.

I wanted to comment just briefly on the discussion on governance and income, which I think is one of the important applications of this. There's a real question out there about the relationship between governance and income. I'm quite convinced, on the one hand, as these guys point out, that improvements in governance can lead to stronger economic growth and higher incomes. I don't think that there's any doubt that at least some of the causality goes in that direction. But I'm not convinced that that's the only part of the story, because I actually think that some of the causality goes the other way and I'm sort of unsatisfied by the discussion that's been going on of sort of the two polar sides, that it's more one than the other.

And they've done more quantitative analysis than I have, but I'm still left a little bit unsatisfied because I tend to believe that incomes can influence governance, that countries that are richer, that have more money, that have more financial resources are able to pay for more police and more judges and keep better files and have better court systems that work better and have the resource available to make governance work better. That stuff costs money at the end of the day. It's more than money, of course, but two countries that are otherwise the same, one is richer, that richer country would, all else equal, have more resources to devote to the kinds of government institutions that we need to improve governance.

So I think that there's more that we can learn over time about that important relationship between governance and income. So that's an important application of this data.

The other very important application, obviously, that they talked about is, well, once we know, once we see what these measures are, what does it mean? And if a country does want to improve on its corruption scores or on its rule of law, what can it do? And that takes some diagnostics and some steps to figure out more deeply what the problems are, but then some policy solutions going forward. I don't think we know how to improve governance. I think we like to think we do, and aid institutions get engaged all the time--we're going to improve governance, we're going to increase capacity. I don't think we really know what works and what doesn't. And this kind of data set, over time, is one way that we can begin to help measure a little bit better what's working, what's not working, what's really just, you know, countries just taking steps to make it look like they're doing something, like setting up a corruption commission, versus steps that might actually have some impact.

So I think that this kind of information can be really powerful, not just in measuring what has happened, but to help inform us about what might work and what might not work going forward. So I think this has a lot of powerful applications.

Let me just talk very briefly about the Millennium Challenge Account. And I don't want to focus too much on that, although everybody likes to look at these indicators. But as many of you know, of their six governance indicators, five of them are used by the Millennium Challenge Corporation, one input to selecting countries that are eligible to submit proposals to the MCC for funding. Many of you know that they chose countries first for fiscal year 2004, 16 countries, and then added one more for fiscal year 2005. So there are 17 countries that are now eligible.

This data, five of the 16 inputs is updated once every two years. So with this new update, I've actually received lots of phone calls and messages and e-mails from many people over the week saying, so, how is this going to affect things in terms of the next selection? Who's in, who's out? Who's up, who's down? Who's going to get the big bucks and who's not?

So I have undertaken an initial analysis, a preliminary analysis of what the data look like. Very preliminary. The MCC will not make its decisions until October. A lot of this data is going to change between now and then. So this is by no means finalized at all. We've written this up. There's a little paper outside that goes into all the gory details, if you really want the gory details, and lists all the data for all the countries--which I will spare you that torture right now, but it is out there if you want to see it. But I will briefly just look at these lists of the main trends in the countries.

Now, there are two groups of countries, or there will be two groups of countries eligible in fiscal year 2006. One is the lower-income countries, which have been eligible--all countries with incomes below $1,465, which is the same group of candidate countries that are now competing. Then there will be a second group, which we'll look at in a minute, with slightly higher incomes, between $1,465 and about $3,000. And they compete separately, so we'll look at them separately.

So this is the same group of countries that the MCC looked at least year. And with updated data mostly from the governance indicators, but a few other indicators that have been updated, we can make some preliminary guesses. Last year when they made their choices in the fall, there were 24 countries that actually passed their tests. Of that, they chose 17. So to emphasize the point, it's not every country that passes these tests that actually gets in. To get in, as most of you know, essentially you have to be above the median score in half of the 16 indicators. It's a little more nuanced than that, but that's more or less the story. And you have to be above the median on corruption.

Last time, there were 24 countries that passed the test. With the new data, there are 27. Two countries that passed last time, Nepal and Burkina Faso, drop out; five countries that did not pass the indicators last time now join in. Those five that now join in that did not pass last time are Malawi, East Timor, Samoa--where I spent two years of my life as a Peace Corps volunteer. And I did not cheat on the numbers for Samoa, I will have you know. Just because I lived there, I did not try to cheat to get them in. Malawi, East Timor, Samoa, Tanzania is the fourth, and Zambia being the fifth--that did not pass the indicators test last time around, but all of them passed it, and most of them actually passed it rather comfortably.

Now, again, some of this data may change. The governance data will not, but others may change, so that might look a little different. But that brings the total up to 27. I take my best guess as to what I think the board might do with this kind of data. And that list is on the right-hand side of countries, and I think there are 21 there that I think, given this data, the board would be most likely to select.

Countries that passed these test last year that were not democracies were dropped by the MCC. They claim that was not the rationale that was used, but in all but one case, Morocco, that is what they did. So on the left-hand side, you see, for example, Bhutan, China, and several other countries that are not democracies--Swaziland down towards the bottom--that are not considered democracies; all of them were dropped. A couple of other countries, like Guyana, were also dropped, for other reasons.

And then two countries that didn't pass the test last year were selected nevertheless. Georgia was one and Mozambique was the other. So assuming that Georgia and Mozambique will still be selected, my list is over there on the right, which drops out the same non-democracies that were not selected this year. Armenia and Burkina Faso are right on the border. Armenia actually does pass, but there's been a strong deterioration in their democracy scores. They still manage to just get above the medians, but barely, and Burkina Faso is also close.

So that's the group for next year. There are a few countries that are quite close. Burkina, as I say, and Nepal have a couple of scores where they're right on the median, as opposed to the median. There are six countries that pass enough indicators but are below the median on corruption, and so get knocked out on that score. Those six, Bangladesh, Djibouti, Kenya, Maldive, Paraguay, and Ukraine. Most of them--I think all of them, actually--were in that same set of circumstances last year and were not selected. So presumably that will be the same. And there's another five countries that are quite close--the Gambia, Mauritania, Rwanda, Sao Tome, and Uganda. Uganda, interestingly enough, improved almost across the board on the new governance indicators by just a little bit, and went from below the median on most of the indicators to above the median on most of the indicators. But they still fall 1 short in the education and health side.

Now, but there's a second group of countries within incomes between $1,465 and $3,000 which will be eligible next year. According to the data that are available now, of that group of 34 countries that can compete, nine of them actually passed the tests, a fairly large number. Brazil, Bulgaria, Jordan, Micronesia, Namibia, Romania, South Africa, Thailand, and Tunisia all passed the basic tests. Colombia, El Salvador, and Turkey are quite close. I don't think that the MCC will actually choose all nine of these. If they follow the pattern that they established last year--the countries that were not democracies but otherwise passed the indicators were not selected--then Tunisia and Jordan are unlikely to be selected. I also doubt that Micronesia because Micronesia receives $932 per Micronesian in foreign aid at the moment. And since they receive almost a thousand dollars per person in aid already, it's a little hard to argue that they'll need a large aid infusion. So my guess is that Micronesia will not be chosen. But that's just my guess.

The other countries are possible. Brazil may not be chosen because it scores absolutely dead at the bottom on one of the indicators, days to start a business, and if that doesn't change, Brazil may not be selected. Brazil receives almost no foreign aid anyway from anybody because they've graduated from most foreign aid programs. In general, I think these countries should receive much less foreign aid because they have access to private capital markets and most have graduated from programs. But the other countries, South Africa and Thailand, in particular, Namibia, Romania, and Bulgaria look stronger on these indicators and may be chosen.

If you want more details on that, please take a look at the paper outside. And I would invite you to also look very carefully at their Web site. It's actually a very usable Web site. They didn't say much about their Web site, but it's quite easy to use. And you can download their governance indicators, any of the six, for this year, for last year, for any countries that you want, for one country, for 20 countries. They've got some interactive maps. You can waste a whole afternoon looking at their Web site. It's good fun.

So let me finish right there and then invite questions from the audience. If you would please come up to either of the two microphones, we'll go from the front and then back. We'll alternate front-back, front-back. Please state your name and your affiliation. Please keep it to questions rather than long comments, and keep them very short and direct. And you can direct them to any of the three, but the shorter, the better.

QUESTION: Good afternoon. My name is Frank Vogel [ph]. I'm afraid I've got three, I hope short, questions.

First of all, the median corruption score. I'm quite worried about the context here. Maybe you can explain this. My guess is that almost all of the countries, the 70 countries that we're talking about, have very high levels of corruption anyhow. So what we're really doing in setting the median corruption bar in the middle is to say we are separating those with extremely high levels of perceived corruption from those that only have very high levels of perceived corruption. And I wonder, really, what the benefit is of doing that. Perhaps you can add something to context, because if even those above the bar are perceived to have extremely high levels of corruption, then shouldn't we think about them in a different way than whether they qualify for special grants or loans or MCA just because they're a little less corrupt than the worst offenders?

That's the first question. The second question is about change. I'm concerned about this because of the time frame. My experience is that countries--and I'm looking now, really, at perceptions of corruption--that countries can improve for a period of time and then they tend to slip back, and that it isn't a straight upward line, and that--how do you factor in, when you're talking about this perceived serious significant change, the backsliding? Unfortunately, if you just look at Kenya as a good example, for 18 months we thought our new government was doing everything in the right direction. Now, however, six months after that period, we'd have to admit that they've slid back considerably and that in fact the improvement was less than we thought it was. So how do you take into account in fact the backsliding which, given the fact that the amount of experience you have in this is actually less than 10 years?

Final point, starting a business. You've looked at companies in the World Economic Forum, and therefore, when they look at most of those 70 countries, they are primarily thinking about foreign direct investment. If you take some of the remote poorest countries, that would be, for example, quite probably investment in the natural resources area. Now, my experience is that it's much easier to get an environmental permit--much quicker to get one to explore for gold or open a mine in Tanzania than it is in the United States. And yet your data does not seem to distinguish between industries even though, when we look at the poorest countries, surely that is very important indeed. Otherwise, you're really just comparing apples and oranges, and I wonder what benefit you really get from that.

Thank you.

MR. RADELET: Okay, thank you very much. We'll take a few questions and, I think, take a pile, because there's obviously a lot, and then answer some of them and then go back for another round.

QUESTION: I'm Gordon Johnson. I'm a retired business and Center for Privatization. I came to Washington to work in the Marshall Plan and have watched nothing happen. And I want to congratulate you on after 50 years we are finally taking Lord Kelvin's advice: If you can't measure it, it's very hard to improve it. And I think after 50 years to finally figure that out is a very helpful step forward on foreign aid.

My question wanted to follow up on Steve's comment on income. My concern is another philosopher, Lord Acton, on power tends to corrupt and absolute power corrupts absolutely. Is it possible that the money coming in from natural resources, particularly oil, which is the obvious one with a huge amount of economic rent, could account for higher income but no improvements in government? In other words, it depends on where the income comes from as to whether or not governance is going to improve or not. And I wondered, my question, really, is have you looked at the countries where oil money is going into the government, as a question? And I did a little bit of this with some Muslim nations on voice and accountability. They are all way, way, way down on the --they're more scattered than the others. But I just wondered if you have looked at oil.

QUESTION: My name is Rigi Nabina [ph] from the International Food Policy Research Institute, IFPRI.

First, congratulations to this very important exercise. My question refers to another methodological challenge related to the first question. In Africa the majority of the population actually live in rural areas and they're engaged in the non-formal sector, agriculture and so on. Looking at the data sources, especially for government effectiveness and quality of regulation, seems to come more from surveys among business in the formal sector and in the nonagricultural sector. Therefore the question, is there an urban bias in the governance data?

MR. RADELET: Thank you. Bilal, I'm going to make you wait and switch places with the lady behind you, because she's expecting. It would be impolite to have such an esteemed person as Jennifer Windsor, who's expecting, to wait standing in line.

MS. WINDSOR: Thank you so much.

MR. RADELET: With that introduction--Jennifer.

MS. WINDSOR: Sorry about that.

MR. RADELET: Now that I've totally embarrassed you, Jennifer.

MS. WINDSOR: Well, at least people think I'm not just fat.

The question, I guess, is for Danny and Aart. First of all, congratulations again.

MR. RADELET: This is Jennifer Windsor, who's the executive director of Freedom House.

MS. WINDSOR: Freedom House. Yes, sorry.

It's the issue of the rule of law indicator in particular and the correlation, or lack thereof, of Freedom House's civil liberties indicator as one indicator. But I just went to a Carr Center conference of all the major human rights organizations, including a number of international organizations. And one of the issues came up, I think, about your indicator and composite indicator, that it does not weight a lot of issues that are of importance to the human rights community versus the private sector or commercial community. So the issues of due process, discrimination, access to justice and impunity, I'm just wondering--I was looking at all the things you were adding how that--if you've tried to address this, because it is one of the issues that were raised.

Because if you look at the six ruling justly indicators in the MCA, it's interesting that there's a correlation between the voice and accountability and the political rights and civil liberties indicators from our indices, but that rule of law, effective governance, and corruption are separate. Now, I can see effective governance and corruption going off, but the question is why there isn't more of a correlation of the rule of law indicator, and I just wonder if you could expound on exactly how you weight those variables.

QUESTION: Passing over the question of the extent to which American money has supported orange revolutions in various locations and whether that's been a good thing, my question is that the corporation MCC over its long history has done one deal, and that's for $100 million with Madagascar, and the deal is not different than what AID does. So why should we care about what MCC is doing?

MR. KRAAY: Danny's going to answer that.

MR. RADELET: Bilal, go ahead, please.

QUESTION: Thanks, Steve. Bilal Siddiqi. I'm at the Center for Global Development. I have three small questions. One of them actually takes off directly from what Jennifer said, which is the fact that you guys use Freedom House's political rights, civil liberties indicator as part of your composite indicator and hence, obviously, there's likely to be a correlation irrespective of actual trends in the data, because you actually use it. My point is that--and this is taking off from a criticism that Steve has made earlier about the indicators, is that they--about Freedom House, with apologies to Jennifer, the indicators basically are just straight units, 1, 2, 3, 4, 5, 6, or 7. As a result, when we crunch numbers for the MCA, a lot of countries actually fall on the median, countries make discrete jumps, go up and down on these indicators.

My question on that is, is there an argument implicit in the fact that you use this indicator for the political rights and civil liberties indicators to be not separate considerations but rather seen as subsumed into voice and accountability, since they're already part of that? For the MCA, is this a broader recommendation that one could make? And, you know, does that indicator really strongly correlate with political rights and civil liberties?

My second question is on this whole notion of the global trend. What Aart, I believe, mentioned was that a number of countries--I'm sorry, what Danny mentioned was a number of countries seem to have improved, but an equal number of countries seem to have declined. My question there was, to what extent is that due to the fact that your indicators are based on perceptions and that perceptions, more so than objective indicators, are likely to be relative. And therefore, if both in the sources that you draw from initially as well as the nature of the sources, if the rankings or the scores that are assigned are relative, then wouldn't you expect more of a regression to the mean effect if you're comparing across two distinct time periods? And is that perhaps a reason why we don't see any global trend in governance?

And the third and last question is about the income/governance, just taking off from where Steve started. I would also assume that potentially the causality could change depending on your income thresholds. So if you're an extremely poor country relative to a middling country, would you expect to see a different relationship of causality between income and governance? Do you need a minimum level of per capita income to be able to see the causality working from income to governance rather than the other way around?

Thank you so much.

MR. RADELET: Thank you. In the back, please.

QUESTION: Thank you. My name is Patricia Lopez, from the Commission for Labor Cooperation.

My question refers to the corruption index. How is that different from the one produced by Transparency International, which is also a perception-based corruption index?

And that's it. Thank you.

QUESTION: I'm Argie Styman [ph] with the Government Accountability Office, GAO.

One simple question. Have you found any evidence among the candidate countries for the MCA program that those countries with the lower corruption scores have made more progress towards achieving their millennial development goals?

Thank you.

MR. RADELET: The countries below the--

QUESTION: The countries with lower corruption scores have made more progress towards achieving their millennial development goals.

MR. RADELET: Last question, in the back.

QUESTION: My name is Alicia Phillips Mandaville. I work at the National Democratic Institute, NDI. As I'm on the governance team there, I was also relieved to hear that governance matters as a conclusion.

I have a question about the potential link between expectations and perception of governance, particularly as you see some very visible changes in the nature of governance, or very visible changes in power in different countries. Is there a change in what's expected to count as good governance, and could that possibly be linked to what you see as a stagnation effect in perception of good governance?

And might that be a fruitful area to explore in terms of explaining that link?

MR. RADELET: One last one. Yes, sir.

QUESTION: Peter Knight [ph], [Inaudible.]

As the question for Danny and colleague, the question is you use the word "causality" when you link in this regression these indices and income, and there must be an awful lot of multicollinearity between all the good things in governance and other things like education, health, capital stock, and other things that are normally related to income. Wouldn't it be better to say it's "associated with"?

MR. RADELET: Great. This is a long and very good set of questions that will take a few minutes to tackle. Why don't you guys--do you want to start? There were a couple that were specifically on the MCC, which you can leave for me if you want. Or you can answer them if you want. That would be fine with me, too. So, go ahead.

MR. KAUFMANN: We are very pleased to leave that to you. We don't have a view.

I'll take a few, and Aart will take the rest. So whenever you feel that I've not answered one of your many questions--and we really appreciate the comments and question interaction--it's because Aart will take it.

[Laughter.]

MR. KAUFMANN: One question by Frank Vogel was on the issue that the country can very quickly go back and forth and slip back, so the whole issue of time frame is absolutely crucial. At the very fundamental level, look, we are also very pragmatic. We have at our disposal this data set, which in some sense is very short-term. '96. We would be having a different discussion if it was 20 years and we'd be able to say and make inferences which are more fundamental. But we are quite encouraged and somewhat surprised that already we start seeing some trends in these six to eight years.

Having said that, I totally agree with you that in a short time frame of two years, for instance, you can see lots of ups and downs, you can see a lot of expectations building, some measures being taken, and then some reversals. You just gave the example of one country. There are many others like that. This is the reasons, A, we do not believe in doing this exercise annually, as opposed to many other organizations, because in this world things do not happen in a meaningful way in one year. In fact, all the inferences we made about significant changes are six to eight years. If we only compared two-year periods, it's almost no country did that. If anything, a couple in the downward direction. Zimbabwe is one where something of that happened. So we have to take that perspective and our sources.

Now, you asked about the World Economic Forum and service of these enterprises. Let's address--this is a bit of a myth that everybody thinks about the World Economic Forum and Davos being such a lead, and therefore these are a lead for investors who respond to questionnaires. Not so. It's a completely different survey done within every country by local institutions of about 9,000 enterprises worldwide, 85 to 90 percent of wage are totally domestic enterprises; others in the country are operating with their headquarters abroad. Number two, the coverage by last year was 104 countries, by this year--and thanks to collaboration with us, with the U.S. and so on--it's going to be about 130 countries, covering most of Africa. So those very countries are your concern.

This is a big push that we're trying to make to have all these agencies and especially more surveys covering more and more countries. We're discussing with Gallup the same, and so on, because we agree very much with the thrust of your concern. But significant progress has taken place. This is not the old days of the--like there were competitors in a yearbook of IND. Yes, they cover only 50 countries and so on as lead countries. But others are going much further. Us in the Bank, with the world business environment service, and others. So I think that's the way into the future.

I'll leave others to Aart.

At the margin, I think on the urban bias question from IFPRI, I think that's correct. That's the nature of the aggregation of all these data--they do come mostly from urban areas. But let's keep in mind that there are citizen services which cover it a bit more broadly, and then there are expert assessments where they do have to fill out questions about issues taking place at the more local level in terms of unrest, effectiveness, and others. So it's not totally devoid of that. Whatever additional data source you know that we can incorporate in that context will be very welcome.

There were a number of questions related to voice and accountability and human rights. I'll leave some for Aart. But I just want to take the issue of human rights. The concern expressed, what extent issues of human rights may be devoid of this type of work, was a concern for us from the beginning. And the main challenge--you know, we have tried to be politically daring and incorporate everything even though we are an institution where we are not involved in terms of policies on political issues. We believe in terms of measurement, analysis, and research. The whole spectrum should be covered.

So in human rights, the main constraint has not been within our institution, it's been on the availability of data. The human rights field has been devoid of serious and political work until recently, unfortunately. The corruption work with Transparency International and other efforts was light years ahead of the human rights work. So the message about human rights should be also a message to the whole human rights community of why not codify more statistically what's really happening.

We have taken that on board, and we are very pleased to report that in this 2004 data set our measures include a significant and non-negligible number of human rights measures, through collaboration with Binghamton University and a set of excellent researchers having pored over all the State Department, Amnesty International, and other such reports, Economist Intelligence Unit and others. It's all codified with much detail in the back. So you'll find some surprise in terms of more variables than one thought that there would be.

There was from a fellow from CGD a number of good questions. One is whether the lack of worldwide trend may not be related to the fact that we deal with perceptions. Well, let's keep in mind, A, that there was a notable result that once we go to country level, there are some significant changes. And this is with the same data, which is mostly perceptional subjective-based.

We did not cover the issue--and I'll take half a minute to the good point that Steve made, which is in the same vein--are there regions, sub-regions where trends can be detected? Well, we did mention the EU accession countries. They are going up. It's very interesting also to unbundle regions. If we take Latin America and the Caribbean, it's totally stagnant. What's happening? Unfortunately--I'm from Latin America--the Latin America side has been going slightly downhill and the Caribbean side has been improving. The question is why. In Africa, as you said, there are pockets of significant improvement. They are all in the note that we made available, which is a [inaudible] paper. There's a table at the end, and you can see which countries are improving, which countries are not.

Bottom line is that these data thus enable--which is based on subjectivity and perceptions--thus enable seeing changes. So that cannot account for the lack of it.

The question finally I will take is with Transparency International, which does do and were the first in doing that very [inaudible] work, the corruption index. Well, the first distinction with Transparency International is that they do one index. Our effort was more based to try to look at governance much more broadly defined, within which one such component is corruption. A question very often asked is how come we do not use that index. Well, it's also a poll of polls; it's also an aggregated index. In fact, we collaborate, we help, and we advise. There's very good collaboration. There's no surprise also that the correlation is about .95.

The TI index does not cover countries that have less than three sources, so it's more like 130, 140 countries, so there are a few differences at the margin. And they do the survey annually. And they do rank countries. It's an advocacy institution for which we have much respect. We have different objectives, so we do not rank countries. Also, we are extremely concerned about the margin of error type of issues.

MR. KRAAY: Let me, then, just add a few comments based on some of the ones that Danny skipped.

I was actually struck by Frank Vogel's very first statement, you know, why is it that we bother trying to distinguish countries potentially eligible for the MCC according to corruption when--if I may paraphrase what you said--they're all hopelessly corrupt anyhow. And actually, that's surprisingly not the case. You have to remember that by virtue of MCA-eligible, they're very poor countries. Nevertheless, when you look at the range of corruption that's spanned by those 70 countries, they do indeed range from the very worst right up to the median for the world as a whole.

So basically the whole bottom half of the distribution of corruption is represented among those countries. So within that, it's certainly--I think it would be a stretch to say that, you know, they're all hopeless and there's no point in distinguishing between them. There are sort of--there are practical and substantive differences between countries.

I like very much Gordon Johnson's comment about oil rents, because that was actually something that I wanted to say in response to one of the questions that Steve raised about he's sort of puzzled why there isn't more evidence that increases in income have some beneficial effect on governance. And, you know, while I can't disagree with the comments and statement that providing justice costs money, providing rule of law costs money, there's clearly much more to it than that. And simply looking at the experience of countries that have had commodity booms, oil booms, and so on is suggestive of that.

In earlier work that Danny and I have done, where we've tried to sort of statistically disentangle the two directions of causation, what we found, actually, was that, if anything, there was a negative impact of income on governance, which we think might be a little bit extreme but certainly not a strong positive impact that many people, I think, have sort of come to expect based on intuitions. And I think also the sort of ideas that we have from what the pernicious effects of commodity windfalls are, I think, is part of the picture.

Another interesting--there's a paper by a colleague of ours at the World Bank, Steve Knack, an interesting paper looking at the effects of aid inflows on corruption in countries in Africa. And his claim--and I've looked at the paper very carefully--is that there's some evidence sort of large-scale infusions of aid into countries can have deleterious effects on governance. There are other results out there suggesting that when you look at more diffusely spread transfers, such as workers remittances, you don't see those adverse effects. So I think a key issue is how much money is going into the pockets of governments--into the control of governments. And then how much of it goes into pockets--I think my cynical self has just displayed itself.

MR. RADELET: On Gordon's specific question, in your earlier analysis, did you distinguish between income increases from natural resource--

MR. KRAAY: No, that's not something that we've done because--

MR. RADELET: That question hasn't--

MR. KRAAY: That's something that definitely seems worth doing.

MR. RADELET: So the short answer is it hasn't been looked at. But I think it's a good question.

MR. KAUFMANN: But others have looked at the course of natural resources.

MR. RADELET: Yes. Right. But that's a slightly **different question.**

MR. KRAAY: On the--a couple of questions relating to our rule of law measures and what exactly they're measuring. One thing I should stress in answer to Jennifer Windsor's question is that our rule of law measure is actually very much capturing--if you look at all the questions that go into it--very much capturing an economist's notion of rule of law, where essentially--and this is something I mentioned quickly in the presentation--it's really capturing protection of property rights. And there's much more to human rights than simply the protection of property rights. Certainly take on board the point that, you know, human rights work isn't covered and, as Danny has suggested, there's a lot more to be done there.

This brings me also to Bilal's comments about sort of why is it, if the Freedom House measures are included in our voice and accountability measures--I should also mention this--the Freedom House measures, civil liberties and political rights, actually we put it in our voice and accountability measure because that's where, according to our organization of the data, they belong. The question that Bilal asked is, well, you know, why should they be counted separately at all in the MCC. I can't claim to speak for how the MCC came up with their decision rule, but certainly a consequence of doing that is in a sense it over-weights these concerns. I shouldn't say "over" weights, but increases the weight that is placed on these sort of considerations. One could argue that that's a valid reason for doing so.

Picking up also on the second of Bilal's questions and the one that was raised by I think it was Alicia towards the end on expectations and perceptions and how relative are these, I think it's a really interesting question, that we have worried about. And the relativity, its play depends a lot on the data sources that we're looking at. Some of our sources are polls of experts, people sitting in one city, be it New York or Washington or London or elsewhere, who are rating a whole bunch of countries. And there is the greatest temptation to be relative, although a number of their sources, when we've talked with them, they try very hard to actually be absolute in their ratings. How successful they are, I don't know.

Interesting question when you think about people responding to surveys. People say, well, you know, if there's a survey question about whatever it happens to be--do you think that corruption is a problem in the country, which is a very vague question, obviously--people certainly don't benchmark that against other countries, or are less likely to do so. But they may benchmark it against what has happened recently.

But at the same time, just to share an anecdote with you, we just released the governance data last week. A couple of days ago I got an e-mail from a guy in Costa Rica saying I've been looking at your governance indicators for Costa Rica and I don't understand why control of corruption hasn't gone down enormously, because we've had a big scandal and so--you know, he had some questions about the dates and the timing and such. And I sent him an e-mail back, and he sends me an e-mail back in a couple of days and says, you know, I've been talking about this with colleagues of mine. And, you know, we figure that probably the reason that perceptions haven't deteriorated a lot is because people are actually very happy about how the scandal was dealt with, in terms of what the government's response to the scandal was, and so on. I don't know the specifics of the scandal in question, but all these factors are at play.

In fact, thinking about my own country, Canada, where the minority governing Liberal Party has been mired in a very smelly corruption scandal for the last six months or so, I'm very curious to see how that's going to show up in Canada's ratings. You know, are there going to be declines, are people going to realize that while these things happen, they're going to get sorted out one way or the other and justice will be done, whatever is required. I don't know how these things are going to come out, but I think it's a legitimate concern.

Just briefly on--I'm sorry, I didn't catch the name of the lady from the GAO, but the point there, does corruption hinder progress to the MDGs, I think there's a pretty strong consensus in the whole development profession that corruption has a lot of harmful effects. You can see it both from these relationships between corruption and per capita income when you try to sort out the causal effects. It really does seem to have a causal effect there. A variety of studies have claimed to show that corruption hinders growth and absence of growth is really going to hinder progress towards the MDGs and so on. So I think certainly one can be comfortable in asserting that corruption is a problem for progress towards MDGs.

So I hope that this answered most of the questions. Steve, you probably want to--oh, Steve has to justify the MCC still.

MR. RADELET: Yes, I'll do that in about 5 seconds here.

Just very quickly on two issues that were specific to the MCC. Frank's first question about the corruption, although these guys have touched on it, I think it's largely right, there are some big differences within this group about which countries are more corrupt and which countries are less corrupt. And the objective of the filter within the MCC is to try to distinguish the countries that are actually doing relatively better and can therefore, we think, use the aid more effectively.

The fact is--well, two facts are relevant. One, the one that Aart just mentioned. Corruption has enormous deleterious effects. That's number one. Second, you can make a lot of progress on countries that have a lot of corruption. And if we hold too high a standard of, by God, they've got to get rid of their corruption or we can't do anything, then we're not going to make any progress at all. Korea made outstanding success with a corrupt government. China is doing wonders at the moment. I lived in Indonesia for four years, one of the most corrupt governments in the world, where there was the largest reduction in poverty reduction anywhere in the world for 30 years and, generally speaking, pretty good use of foreign aid.

So the corruption indicator gives us some filter to distinguish the countries that are doing a little better from those that are doing worse. I don't think it's appropriate to use an even stronger standard--although, in those countries, of course, we should be designing programs that help both to improve corruption and to make sure the funds that are given are used as appropriately as possible.

So that's on that. And very briefly, the gentleman's question why do we care about the MCC. Well, we could be here for hours on that. There's a lot of discussion going on right now. There's been hearings up on the Hill. We have some testimony on our Web site, both that we did--the GAO just released quite a nice report talking about various issues. And I think there are some concerns. I certainly have some concerns about the way things are developing. I think your question really speaks to, you know, three years later we haven't done anything, why should we care. I do believe that the administration was really at fault for not doing much for two years and really getting this program off to a very slow start. At the moment, we don't have a whole lot to judge it by.

In terms of is the Madagascar proposal the same as an AID proposal--it's one proposal; I think we should give it a little bit of time and see. I think it's a valid question. I think it really is a valid question. It's one that they have heard and that they are registering. Whether it affects programs going forward, we'll have to see. They will approve a second compact on Friday for Honduras. The board is meeting and I presume the board will approve it, and presumably they plan that by the end of the summer there will be three more, still a relatively small sample.

But the tone of your question I think is at least correct in the sense of, you know, the jury is still very much out. And whether the promise of this program is actually brought to fruition, we'll have to wait and see. It's been a long time coming and it's going to be a little bit longer, and we'll have to just wait and see.

But let me thank you all for coming. It's been a long afternoon. You have stayed a long time, and we appreciate it. Thank you very much.

[Applause.]

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