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Use of governance and corruption indicators in incentive programmes

Query

What is the track record of using anti-corruption or related governance indicators in incentives schemes? What has worked in focusing attention on key priorities and what has not worked (e.g. either because the focus was wrong or the milestones proved too difficult to measure)?

Purpose

I am interested in anti-corruption or governance indicators in incentive programmes in general. Global lessons and especially donor experiences would be really useful.

Content

Summary

Conditionality mechanisms such as incentive programmes can work as a means of bolstering policy changes, signalling particularly important reforms and stiffening the resolve of reformers. Governance and corruption indicators can play an important role in assessing eligibility and monitoring progress in performance-based aid disbursement projects.

Research reveals that corruption and governance indicators that can satisfy the particular needs of benchmarking and performance monitoring in incentive programmes are still largely absent and donors tend to rely on existing, broader, governance assessment tools.

This expert answer details some of the donor experiences with these indicators in incentive programmes. It finds that use of these blunter and broader instruments have generated mixed results. Donor assessments and analysis of incentive programmes are increasingly emphasising the need to develop more targeted corruption a governance indicators that are better suited to these projects.

1. Governance, corruption indicators and incentive programmes

According to a 2009 OECD report, governance assessments broadly serve three different sets of purposes: those related to donor decisions and concerns, to general donor-partner co-operation and to

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the promotion of or support for governance reform. Governance assessments can help donor decision-making on overall allocation of aid to and between countries, country strategies and allocations to sectors and incentive-based aid allocation linked to the outcome of assessments, among others.

Approaches to governance assessments can rely on quantitative indicators (enabling cross-country or in-country comparison), qualitative or narrative description and analysis and underpinning of political economy / power issues. Tools can focus on governance in general or on specific issues such as public financial management and anti-corruption. The assessments can be performed by the aid agencies with little or no input from partner countries, with some input from partner countries or jointly by partner country actors and the aid agency or agencies (OECD, 2009).

An **incentive programme** is a scheme by which the government of a recipient country receives funding for (on the condition of) achieving certain agreed milestones or benchmarks. There is a growing agreement among major donors that a cautious use of this type of outcome-based conditionality can facilitate an increased focus on results in the donor-government dialogue and in monitoring and evaluating the effects of programmes such as budget support. The focus on results rather than specific policy actions is thought to encourage the development of local policy solutions and increase aid effectiveness. (NORAD, 2005) Critics, however, contend that the evidence that results-based conditionality actually does incentivise policy innovations geared to improving results is rather weak (Irish Aid, 2008)

Incentive programmes, such as trenched disbursements, is a form of budget support that is used extensively by the European Commission (EC) and is the most formalised graduated response mechanism. The variable tranche components are additional resources that are released in a graduated form, depending upon the extent to which targets and performance indicators are achieved. Similar approach has been used by other donors such as the World Bank, IMF, and bi-lateral donors like NORAD, SIDA, and the Swiss Agency for Development and Cooperation (NORAD, 2005) The Millennium Challenge Account is a well known U.S. aid effort that also employs an incentive model.

Corruption is viewed by donors as a symptom of weak governance and corruption or governance indicators are often used as benchmarks and decision-making tools by donor agencies in incentive programmes. Desk research revealed that donors tend to rely on available corruption and governance indicators for purposes of assessment and benchmarking in incentive programmes, rather than specialised indicators tailored specifically for incentive programmes.

According to an OECD synthesis report on donor anti-corruption efforts, the type of indicators used in incentive programmes can range from high level perception-based indices such as the World Bank Worldwide Governance Indicators (WGI) and Transparency International (TI)'s Corruption Perceptions Index (CPI) to regional comparisons as the Ibrahim Governance Index. Surveys and assessments can also provide helpful benchmarks for targeted sectoral programmes; these include the World Bank Country Policy and Institutional Assessment (CPIA), the Public Expenditure and Financial Accountability (PEFA) assessments, the Global Integrity country assessments, the Bertelsmann Transformation Index and National Integrity System assessments developed by TI.

The effect of corruption on doing business is surveyed in Investment Climate Assessments. The World Bank's Ease of Doing Business index and the World Economic Forum's Global Competitiveness Report. Donors have also drawn on perception surveys produced by local NGOs, although availability of this type of data varies widely between countries. For example, in Afghanistan, the government and the international community have only begun to generate locally knowledge and data about corruption since 2006 and there are logistical difficulties in conducting surveys due to security. In Mozambique, the first national survey on corruption was carried out in 2001, and studies of corruption in key sectors in 2006 (OECD, 2009).

One of the most widely used cross-country comparison tools is Transparency International's Corruption Perceptions Index (CPI), which is valued by donors for providing a snapshot of perceptions of corruption and how these change over time. Although it is not an appropriate tool for measuring progress in anti-corruption reform, some donors do still use it for this purpose.

A popular tool for sectoral-level analysis is the PEFA, which is a joint donor initiative to strengthen recipient and donor ability to assess the condition of country public expenditure, procurement and financial accountability systems, and to develop a practical sequence of reform and capacity-building actions. In recent years, particular attention has been paid to indicators of quality and improvement in the PEFA assessments. Information generated by the indicators is considered vital to donors' assessment of fiduciary risk, and to determining the extent to which aid is channelled through government financial management systems and whether additional safeguards are required (OECD, 2009).

2. Examples of incentive programmes and indicators used

Bilateral aid agreements and joint financing agreements establish in advance how donors can and should respond to corruption in incentive programmes. Often they provide for a graduated response of consultation and dialogue, escalating to reductions or delays in aid disbursements if action is not taken to improve performance against the reform indicators. These graduated response mechanisms can focus partner government attention on the need to deepen or accelerate certain reforms.

This section discusses donor experience of using governance and corruption indicators in incentive programmes for three donors – the Millennium Challenge Account administered by the U.S. government, the European Commission (EC)'s tranche disbursement mechanism and the World Bank Poverty Reduction Support Credit (PRSC) programme. The challenges faced by various donors and lessons learned are described in section 3.

The Millennium Challenge Account

One of the better known incentive programmes in recent years has been the Millennium Challenge Account (MCA), which was created to help reduce poverty through sustainable economic growth in countries that have demonstrated a commitment to good governance. Commitment to good governance is determined by its performance in three categories: Ruling Justly, Encouraging Economic Freedom and Investing in People.

The Millennium Challenge Corporation (MCC), which administers the MCA, references several global policy indicators for each category generated by independent organizations, including the World Bank Institute, Freedom House, the World Health Organization, the International Monetary Fund and UNESCO in determining eligibility for MCA funding. Control of Corruption is one of six indicators under the Ruling Justly index. To measure the Control of Corruption, MCC uses the World Bank Institute (WBI) indicator which monitors the extent to which public power is exercised for private gain based on surveys of firms, individuals and experts.

Annually, the MCC issues country scorecards, plotting a country's status against performance scores of countries in a comparable income category. Countries that are above the median score on the Control of Corruption index and in at least half of the performance criteria in each of the three substantive categories, are eligible to submit a proposal for a Compact, a large five-year grant to fund specific programs targeted at reducing poverty and stimulating economic growth. To date Compact grants have been granted to 21 countries. MCC's threshold program is designed to help countries that fall just short of qualifying for Compact eligibility. Threshold programs are typically two to three years in duration and involve comparatively large sums of money for programming focused on the specific policy indicators that are precluding that country from Compact consideration (USAID, 2009).

The EC governance incentive tranche methodology

The EC "Governance Initiative" is an incentive mechanism that was established according to the Contonou Agreement, which is the most comprehensive partnership agreement between developing countries and the EU. It gives partner countries in Africa, the Caribbean and the Pacific (ACP countries) access to additional funding on the basis of their commitment to deliver governance reforms. A total of €2.7 billion from the 10th European Development Fund was reserved for such incentives and allocated through the "Governance Incentive Tranche". There are several stages to this process. The EC first prepares a "Governance Profile", which provides an overview of governance in nine areas. Partner country governments are then requested to put forward a "Governance Action Plan" detailing the ongoing and planned initiatives designed to address priorities identified in the Governance Profile. The size of the Governance Incentive Tranche is determined according to the assessment of the Governance Action Plan (GAP) presented by partner countries (European Partnership for Democracy, 2008).

The specific action, indicators, timetables and means of verification vary between partner countries. However, the PEFA methodology has been used to track progress in many countries in this European Commission (EC) incentive programme. For example, in Mozambique, PEFA indicators form part of the performance assessment framework for budget support. Three successive assessments have shown substantial improvements in areas relevant to tackling corruption. According to an EC Working Paper, in the future ACP partner countries will be consulted on the development of appropriate indicators for performance assessment (European Commission, 2009).

World Bank Poverty Reduction Support Credit (PRSC) programme

The World Bank has introduced the Poverty Reduction Support Credit (PRSC) to support low-income countries implement its poverty reduction strategy through policy and institutional reforms. The PRSCs involve a series of single-tranche operations with a medium-term framework specified at the outset. A number of policy actions are selected as prior actions and triggers for disbursement which include a strong emphasis on governance assessments.

The possible use of PRSCs for a country is set out in the Country Assistance Strategy (CAS). The PRSC scheme progresses through a series of operations: each individual PRSC in the series is focused on completed priority actions. Each subsequent PRSC builds on the previous one(s); its prior actions formulated and agreed on when it is negotiated and draw on the progress benchmarks laid out at the outset as part of the medium-term framework. In moving from one PRSC to the next, if progress is found to lag behind expectations, a judgment is made on whether to (a) adapt the medium-term program, (b) reduce the amount of the subsequent PRSC operation, or (c) delay the subsequent operation until further progress has been made.

PRSCs are normally based on two analyses: a cross-cutting assessment of the country's development policies (social, structural, and key sectoral), which cover the policy reform and institutional development priorities for sustainable growth and poverty reduction and an assessment of the country's public financial accountability arrangements, which covers its public expenditure, procurement, and financial management systems (World Bank, No date).

There is some evidence that, in terms of process, PRSCs have worked well. Findings show that they incorporated many envisaged changes in design and implementation, including stronger country ownership, eased conditionality, and a shift of focus toward public sector management and pro-poor service delivery. It is thought that PRSCs balanced tensions between predictability and program credibility. They reflected commitment to aid harmonization and in a small number of countries served as a donor focal point. The outcomes of PRSCs are, however, less clear. While PRSC countries have been somewhat superior performers in growth and poverty reduction, it is not possible to attribute this to the PRSC and it is not clear that more difficult public financial management or governance issues were tackled successfully (World Bank, No date).

3. Challenges and lessons learned

From the various donor experiences, most of the challenges stem from using governance and corruption indicators in incentive programmes stem from the fact that generic governance tools are usually used in these programmes where their use might not be well suited to the purpose of this type of performance monitoring. In fact, donor assessment of incentive programmes point to the need for developing more specific, consistent and targeted tools, baseline data and intermediate milestones (NORAD, 2005 and World Bank, No date).

The general challenges and lessons learned from country experiences are described below.

Time lag of perception-based indicators: This problem stems from the fact that perception-based high-level indicators are ill-suited to time-sensitive monitoring of actual progress in fighting corruption on the ground. The process for deriving the indicators is time and labour consuming. Typically, the data underlying the indicator is collected 12-18 months before the publication of the index. Perception surveys do not reflect improvements as they are made, but only after the populace experiences and trusts that the reforms are real, a lag time that could extend several years after the activity itself. Since the decision points in incentive programmes are usually 2-3 years apart or shorter, most improvements made will not be reflected in the indices until after the programs have ended.

Increased awareness about corruption can also lead to worse performance in perception indicators. Therefore, activities designed to increase public awareness of corruption or to prosecute officials engaged in corrupt activity can actually skew the results, making it seem that corruption is increasing when in fact public perception is merely reacting to the greater frequency of corruption in the news (USAID, 2009).

Guidance to policy or priority setting: From the experience of the Millennium Challenge Corporation, it has been found that global indices are not sufficiently nuanced to reflect the incremental changes in discrete areas affected by incentive programmes. As there is practically no way to disaggregate all of the factors that contribute to the index compilations, it is difficult to ascertain to what extent the programme activities, as compared to other reforms and external factors, may have impacted the overall index. Lack of detailed baseline information concerning the level of corruption in a particular area can make it very challenging to determine how much corruption may have existed absent the reforms (USAID, 2009).

Sectoral assessments such as the CPIA and the PEFA generally perform better as priority-setting tools. However, much work still needs to be done to develop targeted indicators that are easy to evaluate for purposes of policy or priority setting (OECD, 2009). However, these indicators are often geared towards "on the books" or “de jure” rules and procedure reform. Therefore, they are only imperfect proxies for actual corruption, not least because the "on the ground" application of these rules and procedures might be very different (Kaufmann and Kraay, 2006).

Perverse reform incentives: Using numeric indicators in an incentive structure carries with it the risk of creating a “teach to the test” orientation. The experience of the Millennium Challenge Corporation in Liberia provided an illustrative example in a non-anticorruption context. The policy goal of the Ministry of Education was to improve the quality of education; however, the introduction of the MCC indicator on girls’ education created tension as the Ministry of Planning focussed primarily on keeping girls in school, irrespective of the quality of the education provided (USAID, 2009) .

Political economy: In recent years, power and political economy perspectives have gained ground as particularly relevant for societies where informal governance is still strong or even dominates. They have largely focused on explaining why the governance paradigms from OECD countries have not been easy to apply in many developing countries. This type of analysis helps to determine precise and feasible interventions and/or strategies for developing greater support for progressive change.

Assessment and monitoring tools used in incentive programmes have been criticised for taking little account of the political economy context of aid programmes and incorporating this knowledge into future operations (ODI, 2011). This dimension of governance measurement is increasingly being recognised by donors as important to incentive programmes. In an assessment of the EC governance incentive programme by the Commission, it was recommended that some of the questions integrated into the governance profile should be reformulated or expanded and specific questions should be added to assess the underlying causes of weak governance, to sharpen the focus on informal institutions and enhance focus on international obligations. This is of particular benefit in contexts of fragility (European Commission, 2009).

Difficulty in data collection and monitoring: This is a considerable obstacle in monitoring progress in incentive programmes and is not limited only to governance / corruption indicators. For example, the PRSC programme in Nicaragua had systemic problems with the Monitoring & Evaluation framework, with important shortfalls in the design, implementation, and utilization of M&E. Concerning design, a key performance indicator, the proportion of the population living in extreme poverty was not constructed with a view toward ensuring that data would be available to track the outcome. Concerning implementation and utilization, data for 3 of the 12 performance indicators were not available. Moreover, many of the expected outcomes from the first phase of the project appear to not have been tracked. An assessment report of the project also found that the government substantially changed its estimate of a number of performance indicators, which led Bank supervision missions to conclude that the project was highly satisfactory. This suggests that monitoring and evaluation was at least not given due attention and may have been manipulated (World Bank, No Date).

Risk to partner country: Another very important consideration in choosing the optimal indicator level is the risk to the recipient country. The increased flexibility with result-based conditionality involves increased risk for the recipient country - if the disbursement of a component is conditioned on the success of a policy measure, then the recipient country bears all the risk connected to selecting the right policy measure. If the disbursement on the other hand is contingent on the recipient country carrying through some agreed policy action, but not on the actual results of the policy, the risk is partly shifted over to the donor.

According to donors such as NORAD and SIDA, while the practical problems with impact and outcome indicators are of great importance, the increased risk for the recipient country is a more fundamental argument against outcome and impact based conditionality. On the other hand, if risk sharing is an objective in itself for the variable component of the budget support, then process or action based indicators can be the more appropriate level of indicators to choose (NORAD, 2005).

Partner country ownership and involvement in tool development: The OECD has stressed the importance of partner country ownership in governance assessments in general. Incentive programmes can be less susceptible to this logic since they are predominantly donor-led initiatives.

On the other hand, it has been pointed out that governance assessment processes matter. The manner in which assessments are conducted affects the relationship between different groups of staff in the agency, as well as the relations with in-country stakeholders, and hence the impact. Assessment tools which are intended to benchmark specific government processes (public financial management, fiscal decentralisation, auditor-general functions, judicial case processing) will benefit in terms of pertinence and legitimacy when stakeholders in developing countries participate in their development. Therefore, donors are increasingly looking for ways to balance reform incentives with recipient ownership (World Bank, No Date and NORAD, 2005).

Coordination of donor efforts: An important question for donors to consider is the extent to which donors should coordinate their use of indicators – and whether it is detrimental if some donors use input and process indicators while others use result indicators. One view is that the use of different indicators spread the risk for the recipient country. However, the desired flexibility for the recipient country of linking disbursements to result indicators can be undermined if other donors put up input conditionalities on the same area (NORAD, 2005).

For example, in Mozambique, there have been instances where a single donor country has carried out different assessments, leading to a mixed response, or where different donors have carried out assessments in parallel and each responded in line with their own assessment. At the same time as a USAID study was being prepared which was very critical of the government's governance reform efforts, the US Embassy was co-ordinating a parallel process that led to Mozambique's subsequent qualification as a threshold country for the Millennium Challenge Account. In 2006 a modification to international data used to inform the World Bank CPIA led the Bank to reduce funding. In the same period the EU increased funding in response to a governance assessment that showed a positive trend. In 2007 the World Bank CPIA governance indicators improved, but other donors who were monitoring governance via the PAF decided to reduce their budget support (OECD, 2009).

It is hypothesised that the potential conflict between different donors use of input and result-indicators should in principle be reduced if donors adhere to the principle of drawing indicators and conditions from the broader PRS. However, political motivation and programme priorities of different donors can create obstacles to a harmonised approach.

Political nature of governance and corruption indicators: It has been found that overly political nature of indicators can give rise to challenges for donors in implementing incentive programmes. This was found to be the case for the EC in Ethiopia. In the early 2000s, the first version of the financing proposal contained indicators on elections and democratization. The intention was to condition the disbursement of € 2 million of the overall volume of € 95 million on compliance with these governance indicators. However, in practice, he EC had difficulty defining a goal matrix for these indicators and no agreement could be reached either with the Ethiopian government regarding these indicators for the variable tranche. It was furthermore noted that since respect for democratic principles, human rights, or the rule of law are of paramount importance, these aspects could not be covered in an individual financing agreement and should instead be regarded as a basic principle of cooperation. This view prevailed in the EC, and the governance indicators were removed from the financing agreement (Schmidt, 2006).

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