

Why Governance Matters

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Economists recognize the crucial role of good governance in economic growth. The literature reveals that significant improvements in governance can triple a country's income per capita in the long run and decrease mortality and illiteracy. Countries with good governance encourage their citizens to participate in productive rather than diversionary activities (bribery, thievery, piracy). Large increases in productivity, in turn, lead to high growth rates.

The World Bank defines governance as the traditions and institutions by which authority in a country is exercised for the common good. It includes the process by which leaders are selected and monitored, the government's ability to manage resources and implement policies, and the state's and citizens' respect for institutions. Good governance leads to higher production by ensuring that laws are properly enforced, public office is not used for personal gain, and businesses are unhampered by complex regulation.

Since 1996 the World Bank has provided measures of governance for countries worldwide. The aggregate governance indicators are updated every other year by economists Daniel Kaufmann, Art Kraay, and Massimo Mastruzzi through their paper entitled "Governance Matters". The database covers six dimensions of governance: voice and accountability; political stability and the absence of major violence and terror; government effectiveness; regulatory quality; rule of law; and control of corruption. The indicators range from -2.5 to +2.5, with higher values reflecting better governance. This article takes a look at the results of the recently released 2004 indicators for the Philippines and compares these with the regional averages for East Asia.

Voice and accountability refers to the extent to which citizens are able to participate in the selection of those who will govern them. It takes into account factors such as civil liberties and political and human rights. The Philippines' scored 0.02 in this area in 2004, down from 2002's 0.17. We are not far off though from the regional average of 0.02; however this figure is a considerable improvement from 2002's -0.02.

Political stability and the absence of violence indicate perceptions of the government's tendency to be overthrown through extra-legal means. The Philippine rating decreased to -1.01 in 2004 from -0.61 in 2002. The average score for East Asia in this category is 0.23, higher than its rating of 0.19 two years ago.

Government effectiveness signals the quality of public service and the bureaucracy, credibility of government policy, the competence of civil servants, and their independence from political pressure. The Philippines once again performed badly in this area, rating -0.23, a little lower than its score of -0.07 in 2002. The regional average is -0.15, a deterioration from 2002's -0.07.

Regulatory quality reflects the state of market regulation. It measures anti-market policies such as price distortions, poor banking supervision, and other forms of burdensome business and trade regulation. We received a rating of -0.06 in this category, much lower than our 2002 rating of 0.05. Our neighbors appear to be doing better however, as indicated by the regional average of 0.01, an improvement from 2002's -0.27.

Rule of law measures the extent to which societal rules are abided by and enforced. It factors in perceptions on crimes, the predictability of the justice system, and enforceability of contracts. The Philippines scored -0.62 in this category, slightly lower than its 2002 rating of -0.55. On the average, we performed worse than our neighbors. The regional average increased to 0.1 in 2004 from 0.02 two years ago.

Control of corruption is constructed from scores given by experts or survey opinion polls. Our country's rating for 2004 is -0.55, down from -0.50 two years ago. The rest of the region appears not to be doing much better in this area as reflected by its score of -0.18, although this is a minor improvement compared to its 2002 rating of -0.22.

These results reveal that governance in the Philippines deteriorated between 2002 and 2004, with negative ratings in all aspects except for voice and accountability. In contrast, governance in the rest of East Asia appears to be better in all aspects, except for government effectiveness.

After looking at the figures, the more important question is what bad governance means for our country, in terms of economic performance and FDI inflows. The average growth rate in East Asia was 7.6 percent while the growth rate for the Philippines was only 6.1 percent. The Asian Development Bank attributes robust regional growth last year to favorable developments in the global economy, such as improved growth in the USA and Japan, the region's largest export markets. Despite these favorable external conditions, the Philippines did not manage to grow at the same pace as the rest of East Asia. We also lagged in terms of FDI inflows. The World Investment Report reveals that in 2004 FDI inflows in the Philippines were worth \$469 million. Thailand and Malaysia received \$1,064 million and \$4,624 million worth of inflows respectively last year.

Investors shy away from countries where governments are seen as incapable of implementing policies and enforcing contracts. At the same time, corruption prevents businesses from reaping the full rewards of production as some of these will be expropriated to rent-seekers. This provides a disincentive to expand production, and encourages citizens to partake in diversionary activities instead. Hence, the persistence of ineffective governance and poor economic performance is not a coincidence. Improving governance is crucial to economic growth.

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