

Structures and Institutions of Good Governance: A View from Ireland

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Introduction

In efficiently functioning Western-style democracies, good governance revolves around an interlocking system of parliamentary, judiciary, press and civil-society scrutiny of government, clear lines of responsibility and accountability, a meritocratic civil service, and institutions that can help provide “political cover” for governments seeking to adopt growth-enhancing policies in the face of entrenched interest-group pressures.

Several fundamental pillars of good governance can be identified. The first is the system of oversight of executive power, which helps to ensure that power is exercised to the benefit of society rather than in support of special interest groups. It also helps establish a “competitive market” for ideas and policy initiatives, as does a democratic electoral system. Successful implementation is, in turn, facilitated by the consensus-building capacity of government.

A meritocratic civil service bureaucracy is another fundamental pillar, entailing recruitment and promotion on the basis of merit rather than on an official’s political contacts. A finely gradated separation of powers is also important. The concept of the separation of powers between the executive, the judiciary, and the legislature is well known. However, good-governance systems are also characterised by independent audit and competition authorities, independent regulators for natural monopolies, and so on. It is important that, as a country develops, progress be made on all these fronts.

The next section of the paper discusses some of these issues in greater detail. Section 3 offers a brief comparison of institutional capacity in Ireland and the Balkans, while

Section 4 discusses the role of institutional capacity in the emergence of Ireland “Celtic Tiger” economy.¹

2. Factors impacting on Governance and Institutional Capacity

Parliamentary Scrutiny

Parliamentary scrutiny is necessary to keep the executive arm of government in check. Most developed countries have an independent office, frequently known as the Office of the Comptroller and Auditor General (C&AG). This plays a central role in the public accountability process by providing assurance to parliament on the manner in which public funds have been administered.²

Many countries have followed the UK model in instituting a Public Accounts Committee (PAC) to which the C&AG reports.³ Traditionally, the Chair of the UK committee is provided by the Opposition. The PAC adopts a non-party attitude in its work and seeks to reach dispassionate findings and recommendations whichever party is in government, as committee members realize that their public reputations are enhanced by carrying out this work diligently. In matters affecting parliamentary control of expenditure, its recommendations are usually accepted by the Executive.

It is important to note that membership – and particularly chairmanship – of the PAC and other parliamentary committees are regarded as highly prestigious by members of parliament. This encourages members and aspirants to develop a detailed knowledge of the relevant briefs.

Ethics in Public Office

The Council of Europe’s Greco initiative is an anti-corruption program which includes periodic evaluations of the legislative efforts of participating states in fighting corruption. The evaluation reports offer an overview of a state’s legal and

¹ The terms “good governance” and “institutional capacity” are used interchangeably here to refer to an institutional system that facilitates the adoption of growth-enhancing rather than growth-inhibiting policies. This involves (i) reducing corruption and promoting transparency, (ii) controlling the legitimately-exercised influence of interest groups (and “saving the electorate from itself”), (iii) policy learning, which facilitates the abandonment of growth-inhibiting ideologies and practices, and (iv) ensuring the efficiency of the public-service bureaucracy.

² See:

<http://audgen.gov.ie/ViewDoc.asp?fn=%2Fdocuments%2FNational%5FAudit%5FOffices%2Ehtm&Ca tiD=19>

³ See http://www.government-accounting.gov.uk/current/content/ga_03_3.htm

institutional arrangements in areas such as policing, criminal prosecution, public procurement, the courts, public appointments, auditing of the accounts of public bodies, party political funding, and officeholders' immunity (or lack thereof) from criminal prosecution.

With regard to the financing of political parties, many countries have in recent times adopted new donation limits, disclosure rules, and campaign spending limits, as well as offering greater access for political parties to the public purse.

Media Scrutiny of Government and Parliament

There is an academic literature that explores the impact of media scrutiny on corruption. Brunetti and Weder (2003), for example, find evidence of a significant negative relationship between press freedom and corruption in a large cross-section of countries and show furthermore that the direction of causation runs from higher press freedom to lower corruption. The imputed reason is that independent journalists have a strong incentive to investigate and uncover stories on wrongdoing.

Potential media reports raise the costs of corruption as the probability of being detected is increased. It is much harder, furthermore, for an administration to levy low penalties if this fact is likely to be reported in the media. As long as there is free entry in journalism and in publishing, it is difficult to form an effective cartel to silence journalists, as the more corrupt the arrangement the more fame an investigative journalist can earn by uncovering it.

The Legal System and Judicial Scrutiny

Amongst the principles of a properly-functioning judicial system, as set out by the chairperson of Transparency International, are the following:⁴

- The judiciary must be independent of the executive if it is to perform its constitutional role of reviewing actions taken by the government and public officials, and guaranteeing that new laws do not violate the constitution or other legal requirements.

⁴ Transparency International is a highly-respected non-governmental organization devoted to combating corruption; see: http://www.transparency.org/speeches/pe_stpetersburg.html

- The selection of judges for promotion, and the policing and possible removal of judges, should be done by the judiciary itself.
- It is essential that the task of assigning cases be given not to government servants but to the judges themselves, and that court officials be accountable to, and subject to the sanction of, the judiciary.⁵
- The practice in some countries of "rewarding" selected judges with diplomatic posts upon retirement is clearly open to abuse if not handled in a completely transparent fashion.

Accountability is enhanced through the following processes:

- Judges sit in courts open to the public
- they are subject to appeal;
- they are subject to judicial review;
- they are obliged by the law to give reasons for decisions and to publish them;
- they are subject to media criticism;
- they are accountable to their peers.

Meritocratic Public Sector Bureaucracy

Evans and Rauch (1999) show that the extent to which core state economic agencies employ meritocratic recruitment (based on a combination of education and examination) and offer predictable, rewarding long-term careers significantly enhance a country's prospects for economic growth, even when initial levels of GDP per capita and human capital are controlled for. The measure also has a consistently significant positive effect on end-of-period private-sector investment levels.

⁵ In one country it was found that court clerks were refusing litigants access to their files unless they were paid a small bribe. The Chief Justice, on discovering this, ordered that the court list be posted on the Internet. This action stripped the court clerks of their monopoly and the practice of demanding bribes vanished abruptly.

These authors show how meritocratic recruitment and predictable career ladders help structure the incentives of individual bureaucrats in a way that enhances the ability of the organizations they manage to effectively pursue long-term goals.

A meritocratic civil service bureaucracy, furthermore, ensures not only that executive decisions are implemented efficiently but that valuable policy initiatives will emerge from within the civil service. An efficient civil service represents a repository of institutional experience and organisational learning that is of huge benefit to newly-elected governments. Without a knowledgeable public service, government will find it difficult, in formulating policy, to distinguish between information that is of genuine value to policymakers and the special pleadings of interest groups.

Rauch and Evans (2000) show furthermore that the more that recruitment and promotion are based on merit, the lower is the extent of corruption, while Van Rijckeghem and Weder (2001) find a statistically significant negative relationship between public-sector wage levels and corruption. Higher public-sector wages also help prevent the poaching of good civil servants by the private sector. Improvements in institutional controls and increased transparency of rules and procedures must go hand in hand with changes in wage structures, however, in battling corruption.

To be effective, anticorruption commissions must have independence from the political establishment and be adequately resourced and staffed by personnel of integrity. They must also have the power to enforce penalties if the judiciary is insufficiently independent to do so.

The proclivity of political, business and bureaucratic actors to exploit opportunities for corruption also depends on the design features of the economic policy system. Tanzi (1998) suggests that any serious strategy to reduce corruption requires action on at least the following four fronts:

- honest and visible commitment by the leadership to the fight against corruption, for which the leadership must show zero tolerance;
- policy changes that reduce the demand for corruption by scaling down non-transparent regulations and discretionary tax incentives;

- reducing the supply of corruption by increasing public-sector wages, and
- dealing with the issue of how political parties are financed.

Gradated Separation of Powers

The separation of powers in good-governance systems tends to be finely gradated, entailing independent audit and competition authorities and independent regulators of natural monopolies such as electricity, telecommunications, aviation, etc. The trend in recent times has also been towards the granting of independence to the Central Bank. The logic behind this separation of powers is generally to ensure that the decisions emanating from these bodies will be made on economic rather than political grounds and to make it transparent when the decisions of the bodies are overruled on political grounds. Thus the independence of the Competition and Regulatory Authorities can help provide political cover for the adoption of growth-enhancing policies that may be detrimental to entrenched interest groups.

Fiscal Rules

Fiscal rules such as the UK “Golden Rule” of 1997 represent an attempt to overcome the deficit bias of governments.⁶ This can arise from:

- fiscal illusion and lack of understanding of the intertemporal budget constraint on the part of voters
- electoral cycles
- asymmetries in the cost/benefit spread of spending programs, with costs being spread widely across the population (or shifted onto future generations) and benefits being concentrated amongst narrower interest groups, and
- inefficiencies caused by self-interested stakeholders such as bureaucrats or politicians who wish to secure bigger budgets and avoid budget cuts (however necessary).⁷

Canova and Pappa (2005) find however that tight fiscal constraints applying to US states have not produced “more virtuous governments”, since governments “bend the rules and use creative accounting to avoid constraints”. The ultimate restrictions are

⁶ The rule states that, over the course of the economic cycle, the government will borrow for investment purposes only and not to fund government current spending

⁷ Schuknecht (2004).

provided by credibility considerations (since breaking the rule entails the loss of political capital) and the oversight of the legislature and the media.

Infrastructure and Public Procurement

The vast sums of public money involved in infrastructural spending and public procurement make these areas particularly conducive to corruption. Efficiency requires that rigorous standards be employed in the relevant decision-making processes. This in turn requires competitive and well-regulated markets, an open and transparent system for project tendering and a courts system that can be relied upon to uphold contracts.

Social Partnership

Policy uncertainty can be reduced through the advance involvement of private-sector stakeholders in the decision-making process. This will not eliminate disagreements but will minimize or eliminate sudden “policy shocks” and facilitate agreement on unpleasant but necessary reforms. There may be a case for government contributing to the strengthening of private-sector organisations to enhance their access to information on global best practices and policy-making advice.

3. Institutional Capacity: Ireland and the Balkans Compared

The World Bank governance indicators presented in Table 1 provide a measure of the strength of institutional capacity across selected economies for the year 2005.⁸ These indicators lie between -2.5 and 2.5, with higher scores corresponding to better outcomes.

It is clear that Ireland is far ahead of any of the Balkan countries on all of these rankings (as are the vast majority of EU member states), while the most recent accession countries, Bulgaria and Romania, are ahead of the non-member states on most of the rankings.

⁸ They come from the work of Kaufmann, Kraay and Mastruzzi (2006). Kaufmann and Kraay (2002) find a strong causal effect running from governance to per capita income, with a one-standard-deviation improvement in the governance measure estimated to raise per capita income nearly fourfold in the very long run. They find furthermore that growth may not translate into improved governance because of state capture and related forms of influence by the elite. Hence, they conclude, conventional public sector reform must be accompanied by external accountability mechanisms, political contestability and transparency reforms.

Table 1: Governance Indicators, 2005; various countries

	Account-ability of Government	Political Stability and Absence of Violence	Quality of Public-Service Bureaucracy	Regulatory Quality	Confidence in Legal System	Control of Corruption
Ireland	1.40	1.08	1.63	1.56	1.63	1.70
Romania	0.36	0.03	-0.03	0.17	-0.29	-0.23
Bulgaria	0.59	0.16	0.23	0.63	-0.19	-0.05
Serbia and Montenegro	0.12	-0.91	-0.31	-0.53	-0.81	-0.55
Bosnia-Her	-0.11	-0.78	-0.53	-0.53	-0.74	-0.32
Macedonia	0.03	-1.04	-0.28	-0.2	-0.38	-0.5
Albania	0.08	-0.68	-0.49	-0.27	-0.84	-0.76

Source: http://info.worldbank.org/governance/kkz2005/sc_country.asp

Our second data source, presented in Table 2, is related more tangentially to the concept and is drawn from the World Bank's "Ease of Doing Business" website, which ranks countries out of a total of 175 countries worldwide. Again, the EU member states are seen to be far ahead of the non-members shown

Table 2: Ease of Doing Business: rankings out of 175 countries:

	Overall Rank	Starting a Business	Dealing with Licenses	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading across Borders	Enforcing Taxes	Closing a Business
Singapore	1	11	8	3	12	7	2	8	4	23	2
Ireland	10	6	20	83	80	7	5	2	30	24	7
Romania	49	7	116	101	114	48	7	116	101	114	48
Bulgaria	54	85	140	100	65	33	85	140	100	65	33
Serbia	68	60	157	73	110	33	60	157	73	110	33
Montenegro	70	83	154	76	106	83	83	154	76	106	83
Macedonia	92	76	86	117	87	48	83	79	127	72	123
Bosnia-Her	95	141	160	95	139	7	141	160	95	139	7
Albania	120	121	161	113	76	48	121	161	113	76	48

Source: World Bank website: <http://www.doingbusiness.org/EconomyRankings/>

Djankov, McLiesh and Ramalho (2006) employ these measures to establish that, on average, countries with better regulations grow faster. Their results suggest that

improving from the worst quartile of business regulations to the best implies a 2.3 percentage point increase in annual growth.⁹

The indicators used in the rankings are as follows:

- *Starting a business*: Procedures, time, cost and paid-in minimum capital to open a new business
- *Dealing with licenses*: Procedures, time and cost of business inspections and licensing (construction industry)
- *Employing workers*: Difficulty of hiring index; rigidity of hours index; difficulty of firing index, and firing cost
- *Registering property*: Procedures, time and cost to register commercial real estate
- *Getting credit*: Strength of legal rights index; depth of credit information index
- *Protecting investors*: Indices of the extent of disclosure, extent of director liability and ease of shareholder suits
- *Paying taxes*: Number of tax payments, time to prepare tax returns and total taxes as a share of commercial profits
- *Trading across borders*: Documents, time and cost to export and import
- *Enforcing contracts*: Procedures, time and cost to resolve a commercial dispute
- *Closing a business*: Recovery rate in bankruptcy

4. Institutional Capacity and Ireland's Successful Resolution of Growth-Inhibiting Constraints

The Celtic Tiger Era in Historical Context

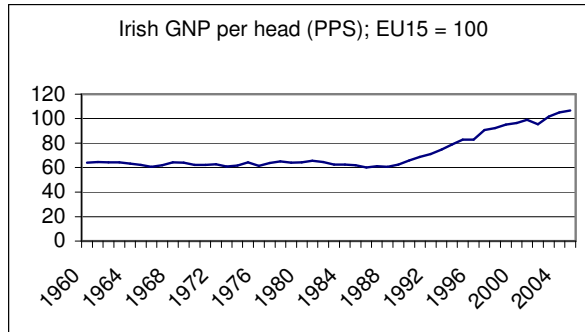
The post-war boom of the 1950s saw Western Europe achieving growth rates of almost 6 percent per annum while protectionist Ireland stagnated with a growth rate of less than 2 percent, an employment growth rate of less than 1 percent, and recurrent balance of payments crises precipitated by the need to import the more sophisticated capital and consumer goods that the country could not produce for itself. Over the

⁹ The Doing Business website includes a simulator worksheet that allows one calculate how a country's ranking would change if reforms were implemented.

course of the 1950s, more than 400,000 Irish people emigrated out of a total population of less than 3 million.

Over the course of the 1960s, 1970s and most of the 1980s, Ireland experienced no convergence on average Western European income per head (Figure 1).¹⁰

Figure 1: Irish GNP per head (PPS); EU15=100.



Source: Eurostat AMECO database; Central Bank of Ireland Quarterly Bulletins for Irish GNP relative to GDP.

The poor performance of the 1950s can be ascribed to protectionism; the lack of convergence of the later decades to labour-market inflexibilities and a poor industrial relations system (similar to that of the UK pre-Thatcher) of the type that Calmfors and Driffill (1988) associate with the poorest macroeconomic outcomes. Citing Olson (1982), they note that “organised interests are most harmful when they are strong enough to cause major disruptions but not sufficiently encompassing to bear a significant fraction of the societal costs associated with pressing their own claims”. Notwithstanding sluggish productivity growth and an unemployment rate 3 to 4 percentage points higher than the EU15 average over the period 1960-73, for example, Irish real wages grew more rapidly than in the other EU cohesion economies, leading to a lower share of investment in GDP.

While economic performance over the 1960s was poor, in that little convergence on Western European income per head was achieved, certain subterranean developments,

¹⁰ GDP figures overstate Ireland’s recent achievements as they include the massive profits recorded by foreign multinational corporations operating in Ireland. These are excluded from GNP, which is the national income measure used in Figure 1 (which is also adjusted for purchasing power differences). Irish GDP is more than 20 percent higher than GNP, a difference not reflected in the data for any other EU country.

particularly in the field of education, would help create the preconditions for the success of the 1990s and beyond. Ireland volunteered, in the early 1960s, to have its entire educational system surveyed by the OECD. The subsequent report, *Investment in Education*, issued in 1965, made newspaper headlines when it reported that over half of Irish children left school at or before the age of thirteen, a far higher proportion than for most of Western Europe. ‘Free’ second-level education and free access to special transport networks for all second-level school pupils were introduced shortly thereafter. Thirty years later the numbers at school had trebled, with 80 percent completing the full cycle (compared to only 20 percent in 1965), while numbers at third-level had increased even more substantially – by a factor of six.

The disequilibrating labour-market conditions that impeded growth in the 1960s were accentuated by poor macroeconomic policymaking over the period 1973-1986, by which time the debt to GDP ratio had grown to 120 percent. Barry (2003) shows that the “cohesion countries” (the traditionally poorer Western European economies) exhibited greater macroeconomic instability than the European average in the wake of the oil shocks and suggests that this phenomenon – of poorer countries losing macroeconomic control more easily than richer countries under difficult global conditions – may account for generally poorer convergence performances over periods of global slowdown. The oil shocks were exacerbated in all the cohesion countries by concurrent wage explosions. While the causes of the wage explosions differed – with Spain, Greece and Portugal all returning to democracy over this period – the events of the late 1970s in Ireland illustrate even more dramatically than in the earlier phase the costs of pro-cyclical fiscal expansion combined with unsustainable wage increases. Further beneficial subterranean developments were in process however even over this bleak period. The strong FDI inflows associated with EU entry in 1973 saw the Industrial Development Agency (IDA) attain increased power within the public-service bureaucracy. How this power was exercised will be analysed in detail below.

Ireland has been one of the global success stories of the period since 1987 of course. Between 1987 and the present day, Irish national income per head rose from 65 percent of the Western European EU average to above parity; unemployment fell from 17 percent of the labour force – double the EU15 average of the time – to around

4 percent (around half of the current EU15 average); government debt fell from 120 percent of GDP to around 30 percent, and an increase of more than 70 percent in the numbers at work saw emigration replaced by very substantial immigration.

The factors behind the boom include:

- Education
- FDI
- Fiscal consolidation
- Social Partnership and Competitiveness, and
- EU Regional Aid

The remainder of the paper discusses how the development of institutional capacity in Ireland helped promote, and in some cases was promoted by, success on each of these fronts.

Education

The education revolution in Ireland began with the government's agreeing to allow the OECD to survey the country's entire education system in the early 1960s. Here, the willingness to receive outside advice set the scene for future developments. The development and expansion of the third-level system of Regional Technical Colleges (RTCs, later renamed the Institutes of Technology) was driven in part at least by the dedication and commitment of senior civil servants in the Department of Education. These characteristics are known to be associated with meritocratic bureaucracies. The civil servants also pushed government to apply for EU regional aid to fund the RTC system. These colleges, in turn, are known to produce the kinds of science, engineering and computer graduates that foreign MNCs investing in Ireland find desirable (Barry, 2007).

Foreign Direct Investment

The Fianna Fáil party has been in government in Ireland over most of the period since independence in 1922. Fianna Fáil was weaned off its hostility to foreign-owned industry through the actions of a short-lived alternative government in the mid 1950s. The rapid success of a newly implemented policy – the granting of Export Profits Tax Relief (the forerunner of the country's long-standing low corporation tax regime) –

convinced Fianna Fáil to jettison its outdated ideology. Ever since then, the country has remained heavily FDI-focussed.

The long-running nature of this FDI orientation and the resulting FDI-intensity of the economy have encouraged the co-evolution of the country's institutional structure to ensure a rapid and flexible response to changes in the characteristics of global FDI flows (Barry, 2006). In the late 1980s, for example, it was noticed that factors such as global deregulation of financial services and the emergence of an electronic marketplace resulting from telecommunications developments had created an opportunity for a regional location like Ireland to become a player in the international financial services industry. Focused government policies since then have seen Ireland's International Financial Services sector become one of Europe's leading off-shore financial centres. Another example of diligent response is seen in the massive increase in the funding of science, technology and innovation policy over the 2000-2006 period, in line with the global trend towards the offshoring of R&D functions by MNCs.

The Industrial Development Agency (IDA) is a key element within the country's public-service bureaucracy and is widely regarded internationally as exemplary of best practice in the industrial-development field. An important element of governance in the agency's operations is that it is subject to frequent external reviews, which have led to substantial changes in structures and procedures in the 1960s, the 1980s and the 1990s.

The agency is facilitated in continuously adapting to changing Irish circumstances and global business trends by its "transnational strategic network" comprising its overseas offices and its relations with investors already located in Ireland. These provide the agency with information about trends in targeted sectors and about newly emerging sectors that warrant the agency's attention. The resulting feedback to headquarters not only influences the industries or subsectors targeted by the IDA but also guides efforts to inform and persuade the government about required legislative changes, necessary additions to infrastructure, and specific training programs to serve the needs of targeted sectors.

Ireland's development agencies (Forfás, IDA-Ireland and Enterprise Ireland), through the strong position they have attained in the policymaking hierarchy, have had an impact in areas not traditionally recognised as lying within the industrial policy remit. They played a major role, for example, in forcing through the modernisation of the country's telecommunications infrastructure in the late 1970s and early 1980s and in the development and upgrading of the human capital necessary to facilitate the country in ascending the ladder of comparative advantage. They were also instrumental in convincing government to reduce the rate of corporation tax on services when it became obvious that services offshoring was increasing in importance, and in driving the push for the massive increase in government spending on R&D in the National Development Plan 2000-06. The importance of FDI to the economy, furthermore, has ensured that the MNC-dominated export sectors have remained corruption-free.

Fiscal consolidation

Economist and former Irish prime minister, Garrett FitzGerald (2000), notes that

“Democratic national governments tend to be subject to such strong pressure from vested interests within their own territories that many of their decisions operate against the interests of society as a whole.”

Efficient political/institutional systems must then develop institutions that help enable these pressures to be resisted, a phenomenon referred to by New York Times columnist Thomas Friedman (2000) as “the golden straightjacket”.

Political wrangling, for example, had prevented the implementation of expenditure cuts over the course of the Irish fiscal crisis of the early to mid 1980s, since trenchant opposition criticism encouraged the defection of government coalition partners or the withdrawal of support for minority governments. The “social partnership” process discussed below helped facilitate the resolution of the crisis, as acknowledged by the Finance Minister who implemented the fiscal cutbacks of the 1987-89 period:

“In 1987, for the first time, a political consensus on fiscal policy was beginning to emerge to underpin the economic consensus already outlined in the NESC report *Strategy for Development 1986-1990*, which had been published the previous November. The NESC analysis of what was wrong

and the prescription of what needed to be done was agreed by all the social partners – including employers, trade unions, farmers and others – without dissent. The NESC described the economic and social problems facing the country as “extremely grave” and set debt stabilisation as a minimum objective of fiscal policy, while relying on public-spending cuts – not taxation – to achieve that adjustment. This was the most critical part of its overall strategy. The boldness of the NESC approach, the consensus of the social partners in backing it, and Fine Gael’s generous promise of political support on fiscal policy all created a new opportunity to tackle, finally, the public finances.”¹¹

[R. MacSharry, writing in MacSharry and White (2000, p.62)]

Ireland’s acceptance of the Maastricht criteria and the Stability and Growth Pact should serve to ensure that a fiscal crisis of the dimension of that suffered over the course of the late 1970s to mid 1980s will not arise again (a further example of Friedman’s “golden straightjacket”).

Social Partnership and Competitiveness

The social partnership process which began in the mid-1980s was Ireland’s way of extricating itself from the bind identified above by way of reference to Calmfors and Driffill (1988).

As seen above, it was also instrumental in providing political cover for the necessary expenditure reductions of the fiscal consolidation period. It further provides a forum for the advance involvement of private-sector stakeholders in the decision-making process. Thus it is difficult to conceive of a case like the recent French debacle – where the government was forced to withdraw its proposed labour-market reforms in the face of widespread outrage – arising in Ireland

EU Regional Aid

Ireland devoted a substantially higher share of its EU regional aid inflows to human capital development, compared to the other cohesion economies of Greece, Portugal

¹¹ NESC – the National Economic and Social Council – can be loosely described as the social-partnership secretariat. Fine Gael is the country’s second largest political party and has led all non-Fianna Fáil coalition governments.

and Spain. This was largely influenced by the successful targeting of its much lower pre-1989 aid funds to develop the non-university third-level Institutes of Technology.

Another factor distinguishing Ireland's decision-making process with respect to regional aid from that of the other cohesion countries was the highly centralised nature of the Irish process. EU agreement had been secured to have Ireland treated as a single region for aid purposes, while decisions in the other cohesion countries were made at the regional level. Regional governments have tended to prioritise spending on roads and other "hard infrastructure", arguably because of the high inter-regional mobility of human capital. Regional governments may be less efficient than national governments, then, at capturing the associated externalities.

The EU regional aid process requires agreement between Brussels and the national authorities on spending priorities (to the extent that they are co-funded), reducing the extent to which domestic political considerations and interest-group pressures can adversely affect outcomes. (It this represents a further example of the "golden straightjacket".) Another beneficial institutional outcome of the EU regional aid process is the embedding of best-practice monitoring and evaluation procedures within the national public-sector bureaucracy.

Conclusions

Abramovitz (1986) includes "social capability" along with "technological congruence" as major determinants of the extent and pace of economic convergence. Abramovitz uses the term to cover issues such as the power of vested interests to block change. This leads to our concern in the present paper with the issues of governance and institutional capacity.

These can be thought of as features of the political/institutional system that increase the likelihood that growth-enhancing and inclusive policies will be adopted and implemented. Strong institutional capacity reduces the scope for government failures and thereby allows for more effective tackling of market failures. Institutional capacity, furthermore, is widely recognised to be a key determinant of a country's investment climate, impacting both on domestic investment and on a country's ability to draw in FDI.

Our concern with institutional capacity raises a number of important questions. How can the power of vested interests be overcome? Where do policy innovations come from? And how can effective implementation be secured?

There are a number of shared ingredients in the answers offered. Among the factors argued to be of importance are:

- The degree of supervision of executive power (necessary to reduce corruption and promote transparency)
- The meritocracy of the public-sector bureaucracy
- The capacity for organisational and institutional learning, which facilitates the abandonment of growth-inhibiting ideologies and practices (and where innovative policy solutions can come from capable individuals, from external sources, from occasional changes in government, or from within a meritocratic public-sector bureaucracy)
- The consensus-building capacity of government, which assists in policy formulation and implementation

Finally, in response to the point raised earlier, that “democratic national governments tend to be subject to such strong pressure from vested interests within their own territories that many of their decisions operate against the interests of society as a whole”, efficiency clearly requires that institutions are developed that help enable these pressures to be resisted.

As an example, consider how WTO negotiations facilitated the EU in rolling back the Common Agricultural Policy. The Maastricht criteria and the Stability and Growth Pact play a similar role in reining in fiscal pressures. We have seen a number of other examples of the role of “political cover”, and the sources from which it derives, in our discussion of the Irish experience.

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