

Preface

Governance has come to the fore in recent years as vitally important in developing countries both for international investors and for providers of official development assistance.

For investors, as the OECD's Business and Industry Advisory Committee recently noted, the quality of governance has become the single most important determinant of investment-location decisions in developing and "emerging market" economies. For OECD development co-operation agencies, both national and multilateral, the watershed was in 1996, when the World Bank reversed its long-standing policy of largely ignoring problems of weak institutions and bad governance in borrowing countries; since then, donors have increasingly used governance indicators to identify and reward developing countries that improve the quality of their governance.

Building on its recent findings on the importance of corporate governance in developing and emerging-market economies, the Development Centre has been analysing for some time the nature of interactions between the quality of governance (corporate and public governance included) and investment behaviour. In the process of this work, the limitations of governance indicators used by investors and donors in their investment and aid-allocation processes became evident; these limitations may in fact hamper the usefulness of the indicators for policy makers, investors and donors. Given the importance of appropriate measurement for good management, the purpose of this study is to highlight these limitations with a view towards reducing the misuse of governance indicators and improving their construction and usefulness.

Based on a careful scrutiny of the indicators most widely used today for investment and aid-allocation processes, the analysis has greatly benefited from information gained by the authors through personal interviews with the management and staff of ten major corporate and financial investors, as well

as with spokespersons for business associations and official development co-operation agencies in Europe and the United States. As part of the Development Centre's on-going work on governance in developing countries, this study hopes to contribute to improving its measurement and quality for the benefit of long-term development.

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