

Corruption: Diagnosis and anti-corruption strategies

Odd-Helge Fjeldstad

Chr. Michelsen Institute (www.CMI.no)

Washington DC, 6 June 2007

Independent Evaluation Group (IEG)
World Bank

Outline of the background paper

1. Introduction
2. Measuring corruption: Governance indicators
3. Macro-level determinants of corruption: Cross-country ratings
4. Microeconomic models of corruption
5. Anti-corruption reforms
6. The World Bank's anti-corruption approaches

Governance:

The World Bank: Governance refers to the manner in which public officials and institutions acquire and exercise the authority to shape public policy and provide public goods and services

UNDP: The exercise of political, economic and administrative authority in the management of a country's affairs at all levels

And UNDP adds:

It is a neutral concept comprising the complex mechanisms, processes, relationships and institutions through which citizens and groups articulate their interests, exercise their rights and obligations and mediate their differences.

Regulation of the oil industry
Antitrust institutions
Human rights
Military in politics
Systems
The function of court systems
Tax systems
Trade politics
Public procurement
Corruption ...and anti-corruption
Free elections
Trust and accountability
Rule of law
Resource allocation

Good governance:

What does it mean?

Corruption - *misuse of public office for personal benefit*

- Involves often money, but not necessarily...
- The many faces of corruption
 - Bribery
 - Fraud
 - Kickbacks
 - Embezzlement
 - Extortion
 - Favouritism
 - Bureaucratic
 - Political
 - Grand
 - Petty

Lesotho Highlands Water Project (LHWP)



Africa's largest infrastructure project

Massive corruption discovered in 1999

12 multinational firms and consortiums bribed the CEO of the project

The CEO found guilty and convicted for corruption

A Canadian company has been blacklisted by the World Bank

Legal institutions in Lesotho commended for the way they have managed the case



The Itaipu Dam, Brazil/Paraguay: The project plagued Argentina-Brazil relations for decades because it failed to recognize Argentina's vested rights in the venture and how the project would negatively affect water flows to Buenos Aires. The project is now under scrutiny because its bi-nationality made it possible for the executives to operate a parallel book account, not declared to any authority. The fraud is estimated to about US\$ 2 billion.

Earthquake in Turkey 2003

Constructors bribed public officials to ignore building regulations



Infrastructure contracts and concessions

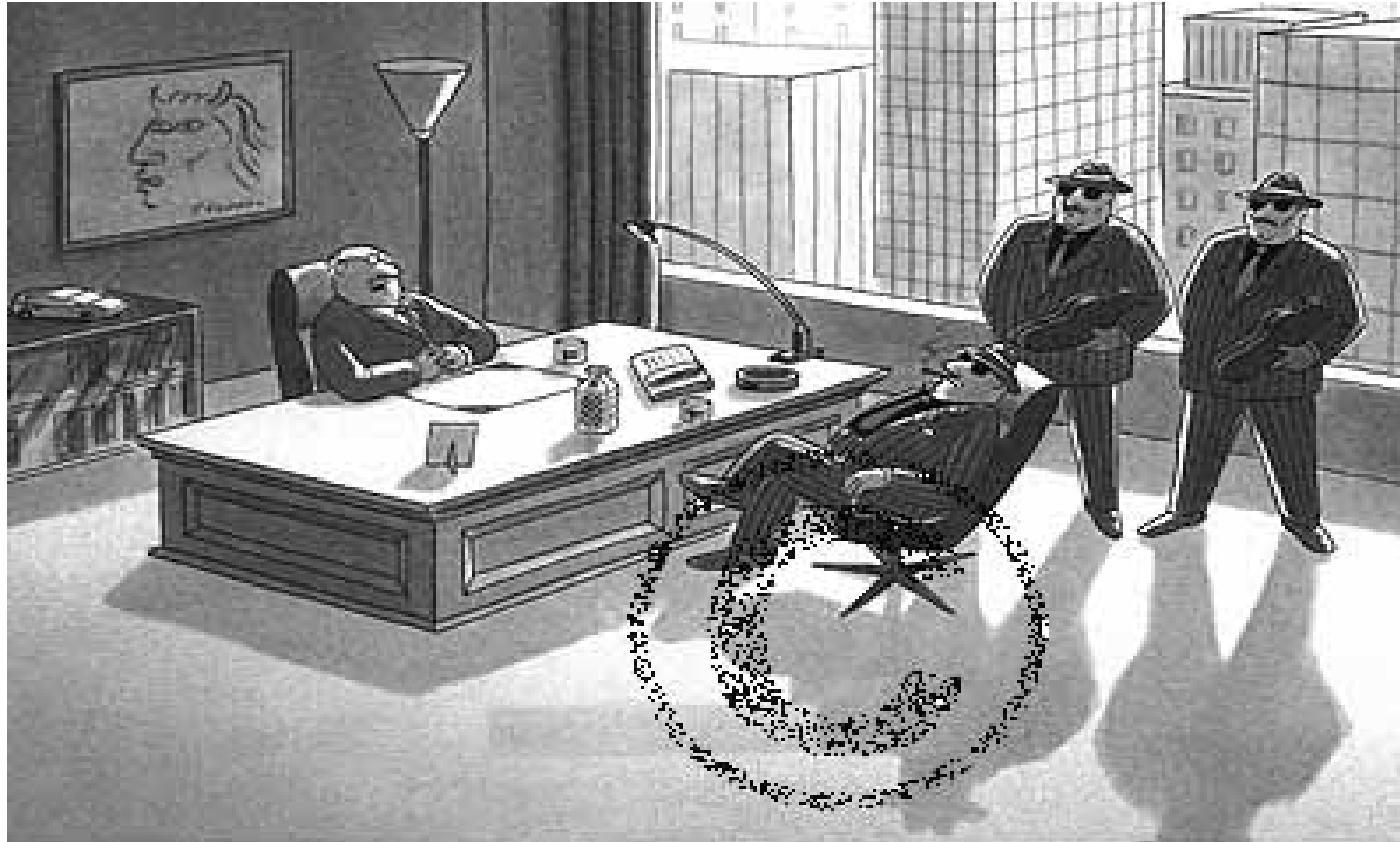
Which factors are important to understand the risk of corruption?

- Size of contracts
- Technology
- Sector
- Opportunities to obtain market power
- Tender procedures
- Urgency
- Local level of corruption
- Risk of being caught
- Trust in business practices of competitors

TI: Corruption is the abuse of entrusted power for private gain (includes private – private corruption)



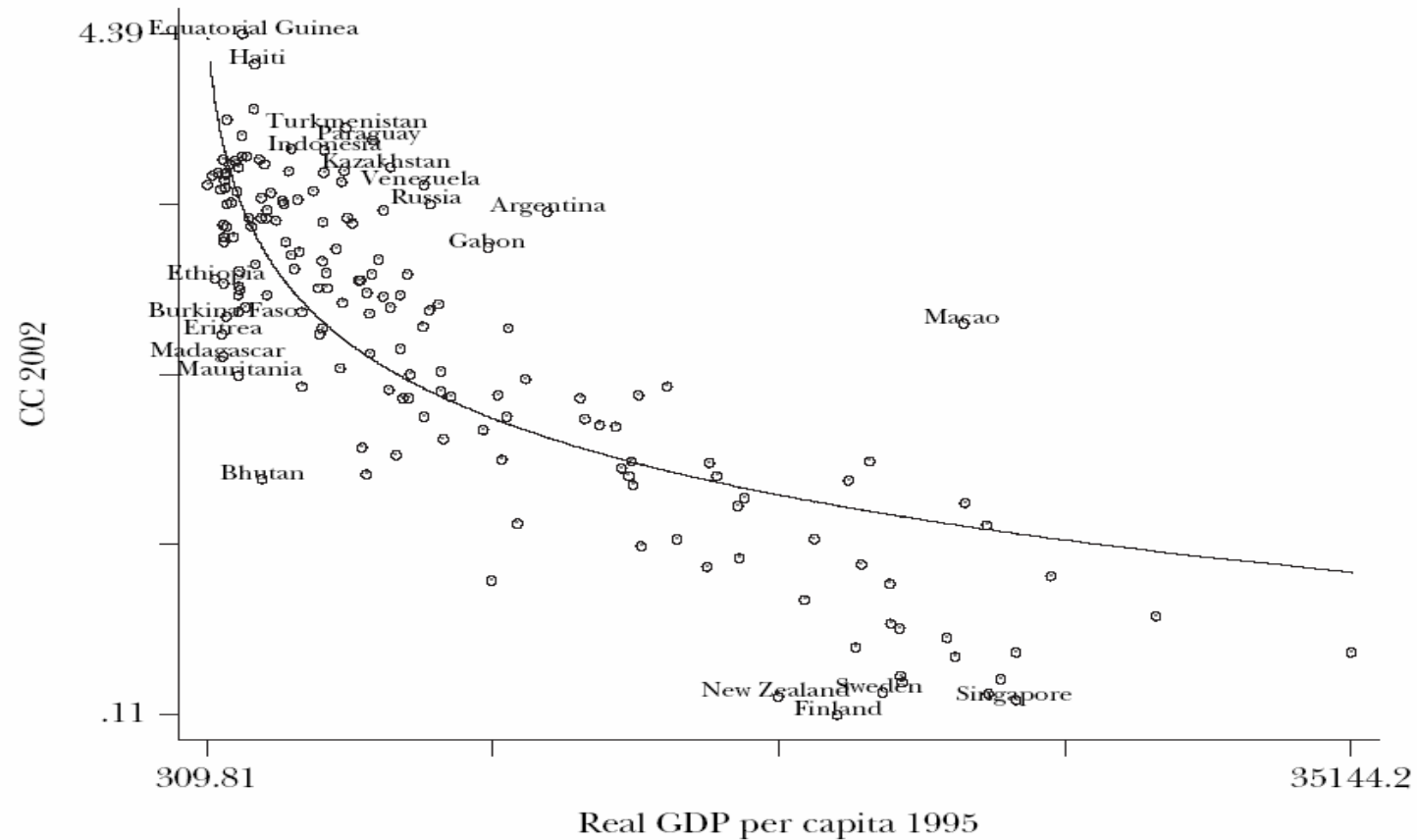
When legitimate business gets too corrupt ...



"I'm thinking of getting back into crime, Luigi,
- legitimate business is too corrupt."

Strong correlation between GDP per capita and corruption ranking

Figure 1
Corruption and Income

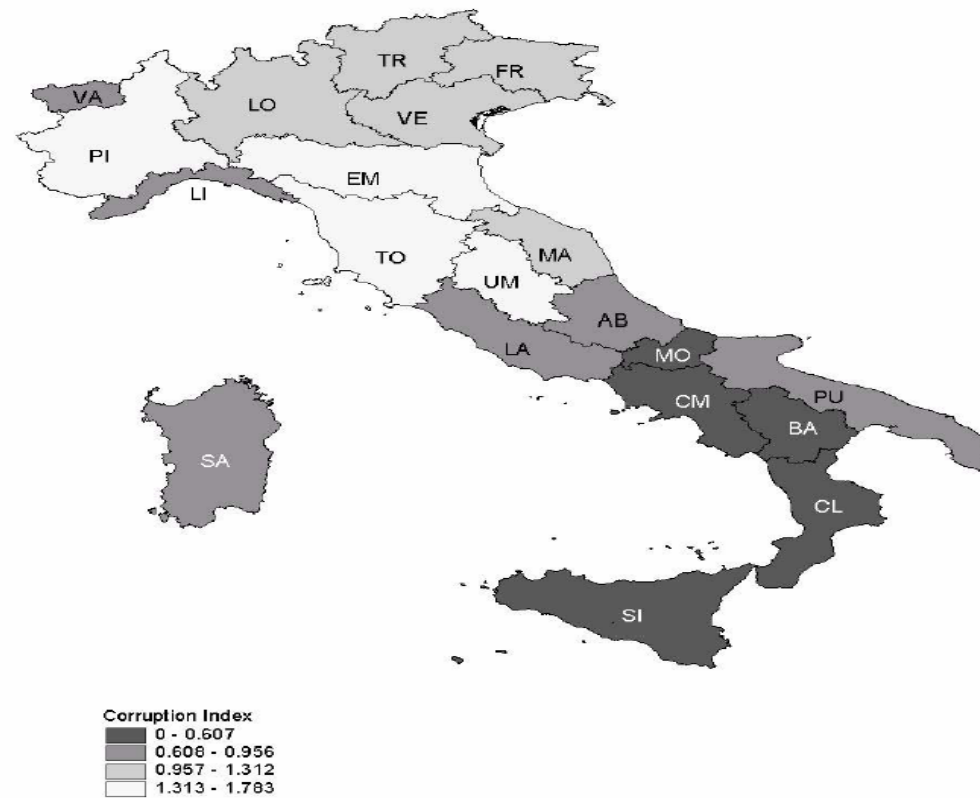


Note: The graph depicts the regression line of corruption (CC 2002) on real GDP per capita (in logarithms) 1995.

Source: Svensson (2005)

Within country corruption – Regional differences in corruption levels in Italy

Figure 3. Regional Map of Corruption Index, 1997



Source: Golden and Picci (2005)

Why corruption is likely to be detrimental to economic development: Theoretical predictions

1. Effects on economic efficiency

- Banerjee. 1997. QJE.
- Ehrlich & Lui. 1990. JPE.
- Sarte. 2000. JME.

2. Diversion of talent, capital & technology away from productive uses

- Murphy, Schleifer & Vishny. 1993. AER.
- Murphy, Schleifer & Vishny. 1991. QJE.

3. Diversion of resources away from investment in human capital to power-seeking activities

- Blackburn & Haque. 2004. Nottingham Uni

4. Predictability may matter

- Schleifer & Vishny, 1993, QJE.
- Choi & Thum, 1998. Columbia Uni WP.

5. Contagious effects of corruption

- Andvig & Moene, 1990. JEBO.

Macro evidence: Cross-country regressions

- Exploits data on corruption derived from perception indices, rather than on direct measures of corruption
- Given the difficulties (and costs) of collecting quantitative data on corruption, the use of perception data makes it feasible to study a large cross-section of countries
- Explains corruption as a function of countries' policy-institutional environment

The most widely used Governance indicators & Corruption indices

International Country Risk Guide (ICRG)

– monthly ratings for 140 countries

Freedom House

- annual ratings of political rights and civil liberties in 192 countries

Transparency International's 'Corruption Perception Index'

– annual ranking - 163 countries in 2006

The World Bank Country Policy and Institutions Assessments (CPIA)

– annual

The World Bank Institute ('KKZ'-indicators, recently renamed WGI)

– annual (from 2006) – 204 to 207 countries dep. on indicator

Sources: Arndt & Oman (2006); Knack (2006); Søreide (2006)

The World Bank Institute – the KKZ-indicators

Six dimensions of governance

- Voice and accountability
- Political stability – and absence of violence
- Government effectiveness
The quality of public services, the quality of the civil service and the degree of its independence from political pressures.
- Regulatory quality
- Rule of law
- Control of corruption

Inputs for Governance Indicators 2002

Publisher	Publication	Source	Country Coverage
•Wefa's DRI/McGraw-Hill	Country Risk Review	Poll	117 developed and developing
•Business Env. Risk Intelligence	BERI	Survey	50/115 developed and developing
•Columbia University	Columbia U. State Failure	Poll	84 developed and developing
•World Bank	Country Policy & Institution Assmnt	Poll	136 developing
•Gallup International	Voice of the People	Survey	47 developed and developing
•Business Env. Risk Intelligence	BERI	Survey	50/115 developed and developing
•EBRD	Transition Report	Poll	27 transition economies
•Economist Intelligence Unit	Country Indicators	Poll	115 developed and developing
•Freedom House	Freedom in the World	Poll	192 developed and developing
•Freedom House	Nations in Transit	Poll	27 transition economies
•World Economic Forum/CID	Global Competitiveness	Survey	80 developed and developing
•Heritage Foundation	Economic Freedom Index	Poll	156 developed and developing
•Latino-barometro	LBO	Survey	17 developing
•Political Risk Services	International Country Risk Guide	Poll	140 developed and developing
•Reporters Without Borders	Reporters sans frontieres (RSF)	Survey	138 developed and developing
•World Bank/EBRD	BEEPS	Survey	27 transition economies
•IMD, Lausanne	World Competitiveness Yearbook	Survey	49 developed and developing
•Binghamton Univ.	Human Rights Violations Research	Survey	140 developed and developing

Source: Kaufmann – WBI (2005)

Summary of findings from cross-country regressions

To the extent we can measure corruption in a cross-country setting, it provides:

1. Inconclusive evidence on how it affects:

- Economic growth
- FDIs and capital inflow
- International trade

2. Indicates that it has negative impacts on

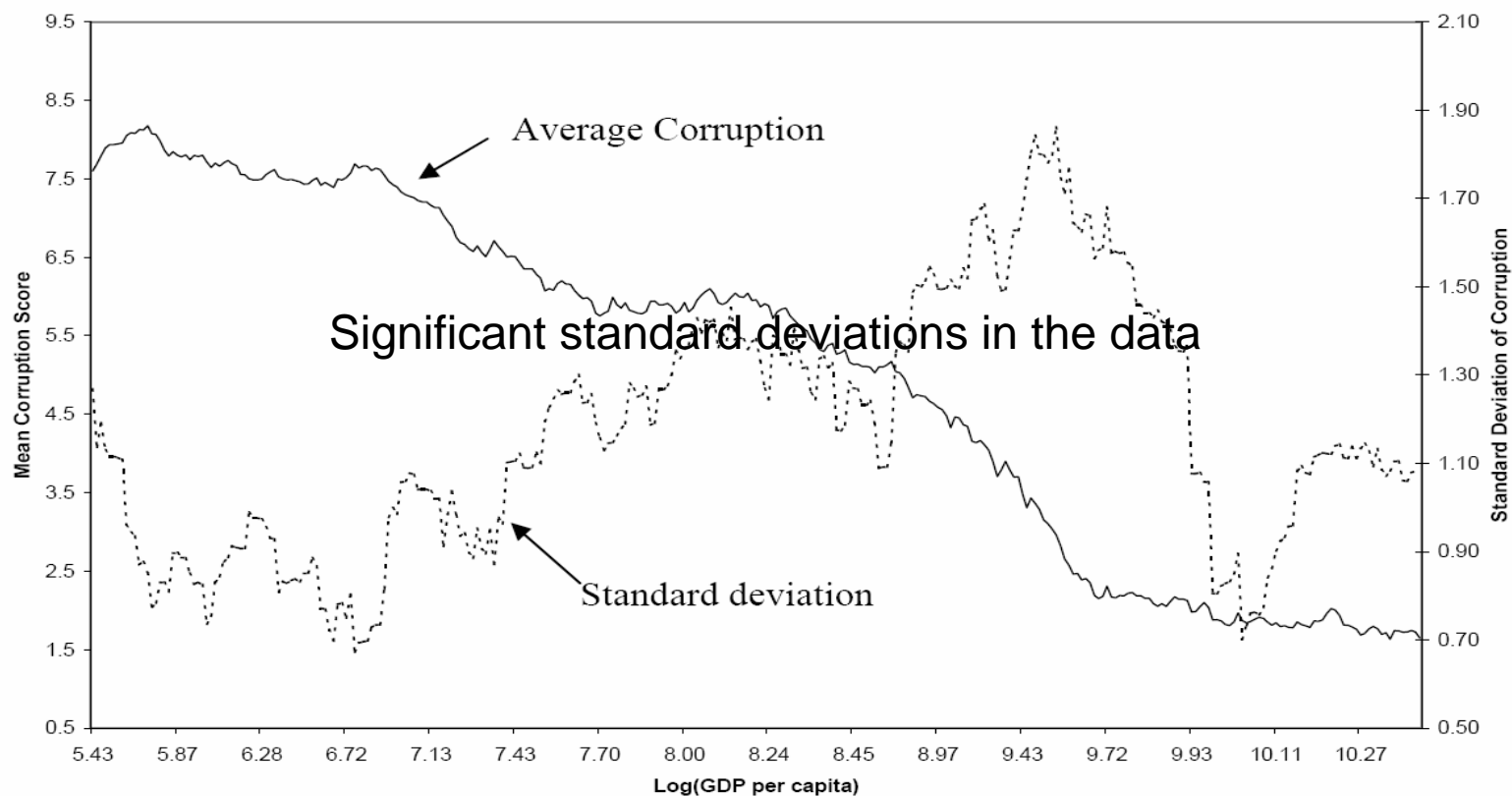
- Composition and quality of public expenditures
- Government revenues

Limits to cross-country research on corruption

- Concerns about perception biases and causation
- Indices based mainly on the perceptions of business people, investors and 'country experts' often miss corruption experienced by ordinary people
- Significant standard deviations in the data - means that respondents have described the corruption situation in a country differently
- Countries with similar rankings may have very different business climates because corruption is concentrated in different sectors
- Conceptually, macro-level determinants cannot satisfactorily explain the within-country variation of corruption
- The aggregate nature of the data tells us little about the relationship between corruption and individual agents, such as service providers or firms

Significant standard deviations in the perception based data

Figure 1: The mean and standard deviation of corruption at varying levels of GDP per capita



Source: Haque & Kneller (2005)

Some very corrupt countries have strong growth experiences. Why?

Different explanations, but still inconclusive evidence

Wedeman (1997): Impacts of corruption depends not only on amounts, but also on the form and how incomes from corruption are spent

Campos, Lien & Pradhan (1999): Corruption regimes in East Asia more predictable than in Africa and Latin-America

Lambsdorff (2005): 'Grand' corruption deters foreign investors less than 'petty' corruption

Andvig (2006): Corruption and growth in transition countries; China vs Russia

General points:

- Corruption should not be treated as an 'undifferentiated' phenomenon
- Corruption takes many forms - no reason to believe that all types of corruption are equally harmful for growth

Micro-evidence: Diagnosing corruption with objective data

1. Firm level surveys
2. Public Expenditure Tracking Surveys (PETS)
3. Service provider surveys

Firm-level surveys

What: Consequences of corruption on firm growth and performance

- Is corruption an extra 'tax' on firms?
- Is corruption 'grease in the machinery'?

How: 'Standard' firm-level survey with a module on corruption/bribe payments:

- Detailed financial & structural information from the firms combined with quantitative graft data
- Survey implemented in coll. with a local industrial association

Findings from Uganda (Svensson, 2003):

- Over 80% of the Ugandan firms surveyed reported they needed to pay bribes
- 20% of firms which reported that they had not paid bribes had chosen to minimise contacts with the public sector
- On average, bribes corresponded to 8% of total costs for bribe-paying firms
 - Bribes more costly than taxation
- Strong negative relationship between bribery payments and firm growth

Public Expenditure Tracking Surveys (PETS)

What: Method for locating and quantifying political and bureaucratic capture, leakage of funds, etc

How: Survey of frontline providers and local governments, complemented by central government financial and other data

- Track the flow of funds from the central gov. on the way to service facilities & local infrastructure projects
- How much of the originally allocated resources reach the facility/project?

Findings:

Uganda (Reinikka & Svensson 2004, 2006):

- Primary schools received on average only 13% of central government allocations to non-wage expenditures (1991-95)
- Captured by local government officials and politicians

Indonesia (Olken 2005):

- 28% of funds allocated to village road building projects were stolen on average
- Captured by road builders who skimmed on materials

PETS in Africa have found large scale capture of non-wage funds (books etc) to schools

- To the extent that human capital accumulation drives long-term growth, the results suggest this is an important mechanism through which corruption can hurt growth

Table 2 *Leakage of non-wage funds in primary education:
evidence from public expenditure tracking surveys*

Country	Year	Mean (%)
Ghana	1998	49
Peru	2001	30
Tanzania	1998	57
Zambia	2001	76

Source: Reinikka & Svensson (2006)

Quantitative Service Delivery Surveys (QSDS)

Frontline provider surveys

What: Information on incentives and corrupt practices in service delivery

- Extent and characteristics of absenteeism
- Job capture
- Drug leakages
- Informal user fees/bribes

How: Emphasis on systematic quantitative data on finances, inputs, outputs, pricing, quality, oversight, and other aspects of service provision

Some findings:

Bangladesh (Chaudhury & Hammer, 2003):

- Absentee rates for medical providers in general: 35%
- Absentee rates for doctors: 40% on average (74% at lower-level health facilities)

Honduras (World Bank, 2001):

- Average attendance rate in health sector: 73% across all staff categories
 - 39% of absences were without justifiable reason
 - 54% of specialist physicians had two or more jobs
- Multiple jobs in education twice as prevalent as in health, with 23% of all teachers doing two or more jobs

Source: Reinikka & Svensson (2006)

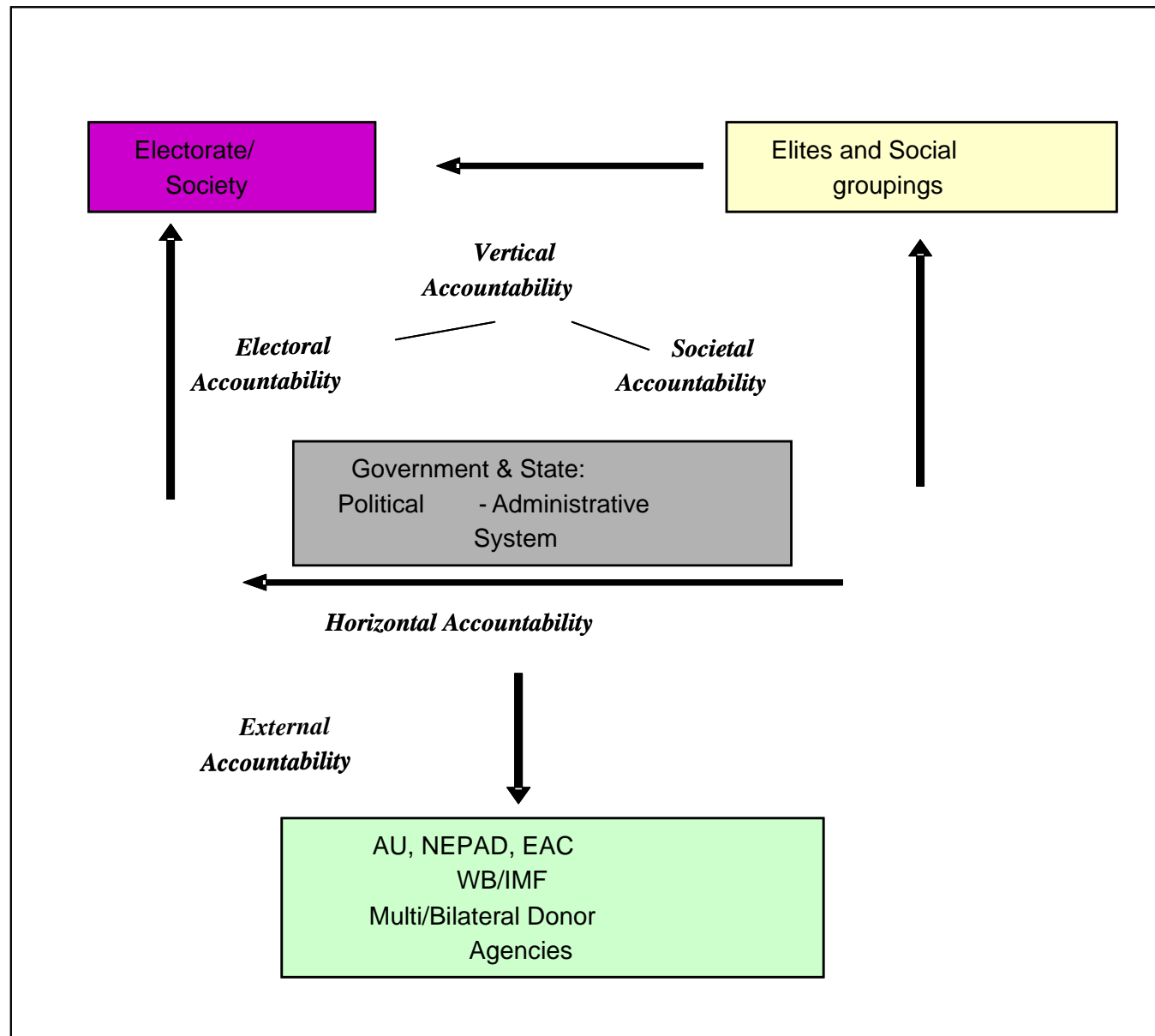
Absence rates among teachers and health-care workers

Table 3 Absence rates among teachers and health-care workers in the public sector (%)

Country	Primary schools	Primary health facilities
Bangladesh	16	35
Honduras	14	27
India	25	40
Indonesia	19	40
Peru	11	23
Uganda 2002	27	37

Source: Derived from Reinikka & Svensson (2006)

Entry points to governance reforms: Dimensions of accountability

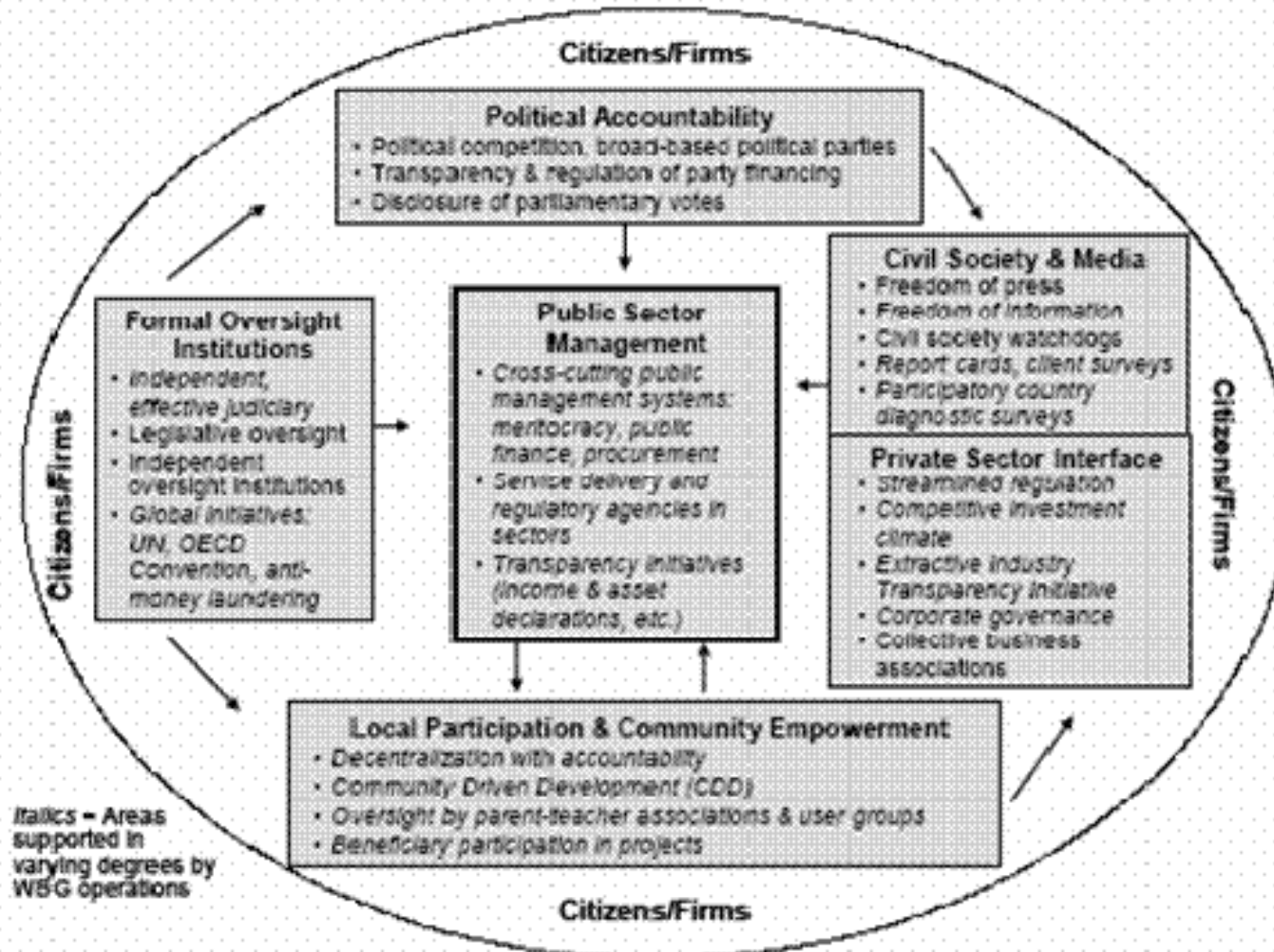


2000: World Bank prescription for anti-corruption

(ref Klitgaard 1988)

1. Encourage the reduction of rents by means of economic liberalisation, deregulation, tax simplification, de-monopolisation and macroeconomic stability
2. Reduce discretion through administrative and civil service reform, including meritocratic recruitment and decentralisation
3. Increase accountability by building up institutions such as auditing and accountancy units, through legal reforms such as judicial strengthening, and by encouraging public oversight through Parliament and a more vibrant civil society

2006: World Bank entry points for governance reform



Governance interventions used in the fight against corruption

1. Political accountability and democratization
 - Political will
 - Political competition
2. Grassroots monitoring and civil society
 - PETS
 - Right-to-information
3. Decentralization
 - Expenditure devolution accompanied by revenue devolution
4. Revenue administrative reforms
 - Simplification, Incentives, Monitoring
 - Exemptions
5. Public expenditures
 - PEFA – not explicitly designed to capture corruption
 - Political and cultural factors left out
 - Public procurement
6. International business transactions

Why do so many ac-initiatives fail?

- The problem is that both assessment instruments and the resulting ac-strategies seem to be simply replicated from one country to another

Mungiu-Pippidi (2006) 'Corruption: Diagnosis and treatment'

- Many ac-programmes are simply folk remedies or one-size fits all approaches and offer little chance of success

Shah & Schacter (2004) 'Combating corruption: Look before you leap'

- Anti-corruption agencies have in many [other] countries been used as an instrument of repression against political opponents, not to fight corruption

Svensson(2005) 'Eight questions about corruption'

- Don't fight corruption by fighting corruption

Kaufmann (2005) '10 myths about governance and corruption'

- AC-reforms in poor countries have often been treated as an ‘engineering problem’ – and as such a phenomenon to be addressed through technocratic ‘toolbox’ or ‘textbook’ solutions
 - assumption that corruption and its solutions can be fully specified in advance, and the required measures implemented on a predictable timetable, over fixed period
- The technocratic approach has overlooked the fact that AC-reform, though it has important technical aspects, also is a social and political phenomenon driven by human behaviour and local circumstances

- Donor approaches to ac-reforms often prescriptive and centred on the design stage of ac-policies
- Less attention on the implementation stage:
 - inter-institutional coordination often difficult
 - political incentives for the implementing partners change
 - multiplicity of players with conflicting interests
- Anti-corruption reforms are often highly political processes that will inevitably pose a threat to important domestic stakeholders
- There are no ‘win-win’ anti-corruption campaigns: Somebody stands to lose

- **AC activities need to be linked to broader governance reforms in each country**
- **There is no ‘best practice’ anti-corruption reform that should be uniformly applied to all countries**
- **Local economic conditions, institutional constraints, administrative capacity, culture and history are important factors that must be taken into consideration when designing and implementing anti-corruption reforms**
- **There is no single cross-country model of reform: The context matters**

**Table 1: Country Types –
Country Strategies**

Corruption	Governance	Priority Anti-Corruption Efforts
High	Poor	<ul style="list-style-type: none"> • Consolidate rule of law; • strengthen institutions of accountability; • rationalize government intervention
Medium	Fair	<ul style="list-style-type: none"> • Decentralization and economic policy reforms; • results-oriented management and evaluation
Low	Good	<ul style="list-style-type: none"> • Anti-corruption agencies; • strengthen financial management; • raise public and officials' awareness; • no bribery pledges, high-profile prosecutions, etc.

No underdeveloped country has the manpower resources or the money to create a high-grade civil service overnight. But it is not sufficiently recognized that the revenue service is the 'point of entry'; if they concentrated on this, they would secure the means for the rest.

Nicolas Kaldor (1963)

Questions to consider for the country studies

- How committed is the government to strengthening governance and tackling corruption, and does it have a track record of progress?
- How effective are domestic oversight institutions, such as the judiciary, the legislature, the supreme audit institution, media and civic watchdogs?
- Does the financial engagement pose a reputational risk to the Bank, and how can that risk be managed or minimized?
- How severe is the risk of fraud and corruption in Bank-financed projects in the country?
- Was anti-corruption part of the WB program?
- Was the emphasis on building up systems for preventing corruption or on combating corruption/law enforcement?
- Was the focus on petty corruption (bribes to frontline officials) or on grand corruption of top politicians and business people? Why?
- Was there any measurable success?
- What was the government ownership? How was it identified (if so) and encouraged?
- Was policy based lending or investment/technical assistance lending more effective in supporting anti-corruption reform? Neither? Or both? Why?