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Good Governance Facades

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1. Introduction

Fashions come and go in the development community. When a policy idea becomes popular, some governments implement a cosmetic variant of the policy. What looks like development, are institutional façades; pretty from the outside, ugly from the inside. A good governance façade can be introduced deliberately to mislead observers and stakeholders to cover political theft. An example from the past is development planning, introduced with good intentions but sometimes exploited as a cover for corruption. In the 1960s donors rewarded developing countries that introduced five years plans by offering more aid.¹ Recipient governments were therefore tempted to come up with cosmetic plans to satisfy foreign donors rather than the needs of their citizens. With recipient governments appearing to follow the suggestions from development experts, the donors raised few questions about their actual performance. Accordingly, it became possible for recipients to appropriate aid money for personal enrichment without facing reactions from the donor community.

Another example is the donor community's demand for privatization in 1980s and 1990s. In some cases cosmetic privatization led to unhealthy reductions in the provision of public goods rather than to healthy market orientation. Both the downsizing of government and the sale of underpriced assets to friends and allies, made it possible for the elite in some countries to grab more rents. This is why many privatization programmes in retrospect are seen as failures, despite the benefits associated with well-functioning markets.²

Among more recent examples is the fashion for budget support, which for recipient governments implies huge transfers combined with wide discretion. This lending modality has been promoted as efficient because it allows recipient countries to “take ownership” of the funds so that spending can depend on the country's most important needs. The use of these unsupervised grants has been difficult to trace or evaluate, however, and in some countries, budget support has opened the door to theft and government contracting in ways that are neither fair nor efficient. Similarly, many anticorruption agencies, charged with powers to prosecute civil servants and politicians, have not served their expected role in promoting government accountability. Too often these agencies are paralyzed at the very moment when members of the government are investigated. As a result, political theft continues behind an anti-corruption facade.

Legal and institutional reforms are difficult to carry out in a developing country. To some extent, honest reformers must expect some disappointing results. Despite the risk of failure, it may still be worth trying reforms. The reform initiatives that we have in mind, however, are different. In their purest form, facades are used for the personal enrichment of government representatives' who may face few consequences when development goals fail. Those involved can insist that all the rules and development targets are implemented, but in reality, state resources are directed to the elite itself.

We argue in this chapter that rents can be extracted under the cover of executing good policies; that nominally beneficial policies permit corrupt decision-makers to hide in plain sight. Hidden behind facades, the real social and economic policies can vary almost inversely with what is needed to serve the population. Popular reforms frequently reduce the opportunity costs of political theft. The reforms cover, or in other ways facilitate, incumbents' efforts to divert resources away from the general public and to their own group. When this is the case, a higher international demand for integrity may lead to more fake supplies of good governance. We are afraid that placing institutional and legal reform at the

¹ The development planning processes, also referred to as neoliberal governmental restructuring (among other terms), have been described by many authors. For a recent critical perspective, see Roberts (2010).

² For review of cases and explanation, see Manzetti (1999), Black et al. (2000) and Bjorvatn and Søreide (2005) – among others.

center of development advice implies a higher risk of such façade institutions, especially in countries where better governance is needed the most.

The view, that the introduction of institutions and laws in some settings can reduce the risk of being held responsible for crime, reflects a declining confidence in laws as a tool for development. Kevin Davies (2004) describes 'the rise and fall of the law and development movement' -- the academic interest in promoting development through better laws which came to expression primarily in the US from the 1960s to the early 1970s. After various disappointments and political incidents, "the principal participants in the exercise became disillusioned and lost their faith in the ability of law, much less legal scholarship, to contribute to development" and "...from mid-1970s to mid-1990s the American legal academy turned its back on development studies" (p 141).

The next wave of optimism about law as a tool for promoting development, he explains, was brought forward by economists and political scientists --- who believed that the development would come with the right legal backbone. Yet laws as remedies for poverty often lack solid empirical support, he claims. New cross-country governance data tempted researchers to study the impacts of policy recommendations without actually visiting countries and understanding the context of development. Enticed by the quick and convincing results, investigators often ignored the methodological difficulties in impact assessments of legal reform. Despite the use of large data sets and sophisticated statistics, their claims of causality were often based on thin inferences.

The policy initiatives directed at law enforcement and redistributive tax reforms had the clearest results (Davies and Trebilcock, 2001). The evidence in other areas, such as property law, contract law and property rights, was less convincing. The intended legal mechanisms may well have a positive impact on development, but the data collected to assess the impact of laws have been weak. As summarized by Davies and Trebilcock (2001:33): "legal institutions do not play a wholly autonomous role in development; their effectiveness is contingent upon the effectiveness of a number of other institutions."³

Our approach is based on the premise that legal institutions are indeed important, but that they must be understood as part of a political and economic equilibrium. Partial reforms are very different from comprehensive reforms: "Governance reform is unlikely to be successful unless we understand the political forces that generate bad governance in the first place. In lieu of such an understanding, policy reforms to improve governance are often ineffective. To be effective, we suggest, reforms have to change the political equilibrium of a society. Though it is possible that small changes may do this, it is more likely that reform has to take place simultaneously in many dimensions." (Baland, Moene and Robinson, 2010)

³ For review of cases and explanation, see Manzetti (1999), Black et al. (2000) and Bjorvatn and Søreide (2005) – among others.

2. The logic of facade investment and diversion

To clarify the mechanisms at play we begin with an overly simplified representation of the basic trade-offs between political fraud and good governance. Although good governance makes the cake bigger for the incumbent, political fraud makes it smaller but gives bigger slices to those in power. First, we present the relevant trade-offs from the perspective both of a totally benevolent incumbent and a scrupulous opportunistic incumbent. Next, we relax some of the narrow assumptions, and discuss the theory's relevance and implications.

2.1 Theory

We start at an abstract level and consider a well-informed incumbent with complete control. He represents the group in power. The group is a small privileged minority, consisting of a share n of the population.⁴ The incumbent determines the institutional governance structure and may divert some of the gains to the members of his group. In doing so, the incumbent is obviously affected by the rules and institutions in the country, including the ones that he himself implements. For now, we disregard this constraint. We do maintain, however, that the choice both of governance institutions and how much money to divert, affect the flow of state revenues. So, by consciously exaggerating the incumbent's ability to coordinate corruption, we ask the following question: *which level of good governance would benefit his group in power?*

To answer that question, we need some notation. The flow of revenues may stem from natural resource extraction, foreign aid, foreign investment, or a combination of these. We denote this flow of income by M . As stated, this flow is affected by governance, good and bad. It is affected by laws and institutions, represented by an indicator of good governance v , such that 'more is always better' for the flow of income. An improvement of good governance is costly, though, and these costs need to be covered by the incumbent. The flow of income is also affected by political fraud as measured by an indicator s , such that 'more is always worse' for the flow of income. The level of political fraud indicates rent diversion to the group in power.

De facto governance is determined by indicators of good governance v (institutions and laws) and bad governance s (political fraud or theft). Accordingly, the flow of income can be written as $M=M(v,s)$. Better institutions and laws lead to a higher flow of income as they improve efficiency (a partial increase in v raises the flow of income; the partial derivative is indicated by $M_v > 0$). More political fraud reduces the flow of income because the incumbent must accept a bad reputation and may have to create distortions to divert money, (hence, a higher s lowers the flow of income; the partial derivative is indicated by $M_s < 0$). The fraction of income that is *not* stolen ($1-s$) indicates political honesty.

The flow of income increases with good governance and political honesty with a constant elasticity for both. In other words, the flow of income is a Cobb-Douglas function of good governance and honesty. A one percentage increase in political honesty raises the flow of income by a constant $\alpha < 1$ per cent. Similarly, a one percentage improvement in good governance increases the flow of income by the constant $\beta < 1$ per cent. The revenue gain of a certain increase in the good governance indicator becomes smaller the higher the institutional quality (i.e. the more improvements that are already in place).

⁴ This implies no assumption about ethnicity.

Likewise the expected impact of an increase in political fraud on the flow of income, is smaller the more income is already being diverted.

What is a façade investment? We can define a successful façade as the level of good governance v that can sustain the initial flow of income with a higher level of diversion sM , or, in other words; that may allow a higher level of diversion without reducing the flow of income. Since diversion of income reduces future flows of income, a façade that sustains the initial flow with more diversion must involve a higher amount of institutional investments.

Now, consider an incumbent who diverts a share s of the flow of income to his group consisting of a fraction n of the population. He puts a weight μ on the income going to his own group and a weight $1-\mu$ on the average income of the remaining population who all in all receives $(1-s)M$. The weights reflect the way the incumbent values different groups in the population, their influence on political decisions. A higher weight on own group relative to its share of the population means that the incumbent becomes tempted to divert income to that group. If he, by contrast, is benevolent and attaches the same weight per member independently of which group they belong to, he is, as we shall see, less tempted to divert income.

Formally, the pay-off to the ruler is

$$R = \gamma M(v, s) - c(v) \text{ with } \gamma = \mu \frac{s}{n} + (1 - \mu) \frac{1 - s}{1 - n} \equiv \gamma(s, \mu)$$

In this expression $c(v)$ is the (convex) costs of facade improvements. We also assume that the costs of good governance has a constant elasticity $\rho > 1$. In this expression $\gamma(s, \mu)$ is the incumbent's personal evaluation of each unit of income. It is greater the more he values members of his own group relative to others, and the higher the share of income that he diverts to his own group.

We recognize the basic trade-off between political fraud and good governance and how it depends on the incumbent's concern for the rest of the population outside his core group of supporters. The essence is that a higher level of v makes the flow of state income bigger, while a higher s makes it smaller, though with a higher share to those in power. Notice also that we have a simple representation of possible reasons for having 'bad governance' in the first place, namely a high value of μ - the power of the ruling elite. Such a position could be the result of insufficient political competition where too much political and economic inequality has diminished the power of the great majority.

We can think of the level of political fraud as the outcome of short-run opportunism, and the indicator of good governance as the outcome of a more long-run investment decision. Before we turn to analytic results, however, it should be noted that the institutional costs of good governance as a share of the flow of income, expressed as $g = c/M$, is increasing in both v and s . It increases in v since there is decreasing returns to investment in good governance, and it decreases in political theft s since the flow of income for given level of good governance v declines in the level of theft, in the following referred to as $g(v, s)$.

Our simple framework can now be used to illustrate some general points. The first establishes a benchmark:

i) A benevolent ruler diverts nothing and chooses the social optimum of good governance.

Being benevolent means that the ruler cares equally much about all citizens whether they are in his group or not, implying that the weights he applies to each group equals the group's share of the population, $\mu = n$. Such a ruler would not divert any income to his own group. Diversion would have opportunity costs as the flow of income declines. Therefore to make the value of R as high as possible the incumbent must

choose $s=0$ and invest in good governance v , till $M_v=c'$. We call this the social optimum of good governance.

Using the constant elasticity both in the flow of incomes ($\beta < 1$) and in the cost of good governance ($\rho > 1$), we can, after some algebraic manipulation, write the first order condition as

$$\beta = \rho g(v^*, 0)$$

v^* is the social optimum of the good governance indicator. Since the cost share g is increasing in the level of good governance, there is a unique equilibrium level v^* . As stated, a benevolent incumbent cares equally much about the population as about his own group. Therefore he would not divert any income. Rather, he would invest in real governance reforms in a manner that benefits the entire population. We now contrast this benchmark to the case of political opportunism and favoritism.

ii) An opportunistic ruler uses good governance facades to divert income.

A less angel-like ruler favors himself and his own group more than the rest of the population. In other words, he attaches a weight to his own group that is larger than its share of the population, $\mu > n$. He would then benefit from diversion till the marginal gain of diverting more money to his own group equals the opportunity cost of the corresponding higher theft. The marginal gain of a higher s is $[(\mu/n) - (1 - \mu/1 - n)]M$. The opportunity cost is the ruler's reduction in income, $-\gamma M_s$. Solving the first order condition, using the constant elasticity (and some patience), we obtain

$$s = \frac{1}{1 + \alpha} - \frac{\alpha}{1 + \alpha} \frac{n(1 - \mu)}{\mu - n}$$

This expression shows that the incumbent diverts more (i) the more he cares about his own group as expressed by a higher μ , and (ii) the less sensitive the flow of income is to diversion as measured by the elasticity α .

iii) A corrupt ruler may have more nominal good governance than a benevolent ruler

Opportunism implies corruption in our set-up. To show whether a corrupt ruler who diverts some of the income to his own group, invests more or less in good governance than a benevolent ruler, consider the first order condition for optimal investments in v . Using straightforward algebra, marginal gain equals the marginal cost can be expressed as:

$$\gamma(s, \mu)\beta = \rho g(v, s)$$

This expression states that the value of the relative increase in the flow of income of a one per cent increase in *good* governance should equal the relative increase in its costs, modified by the cost share of governance g . While a benevolent ruler has $\gamma = 1$ and $s = 0$, an opportunistic ruler has $\gamma > 1$ and $s > 0$.

The introduction of opportunism has two opposing effects: The first captures how the value of g goes up as political fraud increases. Thus facade improvements become more costly as a share of the flow of income. The other effect captures how the incumbent's personal evaluation of income increases. The gain of more institutional window dressing increases as γ goes up for a given value of political theft.

The first effect of higher costs draws in the direction of lower investments in good institutions. The second effect of a higher value of income draws in the direction of more institutional investments. In general we cannot tell which one of the two opposing effects is strongest. The case where the second

effect dominates, i.e. the case where μ is sufficiently high and the share of the population n that belongs to the ruling elite is low, we have the interesting case where investment in a good governance façade is higher when the ruler is corrupt than when he is benevolent.

It is unequal power that yields both high political fraud and a high level of investments in facade institutions. If political theft was not possible, the fact that μ is high and n low would not have had the same positive effect on investments in v . In that sense the high investment in good governance is corruption-induced in this scenario.

iv) Citizens under corrupt leaders may be exposed to “double punishment”

Do the facades investments benefit the great majority? In other words, will the income obtained by the majority $(1-s)M$ increase with the social forces that lead to higher investments in v ? Political theft and good governance are both results of inequality in the distribution of power, reflected in $\mu > n$. Does more political bias (a higher μ) benefit the great majority as well when we account for a higher income – despite the higher level of fraud that it also induces?

A benevolent ruler choose the level of good governance that maximizes $M-c$, while for instance a corrupt ruler who puts all the weight on his own group $\mu = 1$, chooses the level of good governance that maximizes $(s/n)M-c$. The corrupt ruler would divert $s = 1/(1 + \alpha)$, while the benevolent ruler would divert nothing $s=0$. In this case the investment in good governance would be highest with a benevolent ruler, and obviously, the level of diversion is highest with the corrupt ruler. Political fraud implies a “double punishment” of the great majority of citizens - who get a smaller share of smaller pie.

So far, the main insight from our exercise is that the *de jure* good governance and political theft sM may be complements. An incumbent who favors his own group may have both a high diversion and a high investment in facade institutions (introduced to hide the high level of diversion) -- and, it is the same political biases that lead to a high level of diversion that also stimulate a high level of facade investments. In most instances the great majority of the population is the clear loser as *de jure* institutional change may go hand in hand with *de facto* abuse of power.

2.2 The theory’s assumptions

This theory is based on overly simplified assumptions of how good and bad governance determines the flow of income --- as if stakeholders believe in every governance improvement. The dependence of M on good governance v and bad governance s , however, does not require that stakeholders are naive. When governments invest more in a façade, stakeholders do not necessarily take the investment by its face value. Rather, changes in good governance indicators may just make them less convinced that governance was as bad as they thought. Façade investments may modify negative beliefs without changing them completely, and this is sufficient for the results to hold.

The incumbent’s ability to coordinate all political theft is exaggerated in this theory. If we instead let political theft be more decentralized and uncoordinated, but otherwise continue to assume that (i) the ruling elite basically benefits from diversion, and that (ii) political power is unequal as above ($\mu > n$), the same conclusions hold. The more the elite is able to divert at the local level, the more willing the elite is to invest in good governance institutions to attract a higher flow of income to grab from.

Moreover, the theory is based on three further exaggerations. Firstly, we exaggerate the inability of the good governance reforms to constrain the level of political fraud. If good governance actually puts constraints on political theft, and all else were the same, the incumbent would under-invest in such

arrangements. He would, however, search for less restrictive reforms that might have a similar flavor for outsiders and that might attract almost the same flow of income.

Secondly, we exaggerate the level of autocracy in the simple model. A more realistic approach would posit imperfect competition between potential autocrats. This could be captured by a less unequal division of power, narrowing μ - n .

Thirdly, we exaggerate the simple trade-off. Even if the model is crude, it sheds light on basic mechanisms, relevant for development support more generally. For instance, should the development community punish political fraud or reward good governance reforms? What will most efficiently promote development? If the elasticities α and β capture the concern about political fraud relative to good governance reform, we may wonder which one of them should be raised to promote development? A high level of α means that the international income flows may decline dramatically once the fraud is made known. A high level of β , by contrast, would raise the international flow of income once good governance reforms are initiated --- whether the benefits of institutional reforms are stolen by the political leaders or not.

In the simplest version of our exercise only α has a direct effect on the share of political theft; a high level of α reduces the share accruing the ruling elite. A high level of β would, all else being the same, lead to a higher level of good governance reforms. The share $s\beta$ goes to the ruling elite for every one per cent increase in the good governance indicator. If the goal of the international community is to raise the share of income to the great majority $(1-s)M$, it seems that assuring a high α is more appropriate than seeking a high β . If this is true, it seems more important to crack down on political fraud rather than rewarding good governance. More generally, this implies that development partners should rather put more weight on performance targets than on procedures that control government spending.

Finally, the model is consistent with the claim that democratization with comprehensive political competition is required to achieve real governance reforms. In our analytic framework, such comprehensive reforms would be reflected in a smaller difference between influence weights μ and population shares n , thus bringing political decisions closer to what would be the social optimum of good governance.

3. Policy areas exposed

The fraud-façade trade-off for a government is a concern in countries all over the globe. A study on Kenya refers to the mechanism as *straddling*. According to Bigsten and Moene (1996), the government had a financial need to meet donors' demand for democracy and good governance, while at the same time, it sought to broaden its political support by rewarding followers with jobs, licenses, and contracts --- regardless of their qualifications. In a setting with limited political competition, members of the government could “use their political positions as a base for private economic activities.” Political and bureaucratic insiders profited personally from their authority when they invested (as individuals) in the private sector (Bigsten and Moene, 1996:182 and 191). This Kenya case study describes why *straddling* – in terms of hiding rent extraction behind an institutional façade that promised growth and development --- was considered necessary for the government to keep its political authority and to sustain the country's inflow of aid money.

It is generally difficult, however, to determine whether corruption behind a façade is intended at the planning stage of a law or institution, or an unintended result of opportunities that arise because of weak control systems. The effect of laws and institutions in terms of distracting awareness of corruption, as spelled out in the theory above, is nonetheless the same.

We now point at some areas where façade institutions may be particularly pronounced. The risk of political corruption is higher in sectors with large investments, wide discretion, and where there is a justified need for significant government intervention – for example to secure essential public services at low cost. As the listed examples illustrate, façade institutions introduced to reduce the suspicion of corruption may include a range of integrity mechanisms and explicit anticorruption initiatives.

3.1 Infrastructure provision

Infrastructure services are usually subject to more government intervention than other sectors because they are essential services, typically dependent on state investment and subsidies, while their natural monopoly features imply government regulation of service delivery. Estache (2008) summarizes development partners' support of utility sectors over several decades and finds infrastructure performance in developing countries to be generally far below the performance expected by the development partners.

Estimates of the impact of reforms may have been optimistic. Nevertheless, it is a huge gap between the actual achievements and the feasible achievements with many years of loans, aids and development advice. The gap is difficult to explain without reference to some governance failure.⁵ Being aware of this risk, donors have asked for a number of institutional reforms, including independent utility regulation, privatization, the use of independent procurement agents and more detailed audits. The initiatives make it easier to transfer funds to governments, but none of the steps offer any guarantee against corruption.

Argentina is a case in point. According to Natalia Volosin, a corruption expert on the Latin American region, the Argentine government allocated “an unimaginably huge amount of subsidies to privatized utilities for the past 11 years with the purpose of supporting internal demand and maintaining jobs. These subsidies include the energy sector, gas, and others, whose rates were frozen in 2002. The worst sector

⁵ Benitez, Estache, Søreide (2012) explain why governance failure in this sector is the result not only of corruption, but also populism, patronage and protectionist priorities, and suggest indicators that may help distinguish between these different dysfunctions.

in this context was transport, where subsidies were given to companies (trains, buses, etc.) with absolutely no control under the leadership of former Ministries of Transport Ricardo Jaime and his successor Juan Pablo Schiavi, who both are under several investigations, not only for corruption.”⁶

The corruption in these cases grew up behind the political aim of industrial support and job creation. Despite the potentially corrupt ministers’ high position, they needed an institutional cover for their corrupt transfers. External controls were not targeted on performance that deteriorated as the result of the fraud. As a façade strategy in Latin American infrastructure sectors, Natalia Volosin also points at privatization. It is constantly defended as a development strategy, while its effects depend on implementation. In Argentine, privatization was first defended by President Menem to benefit the poor, while those involved in the process drew huge benefits. After the change of incumbent (from Menem to Kirchner), several entities were re-nationalized, now with “allies or even partners to government officials and high-rank politicians” securing profitable positions.

Corruption-driven infrastructure provision is not only a developing country problem.⁷ Spain, for example, has a political inclination to overinvest in transport infrastructure, according to Bel et al. (2014). Like other OECD members, the Spanish government applies strict procurement rules and public investments have to be defended with references to society’s needs, demands and opportunity costs. Nonetheless, Spain has spent far more revenues on infrastructure than most European countries. At first glance their transport networks look impressive, but digging deeper behind the figures, the networks rank worse when it comes to cost-efficiency, quality and the match between users’ needs and service delivery. Ghost projects like huge airports that are built, but never put into use, are other examples. Subsidy rates to the sector are among the highest in Europe. Despite the general perception that political parties are among the most corrupt institutions in Spain, the rules and procedures for infrastructure regulation and investment make it difficult to hold government representatives legally responsible. Some incidents of obvious corruption have been revealed, but according to Bel et al. (2014) most of the corruption takes subtle forms hidden in various legitimate reasons for a close relationship between owners of infrastructure construction companies and Spain’s political elite. The combination of formal procedures and discretion enables the political elite to benefit personally from decisions they make as politicians with sector oversight responsibility.

3.2 Development programs

Social development programs are sometimes used as a facade for corruption. Politicians gain popular support for their noble ambitions while, in reality, few transfers are made to benefit the poor in these cases. Our Argentinean contact, Natalia Volosin, illustrates the point with the scandal Sueños Compartidos, a program destined to construct social houses for the poor, which, through the engagement of an intermediary with high moral credentials --- the organization called Mothers of Plaza de Mayo --- avoided the usual procurement controls. It ended up with houses of poor quality, while several staff members from the Fundación were indicted. The housing benefits to the poor were offered “at glacier speed” according to one media source. President Kirchner secured large public transfers this housing program, and has in return, benefited from the organization’s pronounced support in various political combats.

⁶ Personal interview, July 2014. Natalia Volosin is Senior Researcher at Centro de Investigaciones sobre Desarrollo Económico de América del Sur at the Universidad Nacional de San Martín, Argentina.

⁷ Estache (2011) provides a collection of chapters explaining challenges in utility regulation and investment across Europe.

Another example is reported by the media in Zambia. The Citizens Economic Empowerment Fund Commission was supposed to provide investment support for innovative business projects proposed by citizens in need of start-up capital. In reality it appeared to be a scam to benefit politicians at the expense of the eligible citizens. It gave government officials an opportunity to benefit personally from public funds and make transfers to their patrons. All decisions passed through evaluation formalities and appeared legitimate. Zambia is one of the most aid-dependent countries in Sub-Saharan Africa, and the government operates in close dialogue with development partners. Apparently, without institutional facades it would not be possible to allocate parts of loans and aid transfers to clients of the ruler.

A similar but more sophisticated example is reported in the pharmacy sector in Colombia, as described by Hussmann and Rivillas (2014). A public health insurance fund was set up as an independently managed fiduciary under the Ministry of Health with the purpose of subsidizing medicines for the poor. The whole scheme would be subject to scientific as well as financial scrutiny. At first sight, the system's targets and formal procedures appeared corruption-proof.

In practice, however, the fund was subject to grand corruption. Ministry representatives executed the fraud in terms of reimbursement at prices far above the market prices of medicines. They also allowed collusion between health companies and made transfers to health care institutions that did not exist. Hussmann and Rivillas (2014) list a number of warning signals which were not acted on by the investigators. In the end the fraud was simply too excessive to be ignored. The scandal was eventually revealed, apparently because the ministry representatives had too much appetite for illegal rents – leading to suspiciously high drug prices and too low benefits to the poor. The corruption could not have gone that far without the façade which kept investigators at a distance, while attention was directed towards procedures while ideas were emphasized. A sharper focus on results from day one would have limited the opportunity to hide the corruption behind the facade of a development program.

3.3 Anticorruption agencies

The most obvious integrity facade for covering up political corruption is perhaps the anti-corruption agencies (ACAs). Recanatini (2011) presents a comprehensive study of how anticorruption agencies worldwide perform, and what constitutional aspects secure their independence. They are often politically celebrated when established, but curtailed once they use their authority against members of the incumbent's political party. She also finds that “the legislative set-up for the agencies is critical but cannot alone guarantee independence since ACAs cannot be fully insulated from political interference.”

A study of anticorruption agencies in Central Europe confirms this impression: “the impetus for setting up ACAs has strong implications for how viable these organizations will be” - and “the desire to please an external actor (international organization) or to flaunt anticorruption credentials to voters could well result in nothing more than a symbolic action” (Batory, 2012: 649).

Challenges of this sort were confirmed in interviews for this book chapter. Khusraw Parwez, a Governance Advisor at the German Cooperation Organization in Afghanistan, explains how the government decided to curtail the High Officer of Oversight and Anti-corruption when it reacted against the Attorney General's Office for its tolerance of grand corruption. As a result, the parliament suspended (with only four votes against) the High Officer of Oversight and Anti-Corruption by claiming that this institution was “not efficient given the budget it spends every year.”

In order to keep an integrity facade, it seems, the government submitted a new law to the parliament for its approval; the Anti-Money Laundering and Terrorism Financing Law. Interpreting the proceedings, Parwez comments that the parliament of Afghanistan consists of many warlords, gunmen and mafia leaders. Through suspending the High Officer of Oversight and Anti-corruption and at the same time

approving the anti-money laundering law, the strongmen managed to divert anticorruption efforts and limit the ability of prosecutors to track their own illicit funds.

Over the last decade billions of US dollars have been transferred to Afghanistan from the allied forces, especially the United States. This collaboration has been challenged in many ways - including by a USD 920 million fraud case involving government representatives and the Kabul Bank. Continued financial support is now subject to more scrutiny than before. If corrupt intentions are constant among the Afghan political elite, more institutional facades are needed if they seek to maintain prior levels of illegal revenues.

In Zambia the government in 2009 curtailed the anticorruption commission's work by removing "the abuse of office clause", a section of a law that empowered the commission to investigate any government official with wealth disproportionate to their official emoluments. The government found the clause unconstitutional and a drawback to personal development of public officers as the law presumed whoever amassed some wealth guilty of abuse of office. Despite the public outcry, the government (then led by a vice president who was at the same time minister of justice), went on and removed the mentioned section of the law. The government claimed that another regulation compensated for the amendment. Nonetheless, this legal modification permitted top government officials to engage in corruption at a lower risk. After a change of government, the abuse of office clause was reinstated to produce the Anti-Corruption Act no.3 of 2012. The former regime's corruption has been investigated and the then president, Rupiah Banda, is being prosecuted for abuse of office.

The examples in this section refer to cases where the corruption was eventually revealed. We do not know how often legal reform is initiated or institutions established with the purpose of covering up corruption and projecting an image of public accountability. What we know is that there are many cases where such schemes have made it possible for officials to secure more illegal revenues than would have been possible to grab without the pro-development facade.

(Barreira and Botelho 2013, 118). In light of these recent operations, questions may be raised as to whether the law regulating the length of military public security intervention will be revised.

4. Three case countries

Our facade argument applies not only to particular areas of governance such as infrastructure, development aid and anti-corruption agencies. It is also relevant for understanding the governance of countries more generally. The façade-theory does not explain all their development challenges, but does help explain why some reforms have failed. The more gullible the stakeholders, the more likely are reforms to fail because of corruption. To illustrate our point, we consider the cases of Indonesia, Colombia and Angola. Government corruption is serious in each of them, but their façades differ.

4.1 Indonesia

Can we expect the World Bank-denoted *priority reforms* to improve financial stability in Indonesia, or will it offer opportunities for façade strategies? More than ten years of reform effort have not produced the needed results. Instead there are numerous examples of fraud in the state administration, demonstrating that behind the country's image of prosperous development and financial modernization, public fraud goes on at high political levels. The reforms and the many institutions and laws to improve governance, seem ineffective at best. Indonesia has severe weaknesses in politics, fiancé, public procurement, courts and security hidden behind its image of a modern democratic state. The country is still dependent on development aid and lending. The civil society and the press are aware of the country's deep-seated governance challenges, and therefore, those who seek corrupt revenues need to hide their illegal transactions behind some kind of façade, typically a cosmetic reform that is too good to be true.

Nevertheless World Bank country website insists that Indonesia is “one of Asia Pacific's most vibrant democracies that has maintained political stability and emerged as a confident middle-income country.” The country has developed a formal modern state with a system of educated civil servants without extravagant salaries, and a well-organized administration on the best principles of procurement legislation --- it is claimed.

Accordingly the World Bank has granted Indonesia a USD 500 million loan for the promotion of financial reforms.⁸ Loans for similar purposes have been granted several times since 2004, including one for USD 300 million in 2012. According to business analysts, there is now more financial stability in Indonesia, but progress on important reforms in the sector has been slow. *Strategic Review* emphasizes how “weaknesses exist that have the potential to destabilize the sector and damage the real economy. Specifically, diversification of the financial sector is low. The financial sector is still highly concentrated, with the banking sector dominating. Within the banking system, the top three state-owned commercial banks account for one-third of all banking sector assets and deposits, while the top 15 banks account for about 70 percent.” Apparently, these distortions and their associated ownership concentration have not been dealt with - despite a decade of collaboration on financial sector reform. The reason seems related to the finding that “the Indonesian banking sector may be one of the most

⁸ <http://www.worldbank.org/en/news/press-release/2014/07/01/indonesia-receives-500-million-world-bank-support-financial-sector-reform-policies>

profitable in the Asian region”⁹ for those who control this industry and the grants for reforms. Most likely, a genuine financial reform would threaten their interests.

The financial problems must be understood in light of the 31-year-long rule of Suharto (Aspinall and Van Klinken, 2010). President Suharto offered low wages to state officials while allowing them access to extra funds by an informal “franchise system” of allocating power, a system which secured him authority while it damaged state administrative integrity. The corruption implied de facto informal taxes on individuals and firms, making public sector careers “far more attractive than what formal remuneration levels would suggest” (McLeod, 2010:45).

The resulting demand for lucrative civil servant positions generated an auction system for such jobs and extra authority for local and central leaders, while the low formal wage at the same time served to “discourage the entry of highly principled individuals” (McLeod, 2010:47). At the end of the Suharto era in 1998, public officials and the ordinary citizenry alike saw nothing wrong in making extra illegal payments for public services. Corruption is still a cross-cutting challenge --- “wherever one goes in Indonesia, state officials are especially likely to be involved in criminal activities that involve a high degree of organization, such as extortion and protection rackets, smuggling, illegal logging and the narcotics trade, while law enforcement officers enjoy murky relations” (Aspinall and Van Klinken 2010: 3-4). The problem is especially difficult to combat since one of the sectors most exposed to corruption is law enforcement and the courts (Butt and Lindsay, 2010).¹⁰

Moreover, what Dick and Mulholland (2010) call “slush funds in current Indonesian politics” are essential for understanding the challenges. The slush funds are “off-budget, non-accountable and discretionary revenues” for the political elite, extracted from public procurement contracts, the allocation of permits and licenses, funds siphoned informally from budgetary and project revenues, and gift loans from state banks (non-or part-repayable loans). In addition, they describe how political positions are still “allocated by internal auction, moderated by patronage and influence” (Dick and Mulholland, 2010:76). The funds are financially supported by business firms including state enterprises pressured for payments in return for political favors. Access to illegal rents has created public sector surplus labor and has permitted Indonesia to sustain a government apparatus that is much larger than what could be supported out of legitimate forms of revenue (Cribb, 2010:43).

The existence and purpose of slush funds suggest that corruption after the Suharto reign is as pervasive as it was under his regime. One difference today, however, is the “need for concealment” and how that can be achieved via “a series of intermediate transactions between the principals” (Dick and Mulholland, (2010). Considering the case of Indonesia, we find several examples of how promises to development partners of new reforms and institutions may have fostered corruption instead of corruption control.¹¹

⁹*Strategic Review* on 14 March 2013, article written by P.S. Srinivas, a World Bank economist. Made available by Stratfor: <http://www.stratfor.com/the-hub/indonesia%E2%80%99s-financial-sector-half-full-glass#axzz3C2wHkgSa>

¹⁰ Corruption in courts has been a problem at all levels of the judiciary. In June 2014 the Chief Justice of Indonesia’s Constitutional Court, Akil Mochtar, was found guilty in accepting bribes in exchange for favorable rulings in regional election disputes.

¹¹ In this respect, the mentioned case of the World Bank USD 500 million loan, for example, would be “safer” if the benefits were to some extent contingent on the owners of the country’s profitable banks giving up their shares – which seems to be a critical aspect of true reform.

4.2 Colombia

Recently Colombia has developed behind a policy of *democratic security*.¹² Whether this policy is a façade or not is perhaps a question for debate. The strategy has helped launching peace negotiations between the government and the FARC guerilla, and in that sense, it has real contents. Nonetheless, this far the strategy has been more successful in attracting foreign investments to certain areas of the country than to improve the life of the entire population.

It started when Alvaro Uribe was elected president in 2002, introducing a democratic security tax, followed by a military offensive that removed the Revolutionary Armed Forces of Colombia (FARC) from half of the municipalities where it was present. The policy might have impressed outsiders. Columbia is no longer considered a failed state; foreign investments have risen from \$1.5 billion to \$13 billion; investment has grown from 17 to 27 per cent of GDP. All this is “a response to enhanced security and greater optimism about the future,” according to Robinson (2013).

Besides, Colombia has experienced steady economic growth over the last decade. Its government institutions, constitution and legal system are commended for its qualities, and the country is ranked well on several indices, such as the Open Budget Index and the Index of Economic Freedom. The government appears receptive to international collaboration on several forms of cross-border crime, and when it comes to anti-corruption and money laundering its legislation is among the most advanced in the world.

Yet, behind the façade serious problems continue as before. The country is still among the most violent in the world and also the main supplier of cocaine to US markets. Colombia has now experienced “half a century of intense armed conflict with insurgent and paramilitary groups perpetuated by their involvement in widespread illegal drug production and trafficking, along with criminal and narcotics trafficking organizations” (the US Department of State web-site). The financial support from the United States, totaling USD 1.600 million in the period 2010-2015, includes primarily support to counter narcotics programs and to support the military.

However, the trade in narcotics and the operations of paramilitary groups also fuel political corruption, and any financial support to counter the illegal activities bears the risk of being misused and stolen. Political corruption is not only a decentralized problem, but extends to levels high up in the government and the military system. At the same time, civil servants, soldiers and politicians seem protected from prosecution and sanctions, almost regardless of what offences they have committed.

The widespread corruption is often “excused” by the difficulty of controlling the guerilla and the paramilitary groups, profiting from the narcotics trade. The high degree of informality implies that many citizens pay bribes without even being aware of their own involvement in corruption (Mehling and Boehm, 2014). US AID explains: “In reality, there are two Colombias: a dynamic and sophisticated Colombia in a half-dozen urban centers, such as Bogota and Medellin, which coexists with a poor, conflictive and neglected rural Colombia.” The level of informality and corruption is so high that there is no need to launder criminal revenues abroad. Despite the country's superb anti-money laundering

¹² The term refers to refers to a specific Colombian security policy presented by President Uribe, launched in 2003 (see for instance *BBC* on 30 June 2003: “Colombia unveils security plan”).

legislation, there is “no reason to take illegal capital abroad to protect it” (Thoumi and Anzola, 2012:165).

The military insecurity seems to create financial security for illegal revenues: “the power of the paramilitary, guerrillas, and drug trafficking organizations” and “culturally accepted informal laws” have “shaped an extralegal economy that is immune to traditional mechanisms for combating illegal economic activities” (Ibid., 2012:147). Citizens often prefer to reinvest illegal revenues locally so that they can secure not only an economic return, but also political influence.

One may suspect that “the dynamic and sophisticated Colombia” draws advantages of the existence of “a poor, conflictive and neglected rural Colombia.”¹³ The inequality is huge. The rich rural elites are inclined to condone human rights violations, corruption and poverty --- or as Robinson (2013: 45) suggests, the “conflicts in rural areas guarantee that the periphery is not able to cooperate against the center ... the center foments chaos in the periphery in order to divide and rule” --- an economic and political situation in constant need of a nicer façade.

4.3 Angola

Being one of Sub-Sahara’s largest and fastest growing economies, Angola attempts to build the façade of a successful petroleum exporter. The incumbent MPLA government brags about its democratic rule that has secured political stability for more than a decade; its development friendly priorities, poverty reduction programs, and an impressive reconstruction program that started in 2002 after 27 years of civil war. Through efficient petroleum sector regulation, the government has secured stable state revenues. A public procurement reform, planned construction of houses for the poor, and more transparency into state finances are among its recent good governance goals.

Are they signs of real progress or a cosmetic façade that enables members of government to continue its fraud? Regardless of the organization of elections, political power in Angola is concentrated primarily in the president himself. He is Head of state, Commander of all armed forces, the Main Adviser on all aspects of governance, and he holds the power to dismiss the Prime minister, the cabinet and provincial governors.

Besides, all government expenses above a rather limited amount must be approved by the President himself. His power is bolstered by a patronage system consisting of threats and corrupt benefits for politicians and high-ranking civil servants. The government controls most information circulating throughout the country, according to Roque (2009:137). And, when it comes to elections, she explains how they have “served as a vehicle for the MPLA to transform Angola into a de facto one-party state while at the same time, gaining long-elusive national and international legitimacy.”

The President not only controls state institutions, expenses and political recruitment; his family owns and controls large parts of the private sector and benefit grossly from (often inflated) government contracts. The international press reports on the unbelievable wealth of the President’s family - his daughter being one of the world’s richest individuals, it is said. All this is consistent with Global

¹³ Citation from the US Aid website on Colombia: <http://www.usaid.gov/colombia/our-work> (retrieved 29 Oct. 2014)

Financial Integrity pointing at huge transfers out of the country to tax havens abroad, while Transparency International points at systemic corruption in the country.

The higher growth has not reduced the country's severe development problems. Angola is one of the countries with the highest levels of inequality in the world. Life expectancy is among the lowest. The child mortality rate is among the highest, and so is the illiteracy rate. Modernization is slow. Only 40 per cent of the population has access to electricity. With the help of its security and intelligence services, the government has neutralized most forms of serious opposition. Independent civil society and the press are strictly restrained, while the often-lauded democracy is a complete scam.

With absolute control, one may wonder why the government needs a façade. Petroleum is exported and sold however the country is governed, and given the revenues from its sale, the government does not need tax revenues from the citizens. So, why give anything in return? Why conceal the fraud?

Apparently, even a corrupt dictator with solid revenues from extractive industries may benefit from the image of a well-functioning society. A facade of good institutions reduces the risk of riots, a concern during the North Africa uprisings in 2011. There are limits to how far the loyalty of civil servants can be secured by threats and fear. The façade can improve domestic relations as well as international relations. The image of the government as 'not so bad after all' facilitates international collaboration more generally. The development community, including the IMF, the World Bank, the United Nations, and powerful governments, is concerned about government legitimacy and the supply of essential services to the citizens. Even if development experts understand the realities on the ground, these organizations have a political interest in maintaining a good dialogue and collaboration with the Angolan government - by offering development loans and aid.

In addition there is an efficiency argument for facades. As Coolidge and Rose-Ackerman (1997) explain, a corrupt regime may well seek productive efficiency except where inefficiency creates extra rents. Institutional reform may therefore be intentional in some areas, while decentralized corruption is generally facilitated with an excessive amount of state interventions in other markets. Moreover, the clearest reason why powerful incumbents conceal their fraud is perhaps the need for foreign direct investment. For firms concerned about corporate social responsibility, often constrained at home by anti-bribery legislation, the facade makes their presence in Angola much easier to bear and defend, and that again strengthens their business opportunities.

In short, a facade of good institutions and governance is useful to be able to claim that the government does what it can to promote development, while the personal wealth of its members and military leaders accumulates.

5. Conclusion

It is a current development paradigm that good institutions can help to cure bad governance performance. Poor countries are poor because they have bad institutions, and countries that grow, or are rich, are those that have improved their institutional quality. It is “the combination of transparent and accountable institutions, strong skills and competence, and a fundamental willingness to do the right thing,” said former President Wolfowitz of the World Bank, emphasizing how such good institutions can “balance the power of governments, and hold them accountable for delivering better services, creating jobs, and improving living standards.”

He did not, however, pay attention to the other possibility where a claim to a “fundamental willingness to do the right thing” blinds observers -- and make them ignore how supposed institutional improvements help the rich to benefit at the cost of the poor. Too much attention directed at institutions and policies, rather than on outcomes and performance, has made it possible for governments to be treated as legitimate despite their failures in securing development for society at large.

As long as governments act as if there is a certain degree of law and order (regardless of whether court decisions are steered by those in power), hold elections (regardless of how much the result is manipulated), and hold speeches about the ambition of providing essential services to a poor population (regardless of what services are indeed provided), they can govern without much risk of actually being held accountable for their fraud – and in fact, attract higher revenues regardless of how they actually perform.

Politicians with a grabbing hand favor reforms that are evaluated by procedures not by its results. The emphasis on fashionable procedures may increase the flow of income to grab, the lack of control of end results may make it politically sustainable.

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INDEXING TERMS

Brazil, Armed forces, Public security,

Civil-military relations

Fashions come and go in the development community. When a policy idea becomes popular, some governments implement a cosmetic variant of the policy. What looks like development, are institutional façades; pretty from the outside, ugly from the inside. A good governance façade can be introduced deliberately to mislead observers and stakeholders to cover political theft. An example from the past is development planning, introduced with good intentions but sometimes exploited as a cover for corruption. In the 1960s donors rewarded developing countries that introduced five years plans by offering more aid. Recipient governments were therefore tempted to come up with cosmetic plans to satisfy foreign donors rather than the needs of their citizens. This paper argues that rents can be extracted under the cover of executing good policies; that nominally beneficial policies permit corrupt decision-makers to hide in plain sight.