

**Transparency, Incentives and Prevention (TIP) for
Corruption Control and Good Governance**

*Empirical Findings, Practical Lessons, and
Strategies for Action based on International Experience*

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Abstract

The graduation from the ‘awareness-raising stage’ in anti-corruption to a concrete action-oriented phase too often has led to a plethora of legal drafting initiatives, changes in internal accountability mechanisms or administrative rules, or focus on enforcement issues on their own. This has been at the expense of prevention within a systemic or incentives-driven approach to institutional change. Based on empirical analysis of experiences of industrialized, transition and emerging economies, we argue on the importance of transparency, incentives and prevention (TIP) in improving governance and addressing corruption. In moving towards an integrated TIP-driven corruption control approach, the importance of broadening the approach to focus on *Governance* is emphasized. Within it, control of *corruption* is *one* important component, closely linked to others, such as rule of law, external accountability, voice, and transparency. Worldwide indicators on such multi-pronged measures of governance are now available, as well as approaches to generate detailed in-country governance diagnostics and monitoring. They in turn are key inputs to a strategy of transparency and incentive-based anti-corruption reforms. Salient findings are presented, suggesting the value of prevention strategies in controlling corruption for increasing welfare of the poor and for enterprise development. These empirical diagnostics tools also assist in the identification of country-specific priorities for institutional change. Yet these advances in pro-transparency approaches can only provide major concrete benefits where complemented by leadership, proper enforcement, and collective involvement of key stakeholders in society for implementing institutional change.

¹ Draft for comments, which are very welcomed. The text in this paper is to be complemented by the powerpoint presentation with graphical evidence supporting the arguments here. The work in various sections in this paper draws on a number of collaborative projects at the World Bank and outside, notably with A. Kraay, J. Hellman, M. Gonzalez de Asis, S. Pradhan, R. Ryterman, F. Recanatini and L. M. Ocampo, as well as with the Governance Group at the World Bank Institute, institutes and experts in the emerging countries we are working on, and partner donor agencies. Some sections in this paper also draw from the author’s chapter in “The Quality of Growth” book. The data discussed here originate from various surveys as well as outside expert rating agencies and are subject to a margin of error. The purpose is not to present fully precise comparative rankings for countries, but instead to empirically illustrate characteristics of governance performance in order to assist in drawing implications for action. Views, errors and omissions are the responsibility of the author, and may not necessarily reflect those of the institution or their Executive Directors. For further details on the materials presented here, contact author at dkaufmann@worldbank.org or visit <http://www.worldbank.org/wbi/governance>.

Introduction

The King shall protect trade routes from harassment by courtiers, state officials, thieves and frontier guards . . . [and] frontier officers shall make good what is lost . . . Just as it is impossible not to taste honey or poison that one may find at the tip of one's tongue, so it is impossible for one dealing with government funds not to taste, at least a little bit, of the King's wealth.

From The Arthashastra (by Kautilya, circa 300 B.C.)

Written in ancient India more than 2,000 years ago, the *Arthashastra* is a detailed, far-sighted vision of a well-governed society that weaves together socioeconomic, institutional, and political variables. Even in this terse excerpt the wisdom of Kautilya's thought thousands of years ago is evident today, as in his emphasis on commensurate incentives to deter corruption, as well as in the recognition that misgovernance does not emanate alone from a state or private source.

In contemporary development writing there have been writings on the interplay of institutions with conventional economic variables. Attention in recent years has turned to corruption because of growing awareness of its importance for development. Yet often missing is the analysis of corruption within a broader governance framework, recognizing that corruption is closely linked both to fundamental transparency and incentive-related weaknesses in the country's institutions. Further, these weaknesses are often driven at least partly by political and economic forces outside of the state bureaucratic machinery. Such omissions often lead to suboptimal practical and strategic advice, such as placing undue emphasis on enforcement-driven 'anticorruption drives' (or 'campaigns') implemented top down by a single agency -- rather than taking a more comprehensive, incentive-driven and preventive strategy to institutional change.

The importance to focus on prevention in formulating strategies for systemic institutional changes is emphasized in this paper, for which transparency-related and incentive-driven reforms are key. We acknowledge at the outset that here we do not present a comprehensive survey of all relevant issues in this context, and furthermore we note that in this emerging field we are in a learning mode on the emerging lessons of success and failure -- and thus we lack many definitive answers. We have learnt some lessons on what works and what does not, however, and we know that the specifics of any country strategy need to be driven by the particularities of each country, backstopping the need to have an in-depth knowledge on governance within a country, and thus not only relying on general cross-country findings. Empirical analysis based on worldwide data does inform the first stage of analysis -- and we provide a synthesis below on key results --, yet for country specific relevance in-depth assessment at the country level is also needed. Thus, empirical and transparency-related tools to perform such in-country assessment, as well as some evidence and illustrations at the country level are also presented in this paper, complementing worldwide analysis.

Governance and Transparency Matters for Development: Definitions, Analysis and Findings

Worldwide evidence shows that a capable state with good and transparent government institutions produces results in terms of income growth, national wealth and social achievements.² Higher incomes and investment growth, as well as longer life expectancy, are found in countries with effective, honest and meritocratic government institutions with streamlined and clear regulations, where rule of law is enforced fairly and protects the citizenry and property, and where external accountability mechanisms involving civil society and the media are present. International and historical experience, as well as ongoing research, also tells us that capable and clean government does not first require a country to become fully

² See World Development Report 1997.

modernized and wealthy. Rule of Law, Corruption Control, or well-developed External Accountability mechanisms are not ‘luxury’ goods that only rich countries can afford, or for which wealth is required for ‘acquiring’ them. The experience of such emerging countries as Chile, Costa Rica, Slovenia, Hungary, Estonia, Poland and Botswana, as well as evidence over the past thirty years from countries like Spain illustrate this lesson.

Defining Corruption and Governance. Corruption is commonly defined as the abuse of public office for private gain. Governance is defined as the exercise of authority through formal and informal traditions and institutions for the common good, thus encompassing the process of selecting, monitoring, and replacing governments; the capacity to formulate and implement sound policies and deliver public services, and the respect of citizens and the state for the institutions that govern economic and social interactions among them.

From the above definition of governance, for purposes of measurement and analysis, it can then be divided into three broad categories as follows, each of which contains two components – for a total of six: (a) **1. voice and external accountability** -- which includes the ability of the government to be externally accountable via citizen feedback, a competitive press, etc., and **2. political stability and lack of violence**; (b) **3. government effectiveness** -- which includes the quality of policymaking and public service delivery--, and **4. the lack of regulatory burden**; (c) **5. rule of law** -- which includes protection of property rights and independence of the judiciary --, and **6. control of corruption** (for details, see KKZ 1999a,b, 2002).³ Governance is thus a broader notion than corruption, the latter being one among a number of closely intertwined governance components.

Empirical Study and Measurement of Governance. Recent empirical studies suggest the importance of institutions and governance for development outcomes.⁴ Applying the above definition we analyzed hundreds of cross-country indicators as proxies for various aspects of governance.⁵ The data are mapped to the six subcomponents of governance and expressed in common units. The data are informative, within measurable limits, but the imprecision in the estimates requires care in their use and presentation for policy advice. These six distinct aggregate governance indicators are then developed (as per the above classification), imposing structure on available variables and improving the reliability of analyses. For illustration, consider the measurement issues for one of the six composite governance components: rule of law, as per results of the first such worldwide aggregate measure, based on data from 1997/98. In figure 1, the vertical bars depict (the rather large) country-specific margins of error --or statistical confidence intervals-- for the estimated levels (or point estimates) of governance. The interval reflects the disagreement among the original sources about the level of governance and the rule of law. The horizontal ‘quartile limit’ lines dividing the group of countries into four groups are further explained in the note to the figure 1 below. The figure depicted below, for one governance component, reflects the data from 1997/98, when the first such measure was performed. By now the second measure also exists, for 2000/01, permitting initial over-time comparisons.⁶

³ ‘Aggregating Governance Indicators’, ‘Governance Matters’, and Governance Matters II, by Kaufmann, Kraay and Zoido [KKZ], 1999a and b, and 2002, Policy Research Papers 2195, 2196, and 2772, The World Bank, <http://www.worldbank.org/wbi/governance>.

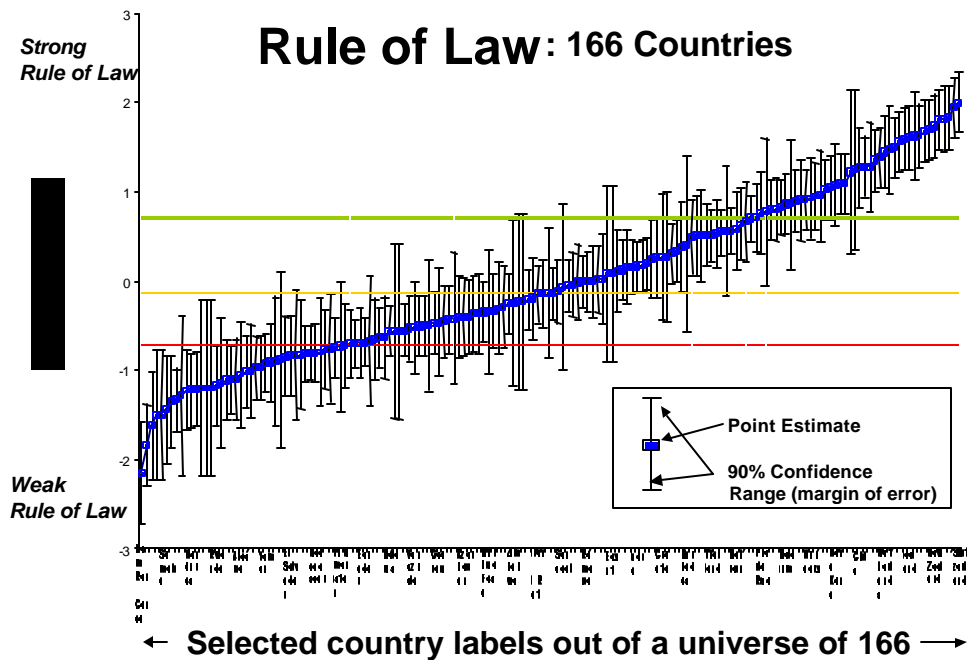
⁴ One study (Knack and Keefer, 1997) performed cross-national tests of institutions using various indicators of institutional quality and found that the institutional environment for economic activity determines, in large part, the ability of emerging economies to catch up to industrialized country standards.

⁵ These indicators came from a variety of organizations, including commercial risk rating agencies, multilateral organizations, think tanks, and other nongovernmental organizations (NGOs). They are based on surveys of experts, firms, and citizens and cover a wide range of topics: perceptions of political stability and the business climate, views on the efficacy of public service provision, opinions on respect for the rule of law, perceptions of the incidence of corruption. For detailed explanation on sources and access to the full governance indicators databank: <http://www.worldbank.org/wbi/governance/govdata2001.htm>

⁶ Through a webinteractive tool adapted to the user’s need, these governance research indicators are available online at: <http://www.worldbank.org/wbi/governance/govdata2001.htm>

The differences among more than 160 countries are quite large for rule of law and the other five measures. Countries are ordered along the horizontal axis according to their rankings, while the vertical axis reports the estimates of governance for each country. The margins of error, depicted by each thin line, for each country can be considerable. Thus, it is misleading having countries “run” in seemingly precise worldwide “horse races” to ascertain their ranking on various governance indicators. Instead, an approach that groups countries into three broad categories akin to a ‘traffic light’ approach for the various separate governance dimensions is more appropriate and statistically warranted: i) **Red light**: -- countries in the bottom category; which are in governance crisis; ii) **Yellow light**: -- governance vulnerability (or at risk, and it is also possible to distinguish between light yellow and orange, with the latter in higher risk category), and iii) **Green light**: -- nations with better governance and not at risk. Thus, notwithstanding margins of error, following such a ‘traffic light’ classification, identification would be possible for a group of thirty or forty countries in the world where there is an urgent need to focus on better and cleaner government, as well as identifying countries at high risk, and contrasting these with the group of countries that are doing well.

**Figure 1. Aggregate governance indicators
—an illustration: rule of law indicator**

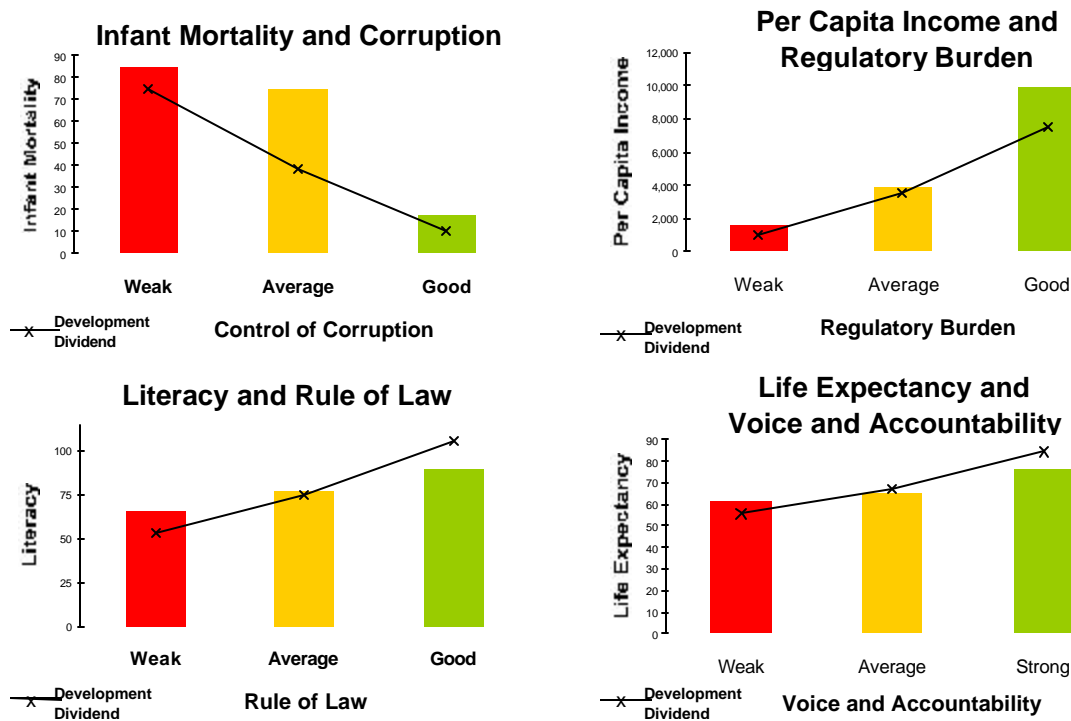


Note: The vertical bars (the 90 percent confidence range) depict country specific confidence intervals for the estimated levels of governance, the ‘point estimate.’ This reflects differences among the original sources about the level of governance in a country, as well as the actual concept of governance—in this case, *rule of law*. Horizontal lines represent quartile limits. The rule of law index is normalized, ranging from -2.5 to +2.5. Data from 1997/98. For details and access to the 2000/01 indicators, visit: <http://www.worldbank.org/wbi/governance/govdata2001.htm>

Causal Effects of Governance. These indicators allow systematic assessment of the benefits of good governance in a large sample of countries. We do find that good governance is strongly correlated with various development outcomes across countries, yet we go further by cleaning out the possibility that the correlation might simply reflect the fact that richer countries can “afford the luxury of good governance” (for which we find little evidence). Indeed, the analysis suggests a *large direct causal effect* from better governance to better development outcomes. Consider an improvement in the rule of law

from the low levels in Russia today to the middling levels in the Czech Republic—or a similar reduction in corruption from that in Indonesia to that in Korea (both amounting to a one-standard deviation). In the longer term, this would result in an estimated three-fold increase in per capita incomes, in a reduction in infant mortality by a similar magnitude, and in significant gains in literacy.⁷ These development impacts are illustrated (figure 2) for four development outcomes and four measures of governance. The heights of the vertical bars show the difference in development outcomes in countries with weak, average, and strong governance, illustrating the strong *correlation* between good outcomes and good governance. The solid lines illustrate the estimated *causal* impacts of governance on development outcomes—the “development dividend” of improved governance.

Figure 2. The Development Dividend of Good Governance



Note: The bars depict the simple correlation between good governance and development outcomes. The line depicts the predicted value when taking into account the causality effects (“Development Dividend”) from improved governance to better development outcomes. [KKZ99b]

While there are clear limits in their sole use for work on strategies within a particular country, composite indicators of governance are powerful in flagging major vulnerabilities for particular countries, for drawing attention to governance issues focusing on country groupings and the various components of governance, for monitoring broad trends over time (particularly now that there are measures for two points in time, 1998 and 2001), and are also indispensable for cross-country research into the causes and consequences of misgovernance.⁸ Given its intimate link with governance, next we briefly define and

⁷ Note that the differences in governance for these two pairs of countries, at one standard deviation, are not very large. Much larger improvements in government effectiveness from the levels observed in Paraguay (well in the bottom quartile) to that in Chile (well in the top quartile) would nearly double the development impacts just mentioned.

⁸ Indeed, worldwide aggregate indicators are a blunt tool for informed action to improve governance within a given country. To move to a more concrete stage of specificity and usefulness within a country, and for useful action programming on the ground by a country intent in making inroads on governance, in-depth country specific diagnostic tools are required (see specific section on diagnostics below for details).

note the importance of the notion of *Transparency*. Thereafter, given that corruption is a key dimension of governance, we ask how it undermines developmental performance and affect poverty, to then present the type of diagnostic approaches can best serve a country intent on making progress towards good governance.

Transparency as key for Good Governance, Anti-Corruption and Financial Stability.

As with the concepts of corruption and governance, it is also important to define, unbundled and operationalize the notion of *transparency*. Transparency is dissected into key characteristics of an effective flow of information: i) access; ii) timeliness; iii) relevance, and, iv) quality.

Defining Transparency. Transparency refers to the flow of timely and reliable economic, social, and political information, which is accessible to all relevant stakeholders. It is thus about private investors' use of loans and the creditworthiness of borrowers; about properly audited accounts of key governmental, private and multinational institutions, about the budgetary process and data from the government, about monetary and real economy statistics from the central bank and government service provision, about political and campaign finance disclosure and about the voting records of parliamentarians, as well as about the activities of international institutions. Conversely, a lack of transparency occurs when an agent -- whether a government minister, a public institution, a corporation, or a bank -- deliberately withholds access to, or misrepresenting information, or fails to ensure that the information provided is timely and of adequate relevance or quality.

Hence, a working understanding of transparency should encompass the following attributes: *access* (including timeliness and non-discrimination), *comprehensiveness* (ensuring key items are also included, such as off-line financial and budgetary items), *relevance* (avoiding superfluous information and overload), and *quality and reliability* (so to aid policy-making and provide market confidence to investors – thus timeliness and accuracy are inter alia important). Though transparency is often desirable, markets on their own rarely induce socially desirable levels of transparency, part due to payoffs from non-disclosure. Further, some key information related to transparency can only emanate from government institutions, such as economic and financial statistics. Consequently, there is a role for government proactive promotion of a transparent flow of relevant information from its institutions.

Transparency and Financial Crisis. The Asian financial crisis, as well as similar crises in Russia and in other emerging markets, such as in Ecuador, Turkey and Argentina, have highlighted that there is a nexus between misgovernance (including, but not only, corruption) and lack of transparency on the one hand, and financial sector fragility and a high likelihood of a crisis, on the other. Since these financial sector crises have had enormous welfare consequences, and since incipiently the evidence suggests that there is a link between good (public) governance at the national level and a strong financial sector, it is central to understand the nature of such linkages and point to key policy and institutional implications to improve such governance factors – in turn affecting the robustness of financial systems. In the recent financial crises literature, several references are made to “*lack of transparency*” as one of the factors that either caused or contributed to the prolonged crises. Yet despite the importance of good governance and transparency for financial markets, there has been little theoretical or empirical effort, and often the notion of transparency is not defined.

There is evidence suggesting a relationship between transparency and financial crises. A story line points for instance to the inadequate information on mutual guarantees, of the firms' and banks' true net worth, and the use of insider relations, masking poor investments. Once a downturn sets in, poor transparency made it difficult for investors to distinguish between firms and bank that were healthy and those that were not. This forced bank runs and destabilizes economies. Incipient empirical research suggest that where

financial liberalization takes place in an environment where transparency is absent and there is corruption, a financial crisis is more likely⁹.

Effects of Corruption: A brief synthesis

Impact on Growth and Investment. The pernicious effect of corruption on development has been shown in many studies. Mauro showed that corruption slows the growth rate of countries (1996). He found that if Bangladesh reduced its level of corruption to Singapore's, its average annual per capita GDP growth rate over 1960-85 would have been 1.8 percentage points higher, a potential gain of 50 percent in per capita income by 1985 (assuming growth of 4 percent a year). Some of the main channels through which corruption weakens economic growth include: i) misallocation of talent and including underutilization of key segments of society; ii) lower domestic and foreign investment; iii) distorted enterprise development and growth of the unofficial economy; iv) distorted public expenditures and public investments; v) lower public revenues and less provision of the rule of law as a public good, and vi) overly centralized government

Unfair and Disproportional Impact on the Poor. Where corruption prevails, the poor receive fewer social services, such as health and education. Corruption reduces total revenues available for social spending, distorts the allocation of public expenditures away from social programs, and denies the poor equal access to public goods. Corruption also impairs the means to escape poverty by undermining property rights and raising a regressive bribery tax on small entrepreneurs. And corrupt regimes bias investment against projects that aid the poor. For example, they often prefer defense contracts over rural health clinics and schools. Further, corruption increases income inequality and poverty through lower growth, less effective social program targeting, unequal access to education, reduced social spending, and higher investment risks for the poor. The mechanisms through which governance affects poverty are varied and complex, and we still don't understand them fully (see graphical evidence in PowerPoint presentation). In-depth country analyses using the new governance diagnostic tools (below) illustrate how regressive corruption is as a tax. Poor households in Ecuador, Latvia and other countries have to spend three times more in bribes—as a share of their incomes—as higher income households for access to public services. In Bolivia, for instance, in those agencies found rife with corruption, bureaucrats were found to discriminate against the poor in terms of access to basic services .

Impact on Business. A common argument in the academic literature has been that bribes to circumvent bad government controls can act like de facto deregulation—and can thus have positive effects. This view may hold conceptually only in a very narrow sense if bad regulations are fixed independently of the decisions of the public official. In reality, officials often have enormous discretion in customizing the type and amount of harassment of individuals firms. Tax inspectors can over-report taxable income, and fire inspectors can decide how many times to check a firm for safety “violations.” Using data on more than 6,000 firms in 75 countries, it is shown that firms that pay more *administrative* bribes (for ‘greasing’ the palms of implementing bureaucrats in expediting licenses, signatures, etc.) end up wasting more (not less) time with bureaucrats, and with a higher cost of investment.

⁹ Mehrez and Kaufmann, 1999

Table 1-- Synthesis Nexus between Corruption and Poverty

Immediate/Proximate cause of poverty-- Corruption Causes:	How Corruption affects immediate/proximate cause Due to:
Lower Growth	Unsound economic/institutional policies due to vested interests Distorted Allocation of Public Expenditures Low human capital accumulation Absence of Rule of Law and property rights; Governance obstacles to Private sector development Capture by elite firms reduces overall enterprise sector growth
Poor gets smaller share in growth	'Capture' by elite of government policies and resource allocation Regressivity of Bribery 'Tax' on small entrepreneurs and the poor Regressivity in Public Expenditures and Investments Unequal income distribution Smaller firms are disproportionately affected by corruption/bribery
Impaired access to public services	Bribery impairs access and quality of basic services for health, education, justice – particularly to the poor Capture by elites of access to quality public services
Health/Education	Corruption affects human capital accumulation (incl. infant mortality, literacy, as per above, with disproportional impact on the poor)

Corporate Responsibility and Governance: On the importance of 'Unbundling' the Measurement of Corruption and focusing on 'Grand' corruption. More generally, misgovernance hobbles enterprise development. And it is smaller firms that tend to bear the brunt of the bribery tax, as evidenced by a recent analysis of about 3,000 enterprises in transition economies conducted jointly by the World Bank and EBRD in mid-1999 (the 'BEEPS' survey). Indeed, it is found that smaller firms are prepared to pay significantly more than their larger counterparts in taxes if their bribes were reduced, suggesting their larger burden.

This research also provides insights into the link between political influence, corruption, and enterprise performance. This is done by 'unbundling' the measurement of corruption, whereby in the survey we attempted to go beyond measuring the conventional ('petty') forms of corruption, and thus data on 'grand' forms of corruption were also measured. In a number of countries in transition, the survey finds that a minority of influential firms that purchased parliamentary laws, presidential decrees and/or undue influence at the Central Bank, also inflicted a large indirect cost on the development of the rest of the enterprise sector. We find that in 'high capture' states, individual 'captor' firms who engage in purchase of legislation and the like do benefit in the short term from increased sales (and thus may see it in their interest to continue such practices). Yet in contrast with such private gain, the costs to society are extremely high. As state capture illustrates, there are some types of bribery (related to 'grand corruption') that have a particularly pernicious cost on welfare. It skews the pattern of capital accumulation towards the firms buying influence, distorting employment patterns and slowing growth.¹⁰

¹⁰ J. Hellman, G. Jones and D. Kaufmann: 'Seize the State, Seize the Day: An empirical analysis of State Capture and Corruption in Transition', at <http://www.worldbank.org/wbi/governance/wp-statecapture.htm>

The evidence from this survey also underscores the high prevalence and cost of another grand form of corruption, namely kickbacks for public procurement. A very large share of firms (including FDI) do engage in this practice in order to secure public sector contracts, and the percentage ‘fee cut’ paid for corrupt contracts are rather significant as well. This practice is also found to be very costly in overall social terms. Further, survey results from the transition region indicate that the greater the extent of grand corruption, the weaker is the investment climate (investing fewer resources in public goods like infrastructure, regulatory institutions, and law and order), the lesser is the protection of property rights and security of contracts, and the lower the growth of the overall enterprise sector. Reflecting the cost of corruption to the enterprise, over 50 per cent of the Russian and Ukrainian firms surveyed said that they were willing to pay *more taxes* if the government could reduce the levels of corruption and crime.¹¹

Results for FDI, and the Responsibility of Foreign Investors. An important finding from the BEEPS survey is the extent to which firms with foreign direct investment (FDI) also tend to use bribery as part of their corporate strategy, for instance in order to secure public contracts. The extent of bribery by firms with FDI in most categories is not lower than for fully domestically financed firms.¹² If we look at developments across the transition economies as a whole, instead of despair, the result from many countries suggest real hope for a way forward. High corruption is neither endemic to the process of transition, nor an inherent historical or cultural trait of the region. The business environment survey shows tremendous variation across transition economies in the extent of corruption and the quality of governance. There is much to learn from the positive experiences of this decade (as illustrated by Estonia and Poland, where promotion of new private sector development, strengthening the capacity of the state, and enhancing the accountability of government all have a key role to play in improving governance and limiting corruption).

Causes of Corruption

Empirical studies of the causes of corruption are fairly new, and the empirical link from corruption to development is yet to be fully understood. But evidence is emerging to suggest that some determinants of corruption are important. This evidence supports the notion that corruption is a symptom of deeper institutional weaknesses.

Absence of External Accountability

Civil liberties and voice of the population, including free and independent media, freedom of assembly and speech, civil society involvement, women inclusion, are all found to be negatively correlated with corruption. Increasing evidence points to the importance of empowerment of civil society in addressing corruption. Devolution from the center to the localities, such as with fiscal decentralization, matters as well, although the manner in which implementation takes place is very important and needs to be adapted to the country circumstances. Similarly, the evidence points to a significant association between rule of law (protection of property rights, independent judiciary, judicial resolution of conflict) and corruption.

Public watchdog institutions often are not the solution. While a few notable exceptions such as the Hong Kong Independent Commission Against Corruption (ICAC) suggests that under very particular

¹¹ Hellman, Joel, G. Jones, D. Kaufmann, and M. Shankerman: ‘Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies’, Policy Research Working Paper 2312, The World Bank, April, 2000

¹² Thus, the progress on ratification of OECD anti-bribery legislation this far at least does not seem to be a significant deterrent to much FDI from these countries being associated with grander forms of bribery in recipient countries. This points to the importance of focusing on transnational bribery as well, and transcending the mere passage of new laws by focusing not only on the enforcement of such laws but also on complementary measures.

circumstances such public watchdog bodies can be successful, the overall record in many other countries is mixed at best. Even in Hong Kong the fact is that other broader reforms took place simultaneously. And in other settings the necessary political independence and ability to work collegially with the citizenry by such public agency was often missing. Even where a watchdog may have a rationale, it is critical that it is part of a much broader program of institutional reforms and civil society involvement.

Civil Service Reform. Civil service professionalism—including training, hiring, and promotion systems—also appear to be associated with less corruption. Contrary to conventional wisdom, the evidence on civil service pay is ambiguous. Better public sector salaries on their own may not explain a significant reduction in corruption. In agencies with better pay in Ecuador, there is no lower incidence of corruption. Indeed, in many settings the most damaging corruption is powerful politicians and government officials. Meritocracy in hiring, promotion and firing within an agency is associated with less corruption, as is transparency and absence of arbitrary discretion. These contrasting results (on salaries vs. meritocracy, transparency and lack of arbitrariness in one in-depth study agency by agency in a Latin American country) show the need to conduct in-depth empirical diagnostics in a country intent on formulating a serious anti-corruption program.¹³

Rule of Law Revisited.

From a simple definition. According to the Palgrave Dictionary of Law and Economics, Rule of Law is defined by its apposite, contrasting it with Rule of a Powerful Man or Woman. The implicit benchmark is the all-powerful ruler of the past, ruling over society, rather than the laws of the land so doing. While there are settings in today's world where manifestation of the rule of (one) all-powerful leader still exists, it is a rarer occurrence than in the past. However, this decline in the prevalence of the rule of an all-powerful political leader does not imply that (even in the strict Palgrave definitional sense) 'Rule of Law' has prevailed worldwide. Implicit in the notion of Rule of Law is that there *is* a strong state or ruler, and the institutions associated with such state and/or ruler are seen as legitimate and respected by its citizenry. In many settings such assumptions related to the strength and legitimacy of state institutions and their leadership do not hold. In some countries with weak states, there can be the 'Rule' of powerful forces outside of state or political leadership -- such as the 'Rule of the Oligarch', or of the powerful few in the Financial/Economic Elite, which may be fully in the private sector, or semi-public (such as when the prime minister of the country possesses enormous wealth, media and economic interests, or where some semi-autonomous state-owned enterprises exert undue influence. This, in turn, can have vast implications in terms of our understanding of the causes of misgovernance and 'misrule' of law, and in terms of institutional and policy reform advice.

The emerging evidence at hand, based on recent data from a number of different sources, and from surveys of many stakeholders (including lawyers, prosecutors, judges, users of legal/judiciary institutions, firms, experts, etc.) suggest that there a large variation worldwide on the both the performance of 'Rule of Law' (judiciary/legal) institutions, and on the apparent forces behind 'functional' vs. 'dysfunctional' rule of law regimes. Within the latter (the 'dysfunctional' context), the phenomenon of 'capture' of judicial and legal systems by vested interests is a particular challenge, which fundamentally questions the prominence given to the traditional 'long list' of obstacles to proper rule of law/judiciary performance in

¹³ Other factors in the empirical work on causes of corruption appear to be important as well. As expected, income per capita and education, holding other factors constant, are correlated with a lower corruption. There are exceptions, however. It may be that general developmental variables are mere proxies for more specific determinants of corruption—such as the quality of public sector institutions or rule of law. See Ades and Di Tella for very useful review. Most of the new studies synthesize the results of cross-country research and are indicative rather than definitive, and furthermore there is the serious challenge of corruption being endogenous. Furthermore, there are important *Country- and regional-specific factors*. For instance, evidence suggests that administrative bribery is more prevalent than judicial malfeasance in the formerly socialist economies. This is a reflection of bloated bureaucracies in many of these countries—and of over regulation and weak judiciaries. In Latin America, by contrast, there has been considerable economic and regulatory reform, but less reform of the judiciary.

the literature and in practitioner's writings -- such the as conventional focus on budgetary resource constraints, on cumbersome procedures, process delays, caseload management, traditional training approaches, study tours, lack of equipment, legal drafting, and the like.

The evidence on 'capture' and poor performance of public rule of law institutions in many settings, the related phenomenon of corruption ('grand', as in the case of 'capture'; 'pettier' as in the case of administrative bribery) suggests the importance of focusing on key interlinkages between rule of law and corruption. Dysfunctional rule of law institutions are after all an important determinant of corruption in a country. Conversely (and often underemphasized) there are forms of 'grand' corruption, which appear to be important as *determinants* of a dysfunctional judiciary and legal regimes. Hence, there are forms of corruption (such as state capture) which rather than being a *symptom* of more fundamental weaknesses in state institutions, can in themselves be the *cause* of a dysfunctional judiciary.¹⁴

Beyond cross-country international evidence, the data from in-depth in-country diagnostics also inform us: a number of recent governance diagnostic surveys in Latin American countries suggests that corruption and dysfunctionality of the judiciary are associated with a large 'regressive bribery tax' on the poor, as well as to the smaller-sized enterprises that end up paying disproportionately. Furthermore, the evidence from these studies also suggest that the poor ends up having less access (and when not denied access, lower quality) of public service delivery – including legal and judicial services. A well performing rule of law and judiciary institutions appear to be very important for providing the poor with fair access to the poor to the courts and for enforcement of their rights, as well as protection of property rights for the small and competitive enterprise sector.

What is the survey evidence on the most important constraints to a Transparent and Fair Judiciary? A finding from a recent *survey* of experts pointed to the result that the powerful *economic* interests of the elite (related to capture) was rated as a particularly daunting obstacle. There were important regional variations in the responses, in many transition economies such powerful economic influence was significantly more relevant than the challenge of political independence; by contrast, in some other emerging economies, the challenge of independence from the executive is more significant on average – although both rated as a major constraint everywhere. These results are consistent with the large-scale enterprise-level survey (BEEPS) and analysis of state capture.¹⁵, and with the evidence from the worldwide internet survey conducted over the past year, including over 1,700 respondents.¹⁶

¹⁴ For details, see the author's paper 'Misrule of Law', presented at the Gorbachev Symposium on Governance and Development, Madrid, November, 2001, which relies on a review of the evidence that include a variety of data sources: i) in-depth country governance [diagnostics](#), surveying users of public services/citizens, enterprises, and public officials; ii) multi-country [governance surveys](#) of enterprises (such as the worldwide World Business Environment Survey [WBES] and the regional Business Environment and Enterprise Performance Survey [BEEPS] for transition economies), iii) the generation of aggregate worldwide [governance indicators](#) for over 170 countries for 1997/98 and 2000/01; feedback surveys of participants in the Governance Learning programs at the World Bank Institute (WBI; through new interactive technologies, yet admittedly of a less scientific sampling nature) and at large conferences, and, iv) large-scale, [internet surveys](#) on governance (with thousands of respondents, yet again in spite of worldwide representation (with significant responses from experts from every region). None of the data sources can be considered as fully representative of the world population at large, or devoid of margin of error -- even though the statistical tests performed suggest that the error is not very large, particularly when the sample size is significant.

¹⁵ For instance, see '[Seize the State, Seize the Day: State Capture, Influence and Corruption in Transition](#)', 2000, and various related. [papers and reports](#).

¹⁶ To the question on the main obstacle to a *transparent Judiciary* in the respondent's region of expertise, the most frequent choice as the obstacle to a transparent and fair judiciary was the '*economic independence*' of the judiciary from the vested interests of the elite, implying that judicial capture by special interests rated even higher than political independence from the executive (See figure in PowerPoint presentation). Such primacy of *judicial 'economic' capture* by the elite was particularly marked for transition economies of the former Soviet Union, East Asia and Latin America. By contrast, in Sub-Saharan Africa and the Middle East/North Africa, the *political independence* of the judiciary rated as the most binding constraint.

More broadly, the evidence challenges the conventional notion that rule of law institutions invariable are the key to the ‘solution’ for corruption. In many settings they may be part of the problem. The evidence suggests in fact that misgovernance and corruption in judicial, legal (and enforcement) institutions is a major challenge in many settings.¹⁷

Towards a multi-faceted strategy to improve governance

A number of factors are known as to what is needed to improve governance and reduce corruption—an independent judiciary, rule of law, good institutional and public sector management, the oversight and involvement of civil society, deregulation and tax and budgetary reform, and financial and procurement reforms (figure 3). There is much less certainty about how to put them together for the most impact. What types of changes are feasible under what political conditions—and how should reforms be sequenced?

Toward a Multipronged Strategy¹⁸

Given what is known about the main determinants of corruption, what kind of programs towards better governance may have an impact? The emerging lessons suggest that reducing corruption and improving governance requires a system of checks and balances in society that restrain arbitrary action by politicians and bureaucrats and foster the rule of law. Institutional arrangements that diffuse power and promote accountability and transparency are key to a system of checks and balances. Furthermore, the recent work on ‘state capture’ highlights the need to place checks and balances on the ‘elite’ corporate sector through promoting a competitive market economy. Another salient feature of a strategy would include a meritocratic and service-oriented public administration.

Promoting Competition and Entry. In many transition and developing countries, one source of grand corruption comes from the concentration of economic power in monopolies that then wield political influence on the government for private benefits. The problem is particularly acute in natural resource-rich economies, where monopolies in oil, gas and aluminum for instance, wield considerable economic and political power that leads to different forms of corruption – nonpayment of taxes, nontransparent offshore accounts, purchasing licenses and permits, purchasing votes and decrees that restrict entry and competition.

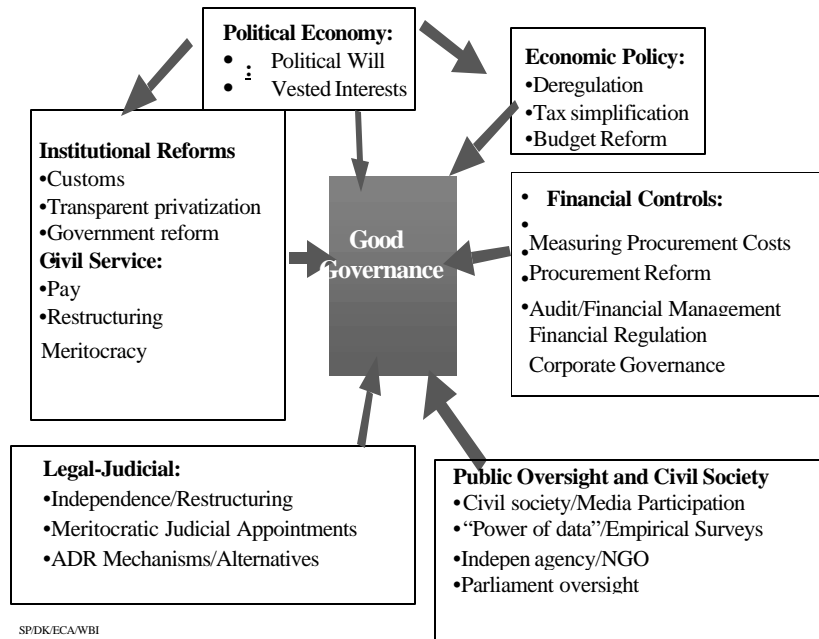
Towards a Social Contract: Facilitating Civil Society Oversight and Participation. Civil society oversight and participation in the decision-making and functioning of the public sector have been a crucial counterweight and instrument to combating corruption and improving governance. This involves making the state transparent to the public and empowering the citizenry to play an active role. Countries such as the Nordics have been in the forefront in transparency reforms. But public-sector culture in many transition and developing countries fosters secrecy of decision-making. In much of the CIS, for example, parliamentary votes are not publicly disclosed; public access to government information is not

¹⁷ The evidence from various sources points to the same direction: i) from a worldwide enterprise survey (GCS), the evidence is that in many countries bribery in the judiciary is at least as prevalent as in the administration (bureaucracy), ii) from in-depth country-specific governance survey diagnostics, based on independent surveys of users of public services, enterprises, and public officials in each country, it emerges that the judiciary is often singled out as one of the most vulnerable institutions in terms of misgovernance and corruption, iii) from the analysis of the enterprise survey in transition (BEEPS), indicating that there is a bipolarity in court performance, with one set of countries where courts are functioning, and another where they are dysfunctional, and iv) the responses of a survey of experts at a worldwide conference on legal/judiciary reform, which also indicated a high share of responses identifying the courts as either the most or second-most corrupt institution in their country of expertise (while almost one-quarter of respondents identified parliaments as the most or second-most corrupt institution). See the author’s ‘Misrule of Law’ for details.

¹⁸ I owe much of this section to the partnership, specific inputs and collaborative work with Sanjay Pradhan and Randi Ryterman and the ECA team at the World Bank.

assured; and judicial decisions are typically not available to the public. Moreover, despite a growing civil society, the government typically does not involve NGOs in the monitoring of its decision-making process or performance. Concentrated media ownership and recent restrictions on reporting have weakened the ability of the media to ensure accountability of the public sector.

Figure 3: Multi-pronged strategies for improving governance, good government, and combating corruption



Changing the culture to one of transparency involves a fundamental change in the way decisions in the public sector are taken. The types of transparency reforms that have been demonstrated internationally to be effective include:

- Ensuring public access to government information (Freedom of Information)
- Requiring certain types of government meetings to be open to public observation
- Conducting public hearings and referenda on drafts decrees, regulations, and laws
- Publishing judicial decisions
- Strengthening the system of administrative appeals (which provide the public with a process to adjudicate wrongful decisions of state)
- Ensuring freedom of the press by prohibiting censorship, discouraging use by public officials of libel and defamation laws as a means for intimidating journalists, and encouraging diversity of media ownership
- Inviting civil society to monitor its performance, especially (i) the implementation of politically difficult reforms such as anticorruption and (ii) key public procurements

Civil society's role ought to be seen as dynamic and providing an opportunity to political leaders intent in building the credibility of the state, by recognizing their potential in coalition-building and collective action. For instance, new activities in many countries where the World Bank is working, in collaboration with donor agencies and local institutions, involve supporting the collective team work of

civil society, the media, experts, the private sector, the reformists in the executive and legislative in formulating governance and anticorruption reform programs. The process of positive involvement by the key stakeholders in civil society creates a momentum towards ownership and sustainability of the reforms, and builds credibility (as in some countries in Eastern Europe and in Latin America).

Accountability of the Political Leadership. Closely related to the above, the political leadership needs to demonstrate its commitment to fighting corruption by public disclosure and transparency of its own financing, income and assets. In several advanced market economies and democracies in the OECD, this has entailed:

- requiring public disclosure of votes in parliament
- reviewing desirability of parliamentary immunity
- requiring public disclosure of sources and amounts of political party finance
- requiring public disclosure of incomes and assets of senior public officials and their key dependents
- preventing conflict of interest for public officials
- protecting the personal and employment security of public officials who reveal abuse of public office by other officials in their organizations (whistleblower statutes)

Building a Meritocratic and Service-Oriented Public Administration. Cross-country evidence conclusively shows that recruiting and promoting on merit (as opposed to political patronage or ideological affiliation) is positively associated with both government effectiveness and control of corruption. While achieving change will take time, effective reforms in this area have included: creating independent, professional institutions with checks and balances and introducing a comprehensive performance management system, with pay and promotion linked to performance (in Malaysia and Thailand, this led to increased recruitment and retention of managerial and professional staff, and to increased effectiveness in civil service performance.) Pay levels for managerial and key professional staff need to be broadly competitive with the private sector, and often allowances and non-cash benefits need to be simplified, monetized and made transparent.

Experience shows that exposing public administrations to pressures and demands from their clients, both from the private sector and from citizens, has a major impact **on improving service delivery** and public administration effectiveness. Reform measures in this area could include setting and publishing service standards; assessing Ministry/agency performance against these standards through in-depth diagnostics (including of public officials), of client surveys, and publishing the results; setting up a wide range of user groups and consultative bodies; and developing Internet-based approaches to delivering services. These measures proved extremely effective in generating demands from customers and an increased service orientation in the U.S., U.K. and Malaysia.

Transparency and Accountability in Public Expenditure Management. Basic systems of accountability in the allocation and use of public expenditures constitute a fundamental pillar for a good and clean government. Accountability in public expenditure management requires the following: i) a comprehensive budget and a consultative budget process; ii) transparency in the use of public expenditures; iii) competitive public procurement; and, iv) an independent external audit.

Many countries face problems of budgetary transparency, where a large proportion of expenditure remains off budget, major areas of budget expenditure do not pass through the Treasury system, and there is substantial recourse to extra budgetary funds and a lack of any effective system of controlling expenditure commitments, leading to persistent accumulation of budgetary arrears. Several countries in transition have made progress in addressing these problems with comprehensive Treasury reform programs, such as Latvia and Hungary. Further, the budget must first have comprehensive coverage of

Government's activities. Second, disclosure matters: many developed countries publish frameworks for public expenditure strategy.

Transparent and Competitive Public Procurement. Corruption in public procurement is pervasive in transition and developing economies. Reducing corruption requires adhering to strict discipline in terms of transparent and competitive bidding of major contracts, maximizing the scope of public oversight and scrutiny. In order to make the process of government procurement more efficient and curb corruption, three Latin American countries (Mexico, Chile and Argentina) have recently adopted electronic government acquisition systems. All procurement notices and their results are placed on a publicly available website. There are other important innovations taking place as well, relating to activist external monitoring. NGOs are increasingly playing a role in spearheading public audiences for setting out the rules of the game for large-scale procurement projects (such as in Mendoza, Argentina and in Slovakia) and throughout the transparent bidding process itself (including TI's integrity pledges). The World Bank has also taken a very active role in aggressively pursuing firms engaged in misprocurement in projects. In fact, publicly delisted firms engaged in corrupt procurement are available on the Bank's website.

Establishing independent external audit. Several Eastern European countries have established Supreme Audit Institutions (SAIs) which are genuinely independent, with constructive impact on public financial management systems (Czech Republic, Poland) In the Czech republic, audit reports are not only published and presented to the legislature, but the report is discussed in Cabinet along with a proposed plan for corrective actions, in the presence of the SAI and relevant ministers.

Transparency in Finance. The recent Enron debacle and the role of poor auditing standards, while a potent example with costly ramifications, illustrates but is not alone in pointing to the need for sounder accounting and auditing practices. The strong case for strict accounting norms ought to note that disclosure alone is insufficient to implement transparency: information must be reliable, based on sound principles and standards that enabling investors and lenders to make consistent assessments of firms' activities and risk profiles. Unfortunately, nowadays most developing countries have weak accounting systems, contributing to lack of transparency. Common problems include the following: i) Insufficiently rigorous accounting conventions; ii) Lack of uniform reporting requirements; iii) Poor information systems, and iv) Inadequate supervision and enforcement. Evidence from countries beset by the recent financial crises suggests that they were affected by accounting failures, specifically, that disclosed financial information did not portraying underlying risks among firms and banks.

Freedom of information legislation: Institutional arrangements are necessary to help governments achieve transparency. Transparency is enabled by various media channels (TV, newspapers, radio, and public notices). It also requires institutional channels for the citizens to participate – to voice concerns and to provide feedback. Freedom of speech, and a free press ensure that such channels remain open. To improve transparency, many governments have imposed disclosure requirements on themselves. For example, the freedom of Information Act in the United States, passed in 1972, and similar legislation in other countries, recently in South Africa, Namibia, Mozambique, Malaysia, requires the government to make accessible to citizens an exhaustive array of records of government actions and debates. Collating its findings on such efforts in the area of fiscal transparency, the IMF has developed a code of good practice on Fiscal Transparency.¹⁹ Further, it is important to focus on developing institutional

¹⁹ The IMF code on fiscal transparency includes the following:

1. Clarity of Roles and Responsibilities
 - The government sector should be clearly distinguished from the rest of the economy, and policy and management roles within government should be well defined. Additionally, there should be a clear legal and administrative framework for fiscal management.
2. Public Availability of Information.

infrastructure, developing standards and accounting practices, improving incentives for disclosure and balancing countervailing regulations to minimize perverse incentives generated by safety net arrangements such as deposit insurance.²⁰

Practical means of improving disclosure when desirable must be part of all development agendas. This includes instituting sound accounting and auditing practices, streamlining reporting requirements, improving information (IT) systems and bolstering institutional supervision. Experience suggests that given their limited resources, developing countries may best address these needs by taking advantage of private sector provision of information and accounting services, building regulatory structures to their best ability, and tailoring supervision and enforcement means to local capabilities and circumstances. This may militate against the institution of uniform international accounting standards currently being debated. Such evidence as exists on means of mitigating incentive problems in financial markets illustrates the merit of using combinations of simple, easily implementable policies.

Notably, transparency in and of itself is not sufficient without accompanying enforcement mechanisms. There is therefore a need for public institutions to both regulate disclosure and enforce appropriate behavior. Indeed, as illustrated by the case of Indonesia – financial reform may be predicated on broader public sector reforms. Notably, the effectiveness of public institutions affects not only the performance of markets – including capital markets – but also the allocation of public goods and the distribution of risk and other implicit costs in an economy. Over and above the more specific recommendations on transparency in financial markets, made above, are thus broader imperatives to improve transparency in governance. Implementing freedom of information legislation, instituted freedom of press laws, built legal enforcement mechanisms, and invest in information infrastructure to improve the gathering and sharing of information. Many governments are already doing this.

Limits of Judiciary and Legal Institutions in leading an anticorruption program.

The evidence from worldwide cross country indicators data (as per figure 1 at the outset of the paper), as well as from diagnostic studies, suggests that in many settings neither citizens, entrepreneurs, country experts nor public officials have significant trust in such institutions to lead an anti-corruption program. Further, the analysis suggests the need to distinguish between settings where public rule of law institutions are part of the public governance ‘solution’ vs. settings where they are part of the ‘problem’, as suggested previously. Under the latter, when formulating anticorruption strategies it is imperative to consider mechanisms and innovations which neither rely heavily or solely on the official legal system and its conventional enforcement mechanisms – at least in the short-to-medium term, where enhancing contestability and applying competitive pressures on the standard rule of law institutions would be part of the strategy. In particular, consideration can be given to the concrete involvement of civil society (including the private sector), integrated with the power of data transparency. Carrying out the in-depth governance diagnostic surveys of citizens, firms and public

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- The public should be provided with full information on the past, current, and projected fiscal activity of government.
 - 3. Open Budget Preparation, Execution, and Reporting.
 - Budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks.
 - Budget estimates should be classified and presented in a way that facilitates policy analysis and promotes accountability.
 - Procedures for the execution and monitoring of approved expenditures should be clearly specified.
 - Fiscal reporting should be timely, comprehensive, reliable, and identify deviations from the budget.
 - 4. Independent Assurances of Integrity
 - The integrity of fiscal information should be subjected to public and independent scrutiny.

Source: IMF (1998)

²⁰ An important suggestion is that since institutional development is gradual, relatively simple regulations such as limits on credit expansion, may be best tailored to developing countries. Implicit in this section is the notion that there are absolute limits to transparency, in particular for lack of adequate enforcement

officials would play a role in: i) enhancing accountability and in providing rigorous inputs for priority areas of reform, and, ii) as entry points for institutional change and improved rule of law. Once a first ‘baseline’ diagnostic survey has taken place, the approach would entail institutionalizing recurrent monitoring approach at regular intervals with rapid survey techniques to assess progress.

In a country with dysfunctional rule of law institutions, and within them, in particular where the state and leadership are not strong, the priority in any strategy for improved rule of law institutions would need to focus more on measures to mitigate judicial capture by economic interests, which, inter alia, may require: i) an understanding of the elite forces that are capturing the judiciary or legal institutions, ii) measures to increase the economic independence of the judiciary, iii) promoting civil society and NGOs to play roles in enhancing the transparency and accountability of these public rule of law institutions, and iv) increasing contestability by promoting the involvement of NGOs in taking up some judicial functions (such as ADRs), etc. Furthermore, the variation in performance within the public sector in general, and within rule of law institutions in particular, suggest points of entry to improve governance by working with well performing institutions and thus to avoid falling into the trap of selecting the dysfunctional public rule of law institutions. In Russia, for instance, while most public rule of law institutions do not function as such, a commercial court system (‘arbitrazh’), relatively speaking, has been an island of good governance due to factors that ought to be well understood and could provide pointers to other institutions in the same country. By contrast, in many countries it is warranted to critically review the role of enforcement agencies (such as the police), as well as anticorruption agencies, for instance, which often are proposed in a rather facile fashion as a key linchpins needed to improve governance.

*Subnational Governance: Working from the Bottom Up*²¹: *Concrete implementation of Participatory Coalition-Building for Governance Reforms at the Municipal Level.* In many countries, the central government is reluctant to engage in anticorruption reform because of the political risk involved. One way that some countries have tried to reduce this risk is by piloting governance reforms at the local level. In a pilot municipality in Venezuela, for example, substantial reductions in corruption and poverty and an increase in business activity were achieved within a short two-year period. This record has sparked interest in various countries replicating this pilot on a wider scale.

Large countries facing daunting governance challenges like Russia and Ukraine are attractive candidates to selectively explore and advise on further reforms at the subnational/municipal level. Competition for investment has provided an incentive for some regions and cities to undertake radical transparency reforms, and for others to begin trying to replicate their successes. While this process has emerged spontaneously (for example, in Obninsk, a small city outside of Moscow, and some settings in Latin America), it is slow and can benefit from information and incentives provided by the Federal Government. At the subnational level there is also much untapped potential to form coalitions between local government and civil society for improving governance. The demonstration effect of grass-root participatory programs that spearhead transparency reforms in coalition with reformist city managers could be dramatic, in Russia and beyond.

Governance and Corruption Survey Diagnostic Tools

The collection, analysis, and dissemination of country-specific data on corruption are altering the policy dialogue on corruption and empowering civil society through collective action.

The first set of in-depth governance and corruption diagnostic surveys of public officials, firms and citizens was carried out in Albania, Georgia, and Latvia. More recently, surveys have been carried out in other countries and cross-country correlations of institutional and other variables have significantly

²¹ For further details (and acknowledgement of their inputs), see writings and inputs by Maria Gonzalez de Asis, Sanjay Pradhan, Randy Ryterman and Shang-Jin Wei on these issues.

expanded our understanding of corruption and its causes, particularly its institutional roots. These surveys, designed to complement other empirical approaches, ask various key stakeholders detailed questions about the costs and private returns of misgovernance and corruption. This includes surveying *citizens* (service delivery users), *enterprises*, and, a new instrument developed more recently, *public officials*. Confounding skeptics who claimed that parties to corruption would systematically underreport it, these studies demonstrate that respondents are willing to discuss agency-specific corruption with remarkable candor, while firms also volunteer detailed information about bribery and misgovernance.

Survey respondents report on embezzlement of public funds, theft of state property, bribery to shorten processing time, bribery to obtain monopoly power, and bribery in procurement. In Georgia, the most common form of corruption (from this short list) in 1998 was found to be embezzlement of public funds, whereas in Albania it was theft of state property. Bribery in procurement is common in all three countries, as are the other types of corruption to a lesser extent. Weakness in the judiciary is identified as one of the primary causes of corruption in Albania, while regulatory failures are much less important. Regulatory failures are serious in Georgia and Latvia, however. Detailed statistics were collected on the frequency and cost of bribes paid by enterprises to regulators in different agencies and can be used to sequence reforms.

A significant share of petty bribes is paid to officials to avoid taxes, customs duties, and other liabilities to the state. Some bribes—such as payments to public officials, positive judicial decisions or other special privileges—may crowd out tax payments and other liabilities due the state. Lost fiscal revenues are substantial in Albania and Georgia, for instance. The survey results from Albania and Georgia indicate that agencies and activities viewed by the public officials as the most corrupt command the highest price for jobs, suggesting that in some agencies corrupt officials rationally invest when buying their public office.^{22, 23}

Yet important challenges remain regarding further progress with the survey diagnostic instruments. One is to continue to refine the method for transforming survey evidence into reform priorities by the appropriate balance between in-depth governance survey data analysis, complementary information from other sources, and the participatory coalition-building work of civil society, the executive and the private sector. Strategies to complement in-depth empirical diagnostic surveys include focus group discussions of governance diagnostics and assessments of a country's readiness to reform—assessments that look at the impact of reforming particular policies and institutions on key stakeholders. A second challenge is to develop a more effective strategy for implementing the reform agenda. Once survey data are in hand, the government must begin the more difficult task of introducing reforms to root out the sources of corruption. A natural temptation is to simply ask for the resignation of the senior officials who manage the most corrupt agencies. But corruption is too pervasive and systemic to disappear with a few individuals, the approach needs to be more systemic, focusing on transparency and incentive reforms in order to enhance prevention – rather than individualizing the problem or only focusing on enforcement.

A third challenge is to sustain the reform effort with broad-based participation involving all government branches, civil society, and the business community. Governments may then be able to promise reform by allowing private competition alongside public provision of some services (for example, private forms of alternative dispute resolution to compete with the judiciary). Data collection needs to be institutionalized, so that statistics on agency-specific corruption can be tabulated annually.

²² This section on survey diagnostics is an abridged version of PREM Note 7, “New frontiers for diagnosing and combating corruption,” October 1998. For additional results of these in-depth diagnostics, refer to new diagnostics in Latin America and Asia. For the full version of this Note, and the Step-by-step Guide to implementation of Governance and AntiCorruption Survey Diagnostics, see in <http://www.worldbank.org/wbi/governance>

²³ When the results from these diagnostics were presented in workshops to members of the business community and civil society, the policy debate abruptly changed from vague, unsubstantiated, and personal accusations to one focused on empirical evidence and systemic weaknesses

Broad dissemination of the statistics can further empower stakeholders to use this information to continue the reform. The next frontier is to further deepen the design of agency-specific surveys and other empirical tools to complement existing methods and deepen agency-specific reforms, and to institutionalize these diagnostic mechanisms into periodic monitoring tools useful for quick response and policy making by governments.

A variant illustrating this empirical approach to external accountability and transparency mechanisms in the ‘Report Card’ approach. Client and citizen surveys that incorporate feedback from citizens have helped to improve public sector performance in many countries. Generating data and disseminating it widely can be a potent instrument to mobilize civil society and apply pressure on political structures. Simple comparative charts illustrating findings on corruption helps mobilize and give voice to previously silent and disparate citizenry groups. The scorecard invented by Sam Paul in Bangalore, India embodies this approach, entailing periodic citizen evaluations of local public services and of bribery and extortion. It has led to improved service delivery. Similar initiatives have taken place in Campo Elias, Venezuela, and Ternopyl, Ukraine.

Transparency and External Accountability through Voice and Participation

Misgovernance and corruption can yield to knowledge—and an informed citizenry. Indeed, a key pillar is empowering civil society with more rigorous and reliable information. Transparency is important in this context. Research shows that the greater the participation of private agents in ownership and management, the better the service performance. Empirical research with the thousands of World Bank-financed projects also shows that participation and civil liberties are vital for improved performance of government projects in emerging markets. The obvious challenge is finding the means of doing so. When this is possible however, numerous experiences have demonstrated that listening to the voice of stakeholders can have a considerable impact. Illustrating, in Mendoza, Argentina, in the past citizens have participated in drafting transparent rules governing public procurement, and more recently similar reforms have been taking place in Buenos Aires. A number of localities throughout the world have embraced similar participatory process, notably the city of Porto Alegre, Brazil. As part of its pioneering system of participatory budgeting, the city holds assemblies that discuss expenditure priorities for education, health, transport development, taxation, city organization, and urban development. They then elect members to a citywide participatory budgeting council, which in turn decides the city’s investment plan. Although there is no rigorous evaluation of this program, preliminary evidence in primary and secondary school doubled.

Concluding

Addressing the challenge of corruption needs to be understood within a broader context of improving governance and institutional change. Misgovernance distorts policy-making and misallocates the human and physical resources, in turn slowing income growth and increasing poverty. Many failed capacity-building approaches and investments in the past did not pay enough attention to fostering good governance, to controlling corruption, or to the understanding of the political economy of institution building. Governance needs to enter center stage in institution-building strategies, and within it, an understanding of the particular vested interests by different influential groups. Within this approach, particular focus is needed on transparency-related mechanisms and a proper set of institutional incentives in order to enhance prevention. Indeed, prevention mechanisms – for which transparency and proper incentives are key inputs – ought to play at least as important a role as traditional legal or individualized enforcement initiatives. The latter, in the absence of a comprehensive system of prevention, can be extremely costly and often ineffective.

From the emerging lessons of experience and analysis, improving governance can be simplistically synthesized as a process integrating a number of vital components related to a Transparency, Incentives and Prevention (TIP) strategy:

- i) *Transparent Information and Knowledge* -- including rigorous data, diagnostic and empirical analysis and monitoring, and improved disclosure and access standards on financial, budgetary and related data
- ii) Providing a proper set of institutional *Incentives for Prevention* -- meritocracy within institutions, transparent monitoring and disclosure mechanisms, civil service reforms, enhanced external accountability mechanisms;
- iii) *Leadership* -- the example of effective political leadership with integrity, and,
- iv) *Collective Action* -- via a systematic participatory and consensus-building approach (rather than anticorruption ‘campaigns’ implemented by one single state agency on its own), with key stakeholders in society, benefiting from the new informatics and transparency tools, enhancing external accountability and thus assisting in prevention.

Within this context of collective responsibility in improving governance, beyond the natural role that governments need to play, the role and responsibilities of the *corporate sector* is also important, both in their domestic and international dimensions. As per recent survey results, corporate responsibility (or lack thereof) can have an important impact on what strategies the corporate sector (including FDI/multinationals) opt to carry out, which may either improve or undermine national-level governance. The corporate sector, abroad and domestically, has an active role to play, with civil society, the executive and the legislative, in improving overall governance. At the same time, with the importance of *decentralization*, initiatives at the sub-national level are becoming increasingly relevant, and thus municipal-level initiatives need to be emphasized, and well integrated into national level programs.

Participation and voice are vital in increasing transparency, providing for the necessary external accountability mechanisms and thus for checks and balances which even the best devised internal accountability rules and systems within government cannot fulfill completely (or even in part, often enough, and in particular –but not only-- where state capture prevails). One ought to keep in mind that transparency-enhancing mechanisms involving a multitude of stakeholders throughout society can be thought as creating millions of ‘auditors’. Indeed, such external accountability mechanisms, which often also include very activist media involvement, are transparency-enhancing, in turn supporting a change in the incentive structure of institutions that are monitored. Thus, for an enhanced focus on attaining sustained growth, poverty alleviation and modernization through institution-building, a concerted approach integrating rigorous empirical understanding of the governance challenges within a country, with a participatory approach involving all key stakeholders and transparency-innovations, championed by the country’s leadership, is likely to bear fruit.

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