Governance and Corruption: *Challenging some Myths, and Implications of the Evidence for Aid*

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*The Capitol, Wash., DC, June 18th, 2004*
Key Themes

1. Governance: Missing in the Washington Consensus
2. The evolution of Governance/A-C at the World Bank
3. Governance can be measured, analyzed, & monitored
4. Governance Matters for Development, Security
5. Learning from Variation across countries, institutions
6. Some Key Findings – and Addressing Misconceptions
7. Salient Policy Implications and Challenges ahead
Evolution of Governance/A-C at the World Bank: From C ... ‘Prohibition’ era to Mainstreaming

- Public Expenditure, Financial Mgt. & Procurement Reforms
- Diagnostic/Data/ Monitoring Tools
- Administrative & Civil Service Reform
- Civil Society Voice, Accountability, Media & Transparency Mechanisms
- State Capture/Corporate Governance
- Legal/Judicial Reform

The ‘Prohibition’ Era

1. WDR on Institutions 1982
2. TI CPI “Cancer of Corruption” Speech (5/95)
3. JDW Speech (10/96)

Broadening & Mainstreaming

1. State in a Changing World (97)
2. Strategic Compact (97)
3. Anti-corruption Strategy (97)
4. Governance Pillar - CDF (98)
5. Gov/A-C Diagnostics start (98)
6. Internal AC unit created in WB (98)
7. 1st set of firms Debarred from WB (99)
8. O.P. Mainstreaming AC in CAS (99)
9. Governance Strategy (00)
10. Formalization of INT (01)

Timeline:
Good governance has many dimensions and “entry points”

**Institutional Checks & Balances**
- Independent, effective judiciary
- Legislative oversight
- Decentralization with accountability
- Global initiatives: OECD Convention, anti-money laundering, WCO

**Political Accountability**
- Political competition, credible political parties
- Transparency in party financing
- Disclosure of parliamentary votes
- Asset declaration, conflict-of-interest rules

**Civil Society Voice & Participation**
- Freedom of information
- Public hearings on draft laws
- Media/NGOs
- Community empowerment
- Report cards, client surveys

**Competitive Private Sector**
- Economic policies
- Restructuring of monopolies
- Effective, streamlined regulation
- Robust financial systems
- Corporate governance
- Collective business associations

**Public Sector Management**
- Meritocratic civil service with adequate pay
- Public expenditure, financial management, procurement
- Tax and customs
- Frontline service delivery (health, education, infrastructure)
Explosion of activities: Examples of major programs launched across countries

Albania (public admin.)
Latvia (anticorruption)
Ukraine (tax admin)
Russia (customs/treasury)
Kyrgyz Republic (governance reform)

Jordan (civil society)

Ghana (PE accountability)
Guatemala (diagnostic to action program)

Colombia (diagnostics & civil society)

Bolivia: (public admin.)

Gabon (water/electricity)

Uganda (PRSC; education)

Pakistan (devolution)

Tanzania (PSR)
Ethiopia (decentralization)

Cambodia (PE; forestry)
Philippines (transport)
Indonesia (local governance)

Bangladesh (civil society)

India – Andra Pradesh (power; e-gov); Karnataka (right to info)
Challenges: Georgia, c. 2000

Judicial Reform

Background
- Comprehensive approach to justice system reform was planned in 1999
- Agreement on principles reached amongst President, Parliament & NGOs

But ...
- Vested interests appear to have triumphed
  - Virtually no political support now from the ex-President, Government & Parliament
- Prosecutor General’s Office remains unreformed
- Reform of Bar Association stalled
- Requalification of New Judges Program – mixed results

Judicial Training
- In 1999 a judicial Training Center (JTC) was created as an NGO and support pledged by European Commission (Euro 1m), OSI, USAID, and World Bank … but
  - EC intervention failed, leaving the JTC ill-equipped to fulfill its mandate
  - OSI withdrew due to management weaknesses in JTC
  - WB was successful in redressing identified problems but important time lost

- 3/4th of the judges replaced by “new” judges
- New judges overall are still challenged in the acquisition of needed skills & qualifications
- Judges are still exposed to corrupting influences of prosecutors & lawyers
Objectives

Increasing efficiency and accountability of gov’t by strengthening: 1) strategic capacity; 2) transparency; 3) incentives; 4) internal controls; 5) participation and oversight

Approach

Building capacity in gov’t – 1) to manage and coordinate reforms and 2) to provide information and opportunities to public to monitor reforms

Results

After 6 years of assistance and program implementation:
• State capture has declined and corruption is less of an obstacle to doing business
• Latvia is expected to integrate into the EU in 2004

Challenges

Implementation is uneven – across areas and over time
• Identify whether constraint is technical or political
  • If technical, provide TA (although resources are limited)
  • If political, withhold financial support (PSAL2 was delayed and then reduced by 50%)
A-C in Practice: WBI – Governance & Anticorruption Program

7 African Countries
Anticorruption Core Course: Integrated Participatory Strategy

Approach

• Participatory process
  Country-led
• Diagnostics, R&D, &
  ‘Data Power’
  ➢ External
    accountability
  ➢ Empowerment
• From individuals to
  multi-stakeholder
  Country Teams
• Integrating
governance
  components
• Participatory Action
  applied to many
  programs

1st Steps for an AC Strategy:
➢ Empowerment & Coalition-Building
➢ Towards Priorities for Systemic Change
➢ Strategy Design
➢ Tools for Diagnosis: Data Power

Distance Learning through VC to 7 capitals in AFR (over 6 weeks)
Specialized Modules for Program Formulation:
➢ Financial Management & Procurement
➢ Rule of Law
➢ Customs
➢ Civil Service Reform

Presentation of Action Program for each country
(international Anti-Corruption Conference in Durban)

Program Implementation – Institutional Reforms
WBI – Governance & Anticorruption Program (1999)

7 African Countries

Results

1. Malawi
2. Benin
3. Ethiopia
4. Kenya
5. Tanzania
6. Ghana
7. Uganda

Obstacles

• Under-estimation of politics and insufficient buy-in by top decision makers

Lessons

• Politics:
  - Understanding & realism
  - State capture?
  - Drawing in the private sector
• Integration of decision makers
• Better integration within the Bank
• Upstream focus on ‘implementability’

General: Major spillover effect from this A-C program in mainstreaming strategies involving ‘voice’/ collective action; in diagnostic data approaches; in action programming; and ex-post recognition of political constraints.
Listening to Stakeholders: Responses on Donor Aid and Anti-Corruption

Most Important Role for Donors in Helping Country on Anti-Corruption (A-C)

% respondents

- Pre-Conditionality
- Work w/ Country A-C
- Awareness/Education
- Control corruption in Donor projects
- Collaborate w/ NGOs
- Donors out of A-C

Percentage of Responses selected as Most Important Role for Donors

Significant progress in a number of countries and institutions – at the same time, some programs that have stalled, and why...

> The challenge of politics:

- No political ‘buy-in’ – despite plethora of diagnostics and pressure from civil society (Bangladesh)

- Difficulties in sustainability when there is no political traction (Georgia judiciary)

- The need to anticipate political obstacles (Action Oriented Learning Program in AFR – Malawi vs. Uganda)

- Opposition from powerful vested interests in Cabinet & bureaucracy (India, Karnataka – right to information)
Empirical Approach to Governance

1. ‘Macro’: Worldwide Aggregate Governance Indicators: 200 countries, 6 components, periodic.

2. ‘Mezzo’: Cross-Country Surveys of Enterprises

3. ‘Micro’: Specialized, in-depth, in-country Governance and Institutional Capacity Diagnostics: Includes surveys of: i) user of public services (citizens); ii) firms, and iii) public officials

*On ‘Aggregate/Macro’ Level first...*
Governance: A working definition

• *Governance is the process and institutions by which authority in a country is exercised:*

  (1) the process by which governments are selected, held accountable, monitored, and replaced;

  (2) the capacity of gov’t to manage resources and provide services efficiently, and to formulate and implement sound policies and regulations; and,

  (3) the respect for the institutions that govern economic and social interactions among them
Operationalizing Governance: Unbundling its Definition into Components that can be measured, analyzed, and worked on

Each of the 3 main components of Governance Definition is unbundled into 2 subcomponents:

- Democratic Voice and (External) Accountability
- Political Instability, Violence/Crime & Terror
- Regulatory Burden
- Government Effectiveness
- Corruption
- Rule of Law

We measure these six governance components...
Sources of Governance Data

• Data on governance from 25 different sources constructed by 18 different organizations

• Data sources include cross-country surveys of firms, commercial risk-rating agencies, think-tanks, government agencies, international organizations, etc.

• Over 200 proxies for various dimensions of governance

• Organize these measures into six clusters corresponding to definition of governance, for four periods: 1996, 1998, 2000, and 2002, covering up to 199 countries
Sources of Governance Data

- **Cross-Country Surveys of Firms:** Global Competitiveness Survey, World Business Environment Survey, World Competitiveness Yearbook, BEEPS

- **Cross-Country Surveys of Individuals:** Gallup International, Latinobarometro, Afrobarometer

- **Expert Assessments from Commercial Risk Rating Agencies:** DRI, PRS, EIU, World Markets Online,

- **Expert Assessments from NGOs, Think Tanks:** Reporters Without Borders, Heritage Foundation, Freedom House, Amnesty International

- **Expert Assessments from Governments, Multilaterals:** World Bank CPIA, EBRD, State Dept. Human Rights Report
Building Aggregate Governance Indicators

• Use Unobserved Components Model (UCM) to construct composite governance indicators and margins of error for each country

• Estimate of governance: weighted average of observed scores for each country, re-scaled to common units

• Weights are proportional to precision of underlying data sources

• Margins of error of the aggregate indicator reflect (a) number of sources in which a country appears, and, (b) the precision of those sources
Control of Corruption: Selected Countries, 2002

Source for data: [http://www.worldbank.org/wbi/governance/govdata2002](http://www.worldbank.org/wbi/governance/govdata2002); Colors are assigned according to the following criteria: Dark Red, bottom 10\textsuperscript{th} percentile rank; Light Red between 10\textsuperscript{th} and 25\textsuperscript{th}; Orange, between 25\textsuperscript{th} and 50\textsuperscript{th}; Yellow, between 50\textsuperscript{th} and 75\textsuperscript{th}; Light Green between 75\textsuperscript{th} and 90\textsuperscript{th}; Dark Green above 90\textsuperscript{th}. 
Governance World Map: Rule of Law, 2002

Colors are assigned according to the following criteria: Red, 25% or less rank worse (bottom 10% in darker red); Orange, between 25% and 50%; Yellow, between 50% and 75%; Light Green between 75% and 90%; Dark Green above 90%
Governance World Map:
Voice and Accountability, 2002

Colors are assigned according to the following criteria: Red, 25% or less rank worse (bottom 10% in darker red); Orange, between 25% and 50%; Yellow, between 50% and 75%; Light Green between 75% and 90%; Dark Green above 90%
Governance World Map:
Government Effectiveness, 2002


Colors are assigned according to the following criteria: Red, 25% or less rank worse (bottom 10% in darker red); Orange, between 25% and 50%; Yellow, between 50% and 75%; Light Green between 75% and 90%; Dark Green above 90%
Measuring Governance Matters  Disentangling Causality Between Incomes & Governance

• Does Good Governance Matter in raising per capita incomes, controlling for other factors and for reverse causality – i.e. is there a large “governance dividend”?
  – Yes, about 400% in terms of incomes per capita, and similar ‘dividend’ in terms of social development

• Conversely: To what extent do increases in income lead to improvements in governance – i.e. is there a virtuous circle?
  – No, governance is not a ‘luxury’ which countries attain only when they become wealthier
Dividend of Good Governance

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. For data and methodological details visit http://www.worldbank.org/wbi/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. For data and methodological details visit http://www.worldbank.org/wbi/governance.
Governance Improving Worldwide? -- Mixed

- On average, over the past 8 years: some progress on Voice and Democratic Accountability, but little if any on the quality of rule of law and control of corruption
- However, the variation across countries is very large: For instance, some countries in Eastern Europe have improved. In each region there is significant variation across countries. Good: Chile, Costa Rica, Botswana
- Important to ‘unbundle’ governance and corruption: improvement in some dimensions, deterioration in others
- Where corruption is systemic, unrealistic to expect that Bank projects/lending could be totally immune
But we are facing many challenges, as on average there is little evidence of significant improvement on control of corruption ...
Extent of Independence of the Judiciary

Source: EOS 1998-2003 (Quasi-balanced panel). Question 5.01: The judiciary in your country is independent from political influences of members of government, citizens or firms?
Signs of progress in some countries & dimensions of governance – *but overall challenges remain*

Less Frequency of Bribes (*transition*)
(*Selected Countries, BEEPS II*)

<table>
<thead>
<tr>
<th>Country</th>
<th>Frequency of Administrative Corruption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Decrease in bribe frequency</td>
</tr>
<tr>
<td>Armenia</td>
<td>No change</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>Belarus</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>BiH</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>Croatia</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>Estonia</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>FYROM</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>Georgia</td>
<td>Increase in bribe frequency</td>
</tr>
<tr>
<td>Hungary</td>
<td>Increase in bribe frequency</td>
</tr>
</tbody>
</table>

...but more firms engaged in State Capture
(*by sub-region, BEEPS II*)

![Bar chart showing frequency of bribe over time](chart.png)

*1999 vs 2002*
Unbundling Governance – some illustrations:

View of the Firm, 102 countries (EOS 2003)

Percent of firms rating constraints as dissatisfactory

- Administrative Bribery
- Bribery to Influence Laws
- Illegal Political Financing

Source: EOS 2003. Each region has the following number of countries: OECD: 23; East Asia (Developing): 6, East Asia (NIC): 4; Eastern Europe: 14; Former Soviet Union: 2 (Russia and Ukraine); South Asia: 4; Sub-Saharan Africa: 21; Middle East North Africa: 7; Latin America and Caribbean: 21.
Capture, Political Influence and Corruption: 3 countries

Preliminary, based on a survey of firms. Percentile ranks based on comparative performance among the 102 countries in the sample. All variables rated from 0 (very bad) to 100 (excellent).
State Capture & Inequality of Influence

• State Capture/Undue Influence: power of elites
• State Capture as extreme manifestation of unequal influence: shaping laws, regulations and policies by powerful firms, illicitly
• Elites appropriate, and resources not funneled to improve public governance – more capture
• So when growth takes place in captured settings, governance will not automatically improve (no virtuous circle)
State Capture

Firms shape the legal, policy and regulatory environment through *illicit, non-transparent* provision of private gains to public officials

• Examples include:
  
  – *private purchase of legislative votes*
  
  – *private purchase of executive decrees*
  
  – *private purchase of court decisions*
  
  – *illicit political party financing*
Economic Cost of Capture for Growth

Based on survey of transition economies, 2000
Addressing Capture: Economic Reform, Political Competition & Voice/Civil Liberties Matter

![Graph showing the relationship between State Capture Index and Political/Civil Liberties Reforms.](image-url)

- **Partial Civil Libs**
  - Slow Pace of Econ Reform
  - Partial Political/Civil Liberties Reforms

- **High Civil Libs**
  - Advanced Pace of Econ Reform
  - Political/Civil Liberties Reforms

The graph illustrates the impact of different levels of civil liberties on the pace of economic reform and state capture.
Working with Competitive Business Associations does Matter (1999 BEEPS)

Source: EOS 2002/03. Question: The threat of terrorism in your country imposes significant cost on business
'Far from a Simple Laudromat': AML within a Broader Perspective – A Schematic Chart

Misgovernance, Money Laundering and Terrorism

Misgovernance and Corruption in Public Sector and Corporate/Financial Sector

Stage 1. Type of Business Activity and Source of Profit:
- Legal Business Concern
  - Drug Trafficking/Arms Trade/Prostitution
  - Corruption by Country Leadership/Politicians
  - Corrupt Public Officials/Procurement
  - Regulatory/State Capture by Corporates/Banks
  - Insider Trading, Stock Market
  - Transfer Pricing/Tax Evasion
  - Drug Trafficking/Arms Trade/Prostitution

Stage 2. Type of Financial Transaction/Intermediary:
- Legal Financial Transaction through Bona-fide Financial Institution
  - Money Laundering: #1:
    a) Through Banks:
      i) 'Placement'
      ii) 'Layering'
      iii) 'Integration'
    -- e*banking
  - Money Laundering: #2:
    b) Through NBFIs:
      -- Real Estate
      -- Securities Brokers/Derivatives/X-Rate Market
      -- Leasing/Insurance Companies
      -- Others

- Informal Financial and other Institutions:
  -- Hawalas
  -- Exchange Rate Mkt. (Peso)
  -- Commodities (gems, etc.)
  -- Cash
  -- Others

Stage 3. Use of Funds/Profits:
- Legitimate Consumption/Investment/Developmental Use of Funds
  - Source A
    - Illegal Political/Campaign Funding
  - Terrorist Activity
    - Other Criminal Activities
  - Luxury Consumption

Stage 4. Development?
- Pro-Development
  - Anti-Development and Global Public 'Bad'

Source(s) B (B1,B2)

Source C
Cost of Terrorism Threat to Business and State Capture (‘Grand Corruption’)
Money Laundering through Banks and Diversion of Public Funds

Diversion of Public Funds

Money Laundering through Banks

$r = 0.85$
Evidence challenges some ‘popular’ notions

1. Country first needs to get to higher incomes to reach good governance, control of corruption
2. Legal-Historical Origins as key Determinant
3. ‘Transplants’ of OECD rules-based codes, etc.
4. Anticorruption by legal fiat
5. ‘Anti-Corruption Campaigns’, A-C Agencies
6. Culture as key determinant (vs. Incentives)
Most effective Anticorruption Measures?

Responses from Officials and Leaders in 62 countries

% of respondents that mark 'high'

<table>
<thead>
<tr>
<th>Measure</th>
<th>% of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anti-Corruption Commissions</td>
<td>35%</td>
</tr>
<tr>
<td>Privatization</td>
<td>45%</td>
</tr>
<tr>
<td>Civil Liberties/Voice</td>
<td>50%</td>
</tr>
<tr>
<td>Public Sector Reform</td>
<td>65%</td>
</tr>
<tr>
<td>Transparent Budget</td>
<td>70%</td>
</tr>
<tr>
<td>Economic Deregulation</td>
<td>70%</td>
</tr>
<tr>
<td>Leadership Example</td>
<td>70%</td>
</tr>
</tbody>
</table>

Deserving particular attention…

1. ‘Data Power’/Metrics Matters
2. External Accountability Mechanisms (voice)
3. Transparency Mechanisms (e*governance, data)
4. Incentives as drivers, Prevention (e.g. Meritocracy)
5. The Role of the Firm and Elites (influence, capture)
6. Political Reform, including Political Finance
7. Governance: linking security & development
8. For Donor Countries, IFIs: i) ‘Tough Aid++’; ii) Trade; iii) access to ‘World Econ. Clubs’
Citizen Voice Improves Accessibility of Public Services to the Poor

Based on Public Officials Survey. The sample of institutions includes 44 national, departmental, and municipal agencies which are a prior anticipated to be accessible to the poor.
Freedom of the Press to improve Rule of Law and Controlling Corruption

Sources: Freedom House, 2002 and KK2002
On the growing gap between EU-accession countries and the rest of transition --Rule of Law Over Time, Selected Regions, 1996-2002


Each region has the following number of countries: OECD: 28; East Asia (Developing): 35, East Asia (NIC): 4; Eastern Europe: 16; Former Soviet Union: 12; South Asia: 8; Sub-Saharan Africa: 47; Middle East North Africa: 21; Latin America and Caribbean: 38.
Governance Indicators: Chile 1998 vs. 2002

Source for data: http://www.worldbank.org/wbi/governance/govdata2002; Colors are assigned according to the following criteria: Dark Red, bottom 10th percentile rank; Light Red between 10th and 25th; Orange, between 25th and 50th; Yellow, between 50th and 75th; Light Green between 75th and 90th; Dark Green above 90th.
Illustration of Concrete Projects and Measures promoting Transparency and Accountability

- Transparency & reform in political/party finance: e.g. new methods for disclosure (expenses), etc.
- E*disclosure (web) of votes of parliamentarians
- Public Disclosure of Assets/Incomes by public officials and legislators and their dependents
- E*procurement; e*data.governance; diagnostics
- In-depth Institutional Country Diagnostics for Agency and Budgetary transparency
- Delisting Firms Publicly
Data for Analysis and informing Policy
Advise, not for Precise Rankings

Data in this presentation is from aggregate governance indicators, surveys, and expert polls and is subject to a margin of error. It is not intended for precise comparative rankings across countries, but to illustrate performance measures to assist in drawing implications for strategy. It does not reflect official views on rankings by the World Bank or its Board of Directors. Errors are responsibility of the author(s), who benefited in this work from collaboration with many Bank staff and outside experts.

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