Ruling Justly

Control of Corruption. Corruption is the exercise of public power for private gain. It undermines the rules that govern interactions between public servants and the citizenry, adversely affects business decisions, and can be especially detrimental to the poor. Many different surveys measure aspects of corruption, including DRI/McGraw-Hill, Transparency International, the Economist Intelligence Unit, and the Political Risk Services Group. These surveys draw both on specialists in individual countries and/or experts with knowledge across many countries. They explore many dimensions of corruption, including the frequency of making additional payments, the effectiveness of anticorruption measures, and the impact of corruption on foreign investment.

The administration draws its corruption indicator from a governance database compiled by Daniel Kaufmann and Aart Kraay (hereafter KK) at the World Bank Institute. The methodology and sources used in this database are described in box 2.3. Although the KK indicators are subjective and more complex than most of the other indicators, they show a strong causal relationship with key development outcomes, are based on a wide range of sources, have 100 percent country coverage for the potential MCA countries, and are updated fairly regularly. They are the best set of governance indicators currently available.

Box 2.3 The Kaufmann-Kraay governance indicators

The administration draws 5 of its 16 indicators from a governance research database compiled by Daniel Kaufmann and Aart Kraay at the World Bank (hereafter KK). To create this database, the authors compile 275 governance variables from 20 sources and 18 organizations, including Freedom House, Gallup International, the Economist Intelligence Unit, DRI/McGraw-Hill, the Heritage Foundation, the World Bank, the European Bank for Reconstruction and Development, Latinobarómetro, and others. The authors construct the most comprehensive composite measures of governance available, which they organize into six separate indicators, covering four time periods: 1996, 1998, 2000, and 2002. Note that these data are not World Bank data per se but are aggregate indicators based on data compiled by Bank researchers from independent sources. The administration uses four of these KK aggregate governance measures as “ruling justly” indicators (control of corruption, rule of law, voice and accountability, and government effectiveness) and one as an indicator of “economic freedom” (regulatory quality). It does not use the KK “political stability” variable as an indicator.

Since the KK database draws from so many sources, it covers a much larger set of countries than any individual source. Country coverage for the MCA is complete, with data on all 115 countries with per capita incomes below $2,975. Importantly, research with these indicators reveals more than just an association with (box continues next page)
development indicators—there is a strong causal relationship with these indicators to higher levels of income, lower rates of infant mortality, and higher rates of literacy. Moreover, the method of aggregation provides measures for the precision of the estimates so users know the margin of error associated with any indicator. Most other survey sources do not discuss the sampling error associated with their estimates, giving users a false sense of precision. The authors have written a paper focused on the use of their indicators for the MCA in which they discuss the issue of margins of error at some length, including expressing reservations about using a “hard hurdle” for corruption in the selection process (Kaufmann and Kraay 2002a). In the aggregation process, the KK methodology gives greater weight to survey results with a smaller measurement error and lesser weight to survey results with greater uncertainty. The aggregation methodology, coupled with the multiple sources that the construction of the indicators draws upon, significantly reduces the margins of error, compared with relying solely on a single source.

The KK database, however, has some drawbacks. As with most databases on corruption and other governance concepts, the KK database is primarily based on subjective measures of governance. As a result, a country’s score is measured relative to other countries in a particular year. When a country improves from one year to the next, it is difficult to tell the extent to which it improved or others got worse (this is a weakness of most governance-related indicators). However, in their latest update, Kaufmann and Kraay have undertaken to present an “adjustment” factor correcting for changes in world averages over time to ascertain whether there has been an improvement or deterioration on average, and thus estimate the likely difference, if any, between relative and absolute changes over time. Also, the database has a relatively short history, with data available only for 1996, 1998, 2000, and 2002 (although there is now an institutional commitment to periodically generate these estimates). Finally, the statistical methods used to combine various surveys to create the KK database are more complicated than the methodology for any individual survey, making the final scores somewhat less transparent than other measures. The advantages of this method, however, are far more information from many data sources, excellent country coverage, and a better idea of the precision of the estimates. This accuracy and increased information are well worth some complexity. All in all, this is the most comprehensive and best-quality database available on governance indicators.

1. Specifically, the scores are scaled so that the mean value for the world is set to equal zero, and the scores that are one standard deviation above and below the mean are set equal to +1 and –1, respectively. Thus, each variable is reported on a scale from approximately –2.5 to +2.5 (corresponding to 2.5 standard deviations below and above the mean, respectively).

In creating their indices, Kaufmann and Kraay draw on nearly 275 indicators from 20 sources to construct six aggregate indicators of dimensions of governance. The KK “control of corruption” indicator draws on surveys by DRI/McGraw-Hill, the Economist Intelligence Unit, the World Bank’s business surveys, the Political Risk Services Group, and others. It does not draw directly on Transparency International’s (TI) well-known corruption indicator, as TI is itself a compilation of other surveys rather than an original source. The KK indicator draws on all the surveys contained in the TI index and several others. The KK control of corruption index contains data for all 115 countries in the world with incomes below $2,975 in 2002.

The KK control of corruption index is scaled so that the worldwide mean score is 0, and values that are one standard deviation above or below the mean are reassigned values of 1 and -1, respectively. We use a recalibrated version of the data in which each country’s score is shown as a percentile rank. As shown in table 2.2, this index performs fairly well statistically: it shows a modestly strong correlation (controlling for initial income) with faster economic growth and a very strong relationship with reduced infant mortality. It is also correlated with improved literacy, although the controlled correlation is not statistically significant at conventional levels.

Rule of Law. For economic development to proceed, societies need fair and predictable rules to govern economic and social interactions. Ideally, these rules should govern the enforceability of contracts, dispute settlement, criminal behavior, procedures for the judiciary, the protection of
property rights (including intellectual property rights), the extent of tax evasion, and the extent of black market activity as an impediment to business development. There are several sources that touch on these issues, including DRI/McGraw-Hill, the Economist Intelligence Unit, Heritage Foundation/Wall Street Journal, and others. The administration uses the KK index on rule of law, which compiles information from each of these sources and covered all 115 countries in 2002. As shown in table 2.2, this index shows a strong and statistically significant correlation with faster economic growth and lower infant mortality in the 1990s. It is positively associated with higher literacy, but the controlled correlation is not statistically significant.

**Voice and Accountability.** For governments to rule justly, countries require institutions that protect civil liberties; ensure that governments are held accountable for their actions; and allow citizens to participate in the political process, choose and replace their leaders, and freely voice their opinions. Countries with free and fair elections, representative legislatures, fair legal systems, a free press, and minimum role for the military in elections are more likely to be responsive and accountable to their people. Similarly, governments must respect basic freedoms of speech, assembly, and religion. Several surveys focus on these issues, most importantly the one by Freedom House. In addition, the Economist Intelligence Unit and the Political Risk Services Group include questions that touch on these topics, as do several other surveys. The KK indicator on voice and accountability incorporates measures from all these sources, covering all 115 MCA countries in 2002. This measure is positively correlated with economic growth, although the correlation is not statistically significant. The relationships with infant mortality and literacy are both very strong and highly statistically significant.

**Quality and Effectiveness of Government Institutions.** Good governance requires effective public institutions. Poor-quality civil service, red tape, ineffective bureaucracies, and weak management impede the government's ability to deliver basic public services and serve the general public. Drawing from a similar set of sources, the KK indicator on government effectiveness compiles data on these and related issues for all 115 MCA countries in 2002. This measure shows a moderately significant relationship with economic growth and a strong relationship with reduced infant mortality. It is also positively associated with literacy, but the relationship is not statistically significant.

**Civil Liberties.** The Freedom House civil liberties and political rights indices evaluate the rights and freedoms enjoyed by individuals in countries and territories around the world. Freedom House does not rate governments per se, but rather the extent to which citizens enjoy basic rights.

The civil liberties index focuses on the freedoms for citizens to develop views, institutions, and personal autonomy apart from the state. It is a subjective index, ultimately based on the judgments of the Freedom House survey team, with the ratings subject to several layers of review. The ratings review process involves about 30 outside regional experts, consultants, and in-house staff. Scores are based on a relatively narrow range of 1-7 (whole numbers only), although underlying these numbers is a confidential Freedom House index in which countries are given a score between 1 and 100.

While this scoring system is appropriate for Freedom House's objectives, the fact that there are only seven possible scores raises a statistical problem for the MCA. Since many countries are assigned exactly the same score (e.g., a 4 or 5), they are bunched together around the median score, which is where the administration draws the line between passing or failing on a
particular indicator. In this case, there is a big difference between the administration's proposal, in which a score greater than the median is given a passing grade, and the alternative, in which a score greater than or equal to the median is given a passing grade. For example, of the 87 countries eligible for the MCA in the second year, 21 countries have the median score of 4 on the civil liberties index. An index with a more differentiated scale would be preferable. The decision as to whether these countries should be given a passing grade on this indicator could make a significant difference in the final list of eligible countries. I return to this issue later in the chapter.

The 2001-02 Freedom House survey contains information on 192 countries, including all 115 MCA countries (Freedom House 2002). As mentioned earlier, this information is also included in the KK voice and accountability indicator, so the Freedom House information is actually counted twice in the MCA process. Using our simple statistical analysis, better civil liberties scores are associated with faster growth, although the correlation is not statistically significant. Better scores are strongly associated with both lower infant mortality and higher literacy.

**Political Rights.** According to Freedom House, political rights "enable people to participate freely in the political process, which is the system by which the polity chooses authoritative policy makers and attempts to make binding decisions affecting the national, regional, or local community." These rights allow all adults to vote and run for election and for elected officials to have decisive votes on public policies. As with the civil liberties index, political rights are measured on a 1 to 7 scale, raising the same issue about median scores. Again, as with the civil liberties indicator, the political rights indicator has a positive but insignificant correlation with growth, and a very strong relationship to reduced infant mortality and higher rates of literacy.