Governance and Corruption: 
*Empirics, Lessons, and Policy Options*
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"If you cannot measure it, you cannot improve it."
-- Lord Kelvin
Challenging Convention – key tenets

1. Governance Measurement Skepticism
   • Unmeasurable, or,
   • Measurable, but so imprecise that it is not useful, or,
   • Measurable, but only through ‘Objective’ Indicators
   • Cannot Assess Trends: Unreliable or No Time Series

2. Some evidence: Governance has improved globally?

3. Good Governance: outcome of development and growth? – & emerging economies are corrupt…?

4. The trouble with Public Sector & Officials in LDCs...

5. Cultural & Historical Determinism of Corruption

6. Fighting corruption by ‘Fighting Corruption’
   (Laws, Codes, Campaigns, Agencies & Regulations)

7. Governance not the domain or competence of donors
Tenet # 8: Challenging the previous ‘popular notions’

1. Data Matters -- on Governance & Institutions: while ‘sensitive’, & margins of error (not uniquely) – data can be gathered, analyzed, and used judiciously

2. Expanding Beyond the Washington Consensus-- Adding to the Macro and the Structural’/Sectoral: Institutions, Governance and Corruption Matters

3. On Average: stagnation on Governance, and level is low - Has it become a binding constraint nowadays?

4. Significant variance: some countries show that it is feasible to improve governance in the short term

5. Interventions that have not worked – vs. what may work better in the future? – Transparency matters

6. Strategic and Policy Implications for IFIs: Governance not a ‘sector’, but approached as an ‘umbrella’ filter?
The ‘Power of Data’: Technical progress in measurement -- gradual increase in use

1. The ‘Macro’/Aggregate Level of Measurement:
   *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…*
Six Dimensions of Governance

Governance as the set of traditions and institutions by which authority in a country is exercised -- specifically:

- The process by which those in authority are selected and replaced
  - VOICE AND ACCOUNTABILITY
  - POLITICAL STABILITY & ABSENCE OF VIOLENCE/TERRORISM

- The capacity of government to formulate and implement policies
  - GOVERNMENT EFFECTIVENESS
  - REGULATORY QUALITY

- The respect of citizens and state for institutions that govern interactions among them
  - RULE OF LAW
  - CONTROL OF CORRUPTION
Governance Data

• Data on governance from 37 different sources constructed by 31 different organizations
• Data sources include cross-country surveys of firms, commercial risk-rating agencies, think-tanks, government agencies, international organizations, etc.
• 352 proxies for various dimensions of governance
• Organize these measures into six clusters corresponding to definition of governance, for five periods: 1996, 1998, 2000, 2002, 2004
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 Voice of the People, Latinobarometro, Afrobarometer, Vanderbilt University/USAID
Sources of Governance Data, Cont’d

- **Expert Assessments from Commercial Risk Rating Agencies:** DRI, PRS, EIU, World Markets Online, Merchant International Group, IJET Travel Consultancy, PERC

- **Expert Assessments from NGOs, Think Tanks:** Reporters Without Borders, Heritage Foundation, Freedom House, Amnesty International, Bertelsmann Foundation, Fundar, International Research and Exchanges Board, Brown University, Columbia University, Binghamton University

- **Expert Assessments from Governments, Multilaterals:** World Bank CPIA, EBRD, AFDB, ADB, UNECA, State Dept. Human Rights Report
Examples of Governance Questions

1. Expert assessment polls
   • Government interfere w/ private investment?  (RQ)
   • How transparent and fair is the legal system?  (RL)
   • Risk of coup, civil war, org. crime, terrorism?  (PV)
   • How severe is the bureaucratic red tape?         (RQ)
   • What is risk of loss of FDI due to corruption?  (CC)
   • Freedom of the press, expression, association (VA)

2. Survey Responses
   • % bribery “to get things done”?               (CC)
   • Transparent info given by government?        (GE)
   • % Management Time spent on red tape?          (RQ)
   • Access & quality of government services?      (GE)
Why Aggregate Indicators of Governance?

- Governance viewed as a much broader notion than ‘formal rules of the game’
- Multiple individual data sources provide a noisy “signal” of broader concept of governance, e.g.:
  - trust in police \rightarrow RULE OF LAW
  - freedom of press \rightarrow VOICE & ACC’TBILITY
  - policy consistency \rightarrow GOV’T EFFECTIVENESS

- Benefits of Aggregation—through U.C. Method
- aggregate indicators are more informative about broad concepts of governance
- broader country coverage (than individual indicators)
- generate explicit margins of error for country scores
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

• Precision depends on how strongly individual sources are correlated with each other

• Margins of error reflect (a) number of sources in which a country appears, and (b) the precision of those sources
Unobserved Components Model

• Observed indicator $k$ of governance in country $j$, $y(j,k)$, is noisy indicator of true governance in country $j$, $g(j)$:

$$y(j,k) = \alpha(k) + \beta(k) \cdot (g(j) + \varepsilon(j,k))$$

• Variance in measurement errors is same across countries for each source, but different across sources:

$$\mathbb{E}[\varepsilon(j,k)^2] = \sigma^2_{\varepsilon}(k)$$

• Identifying assumption: Measurement errors are uncorrelated across sources $\Rightarrow$ highly correlated sources measure governance with more precision
Estimates of Governance from UCM

- UCM allows us to infer the distribution of governance in a country conditional on the observed data for that country

\[
E[g(j) \mid y(j,1), \ldots, y(j,K(j))] = \sum_{k=1}^{K(j)} w(k) \cdot \frac{y(j,k) - \alpha(k)}{\beta(k)}
\]

- Best estimate of governance is the mean of this conditional distribution:

\[
w(k) = \frac{\sigma^2 \varepsilon(k)^{-2}}{1 + \sum_{k=1}^{K(j)} \sigma^2 \varepsilon(k)^{-2}}
\]

- So estimate of governance is weighted average of re-scaled scores, with weights proportional to precision of each source
Precision of Estimates from UCM

- Reliability or precision of estimate of governance for each country is the standard deviation of this conditional distribution:

\[ \text{SD}[g(j) \mid y(j,1), \ldots, y(j,K(j))] = \left(1 + \sum_{k=1}^{K(j)} \sigma_\varepsilon(k)^{-2}\right)^{-\frac{1}{2}} \]

- These standard errors are smaller for countries that (a) appear in more sources, and/or (b) appear in more reliable sources.
Voice & Accountability, 2004 (Selected Countries)

Source for data: ‘Governance Matters IV: Governance Indicators for 1996-2004’, D. Kaufmann, A. Kraay and M. Mastruzzi, (http://www.worldbank.org/wbi/governance/govdata/); 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.
Control of Corruption: one Aggregate Indicator
(selected countries from 204 worldwide, for illustration, based on 2004 research data)

Source for data: ‘Governance Matters IV: Governance Indicators for 1996-2004’, D. Kaufmann, A. Kraay and M. Mastruzzi, (http://www.worldbank.org/wbi/governance/govdata/); 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.
Control of Corruption, 2004: World Map

Source for data: "Governance Matters IV: Governance Indicators for 1996-2004", D. Kaufmann, A. Kraay and M. Mastruzzi, (http://www.worldbank.org/wbi/governance/govdata). 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.
Government Effectiveness, 2004: World Map

Source for data: ‘Governance Matters IV: Governance Indicators for 1996-2004’, D. Kaufmann, A. Kraay and M. Mastruzzi, (http://www.worldbank.org/wbi/governance/govdata); 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.
Regulatory Quality, 2004: Latin America & Caribbean

Source for data: ‘Governance Matters IV: Governance Indicators for 1996-2004’, D. Kaufmann, A. Kraay and M. Mastruzzi, (http://www.worldbank.org/wbi/governance/govdata/); 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.
MCA Eligibility Criteria, Control of Corruption, 2004, 70 Countries – Data for all, lower margins of error

26 countries (green) have a probability of 75% or above to be in the top half; 24 countries (red) have a probability of 25% or less to be in the top half; 20 countries (yellow) have a probability between 25% and 75% to be in the top half.
Precision vs. Number of Sources, KKZ Governance Estimates, 2000/01

Note: See explanatory details in this slide’s note
Significant Decline in Inflation Rates Worldwide

Source: ‘Rethinking Governance’, based on calculations from WDI. Y-axis measures the log value of the average inflation for each region across each period.
Quality of Infrastructure

Source: EOS 1997-2003 (Quasi-balanced panel). Question 6.01: General infrastructure in your country is among the best in the world?
Judiciary Independence (*EOS survey results 1998-2004*)

High Independence

- OECD
- East Asian NICs
- Latin America
- NON OECD

Independencia de la Judicatura

No Independence

1998 1999 2000 2001 2002 2003 2004
No Significant Trend in Control of Corruption
Worldwide Averages

PRS country coverage in 1996: 129, all other periods 140; QLM and EIU country coverage: 115 for all periods.

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No Significant Trend in Government Effectiveness Worldwide

Are all Countries Stagnating in Governance?

• The world on average has not improved
• But large or small variation across countries?
• New method: for each country, we can identify whether there are significant changes over time
• It is found that changes can take place in the short-term: in 6-to-8 years, some deteriorations as well as some significant improvements as well
Changes were calculated on the basis of the differences in country estimates from 1996 and 2004. Classification for major deteriorations and improvements were based on 75% confidence interval. Source for data: [http://www.worldbank.org/wbi/governance/govdata/](http://www.worldbank.org/wbi/governance/govdata/).
Changes were calculated on the basis of the differences in country estimates from 1996 and 2004. Classification for major deteriorations and improvements were based on 75% confidence interval. Source for data: http://www.worldbank.org/wbi/governance/govdata/.
Governance Indicators: Zimbabwe, 1996/2004

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 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.
Croatia 2004 vs. 1996

Voice and Accountability

Political Stability

Government Effectiveness

Regulatory Quality

Rule of Law

Control of Corruption

Comparison between 2004, 1996 (top-bottom order)

Country’s Percentile Rank (0-100)

Governance Indicators: Chile, 1996/2004

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.
Governance Matters: The 300% ‘Dividend’

1. Large Development Dividend of Good Governance: *a one-standard-deviation improvement in governance raise incomes per capita in a country by about 300% in long-run*

2. But is such a decline in corruption unrealistically large?: *NO -- One S.D. is the difference from:* Eq. Guinea → Iran or Uganda → Mauritius → Portugal → Finland or New Zealand

3. The impact is *from governance to incomes, and not viceversa* -- higher *incomes alone will not do*

4. Urgency of interventions to improve governance
Governance Matters -- The ‘Development Dividend’
Isolating Causality: From governance to income

Rule of Law 2004

log(Real GDP Per Capita)

-3 -2.5 -2 -1.5 -1 -0.5 0 0.5 1 1.5 2 2.5

Kaufmann-Kraay (2002)
Alcala-Ciccone (2004)
Acemoglu-Johnson-Robinson (2000)
Isolating Reverse Causality: Little if any Effect From Income to Governance

Kaufmann-Kraay (2002)

Development Dividend From Good Governance

Data Source for calculations: KK 2004. Y-axis measures predicted GDP per capita on the basis of Instrumental Variable (IV) results for each of the 3 categories. Estimations based on various authors’ studies, including Kaufmann and Kraay.
The ‘Mezzo’ Level of Governance Measurement

- Based on cross-country surveys, mainly of enterprises – *(such as the EOS of WEF, BEEPS/WBES of WB, etc.)*
- Thousands of firms interviewed on a range of issues; focus on governance, specialized questions
- More detailed unbundling of governance and corruption phenomena than aggregate indicators
- Relatively broad country coverage, but less than aggregate governance indicators
- Measuring what is taking place De Facto matters: it uncovers stark realities masked in De Jure indicators
- Addresses empirically: ‘*It takes two to “tango”*’
Control of Corruption -- view of the firm: Lat Am in comparative perspective, % of firms reporting satisfactory control, EOS/GCR 2004

% firms reporting satisfactory (5,6,7) rating

OECD  Asia Tigers  Lat. America  Chile  Mexico  Venezuela

Illegal Party Financing
Procurement Bribery
Bribes for Laws/Regulations/Policies
Judicial Bribery
State Capture

Powerful Firms often 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

Political/Civil Liberties Reforms
Multinationals Bribe Abroad?

% Firms Reporting Frequent Procurement Bribery, EOS 2005

Source: EOS, preliminary. Question: In your industry, how commonly would you estimate that firms make undocumented extra payments or bribes connected with the following: permits, public utilities, tax payments, loan applications, awarding of public contracts, influencing of laws, policies, regulations and decrees to favor selected business interest, and judicial decisions. Any firms reporting answers 1 through 3 were considered to be reporting at least high frequency of bribery, while answers 4 through 7 were not.
Perceptions Matter

Perceptions-based data on governance are useful:

- Often only alternative (e.g. corruption)
- Captures more closely the concept being measured
- De facto measures are closer to ‘on the ground’ phenomena than objective ‘de jure’ information
- Perceptions do matter
- ‘Perception’ questions are now more rigorous, experiential and quantitative
- Ideological & other biases: concerns are exaggerated
- Their margins of error are not unique
- Adds insights that ‘objective’ data does not
Perception Measures Capture Pervasive Effects of Corruption

How Much Harder is it to Start a Business...

...If Days to Start a Business is High?

...And If Corruption is High?

Source: Kaufmann, Kraay and Mastruzzi (2005). The vertical axis measures the estimated impact on firms' responses to a survey question regarding the difficulty of starting a business (the 2004 Global Competitiveness Survey) corresponding to a de jure measure (capturing the number of days required to start a business) moving from the 50th percentile to the 75th percentile (first bar) and from also having overall corruption levels move from the 50th to the 75th percentile (second bar).
Explanatory Power of Subjective Measures of Corruption: *The case of Tax Burden*

How Much Higher is Perception of Tax Burden...

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Source: Kaufmann, Kraay and Mastruzzi (2005). The vertical axis measures the estimated impact on firms’ responses to a survey question regarding the burden of tax rates (the 2004 Global Competitiveness Survey) corresponding to a de jure measure (capturing the level of corporate tax levels in 88 countries) moving from the 50th percentile to the 75th percentile (first bar) and from also having overall corruption levels move from the 50th to the 75th percentile (second bar).
Large Margins of Error for Objective Governance Indicators

Option A: estimate of standard deviation of measurement error in subjective indicator is correct. Option C: standard deviation of measurement error in subjective indicator is twice as large as that in the objective indicator. The standard error of subjective indicator refers to the Governance component closely related to the associated objective indicator.
The ‘Micro’ Level – In-depth in-country diagnostics for action programs

Key Features of Governance Diagnostic Tools

• Multi-pronged surveys of: households, firms and public officials ['triangulation']
• Experiential questions (vs. ‘opinions’/generic)
• Local Institution Implements, w/WB Collaboration
• Recognizing Multidimensionality of Governance
• Focus on Service Delivery
• Input for Action and Change: Action Programs
Misgoverned vs. well Governed Agencies in-Country
(as ranked by public officials, 2000 diagnostic)

- The Transit Commission of Guayas
- Congress
- Transit Council
- Customs
- Police
- Petroecuador
- The President of the Republic
- Ombudsman
- NGOs
- Army
- The Church
- Professional Organizations

% reporting that the agency is very corrupt
Citizen Voice Helps Control Bribery

(Bolivia Diagnostics)

Based on 90 national, departmental, and municipal agencies covered in the Bolivia Public Officials Survey.
Transparency within Government Agencies Prevents Purchase of Public Positions

Based on 90 national, departmental, and municipal agencies covered in the Public Officials Survey.
Voice & Accountability vs. Control of Corruption

Source: KK 2004

$r = 0.73$
Conclusions and Policy Implications

1. Measuring governance is important
   • Policymakers, citizens, enterprises and investors know that good governance is key: demand data
   • Empowers civil society and reformers for change
   • Helps donors assess aid effectiveness
   • Enables policy-relevant research on causes and consequences of good (and bad) governance

2. Measuring Governance is feasible
   • Important to exercise care, margins of error matter
   • ‘Objective’ Indicators are also challenged
   • Being precise about degree of imprecision in all data
Policy Implications, Cont’d

3. Governance Matters: large “development dividend”
   • strong causal impact of governance on incomes, but little evidence that higher incomes raise governance
   • Thus, no rationale for applying a ‘governance discount’ to poor countries

4. The world on average is ‘stagnant’– *some countries have improved significantly, others deteriorated, many stagnated*

5. Need to refocus efforts to improve governance
   • frank questioning of what *doesn’t* ‘hold water’:
     -- Anti-Corruption campaigns
     -- Drafting more laws, codes, and Conventions
     -- Create additional ethics and A-C agencies
     -- ‘Blame’ History, Culture or Legal Origins
     -- ‘Blame’ Reform, Privatization, Globalization
Does Legal Origin Matter for quality of Governance today in emerging economies?

Legal Origin:

- Common law
- Civil law

Governance Indicators:

- Voice and Accountability
- Political Stability, No Violence
- Government Effectiveness
- Regulatory Quality
- Rule of Law
- Control of Corruption

Percentile Rank

Good Governance

Poor Governance
What Appears to Work or Holds Promise…

1. ‘Data Power’ / Metrics Matters
3. Transparency Strategy and Reforms (vs. Over-Regulations)
4. Focus on Incentives and on Prevention
5. Political Reform, including on Political/Campaign Finance
6. Working with the Corporates, MNC, Banking Sector
7. Capital Markets Development – as ‘market-disciplining’
8. For Rich/Donor Countries, & IFIs: ‘Tougher Love’ on Governance may make a difference? – on some of the above
For IFIs and Donors – Issues for Debate

1. Towards a ‘Governance Lense’ in our programs?

2. More explicit Linkage of Aid & Good Governance, with some further selectivity?

3. Global incentive: Supporting Countries in Joining ‘Elite Political/Economic Groups’

4. Supporting Transparency Reform Strategies
Policy applications - Transparency reforms as second generation institutional change

• Despite potential benefits, transparency reforms insufficiently integrated into reform programs
• Transparency reforms can be substitutes to costly (over)-regulation, to creation of additional public institutions (eg. A-C agencies) and to incessant legal drafting
• Transparency reforms have low financial cost, and high benefits: net savers of resources (eg. E*procurement)
• Transparency reforms may require political capital: but where present, technocratic areas where IFIs have a role
• Transparency reforms well-suited to be “entry points” catalyzing further institutional change, since: i) effective in changing incentives of political leaders to serve broad social groups, and ii) politically more feasible
## Freedom of Information Law (FOIL) vs Fiscal Transparency (IMF)

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<th>Processing FOIL</th>
<th>FOIL Adopted</th>
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<td><strong>High Transparency</strong> (IMF rating &gt;.5)</td>
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<td>AZERBAIJAN, BENIN, BURKINA FASO, CAMEROON, IRAN, KAZAKHSTAN; KYRGYZ REPUBLIC, MALI, MAURITANIA, MONGOLIA, RWANDA, TUNISIA</td>
<td>BANGLADESH, GHANA, HONDURAS, MALAWI, MOZAMBIQUE, NICARAGUA, SRI LANKA, TANZANIA, UGANDA, URUGUAY</td>
<td>ALBANIA, ARMENIA, BULGARIA, CANADA, CZECH REPUBLIC, ESTONIA, FRANCE, GREECE, HUNGARY, INDIA, ISRAEL, ITALY, JAPAN, LATVIA, LITHUANIA, MEXICO, POLAND, PHILIPPINES, PORTUGAL, ROMANIA, SLOVAK REPUBLIC, SLOVENIA, SWEDEN, UKRAINE, UNITED STATES</td>
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Economic/Institutional & Political Transparency Index (Initial, 2004)

Index ranges from -2.5 (worst) to 2.5 (best).
The case of Chile: unbundling transparency

• Since 1996, Chile has made considerable advances in governance indicators compare to the Latin American average, and today it is highly rated in governance.

• In terms of economic and institutional transparency, Chile is in 8th position (eg Central Bank of Chile among the best rated in effectiveness and transparency in the world).

• Yet Chile faces challenges on political transparency -- the ‘gap’: Ec/Institutional Transparency = 2.38 vs. Political Transparency = 0.82.

• Weak areas requiring specific progress:
  – Implementation of Freedom of Information law with effective mechanism to access the information.
  – Financial disclosure for public officials, legislators, judges, etc.
  – Further transparency in (‘sole sourced’) procurement.
  – Disclosure of political funding/expenditures (& lobby law).
10 Transparency Initiatives in a Strategy

2. Public Disclosure of Political Campaign contributions by individuals and firms, and of campaign expenditures
3. Public Disclosure of Parliamentary Votes, without exceptions
4. Effective Implementation of Conflict of Interest Laws, separating business, politics, legislation, & government
5. Publicly blacklisting firms bribing in public procurement
6. Effective Implementation of Freedom of Information Law, with easy access by all to government information
7. Fiscal/Financial transparency: central/local budgets; EITI
8. Transparency in Ownership and Financial Status of Banks
9. E*procurement: transparency (web) and competition
10. Governance Diagnostic Surveys and PETS
Governance Has Improved in Some Groups: e.g. “Pull Effect” of EU Accession

Rule of Law

Bibliographical References


Data for Analysis and Informing Policy Advice, Not for Precise Rankings

Any data on Governance, Institutions, and Investment Climate is subject to a margin of error. It is not intended for precise country rankings, but to highlight relative strengths and weaknesses and draw analytical and policy lessons. The data and indicators do not necessarily reflect official views on rankings by the World Bank or its Board of Directors. Errors are responsibility of the authors.

Further materials & access to interactive data:
General:  www.worldbank.org/wbi/governance
Data:  www.worldbank.org/wbi/governance/govdata/