Myths and Realities of Governance and Corruption

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CHAPTER 2.1

Myths and Realities of Governance and Corruption

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Governance and corruption remain controversial and misunderstood topics. But they are now given higher priority in development circles and by the corporate sector, including multinationals.

Indeed, some donors and international financial institutions (IFIs) increasingly work with emerging economies to help reduce corruption, and increase citizen voice, gender equality, and accountability. The 2005 World Economic Forum in Davos highlighted the agreement reached among 63 multinationals in key sectors to work within a set of principles to control corporate bribery. Further, with 29 countries having ratified already, and another handful of developing countries on the verge of doing so, the UN convention against corruption signed almost two years ago is about to come into force, requiring, among other things, repatriation of looted assets stashed abroad by corrupt leaders.

And when in July 2005 the Group of Eight countries announced their decision to double aid and debt relief to the poorest countries in Africa, governance concerns were prominent. As the recent joint report by the Africa Commission explicitly stated, “Good governance is the key.... Unless there are improvements in capacity, accountability, and reducing corruption ... other reforms will have only limited impact.” Similar statements are voiced in other regions of the world, and there is also increasing scrutiny about corruption in OECD countries, and of multinationals.

But is good governance and controlling corruption really fundamental for growth, development, and security? The explosion of empirical research over the past decade, coupled with lessons from countries’ own experience, have given us a more solid basis for judging many of the effects of governance on development, and the effectiveness—or lack thereof—of strategies to improve it. In our contributions to the Global Competitiveness Reports (GCR) in recent years we have presented a number of selected governance topics. Insights derived from the analyses of the Executive Opinion Surveys (Survey) conducted by the World Economic Forum every year, and presented in previous GCR chapter contributions, include the study of determinants of governance at the city level, the anatomy of undue influence, state capture and bribery involving many domestic private firms, multinationals, and public officials, and the links between governance, corruption and security threats, and others.

Unfinished business

Yet in spite of the myriad contributions to the field by many authors, there are still serious unresolved questions and debates in the development community, not only about the importance of governance and corruption, but also about the willingness and ability of the international
Myth #1: Definition: Governance and anti-corruption are one and the same.

We define governance as the traditions and institutions by which authority in a country is exercised for the common good. This includes:

- the process by which those in authority are selected, monitored, and replaced (the political dimension);
- the government’s capacity to effectively manage its resources and implement sound policies (the economic dimension); and
- the respect of citizens and the state for the country’s institutions (the institutional respect dimension).

By contrast, corruption is traditionally defined more narrowly as the “abuse of public office for private gain.” In last year’s GCR chapter on governance, we challenged this definition of corruption as placing too much emphasis on public office, and on the ostensible legality of the act. We analyzed the implications of viewing corruption as a broader phenomenon where private agents also share responsibility, and where many acts which are not ethical (and thus may be regarded as corrupt) may not necessarily be illegal. We presented empirical evidence of the extent to which many powerful private firms engage in undue influence, to shape state policies, laws and regulations, for their own benefit. Related to this, we also highlighted the extent to which they make campaign contributions, which may, in fact, be legal, but which unduly influences the rules of the game, for their benefit. Moreover, from the Survey results we showed that favoritism toward particular firms in the awarding of public procurement bids and contracts is widespread.

To generate debate, we offered an alternative, broader definition of what constitutes corruption, namely, “the privatization of public policy,” in which public policy is seen as including access to public services. According to this more neutral definition, an act may not necessarily be illegal for it to be regarded as corrupt in a broader sense. Consider the situation in which legislative votes or executive decisions in sectoral policy-making—e.g., in telecommunications or energy—have been unduly influenced by either private campaign contributions to legislators, or by private favors provided to decision-makers. In such a case, corruption would be considered to have taken place, even if the act was not strictly illegal. And within such a broad definition, responsibility resides with both those who exert undue influence, and those who are unduly influenced. Based on the empirical results from the Survey last year, we also provided an illustrative index of corruption within this broader definition, which pays closer attention to the deeds of the private sector. We found that a number of rich OECD countries fare rather poorly when this more subtle, and not purely legalistic, definition of corruption is used in the analysis.

Such debates on alternative definitions of corruption notwithstanding, it is clear that the scope of the concept of governance is much broader than that of corruption. As we will see later, governance and corruption may be related, but they are distinct notions, and ought not to be regarded as one and the same.

Myth #2: Governance and corruption cannot be measured.

Less than a dozen years ago, few comparable, worldwide measures of governance or corruption existed. Yet in recent years, through the efforts of institutions such as the World Bank (the Governance Indicators), the World Economic Forum (the Executive Opinion Survey), Transparency International (Corruption Perception Index), Freedom House (political and civil liberties and freedom of the press), and numerous other institutions, we have sought to counteract this widespread perception.

At the World Bank, in order to more closely define and measure governance, we have constructed these aggregate Governance Indicators, which now cover more than 200 countries, based on more than 350 variables, obtained from dozens of institutions worldwide, including the Survey. The Governance Indicators capture six key dimensions of institutional quality or governance, and measure, through two indicators each, the political, economic, and institutional dimensions of governance described above.

The following six dimensions are measured:

1. Voice and accountability—measuring political, civil and human rights
2. Political instability and violence—measuring the likelihood of violent threats to, or changes in, government, including terrorism

3. Government effectiveness—measuring the competence of the bureaucracy and the quality of public service delivery

4. Regulatory burden—measuring the incidence of market-unfriendly policies

5. Rule of law—measuring the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence

6. Control of corruption—measuring the exercise of public power for private gain, including both petty and grand corruption, and state capture

While the Governance Indicators may represent a big step forward, there are measurement challenges. Margins of error are not trivial, and caution in interpreting the results is warranted—i.e., countries cannot be precisely ranked. But these margins of error have declined, and are substantially lower than for any individual measure of corruption, governance, or the investment climate. As a result, these governance indicators are used worldwide for monitoring performance, country assessment, and research. These indicators have been available since 1996, and in recent months we released the last installment for 209 countries, with data up to the end of 2004.3

Myth #3: The importance of governance and anti-corruption efforts is overrated.

In order to give an approximation of the importance of corruption, one might pose the question: How large is the corruption “industry” worldwide? But it is very difficult to obtain even a rough estimate of the size of the corruption industry, given its hidden nature, for corruption and bribery typically operate in the dark. This makes official estimates virtually impossible to obtain, and, of course, unreliable. Nonetheless, thanks to the increasing availability of particular questions in enterprise and household surveys, which ask for quantitative estimates of bribery, it is possible, under certain conditions, to make calculations, and to extrapolate for the whole population.

In interpreting the results of this exercise, significant caution applies, given the margin of error in the data, the assumptions in the extrapolation exercise itself, and the fact that some forms of corruption are not quantified through this approach—e.g., budgetary leakages or asset theft within the public sector. Bearing such serious caveats in mind, an estimate of the extent of annual worldwide transactions that are tainted by corruption puts it close to US$1 trillion. The margin of error of this estimate being obviously large, it may well be as low as US$600 billion; or, at the other extreme of the spectrum, it could well exceed US$1.5 trillion.6

But even if a US$1 trillion estimate of the global size of bribery worldwide seems very large, it does not, in and of itself, give us much of a guide to the actual cost of corruption. Theoretically, it could be argued that all these bribes just grease the wheels of commerce, and no productive value added is lost to the economy. Therefore, to get a closer idea of the costs of corruption and poor governance, it is important to relate governance indicators with outcome variables, such as incomes or infant mortality, for instance.

Thanks to the advances in empirical measurement, a number of researchers have examined the impact of governance on development. The research generally shows that countries can derive a very large development dividend, as we have called it, from better governance. Indeed, there is now a growing consensus among both academics and policymakers that good governance provides the fundamental basis for economic development. Academic research has focused on the effects of institutional quality on growth in the very long run, noting that there is a strong causal impact of institutional quality on per capita incomes worldwide. These estimates of the development dividend of good governance suggest that a realistic one-standard-deviation improvement in governance would raise incomes in the long run by about two- to threefold.7

Such improvement in governance by one standard deviation is feasible, since it is only a fraction of the difference between the worst and best performers, and would correspond, for instance, to an improvement in the current ratings of voice and accountability from the lowest levels of Myanmar to that of Kazakhstan, or Kazakhstan to Georgia, or Georgia to Botswana. For improvements in rule of law, a one standard deviation difference would constitute the improvement from the level of Somalia to those of Laos, from Laos to Lebanon, Lebanon to Italy, or Italy to Canada; for control of corruption it is the improvement from the lowest levels of Equatorial Guinea to those of Cuba, Honduras, or Uganda, from Uganda to Lithuania or Mauritius, from Mauritius to Portugal, or from Portugal to the stellar standards of Finland, Iceland, or New Zealand. We also find that even over much shorter periods, such as the past 10 years, countries with better institutional quality have grown faster. And in our research, we have also found that good governance not only matters significantly for higher incomes per capita, but also for substantially reducing infant mortality and illiteracy.

Governance also matters significantly for a country’s competitiveness. For this year’s GCR, we performed a simple exercise, relating the recently released Governance Indicators (measuring country’s ratings for the 2004 period), with the updated Growth Competitiveness Index
(GCI) for 2005, which is featured in this Report (Part 1). It should be noted that the data used to compute the GCI this year (drawn in large measure from this year’s Survey) did not feature in any of the calculations for the Governance Indicators, which utilized earlier data. Against such a background, it is noteworthy that the correlation between governance (measured through the Governance Indicators) and competitiveness (through the GCI) is extremely high. As we observe in Figure 1, for the case of one of the Governance Indicators, namely corruption control, the correlation is 0.9, i.e. an extremely tight fit. Obviously such a close correlation is highly significant statistically, and remains so after controls for income levels are included in econometric specifications which explain the country’s competitiveness. On average, an improvement in control of corruption by only one standard deviation (which is realistic) is associated with a jump in the GCI for a country by almost 30 rank positions. Even after controlling for the income level of the country, improvement in corruption control can produce a very large jump in the competitiveness of a country, between 15 and 20 rank positions.

The most direct way to ascertain the importance of governance is to ask firms and households themselves. In the case of enterprises, insights can be derived from the synthesis question, at the end of the Survey, which asked firms to rank the most important constraints from a long list of 14 potential problems. The results are telling: firms in OECD countries rated labor regulations, bureaucracy, and taxes as the most problematic for their business, while firms in emerging economies considered that by far the largest constraints are bureaucracy and corruption. Finance and infrastructure are rated significantly lower than corruption and bureaucracy, but are still perceived by business executives worldwide as posing serious concerns for many enterprises. In terms of constraint severity, these dominate many of the other constraints.

It is important to disaggregate to the regional and country level, however, since averages for emerging economies mask significant variations. We see some of these in Figure 2, showing regional averages for some constraints. Bureaucracy is a serious constraint on governance everywhere, including in OECD countries. Corruption is also a serious impediment, especially in many emerging economies. Tax regulations constitute a severe constraint in OECD and in post-socialist transition countries, in contrast with regions such as South Asia, where it ranks low as an impediment, relative to the other constraints. Similarly, infrastructure is a major constraint in Africa and developing Asia, in contrast with the East Asian tigers, and, to an extent, Latin America and the transition economies (see Figure 2). This does not imply that in these regions it is unimportant to focus on infrastructure investments, since this type of question gives only a rela-
tive ranking across different constraints for each country. But the fact that infrastructure was not rated at the top in so many countries—in Latin America, Africa, transition, and others, which also suffer from infrastructure problems, and are in dire need of investments—is a sure sign of the extent to which some other factors—largely governance and corruption-related—impose even more severe constraints on business development.

Regional averages always mask substantial variations across countries in each region. For instance, at only 3 percent, the percentage of firms reporting that corruption is one of the top three constraints across the 24 countries in the OECD (in the Survey) is very low. Yet this is only an average of varying country estimates ranging from zero—i.e., not a single enterprise ranking corruption as a constraint—in countries such as Finland, New Zealand, Norway, Iceland, and Australia, to a much higher 18 percent of the respondents mentioning corruption as a top impediment in Greece. In fact, there are a number of emerging economies in the various regions where the response rate is lower than for Greece, such as the cases of Uruguay (4 percent), Chile (7), Slovenia and South Africa (10), Botswana and Ghana (12), Estonia (13), and others. Yet the constraint posed by corruption to business, ranked much higher, on average, in the emerging economies, is the result of the prevalence of countries where over one-half of the respondents claim that corruption is one of the top constraints to their business, such as Armenia, Azerbaijan, Bangladesh, Benin, Cambodia, Cameroon, Guatemala, Kazakhstan, Kenya, Morocco, Mozambique, Pakistan, Paraguay, Romania, Russia, Uganda, and Vietnam, among others.

The impact of poor governance and corruption is not limited to the corporate sector. In many countries, corruption represents a “regressive tax” on the household sector as well: as compared with higher-income groups, lower-income families pay a disproportionate share of their incomes in bribes to have access to public services, and end up with less access to such services because of corruption. Related, there is also the finding of research that corruption increases income inequality.

Moreover, governance matters significantly for aid effectiveness. While some have challenged their findings, the widely known Burnside and Dollar work on assessing aid effectiveness shows, on the basis of cross-country aggregate data, that the quality of policies and institutions of the aid recipient country is critical. It is at least as revealing, however, to explore these links at the microeconomic level, focusing, for instance, on the effectiveness of investment projects, which show that institutions matter for project effectiveness. Also, our calculations of World Bank–funded projects suggests that if there is high corruption in an aid-recipient country, the probability of project success, of institutional development impact, and of long-
term sustainability of the investment, is much lower than in countries with better governance.

These results are of particular relevance in the context of a corollary myth, the contention that donor agencies can “ringfence” projects in highly corrupt countries and sectors, and thus ensure that it is efficiently implemented, and that objectives are attained, even where other projects fail. This is unrealistic. With the possible exception of some humanitarian aid projects, the notion that the aid community can fully insulate projects from a country’s overall corrupt environment is not borne out by the evidence. The data suggest that when a systemic approach to governance, civil liberties, rule of law, and control of corruption is absent, the likelihood of an aid-funded project being successful is greatly reduced.

Clearly, governance and corruption matter. Space constraints preclude an exhaustive presentation in this chapter of the literature on this topic, or a presentation of all the complex links between governance and other important factors and outcomes. For instance, the extent to which corruption and the absence of rule of law may undermine fledgling democracies is of critical importance, and worthy of deeper treatment elsewhere. Similarly, the links between misgovernance, corruption, and money laundering with such security threats as organized crime and terrorism require deeper analytical and empirical treatment.12

The answer to the myth that the importance of governance and anti-corruption is overrated would be incomplete without pointing out the obvious: governance is not the only important driver of development. Macroeconomic, trade, and sectoral policies are also important. But when governance is poor, policymaking in other areas is also, and often, compromised.

**Myth #4: Good governance and corruption control is a luxury that only rich countries can afford.**

Some claim that the link between governance and income does not mean that better governance boosts incomes, but, rather, the reverse, that higher incomes automatically translate into better governance. However, our research does not support this claim. It is misleading to suggest that corruption is due to low income, and thus, to invent a rationale for discounting bad governance in poor countries. In fact, the evidence points to better governance as being the cause of higher economic growth. Furthermore, a number of emerging economies, including the Baltics, Botswana, Chile, and Slovenia, have shown that it is possible to reach high standards of governance, without having yet joined the ranks of the wealthy nations.

While this finding applies across the globe, the recent focus on Africa by the international community makes this point particularly relevant for debates on aid effective-

ness, and about the priority the continent needs to give to improving governance to complement aid inflows. Indeed, in recent years, the international community has rightly turned its attention to the problems of underdevelopment in Africa. Not only is Africa poorer than other regions in the developing world, it also lags far behind other regions in terms of progress in achieving the Millennium Development Goals. If past trends continue, many countries in Africa will have to double their per capita incomes over the next decade, in order to attain the goal of halving poverty by 2015. There is widespread consensus that a combination of substantial aid inflows, together with concerted domestic policy effort, is necessary to meet this challenge.

In light of the strong positive effect of governance on development, and in light of its importance for effective aid delivery, it is then a matter of considerable concern that governance performance in sub-Saharan Africa is on average quite weak. Many countries in Africa are not only poor, but also poorly governed. Fully 38 out of 46 countries in the region are both poorer than the world average, and also exhibit worse governance than the world average. Some observers have argued that we should thus discount the poor governance performance of the region, based on the fact that these countries have very low income levels, thus arguing that good governance costs money. Yet, as described above, recent research provides very little evidence to support the proposition that poor governance (or corruption) in Africa is attributable to Africa’s poverty. Rather, the direction of causality is largely in the opposite direction, from better governance to better development outcomes.13

**Myth #5: It takes generations for governance to improve.**

Reformers in many governments as well as investors, civil society leaders, and the international aid community increasingly view governance as being key to development, and to improving the investment climate. This, in turn, has increased the demand for monitoring the quality of governance in a country over time. Further, aid donors are also coming to the view that aid flows have a stronger impact on development in countries with good institutional quality. In light of this, it is important to measure trends over time, as well as levels of governance. Our new governance indicators now span an eight-year period from 1996 to 2004, a sufficiently long period to begin looking for meaningful trends in governance. As we have emphasized in our work, the presence of measurement error in all types of governance indicators, including our own, makes assessing trends in governance a challenging undertaking.

In the recently released paper “Governance Matters IV” (Kaufmann et al., 2005) we develop a formal statistical
Importantly, we show that there is a great deal of agreement among our many data sources about the direction of change in governance in these countries. Overall, this reminds us that, while changes in institutional quality are usually gradual, there are also countries which have achieved sharp improvements—or suffered rapid deterioration—over an eight-year period. This finding is of particular interest, given the common perception that, while deterioration in a particular country can take place rather quickly, improvements are of necessity slow and incremental.

Challenging the “institutional pessimists,” Table 1 provides a list of countries that have improved markedly in selected dimensions of governance since the late 1990s. As we can see, this also challenges the “Afro-pessimists,” since we can see in the same table that there are a number of countries in Africa which have improved in a rather short period of time, even if it is still the case that other countries have not. Generally, as shown in Table 1, it is found that roughly as many countries in Africa show declines in these particular governance dimensions as show improvements.

As Table 1 shows, there has been significant improvement since 1998 in voice and accountability in a number of countries, such as in Chile, Bosnia and Herzegovina, Croatia, Serbia, Ghana, Indonesia, Sierra Leone, Slovak Republic, and Peru, while a significant deterioration has taken place in countries such as Ivory Coast, Zimbabwe, Kyrgyz Republic, Russia, Venezuela, Pakistan, Belarus, Nepal, and Haiti. Similarly, a deterioration in rule of law during that period has taken place in a number of countries, such as Ethiopia, Namibia, and Argentina, while significant improvements in government effectiveness have taken place in South Africa and Bulgaria, among others.

We have also addressed the question of whether governance has been improving worldwide on average. We find that, in fact, there is no evidence that governance has improved since 1996 (or any period thereafter). It is quite sobering to see, from the review of these indicators, that, on average, the quality of governance worldwide has remained stagnant. Although, as pointed out earlier, there are a number of countries where significant improvement has taken place, there are also countries exhibiting significant deterioration, and many where little change has taken place.

In this context, it is telling that there are clusters of countries that have been improving, in comparison with others. For instance, there is some evidence of improved governance in a number of dimensions in some Caribbean countries, in contrast with much of Latin America. Particularly telling is the story of the post-socialist transition countries. As illustrated in Figure 3, those transition countries, which in the mid-1990s were promised potential entry to the European Union—upon fulfillment of an appropriate institutional and political path—exhibit an

### Table 1: Significant changes in governance worldwide in short-term, 1998–2004

<table>
<thead>
<tr>
<th>Voice and accountability</th>
<th>Significantly worsened</th>
<th>Zimbabwe, Venezuela, Ivory Coast, Ethiopia, Bangladesh, Pakistan, Philippines, Lebanon, Egypt, Zambia, Myanmar, Guinea, Eritrea, Bolivia, Peru, Tunisia, Honduras, Guatemala, Ecuador, Kazakhstan, Cameroon, Cuba</th>
<th>Significantly improved</th>
<th>Chile, Kenya, Bahrain, Gambia, Algeria, Mexico, Senegal, Peru, Turkey, Slovak Republic, Nigeria, Indonesia, Ghana, Croatia, Bosnia and Herzegovina, Sierra Leone, Serbia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rule of law</td>
<td>Significantly worsened</td>
<td>Zimbabwe, Bangladesh, Eritrea, Ivory Coast, Swaziland, Ethiopia, Equatorial Guinea, Central African Republic, Sudan, Moldova</td>
<td>Significantly improved</td>
<td>Mozambique, Slovak Republic, Estonia, Latvia, Lithuania, Madagascar</td>
</tr>
<tr>
<td>Control of corruption</td>
<td>Significantly worsened</td>
<td>Zimbabwe, Bangladesh, Eritrea, Ivory Coast, Swaziland, Ethiopia, Equatorial Guinea, Central African Republic, Sudan, Moldova</td>
<td>Significantly improved</td>
<td>Tanzania, Madagascar, Croatia, Serbia, Colombia, Bulgaria, Estonia, Latvia, Slovak Republic</td>
</tr>
</tbody>
</table>

Note: The significance level for the list of countries shown in this table was calculated at 75 percent confidence level. For the full list, including all governance components, and also at 90 percent confidence level, see Kaufmann et al., 2005. Source: Kaufmann et al., 2005.
improved trend in governance (shown in the figure on the rule-of-law variable), while those post-socialist countries which were not offered such a window of opportunity, stagnated or worsened.

Thus, while it is true that institutions tend to change only gradually, and that in many countries there has been little improvement in the short term, we can also see that in some countries there has been a sharp improvement during a short period of time. This defies the view that while governance may deteriorate quickly, improvements are always slow and incremental.

**Myth #6: Fight corruption by fighting corruption.**

A fallacy promoted by some in the field of anti-corruption, and at times also by the international community, is that the best way to fight corruption is by fighting corruption—that is, by means of yet another anti-corruption campaign, the creation of more anti-corruption commissions and ethics agencies, and the incessant drafting of new laws, decrees, and codes of conduct. Moreover, in some settings, the disproportionate emphasis on prosecutions—typically of a few corporations or individuals, and often of the political opposition—at the expense of a focus on prevention and incentives for integrity, has reduced the effectiveness of anticorruption efforts. An instinctive tendency to over-regulate, which may take place in the throes of a corruption scandal, is not infrequent, and can also be counterproductive. Excessive regulations not only do not address the more fundamental causes of corruption, but often create further opportunities for bribery. Overall, these anti-corruption initiatives-by-fiat appear to have little impact, and often serve as politically expedient ways to react to the pressure to “do something” about corruption. Often, this results in neglect of more fundamental and systemic governance reforms.

**Myth #7: The culprit in developing countries is the public sector, which is solely responsible for shaping the inadequate business environment.**

A common fallacy is to focus solely on the failings of the public sector. The reality is much more complex, since powerful private interests often exert undue influence in shaping public policy, institutions, and state legislation. In extreme cases, so-called oligarchs capture state institutions. These are issues we have reviewed in some detail in the chapters on governance in previous Reports, presenting evidence from previous Surveys on the extent of undue influence, as well as outright capture of state institutions by corporate potentates. Contrary to conventional wisdom, the public sector is not the sole shaper of the investment climate faced by domestic firms and foreign investors in a country, and, similarly, the private sector is not the passive recipient of the investment climate. In reality, there is a complex interplay between corporate and...
public sector governance and policymaking, whereby powerful segments of the private sector also play a very important role in shaping key public policy, legislation, and regulations which constitute the rules of the game, and the business environment within which these corporations operate.\(^\text{14}\)

Behind the conventional definition of corruption (as the abuse of public office for private gain) lies the image of a predatory state, seen as a huge outstretched hand, extorting firms for the benefit of politicians, high officials, and bureaucrats. The research carried out over the past six years argues for balancing the focus, to include the important role of private firms, since the evidence suggests that many firms collude with politicians for their mutual benefit. Even in strong states, such as in rich OECD countries, powerful conglomerates can have significant influence in shaping regulatory policy. Consequently, it is of paramount importance to revisit the traditional notions of the investment climate. More specifically, money in politics is at the heart of the interplay between the corporate and public sectors, in terms of policy and institutional outcomes, and within it, the role played by political finances in exerting undue influence.

The private–public sector governance challenge is not confined to the domestic players in a country. In spite of the fact that the OECD Anti Foreign Bribery Convention came into force over five years ago, many multinational corporations still bribe abroad, at times affecting public policy, and more generally undermining public governance in emerging economies. In the articles in previous Reports we codified in some detail the fact that there still appears to be considerable bribery by multinationals headquartered in OECD countries, but which operate outside of the OECD. While one ought not rule out that the OECD Convention may be effecting some progress—and there is an increase in the number of investigations in a few OECD countries—there appears to be little progress in most OECD signatory countries in actually bringing serious cases of bribery to court.

In fact, the data from the 2004 Survey illustrate the fact that domestic and multinational firms operating within the OECD may be behaving rather differently from those multinationals headquartered in the OECD and operating outside it. About 7 percent of firms were estimated to have bribed in public procurement contracts by multinationals headquartered in an OECD country and operating in another OECD country, which compares favorably with the estimate of about 10 percent of domestic firms bribing within their own OECD country. However, it does not compare well with the estimate exceeding 17 percent for multinationals that are also headquartered in an OECD country, but which operate outside of OECD.\(^\text{15}\)

We lack the same type of data from years past for precise comparison, and therefore it is not possible to indicate whether a downward trend is evident. Yet the existence of a significant gap between practices of multinationals within the OECD and outside of it in terms of bribery points to the need for tougher monitoring and enforcement of the Convention across the OECD, and of considering more effective complementary measures.

The fact that the private sector also plays a key role in governance and corruption has rather different implications for action. In fact, having ignored the private-public governance nexus for very long, the international community has often erred in its emphasis on conventional public sector interventions as a key instrument to help countries improve governance. Simply put, traditional public-sector management interventions have not worked, because they have focused on technocratic organizational “fixes,” often supported through technical assistance, the importation of hardware, organizational templates, and visits by “experts” from rich countries.

**Myth #8: Countries can do little to improve governance, and IFIs and the donor community can do even less.**

Given the long list of interventions that have not worked, as well as the role often ascribed to historical and cultural factors in explaining governance, it is easy to fall into the pessimist camp. That would be a mistake. First, historical and cultural factors are far from deterministic—witness, for instance, the diverging governance paths of neighboring countries in the southern cone of Latin America, the Korean peninsula, the transition economies of Eastern Europe, and in southern Africa. Second, there are strategies that offer particular promise. The coupling of progress on improving voice and participation—freedom of expression and gender mainstreaming—with transparency reforms can be particularly effective, as seen in Figure 4.

Unfortunately, progress in these areas of political and institutional governance, such as freedom of the press, gender equality, and transparency, has been checkered in many countries in the world. This disappointing reality highlights the pitfalls of focusing only on formalistic political changes. For instance, over the past 20 years there has been a substantial increase in the number of electoral democracies across emerging economies, with dozens more countries joining the ranks of countries holding elections. However, improved formal polity has not always translated into improved freedoms for the press, increased citizen voice, or opportunities for women. For instance, out of the 121 countries which Freedom House classified as electoral democracies in 2002, 49 are in fact classified as not having a fully free press.\(^\text{16}\)

The data for Africa are also telling. According to Freedom House, there has been significant progress in the area of political rights over the past two decades. Yet press freedoms, which it has been tracking since 1995, have not
improved, as seen in Figure 5. There is evidence, in fact, that some deterioration may even have taken place in recent times in a number of countries in the continent, as suggested not only by the Freedom House evidence depicted here, but also by the responses by firms to the Survey questions. Over the past couple of years, an increasing number of respondents from the enterprise sector in Africa do report growing obstacles in terms of what media can report and print.

In sum, while in many countries in the world there has been progress in selected political rights areas, this has not always been translated into enhanced media freedoms, gender equality, or political and institutional transparency. And this matters a great deal, because where there is progress in these areas, progress can also be expected in corruption control. There is nothing deterministic about corruption, yet difficult political and systemic institutional reforms are often needed.

Some argue that there is not much the IFIs can do about helping a country improve governance and controlling corruption, even if the country is not viewed as facing a historical or culturally deterministic fate to stay with poor governance for many generations to come. Some development experts are skeptical about the ability of IFIs and donors to help countries improve their governance, either because of a conviction that the “macro” matters more, a mistaken belief in historical determinism, or, the more nuanced view, that because the interventions needed to improve governance are politically sensitive, they are very difficult for outsiders to encourage.

Indeed, there are areas that fall outside the mandate of IFIs, such as promotion of fair multiparty elections. But it may well be within the ability of IFIs and donors to do something about initiatives to encourage transparency, freedom of information and an independent media, participatory anti-corruption programs led by the country, and gender equality—all of which have been underemphasized so far in the fight against corruption.

The next stage of institutional reform: A strategy for transparency
Parth because there is a higher comfort level with technocratic “fixes,” traditional themes such as Public Sector Management (including civil service reforms, codes of conduct, etc.) continue to be given significant prominence in the aid community. By contrast, transparency has been an underemphasized pillar of institutional reforms. That there has been relatively little progress on the ground in this area is regrettable, in view of the influential conceptual contributions of a number of Nobel-laureates, who have developed a framework linking the citizen’s right to know and access to information with development outcomes. Even popular lore subscribes to the importance

Figure 4: Gender equality, freedom of the press, and transparency are associated with corruption control

Note: Satisfactory Freedom/Rights reflect higher ratings in press freedom, gender equality, and transparency.

of transparency, as illustrated by the old adage “sunlight is the best disinfectant.”

Yet not only does the implementation of transparency-related reforms remain checkered on the ground virtually everywhere, but, in contrast with other dimensions of governance, such as the rule of law, corruption, and regulatory burden, there is a large gap between the extent of the conceptual contributions and the progress on its measurement and empirical analysis.  

Thus, we are attempting to contribute to the empirical understanding of various dimensions of transparency by undertaking construction of a transparency index for 194 countries, based on over 20 independent sources (including the Survey). Country ratings and their margins of error are generated, for an aggregate transparency index with two subcomponents: economic/institutional transparency and political transparency. The results suggest enormous variation across countries in the extent of their transparency. In fact, transparency reforms are substantial net savers of public resources, and can obviate the necessity for excessive regulations or rules. And transparency reforms need not remain abstractions at the level of rhetoric any longer. Some concrete examples of concrete reforms, which some countries have taken selectively, and which many more could consider undertaking comprehensively, are listed in the accompanying box.

Of course, transparency reforms are not the only institutional reform priorities. IFIs and donors can complement these reforms by continuing to support traditional core competencies, helping with capacity-building, sharing knowledge, and focused reforms in key institutions in emerging economies, such as in the judiciary, customs, and tax and procurement. Further, at the municipal level, and in the context of decentralization, the donor community can also help to further institutional progress and anti-corruption in emerging economies.

These targeted reforms supporting highly vulnerable institutions would have, however, to be adapted to the specific country realities, and thus might vary considerably from country to country in their priority and in specific design. In some countries, the first priority identified might be to support procurement reforms, strengthening accountability institutions in parliament, and freedom of the press; in others, it may be reforms in the judiciary, women’s rights, and the revamping of customs. In-depth
Figure 6: Transparenting transparency: Toward an index of overall country transparency, selected countries

Note: Selected countries are presented for illustration, and due to margins of error, no precise ranking is warranted.

Box 1: Concrete Transparency Reforms

Since research shows clearly that transparency helps improve governance and reduce corruption—essential ingredients for better development and faster economic growth—the international community and individual countries must pay closer attention to this issue. Within a concerted, practical, and comprehensive pro-transparency strategy, a basic checklist of concrete reforms, which countries may use for self-assessment, a report-card of sorts, might include the following items:

- public disclosure of assets and incomes of candidates running for public office, public officials, politicians, legislators, judges, and their dependents;
- public disclosure of political campaign contributions by individuals and firms, and of campaign expenditures;
- public disclosure of all parliamentary votes, draft legislation, and parliamentary debates;
- effective implementation of conflict of interest laws, separating business, politics, legislation, and public service, and adoption of a law governing lobbying; publicly blacklisting firms that have been shown to bribe in public procurement (as done by the World Bank); and a requirement to “publish-what-you-pay” by multinationals working in extractive industries;
- effective implementation of freedom of information laws, with easy access for all to government information;
- freedom of the media (including the Internet);
- fiscal and public financial transparency of central and local budgets, adoption of the IMF’s Reports on Standards and Codes framework of fiscal transparency, detailed government reporting of payments from multinationals in extractive industries, and open meetings involving the country’s citizens;
- disclosure of actual ownership structure and financial status of domestic banks;
- transparent (Web-based) competitive procurement;
- periodic implementation and publicizing of country governance, anti-corruption and public expenditure tracking surveys, such as those supported by the World Bank;
- Transparency programs at the city level, including budget disclosure and open meetings.
governance diagnostics at the country level are thus required first, working closely with experts and institutions within the country, which must, itself, take the lead in such reforms, allowing donors to play an important, but supportive, role.

Conclusions: A global compact on governance?
The challenge of governance and anti-corruption confronting the world today calls for something other than business-as-usual. A bolder approach is needed, and collective responsibility at the global level is called for. The myths discussed in this chapter highlight areas where the international community and individual countries may need to reconsider strategies and approaches. Improving governance and controlling corruption matter enormously for development, and countries can substantially improve, even in the short term, if the appropriate strategy and political resolve are present.

Whatever the strategy, it ought to benefit from the support of the international community, as well as the involvement of the private sector. Indeed, we emphasize that governance and corruption challenges are not the exclusive responsibility of the emerging economies (or poor world), nor are public institutions the only culprits. The rich world must not only deliver on its aid and trade liberalization promises, it must also lead by example. OECD countries, which are lagging behind, should ratify and effectively implement the 2003 UN Convention Against Corruption, and take concrete steps—as Switzerland is beginning to do—to repatriate assets looted and stashed abroad by corrupt officials. It is also important that OECD countries address the daunting challenges of cross-border money laundering and arms trading.

Much more should be done to ensure that transnational corporations refrain from bribery abroad, and that they contribute to improved governance practices in host countries. Corporate initiatives promoting general principles against corruption, or voluntary codes of conduct, may raise awareness, and at times have a modest impact, but much tougher incentives and measures are called for, to encourage the private (including multinational) sector to refrain from engaging in bribery. Public disclosure and widespread dissemination of lists of offending firms could act as a serious deterrent. As for the IFIs and donors, there is a need to grapple with questions of selectivity and effectiveness in aid programs, rewarding countries which are making improvements in governance, and moving away from the notion that large scale financing to highly corrupt governments will benefit the poor. The notion that the donors can “ringfence” (or insulate) most projects from a generally corrupt environment ought to be abandoned.

It is clear that additional income flows alone will not improve governance. Indeed, we have learned that improved governance by a country results in higher incomes, not the other way around. Countries themselves must shoulder responsibility and take the lead in implementing often difficult political and institutional reforms.

Notes
1 The author is Director of Global Programs at the World Bank Institute. This chapter draws on collaborative research projects with Aart Kraay, Joel Hellman, Massimo Mastruzzi, and Ana Bellover, and has benefited from collaboration with Augusto Lopez-Claros and the Global Competitiveness team. I also thank Massimo Mastruzzi and Lorena Lenhart for their invaluable assistance. The views and errors expressed are the author’s own. Neither those errors nor the data (which are subject to margins of error and do not imply precise country rankings) necessarily reflect the official views of the World Bank. An abridged version of some of the detailed material in this chapter is forthcoming in the fall issue of the IMF quarterly Finance and Development.

2 At the time of this writing, of the countries having already ratified the Convention only one is a rich OECD country, the remaining 28 being emerging economies, as is the next set of countries about to ratify. Well over 100 countries have signed the Convention, which requires ratification by 30 countries in order for it to come into force. Once the Convention is ratified—which is imminent—the central challenge will be its effective monitoring and implementation by the countries.

3 A precedent-setting concrete case is currently in the making, thanks to the imminent return by Switzerland to Nigeria of funds looted during the Abacha regime and stashed in Swiss banks.


5 The updated set of aggregate governance indicators is available at: http://worldbank.org/wbi/governance The complete methodology, new findings, and data may be obtained in Kaufmann et al., 2005.

6 See Appendix for a methodological explanation of how these estimates were derived.


8 Caution in making precise comparisons across regional averages is warranted, since some regions are significantly underrepresented in the Survey. The Survey coverage has been steadily increasing over the years, and, with a current coverage of 117 countries in 2005, it is by far the broadest of any cross-country survey of firms. Yet it is typically those countries not covered in these surveys, such as some in the Middle East, Africa, and the CIS, which tend to rate lower in governance within their regions, compared with those surveyed.

9 Alonso-Terme et al., 1998.

10 Burnside and Dollar, 1999.


12 See, for instance, the Report of the Commission on Weak States (2004), and Kaufmann (2004), each reporting on selected links between governance and security, areas which have typically been treated in isolation from each other. It is worth noting again the extent to which terrorism may often constitute the globalized result, in one country, of misgovernance in another.

13 See Kaufmann et al. (2005) for details.

14 Even the definitions and views as to what constitutes the investment climate tend to underestimate the importance of governance factors. Until very recently, the focus has been on a rather narrow and traditional set of factors comprising the investment climate, emphasizing economic, financial, and legal regulations by law, while divorced from the political dimensions of governance. A simple Web search illustrates the biases in how the investment climate is viewed and ana-
lyzed: of the almost 10,000 articles on investment climate since 1996 that come up in a search for prominent papers in the Factiva search engine (online at http://www.factiva.com) over 50 percent address issues related to economics or policy, 30 percent address monetary or financial factors, almost 20 percent address issues related to law or legal matters; yet less than 10 percent bring up issues related to corruption or governance. This means that in the literature, the treatment of the concept of the investment climate itself is not in tune with what the enterprises themselves report in surveys of what matters the most for their operations.

15 These are conservative estimates, and based on the sample of countries covered by the Survey. In countries not covered by the Survey, the prevalence of such bribes may be even higher, since there is a direct correlation between the propensity of multinationals to bribe, on the one hand, and the overall extent of domestic corruption in the host investment country, on the other.

16 Freedom House, online at: http://www.freedomhouse.org

17 For instance, the Survey reports that, while 29 percent of the respondent firms in 17 countries in sub-Saharan Africa reported very serious constraints in what the media could publish in their countries, the percentage of highly dissatisfied respondents in the same set of countries rose to 41 percent.


19 Further, there has been a particular paucity of literature on transparency which breaks down or unbundles transparency into its specific components, such that it becomes usable as policy advice and intervention. Our ongoing research attempts to partly fill these empirical and policy-related gaps. In a recent paper, we have reviewed the existing literature, and present various definitions of transparency, with a view to providing an empirical framework of worldwide indicators on various dimensions of transparency. These initial empirical results are intended to help bring about concrete policy and institutional innovations related to transparency reforms. See Beliver and Kaufmann (2006).

20 There is even significant variation in transparency within countries, such as differences in performance between the economic/institutional and political dimensions of transparency, or, related to this, differences in the way institutions within a country operate as regards transparency.

21 For details of participatory in-depth governance diagnostics at the country level, in which the country takes the lead in designing action programs, see http://www.worldbank.org/wbi/governance/capacity-build

22 It should be noted that there is more corruption in some of the richer OECD countries than in some emerging economies; thus the OECD must redouble its efforts among its own members.

References


Factiva. Online at: http://www.factiva.com


2.1: Myths and Realities of Governance and Corruption


We present here, in brief, the method used to arrive at a rough estimate of the annual amount of worldwide bribery. Calculations are made under various scenarios and assumptions, which provide our range of estimates. A likely estimate derived from these calculations is roughly US$1 trillion, although the confidence range may be relatively wide, as will be suggested in the following. Nonetheless, even under very conservative assumptions, the estimate is highly unlikely to be less than about US$600 billion, while at the other extreme of the likely range of values it may well exceed an annual amount of US$1.5 billion.

Additionally, we reviewed the available literature and explored alternative estimation procedures, as a sort of external validation of this estimation exercise, simply by comparing the rough estimates derived from our method with independent proxies drawn from other sources or studies. Following is a description of the approach.

The strategy for estimating the annual amount of bribes is based on available data from surveys, in which firms and households report on average annual bribery payments as a share of sales (for enterprises), or incomes (households). Based on these, we made extrapolations for countries not covered in these surveys, and then also assumed that the overall population exhibits similar patterns to those of the sampled population.

We utilized various enterprise and household surveys for this estimation, including two different enterprise surveys: the World Bank Enterprise Survey (WBES) carried out in the year 2000 in 81 countries, and drawing on 10,033 responses from firms (WBES 2000), and on the Global Competitiveness Survey in 104 countries, drawing on 8,729 responses (Survey 2004). We also used the results from household surveys carried out by the World Bank in the context of 16 different Governance and Corruption Diagnostic Surveys. From these we extrapolate and compute estimates of bribery worldwide. Given the gaps, measurement errors and difficulty of data collection in the area of corruption, mentioned earlier, calculations were made under multiple scenarios, utilizing different assumptions, ranging from least to most conservative. Indeed, the main objective of this exercise was to arrive at a preliminary likely range of estimates, rather than a precise point estimate, which would be misleading.

Bribery paid by the household sector was computed by first obtaining the estimated share of bribes in total incomes from the diagnostic surveys, carried out between 1999 and 2003 in 16 countries. We mapped these available estimates of household bribery against the control of corruption indicator available worldwide from our aggregate Governance Indicators database (which is denominated in an ordinal scale), and regressed the reported bribe share from the household responses (dependent variable) against the control of corruption variable. The resulting coefficient from the regression and the actual values of the control of corruption variable was then used to have an estimate of the household bribe share for the countries, which did not have a direct measure from a country diagnostic report. This then gave an estimate of household bribery share in personal incomes for all countries. Each country estimate was multiplied by its GDP and then factored by 0.7, the estimate of the ratio of personal consumption to GDP.

Estimates from corporate bribery were computed on the basis of two different surveys, utilized for alternative estimation scenarios, namely the WBES 2000 and the Survey 2004, respectively. In each scenario, we extrapolated worldwide bribe shares on the basis of quantitative responses of firms to the questions on the extent of administrative bribe share (in sales), as well as the bribe fees paid to secure public procurement contracts (as a share of the contract). Sensitivity analysis with multiple scenarios, under different assumptions, was done (including very conservative assumptions), in order to derive a broad-based range of likely bribery estimates.

In the case of WBES, worldwide administrative bribery was computed as the product of the world-weighted bribe share average and overall GDP (net of procurement), factored by 0.7, the assumed contribution of business to overall GDP. The bribe share average, in turn, was drawn from WBES 2000 findings, weighted by GDP per capita levels and converted using either midpoints (base scenario) or initial points (conservative case).

In the case of the alternative scenario based on the Survey, administrative bribery was computed as the product of the world-weighted bribe share average and overall GDP (net of procurement), factored by 0.7, i.e. contribution of business to overall GDP. The worldwide bribe and procurement shares, in turn, were drawn from Survey 2004 findings, weighted by GDP per capita levels.

The multiple scenarios, under many different assumptions, yielded multiple results and a range of estimates. Overall, 138 different scenarios were run, including 48 scenarios based on the WBES, and 90 scenarios...
Appendix: The US$1 trillion estimate of worldwide bribery: Synthesis of the approach (cont’d.)

Unofficial economy estimates ranging between US$3.4 to US$5.1 trillion worldwide

The first, and lower, estimate of the unofficial economy, based on the data in Friedman et al. and part of the World Bank governance databank was computed as the sum of the products of individual unofficial country economy figures in 1997, and the associated GDP in 2002 (assuming no change in estimated shares in the last five years), adjusted by a factor of 1.19, on the assumption of a similar trend in unofficial economy shares in the countries missing from the database. A higher estimate was drawn from Schneider and Enste (2002), who provide estimates of the shadow economy in 76 developing and developed economies. Their findings highlight a large shadow economy. For 21 OECD economies they estimated the size of the underground economy as having moved from US$2 trillion (12.7 percent of GDP) in 1989, to US$3.4 trillion (16.7 percent of GDP) in 2001. It should be noted, however, that many unofficial economy transactions are not necessarily corrupt, and, conversely, many bribes and corrupt transactions do not necessarily take place in the unofficial economy.

Worldwide money laundering estimates: US$600 billion to US$2,800 billion

In a 1998 IMF study, it was estimated that the aggregate size of money laundering in the world could be somewhere between 2 and 5 percent of the world’s gross domestic product, or between US$600 billion and US$1.5 trillion. In an unrelated study, conducted by John Walker (1999), the author provides an alternative estimate of money laundering of US$2.8 trillion. He does so by first estimating the numbers of crimes recorded by police in each country in each of eleven crime types, using data from United Nations Centre for International Crime Prevention database of recorded crime statistics, the UN Survey on Crime Trends, and the Operations of Criminal Justice Systems. The author then uses this model to estimate the total amount of money that is laundered within a country, or to a foreign country (per recorded crime). Such estimates are extrapolated for each country keeping accounts of corruption and income levels.

Other bribery estimates: US$1 trillion and higher

Further, and separately, a “Worldwide Bribe-Fee Commission in Tainted Procurement” was drawn from

External checks and validation

In order to obtain a reality check on these rough estimates, we searched the literature for existing estimates in related areas. There were no existing estimates of bribery worldwide, hence the search was broadened to estimates of related areas such as the unofficial economy, money laundering, and the like. For other proxies for corruption, or related to it, we did a literature and data review search, and provide calculations for the unofficial economy and money laundering, as well as other bribery estimates. For the size of the unofficial economy, we rely on studies by Schneider and Enste (2002) and Friedman et al. (2000). For money laundering, we use an IMF study (Camdessus, 1998), as well as a paper by John Walker (1999). And finally, for other bribery estimates, however unreliable, we look at the results of an online survey, and report on a recent survey of corruption in Russia.

Based on the Survey, and within each, under many different scenarios and assumptions about different degrees of “conservatism” in the data analysis. For instance, under many scenarios, instead of deriving the bribe share estimate from a firm by computing the midpoint in the survey questionnaire range questions, the initial point of each range, given as the option in the question was used.

Utilizing the 48 estimations derived by adding household bribery estimates to those for corporate bribery, based on the survey of firms from the WBES, we obtained an average bribery estimate of US$1.25 trillion (with a median value of US$1.18 trillion). If, instead of the WBES, we use an IMF study (Camdessus, 1998), as well as a paper by John Walker (1999), the author provides an alternative estimate of a similar trend in unofficial economy shares in the countries missing from the database. A higher estimate was drawn from Schneider and Enste (2002), who provide estimates of the shadow economy in 76 developing and developed economies. Their findings highlight a large shadow economy. For 21 OECD economies they estimated the size of the underground economy as having moved from US$2 trillion (12.7 percent of GDP) in 1989, to US$3.4 trillion (16.7 percent of GDP) in 2001. It should be noted, however, that many unofficial economy transactions are not necessarily corrupt, and, conversely, many bribes and corrupt transactions do not necessarily take place in the unofficial economy.

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Further, and separately, a “Worldwide Bribe-Fee Commission in Tainted Procurement” was drawn from
Appendix: The US$1 trillion estimate of worldwide bribery: Synthesis of the approach1 (cont’d.)

an online governance survey, carried out in 2003 by the World Bank Institute.4 The estimate was computed as the sum of the products of regional procurement figures (using 1998 worldwide procurement figures of US$5.5 trillion) and the associated bribe shares in procurement. The latter was derived directly from the survey results, using midpoints. The resulting estimate from this independent Web source is about US$1 trillion. It should be noted that this estimate focuses on one area of bribery, namely procurement. Particular caveats apply to this exercise, given margins of error, and potentially large sample biases (through voluntary surveys on the Web).

Finally, a new study estimating bribery in Russia (Satarov and Levin, 2005), if validated, would hint at a vastly larger estimate of worldwide corruption. The report estimated an annual bribe amount exceed US$316 billion, or 73 percent of Russian GDP. Even if figures such as these are, in fact, substantial overestimates, and the actual figure is much smaller for Russia, the implications for worldwide bribery would suggest a global estimate that may vastly exceed an annual figure of US$1 trillion.

Notes
1 A more detailed description is available from the author upon request.
2 Many variations of the base scenario were performed, and are described in detail in Kaufmann and Mastruzzi (2005).
4 See http://www.wbigf.org/hague/hague_survey.php3