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# AN ANTICORRUPTION READER:

SUPPLEMENTAL SOURCES ON TRANSPARENCY, ACCOUNTABILITY,  
PREVENTION, ENFORCEMENT & EDUCATION

**August 2005**

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**ABSTRACT**

Designed as a quick reference source, the Reader collects and summarizes key books and articles on corruption and anticorruption programs. It is intended to provide USAID field and headquarters staff, as well as USAID contractors and interested persons from other government agencies, with background analysis and information to deepen their understanding of the symptoms, causes, and effects of corruption, as well as successful strategies for attacking it.

**KEY WORDS**

Corruption, anticorruption, institutions, accountability, transparency, principal-agent theory, Europe, Eurasia, USAID, government integrity, governance, assessment, institutional reform, transition economies.

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# INTRODUCTION

## USAID'S ANTICORRUPTION STRATEGY

Over the past twenty years, members of the donor community have increasingly recognized that corruption — commonly (but not uniquely) defined as the abuse of public office for private gain — is a major impediment to economic development. As the new USAID Anticorruption Strategy (ACS) spells out, corruption reduces the efficacy of public service delivery (especially for the poor), puts democratic institutions at the service of privileged groups and individuals, impedes economic growth, and generally undermines efforts at achieving social, political, and economic development.

The ACS calls for development of a “new assessment methodology” to facilitate the planning of initiatives for addressing both high-level (“grand”) and low-level (“administrative”) corruption. It also calls for building knowledge about experience with anticorruption strategies. This *Reader* aims to contribute to both of these areas by providing interested readers with summaries of key writings on the diagnosis and analysis of corruption and on donor experiences with anticorruption programs.

## EXPERIENCE IN THE EUROPE & EURASIA REGION

This version of the *Reader* is oriented toward experience in the Europe and Eurasia (E&E) region, partly because it was prepared with the support and sponsorship of the USAID/E&E Bureau but also because of the pervasive integrity problems in the bureaucracies of most post-communist transition regimes — and by implication, those of the predecessor regimes. These problems became evident as extensive donor technical assistance programs were carried out after 1989; problems

affected not only the reforms aimed explicitly at the government, judiciary, and political life, but also programs dealing with the social and economic areas, where progress has often been hampered by the underlying unwillingness of civil servants and politicians to depart from long-standing patterns of clientelism, favoritism, bribery, and extortion. Aid strategies have had to be refashioned in order to start a process of reducing the incentives and opportunities for engaging in these practices.

## THE TAPEE FORMULA: TRANSPARENCY, ACCOUNTABILITY, PREVENTION, ENFORCEMENT, & EDUCATION

Corruption is a multi-headed hydra: more precisely, it is a word, perhaps overly used, that describes a multitude of corrupt practices — from the “speed money” paid to a local government clerk to expedite a routine permit to rake-offs by high-level federal officials responsible for approving large government purchases. Many government interactions with the public hold opportunities for corrupt transactions. In countries with high government integrity, these opportunities are countered by the presence of certain institutional factors that discourage corruption. These factors are summarized by

the TAPEE (*Transparency, Accountability, Prevention, Enforcement, and Education*) formula developed in the E&E Bureau to assist USAID Missions in planning effective anticorruption programs. TAPEE summarizes the characteristics needed if official decisions and transactions are to be free from corruption:

- **Transparency** refers to public availability of information about government decisions and participation of the public — directly, through delegated representatives, and indirectly through full reporting of results — in the processes of government decision-making.



## PLAN OF THE READER

- **Accountability** refers to the responsibility of government officials for doing their duty and their answerability to those to whom they report and ultimately those whom they serve. Accountability may be both horizontal (referring to checks and balances across government bodies) and vertical (referring to accountability vis-à-vis higher authority and the general public).
- **Prevention** refers to the elimination and control of corruption risk factors and vulnerabilities by means of institutional reforms that reduce corruption opportunities and align the

Since the absence of these institutional factors facilitates corrupt behavior, for which opportunity inherently exists, it is clear that building these factors must constitute the basis of an effective anti-corruption strategy. Nevertheless, to apply an anticorruption strategy in a well-targeted fashion, it is necessary to understand the form of corruption particular to the country and the type of government activity involved. To paraphrase Tolstoy, every corrupt organization is corrupt in its own particular way. For this reason, an anticorruption strategy must be built upon the proper diagnosis of corruption. Yet teasing a diagnosis out of the hidden, unreported realities of corrupt transactions is not always easy, as the selected summaries in this *Reader* illustrate.

The approach taken in this *Reader*, therefore, follows the medical analogy of diagnosis and prescription:

- Part I focuses on *diagnosis*, that is, analytical frameworks and empirical testing of hypotheses concerned with both the causes and/or consequences of corruption.
- Part II focuses on *prescription* — that is, anticorruption and integrity-building strategies. Included in the

incentives of government “agents” with the public they are supposed to serve.

- **Enforcement** refers not only to the police and judicial enforcement of criminal and civil law, but also to the setting and implementation of standards that ensure government integrity.
- **Education** involves both providing the public with information that raises their awareness of corrupt behavior in the government and inculcating citizens — beginning at the school level — with moral values that militate against corrupt behavior.

discussion are both general prescriptions (like Klitgaard's *Controlling Corruption*) and specific case studies.

Both diagnosis and prescription are broadly compatible with the TAPEE approach: diagnostic studies look for the *underlying causes* of the *lack of transparency, accountability, prevention and enforcement* — as well as cultural attitudes (related closely to education); while prescription tends to follow, even if sometimes using different (though related) concepts, major elements of the TAPEE approach.

The summaries of key books and articles on corruption and anticorruption programs contained in this *Reader* are intended to provide USAID field and headquarters staff, as well as USAID contractors and interested persons from other U.S. Government agencies, with background analysis and information to deepen their understanding of the symptoms, causes, and effects of corruption, as well as successful strategies for attacking it.

Each *Reader* item follows an identical format:

- author, title, and publishing information;

- a brief abstract (in italics);
- a summary of the text (concentrating on the elements of greatest relevance to corruption and integrity and to USAID); and
- a section on “policy implications,” that is, lessons for anticorruption strategies.

# I. DIAGNOSIS: TAXONOMIES, ANALYTICAL FRAMEWORKS, MEASUREMENT, & ANALYSIS

The “Diagnosis” portion of this *Reader* has five sections:

- **Empirical Overviews** summarizes several broad surveys of corruption, either worldwide or pertaining to the E&E region.
- **Definition and Typologies of Corruption** includes a survey of social-scientific analysis of corruption, and several articles that discuss the various types of corruption prevalent in the E&E region.
- **Causes and Determinants of Corruption** includes a broad sampling
- **Consequences and Costs of Corruption** summarizes both theoretical and empirical studies of the effects of corruption.
- **Measurement of Corruption and Integrity** adds to studies already covered in the “Overview” section and includes surveys of empirical studies that link corruption to different types of economic outcomes.

of the different approaches taken toward explanation of corruption by economists, political scientists, sociologists, and political economists.

## I.A EMPIRICAL OVERVIEWS: THE PICTURE OF CORRUPTION

The USAID Anticorruption Strategy, in comparing corruption levels among countries over time and examining changes over the past several years, uses one well-known measure, the Control of Corruption indicator developed by the World Bank. This indicator is also used as one of the eligibility criteria for assistance under the Millennium Challenge Account. This is, however, not the only available indicator of good governance, and it is of limited use in designing anticorruption programs.

This section summarizes broad, statistically based studies that allow inter-country comparisons of corruption. Two entries — the Transparency International (TI) corruption indicators (I.A.2) and the World Bank governance indicators (I.A.3) — are worldwide in scope. Two other entries — the *Nations in Transit* reports (I.A.1) and the *Anti-corruption in Transition 2* report (I.A.4) — concentrate on countries in the E&E

region. Most of these studies report on broad perceptions of corruption prevalent in entire societies: The exceptions are the *Anticorruption in Transition 2* report, which details the corruption faced by businesses in particular public agencies, and TI’s “Global Corruption Barometer,” which shows public perceptions about corruption in particular public bodies and agencies.

The most popular statistics used to compare corruption across countries — namely, the TI indices and the World Bank governance indicators — are based on averages of various surveys. Some are surveys of local citizens; others, of foreign business representatives and experts. Different bases of experience create a profound problem in inter-country and inter-temporal comparisons. That is, survey interviewees, especially local residents, typically base their responses on a set of values, experiences, and socioeconomic (not to speak of political) contexts that may

be substantially different from those of respondents in other countries, and from those of respondents at different times, as rapidly changing markets and institutional frameworks affect attitudes and expectations. The same problem of inter-temporal comparisons arises with surveys based on foreign business representatives and experts — although such surveys (compared to surveys of

residents) may achieve greater consistency of results across countries. Moreover, when comparing country outcomes, one should beware of attaching importance to differences in scores that may be statistically insignificant. Finally, while surveys of corruption are of interest, they tell us little about the characteristics and mechanisms of corruption in particular institutional contexts.

## I.A.1 Nations in Transit: 2003 and 2004 Editions

Freedom House (Adrian Karatnycky, Alexander Motyl, Amanda Schnetzer, eds.). *Nations in Transit 2003: Democratization in East Central Europe and Eurasia*. Lanham, MD: Rowman and Littlefield, Inc., 2003.

Freedom House. *Nations in Transit 2004: Democratization from Central Europe to Eurasia*. Lanham, MD: Rowman and Littlefield, Inc., 2004. Also available online at <http://www.freedomhouse.org/research/nitransit/2004/index.htm>.<sup>1</sup>

*Each year, Freedom House measures the gains and setbacks in the economic and political reforms of countries in Central and Eastern Europe and the former Soviet Union. Each edition provides an analysis of significant political and economic events and how the consequences of these events affect a country's scoring. Comparisons are provided to give the reader an overall understanding of changes in scores within regions and over a specific time period.*

1. The 2005 edition was released at the time this *Reader* was being finalized. As of mid-summer, it was available in hardcover, and certain results were available online.

Freedom House, a non-profit organization supported by USAID and the Open Society Institute, has been reporting on the democratic transition in Central and Eastern Europe and the countries of the former Soviet Union since 1995. Each edition is comprised of 27 country reports — the 2003 and 2004 editions cover the period January 1 to December 31 in 2002 and 2003, respectively. Each report summarizes survey results on the progress in, and impediments to, political rights and civil liberties. The survey produces country scores based on two main sets of factors:

- *democratization*: (1) electoral process, (2) civil society, (3) independent media, and (4) governance; and
- *rule of law*: (1) constitutional, legislative, and judicial framework, and (2) corruption.

A broad analysis of each country's progress in democratization and rule of law yields a set of ratings for each factor (1 the best, 7 the worst). Ratings reflect the opinions of country report authors, a panel of academic advisers, and Freedom House staff. These opinions are elicited through answers to a checklist of questions created by Freedom House staff (provided in the 2003 edition). A number of the questions are quite broad, and answers to them are necessarily based on subjective judgments. Ratings given for each of the six sub-factors are based on a broad set of policy and practice criteria (also included in the 2003 edition). The country's democratization and rule of law scores are based on these ratings. Information for each country report comes from various sources, including nongovernmental organizations, government data, media, multilateral lending institutions, and other international organizations.

The 2004 edition introduces a new democracy score — an average of the ratings for all 6 categories listed above. This new aggregate is provided for comparative and interpretive purposes

to assist in evaluating the progress and obstacles faced by the countries being studied. Using the 1–7 scoring scale, Freedom House now groups democracy scores according to these respective regime types:

Democracy Score	Regime Type
1–2	Consolidated Democracy
3	Semi-Consolidated Democracy
4	Transitional Government or Hybrid Regime
5	Semi-Consolidated Authoritarian Regime
6–7	Consolidated Authoritarian Regime

**2003 Edition.** This volume provides ratings and scores for each country and for regional trends in reform since 1997. Not surprisingly, scores vary widely among the countries — from democratization scores of less than 2 for the Baltic countries and other early EU entrants to 6 or 7 for Belarus, Kazakhstan, Turkmenistan, and Uzbekistan. The rule-of-law scores show a similar pattern, although with a slightly smaller dispersion.

Each of the country reports provides a wealth of detail for each of the four democratization and two rule-of-law factors, providing a review of the country's political and economic history as well as an overview of recent significant developments. A helpful chapter in the beginning of the volume gives the reader a quick summary of the major setbacks and gains in country scoring in 2003, with more detailed information on regional trends and future outlooks.

In addition, the 2003 edition includes two articles. The first article, "Western Conditions and Domestic Choices: The Influence of External Actors on the Post-Communist Transition," by Alexander Cooley focuses on the substantial (if in some cases waning) influ-

ence of “Western” institutions and conditions on post-communist transition. These “Western actors” were found to have more influence on those countries that were committed to significant reforms at the beginning of their transition into democracy (such as the Central European and Baltic states); this was due to such factors as reaction to communist culture, geographic factors, and an active civil society. Conversely, those countries that were entrenched in “Soviet-era” policies such as top-down patronage networks and corrupt bureaucracies had difficulty transitioning even if they actively courted Western actors. The scores of many of these countries continue to hover at the same level as in the early 1990s. In contrast, the influence of NATO and the European Union on Southeastern European countries has steadily improved those countries’ scores.

The second article looks at the impact of the war on terrorism in Central Asia and the Caucasus, focusing on the efforts by the U.S. and Uzbekistan to fight terrorism as well as on the increasing need for a firm U.S. commitment to address the development issues facing this area. In “Central Asia and the Caucasus: The Impact of the War on Terrorism,” Fiona Hill writes that September 11, 2001, put Central Asia on the “map of America’s world,” particularly Uzbekistan because it was significantly affected by the U.S. war against insurgent Islamic forces in Afghanistan and became a target of terrorist activities in Central Asia. The U.S. effort brought increased border security to the area, but did little to encourage positive change in political and economic development in the region. On the contrary, the war on terrorism only encouraged Uzbekistan to continue to stifle domestic political opposition, using the threat of terrorism to repress political opposition in the name of security. The article concludes that U.S. intervention in Central Asia should continue, but should

not focus entirely on military intervention: a crucial element for success is a long-term commitment to peaceful transfers of power and political development, primarily within Uzbekistan.

**2004 Edition.** Not surprisingly, the democracy scores listed in the 2004 edition do not significantly differ from most scores listed in the 2003 edition, particularly for the Central Asian nations. Averages are presented for three main regions: “New EU Members,” “Balkan Countries,” and “Non-Baltic Former Soviet Union.” New EU members continued to score the best, with their average score improving from 2.04 in 2003 to 2.01 in 2004. The average score of the Balkan countries also continued to improve, although their average score of 3.84 is significantly higher (worse) than that of the EU nations. The non-Baltic former Soviet states continued to score poorly — their average score declined from 5.57 in 2003 to 5.66 in 2004. These countries, including Belarus, had the poorest scores (6.88 for Turkmenistan) and are grouped as “consolidated authoritarian regimes.” In contrast, the group with the lowest (best) scores (1.75 for Poland and Slovenia) are labeled as “consolidated democracies.”<sup>2</sup>

The rest of the volume consists of the 27 country reports, each listing previous ratings for all 6 categories dating back to 1997. Each report includes an executive summary, plus separate sections for each *Nations in Transit* category, giving more in-depth information on the progress and setbacks that occurred within the past year.

**Policy Implications.** The authors of the 2003 edition express the view that donor programs should continue to focus on developing and supporting the electoral processes, independent media, governance, and anticorruption programs in those countries with the

2. The online summary for the recently issued 2005 edition shows that average democracy scores improved for the Balkan countries, deteriorated for the non-Baltic Former Soviet states, and were nearly unchanged for the new EU members.

poorest democracy scores. It is apparent that EU member countries have already accomplished much of the reforms within legal institutions and electoral processes needed to become consolidated democracies, and that the semi-consolidated democracies in the Balkans are also progressing, but the former Soviet states and Central Asian countries continue to repress

fair elections and independent media; indeed, recent scores show a worrisome backsliding in Russia. For these latter countries, capabilities in good governance need to be developed. Policymakers must find a way to balance the military interventions required by the war on terrorism with political and economic institutions in this area of the world.

## I.A.2 Transparency International: Global Corruption Report

Johann Graf Lambsdorff, "Corruption Perceptions Index 2003," and Transparency International, "Global Corruption Barometer 2003." In *Global Corruption Report 2004*. London and Sterling, VA: Pluto Press, 2004.

*Two brief articles outline the background and findings for prominent indicators of corruption produced by Transparency International. The first article, by Johann Lambsdorff, details the newest installment in the yearly Corruption Perceptions Index. The second article, by Transparency International staff, details a new survey of public opinion on corruption in 47 countries. The Global Corruption Barometer offers a more in-depth view of how corruption is perceived to influence many aspects of society.*

### *Corruption Perceptions Index.*

Transparency International has published the Corruption Perceptions Index (CPI) annually since 1995, providing ample data for those researching corruption. The 2003 update is distinguished by expansion of the index to 133 countries from 102 the previous year. The index is a composite measure of seventeen data sources, each comparing overall corruption levels among countries, from thirteen organizations:<sup>3</sup>

- The World Economic Forum
- The Institute of Management Development (in Lausanne)
- The Economist Intelligence Unit
- Information International (Beirut)
- World Markets Research Centre (London)
- Gallop International (for TI)
- Freedom House, *Nations in Transit*
- PricewaterhouseCoopers
- Political and Economic Risk Consultancy (Hong Kong)
- World Business Environment Survey (World Bank)
- Columbia University
- A multilateral development bank
- Business Environment and Enterprise Performance Survey (European Bank for Reconstruction and Development and World Bank)

A CPI value is intended to capture "an annual snapshot of the views of decision-makers" on corruption in a particular country. A country is included in the CPI if it is found in three or more of the seventeen original sources; some prominent countries are found in more than ten rankings. All these sources represent views of "well-informed people" and "decision-makers" — often outside business representatives and experts,

but in some cases domestic business representatives. Despite these differences, surveys containing domestic viewpoints were found to correlate well with surveys that poll expatriates.

Transparency International also provides 90 percent confidence intervals for each country's score to reflect measurement precision; from these confidence intervals, it concludes that rankings based on the CPI are possible for most countries in the sample. Other statistical support for the CPI approach is the strong correlation among the underlying indices and also between the views of residents of a country and its expatriates. Nevertheless, year-to-year changes in a country's score reflect changing samples and methodology, not just changing perceptions of corruption.

**Global Corruption Barometer.** The Global Corruption Barometer (GCB) is distinct from, but complementary to, the Corruption Perceptions Index. Unlike the CPI, the GCB is based on the opinions of the general public (nearly 41,000 people in 47 countries were surveyed), not the perceptions of decision-makers. It goes beyond an overall ranking of corruption to investigate how corruption influences various facets of a society and different income groups, and how corruption levels are changing over time.

The results indicate that public attitudes do not necessarily correlate with corruption levels as measured in the CPI. Three results stand out from the inaugural survey. First, when asked in which institution they would most like to see corruption abolished, survey participants most often respond "political parties" (30 percent), followed by "the courts" (14 percent) and "police" (12 percent). Second, respondents with low incomes are significantly more likely to report that corruption has a "very significant effect on their personal and family life"

3. The Corruption Perceptions Index 2004, which was issued shortly before this *Reader* was finalized, expands coverage of the index to 146 countries. There are also a few changes in the organizations providing data sources.



than those with higher incomes. Finally, the general public is pessimistic about how corruption levels are trending over time. Of those surveyed, 47 percent think corruption has increased in the past three years, while roughly 10 percent think it has decreased. When asked about the next three years, 42 percent expect corruption to increase, while 20 percent take the opposing view. If Transparency International repeats this survey in the future, as it hopes, the GCB will provide another valuable resource, in addition to the CPI, for those researchers investigating corruption.

***Policy Implications.*** The CPI and the GCB can be used by policymakers to identify which countries and institutions appear to be in most need of further scrutiny in anticorruption efforts. Nevertheless, care should be used in interpreting the results of surveys based on perceptions. Changes in the CPI score and ranking of a country over time do not necessarily indicate that the level of corruption in a country has changed in the same direction; nor does popular desire to remove corruption in a particular institution mean that other institutions are not corrupt or even less corrupt.

### I.A.3

## World Bank

### Governance Indicators

(1) Daniel Kaufmann, Aart Kraay, and Pablo Zoido-Lobaton. *Aggregating Governance Indicators*. Policy Research Working Paper No. 2195. Washington, DC: World Bank, October 1999.

(2) \_\_\_\_\_. *Governance Matters*. Policy Research Working Paper No. 2196. Washington, DC: World Bank, October 1999.

(3) \_\_\_\_\_. *Governance Matters II: Updated Indicators for 2001/01*. Policy Research Working Paper No. 2772. Washington, DC: World Bank, February 2002.

(4) Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi. *Governance Matters III: Governance Indicators for 1996–2002*. Policy Research Working Paper No. 3106. Washington, DC: World Bank, June 2003.

(5) \_\_\_\_\_. *Governance Matters IV: Governance Indicators for 1996–2004*. Policy Research Working Paper No. 3630. Washington, DC: World Bank, June 2005.

*In this series of five papers, Kaufmann, Kraay, and their collaborators combine governance indicators from several different surveys to produce six aggregate measures of governance. Items (3), (4), and (5) update and extend the results presented and explained in (1) and (2).*

**The Need for Indicators.** Since the 1980s, there has been growing interest in “good governance” and “corruption.” But these are broad terms whose meanings are unclear. Scholars and the policy community need more precise definitions and measurements of the institutional characteristics and outcomes that underlie these broad concepts. A team in the World Bank has broken the “governance” concept into six separate areas and constructed an indicator for each:

- voice and accountability,
- political stability,
- government effectiveness,
- regulatory quality,
- rule of law, and
- control of corruption.

**Data Sources.** The measures of governance explained in these papers are based on a number of sources — listed in detail in the *Governance Matters* papers — that measure corruption or positive governance characteristics either by expert assessments (referred to in the papers as “poll of experts”) or surveys of firms or households. Expert assessments are designed for cross-country comparability and have some related advantages. Surveys generally cover a range of topics and may have one question on corruption; some surveys — like those designed by the World Bank — have several corruption questions.

**Basic Methodology.** These studies assume that there is an underlying true value for each country of the relevant governance variable (for example, control of corruption) that can only be imperfectly

measured. For example, the International Country Risk Guide (ICRG) measure of corruption (popularized by IRIS as ICRG but now called PRS, for Political Risk Services) is an imperfect measure of the true value of corruption. The papers use a statistical technique to estimate a “best guess” of the true value, the errors associated with each particular measure of corruption, and the authors’ estimate of the error with which the “best guess” is estimated. The larger the number of sources available for each country and the lower the calculated errors for each of these sources, the lower the authors’ estimate of the error with which governance in that country is measured.

**Standard Deviations.** Despite optimistic assumptions, these studies find that the standard deviations on their “best guesses” are large enough that more than half of the countries cannot be confidently ranked either above or below the mean of the distribution (around 40 lie clearly below the mean and around 30 lie clearly above in a sample of 154). In applying a more demanding test of whether a country can be ranked with confidence as either better or worse than most other countries, the studies find it can be done only for approximately 20 countries.

**Tracking Changes in Governance.** Errors in measurement also make it difficult to track progress in governance in these countries. Such an exercise is explicitly tried in *Governance Matters II*, but the authors can state with confidence only that there were improvements in 5 countries and a worsening in another 5. In *Governance Matters III*, which updates the findings to 2002, the authors find that “the evidence is suggestive of deterioration, at the very least in key dimensions such as control of corruption, rule of law, political stability, and government effectiveness.” In *Governance Matters IV*, the authors provide a stronger basis for assessing statistical changes in governance over time; they argue that while

the quality of governance in a number of countries has changed both for better and for worse, there are no discernible trends in global averages of governance.

*Policy Implications.* The indicators developed by the World Bank team have become a popular source of data for those who wish to explore cause-and-effect relationships between governance and various economic and social outcomes, as well as for donors wishing to find confirmation for the effectiveness of the programs they support. While the data are certainly of great interest, one should be cautious in making inferences based on small differences among countries in indicator magnitudes, which (as the creators of the indicators clearly explain) are statistically insignificant over quite broad numerical ranges. For example — as clearly explained in *Governance*

*Matters III* — it is not legitimate to use the median point of the corruption indicator to separate those eligible from those ineligible for Millennium Challenge Account funds when there is in fact no statistically significant difference between the countries just under and those just over the median. However, the finding in the most recent report, *Governance Matters IV*, that overall global governance does not appear to have improved, and in some countries has in fact declined, lends greater urgency to donor interventions and government efforts to improve governance, especially since good governance seems to be a stronger causal factor in improving income than income is in improving governance. In other words, improving income is not enough to ensure better governance; efforts have to be specifically focused on improved governance itself.

## I.A.4 Anticorruption in Transition 2: The Second of Two Surveys

Cheryl Gray, Joel Hellman, and Randi Ryterman. *Anticorruption in Transition 2: Corruption in Enterprise-State Interactions in Europe and Central Asia, 1999–2002*. European Bank for Reconstruction and Development and World Bank, 2004.

*This report details the second installment of a large survey on corruption in the transition countries of Europe and the Central Asian region conducted in 2002. Utilizing the survey responses of more than 10,000 businesses, the authors delineate patterns in corruption between firm and state since 1999 and investigate what factors could be driving these patterns.*

**Background and Methodology.** The initial installment of the business survey, or the Business Environment and Enterprise Performance Survey (BEEPS), was conducted jointly by the World Bank and the European Bank for Reconstruction and Development in 1999. Its results were widely discussed and gave impetus to a follow-up survey, BEEPS2, in 2002. The questions in both surveys examine various facets of corruption as perceived and experienced by businesses in their interactions with the state.

Respondent firms are asked to rank how much of an obstacle corruption is to firm performance and whether state capture has a direct impact on their firm. In addition, they are asked multiple questions about bribery behavior at “firms like yours.” How frequently are bribes paid to the state? This includes both a question on the general level of bribery and questions on bribes in particular state activities — tax administration, regulations, public utilities, customs, etc. — including those made to influence legislation or rules (state capture). How large are total bribery payments as a percentage of revenues (bribe tax)? The corruption responses are then aggregated by country. A respondent firm is also asked to what extent macroeconomic instability hampers its performance; the authors regress this answer on actual macroeconomic instability to gauge the relative optimism or pessimism of the firm’s manager:

**Corruption Trends across Time and Countries.** For questions allowing comparison between the 1999 and 2002 surveys, corruption trends are mixed but somewhat encouraging. Corruption has become less of an obstacle to firm performance in ten of the twenty-four countries; the opposite is the case in only two countries. Nine countries report a lower frequency of bribes in general versus three countries reporting a higher frequency. However corruption

remains an important element of the business environment, ranking in the “top third of business obstacles” in more than half of the countries. Meanwhile, the share of firms engaged in state capture is on the rise. Eight countries experience a statistically significant, and often sharp, increase in this share from 1999 to 2002; only two countries can claim a decrease.

The survey results also allow comparison of corrupt behavior by geographical region. Bribery is most frequent in the countries of the Commonwealth of Independent States (CIS) and South-eastern Europe (SEE). The perceived impact of state capture is also highest in SEE. By contrast, the countries of Central and Eastern Europe have moderate levels of both bribe frequency and state capture.

The authors explore possible factors explaining cross-country patterns in the 1999 and 2002 results. Firm characteristics prove statistically significant; private, small, and young firms are more ensnared in corruption. Better institutions, as measured by a composite index of eight policy and institutional indicators, are associated with less frequent bribes, a lower bribe tax, and lower perceptions of corruption as a business obstacle. Finally, countries whose managers are more optimistic about macroeconomic stability witness lower levels of all broad measures of corruption.

**Policy Implications.** An important policy use of the BEEPS data is disaggregating responses to questions about bribes to pinpoint those government activities where corruption is worst. This could assist donors in targeting scarce assistance in areas where the economic impact of corruption is especially harmful. Moreover, periodic repetition of the survey permits monitoring the effect of reform efforts aimed at improving government integrity.

## I.B DEFINITIONS & TYPOLOGIES OF CORRUPTION

In the USAID Anticorruption Strategy document, corruption is defined as “the abuse of entrusted authority for private gain.” This is a broad definition that encompasses not only corruption involving abuse of public office but also various types of corruption within the private sector — like a bank president misusing bank funds for his personal gain. In practice, USAID and other donors tend to focus especially on public sector corruption; in that context, the ACS defines “*grand corruption*” and “*administrative corruption*” as the two major categories of public sector corruption. This simple dichotomy summarizes a wide range of behaviors, listed exhaustively in *Thomas and Meagher (I.B.1)*. The many types of corruption they define suggest that the distinction between grand and administrative corruption may sometimes be unclear. The authors also point out that the typical definition of corruption in terms of the use of public office for private gain assumes a society where there is a clear delineation between the public and private spheres — for example, “Western”-style political institutions and public morality.

*Corruption has taken on distinctive forms in post-communist transition countries. Karklins (I.B.2) presents a comprehensive typology of corruption in transition countries, distinguishing between “low-level administrative corruption,” the bribes and occasional extortion that are commonly experienced by ordinary citizens, and “state capture,” which refers to the interactions between business representatives and government officials for mutual gain. The author shows how these types of corruption emerged from systemic features of the previous communist regimes.*

A further type of corruption in Karklins’ typology, *asset stripping* by officials, refers both to illegal private expropriation of public assets and to abuses that

occurred during the process of privatizing state-owned firms. These abuses are further discussed — with reference to Russian experience — by *Black, Kraakman, and Tarassova (I.B.3)*, who show how *private corruption* (such as self-dealing by insiders) was intertwined with *public corruption* (such as well-connected officials using the state budget to acquire interest in companies and rigging auctions so they and their friends can buy major companies for a fraction of their value).

The nexus of business and government in transition countries is further explored by a team of World Bank economists (*Hellman, Jones, and Kaufmann, I.B.4*), who focus on ways in which firms seek to obtain advantages for themselves from the state. The authors define three methods for accomplishing this: *state capture*, or affecting the formulation of laws and regulations through payments to public officials and politicians; *influence*, or accomplishing the same without recourse to payments; and *administrative corruption*, or bribery in connection with the implementation of laws, rules, and regulations. Data from the BEEPS survey (*I.A.4*) are used to show the degree of “capture” that occurs in the transition countries.

Transition countries are not unique in the role played by corruption in the business-government interface. The important World Bank study, *Doing Business in 2004 (I.B.5)*, is concerned primarily with the inefficiencies of business regulation by government in most developing and transition countries: corruption plays a marginal role in this report. But implicitly, the report demonstrates the many opportunities for corrupt exchanges by over-bureaucratized, inefficient, and costly processes created for carrying out certain business transactions.

## I.B.1 Analytical Approaches in the Corruption Literature

Melissa A. Thomas and Patrick Meagher. "A Corruption Primer: A Policymaker's Overview of Concepts in the Corruption Literature." In IRIS Center, *The Corruption Nexus and the People's Republic of China*. College Park, MD: IRIS Center, 2004, pp. 29–70.

*This survey article provides a critical overview of some of the key ideas regarding corruption from the literatures of political science, political economy, and economics. The authors discuss the conceptual problems related to definitions, typologies, measurement, and dynamics of corruption, making a key distinction between "individualist" and "structuralist" approaches to analyzing corruption phenomena.*

**Definitions and Causes.** Definitions of corruption vary across the literature. The most common definition is "the use of public office for private gain." This definition encompasses a wide range of behaviors that include embezzlement, self-dealing, and selective law enforcement. The common definition of corruption may include legal acts, such as the Ugandan law that allows public officials to use the resources of the office for re-election campaigns. One criticism of the commonplace definition is that it exclusively focuses on behavior of government officials, omitting corruption in the private sector. The common definition, by assuming a clear delineation between the public and private spheres, implies the existence of "Western" political institutions and public morality.

The causes of corruption can be divided into two categories: *structural* and *individualist*. *Structural factors* include the legitimacy of the political regime, history, culture, values, norms, and loyalties. *Individualist factors* include the incentives that lead individuals to engage in corrupt acts.

*Structural causes* include the lack of certain political prerequisites for governmental integrity: the existence of a government, a population ruled by a government, a clear distinction between the private and public sectors, and an established norm that public office should be used for public purposes. Other structural factors that limit corruption include a hard budget constraint, limits to the size of the public sector relative to the private sector, and a strong system of checks and balances. Each of these factors affects the ability of public officials to engage in corrupt acts.

Analysis of *individualist causes* focuses on the incentives that public officials and private agents face. Punishment of corrupt agents and the provision of positive incentives such as higher salaries help to encourage honesty by public officials. These factors influence

the cost-benefits analysis of a potentially corrupt public official.

**Typologies of Corruption.** Due to the large number of activities associated with corruption, typologies of corruption offer a way to better understand the effects of corruption. The dichotomy between *systemic* and *individual* corruption directs attention to the industrial organization of corruption. Systemic corruption involves the compromising of public institutions. Individual corruption represents an act by a deviant individual. The distinction between *grand* versus *petty* corruption focuses on corrupt acts by high-level officials in contrast to that carried out by low-level administrators. *State capture* versus *administrative corruption* highlights the difference between corruption of politics and public institutions and that associated with the daily, local implementation and enforcement of specific policies.

**The Dynamics of Corruption.** Most models of corruption focus on the theoretical, static consequences of corruption. One notable exception is Michael Johnson (see I.C.2), whose analysis suggests that the economic and political balance of society shapes corruption trends. An imbalance, such as rapid economic or social change, alters the extent of corruption. If the political and economic agents expect each other to engage in a corrupt act to protect their interests, the new balance of forces will have a higher level of corruption than the previous balance. Once the new level of corruption is reached, reducing it becomes increasingly difficult. One possible mechanism to reduce corruption is to alter the normative basis of the political and economic balance. For example, if public officials alter their behavior, then individuals may change their perceptions of the legitimacy of corrupt acts.

**Measurement of Corruption.** Measuring corruption is inherently difficult, since corruption involves private, often illegal acts, and typically goes unrecorded and

unrevealed. Good financial records allow for better detection of corruption, but in many developing countries records are of poor quality or even non-existent. Surveys that attempt to measure corruption suffer from major drawbacks; for example, the survey may focus on specific types of corrupt acts at the expense of other types, and certain forms of corruption may simply not appear in the survey results. Another example of the limits of surveys is that surveys may focus on the perceptions of the general public, which are affected by media exposure of corrupt acts; but media coverage itself may reflect freedom of the press rather than the extent of corruption.

***Policy Implications.*** The main conclusion of the authors in the policy area is to

sound a skeptical note. They argue that the standard policy recommendations found in the literature — promoting competition within the government and the marketplace, improving monitoring, increasing government salaries, reducing discretion of government officials, and generally strengthening institutions that check government from within and without — may find limited success in systemically corrupt environments. “Aside from a few successes that have become iconic — like the cleanup of Hong Kong under the Independent Commission against Corruption — it is not clear to what degree these interventions have been successful, or whether we have data that would allow us to determine which interventions have been successful.”

## I.B.2 Post-Communist Corruption

Rasma Karklins. "Typology of Post-Communist Corruption." *Problems of Post-Communism*, Vol. 49, No. 4 (2002).

*Post-communist corruption has many sub-types and its influence on state institutions can vary among countries. There are, however, basic features that are evident across the region, indicating that corruption is rooted in the systemic features of previous regimes as well as in the transition process. This article describes the typology of corruption and ranks corrupt practices in terms of their political costs.*

Many post-communist countries have fallen victim to "state capture," a situation in which the misuse of public power is so widespread that corruption represents a hidden political arena. The author uses Transparency International's definition of corruption: "the misuse of public power for public gain," but adds "at the expense of the public good." It is not the type of corrupt act itself, but the consequences of the act on state institutions, that is significant. There can be serious and often hidden consequences to corruption, particularly for economic and political development. The author presents a typology of three forms of institutionalized corruption: low-level administrative corruption, asset stripping by officials, and state capture by corrupt networks.

### **Low-Level Administrative Corruption.**

In instances where individuals pay bribes to be seen by a doctor more quickly, the political consequences are minimal and the health care system is only indirectly undermined. In instances where groups of police officers organize themselves to systematically demand bribes for obtaining driver's licenses, both the rule of law and public safety are directly undermined, and corruption becomes institutionalized, because the official rules are discarded in favor of a de facto set of practices.

Overregulation, disorganization, and deliberately hiding rules and regulations create other opportunities for officials to demand bribes to cut through bureaucratic red tape. Corruption thrives on disorganization and gives offenders the opportunity to hide their illicit behavior. Officials often coalesce to make the bureaucracy more difficult to navigate, in order to prevent reformers from cleaning it up and reforming its culture.

**Asset Stripping by Officials.** Public officials have found many ways to divert public funds and mismanage public assets for personal gain through the privatization process, as well as through the contin-

ued management of public goods. A common strategy is the use of a hidden "second budget" that is often much larger than the official agency budget, and is used to divert money from the agency's official coffers. Public money also funds "second salaries" and large bonuses, used for personal gain and to enforce collusion and compliance. "Second salaries" are offered at a supervisor's discretion and are arranged through confidentiality agreements signed by the supervisor and employee, indicating that all involved are aware of the corrupt implications of their actions.

The misuse and abuse of public assets can have long-term consequences. A common occurrence has been the exploitation of natural resources for profit. Clear-cutting vast areas of forest or illegally dumping nuclear waste and side-stepping environmental regulations have significant implications for the common good and future generations.

The privatization process has been most corrupt in cases where officials have organized themselves in such a way that they personally benefit from a climate devoid of public scrutiny or open-market competition. Extracting spoils, rents, and tributes tends to be systematic, since formal rules must be repeatedly broken down over a long term in order for extraction to work. To continue the profiteering, offenders must learn to effectively cover up their actions and entice others to become involved in their deceptions. Corruption is so rooted in most institutions, one has little choice but to be involved, particularly with regards to nepotism and job appointments. Candidates who may favor reform and accountability in government are likely to be rejected for positions, while an "old-comrades" network protects those already in key positions. The threat of losing a position can also force officials into becoming involved in corruption schemes. Misdirecting public assets is not only harmful to the public good, but also allows a



hidden political regime to be substituted for the formal one being destroyed.

**“State Capture” by Corrupt Networks.**

High-level political corruption can establish a hidden political regime that is at odds with the constitutional purpose of state institutions. In cases where an entire institution has been redirected for the benefit of certain business or criminal activity, this state capture has more than likely spread to other similar institutions. This high level of corruption makes it difficult to prove and to fight, given the influence criminal networks have on critical points in the institution.

Limited political competition is further evidence of high-level state capture. Using old-comrade networks and *nomenklatura* to stymie competitiveness is a corrupt practice that can seriously stunt political development. Political elites who survived the transition from communism continue to combat “counter-elites” for power and are strongly motivated to do so in order to retain their influence and discourage reform. The *nomenklatura* had a distinct advantage in the first years of the post-communist period since alternative social networks did not exist during communism, so this type of behavior is deeply rooted in the transition of not

just the political processes but also the privatization of assets and capital goods. State leaders have openly encouraged corruption as a way to gather compromising material on their subordinates, which has then been used for political blackmail. Corrupt networks of officials and politicians remain intact because of the use of mutual blackmail.

**Policy Implications.** Corruption involves all sectors of government — administrative, judicial, and legislative. The squandering of public accountability leads to mistrust of public officials and a loss of civic-mindedness and civil service, both of which are crucial for good governance. This typology of corruption offers a way for analysts to understand the nature, context, and political implications of post-communist corruption and therefore can help to make promising strategies and research for combating corruption successful. Analysts tend to focus on the private gain part of the definition of corruption, but it is the meaning and the consequences of the misuse of power that matter. Corrupt acts and their effects on the political system and public institutions should be studied in three ways: the economic burden of the corrupt act, its institutional aspects, and its consequences for the polity.

### I.B.3 Corruption in Privatization: The Russian Case

Bernard Black, Reinier Kraakman, and Anna Tarassova. *Russian Privatization and Corporate Governance: What Went Wrong*. Working Paper No. 178. Stanford, CA: Stanford Law School John M. Olin Program in Law and Economics, 1999.

*The lack of transparency and accountability can damage an otherwise worthwhile economic reform, allowing those with special access to information to manipulate reform processes to their own advantage. The massive privatization of the Russian economy implemented in the 1990s is a case in point, showing that the TAPEE components (transparency, accountability, prevention, enforcement, and education) must be built into institutional reforms if the latter are not to yield perverse results.*

According to the authors of this paper, transferring property rights over Russia's industrial firms to private owners without first supplying the necessary institutional foundations, including enforceable corporate governance and oversight laws, has been a major policy misconception and miscalculation. As a result of this error, those who acquired controlling stakes in privatized firms resorted to asset stripping and other "skimming" practices. Instead of maximizing firms' values, insiders preferred to extract their values and stash the proceeds at offshore "safe havens."

*Private and public corruption was rampant and intertwined in this process. Patterns of private corruption included insiders' "self-dealing," abuse of agency relations vis-à-vis minority shareholders and other outsiders, and neglect of fiduciary duties. Public corruption allowed the initially cash-constrained but well-connected "kleptocrats" to tap the state budget for "down payments" for crown jewels of the Russian economy, and afterwards to rig privatization auctions to leverage the initial wealth by buying major companies for a fraction of their values.*

*Private and public corruption in Russian privatization was mutually reinforcing. The dubious legality of unscrupulous acquisitions and business practices made the kleptocrats dependent on corrupt officials and politicians as sources of support and protection against criminal investigation — private corruption was therefore a breeding ground for public corruption. "In a vicious circle dirty privatization ... reinforces corruption ... as new owners (some already with Mafia ties) turn their new wealth to the task of bribing judges and government officials." Conversely, corruption in the public sector — including the tax service, regulatory agencies, and law enforcement — made conventional profit- and value-maximizing business behavior less appealing to enterprise insiders than was asset stripping, which provided de facto insurance against*

institutional uncertainty and predatory bureaucracy. The authors point out that "benign" bribery was deliberately built into the design of the Russian privatization program as a means to overcome the opposition to privatization by stakeholders whose consent was of critical importance. "The political solution was to bribe [enterprise managers] with enough cheap shares so that they would pursue privatization voluntarily."

The authors ascribe the failure of this approach, at least in the short-to-medium run, in part to the unwillingness of Russian society to accede to a privatization that it associates with massive corruption and theft. However, the biggest disappointment has been a lack of interest among the new private owners in enactment and enforcement of laws and regulations essential for an efficient private property rights regime. The key argument in support of implementing a sweeping privatization program in the early 1990s, before the necessary legal and regulatory groundwork had been laid, was that demand for secured property rights would ensue once firms were transferred to private owners.

*Bets on post-privatization grassroots demand for secured property rights proved wrong. "That emphatically did not happen. Instead, company managers and kleptocrats became powerful opponents of efforts to strengthen the capital market laws and opponents of better enforcement of those laws. ... The early absence of a legal and institutional framework to control insider self-dealing contributed to a downward spiral into dishonesty and theft." The authors caution that any counterfactual analysis would be hypothetical and lacking evidence to support the claim that a "rules come first" strategy would have produced a better outcome. However, they found ample evidence that under a strategy whereby privatization precedes rules, "bad, politically powerful owners reinforce corruption and create pressure for weak rules and weak enforcement!"*

***Policy Implications.*** The paper stresses the need for an attack on corruption and organized crime as a prerequisite for privatization and for pro-active

efforts to build “strong enforcement institutions before privatized businesses could become supporters of the corrupt status quo.”

## I.B.4 The Role of State Capture in Transition Countries

Joel S. Hellman, Geraint Jones, and Daniel Kaufmann. *Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition*. Policy Research Working Paper No. 2444. Washington, DC: World Bank, September 2000.

*The authors note at the outset that while the main challenge of the transition has been to redefine how the state interacts with firms, little attention has been paid to the flip side of the relationship: how firms influence the state — especially how they exert influence on and collude with public officials to extract advantages. Some firms in transition economies have been able to shape the rules of the game to their own advantage, at considerable social cost, creating what the authors call a “capture economy” in many countries. In the capture economy, public officials and politicians privately sell underprovided public goods and a range of rent-generating advantages “a la carte” to individual firms.*

The authors define three ways in which firms seek to obtain advantages for themselves from the state:

- *state capture*: firms shaping and affecting formulation of the rules of the game through private payments to public officials and politicians;
- *influence*: doing the same without recourse to payments; and
- *administrative corruption*: bribery in connection with the implementation of laws, rules, and regulations.

The authors then develop economy-wide measures for these phenomena, using firm-level data from the 1999 Business Environment and Enterprise Performance Survey (BEEPS), which permits the unbundling of corruption into meaningful and measurable components. These measures make it possible to distinguish between “low-capture countries” and “high-capture countries.” The former include the more rapidly reforming countries of Central Europe and the Baltic, as well as a few of the least politically and/or economically transformed countries (Albania, Armenia, Belarus, Kazakhstan, Uzbekistan); the high-capture countries include most other countries in the Commonwealth of Independent States, plus a few in the Balkans. Nevertheless, the authors are careful to point out that corruption in one form or another is present to some degree in all these countries. One should also bear in mind that the BEEPS survey focused on small and medium-size firms, thus generally leaving out the “oligopolists” whose influence over the state is often greatest (for example, in Russia).

State capture, influence, and administrative corruption are all shown to have

distinct causes and consequences. Large incumbent firms with formal ties to the state tend to inherit influence as a legacy of the past and tend to enjoy more secure property and contractual rights and higher growth rates. To compete against these influential incumbents, new entrants turn to state capture as a strategic choice — not as a substitute for innovation but to compensate for weaknesses in the legal and regulatory framework. When the state under-provides the public goods needed for entry and competition, “captor” firms purchase directly from the state such private benefits as secure property rights and removal of obstacles to improved performance — but only in a relatively high-capture economy.

Consistent with empirical findings in previous research, administrative corruption — unlike both capture and influence — is not associated with specific benefits for the firm. The authors imply that firms that find themselves requiring the benefits arising from administrative corruption are those that have not been able to avail themselves of possibilities for state capture or influence.

*Policy Implications.* A major conclusion of this paper is that the focus of reforms should be shifted toward channeling firms’ strategies away from current illegal or illegitimate forms of rent seeking toward more legitimate forms of influence, involving societal “voice,” transparency reform, political accountability, and economic competition. Where state capture has distorted reform to create (or preserve) monopolistic structures supported by powerful political interests, the challenge posed by such reform is particularly daunting.

## I.B.5 Doing Business in 2004

World Bank (Simeon Djankov et al.). *Doing Business in 2004: Understanding Regulation*. Washington and New York: World Bank and Oxford University Press, 2004.

*The Doing Business report studies the length of time and cost of several key processes related to business regulation. Inter-country comparisons show that delays and costs are far higher in most developing countries than in the typical Organization for Economic Cooperation and Development (OECD) country. In certain of these processes, there is ample opportunity for corruption.*

The main focus of the *Doing Business* report is on key aspects of government intervention in the business environment — broadly speaking, “regulation of business.” These areas, in the wording of the relevant chapter headings, are:

- starting a business,
- hiring and firing workers,
- enforcing contracts,
- getting credit, and
- closing a business.

*Doing Business* explores differences in the types of business regulation across countries, the most successful regulatory models, and how successful regulation leads to good economic and social outcomes. The method of the study is to document the stages of the process (of starting a business, enforcing an overdue contract, etc.), quantifying both the length of time and the cost of each stage. Inter-country comparisons are then based on the aggregate time period and cost of each process.

The authors find that regulation and contract enforcement are more cumbersome and time consuming in poor countries than in developed countries, and that heavier regulation is “generally associated with more inefficiency in public institutions — longer delays and higher cost... — and more unemployed people, corruption, less productivity and investment, but not with better quality of private or public goods.” One effect of excessive regulation is to drive business activity into the informal sector:

There are well-known and proven paths to reform in this area. Reforms that have proved successful in developing and transition countries include: reducing entry regulations, designing credit information registries, and introducing electronic information technology into business registration and tax offices. Some reforms, such as improving contract enforcement mechanisms and bankruptcy systems, are not easy to

introduce in poorer countries, because they lack the honest, efficient judicial systems required to implement such reforms.

For the purposes of this *Reader*, the areas where business regulation concerns intersect with concerns relating to government integrity and anticorruption efforts are of particular interest. Of the five areas of business regulation covered by the report, the two where vulnerability to bribery and extortion have been widely observed are “starting a business” and “enforcing contracts.” Another area where subtler forms of corruption prevail in many countries is “getting credit,” but the report limits itself to registries of credit information, sharing of such information, creditor rights, and enforcement of those rights; the misuse of fiduciary responsibilities to favor personal interests of bank officials is not examined. Consequently, the discussion here focuses on the two areas where the report identifies significant opportunity for corruption.

**Starting a Business.** Poor countries tend to have burdensome entry regulations, associated with a large number of procedures associated with registering and obtaining approvals to start a business; the report measures this burden in terms of both days required to complete the process and the cost of fees (as a percentage of GDP). The authors find that “[c]ontrolling for income per capita, cumbersome entry procedures are associated with higher corruption in the government offices that handle the procedures, particularly in developing countries... Each procedure is a point of contact — an opportunity to extract a bribe.” Expensive and lengthy entry procedures tend to push more entrepreneurs into the informal economy. (One might add that the heavier relative cost of business entry in developing countries is understated in this report, since bribes are not included in the cost calculations and the burden of bribes tends to be heavier in these countries.)

**Enforcing Contracts.** Lengthy and expensive judicial procedures to obtain overdue payments create another major opportunity for corruption; they are another area where the gap between developing and Organization for Economic Cooperation and Development (OECD) countries is sizable. The book cites surveys in the Slovak Republic that found that “giving ‘something special’ to a court clerk or judge was necessary to speed the process along. Between a third and a half of the respondents found Slovak commercial judges to be corrupt.” A wider survey based on the *Doing Business* database found that “a higher number of procedures is associated with more opportunities in the judicial system for extracting bribes.”

**Policy Implications.** The report specifies a detailed agenda of reform measures in

each of the five areas covered. For the two discussed above, reforms include:

- *Starting a business:* Business registration procedures can be dramatically simplified, for example, by adopting “one-stop shops” where all requirements can be satisfied at the same time in a single office. Electronic registration reduces the bribe opportunities inherent in face-to-face contact between registrant and official. The report also mentions several legal changes that can serve to simplify these procedures further.
- *Enforcing contracts:* Reform measures in this area include establishment of information systems and judicial statistics, taking nondispute cases out of courts, simplifying judicial procedures, and establishing specialized courts.

## I.C CAUSES & DETERMINANTS OF CORRUPTION

The USAID ACS document does not discuss the root causes of corruption; the authors of the report are content to describe the forms corruption takes, outline its consequences (see *I.D.*), and discuss strategies to defeat it. The ACS document recognizes that an effective program strategy must be based on an assessment. Many students of corruption believe that any assessment methodology requires diagnosis of the causes of corruption in terms of the specific institutions and values with which history has endowed a country or region and the resulting political, economic, and social mechanisms that produce corrupt behavior. In other words, understanding the path dependency and dynamics of corruption in a country is a necessary first step to designing an effective reform strategy that sets the country on a new path toward greater government integrity and resulting economic development.

In recent years, research into the causes and consequences of corruption has been dominated by economists, although with important contributions by political scientists, as well as anthropologists and sociologists. As *Thomas and Meagher (I.B.1)* show, approaches to analyzing corruption tend to emphasize either “individualist” or “structuralist” causes — the former favored by economists, the latter associated with political scientists and sociologists. The best-known descriptions and analyses of corruption are based on the individualist approach: therefore, most recommended anticorruption initiatives stress changes in the incentives facing politicians and civil servants in government agencies. The policy implications of the structuralist approach are more difficult to formulate and inevitably more complex, as they involve programs to change entire social, economic, and political systems and “cultures” — a goal that is not only long-term but that involves active participation of committed, well-organized local stakeholders.

The “individualist” approach tends to emerge from the tools of analysis based on economics and political economy. Corrupt individuals are intent upon maximizing their welfare, operating within an environment of incentives and constraints created by prevailing public and private institutions and government policies. Economists commonly believe that government intervention in market processes — for example, price controls, quotas, import tariffs, subsidies — provide fertile ground for the cultivation of corrupt behavior. (See *Olson [I.C.3]* for a clear exposition of this view; *Tanzi [I.C.1]* and *Bardhan [I.D.2]* provide additional details.) It follows from this view that a principal strategy for prevention of corruption is reducing government intervention in the economy. An application of this view to transition economies is analyzed by *Shleifer and Vishny (I.C.4)*.

Another “individualist” view is that strong, properly enforced laws and rules are a key line of defense against corruption: the individual, weighing costs and benefits of corruption, will be deterred by sure detection of corrupt acts, systematic prosecution, and serious penalties (see, for instance, *Rose-Ackerman [II.C.1]* and *Klitgaard [II.A.1, I.C.9, and II.C.4]*). Thus this approach emphasizes the importance of *enforcement*. A further factor directly addressed by the individualist approach is the issue of incentives confronting government officials — with regard both to their pay and to the broader question of whether the civil service is run on meritocratic grounds.

The restructuring of governmental processes to encourage *accountability* and *transparency* can help bring about an evolution toward less corrupt tendencies in the overall system. Likewise, *education* can support efforts to modify a “culture of corruption.” *Accountability* and *transparency* are also features that can be built into administrative structures in ways that provide appropriate

incentives to individuals: Klitgaard's related concepts of *discretion* and *monopoly* provide guidelines for structuring administrative procedures along pro-integrity, anticorruption lines. Both approaches lean heavily on *principal-agent* analysis, which is concisely summarized by Klitgaard (I.C.9).

The *structuralist approach* — employed largely by political scientists and sociologists, but to some extent by political economists — is not in opposition to the individualist approach, but tends to be more holistic, and may lead to policy implications that are not normally considered by “individualist” theorists. Corruption is seen not only as the result of specific incentives faced by particular individuals, but also as part of a social and political system whose values and procedures are deeply embedded in the historical evolution and daily transactions of a society. For example, a constitutional framework in which the executive branch of the government has strong powers, largely unchecked by the legislature or judiciary, will tend to encourage the use of power by persons in the executive for illegitimate means (Thomas and Meagher, I.B.1); this point is spelled out from the

standpoint of *clientelism* and *patronalism* — two typical features of defective constitutional systems — by Brinkerhoff and Goldsmith (I.C.6). Another, particularly complex question of political structure is whether corruption is more closely associated with a more decentralized or less decentralized political system (explored by Bardhan, [I.D.2] and Shleifer and Vishny [I.C.4]).

Structuralists also look at the sociological origins of corruption. One approach is to examine the prevalence and types of social capital (see I.C.7 and I.C.8, prepared by authors participating in the World Bank social capital project). Another sociological perspective looks at the question of whether access to economic or political power can be achieved (by a non-elite individual) through talent and hard work alone or whether it requires corrupt transactions (Lipset and Lenz, [I.C.5] and Johnston [I.C.2]). From this standpoint, *prevention* in the TAPEE framework must encompass fundamental features of the economic, social, and political system, such as reducing barriers to entry in business and promoting constitutional reforms that check the power of the executive branch.



## I.C.1 An Economist's Overview of Corruption's Causes, Consequences, and Cures

Vito Tanzi. "Corruption around the World: Causes, Consequences, Scope, and Cures." In George T. Abed and Sanjev Gupta, *Governance, Corruption, and Economic Performance*. Washington, DC: International Monetary Fund, 2002, pp. 19–58.

*This overview article describes and analyzes corruption phenomena from an economist's viewpoint and reviews empirical work on the economic effects of corruption.*

**Growth of Corruption.** Corruption has attracted more attention than in the past for several reasons: the end of Cold War policies that led donor countries to ignore political corruption in certain countries, the larger number of countries with democratic governments and free media, the increased contacts in a globalized economy between high-corruption and low-corruption countries, the increased role of Transparency International and other NGOs, and the widely recognized need for greater competitive efficiency. Corruption has nevertheless grown in recent decades because of increases in taxation, the level of public spending, and regulations and controls; the growth of international trade and investment; and widespread privatization.

The author's definition of corruption is "the abuse of public power for private benefit," where "public power" includes certain private sector activities and "private benefit" can include actions favoring one's party, class, tribe, friends, and family. He mentions some distinctions useful to analyzing corruption: bribes versus gifts; petty (administrative) versus grand (high-level); cost-reducing versus benefit-enhancing; briber-initiated versus bribee-initiated; coercive versus collusive; predictable versus arbitrary; and cash versus non-cash.

### **Factors Contributing Directly to Corruption.**

While corruption is generally connected with activities of the state, there is no correlation between corruption and the relative size of the public sector (Scandinavian countries, for example, have large public sectors and low corruption). What is crucial is the way the state operates. Opportunities for corruption are created and fostered by:

- widespread use of *regulations and authorizations*, requiring permission by government officials;
- *tax administration* based on unclear laws, direct contacts between taxpayers and officials, officials' low

salaries, and poor monitoring of the administration;

- *public expenditure systems* in which public officials have excessive unmonitored discretion over investment and procurement decisions, or when extra-budgetary accounts are used to finance certain types of expenditures;
- *provision of goods and services at below-market prices*;
- *other discretionary decisions* — such as the provision of tax incentives, the use of public land, authorization of foreign investment, and privatization decisions; and
- *financing of political parties* by private sources.

**Indirect Causes of Corruption.** Indirect causes include a poorly run and motivated civil service, low levels of public wages, lack of enforcement of anticorruption rules/laws, poor institutional controls operating within and on public agencies (that is, poor performance with regard to supervision, auditing, clear rules, media attention and freedom), corrupt top leadership, and non-transparency of rules, laws, and procedures.

**Measurement of Corruption.** Tanzi cites press reports, case studies, and questionnaire-based surveys. The latter go into Transparency International's Corruption Perception Index, data from which is reported.

**Economic Effects of Corruption.** Some have argued that corruption — for example, in Southeast Asia — is not harmful, and may even be efficiency-enhancing, because it removes governmental impediments to investment and other economic decisions. Tanzi believes these arguments are not valid: governmental rigidities can be simply removed, those paying bribes are not necessarily the most productive or efficient, and payment of speed money may be an inducement for bureaucrats to cut back

further the speed of their procedures. He details the following serious effects of corruption on the economy:

- Corruption reduces public revenue and increases public spending, contributing to larger fiscal deficits.
- Corruption increases income inequality because it allows certain individuals to gain at the cost of the rest of society.
- Corruption distorts markets and resource allocation, and therefore growth, because it undermines the government's proper regulatory role, distorts incentives, arbitrarily taxes those who must pay bribes, distorts the government's role in protecting property rights and enforcing contracts, reduces the legitimacy of the market economy and democracy, and is likely to increase poverty.
- Corruption tends to favor large enterprises rather than small enterprises, which are normally the main engine of growth in their countries.

These effects of corruption have been demonstrated by econometric results that show that corruption reduces investment growth, reduces expendi-

tures on education and health, increases public investment, reduces expenditure for operation and maintenance, reduces the productivity of public investment and a country's infrastructure, reduces tax revenue, and reduces foreign direct investment.

**Policy Implications.** A strategy to reduce corruption requires at least the following:

- honest, visible commitment by the government leadership to fight corruption;
- policy changes that reduce demand and incentives for corruption by reducing government regulations, provision of goods and services at below-market prices, tax incentives, and other government activities that create corruption opportunities — and to the extent that some of these activities and rules must be kept, by making them as transparent as possible;
- increased government wages and incentives for honest behavior by officials; and
- resolution of the problem of financing political parties.

## I.C.2 The Political Roots of Corruption

Michael Johnston. "Public Officials, Private Interests, and Sustainable Democracy: When Politics and Corruption Meet." In Kimberly Elliott (ed.), *Corruption and the Global Economy*. Washington, DC: Institute for International Economics, 1997.

*This piece builds on the political science literature that views corruption as a mechanism of influence and exchange occurring in virtually every political system. The author puts corruption into a comparative framework in order to shed light on its political impacts, for example whether it supports political stability, whether it galvanizes movements for reform, or whether it leads to violence and collapse. Some forty cases are categorized accordingly.*

**Political and Economic Balances.** The main focus of the piece is an attempt to understand disparate national experiences. To explain these disparities, the author puts forward the concept of "sustainable democracy." This concept looks beyond the existence of liberal political and economic institutions to the "existence of multiple and broadly balanced political forces." The balances involved are:

- between the *accessibility* and *autonomy of political elites*, that is, private interests can influence policy through legitimate channels (elections, media, legal lobbying) but officials can formulate and carry out policies without vulnerability to direct private influence; and
- between *wealth* and *power*; that is, both political and economic paths of advancement are sufficiently numerous and open that trading wealth for office (or vice versa) is not a serious temptation.

When these factors are in balance, corruption remains under control and does not destabilize politics. But serious imbalances foster corruption. Particular combinations of imbalances give rise to characteristic systems and problems of corruption. Moreover, these situations are dynamic, with social ferment, economic change, and political contention shaping opportunities and influencing where society draws the line between the state and the market, and between acceptable and unacceptable influence.

**Four Corruption Scenarios.** This analysis leads into a discussion of four "syndromes" or scenarios where particular imbalances generate different political dynamics and forms of corruption. The four scenarios are:

- "Interest group bidding," typical of industrial countries, where economic

opportunities exceed political ones and elite accessibility outweighs autonomy.

- "Patronage machines," such as those in Suharto-era Indonesia or nineteenth century U.S. cities, where a preponderance of political over economic opportunities and greater elite autonomy produced significant, but reasonably well-organized, corruption.
- "Elite hegemony," such as in some military regimes and East Asian countries during the 1980s and 1990s, where both economic opportunity and elite autonomy are high, and lack of accountability at the top can lead to extreme corruption.
- "Fragmented patronage," typical of many African countries and of Russia during the 1990s, where high elite accessibility and predominance of political opportunities leads to indiscipline, oligarchic fiefdoms, and potentially extreme corruption.

**Policy Implications.** The discussion of these syndromes points out the key social driving forces behind their distinct forms of corruption, which in turn imply choosing anticorruption strategies tailored to the different scenarios. Each strategy essentially consists of choosing policies and institutional reforms that help correct the balance between accessibility and autonomy and that between economic and political opportunity. For example, policies to foster more rapid and broader economic growth can help rectify a situation in which political opportunities are superior to economic ones; introducing greater political competition can reduce the excessive power of an overly autonomous political elite. The author concludes that, while political reform does not by itself cure corruption, it is a necessary condition for more focused anticorruption programs.

### I.C.3 Poor Economic Policies and Institutions: Opportunities for Corruption

Mancur Olson. "The Sources of Law Enforcement and Corruption." In *Power and Prosperity*. New York: Basic Books, 2000. Ch. 6, pp. 101–109.

*To a considerable degree, prevention of corruption involves the prevention of policies that encourage corruption. Olson pithily summarizes the types of economic policies and institutional structure that breed corruption and, by implication, the policy stance that is to be avoided if prevention of corruption is an aim.*

**How Good Government Promotes the Rule of Law.** Olson argues that "when we understand why the costs of providing law and order and other public goods needed for governmental viability can be relatively trivial, we will have a new and better comprehension of official corruption, crime, and why some countries have large shadow economies or informal sectors." He goes on to show that since government is normally much greater in power than an individual citizen, it is rational for the citizen not to challenge the government's authority. Furthermore, when a government adopts "the right public policies and institutions," including "good economic policies and clearly delineated property rights," it is in the self-interest of individuals and firms to be law-abiding and to undertake "theft-averting activities" that reinforce law enforcement, as well as to give the government information that helps it to apprehend criminals. In such an environment, the pressures to uphold the law limit the need to actively enforce it; for example, businessmen tend to honor contracts for fear of being taken to courts, creditors pressure debtors to make payments, and so on.

**How Poor Policies and Institutions Lead to Corruption.** When countries do not have good economic policies and

institutions, other mechanisms come into play. When governments fix prices above or below the market-clearing price level, there will be an inequality of demand and supply at the official price, and buyers and sellers have an incentive to make illegal deals at another price — thus evading the legal price. Such "market-contrary policies" inevitably lead to large informal sectors operating outside the legal market regimes; since market-contrary policies are typical of developing and transition countries, "huge informal economies" are normally found in these countries. Moreover, since informal markets were rife in Soviet-type regimes, they are simply a carryover to successor regimes.<sup>4</sup>

**Policy Implications.** A major element in corruption prevention is avoiding policies that distort markets through government intervention, thereby creating incentives for bribing government officials to gain access to goods and services at subsidized prices. Furthermore, since the roots of corruption in E&E countries precede the transition to a market-oriented economy, designing a strong TAPEE-based anticorruption program requires identification of the networks of influence peddling that have carried over from the former into the current system.

4. This is true even where price and quantity controls have been abandoned by the post-communist successor regime; current incentives for informal economic activity include burdensome taxes and business regulations and licensing arrangements. —Ed.

## I.C.4 The Economic Theory of Corruption Applied to Transition Countries

Andrei Shleifer and Robert Vishny.  
*The Grabbing Hand: Government  
Pathologies and Their Cures.*  
Cambridge, MA: Harvard  
University Press, 1998.

*The authors argue that “the grabbing hand” concept of government has a greater explanatory power and is more useful in design of policy reform than its traditional alternatives — the “helping hand” and the “invisible hand” concepts. The authors provide a seminal theory of the corruption mechanism.*

This volume is a collection of articles, several of which are relevant to anti-corruption efforts in the countries of the Europe and Eurasia region. This summary focuses on Chapter 1, which introduces the “grabbing hand,” “helping hand,” and “invisible hand” models, and Chapter 5, which outlines the authors’ theory of corruption with and without theft.<sup>5</sup> The authors’ concept of the “grabbing hand” government emphasizes incentives of politicians who respond to preferences of grassroots constituencies and are also susceptible to influence peddling. The authors argue that this concept has a greater explanatory power and is more useful in design of policy reform than its traditional alternatives — the “helping hand” model, where the government interferes in the economy to correct market failures, and the liberal concept of the “invisible hand,” where a limited government is restricted to providing basic market-augmenting institutions such as law and order and macroeconomic stability.

**The “Grabbing Hand” Model.** In this model, the behavior of governments is opportunistic, foregoing the pursuit of social welfare in favor of catering to voting majorities and/or organized interests. A reform strategy should therefore aim at empowering voting constituencies and lobbies whose interests are aligned with social welfare. In practical terms, this approach calls for building coalitions for reforms, assuming a realistic view toward “grabbing hand” governments, and manipulating the political process toward a desired outcome. According to the authors, foreign aid can help this process if “surgically” directed toward pro-reform groups and constituencies that might otherwise lose out to anti-reform forces; for example, the massive transfer of property rights over Russian firms to private owners (in which Shleifer

played an active role as a USAID-sponsored consultant) was expected to create an influential constituency for supporting and enforcing private ownership. By this argument, privatization should thus precede the creation of legal and regulatory institutions of private ownership; reversing this order would be counterproductive, given the “grabbing hand” nature of the government.<sup>6</sup>

The authors distinguish between *corruption without theft*, when a public servant charges a private sector agent the officially set fee for a government service (and remits the fee to the treasury), but collects a bribe on top of the fee, and *corruption with theft*, when the transaction remains officially unreported and the corrupt official appropriates the payment in full. Corruption without theft always raises the cost of the service, whereas in cases of corruption with theft a revenue-maximizing official could set the bribe below the official rate. Corruption with theft is more difficult to eradicate than that without theft, because private sector agents benefit from reduced fees and thus have no incentive to be whistle-blowers. This form of corruption aligns incentives of bribe-takers and bribe-payers. Corruption without theft, however, creates conflict between the interests of corrupt officials and private sector agents, who then become opponents of corruption.

Corruption spreads by competition both in the private sector and among public sector employees. Applicants for slots in bureaucracy pay for their appointments to higher-ups, expecting to recoup the “entry fee” by future bribes. This perverse “competition” for government jobs favors those who are more skillful in corruption, and leads to maximization of bribe collection. As for the private sector, corruption with theft

5. Also of special interest are Chapters 3 and 4, which analyze the economic costs of rent seeking (an activity often inseparable from corruption), and Chapter 11, which provides an overview of transition government policies since 1990.

6. This opinion is in striking contrast with the views of *Black et al. (I.B.3)*, who conclude that privatization in Russia prior to laying legal grounds for private property rights was a major policy misconception.

often allows a market agent to reduce the fee for a government service (permit, license, etc.) below the official rate, and unless other private sector agents follow suit, they lose out to competitors engaged in corrupt behavior. Corruption therefore becomes a necessary condition of staying in business — “observance of the law does not survive in a competitive environment.”

**Overlapping Jurisdictions.** According to Shleifer and Vishny’s analysis, another result is that if several government agencies are responsible for complementary permits and services, all of which are necessary for private sector production, and if such agencies are autonomous in their actions, then the total losses due to corruption would be higher than in the case of a consolidated and centralized bureaucracy that maximizes aggregate bribes. This explains why dismantling of authoritarian regimes into overlapping fiefdoms within the government is often accompanied by increased corruption.

Finally, the authors note that corruption distorts resource allocation and thus leads to further efficiency losses, because different areas of economic activity are to different extents exposed or vulnerable to corruption. Bureaucrats favor projects and activities where corruption is easier and/or more lucrative (an example is the bias toward procurement of

unnecessarily complex machinery without competitive benchmarks), whereas private investors who suffer from corruption tend to target sectors that are better protected from bribery by natural barriers. Both of these biases tend to lead to inefficient resource allocation.

**Policy Implications.** The following implications can be drawn:

- Instead of strengthening incentives for honesty in the government by means of greater remuneration, performance-based promotion, and stiffer penalties for bribery, a “grabbing hand” anticorruption approach would include elimination or reduction of regulations and restrictions that breed corruption in the first instance. To the extent that such regulations are unavoidable, public servants’ discretion over their enforcement should be kept to a minimum.
- Better accounting and auditing, by preventing theft in the government, reduces overall corruption by shifting to *corruption without theft*; but because this raises the cost of public services, it creates greater grassroots resistance to corruption.
- Centralized government may well produce less corrupt outcomes than decentralized regimes where different government agencies compete for bribes.

## I.C.5 A Sociological Analysis of the Culture of Corruption

Seymour Lipset and Gabriel Salman Lenz. "Corruption, Culture, and Markets." In Lawrence E. Harrison and Samuel P. Huntington, eds., *Culture Matters*. New York: Basic Books, 2000.

*A country's cultural values and — reflecting those values — the historical evolution of its institutions are important determinants of the prevalence of and tolerance for corruption. The authors — distinguished sociologists — spell out specific reasons why corruption may be a preferred means of achieving an individual's personal and family objectives. Corruption may thus be especially acute when access to economic and political opportunities is severely restricted, and when family ties and attendant personal obligations are esteemed more highly than broader social and economic norms. Both these conditions are typical of pre-capitalist societies and authoritarian polities.*

The first cultural explanation for corruption — an insight derived from the great American sociologist Robert Merton — is that in societies where the culture stresses economic success but restricts access to opportunities, those with little access will try to succeed by innovative or criminal means. The key factor here is the gap between the motivation to achieve and the access to opportunities — both of these factors differ considerably among societies. This gap is especially severe in societies where access to economic and political opportunities is severely restricted, but the motivation to achieve is high.

A second cultural explanation for corruption is particularism: the felt obligation to assist family, friends, and membership groups. Such loyalty is antithetical to the norms of an impartial market and, to some extent, also to fair, democratic political competition. Cultures, like those of southern Italy, that are deficient in communitarian values but emphasize familial ties, will tend to foster "amoral familism."

These cultural explanations may, in turn, be partially explained by religion. "The Protestant religious ethos is more conducive to norm-adhering behavior. Protestants ... believe that individuals are personally responsible for avoiding sin, whereas other Christian denominations, particularly the Catholic church, place more emphasis on the inherent weakness of human beings, their inability to escape sin and error, and the need for the church to be forgiving and

protecting." Initially, the achievement motivation of Protestant societies was very high — hence Max Weber's classic association of Protestantism with the rise of capitalism — but, according to the authors, now-wealthy Protestant societies may have lower levels of achievement motivations — implying lower corruption. Catholic governments may also tend to limit economic freedom (hence access) more, implying more corruption. And the greater emphasis in Catholic countries on familism (as opposed to Protestant individualism and self-reliance) also tends toward more corruption.

**Policy Implications.** According to the authors, a clear policy implication of their analysis is that accelerating the development of markets (with broader access) and democratic institutions should reduce the tendency toward the employment of corrupt means to achieve ends. To back up the contention that over time efforts to build democratic institutions will lead to less corruption, they cite Freedom House data and Treisman's results.<sup>7</sup> They suggest that civil liberties and the rule of law enforced by an independent judiciary may be even more important than "political rights," such as free and fair elections of legislators and the head of the executive, and real political competition. They do not discuss, however, strategies for introducing such political institutions in countries where they do not exist and where cultural values support alternative mechanisms for organizing government.

7. Daniel Treisman, "The Causes of Corruption: A Cross-National Study," *Journal of Public Economics*, Vol. 76, pp. 399–457.

## I.C.6 Clientelism, Patrimonialism, and Corruption

Derick W. Brinkerhoff and Arthur A. Goldsmith. "Clientelism, Patrimonialism, and Democratic Governance: An Overview and Framework for Assessment and Programming." Prepared for the USAID Office of Democracy and Governance, December 2002.

*The authors explore the closely related concepts of clientelism and patrimonialism and how these informal systems pervade governance in developing countries. Both are originally sociological concepts, rooted in the interplay between socioeconomic classes and ethnic groups. In order to ensure effective reform, including anticorruption efforts, one must be aware of these underlying relationships, understand their latent functions, and target reforms to countervail only harmful clientelistic practices.*

**Key Concepts.** Clientelism is an overarching concept; it encompasses the complex framework of relationships "between political patrons or bosses and their individual clients or followers." The practice of patrimonialism is perhaps the most important of such relationships, in which administrative workers owe their jobs and allegiances to top political leaders and view their positions as "income-producing assets." The key to understanding clientelism and patrimonialism is their reciprocal nature. They persist because clients derive some advantage from them, a phenomenon sociologists term "latent functions."

One way of understanding clientelism and patrimonialism is to see them as opposite poles to democracy and rational-legal bureaucracy, respectively. In practice, political systems contain elements of both *clientelism* and *democracy*, just as administrative systems generally contain elements of both *patrimonialism* and *rational-legal bureaucracy*; but developing countries tend to lie more at the clientelist and patrimonial ends of the spectrum, while advanced countries are closer to the democratic and rational-legal poles.

*Clientelistic political systems* are based on personal authority of leaders, non-transparent decision-making procedures, fragmented civil society, wide scope for patronage appointments, and decisions guided by supporters interests — while *democratic systems* tend to be rule-based, with transparent decision-making, "deep" civil society, limited scope for patronage, and decisions guided by the public interest. *Patrimonial administrative systems* feature recruitment of administrators through personal connections, a blurred distinction between public and private business, arbitrary actions, oral communication and poor documentation, rules applied with partiality toward those favored by the regime, lax internal controls, and little citizen recourse for poor service; against this,

in *rational-legal bureaucratic systems* administrators are recruited through competitive processes, public and private realms are kept separate, actions are predictable and rule-based, orders and decisions are fully documented, rules are applied with neutrality, internal controls are strict, and citizens have channels of appeal for poor service.

**Clientelism and Patrimonialism in Practice.** The informal, often shadowy, nature of clientelism and patrimonialism permits ad hoc governance, with both negative and some positive outcomes (tied to their latent functions). Perhaps the most prominent of the negative outcomes is public corruption (others are stop-and-go reform and weak implementation capacity, an emphasis on ethnic politics, and uneven effects on poverty reduction). "Bribery and graft thrive in neopatrimonial states due to the murkiness of government procedures and the wide discretion afforded public officials." Corruption, in turn, discourages economic activity by fostering cynicism among citizens and deterring international investment. The authors take pains to emphasize that other aspects of political patronage are not uniformly negative. Discretion wielded by government officials can temper the "impersonal" face of the state, allow lower classes access to public assistance, and engender loyalty among diverse constituencies. Latent functions of this sort "are important, because they help explain opposition to well-intended governance reforms."

**Policy Implications.** As indicated, attempts to reform the governance structure in a developing or transitioning country must include an understanding of the clientelistic and patrimonialistic structure in that particular society. Accomplishing this would require study of the existing social power and dependency relationships. Major reform efforts not specifically aimed at clientelism — economic liberalization, democratization, decentralization, and civil service reform — can



reduce the scope of patronage to some degree but can also run into unanticipated roadblocks. Specific policies to tackle informal, clientelistic governance would be more effective in countering behavior such as corruption. Such policies should isolate harmful from non-harmful aspects of clientelism and combat them by building constituencies for either containment or reform among local agents. The authors attempt to

spell this out with reference to USAID democracy and governance assessments, describing four strategies: containment (carrying out programs while avoiding resources falling into the hands of a single group, and if possible bypassing corrupt government institutions); civic education; supporting pockets of reform ("islands of alternative systems"); and backing groups that may generate alternative nodes of political power.

## I.C.7 Measuring Social Capital

Christian Grootaert and  
Thierry van Bastelaer.

“Understanding and Measuring  
Social Capital: A Synthesis of  
Findings and Recommendations  
from the Social Capital Initiative.”  
IRIS Discussion Paper No. 0201.  
College Park, MD: IRIS, January  
2002.

*The Social Capital Initiative was launched in 1996 by the World Bank to assess the impact of social capital on the effectiveness of development projects, and to contribute to the development of monitoring indicators for social capital and methodologies for measuring its impact. This essay describes the approaches, results, and recommendations for this large empirical exercise.*

A growing body of empirical evidence suggests that the density of social networks and institutions, and the nature of interpersonal interactions that underlie them, significantly affect the efficiency and sustainability of development programs. In order to advance the theoretical understanding and practical relevance of this concept, a large empirical exercise — the Social Capital Initiative (SCI) — was undertaken by the World Bank, with financial support from the Government of Denmark. Twelve case studies examined the role of social capital at the micro, meso, and macro levels, representing a broad methodological spectrum (quantitative and qualitative), with wide geographic and sectoral coverage. This volume examines these case studies and makes recommendations based on their findings.

Social capital within a society includes the institutions, the attitudes and values, and the relationships that govern interactions among people and contribute to economic and social development. The concept of social capital can be viewed along three dimensions: its scope (unit of observation), its forms (manifestations), and the channels through which it affects development. It should be noted that social capital can result in negative externalities (for example, the Mafia) as well as the positive externalities more commonly discussed.

**Scope.** Social capital at the micro level can be defined as those features of social organization, such as networks of individuals and households, that create externalities for the community as a whole, along with their associated norms and values. These externalities can be both positive and negative. A broader interpretation of social capital exists at the meso level, expanding the concept to include vertical as well as horizontal associations and behavior within and among other entities, such as firms. Vertical associations are characterized by hierarchical relationships and an unequal power distribution among

members. The most encompassing view includes the social and political macro environment that shapes social structure and enables norms to develop.

**Forms.** At all of the above levels, social capital influences development as a result of the interactions between two types of social capital: structural and cognitive. Structural social capital refers to information sharing and decision-making through roles, social networks, and other structures supplemented by rules, procedures, and precedent. Cognitive social capital refers to shared norms, values, trust, attitudes, and beliefs.

**Channels.** Social capital affects development through the channels of information sharing, collective action and decision-making, and a decline in opportunistic behavior.

**Findings.** The SCI studies attempted to measure social capital across some combination of the above dimensions. The overriding lesson that emerges from the SCI is that it is possible to measure social capital and its impact. The studies indicate that social capital has a profound impact in many different areas of human life and development by improving the outcome of activities that affect them; more generally, social capital helps alleviate poverty for individuals and for countries as a whole. The authors note, however, that the extent to which social capital matters varies across settings, as do the aspects of social capital that are effective.

These findings were consistent across both the qualitative and quantitative studies, thus reinforcing the importance of researching social capital in a methodologically diverse manner. Social capital cannot be analyzed strictly within the economic paradigm, using quantitative methods, or solely through anthropological or sociological case studies.

The SCI results show that the conceptual debate should steer away from viewing different concepts of social

capital as alternatives. They show that both cognitive and structural capital matter and that social capital is relevant both at the micro and macro levels. The authors believe that the way forward is to further pursue the integrating view on defining and measuring social capital. However, care must be taken not to equate the measurement variables with underlying social capital.

Experience with the many social capital indicators used in the study suggests that the focus should be on three types of proxy indicators: membership in local associations and networks, indicators of trust and adherence to norms, and an indicator of collective action. As proxies, these indicators measure social capital from different vantage points and provide a helpful framework for designing a measurement instrument.

***Policy Implications.*** SCI studies have been more successful at documenting the beneficial impact of social capital than at deriving policy prescriptions. This documentation, however, yields several important lessons that are useful when designing development interventions: social capital often matters more than

technical or economic features of a project design; certain types of infrastructure should not be proposed for villages that lack the social capital to maintain them; the successful management of common resources requires minimum levels of human and social capital; and efforts at stimulating social capital have worked in enough settings to warrant pursuing strategies for investing in social capital.

These lessons suggest that the promotion of social capital should also be the poverty reduction agenda. Thus the identification, protection, and strengthening of existing social capital should be integral elements of poverty alleviation programs. Current and new assessment tools can be used to understand the nature of existing institutions in client countries and their roles in social and economic development. Building on this understanding, existing social capital — especially associations and organizations of project beneficiaries — should be employed in the design and delivery of projects. Finally, donors should facilitate enabling environments that foster the strengthening of social capital in partner countries.

## I.C.8 Social Capital in Transition

Martin Paldam and Gert Tinggaard Svendsen. "Missing Social Capital and the Transition in Eastern Europe." *Journal for Institutional Innovation, Development, and Transition*, Vol. 5 (2001), pp. 21–34.

*The transition of the "old communist" countries of Eastern and Central Europe has been slow, given the amount of human and physical capital available at the start of the transition. This paper argues that the slowness is caused by the lack of social capital, which is an important factor of production.*

The authors argue that the transition of the old centrally planned systems in Eastern and Central Europe has been disappointing in three ways: (1) the output collapse immediately following the big change in 1989/1990 on average represented 40 percent of GDP; (2) the upswing has been slow and in some cases has hardly started; and (3) the transition has caused an increase in corruption, rent seeking, and crime. The first and second trends have occurred despite high levels of existing human and physical capital; the authors argue that the lack of social capital caused the negative effects. The third trend resulted from an increase in negative social capital after the start of the transition.

The main theory behind this study is the "dictatorship theory of missing social capital," which holds that dictatorships destroy social capital. Some dictatorships, such as the communist ones, even create conditions that favor the building of negative social capital. Based on this approach, the authors present three hypotheses:

1. Dictatorship and especially totalitarianism destroys normal social capital.
2. The communist model generates gray/black networks, which are kept at bay by a large control apparatus.
3. The transition switched the gray/black networks from necessary to harmful, and the weakening of institutions allowed this negative social capital to grow and become a barrier to a normal economic development.

**Hypothesis 1.** Dictators normally strive to build safeguards to ensure that all, or at least the main, organizations of society remain under their full control and that leaders of organizations have no possibility to build up their own power base. Social control is crucial for the dictator to retain power. In the Soviet system, all voluntary organizations were brought under the leadership control of the communist party. The state

made almost all decisions and did not leave any room for entrepreneurship, experiments, or voluntary organization into social groups. Available data show generally low levels of social capital in the transition countries.

**Hypothesis 2.** Both supply constraints and plan fulfillment measures in the communist system created informal networks, bordering on the illegal. To go through public channels to fulfill the plan was generally a long and cumbersome process. As a result, gray and black markets developed, and were even tolerated by the government to allow for some economic flexibility. Similarly, to address supply constraints, governments allowed these markets to exist to increase supply of foodstuffs or to reduce excess supply of currency. However, some control mechanisms were put in place, such as police corps and financial controls.

**Hypothesis 3.** Although the gray/black networks were necessary for the communist system, they are harmful in a market economy, where trading rules are to be respected and not bypassed. When the transition began, the control mechanisms that had been in place weakened or disappeared, and these networks grew, with negative effects on economic growth. Additionally, many people had learned to distrust and to take no initiatives of their own, adding additional harm. Still other factors adding to the slowness of post-communist social capital growth include the post-transition decrease in public salaries and arbitrary redistribution of assets and income as a result of privatization.

The authors point out that their findings are tentative, owing to the lack of systematic knowledge on the topic of social capital and the lack of data. The findings should be used to encourage further research.

**Policy Implications.** Since only limited evidence is available on the topic, the authors do not delve deeply into

the area of policy implications. They do state that a couple of decades may be sufficient to create the building process for positive social capital. Additionally, they point out that governments can do much by creating the proper enabling environment for

social capital generation and by resisting the growth of negative social capital (for example, through encouraging wide political participation, transparency in government dealings with the public, and permitting freedom of speech and assembly).

## I.C.9 The Principal-Agent Problem

Robert Klitgaard. *Controlling Corruption*. Berkeley, CA: University of California Press, 1988.

*A powerful tool for dissecting the mechanisms of corruption comes from political economy: principal-agent analysis. Klitgaard applies this analysis to the practical problem of reducing corruption in government agencies.*

**Principal-Agent-Client Analysis.** In investigating public sector corruption — the use of public office for private gain — one posits a *principal* (a senior minister or agency head) who represents the public interest and who faces the task of getting the *agent* (a bureaucrat subordinate to him) to serve the *clients* — the public and its interests — rather than serve his/her own private interests. The principal faces information asymmetry vis-à-vis the agent, who has more knowledge of ground-level cases. In this context, the *Corruption = Monopoly + Discretion – Accountability* equation tells us that the greater the agent's power over clients, the greater his/her discretion, and the less his/her accountability to the principal, the greater the likelihood that corruption will occur.

One can see why this is so when one employs the standard cost-benefit analysis used by economists. The agent weighs the pecuniary benefits of receiving a bribe against the costs of (a) getting caught and punished (including possible loss of job) and (b) knowing one has done the wrong thing. The principal is hampered by asymmetric information about the agent's activities: the agent is much better informed about this than is the principal.

**A Principal's Strategy.** There are various things principals can do to mitigate the principal-agent problem:

- select agents who are screened for honesty, obtaining outside assistance (from networks or groups that might punish the dishonest agent, or from international agencies or firms);
- set the agent's rewards and penalties so as to create a set of incentives

that motivate the agent to act honestly (for example, raising pay while making it more likely that a dishonest agent loses his/her job);

- collect better information about the work and performance of the agent (by using improved information systems, more frequent audits and inspections, and shifting burden of proving honesty to the agent);
- restructure the principal-agent-client relationship in ways that eliminate or reduce the opportunities for agents to take advantage of their superior information — for instance, by reducing their discretion (for example, eliminating face-to-face contact), by increasing transparency of decisions, and possibly creating competition among alternative channels for a client to carry out a transaction with the government; and
- change attitudes about corruption through education of the civil service and the general public — here a free media can play a key role.

**Policy Implications.** There are many ways donors can support the types of measures outlined in the points under “a principal's strategy.” For example, what is usually described as “civil service reform” covers the first three measures. For example, programs to modernize for tax administration or to simplify business registration procedures serve to restructure the principal-agent-client relationship. Donors are often able to assist with citizen education campaigns. Nevertheless, reforms of this sort cannot be implemented without strong political support from within the recipient country.

## I.D Consequences & Costs of Corruption

The USAID ACS document spells out three main negative consequences of corruption, saying that it:

- “undermines service delivery, particularly for the poor;”
- “cripples democracy,” and
- “impedes economic growth.”

The document goes on to point out that, in each of these areas, strengthening key institutions both helps achieve the broad objective and reduces relevant forms of corruption. For instance, public service delivery is improved by strengthening procurement and financial management systems — which, in their weak condition in many developing countries, create corruption opportunities.

Behind these ACS conclusions lies a substantial empirical literature that links corruption to economic outcomes. Two articles included in other sections of this Reader — those by *Tanzi (I.C.1)* and *Lanyi (I.E.1)* — summarize the empirical literature on the economic impact of corruption. There is widespread agreement that corruption tends to be associated with low per capita incomes and low rates of investment and economic growth. However, the direction of causality is complex: reduction in corruption seems likely to spur investment and growth, but, for any particular country, a pickup in economic growth may, at least in the short run, lead to an

increase in corruption, as the government officials and private sector players discover new opportunities for mutual benefit. It is generally believed, however, that in the long run the larger middle class created by economic growth will demand greater political participation and, with that, more transparent and accountable government.

Another consequence of corruption, emerging from the *Tanzi* and *Lanyi* articles, but also from the excerpt from *Rose-Ackerman's* book (*I.D.1*) and from *Bardhan's* article (*I.D.2*), is that corruption undermines the effectiveness and legitimacy of the state. The reduced effectiveness of the state, in turn, leads to less adequate public services, upon which lower-income groups especially depend. In other ways, too, successful rent seeking via corruption leads to increasing incomes for the rich, at the expense of lower-income groups. Both *Rose-Ackerman* and *Bardhan* also delineate the devastating effect of corruption on the efficiency of government and, more broadly, the efficiency of resource allocation in the economy as a whole. Each of these analyses suggests a range of strategies that would strengthen transparent and accountable government, improving incentives for public servants to improve the delivery of public services and enhancing the role of ordinary citizens in serving as a watchdog of government performance.

## I.D.1

### A Political Economist's Take on Causes and Consequences of Corruption

Susan Rose-Ackerman. "The Economic Impact of Corruption." Chapter 2 in *Corruption and Government: Cause, Consequences, and Reform*. Cambridge and New York: Cambridge University Press, 1999, pp. 9–26.

*Many forms of corruption arise as a result of economic incentives, often created by misconceived government policies. Attacking corruption effectively requires precise knowledge of the economic incentives motivating corrupt transactions. In this chapter, Susan Rose-Ackerman — a political economist — presents a useful taxonomy of the types of corrupt transactions and their motivations.*

The author defines four types of economic motivations for bribery:

- bribes that equate supply and demand in markets where governments interfere with the market-clearing process,
- bribes that give officials incentives to do their jobs better,
- bribes that lower costs, and
- bribes that permit criminal activity.

#### **Payments that Equate Supply and Demand.**

Such payments arise where governments provide goods and services for free or sell them at below market prices to favored individuals or firms. Systems of dual prices, like in China, encourage payoffs to suppliers to purchase goods at the lower price. Multiple exchange rates for foreign currencies lead to analogously illegal payoffs to officials for issuing foreign exchange licenses or import licenses to acquire foreign exchange at the lowest available price. Artificially low prices for oil or gasoline similarly encourage smuggling and its associated bribery. Rationing credit at artificially low interest rates, when controlled by the state, leads to bribes for access. Other types of corruption arise in connection with programs to provide the poor with grain, housing, or other goods and services at subsidized prices: those with more resources bribe officials for access to the lower-cost supply. Finally, officials may collect bribes for providing services whose supply they control, like the issuance of passports, driver's licenses, or pensions.

In some of these cases, such as the allocation of foreign exchange, it could be argued that bribes act as the equivalent of prices bid in a market-clearing process: but even in this case, an open competitive market would be preferable, since the bribery process involves non-transparent transactions and therefore poor information to potential market participants. In other cases, the

economic impact is even more negative: for example, bribery for access to subsidized goods and services displaces low-income individuals by those who have more money to pay.

#### **Bribes as Incentive Payments to Bureaucrats.**

Such incentive payments may extend over all government dealings with the public. Where officials extract bribes for doing their jobs, the net result may be both an artificial restriction of supply and unfair discrimination against low-income people trying to obtain driver's licenses, passports, pensions, and other government-issued goods and services to which they are entitled. Bribes to get the government to pay its bills are also economically harmful, as are payments to officials to evade taxes and health and safety regulations. The result is excessive time spent by businesses in rent seeking; arbitrary and unfair payments that discourage entry by new businesses (or force the latter into the informal economy); an uncertain business climate; and a tendency to hold back state reform.

**Bribes that Lower Costs.** Bribes to reduce the cost of government regulations and taxes can result in poor construction of buildings and harmful environmental impacts — both of which can lead to death, injury, and illness to large numbers. Bribes to officials for the purpose of tax evasion result in governments starved of revenues and thus unable to provide adequate public services. The economic impact of this corruption tends to favor the rich over the poor and undermines the legitimacy of all laws and regulations, even those that are well-justified. Once bribery has become systemic, even a reform-minded political regime will find it difficult to eliminate corruption.

#### **Bribes that Permit Criminal Activity.**

Payoffs to officials by organized crime become harmful to economic development "when organized criminal groups begin to dominate otherwise legal business." Bribery in connection with



privatization, licenses, and government procurement can help criminal groups dominate cartels, public utilities, and businesses doing heavy business with the state (for example, road repair or garbage collection). Criminal activity can become intertwined in politics and may become hard to control by any one country.

***Policy Implications.*** The lessons of this taxonomy of government corruption are two-fold: first, allowing corruption of government officials by private interests

to become deeply entrenched risks undermining the overall effectiveness of the state; and second, the strategy for attacking each type of corruption needs to be based on the incentives involved. In some cases, abolishing unnecessary or harmful government controls is sufficient to remove the opportunity for corruption; in others, a more determined, broader TAPEE-type approach is required, but each facet of this approach must be geared to reshaping the incentives of the relevant actors.

## I.D.2 Does Corruption Slow Economic Development?

Pranab Bardhan. "Corruption and Development: A Review of Issues." *Journal of Economic Literature*, Vol. 35, No. 3 (September 1997), pp. 1320–1346.

*This is an important review, by a prominent economist in a major economics journal, of the principal theories relating to the impact of corruption on development, as well as the effect of economic growth on corruption, and the implications of these theories for policies designed to reduce corruption. Empirical evidence is not seriously discussed.*

Bardhan chooses to use "the use of public office for private gain" as the *definition* of corruption for his paper, pointing out that "private gain" can be both economic and political and that corruption can occur in the private as well as the public sector. The *level* of corruption cannot be described one-dimensionally, because larger single bribes may result from centralized corruption, while smaller bribes paid on a decentralized basis may be associated with higher bribes per transaction unit.

**Corruption and Efficiency.** The argument that corruption might improve efficiency by overcoming pre-existing, policy-induced distortions — through "speed money" to overcome bureaucratic obstacles — is shown by Bardhan to be valid only on very limited assumptions. For instance, the assumption that distortions are exogenous to the corruption is weak: in fact, administrative delays are typically created to attract more bribes. In addition, corrupt "contracts," because carried out in secret, are not enforceable in courts. Worst of all, the secrecy and illegality (and/or immorality) of corruption lead officials to concentrate on low-detection activities — such as large contracts — which may be less efficient choices for a developing economy. Secret payments may also be accumulated and spent abroad, possibly undermining the best use of domestic resources. The author points out that a strong centralized government is likely to carry out corruption in a less distortionary and costly way than a highly decentralized, fragmented government; when a weak government carries out further decentralization, additional corruption may well emerge. He notes also that bribes tend to be small relative to rents, but this is truer in democracies than in autocracies.

**Corruption and Growth.** *Corruption retards growth* for a number of reasons. For instance, corruption lowers the rate of return on investment (because of the additional cost of bribes, etc.), encour-

ages the misuse of public funds (thus lowering the quantity and quality of public investment), and discourages entry of new goods and technology that require an initial fixed cost. Against this, some historians point out those initial corrupt transactions (obtaining licenses, loans, and concessions from the government) were steps in the creation of an entrepreneurial class in Western Europe and the United States.

*Growth tends to reduce corruption over the long run*, but at early stages of modernization, opportunities may rise as the economy expands and becomes more complex. This can be seen in transition countries as well as in China, where the simultaneous existence of a market economy and state-controlled prices for some goods leads to vast corruption. Nevertheless, over time, sustained growth leads to growing rewards to entrepreneurship and productive investment relative to rent seeking; and a richer economy can afford to pay civil servants well, lowering incentives for corruption (see below). As countries develop, the growing middle class demands democratic reforms, including mechanisms of accountability and transparency to combat corruption, and rich democracies enforce laws better (although they are not always so successful in reducing the influence of money in enacting laws).

Bardhan pays close attention to factors behind differential incidence and persistence of corruption. Economists favor the explanation that corruption is fostered by excessive regulation. Others talk of "social norms" as a cause, but, in Bardhan's opinion, this is a near tautology. He explores a model that yields multiple equilibria, based on the notion that the marginal net benefit of corruption to an official depends on the number of other people who are expected to be corrupt: if all are honest, it does not pay to be corrupt, while if all are corrupt, it does not pay to be honest. In between these extremes,

there is a point at which the benefits and costs of corruption are finely balanced: on either side of that point, the system tends to move toward one extreme or another.

**Policy Implications.** The author adduced extensive policy implications:

- *Eliminating regulations and the bureaucratic allocation of scarce public resources removes opportunities for corruption.* However, moving from a public to a private monopoly doesn't necessarily raise efficiency. Because some regulations serve valued social objectives, there may be a tradeoff between those objectives and that of reducing corruption.
- *Fostering bureaucratic competition and overlapping jurisdictions is a potential strategy to reduce monopoly power of bureaucrats — but must be accompanied by intensive monitoring and auditing.*
- *Anticorruption campaigns, to be effective, must be credible and sustained.*
- *Accountability mechanisms must be institutionalized within the public administration.* These mechanisms include making supervisors answerable for subordinates' malfeasance; encouraging and protecting whistleblowers; probing officials' "unexplained" assets; and promoting merit-based civil service promotion, job rotation, and codified civil service rules.
- *Over time, higher civil service pay tends to reduce corruption because it raises the cost of losing one's job.* But combining this with more complicated incentives relating to inspection of compliance to regulation must be analyzed with regard to the effects on both corruption and the ultimate goal of the regulation, and these two impacts may not always move in the same direction.

## I.E MEASUREMENT OF CORRUPTION & INTEGRITY

The USAID ACS calls for development of an “assessment framework to explicitly incorporate a disaggregated analysis of locations, severity, and key political and economic drivers of administrative corruption and grand corruption.” It also emphasizes the ability “to measure and improve the effectiveness of its anti-corruption programs.” Crucial to such assessment, and also to evaluation of how well anticorruption programs have brought corrupt practices and corruption vulnerabilities under better control, is the measurement and empirical analysis of corruption and its counterpart, government integrity.

Some broad-brush measures of corruption — and even cruder international comparisons — are achieved by various surveys of perceptions of “experts” (often foreign investors and journalists), local business representatives, officials, and households. Each year Transparency International produces the Corruption Perceptions Index constructed by averaging the results of a number of such surveys. These, the measures they are based on, and more generally the problems with measuring corruption, are reviewed in the survey article by *Lanyi* (I.E.1).

Recent work of the World Bank — presented in the “Governance Matters” papers already discussed (I.A.3) — has created a series of governance indicators that have been widely used in empirical work; these indicators are also the basis of some of the criteria that

have been used (and misused) to determine which countries are eligible for the Millennium Challenge Account. The strength of these indicators is the breadth of country coverage and the large number of different surveys on which they are based. Their principal weaknesses are (1) that they are based largely on perceptions (of experts, stakeholders, and the general public) and (2) that they are quite unspecific as to the locus, cause, and mechanism of particular types of corruption. An attempt to rectify the first of these weaknesses is provided by the work of *Knack and Kugler* (I.E.2), who have begun the work of constructing “objective indicators” of good governance. Another effort to identify more specific loci and nature of corruption is the BEEPS survey of E&E countries discussed in I.A.4. Finally, recent investigation of the Latin American health sector (II.C.5) demonstrates how “hard” data can be used to provide presumptive evidence of corruption and (incidentally) its impact on a particular sector:

A good deal of empirical quantitative analysis of the economic causes and consequences of corruption has been carried out by economists and political scientists, utilizing data from several of the above-mentioned surveys, together with standard economic statistics. These results, too, are summarized in *Lanyi* (I.E.1) and in *Tanzi* (I.A.1). The bibliography in that article provides further leads for the interested reader.

## I.E.1 Surveying the Measurement of Corruption, Its Causes, and Its Effects

Anthony Lanyi. "Measuring the Economic Impact of Corruption: A Survey." In IRIS Center, *The Corruption Nexus and the People's Republic of China*. College Park, MD: IRIS Center, 2004, pp. 71–110.

*This paper surveys the literature on the measurement of corruption, its causes, and its consequences. After analyzing the various attempts to solve the problem of measuring corruption, the author surveys empirical estimates of the causes and effects of corruption. While there is broad agreement that corruption is damaging for economic growth and for the well-being of the poorest members of society, the evidence on the effect of economic growth on corruption is more ambiguous. None of this work, thus far, has much bearing on the interesting question of the dynamics of corruption: that is, the interaction between changes in income levels and economic structure, on the one hand, and government integrity or corruption, on the other.*

**The Measurement Problem.** Corrupt transactions, by their very nature, defy direct measurement. Students of corruption try to get around this problem by measuring either perceptions of corruption or other variables — typically related to various aspects of governmental integrity — that are believed to be related to corruption. There have been less frequent, though interesting, attempts to measure the experience of individuals or firms with corruption and to collect hard evidence of corrupt transactions. Most measures used in the empirical work cited in this study are based on surveys of perceptions, usually of foreign business representatives and other outside observers.

**Estimating Causes of Corruption.** The principle causes of corruption revealed by the empirical literature are: governmental policies favoring particular industries ("industrial policies," tariff protection, etc.), low civil service pay, ethnic fragmentation, and certain cultural and sociological factors. The jury is out on whether corruption is positively or negatively affected by the level of income: while cross-section analysis shows that the higher a country's per capita income, the lower its level of corruption is likely to be, time series analyses of individual countries show that economic growth does not necessarily lead to lower corruption levels, at least not in the short to medium term, because changes in economic structure create new opportunities for corruption. Similarly, whether decentralizing governmental functions produces more or less corruption is unclear. Greater participation of citizens in local government is a factor contributing to less corruption, while capture of local government by provincial elites results in worse governance. There is wide agreement that the prevailing type of institutions — with respect to rule of law,

"voice" and accountability, and other government functions — is a determinant of corruption.

**Estimating the Consequences of Corruption.** Empirical studies show that higher corruption has the following consequences: lower overall economic growth, smaller tax revenues, poorer quality of public expenditures (both investment and current expenditures), worse functioning of decentralized governmental functions, discouragement of both domestic and foreign private investment, impediments to economic reforms (especially customs reforms), more financial instability, greater income inequality, and lower levels and quality of health and education services (especially those available to low income groups).

**Corruption Dynamics.** The empirical results — granted their weak basis in surveys of corruption perceptions — do suggest that strenuous efforts to reduce corruption will be rewarded by higher income levels. Unfortunately, it is not clear that higher income necessarily leads to less corruption. A key issue is whether economic development leads to political development, which in turn would imply a stronger public consensus to fight corruption and greater likelihood that government would enforce the public will. A lot more evidence, as well as careful historical analysis of individual countries, would be required to come to more definite conclusions on this score.

**Policy Implications.** The economic benefits of fighting corruption seem clear. In addition, analysis of the causes of corruption suggests that reducing government regulation, liberalizing import tariffs and other government market interventions, and improving civil service salaries (combined with meritocratic pay and promotion criteria) tend to lead to reduced corruption.

## I.E.2 Second Generation Indicators

Steven Knack and Mark Kugler.  
“Constructing an Index of  
Objective Indicators of Good  
Governance.” Washington, DC:  
World Bank, PREM Public Sector  
Group, October 2002.

*Prevailing corruption indicators are based primarily on the subjective opinions of foreign experts or surveys of local perceptions. The authors attempt to measure governance quality, closely connected to corruption, in a more objective manner. Nine indicators are proposed and are aggregated into a composite governance index whose values comport with those of respected, existing measures.*

### **Background on Governance Indicators.**

This article addresses a shortcoming of traditional indicators of good governance: the subjective nature of the opinion- or perception-based responses that constitute them. The authors wish to place these indicators on a more accurate, replicable foundation, with the additional benefit of such indicators being more palatable to the governments of covered countries. Therefore, the authors mine existing statistical sources, including government budgets, telephone service records, and reported bribe payments, to create more objective measures of governance quality. The nine resulting indicators are “regulation of entry, contract enforcement, contract-intensive money, international trade tax revenue, budgetary volatility, revenue source volatility, telephone wait times, phone faults, and the percentage of [firm] revenues paid to public officials in bribes...”

The term “contract-intensive money” refers to the ratio of noncurrency money (that is, bank accounts) to the total money supply. The authors argue that the higher this proportion, the more trust citizens have in their government and its oversight of the financial system.

**Methodology of Objective Indicators.** The authors run a number of statistical checks to conclude that the individual governance indicators are sufficiently reliable and their values generally consistent with another prominent, and more comprehensive, set of governance measures. Because most of the nine indicators are narrowly focused and prone to idiosyncrasies, they should be aggregated to provide a broad measure of governance. The authors create such a composite index using a careful technique to control for potential bias from non-representative sampling. They conclude, via additional statistical procedures, that the index successfully embodies a broader measure of governance, whose values are even more closely correlated with those of prominent, but subjective, governance indicators than are any of the nine individual indicators.

**Policy Implications.** The methodology behind these objective governance indicators is a promising avenue for future research. It offers the possibility of policy recommendations more firmly grounded in “hard” evidence and thus potentially more palatable to governments in need of reform.

## II. PRESCRIPTION: ANTICORRUPTION INITIATIVES

One of the “broad actions” that the USAID ACS sets out as a means of addressing the challenge of corruption is to “build USAID’s anticorruption knowledge.” The ACS also calls for anticorruption components in all sectoral programs affected by corruption. But just as corruption itself is a complex phenomenon that is difficult to analyze and measure, so is achieving a better understanding of what makes for successful sectoral anticorruption initiatives — a task both arduous and multi-dimensional. One must first look at the system as a whole to figure out what corruption factors pervade the entire society and state and which are specific to a particular agency or organization. Next, one must come up with a plan to build integrity factors that defeat corruption in each of its specific manifestations. In doing so, it is useful to build on previous experience, with regard to fighting corruption in the particular sector, country, and region

of interest. Thus the literature in the “Prescription” portion of the *Reader* is organized in the following sections:

- The first section on *strategic overviews* examines frameworks within which an anticorruption program can be thought about and constructed.
- The next section discusses pieces that take on elements of the integrity-building agenda, organized according to the integrity factors contained in the *TAPEE framework*: separate items discuss *transparency, accountability, prevention, enforcement, and education*.
- The subsequent section provides a number of *sectoral anticorruption case studies*, based on global experience, including that of transition countries.
- Finally, there are several *national and regional anticorruption case studies* from the E&E region itself.

## II.A OVERVIEWS: DEVELOPING A FRAMEWORK FOR ANTICORRUPTION INITIATIVES

The first step in building anticorruption knowledge — as called for by the USAID ACS — is understanding frameworks designed to analyze corruption and its possible antidotes. The grandfather of such frameworks is that of *Klitgaard's* paradigm from the late 1980s:  $C = M + D - A$ , or *corruption equals monopoly plus discretion minus accountability* (II.A.1). The correspondence between this approach and the TAPEE framework is somewhat complex: *transparency* relates to Klitgaard's discretion and accountability; the TAPEE *accountability* is a narrower concept than Klitgaard's, because the latter includes elements of TAPEE's transparency and enforcement as well; monopoly and discretion are both related to TAPEE's *prevention*; and the *education* in TAPEE in some sense underlies the implementation of effective reforms for all the Klitgaard factors.

The institutional reforms envisioned by *Meagher* (II.A.2) are broader in scope than those implied by Klitgaard's model, though focused on several specific types of government corruption. Meagher suggests that in addition to the type of specific actions suggested in the

Klitgaard and TAPEE frameworks, broader systemic reforms may be required to carry out effective changes in the integrity of specific government functions. For the E&E countries, such a comprehensive approach is specified in greater detail in the World Bank study on *Anticorruption in Transition* (II.A.3). This document spells out the key distinction between *administrative corruption* and *state capture*, types of corruption that are quite different in locus and in the implied reform strategy.

One approach to anticorruption strategy is the spelling out of *international standards*. The *UN Convention against Corruption* (II.A.4) is the most prominent of these, and is remarkable in the detail in which it spells out the many different forms of corruption that may prevail in both the public and the private sectors, as well as the many ways in which such corruption may be prevented and malfeasance punished. The bar is set high for signatories to the convention, but the United Nations itself sets out no ways in which countries that hold to the standards might be rewarded, or countries that do not do so might be punished.



## II.A.1

### **Klitgaard's Formula: Corruption = Monopoly + Discretion – Accountability**

Robert Klitgaard. *Controlling Corruption*. Berkeley: University of California Press, 1988.

*Many basic concepts commonly used to analyze corruption and its remedies originated in, or were first explained in a clear way for non-technical readers, in this book. The TAPEE approach itself derives in part from Klitgaard's classic formulation: Corruption = Monopoly + Discretion – Accountability; and Klitgaard's real-life stories of anticorruption initiatives illustrate clearly all five facets of the TAPEE approach. The book weaves analytical concepts together with a number of interesting examples of successful (and unsuccessful) anticorruption programs. The following summary of three key chapters — Chapters 2, 3, and 7 — focuses on the chief analytical arguments and refers briefly to the best-known of his exemplary tales.*

**Costs of Corruption.** Like most authors, Klitgaard argues that corruption is harmful for development. Recognizing that in some systems, corruption may play a useful role in reducing red tape or in promoting political integration, these benefits are achieved within systems that are badly in need of improvement. Moreover, such benefits are outweighed by the harmful effects of corruption: inefficiency, inequity, incentives for unproductive rent seeking, and political alienation and instability.

**Conditions Favoring Corruption.** Klitgaard quotes the argument that corruption flourishes in societies where personal loyalties are held to be more important than formal rules and public duties, but he argues that in all societies, most people understand that most forms of corruption are neither lawful nor customary. He also discounts views that corruption comes from too much or too little capitalism, pointing out that both private sector monopolies and public sector monopolies tend to be inefficient and corrupt.

**Optimum Degree of Corruption.** Klitgaard argues that the marginal social cost of corruption rises as the amount of corruption increases (for instance, because social norms break down and income distribution worsens) while the cost of reducing corruption gets *lower* when corruption is relatively high (it is easier to detect and one can target the most morally objectionable types of bribery and extortion). However, trying to eliminate even the smallest amount of corruption in the system can create excessive red tape and divert resources from other objectives. It follows that there is some, probably moderate, level of corruption beyond which there is a net social gain to fighting it, and below which the cost of reducing corruption somewhat more is greater than the harm caused by the corruption.

**Examples.** The most elaborated example of anticorruption reform Klitgaard cites

is that of Justice Efren Plana in the Philippines, who, beginning in 1975, carried out a thorough reform of the hitherto highly corrupt Bureau of Internal Revenue. Some features of his approach included: careful initial fact-finding; positive incentives to agents; quick and firm punishment of high-level officials early in the process (to set an example); hiring many new, honest officials; tightening central supervision; rotating agents; and indoctrinating staff to establish different attitudes within the Bureau. (The shortcoming of his approach was not involving the public, perhaps one reason why there was backsliding after his departure.) Other well-known examples Klitgaard describes in detail are the creation of the Independent Commission Against Corruption (ICAC) in Hong Kong — perhaps the most successful example of an anticorruption agency — and the reform of the Customs and Excise Department in Singapore; both of these reforms were undertaken in the 1970s.

**Policy Implications.** It follows from principal-agent analysis — see Klitgaard's principal-agent-client analysis separately summarized in *I.C.9* — and the stories Klitgaard tells that the principal can reduce the propensity to corruption by:

- selecting agents for incorruptibility (as well as technical competence),
- raising the reward for keeping the agent's job (that is, pay),
- increasing the probability that corruption will be detected (through better oversight),
- raising the penalty for corruption,
- restructuring the principal-agent-client relationship, and
- working to change moral attitudes (through *education* both within the bureaucracy and among general public).

Changing the principal-agent-client relationship involves several facets:

- inducing competition in service provision,
- reducing agents' discretion (tighter rules, working in teams, separating tasks, hierarchical review),
- rotating agents (functionally and geographically),
- redefining an organization's objectives or activities, and
- organizing client interest and advocacy groups.

An anticorruption implementation strategy that takes broader political

goals and realities into account would include the following elements:

- cultivating political support (taking into account who gets hurt and who gets helped by corruption),
- getting the public behind anti-corruption efforts,
- breaking the culture of corruption within an organization,
- taking positive as well as negative steps,
- linking the type of anticorruption measures to the nature of the organization's mission, and
- finding a "Mr. Clean" to lead the effort.

## II.A.2 A Framework for Linking Corruption Analysis and Specific Reforms

Patrick Meagher. "Combating Corruption in Africa: Institutional Challenges and Responses." Working Paper No. 203. College Park, MD: IRIS Center, University of Maryland, 1997.

*This paper offers an analytical and practical approach to corruption tailored to the needs of policymakers. It first applies extant analytical tools to four common types of corruption, and then discusses a series of near-term and long-term steps that are likely to be critical in any national effort to bring corruption under control.*

The four types of corruption discussed are:

- bribery in investment approval,
- bribery in the judicial system,
- bribery in government procurement, and
- misappropriation of public resources.

Regarding each of these types, the paper provides a brief analysis of cost/benefit (both immediate and systemic), causes, responses, and factors determining the likelihood of reform. Thus, for example, in the investment approval area, causes could include non-market allocation of permits, monopoly control of permitting power, the ability of administrators to make procedures more opaque and complex, the lack of surveillance and penalties, low pay and status of relevant officials, and the likelihood that this agency is an important target of rent-seeking patronage networks. Effective responses to the problem would need to involve some combination of competition, simplification, administrative and criminal accountability, and improved pay and standards (in addition to broader systemic and political changes).

How feasible are such changes in the near term? This depends on the existence of honest, reform-minded officials

at higher levels in the agency, as well as the effective cooperation of the private and civic sectors. However, political constraints and entrenched social expectations will pose severe obstacles in all four corruption areas examined. Thus, in order to complete and sustain anticorruption reforms in these four sectors, broader systemic issues will need to be addressed. Long-term changes will need to include economic and public sector restructuring, in order to make the state less directive and more service-oriented. Other needs are for a stronger administrative law system, a more professional and politically neutral civil service, credible audit and oversight institutions, and a competent, independent judiciary.

**Policy Implications.** Pending long-term reforms, a number of near-term reforms can have an important impact. These essentially involve opening channels of information and accountability to the public, thereby reducing the system's dependence on formal watchdogs that might be weak or compromised. These near-term targets include transparency and information rights, competition in public service provision, mechanisms for private sector competitors to deter collusion, citizen complaint and litigation venues, and supportive frameworks for watchdogs and whistleblowers.

## II.A.3 A World Bank Strategy for Anticorruption in Transition Countries

World Bank (a team led by Sanjay Pradhan and comprising James Anderson, Joel Hellman, Geraint Jones, Bill Moore, Helga Muller, Randi Ryterman, and Helen Sutch). *Anticorruption in Transition: A Contribution to the Policy Debate*. Washington, DC: World Bank, 2000. Downloadable document at <http://lnweb18.worldbank.org/eca/eca.nsf/0/D74DB51B2D46615D8525695B00678C93?OpenDocument>

*This policy report incorporates previous empirical work of the Bank staff and elaborates an interesting framework for designing anticorruption policies.*

The descriptive-analytical section reports that relative to OECD countries *corruption in transition countries is perceived as high* using the various aggregate indicators available. By these measures, corruption in Central and Eastern Europe and the Baltics is comparable to that in Latin America and the Middle East/North Africa, while corruption in the CIS countries is even higher than in South Asia and Sub-Saharan Africa. The report argues that corruption is especially costly to the poor, because of the resulting weakened public service delivery, misdirected public resources, failures to pay pensions and disability benefits, and economic stagnation.

The report's analysis and proposed anticorruption strategy are based on the distinction between "state capture" and "administrative corruption." Quantitative proxies for these concepts yield a typology according to which countries can be arrayed by the relative levels of state capture and administrative corruption, respectively: *medium-medium* countries, which have been able to contain both types of corruption to relatively manageable levels; *medium-high* countries, where administrative corruption is the more serious problem; *high-medium* countries, characterized by contained administrative corruption but high state capture; and *high-high* countries, where both types of corruption are serious problems. State capture tends to be associated with relatively high resource endowments (for example, energy resources); both types of corruption are negatively correlated with relatively strong legacies of sovereignty and closer links to European standards of civil service and judicial administration.

The report proposes a "multi-pronged" strategy to address both main types of corruption. The five main prongs of this strategy are:

- *political accountability*: encouraging political competition, transparency in party financing, disclosure of parliamentary votes, and conflict

of interest rules (together with asset declaration) for politicians;

- *competitive private sector*: promoting economic policy reform, competitive restructuring of monopolies, regulatory simplification for entry, transparency in corporate governance, and collective business associations;
- *public sector management*: establishing a meritocratic civil service with monetized and adequate pay, reforming budgetary management (including new rules and institutions for the treasury, procurement procedures, and auditing), reforming tax and customs organizations, improving sectoral service delivery (health, education, energy), and decentralizing government with proper accountability safeguards.
- *civil society participation*: implementing freedom of information procedures, public hearings of draft laws, and an augmented role for the media and NGOs; and
- *institutional restraints*: building an independent and effective judiciary, legislative oversight, and independent prosecutorial and enforcement institutions.

The report then illustrates the design of effective anticorruption strategies by showing how this multi-pronged approach applies to the four country types:

- *Medium state capture/medium administrative corruption*. For these countries, the need is to strengthen political accountability and transparency through reforms that avoid backsliding, cronyism, and conflict of interest in the public sector — for example, by promoting further reforms in civil service, public finance, procurement, and the judiciary; by introducing greater transparency into political financing; and by developing strong partnerships with civil society.

- *Medium state capture/high administrative corruption.* Here, the problem is a weak public administration, lack of control/accountability within the state, and an only nascent civil society. The strategy should aim at building public administration capacity, developing instruments for financial management, and encouraging the development of civil society.
- *High state capture/medium administrative corruption.* The strategy for these countries should focus on enhancing political accountability and promoting new entry, building on relatively strong state capacity. The high concentration of power by vested interests determined to block further reforms to preserve their advantages should be fought by both broadening formal channels of access to the state and de-concentrating economic power through competition and entry. The weak monitoring and accountability structures need to be strengthened by enhancing oversight through participatory strategies.
- *High state capture/high administrative corruption.* The strategy for these countries must concentrate on

breaking the hold of vested interests on the policymaking process, at the same time strengthening government capacity and anticorruption constituencies. The priorities should be to de-concentrate economic interests through restructuring, competition, and enhanced entry; build accountability and oversight mechanisms; and promote collective action among countervailing interests. In this type of country, stand-alone technocratic reforms will have limited impact.

**Policy Implications.** Operationalizing the strategy set forth in this paper depends on meeting several general requirements that cut across the typology set out above: credible and committed political leadership; careful, country-specific diagnosis of the nature and extent of the corruption problem in each case; assessing the social and political environment for anticorruption initiatives; finding appropriate entry points; and designing “win-win” anticorruption strategies that promote the interests of major politicians and businesspeople and deliver positive externalities such as enhancing economic growth, strengthening governance, and reducing poverty.

## II.A.4 Corruption and International Law

United Nations General Assembly,  
*Revised Draft United Nations  
Convention Against Corruption.*  
Fourth session, Vienna.  
January 2003.

*The United Nations Convention  
Against Corruption was signed in  
December 2003 by 95 countries,  
including the United States, during  
a conference in Merida, Mexico.*

This convention represents an important symbolic and practical commitment by the world community to reduce the economic, social, and political damage caused by corrupt practices around the globe. The Convention addresses corruption involving national and foreign public officials as well as the private sector; sets forth a compendium of practices that nations must declare as criminal violations, while encouraging others to be criminalized; strengthens international cooperation against corruption, including default provisions for an effective system of mutual legal assistance in the absence of other bilateral or multilateral mechanisms; establishes procedures for confiscating and returning assets derived from corrupt acts; and creates a mechanism to monitor implementation of the Convention by those states that ratify it. The Convention expressly recognizes the right, however, of individual states to implement the Convention in specific ways consistent with their own legal constitutional systems. While the Convention also does not contain a direct enforcement mechanism — and even states that ratify the Convention may do so with formal reservations that render certain provisions ineffective — it provides a powerful political and rhetorical weapon in the global fight against corruption.

**Background.** In 1996, the U.N. General Assembly adopted the U.N. Declaration Against Corruption and Bribery in International Commercial Transactions. It later negotiated the U.N. Convention on Transnational Organized Crime, which came into force in September 2003. While both of these instruments addressed corruption in discrete settings, there was significant momentum in the U.N. and in the global NGO community to adopt a more comprehensive international agreement against corruption, particularly one that addressed government corruption in all of its manifestations and that strengthened formal inter-governmental cooperation and monitoring. In December 2000, the

U.N. General Assembly decided to establish an ad hoc committee to negotiate a more sweeping anticorruption convention, and over a two-year period (from January 2002 through the end of 2003), the convention was hammered out.

**Major Provisions.** One of the most interesting — and to some, potentially discouraging — features of the Convention is its wide spectrum of types of legal obligations imposed on signatory states. There are as many as nine different formulations of such obligations, ranging from “mandatory,” to “mandatory where appropriate,” to “taking steps as may be necessary,” to encouragement “to consider” adoption of certain provisions. There is an explicit understanding that implementation will be a dynamic process that will take time, experience, and international cooperation.

**Criminalization.** The Convention sets aside one chapter for cataloguing criminal offenses for signatory states. Among the acts required to be criminalized are the *intentional bribery* of domestic, foreign, and public international organization officials; the solicitation or acceptance of *an undue advantage* by a public official; and *embezzlement* or *misappropriation of funds* by a public official. In the category of acts involving public officials that states must consider criminalizing are: *abuse of position* (defined as an official's performance of or failure to perform an act that violates a law in order to obtain an undue advantage for himself or another); *illicit enrichment*, defined as a significant increase in a public official's assets that cannot be reasonably explained; and *trading in influence* — promising or giving a public official an undue advantage such that the official will use his or her official influence to obtain from the government an undue advantage for the instigator of the act (or the solicitation or acceptance of such an advantage by an official for such a purpose). In addition, states must also consider enacting measures to

criminalize acts of bribery and embezzlement in the *private sector* when committed intentionally in the course of economic, financial, or commercial activities.

Perhaps the most significant contribution of the Convention is the extensive treatment of *money laundering*. The Convention defines money laundering in very broad terms to include such acts as converting and concealing the proceeds of a crime; concealing the true nature, source, or location of such proceeds; and the knowing acquisition or possession of the proceeds of a crime. The convention also explicitly criminalizes participation or conspiracy in any money laundering offense, as well as any attempt to commit or aid or abet a money laundering offense. States are required to apply these provisions to a wide range of underlying offenses, both within the state's jurisdiction and outside its jurisdiction (when the act constitutes a crime in both places).

**Preventive Measures.** The Convention contains a number of important preventive measures that states are required to take to address corruption in the *public sector*, including (1) establishment and maintenance of an independent body to implement anticorruption policies; (2) establishment of a transparent and competitive system of public procurement; (3) enhancement of the transparency of government functions; and (4) policies designed to prevent corruption by members of the judiciary. In addition, parties are encouraged to establish and maintain a civil service system based on merit that incorporates adequate pay and appropriate training; establish criteria for elected public office and the financing of election campaigns and political parties; and establish codes of conduct for public officials, including the reporting of outside activities and financial interests.

In the *private sector*, state signatories must establish a comprehensive regulatory system for banks and financial institutions in order to detect and deter

money laundering; disallow entities from taking tax deductions for bribes; and take measures to prevent corruption and enhance accounting and auditing standards, such as promoting cooperation between law enforcement and private entities, promoting the development of standards and codes of conduct, preventing conflicts of interest, and enacting measures to prohibit off-the-books accounts or incorrect identification of transactions. States are also encouraged to take further measures such as establishing systems to monitor cross-border movement of cash and negotiable instruments, and requiring financial institutions to collect and maintain information on originators of electronic funds transfers.

**Asset Recovery.** Another major achievement of the Convention are agreed-upon provisions for asset recovery, which specify (1) how financial institutions must closely scrutinize accounts of persons who hold or have held prominent public positions, as well as accounts held by family members and close associates; (2) how property will be returned to the state requesting it, including through court actions designed for that purpose; and (3) how authorities may confiscate or freeze property when requested by another state.

**International Cooperation and Technical Assistance.** Separate chapters of the Convention address a broad program of global cooperation to combat and prosecute corruption, and the establishment of domestic training programs for anticorruption personnel and sharing of technical assistance (especially for developing countries). As to the former, the Convention provides a default system of mutual legal assistance to investigate and prosecute offenses and share information on criminal matters even in the absence of an extradition treaty or other mutual legal assistance agreement. As to the latter, the Convention encourages parties to conduct and share analyses on trends in corruption,

in order to develop shared methodologies and good practices for combating corruption.

**Policy Implications.** The Convention is a very significant step forward in creating an international consensus around the adoption of certain law enforcement and preventive measures in and between states. Although a number of key criminalization and preventive measures are not made mandatory (for example, abuse of position violations, establishment of a merit-based civil service employment system; political finance reform measures, and reporting of public official financial interests), a strong foundation has been laid for international movement toward mandatory provisions in these areas. Requirements on the preventive side

to increase government transparency and more competitive procurement systems while bolstering anticorruption training and technical assistance will provide important practical and rhetorical tools for donor organizations, the private sector, and NGOs; however, the human and financial cost of serious engagement on these matters will be quite high. It is also unclear how useful will be the requirement that a signatory state establish an independent anticorruption body; in some countries, this might become a large and unhelpful fig leaf for inaction in other important areas. Certainly, the Convention's explicit support for information sharing and analysis lends support for more creative and nuanced ways of measuring corruption phenomenon.



## II.B TAPEE ANALYTICAL FRAMEWORK

The TAPEE analytical framework, developed in USAID's Europe and Eurasia Bureau, is an approach specifically geared to diagnose sectoral corruption vulnerabilities and design programs to reduce those vulnerabilities. The summaries of writings concern diagnosis and prescription under the headings of the *TAPEE strategic framework: Transparency, Accountability, Prevention, Enforcement, and Education*. In each case, summarized articles or volume chapters explain and give examples of the integrity factor being discussed; and introductory paragraphs discuss the definition and facets of the particular integrity factor.

Brief definitions of these five aspects of institutional integrity were given earlier. To repeat, for the reader's convenience, they are:

- *transparency* (public availability of information about government decisions and participation of the public — directly, through delegated representatives, or through full reporting of results — in the processes of government decision-making);
- *accountability* (the responsibility of government officials to do their duty and their answerability to those to whom they report and ultimately those whom they serve; accountability may be both horizontal — referring to checks and balances across government bodies — and vertical — referring to accountability vis-à-vis higher authority and the general public);

- *prevention* (elimination and control of corruption risk factors and vulnerabilities by means of institutional reforms that reduce corruption opportunities and align the incentives of government “agents” with the public they are supposed to serve);
- *enforcement* (not only the police and judicial enforcement of criminal and civil law, but also to the setting and implementation of standards that ensure government integrity); and
- *education* (the provision of the public with information that raises their awareness of corrupt behavior in the government, and inculcation of citizens — beginning at the school level — with moral values that militate against corrupt behavior).

These five integrity “TAPEE pillars” — as they shall be referred to — are convenient reference points for particular types of anticorruption programs. They are not intended to comprise a philosophical system, in which each term defines a wholly separate entity. As a result, there will sometimes be found some degree of overlap between these concepts — a fact illustrated by some of the summarized writings, whose authors were necessarily unfamiliar with the TAPEE framework. Thus, in the pieces on accountability, elements of “transparency” are evident. Likewise, there is overlap between aspects of prevention and enforcement. It is hoped that the short introductory sections on each of the five TAPEE pillars will serve to clarify their core meanings.

## II.B.1 TRANSPARENCY

“Transparency” can be thought of as the fundamental pillar of the TAPEE approach: without it, none of the other pillars are possible. Transparency typically refers to the sharing of information between principal and agent, in the first instance: this makes it more difficult for the agent to act in opposition to the interest of the principal. The further sharing of information with clients of government agency — who can be thought of as the general public — is a *sine qua non* of principals and agents being held accountable by the public for the actions of a government agency.

One can distinguish between two types of transparency: “substantive” and “procedural” transparency. *Substantive transparency* refers to reducing the information gap that separates principals from agents — for example, the general public (“principals” in a democratic setting) from agents (those running the government agency). *Procedural transparency* refers to the openness of decision-making processes in government agencies; openness often also implies some degree of participation by those outside the relevant agency. It is obvious that the lack of procedural transparency will be buttressed by a lack of substantive transparency, and vice-versa; if key information pertinent to government decisions is kept from the public, the decision-making processes will also be more easily kept secret, while, conversely, if decision-making is

open to public scrutiny, the information that enters into those decisions will be more difficult to hide.

Transparency issues pervade the entire range of corruption and integrity concerns; the lack of transparency is normally a precondition for corrupt dealings. The two articles below both explore the implications of transparency for international donors and for a country’s relations with the outside world. *Florini (II.B.1.a)* discusses the types and extent of transparency that should be encouraged by the IMF and World Bank, pointing out both the importance of creating incentives for businesses and governments to be more transparent and ways in which improved transparency can facilitate global financial markets. *Gelos and Wei (II.B.1.b)* underline this point with evidence that more transparency (or less “opacity”) in a country raises the level and quality of international investment coming into that country.

Given the need to create incentives for greater transparency, and the positive effects of the latter on a country’s participation in globalized markets, it is evident — as noted by Florini — that it is important that achieving increased transparency involves building national and international constituencies for that goal. However, it is also noted that there are some downsides to certain kinds of transparency, and in some circumstances if transparency is carried too far.

## II.B.1.a.

### Transparency in the Global Economy

Ann M. Florini. "Does the Invisible Hand Need a Transparent Glove? The Politics of Transparency." Annual World Bank Conference on Development Economics, 1999.

*The demand for more transparency in governments and institutions is a reflection of globalization: as the world becomes increasingly integrated, the impact of financial crises and political change can stretch far beyond national borders. Increasing transparency requires incentives that will encourage governments and corporations to provide information that can hold them accountable for their actions. International financial institutions can play a significant role in increasing transparency by demonstrating the benefits of it through their own behavior.*

The purpose of transparency is to permit the evaluation of and to hold accountable those whose policies and performances directly affect others. Overcoming the principal-agent problem is necessary in order to ensure that government officials are working on behalf of their constituents and that stockholders are making wise investment decisions. When principals are assured that their agents are working in their best interests, the prevalence of financial or political crises can decrease, and the impact of these crises beyond international borders can be lessened.

**Incentives for Transparency.** The fundamental tool in creating greater transparency is self-disclosure. However, increasing disclosure is dependent upon the cooperation of those who are accustomed to withholding sensitive information. In order to be able to induce disclosure, appropriate incentives or coercion tactics have to be used. Whether through coercion or incentives, disclosure always shifts the balance of power from the one who discloses to the information seeker, rendering more vulnerable those who try to protect opportunities for rent seeking or who try to hide criminal behavior. The focus should be on creating incentives, because transparency most often relies on the voluntary release of information.

The definition of transparency has not been rigorously or universally defined and its meaning can change depending upon the issue, whether it is politics, arms control, or finance. However, all definitions agree that the purpose of transparency is to allow citizens, markets, and governments to hold others accountable for their policies and performances; transparency can be described as "...the release by institutions of information relevant to evaluating those institutions." Whether an institution would be willing to be evaluated depends on how the information released will be used. If the goal is deterrence, highlighting bad behavior

helps meet this goal, if such behavior can be identified and penalized. Deterrence can also promote reassurance, allowing institutions to prove they are abiding by a set standard of shared behavior. Businesses, however, may be reluctant to meet the transparency standards demanded by NGOs, because they may be criticized for failing to meet standards that they have never agreed to. Misinterpretation or even the deliberate misuse of information can also discourage self-disclosure.

**How Much Transparency?** It is also possible to have too much transparency, as too much information can create a "white noise" effect that makes it difficult for a seeker of information to distinguish between which information is significant and which is not. A deluge of information also makes it easier to conceal incriminating behavior. Consideration must also be given to the burden placed upon those who hold the information, as the time and effort it may take to disclose information can be difficult for some to handle. For transparency to work, attention must be given to minimizing this burden and creating user-friendly formats that reduce the "white noise" effect.

Information generated through greater transparency can also be used maliciously. For example, a country that discloses information about its weapons stockpile can make itself vulnerable to another country's attack. Or, deliberately misusing or misinterpreting information about one's business rivals can lead to harmful economic consequences, such as plunging stock prices or capital flight.

**Civil Society and Corruption.** According to the author, shining the spotlight on corrupt officials has been done so often already that even the prospect of becoming more transparent has been a deterrent for bad behavior. IMF and World Bank programs should be directed toward building civil societies that demand transparent and accountable governments. Accountability in

government is likened to competition between firms — it can lead to efficiency in competition between political ideas within an open society. It may also increase efficiency in market operations, possibly decreasing the risk of financial crises. Decreasing corruption can also alleviate the frustrations of international donors and NGOs tired of development funds diverted for unscrupulous uses.

***Transparency in the Global Economy.***

It is widely believed that greater transparency can improve some of the negative aspects of global financial markets, particularly with regard to volatility, money laundering, and the avoidance of necessary fiscal reform. Transparency can provide investors with reliable information on the quality of expanding international investment opportunities — in order to make good decisions, investors must be able to discriminate among clients vying for their business. Personal trust, reputation, and well-functioning legal systems (to persecute fraud, if necessary) do not appear to be working well in such a rapidly evolving financial system. Access to better information could ameliorate or even prevent financial crises, because better information on the economic and

financial affairs of others' banks and businesses can strengthen market discipline and highlight the need for any corrective action. It would also improve the reliability of risk assessment, leading to more stable investment decisions and efficient government policy.

***Policy Implications.*** Increasing transparency is the key to greater global economic integration and success, for only with transparency is it possible to deter bad behavior such as corruption and encourage the efficient allocation of investment across countries and companies. The key is to build up national and international constituencies for transparency by creating incentives for corporations and governments to become more transparent. In order to encourage markets to instill incentives and impose penalties for opacity, the World Bank and IMF should build transparency registries and make transparency a condition for receiving loans, as well as help policymakers identify the need for corrective action. Demonstrating the economic advantages of their own good behavior would underscore the point that transparency, although at times difficult to implement, can increase an institution's legitimacy and efficiency.

## II.B.1.b Transparency and International Investment

R. Gaston Gelos and Shang-Jin Wei. "Transparency and International Investor Behavior." NBER Working Paper No. 9260. Cambridge, MA: National Bureau of Economic Research. October 2002.

*Measures promoting transparency are touted by organizations such as the International Monetary Fund (IMF) as preventative medicine against financial crises and contagion. The authors of this paper explore the empirical relationship between opacity and international mutual fund flows. Their results provide evidence that more transparent (less opaque) countries exhibit higher levels of international investment, less herding behavior among international investors, and lighter outflows of capital in periods of crisis. The opacity indices, and their construction, are perhaps as noteworthy as the regression results.*

**Measuring Transparency.** The authors distinguish among four types of opacity: government "macro policy opacity," government "macro data opacity," corporate opacity, and a composite index covering both government and corporate aspects.

*Macro policy opacity* is a one-time country average derived from separate measures for fiscal and monetary policy by Oxford Analytica for Wilshire Associates.<sup>8</sup> In turn, the Oxford values are based predominately on country compliance in IMF "Reports on Standards and Codes." *Macro data opacity* is based on IMF figures as well; Allum and Agca (IMF Working Paper No. 01/173, 2001) construct two measures for frequency and timeliness of macro data dissemination for member countries. Gelos and Wei take a simple average of the two measures for each country in each of three available years.

*Corporate opacity* is based on survey responses in the "Global Competitiveness Report" from the World Economic Forum. Respondents are asked to rate the level of financial disclosure and also the availability of corporate information in their home country. Gelos and Wei compute a one-time, simple average across countries from these values.

Additionally, the authors utilize a *composite index* that straddles the divide between government and corporate opacity. This index is derived from a 2000 PricewaterhouseCoopers survey of firms, banks, and analysts on "opacity in five areas: bureaucratic practices (corruption), legal system, government macroeconomic policies, accounting standards and practices, and regulatory regime" (Gelós and Wei, p. 8).

**Empirical Analysis.** The authors obtain their dependent variables from monthly data on investment allocations by country for some 300 international mutual funds from 1996 to 2000. Their panel regressions can be divided into three categories. Their first regressions explore the relationship between investment allocation levels and the four opacity indices individually, controlling for a multitude of additional factors including liquidity, exchange rate regimes, and return chasing. Without exception among the four indices, opacity is significantly associated (at the five percent level) with lower fund allocations.

Additionally, Gelos and Wei regress a measure of investor herding on the opacity indices and proxies for liquidity and market size. Their results are weaker than above; only two indices — corporate opacity and composite opacity — have significant coefficients. The final regression exercise tests whether investment outflows during the Asian and Russian financial crises of 1997–98 are associated with government and corporate opacity. With additional controls, only the indices for macroeconomic data and policy opacity are significant.

**Policy Implications.** Government policies in two areas — the government's own transparency in disseminating macroeconomic data and formulating macroeconomic policies and its policies to compel domestic corporations to practice transparency with regard to their finances and governance — can have significant influence over the level and stability of international capital inflows.

8. Wilshire Associates, "Permissible Equity Markets Investment Analysis and Recommendations," prepared for the California Public Employees' Retirement System (2002). Available online at [http://www.calpers.ca.gov/eip-docs/investments/assets/equities/permissible.analysis\\_2002.pdf](http://www.calpers.ca.gov/eip-docs/investments/assets/equities/permissible.analysis_2002.pdf). An updated version is available for 2005.

## II.B.2 ACCOUNTABILITY

Accountability refers simultaneously to:

- the *responsibility* of governing institutions and their personnel to carry out certain duties for the benefit, broadly, of the general public or, more narrowly, of that part of the general public who are the intended beneficiaries of the government program, and
- the *answerability* of the government agency, that is, the requirement that the agency and its personnel render periodic accounting of their actions, disclosing relevant information either to the public or to other agencies within or outside the government that are designated by the public.

Answerability, in turn, implies certain mechanisms, explained by *Schedler (II.B.2.a)*: these include the elements of *monitoring, justification, and enforcement* (thus linking up with another TAPEE pillar). Schedler describes the fundamental distinction between *vertical* and

*horizontal accountability* and the problem of "second-order accountability," that is, the question of how to hold institutions of accountability accountable themselves.

*Vertical accountability* means the ability of citizens to punish or reward incumbents by voting against or for them, respectively. *Horizontal accountability*, further discussed by *O'Donnell (II.B.2.b)*, is often referred to as "checks and balances"; this type of accountability requires state agencies that are authorized and willing to oversee, control, redress, and sanction unlawful actions of other state agencies. New democracies with vertical accountability and weak horizontal accountability tend to provide limited means of redressing wrongdoing exposed by public criticism; as a result, guilty officials escape sanctions. Thus building stronger horizontal accountability in developing and transition countries is a means to improve governance, build the rule of law, and strengthen basic liberal freedoms.

## II.B.2.a Accountability: Vertical, Horizontal, and Other

Andreas Schedler. "Conceptualizing Accountability." In Andreas Schedler, Larry Diamond, and Marc F. Plattner, *The Self-Restraining State: Power and Accountability in New Democracies*. Boulder, CO: Lynne Rienner, 1999.

*Schedler shows that accountability is a broad, multi-faceted concept; defines its main features — monitoring, justification, and enforcement; and shows that these features differ depending on who is accountable, to whom, and about what. The key distinction between horizontal and vertical accountability relates to two quite different sets of institutional structures and safeguards.*

**Answerability and Enforcement.** The concept of accountability is meant to address the problem of how to constrain the power of the state: without checks on a government's power, its arbitrary use is probable. Accountability is a broad concept, embracing three different ways of preventing and redressing the abuse of power: subjecting power to the threat of sanctions (*enforcement*), obliging it to be exercised in transparent ways (*monitoring*), and forcing it to justify its acts (*justification*). *Monitoring* and *justification* can be summed up as *answerability*. Thus answerability implies the need for transparency, the right of others to receive information, and the corresponding obligation to release all necessary details. It also implies a dialogue between those accountable and those doing the accounting. *Enforcement* implies the existence of sanctions — typically either forms of *legal accountability* (for example, taking the accountable official or agency to court) or *political accountability* (for example, removing the accountable official from office).

**Partial Forms of Accountability.** In practice, there can be different degrees and forms of accountability. There may be monitoring — that is, information provided by the accountable person or agency to the public or a monitoring agency — without any practical sanctions, sometimes even without meaningful dialogue ("justification"), for example, the provision of information by an essentially autonomous central bank. Conversely, there have been instances of enforcement without meaningful monitoring and dialogue, for example, the ouster (through civil unrest) of Indonesia's President Soharato in 1998.

**Limits to Accountability.** The notion of accountability presupposes that an agent with some power and margin of discretion is responsible for decisions and actions; it follows that accountability is not synonymous with tight regulation or control by those to whom accountability is due. There are also practical

limits to transparency; it is important to distinguish between *public accountability* and *confidential accountability* (that is, accountability to a small group, often also sharing power) — the latter type tends to be perceived as a caricature of accountability. Public accountability implies that the actions of any agencies responsible for monitoring must be open to the general public, thus ensuring at least some degree of both answerability and enforcement (at least "reputational consequences").

**Agents of Accountability: Horizontal versus Vertical Accountability.** *Vertical accountability* describes a relationship between a more-powerful and a less-powerful actor. This could be either the classic case of *bureaucratic accountability*, in which higher-ranking public officials ("principals") try to control their lower-ranking subordinates ("agents"), or the case of *electoral accountability*, in which citizens periodically pass judgment over their representatives through elections, or civil society actors try to hold state agents accountable. *Horizontal accountability* refers to a relationship between accounting and accountable parties that are autonomous vis-à-vis each other (not formally superior or subordinate) but where the accounting agent has more power in its own sphere of competence than the accountable agent, that is, the accounting agent has enforcement mechanisms at its disposal. Checks and balances among different branches of government is a classic form of horizontal accountability that "presupposes a prior division of power" within the state. The author argues that it is sensible to limit the notion of horizontal accountability to intra-state relations. The notion of accountability operating across national borders is not one that fits easily into the dichotomy of vertical vs. horizontal accountability: it is, rather, a wholly different dimension to accountability.

**Second-Order Accountability.** The problem of how to hold institutions of accounta-

bility accountable themselves arises when “specialized, nonelective, autonomous state organizations ... are supposed to pursue their narrow missions with professional single-mindedness, while they are nevertheless vulnerable to inefficiency and abuse the same as any other locus of power.” The ultimate solution may be for a set of agencies that are mutually accountable to each other.

***Policy Implications.*** A TAPEE-based program to strengthen accountability in government must be formulated for each government agency, with due

regard to the different types of accountability in operation and with a careful choice of the types of accountability to foster, taking into account what seems to be more effective and feasible. For some agencies, electoral accountability will be less relevant than putting in place a proper set of checks and balances vis-à-vis other government agencies; however, on the local government level, electoral accountability (for instance, elected local boards of education) may indeed be the appropriate institution to be strengthened.



## II.B.2.b Horizontal Accountability

Guillermo O'Donnell. "Horizontal Accountability in New Democracies." In Andreas Schedler, Larry Diamond, and Marc F. Plattner, *The Self-Restraining State: Power and Accountability in New Democracies*. Boulder, CO: Lynne Rienner, 1999.

*Horizontal accountability is the exercise of oversight and sanctions by government agencies against the unlawful activities of other agencies. In new democracies, such accountability tends to be weaker than vertical accountability — the exercise of the electorate's power to elect and remove governments from power and to freely criticize government. In part, this is because liberal and republican traditions may be weak in these countries and the executive power — also following historical precedents — tends to exert unlimited authority. Strengthening horizontal accountability in these countries requires a multi-faceted agenda that, in some places, may face a long, uphill struggle.*

**Vertical and Horizontal Accountability in New Democracies.** In these countries, which have recently become "polyarchies" — the author's term for political democracies — vertical accountability thrives: that is, citizens are able to punish or reward incumbents by voting for or against them and freedoms of opinion and of association permit open articulation of demands upon, and criticisms of, public authorities. By contrast, horizontal accountability tends to be weak, with the results that (1) there are limited means of redressing wrongdoings exposed by public criticism, leading to a climate of public disaffection with the government that in turn undermines effective leadership and (2) guilty officials often escape sanctions, while innocent ones are tainted, without due process in either case.

**Three Historical Currents: Democracy, Liberalism, and Republicanism.** Three concepts of modern government underlie effectively operating accountability structures. *Democracy* — "the participatory right of citizens to choose who is going to rule them" and to "freely express their opinions and demands" — underlies vertical accountability; while effective horizontal accountability presupposes the components of *liberalism* — "the idea that there are some rights that should not be encroached upon by any power, including the state" — and *republicanism* — "the idea that the discharge of public duties is an ennobling activity that demands careful subjection to the law and devoted service to the public interest, even at the expense of sacrificing the private interest of the officials." An effective polyarchic state requires a balance among these three, partly contradictory, sometimes complementary ideals. In practice, one finds different types of polyarchies embodying different balances among these three elements.

**Horizontal Accountability: Definition and Forms.** Horizontal accountability "is the existence of state agencies that are

legally enabled and empowered, and factually willing and able, to take actions that span from routine oversight to criminal sanctions or impeachment in relation to actions or omissions by other agents or agencies of the state that may be qualified as unlawful." These actions can address infringements upon the following areas: *democracy*, when government decisions cancel freedom of association or conduct fraudulent elections; *liberalism*, when state agents violate (or allow private actors to violate) freedoms and guarantees; and *republicanism*, when state officials do not properly subject themselves to the law and/or favor private rather than public interests. In order for horizontal accountability to operate, there must be state agencies that are authorized and willing to oversee, control, redress, and sanction unlawful actions of other state agencies — this includes standard institutions of the executive, legislative, and judicial branches of government, but also "various overseeing agencies, ombudsmen, accounting offices," and so forth.

**Problems of Horizontal Accountability in New Democracies.** There is a tendency in these countries for the executive, claiming public support in democratic elections, to discharge broad responsibilities, ignoring — even eliminating, co-opting, or neutralizing — other agencies that are supposed to be autonomous. In large, federal systems, local governments may behave in a similar fashion, although the local and central powers may to some extent limit each other. So far, in most of these countries "the path of nonaccountability seems to be the dominant strategy." Horizontal accountability is violated in two main ways: "the unlawful encroachment by one state agency upon the proper authority of another" and corrupt behavior by officials. In the long run, the first of these is more dangerous for survival of polyarchy; it tends to destroy polyarchy and places large obstacles to the emergence of state agencies acting

according to properly defined, institutionalized authority. This tendency is helped by the weakness of liberal and republican traditions in these countries. The good news is that in many of these countries (1) there is a growing mood of condemnation of corruption and (2) organizations are emerging that demand both respect for basic liberal freedoms and guarantees for the weak and poor; that educate the population in their political rights; and that act as watchdogs of the lawfulness of state actions.

***Policy Implications.*** Initiatives to strengthen horizontal accountability include:

- giving opposition parties a role in investigating corruption,
- giving agencies like general accounting offices the financial and human resources, and the independence, to do their jobs;
- strengthening the professionalism,

resources, and independence of the judiciary;

- ensuring that the weak and poor are at least decently treated by state agents — this is an especially difficult problem in societies marked by deep inequalities;
- publicly supporting agencies that are independent from the government and make data on a broad set of indicators, not only economic, widely available, complemented by independent media and research institutes;
- maintaining vertical accountability, thereby putting pressure on the state to pursue horizontal accountability; and
- presenting good examples by highly placed individuals “who act, and persuade that they act, according to the liberal and republican injunctions.”

## II.B.3 PREVENTION

The prevention pillar of the TAPEE approach is based on the idea that corruption is a response to opportunities for civil servants and their clients to take advantage of the “Monopoly” and “Discretion” sides of Klitgaard’s corruption equation. *Prevention*, in the anticorruption strategy context, means *reducing opportunities for corruption*, as well as *changing incentives* so that the benefits of corruption decline and the costs of corruption increase. These costs, of course, are closely related to the enforcement pillar; but the initial setting of rules, regulations, and laws falls under the category of prevention.

The one item summarized here is a chapter (II.B.3.a) from Rose-Ackerman’s book *Corruption and Government*. It encapsulates in a comprehensive way the various modalities of *prevention* reforms:

- eliminating programs (like price controls) that serve no legitimate economic or social purpose and

“function principally as bribe-generating machines for officials”;

- privatizing state-run firms, which typically involve corrupt transactions (payoffs to politicians and civil servants, hiring relatives of government officials, etc.), but perhaps more crucially, ensuring that the privatization process itself is not vulnerable to corruption;
- reforming public programs, like tax administration, health provision, and education, that tend to lend themselves to corruption of various sorts;
- creating competitive pressures in government administration;
- adopting anticorruption laws covering a wide range of government activities; and
- reforming procurement systems (which frequently provide ample opportunity for payoffs to officials responsible for government procurement).

## II.B.3.a

### A Strategy for Preventing Corruption

Susan Rose-Ackerman. "Reducing Incentives and Increasing Costs." Chapter 4 in *Corruption and Government: Causes, Consequences, and Reform*. Cambridge and New York: Cambridge University Press, 1999, pp. 39–68.

*Corrupt incentives exist because state officials have the power to allocate scarce benefits and impose onerous costs. The author reviews various options for reforms that can reduce these incentives and increase the cost of engaging in corrupt transactions.*

Because officials' power to allocate scarce resources is what creates opportunities for corruption, a prevention strategy is based upon various ways to reduce that power, by eliminating or restructuring government programs that involve this allocation, that is, *reducing incentives and increasing costs* for officials to engage in corrupt practices. The various ways of doing this can be categorized as follows:

- program elimination,
- privatization,
- program reform,
- administrative reform,
- anticorruption laws, and
- reform of procurement systems.

**Program Elimination.** Eliminating government programs in which corruption is prevalent is the most straightforward way of fighting corruption. For instance, programs involving the granting of export or import licenses that are in short supply, price control programs that give certain citizens low-priced food or housing, and programs that regulate business are notoriously vulnerable to bribery. Simply lifting bans on certain imports or products, or reducing very high taxes, will automatically eliminate, or greatly reduce, any incentive for corruption.

**Privatization.** Although privatization can be an anticorruption reform — by eliminating state-owned businesses that are a breeding ground for corruption — care must be taken to reduce incentives for corrupt gains in the privatization process itself. "The process should assure the widest level of participation rather than favoring consortia with strong ties to local elites and must be transparent and well publicized, especially in the evaluation of assets."

**Program Reform.** Government programs that have strong justification for continued existence must be reformed rather than eliminated. Laws governing the

program must be streamlined "to reduce official discretion and to make monitoring simpler and less arbitrary;" while rules and regulations can be made clearer and their implementation more transparent. Sometimes, however, thoroughgoing civil service reform (see II.C.1) may be necessary; for instance, corruption in revenue collection may be reduced by lower tax rates and simplified tax systems and administration, but complete reform of the tax administration may also be required.

**Administrative Reform.** If each official is uniquely responsible for a particular service in a particular geographical area, he exercises monopoly power over clients. This power can be broken by creating "overlapping jurisdictions that permit clients a choice of which bureaucrat to approach." Such competition will tend to lower the size of bribes or extortion involved in transactions with officials. The effectiveness of this reform, however, depends on the ability of supervisors to monitor outcomes — thereby imposing on civil servants a risk of corrupt behavior being discovered.

**Anticorruption Laws.** Criminalization of corrupt behavior can help deter those involved in corruption. The design of such laws — finding the right mix of penalties, rewards, and intensity of law enforcement — raises complex issues such as the relative penalties on bribers and payees, the size of penalties, and the allocation of law enforcement effort among different kinds of corruption. "Complete rectitude" is usually unattainable at a reasonable cost. "The goals of law enforcement should be to isolate those corrupt systems that are doing the most damage to society and then to organize the deterrence effort to make corruption costly on the margin and to give participants an incentive to report a corrupt deal."

**Procurement Reform.** The procurement process is a major source of corruption in most developing countries, which need to adopt more transparent

processes, more reliance on bargaining, and use of such methods as experience-rating for contractors, benchmarking, and the purchase of standard items. Reforms must be suitable to the level of expertise available in the government and the efficiency of legal systems.

***Policy Implications.*** Corruption is an area where an ounce of prevention is worth a pound of cure. Donors interested in assisting with anticorruption efforts should first pay careful attention to opportunities for eliminating or restruc-

turing government programs, to the way privatization is conducted, and to government procurement systems, before putting too much emphasis on fighting corruption via the criminal justice system, which itself may be in need of reform. Another major point made by the author is that the costs and benefits of an anticorruption program must be weighed: the outcome of such a calculation is likely to be short of complete eradication of corruption from government systems.

## II.B.4 ENFORCEMENT

The *enforcement* pillar of TAPEE comprises a complex set of institutional mechanisms, which include:

- anticorruption rule-enforcement units within government agencies and the criminal justice system (both police and judiciary),
- government audit bodies (reporting to either the executive authority or the legislature), and
- centralized anticorruption agencies appointed to exercise jurisdiction over the entire range of government activities.

*Meagher (II.B.4.a)* addresses the third of these enforcement mechanisms by reviewing experience with centralized anticorruption agencies in a number of countries. He finds that while a coordinated attack on corruption is an attractive idea — and there have been a few well-known success stories — such an agency is likely to be unsuccessful unless a number of conditions are met:

- adequate public and political support,
- adequate funding,
- adequate data collection and enforcement by individual government agencies, and
- properly functioning, honest, and cooperative judiciary and police.

Meagher also points out that the larger the country in question, the more difficult it is for a single anticorruption agency to play an effective role. It is

perhaps significant that the two most famous success stories — Hong Kong and Singapore — are both geographically compact city-states. In larger countries, more decentralized anticorruption efforts in individual government agencies become crucial for success.

Effective enforcement also presupposes a well-articulated, transparent set of rules, regulations, and laws — which falls under the “prevention” category. One danger — especially in countries where transparent, accountable democratic government is not well-established — is that enforcement is “selective,” that is, that it is used to suppress individuals who are in opposition to the ruling party or group. (Recent events in Russia are an excellent example of this danger.)

The need for support from the police and the judiciary is of obvious importance. However, the judiciary and the police are themselves notorious breeding grounds for corruption in most developing and transition countries; reform of these agencies is a separate topic, beyond the scope of this *Reader*. Suffice it to say that reform of poorly functioning, corrupt judiciaries and police forces has proved a complex, difficult, and long-run task; it follows that simply strengthening the police, when corruption is a problem within the police force itself, in no way furthers the anticorruption agenda. For this reason, anticorruption efforts should be concentrated, to the extent possible, on other types of enforcement mechanisms and on other pillars of the TAPEE strategy.

## II.B.4.a A Review of Anticorruption Agencies

Patrick Meagher. "Anti-Corruption Agencies: A Review of Experience." Prepared for World Bank PREM-ECA. College Park, MD: IRIS Center, University of Maryland, 2004. Also available in Patrick Meagher. "Anti-Corruption Agencies: Rhetoric versus Reality." *Journal of Policy Reform*, Vol. 8, No. 1 (2005).

*This paper examines centralized or single-agency approaches to combating corruption. The author analyzes documentation on existing anticorruption agencies and presents three original case studies to assess the strengths and weaknesses found in these agencies. The aim of the paper is to provide practical guidance to policymakers in implementing agency objectives and to identify strategies that would allow for the creation of a more rigorous assessment framework of anticorruption agencies.*

### *Assessing Performance of Anticorruption*

**Agencies.** In recent decades, policymakers have increasingly turned to anticorruption agencies (ACAs) as consolidated mechanisms used to fight corruption. The establishment of such an agency, however, can pose more questions than answers, as policymakers must determine how much authority to allocate to such an agency, how large such an agency should become, and most importantly, how to measure its outcomes.

Assessing the performance of ACAs has proved difficult, particularly because data on agency outputs was often lacking or their missions were too broadly defined. The authors collected data on approximately thirty ACAs and identified six commonly performed functions. These functions can be measured by performance indicators such as output, outcome, efficiency, and productivity. The indicators, identified by the ACAs themselves, suggested that the generally expected outcome of an ACA is "an overall improvement in the performance of anticorruption functions." Having reviewed and compared indicators of ACA performance, the author analyzed several case studies in an effort to explain the successes and failures of these agencies. The author proposed a set of likely determinants of success — gleaned from the sparse literature on ACAs — and used them to evaluate the case studies, using two historical examples for comparison.

### *Historical Examples: Singapore and Hong*

**Kong.** The idea of shifting multiple anticorruption activities into a single agency first gained prominence in Singapore and Hong Kong. In both city-states, agencies were established in response to major corruption scandals. The agencies have very different approaches to implementing the single-agency approach. Hong Kong's agency is huge and became known early on for large-scale investigations leading to the prosecution of high-level officials and businesspeople, and for its efforts to

change the "ethical climate." It is distinctive in pursuing all corruption allegations and for including citizen input in oversight and reporting of corruption cases. Singapore's agency is much smaller and more secretive. It has helped set a "moral tone" for the government and has also investigated high-profile cases. However, it has also been dogged by accusations of overzealousness and abuse. Both Hong Kong and Singapore are considered anticorruption success stories, but these successes were probably based on specific circumstances that are not likely not be reproduced elsewhere.

Several other countries, including Botswana and Australia (New South Wales province) have adopted the Hong Kong/Singapore model with variations. Botswana's agency lacked resources and faced an uncooperative judiciary. Australia's agency followed Hong Kong's model but molded it to pursue a unique strategy: pursuing test cases and developing preventive tools, leaving the prosecution and follow-up work to other agencies. These varying approaches to fighting corruption show that choosing an ACA's jurisdiction is an integral strategic decision. The Hong Kong and Singapore model requires jurisdiction over a slew of corruption-related offenses, including both public and private sectors. The issue then becomes one of synergy or economy: which activities are more effectively dealt with together? In small jurisdictions such as Botswana and Hong Kong, it is relatively easy to group all corruption-related offenses into one investigative body. However, this encompassing type of power can be easily abused — or, as in the Botswana case, it can create responsibilities that outstrip the means at the agency's disposal.

**Current Examples.** In a subsequent part of the paper, the author analyzes in more depth the anticorruption efforts of three other countries. In Argentina, the anticorruption agency is a special unit within the Ministry of Justice and Human Rights and

ultimately answers to the President. An area of concern is its close proximity to these high levels of government; however, it has proven capable of working effectively outside of the executive chain of command by informing the Ministry of cases after they have been investigated. Importantly, the agency in Argentina, like its counterpart in Australia, has the ability to focus its efforts on high-priority cases, using statutory criteria to make choices. A deterrent common to many ACAs is funding: in Argentina's case the economic crisis severely limited its budget and staffing. The Malaysian ACA is a classic example of the Hong Kong approach. It is well funded and can rely on cooperation from other governmental agencies. It is well known for the professionalism of its staff but has been criticized for not pursuing cases involving "big fish" politicians and businesses. The Tanzanian ACA is also structured like Hong Kong's, promoting prevention through outreach and deterrence through prosecution. It is directly supervised by the office of the president and there are no legal safeguards protecting its independence; hence, it has not gained much public support. The ACA has not been effective in combating corruption, mainly due to the backlog of cases in the judiciary and its weak linkages to other entities such as the police.

**Policy Implications.** The author suggests that an ACA is only a part of the solution to combating corruption. Using a core set of anticorruption functions to measure how well ACAs have performed is somewhat helpful in terms of comparison, but not in terms of understanding why they perform at a given level. Data are often lacking and there are many exogenous factors that affect performance, such as the political and economic conditions described above. Establishing an agency at the right moment is critical to capturing the momentum brought about by scandal. Also critical is gaining consensus on strategy and providing adequate funding for the strategies set forth. If a country does not have an ACA but has pressing corruption issues, the author recommends investigating what existing agencies can do to address corruption. If establishing an ACA is considered a worthwhile priority, it must build on a political consensus in order to achieve its goals and work effectively with other agencies. It must also set up an information-sharing system that allows it to collect, verify, and make public information regarding its performance so that an effort can be undertaken to thoroughly assess its impact.



## **II.B.5 EDUCATION**

“Education” refers in this context to the inculcation of moral values that are opposed to corruption. This is a fundamental element in the process of a society turning away from corrupt behavior; at the same time, it is difficult to define and implement. Cultural attitudes and patterns of social behavior typically take long periods of time to change (see summaries *I.C.5 through I.C.8*) on the sociology of corruption. To some degree, these attitudes and patterns are not derived from cultural and religious traditions but are ways of adapting to hard economic and political necessities. Sometimes positive changes like market-oriented growth and democratization can bring about positive changes in attitude and behavior; but this is not to be taken for granted since — as demonstrated in some transition countries — new markets and democratic systems can create new opportunities for corruption (on the impact of democratization, see *Rose-Ackerman, II.C.8*).

Nevertheless, the task of turning a corrupt society around has to begin somewhere. *Keen’s* overview of “fighting corruption through education” (*II.B.5.a*) covers both the promotion of general public awareness and education of the

young. A public awareness program can be initiated by the government, but it is likely to be more effective when carried out by independent media and civil society. Ideally, the public becomes involved in monitoring government integrity and is provided with outlets for reporting violations. Civil education in the schools can build a more aware public in the future, one that plays an active role in monitoring corruption.

A warning note is sounded by *Uslaner (II.B.5.b)*, who suggests that the causal connections between corruption and cultural attitudes (summed up in the term “trust”) run in both directions and that reduction in corruption — produced, for instance, by active efforts by the political leadership — have little effect on “trust.” A culture of mistrust is slow to change. *Uslander* gives no prescription for trust-building; historical observation suggests that a necessary (though not sufficient) condition for increased trust is far-reaching transformation of political and economic systems previously identified with the prevailing social attitudes. *Johnston’s* ideas on political and economic opportunities are relevant (*I.C.2*).

## II.B.5.a Corruption and Education

Ellie Keen. "Fighting Corruption through Education." Constitutional and Legal Policy Institute (COLPI) Paper No. 1. Budapest: Open Society Institute, 2000.

*The objective of this paper is to assist COLPI in identifying and creating public awareness and public education components missing from current Open Society Institute anti-corruption programs. The paper is divided into two sections. The first focuses on education in the community as a whole for the promotion of public awareness of corruption. The second section offers lesson plans aimed at building awareness among the young. The suggested lesson plans and strategies are designed to appeal to the general public, teachers, and young people, and their broad content allows programs to be adapted according to country-specific situations.*

**Public Education and Civil Society.** The goal of a public awareness program is to introduce the general public to corruption and to increase its knowledge about the issue without proposing actual ways to combat it. Drawing from experience and data from anticorruption programs around the world (and Eastern Europe in particular), the author categorizes various efforts of anticorruption programming and analyzes the components necessary for successful public awareness programs. Public awareness programs directed at civil society are crucial to combating corruption, because civil society itself is involved in corrupt practices and is only one actor among many, including government ministers, law officials, and businesses. However, civil society's role as a potential force against corruption is unmatched by any other actor, because civil society's roles can include monitoring, lobbying, and information dissemination — roles that the others typically do not engage in.

An effective public awareness program includes the collection and dissemination of information. However, the author's objective is not only to create awareness of corruption, but to provide an approach that will allow civil society to achieve actual changes in corruption. Civil society must first realize its own role in corruption and understand its potential role in reducing it. The author describes several functions civil society can engage in:

- "Self-examination." This includes media campaigns shocking the public into an awareness of how close to home corruption can be and of its own possible participation in it.
- "Cheerleading" or seeking out the positive outcomes of others' efforts. Publicity campaigns that promote positive results are just as important as reporting harmful results. The public needs to be shown that change, however slowly it occurs, can happen.

- "Monitoring." The public can have two kinds of monitoring roles. The first involves generally being aware of corrupt practices that take place in everyday situations. The second involves monitoring specific aspects of society, such as the practices of traffic police. In either role, the public should have outlets available for reporting and complaining about corruption.
- "Critic, Whistleblower, Lobbyist." In this capacity, the public is encouraged to take action not for personal, individual reasons, but for the public good. Corruption can be combated when officials feel that they are under the general scrutiny of an empowered public.

**Public Education and Schools.** The author argues that although some civic education or human rights programs discuss themes that are related to corruption, the link between it and other social problems is rarely explicit. For that reason, lesson plans are suggested for introducing corruption themes into school curricula, as well as for current Open Society Institute school programs. A successful public education program can change young people's perceptions and attitudes about corruption and teach them skills needed to reduce it. The lesson plans suggested were created with consideration to existing courses, making it easy to integrate the lessons individually or in combination with others.

Lesson plan topics include exploring the concept of corruption and researching the extent corruption has permeated the students' own lives. Examining moral issues will point out the human rights violations of corruption and can highlight the issue of personal responsibility, thereby encouraging students to take measures to fight corruption. Emphasizing the negative effects of corruption on the market economy and democratic society also gives students a broader perspective on corruption,

demonstrating how corruption not only affects them personally but how it affects the greater good.

***Policy Implications.*** This article gives civil society and education leaders the guidelines necessary for incorporating anti-corruption components into existing programming, as well as for building the foundations for successful public awareness and education programs. The individual components can stand separately or be implemented in conjunction with one another. Using experience and data from existing anticorruption programs,

the author deftly provides the requirements needed for civil society to carry out the four functions described above and provides policymakers with a nuanced analysis of what types of anticorruption programs work. The suggested lesson plans have yet to be proven, but they give teachers the ability to incorporate corruption themes into existing lessons plans. The actual content of these programs should be guided by the specific problems a country faces, as well as a country's capabilities in battling corruption.

## II.B.5.b

### Trust and Corruption

Eric M. Uslaner. "Trust and Corruption." Chapter 5 in Johann Graf Lambsdorff, Markus Taube, and Matthias Schramm (eds.), *Corruption and the New Institutional Economics*. London: Routledge, 2004.

*This paper explores the relationship between trust — "a value expressing the belief that others are part of your moral community" — and corruption across a range of countries. Uslaner outlines two competing explanations of this relationship and tests them empirically. Cross-section regressions of levels of trust and corruption suggest a stronger causal connection running from corruption to generalized trust than vice versa. However, regressions of changes in corruption and trust indicate that countries experiencing increasing trust feature lower corruption, but decreases in corruption do not show a corresponding impact on trust levels.*

**Competing Explanations.** The first explanation, termed the "rotting fish" theory after a Chinese proverb, argues that the causal linkage between corruption and trust is top-down: it is corruption among the politically powerful that discourages moral ties, including trust, among citizens. The disrespect for the law and for each other then fosters numerous social and economic ills. The second interpretation, termed "raccomandazione" after its Italian manifestation, argues that the causation runs from trust to corruption; it is the political culture, lacking in generalized trust, that fosters corruption and backward outcomes.

**Empirical Tests.** Uslaner conducts three sets of statistical tests to weigh these competing explanations. First, he tests the relationship between levels of trust and corruption via two simultaneous equations. Moral trust is regressed on corruption, income inequality, and percentage of citizens that are Catholic. Corruption is regressed on moral trust, political freedom, property rights, belief in the devil (a religiosity measure), and tariffs. "Moral trust" is from responses to the World Values Survey and "corruption" is from Transparency International (TI) estimates (note that the higher the TI score, the lower is estimated corruption). For a sample of 23 countries, he finds evidence of a reciprocal relationship between trust and corruption, with corruption having a stronger impact on trust than vice versa. This provides support for the "rotting fish" or top-down theory in which corruption at the top hampers trust and thus social and economic relationships among citizens.

Second, Uslaner tests the relationship between *changes* in both trust and corruption in two simultaneous equations, arguing that attacking corruption requires an understanding of what

motivates change. Change in trust is regressed on the change in corruption, growth in trade, and change in GDP from 1980 to 1990. Change in corruption is regressed on change in trust, change in political freedom, change in imports, and ethnolinguistic diversity. Uslaner finds that "there seem to be many paths to reducing corruption" as all regressors, including change in trust, in the corruption equation are significant at the five percent level. However, this is not true of the trust equation; most notably, change in corruption is not a statistically significant predictor of change in trust levels. Unlike the first set of results, the "raccomandazione" or bottom-up theory (a culture of mistrust breeding corruption) finds strongest support.

Third, the author tackles the most-cited consequences of corruption; might consequences such as poorer governance and less respect for the law instead reflect the lack of trust in a society? He adds a third equation to his initial setup. Levels of trust and corruption are now endogenous variables in a main equation explaining one of fourteen measures of social and governmental outcomes. Again, the "raccomandazione" theory finds strongest support; in the majority of measures considered, trust has stronger explanatory power than corruption. "Trust, not honesty, seems to produce better government performance, more redistribution, and economic growth."

**Policy Implications.** If it is true that the "raccomandazione" theory best describes the roots of corruption, then anticorruption policies can have little effect in the short-term. Corruption stems from a culture of mistrust among citizens, and culture "changes slowly, if at all."

## II.C SECTORAL ANTICORRUPTION CASE STUDIES

The authors of this *Anticorruption Reader* hope to contribute to the knowledge-building goal of the USAID ACS by giving examples of diagnosis and prescription for sectors in which corrupt practices have been prevalent. In fact, since the late 1980s, there has been a continuing exchange of ideas and experience between those writing on the subject and actual experience with anticorruption initiatives. This symbiotic relationship between experience and its conceptualization is brilliantly exemplified by the work of *Robert Klitgaard* — represented in this *Reader* by his framework piece (already discussed in II.A.1) and his guide on cleaning up “corrupt cities” (II.C.4). The work of *Susan Rose-Ackerman* is somewhat more theoretical than *Klitgaard’s* but nevertheless thoroughly informed by experience of both developed and developing countries; the summaries in this volume focus on her insights on civil service reform (see II.B.3.a and II.C.1) and democratization (II.C.9).

Anticorruption strategies in particular sectors depend, in the first instance, on the difficult task of diagnosing the characteristics and mechanisms of corruption in a sector. The *Meagher* article on the financial sector in Hungary (II.C.2) describes a case in which the nature of corruption seems to have been well

known to stakeholders; this understanding combined with political will to move toward a more effective, efficient financial system resulted in substantial reforms. Health care is another area where corruption has a direct impact on the general public, but diagnosing such corruption takes patient digging for information and analysis. The work of *Di Tella and Savedoff* (II.C.5) — diagnosing corruption in Latin American hospitals — is pathbreaking in this respect. The related problem of corruption in pharmaceutical procurement and distribution is analyzed by *Cohen* (II.C.6), again in a Latin American context but in a way that is readily applicable to circumstances in the Europe and Eurasia region. This type of procurement is a special case of the much larger, and extremely widespread, problem of corruption in government procurement — which is especially the case in large infrastructure projects; this problem and its possible remedies are thoroughly reviewed in *Trepte* (II.C.3). Another area where corruption is a problem in many countries is customs: *Begovic’s* thorough study of corruption in the Serbian customs administration (II.C.7) shows the uses to which surveys of different groups of stakeholders can be put. Finally, the article by *Elliott* (II.C.8) shows the relevance of international efforts to support national anticorruption strategies.

## II.C.1 Accountability, Prevention, and Enforcement in Civil Service Reform

Susan Rose-Ackerman. "Reform of the Civil Service." Chapter 5 in *Corruption and Government: Cause, Consequences, and Reform*. Cambridge and New York: Cambridge University Press, 1999, pp. 69–88.

*Many forms of corruption arise as a result of economic incentives, often created by misconceived government policies. Attacking corruption effectively requires precise knowledge of the economic incentives motivating corruption transactions. In this chapter, Susan Rose-Ackerman — a political economist — presents a discussion of problems affecting the efficiency and professionalism of civil service employment. The author then goes on to discuss various possibilities and components for reform of the sector and the possibility of contracting out certain governmental duties.*

The author points out that public administration/civil service employment decisions should be based on non-political factors in order to ensure professionalism and efficiency and to curb corruption. Circumstances that make this approach especially challenging are countries emerging from one-party or authoritarian rule, newly democratizing African states with former colonialist systems, and post-communist economies.

Two basic ways to reduce corrupt incentives in the public sector are discussed — reform of public employment and contracting with private firms for provision of services.

**Reform.** Many developing countries have very poorly paid civil servants, a situation that can lead to civil servants taking on more than one job, a lack of interest from highly skilled professionals, or corruption. Reform of the civil service to address these issues may involve several important components: increased pay, improved working conditions, replacement of much of the existing work force, and careful redesign of public programs to increase incentives for productivity. In designing any reform program, many factors need to be taken into consideration, such as the relationship between wages and family income, macroeconomic conditions, importance of corruption in public decision-making, and the size and role of the informal economy, among others. The strain of reform can be reduced by complementary policies to create jobs in the private sector and to encourage registration and formalization of businesses.

Resolving conflicts of interest — overlap of personal business activities/interests with public service duties — is an important aspect to consider when designing a reform program. The United States, France, Canada, and the United Kingdom use various methods — administrative, civil, and criminal sanctions — to control conflict of interest problems. Which of these models is

most useful depends on the situation within an individual developing country.

"Carrots and sticks," or positive incentives and punishments, are useful tools to use in instituting effective corruption control. The author discusses punishments in chapter 4 (see II.B.3a), but elaborates on the use of incentives here. Incentive systems can be effective in some cases, but care needs to be taken when designing them. Considerations to be taken into account include whether individual or group incentives are more appropriate; whether the incentives give bureaucrats monopoly power to extract increased levels of rent; whether an incentive can be used to increase the pay base of employees in order to encourage their retention and productivity; and whether the use of institutional rewards is appropriate for a specific public enterprise. Additionally, it is difficult to measure performance in the public sector; and many times government agencies will create inappropriate measurable output indicators. This factor should also be considered and corrected when using incentive systems.

The different levels at which corruption occurs is another crucial variable in reform efforts. "Bottom-up" corruption consists of low-level officials collecting bribes and "sharing" them with superiors. The "top-down" type generally consists of a corrupt superior official buying the silence of subordinates. In situations where these practices are imbedded in the system, reformers should start over with new officials and a new set of rewards and punishments; if this is not possible, the best solution is to change the nature of public service provision and reduce the number of civil servants (these ideas are discussed in depth in chapter 4 of the book; see II.B.3a).

**Contracting Government Activities to Private Firms.** Some countries have used private firms to take on certain government activities in an attempt to curb corruption, increase efficiency, and/or

reduce the size of government. Examples of this type of service include trash collection, food service for prisons, utilities, street maintenance, and security services; usually the government office is allowed to compete in the bid for the contract. In general, there has been success with this method, but attention needs to be paid to several possible problems: corruption in selection of contracts, lack of multiple firms to ensure competitive process, unenforceable contracts, and absence of monitoring and incentive/sanction schemes. The author points out that contracts should only be used for the purpose of downsizing and decentralizing once an effective and legitimate civil service is in place. Otherwise, in poor countries, it could lead to increased concentration of wealth and maintenance of corrupt relationships.

**Policy Implications.** Civil service reform is expensive and politically difficult, and it may appear beyond the capacity of many poor countries. Yet it cannot be avoided. Entrenched corruption needs to be fought both by the reform of civil service and by changes in the nature of government work. A reforming state should reduce the underlying incentives for payoffs by eliminating or restructuring programs and by simplifying tax laws and procurement requirements. It should also improve both positive and negative incentives in the form of civil service, procurement, and law enforcement reform. The best place to start is with the demand for, and supply of, corrupt services. This means restructuring programs that generate corrupt incentives and reorganizing the civil service to allow professionals to make an honest living.

## II.C.2 Introducing Transparency and Accountability into a Reformed Financial Sector in Hungary

Patrick Meagher. "Changing Hands: A Case Study of Financial Sector Governance in Hungary's Market Transition." Working Paper No. 245. College Park, MD: IRIS Center, University of Maryland, 2000. (Produced as one of a series of four anticorruption case studies for the USAID Democracy and Governance Center.)

*Banking reform and privatization in Hungary is a case where a successful response to corruption focused on sequenced restructuring, bearing in mind the need for transparency and accountability, rather than on direct frontal assaults on corruption itself.*

In the early 1990s, Hungary saw rapid institutional change and severe economic downturn. Credit relations and the financial system generally suffered from widespread corruption, including the exchange of loans for bribes, self-enrichment schemes, and manipulation of such procedures as bankruptcy, state-initiated debt restructuring programs, and banking supervision processes. The cost of this early rash of corruption and later episodes throughout the 1990s ran into the hundreds of millions of dollars. Many countries in similar circumstances have failed to come to grips with these problems, with disastrous results; Russia's experience leading up to the crisis of 1998 is a prime example. There, rapid privatization (in the absence of functioning safeguards and market institutions) opened the door to massive self-enrichment by enterprise insiders, and a loosely supervised banking system facilitated the rise of the oligarchs. Hungary saw the beginnings of this in the early 1990s. Its experiments with market socialism had ushered in a complex and murky business environment. Hybrid (state-private) corporate groups, in many cases run by former state managers, linked enterprises, banks, and the state in a collusive mutual embrace.

What could be done? *Economic restructuring to transform heavily corrupt incentives had to take first priority.* The choices confronting Hungary in the early 1990s were tough, and the stakes high. In the event, Hungary escaped the trap of failed transition. The main steps in its reform were the implementation (and adjustment) of a legal reform package known as "legislative shock therapy," a (highly flawed) debt restructuring process, and robust privatization — especially of state holdings in the banking sector.

*These reforms revolutionized ownership incentives and imposed transparency on the system.* The influx of foreign owners, together with the growing strength of markets and public sector institutions, brought banks and enterprises under

the effective discipline of corporate governance and regulation. This helped create one of the strongest financial sectors in the region, a vibrant economy, and a reasonably well-governed and competitive marketplace. Corruption in the financial system, nearly a way of life in 1991, became far more episodic and manageable. The disciplines imposed by the applicable international regimes, especially the EU, have played an important role.

**Policy Implications.** The policy implications of this study are the following:

- Strong governance and curtailed corruption cannot simply be legislated or imposed through crackdowns — a comprehensive shift in property relations and market incentives is often equally, if not more, important.
- Incrementalism can succeed, enabling government to build legal-regulatory frameworks before large-scale divestment and to choose "good" strategic owners for privatized banks and firms.
- High levels of foreign direct investment — especially by strategic investors operating in other transparent competitive markets — are fundamental to timely emergence of sound banking and corporate governances.
- Binding outside constraints, such as international regimes and fiscal deficits, can speed reform by limiting choices and providing political cover.
- "Hard budget constraints" are important for enterprise and bank governance, but arise as much from credible political signals shutting off state support, and from organizational incentives, as from legislation.
- State ownership can be disciplined and made accountable if it is small enough, especially where competitive markets and political pluralism have grown sufficiently strong.



## II.C.3 Corruption in Procurement

Peter Trepte. “Transparency and Accountability as Tools for Promoting Integrity and Preventing Corruption in Procurement: Possibilities and Limitations.” Document prepared for the OECD Public Governance and Territorial Development Directorate, Public Governance Committee, Expert Group Meeting on Integrity in Public Procurement. OECD Document No: Unclassified - GOV/PGC/ETH (2005)1.

*The author identifies opportunities and incentives for corruption inherent in the procurement process and considers ways in which procurement regulation can be used to close off opportunities and apply disincentives. He points out, however, that excessive regulation creates inefficiencies in the procurement process and that regulation is ineffective in situations where corruption is systemic and reaches to the political level.*

### **Corruption Opportunities in Procurement.**

Using the principal-agent model, the author notes the different interests of, and informational asymmetries between, the principal (political leadership of the government) and the agent (bureaucracy in charge of procurement). Such differences of interest and information also exist between the procurement agent and suppliers. In such a setting, the public interest may be set aside in favor of the interests of industry and agents, sometimes abetted by elected officials themselves. It is also noted, however, that “bad” procurement can also be the result of incompetence.

**Administrative Control.** Setting up *procedural requirements* to prevent corruption involves time and cost of monitoring and supervision. Requirements bearing on the *transparency* of the process include such elements as public bidding; publishing technical specifications and qualification and award criteria; and reporting (publicly, or at least to other government bodies) on the procedures that have been followed. Introducing *accountability* into the process depends crucially on strictly following the transparency requirements; accountability involves recording, reporting, and monitoring mechanisms that allow supervisors or monitoring bodies to review all the pertinent facts relating to a procurement decision, and the rationale for the decision. These measures need to be accompanied by *enforcement mechanisms* that penalize procurement agents and suppliers that are guilty of behavior that violates regulations.

**Limits to Administrative Control.** First, administrative control will fail to work against entrenched systemic corruption, where political-level principals are themselves intervening in the procurement process to ensure that favored bidders win. Likewise, administrative control tends to be defeated by a “culture of

corruption,” where bribes and favors are so embedded in interactions between business and government that they carry on even though formal requirements are being met. Furthermore, the procurement process will not be followed correctly — so as to yield correct, reasonable decisions — unless the cadre of procurement agents is thoroughly trained: weak capacity in this area is a problem in many developing countries. Finally, an overuse of regulatory controls, imposed in a fruitless attempt to prevent any and all corruption (or to micromanage incompetent agents) will lead to inefficient, costly, and not necessarily more competent procurement decision-making.

**Policy Implications.** The main conclusions of this study are as follows:

- Government principals can reduce corruption opportunities by applying procedural requirements — involving *transparency, accountability, and enforcement* — to the procurement process.
- For the latter process to work, in terms of both following requirements and producing “good” procurement decisions, the cadre of procurement agents needs to be well-trained and professionalized.
- Over-regulation — which erodes the ability of the procurement agent to make proper decisions (thereby reducing effectiveness of public expenditures) — must also be avoided.
- To the extent that corruption opportunities may exist at the political level — leading to political interference in procurement processes — regulation of agents must be accompanied by reforms that lead to better public control of their principals.

## II.C.4 Cleaning up Municipal Government

Robert Klitgaard, Ronald Maclean-Abaroa, and H. Lindsey Parris. *Corrupt Cities: A Practical Guide to Cure and Prevention*. Oakland, CA and Washington, DC: Institute for Contemporary Studies and World Bank Institute, 2000.

*This short book continues the same line of thought as Klitgaard's earlier work, Controlling Corruption. It is full of practical guidelines and real-world examples, especially from La Paz, Bolivia; Hong Kong; Bangalore, India; and New York City.*

The major forms of corruption that are typical of cities — and their results, falling under the general definition of misuse of office for private gain — include bribes that lead to misallocation of subsidized housing, zoning decisions that favor special interests, breaking safety and health rules, tax evasion, and non-enforcement of criminal law; kick-backs to procurement officers, leading to poor work for the public; public property used by city officials for private ends; and speed money and side payments for permits, licenses, and city services, which tend to victimize the poor. Data are presented that show corruption opportunities, such as average construction permit delays. The example of La Paz, Bolivia, of which Maclean-Abaroa was mayor, is given in detail. Reasons are suggested why most anticorruption campaigns fail.

**Formulating a Strategy.** The volume presents Klitgaard's classic formula:  $C = M + D - A$  (corruption equals monopoly plus discretion minus accountability). The successful Hong Kong Independent Commission Against Corruption (ICAC) is an example of a strategy that departed from the usual law enforcement approaches (corruption was rife among the police) by creating a new, independent anticorruption agency; "frying big fish"; emphasizing prevention by reducing monopoly power, streamlining discretion, and promoting accountability; and mobilizing citizens. As in Hong Kong, such a systemic approach can lead to general reform of local government.<sup>9</sup>

**Economic Analysis of Corruption in Terms of Principal-Agent Theory.** Using principal-agent analysis, the key features of an anticorruption strategy are proper selection of agents (that is, civil servants); setting appropriate rewards (for example, adequate salaries and rewards for success) and penalties for corrupt behavior; obtaining information from

improved auditing and management information systems, information agents, third parties (such as media and banks), clients and the public, and finances of public servants; restructuring the principal-agent-client relationship to weaken monopoly power (for example, through competition in providing public goods and services); limiting agents' discretion (for example, subjecting them to review and clearly circumscribing their authority); and using training, publicity, and a formal code of ethics — among other things — to change the culture of corruption.

**Assessing and Analyzing Corruption in Particular Government Units.** A first step is "participatory diagnosis" by means of workshops in which actors in individual government units are led through case studies from other countries to diagnose corruption in their own agencies. Following steps might include technical studies by outside consultants — including "vulnerability assessments" — followed by "incentive experiments" in which civil servants themselves work with new systems of information, incentives, and accountability. The results of the experiments are then reviewed in workshops. Finally, using the private sector and citizen NGOs to report on municipal services, participate in a new set of rules, and exert political pressure, can be a crucial component of an anticorruption strategy.

**Implementing an Anticorruption Strategy.** The first step is to decide whether this process will be organized by a super-agency in charge of anticorruption strategy, or a coordinating agency working with all government units. The next step is to "pick low-hanging fruit": select a type of corruption where progress can be visible and accomplished soon and at low cost. Simultaneously, it is important for leaders to search for ways to align anticorruption efforts with broader forces in society.

9. For more on the ICAC, see Meagher (II.B.4.a).

Another important element in the strategy is to “rupture the culture of impunity” by “frying big fish” and other highly public steps, like enacting new laws, announcing that all public officials will sign a standard of conduct, establishing experimental programs in revenue bureaus, and creating an anticorruption unit with each government department. The heart of the strategy is to change systems of information and accountability, and a crucial tactic in this strategy is to work with, not against, bureaucrats by giving them incentives to work for the systemic changes.

**Sustainability of Reforms.** For example, in La Paz, after Maclean-Abaroa’s first term as mayor, there was a five-year period during which corruption re-emerged as a serious problem. Sustaining reforms beyond the initial reformist administration is a problem for all municipal policies, not just anticorruption. Sustainability can be built through competitive provision of goods and services; simplified regulation and permit procedures; efficient citizens’ feedback mechanisms about government services; linking such feedback to monetary and non-monetary rewards of city officials; and making municipal affairs transparent.

**Corruption in Municipal Government Procurement.** A lengthy Appendix details this topic, exemplified by

collusion in bidding, kickbacks by firms to officials to win a bid, and bribes to officials who regulate contractors’ behavior. The analysis demonstrates that this is an extremely complex topic. The  $C = M + D - A$  framework is helpful when applied to this type of corruption, and many possible measures parallel those used to deal with other kinds of corruption. But there are issues special to procurement, such as the type of bidding procedures, and the details of the policy approach depend on such factors as the type of procurement involved, the breadth of the market, the honesty and capabilities of the civil service, and the degree of political and media openness.

**Policy Implications.** The key features of the basic anticorruption strategy for municipal government are to *not* rely on conventional law enforcement approaches; to create an independent anticorruption agency; to reduce monopoly power and discretion of officials while increasing accountability; and to mobilize citizens. Additional steps — such as proper selection of agents, setting appropriate rewards and penalties, and improved auditing and management information systems — are detailed in Chapter 3; Chapters 5 and 6 contain practical, concise policy guidelines to ensure the political feasibility and sustainability of reforms.

## II.C.5 Diagnosing Corruption in Health Care

Rafael Di Tella and William D. Savedoff (eds.). *Diagnosis Corruption: Fraud in Latin America's Public Hospitals*. Washington, DC: Inter-American Development Bank, 2001.

*This volume represents an important effort in the study of corruption in the health sector. Its chief features are that it focuses on the incidence of corruption at the micro level — that is, the level of the hospital — and that it does so by examining “hard” data on corruption (like hospital prices and excessive Caesarian deliveries), which allow researchers to check the data they get from possibly biased subjective responses to surveys. Correlation between both types of data provides some assurance that each is measuring corruption, and if both types of data yield similar results on the causes or consequences of corruption, this reinforces confidence in the hypothesized relationship.*

### **Corruption in 30 Bolivian Hospitals.**

George Gray-Molina, Ernesto Perez de Rada, and Ernesto Yañez (pp. 27–55) collect data on corruption perceptions; informal payments from patients, nurses, and doctors; and procurement prices. They find that the data on informal payments and corruption perceptions are highly correlated, although this conclusion must be qualified by certain statistical problems. Gray-Molina et al. also analyze the causes of corruption, using two corruption-related variables, informal payments and input prices. For both variables, they find that the activism of the DILOS (a participatory planning and monitoring board of community members, municipal officials, and prefectural health officials) reduces corruption. This can be thought of as an accountability variable, which they call “voice.” The presence of a personnel supervision system also has the expected sign (though it is not quite significant), and the presence of a private hospital is related to lower levels of informal payments, indicating that competition does reduce corruption.

### **The Effect of Wages and Penalties on Corruption in Venezuelan Hospitals.**

María Helena Jaen and Daniel Paravisini (pp. 57–94) find that higher wages are correlated with more corruption (as indicated by procurement prices). They interpret this as evidence of capture of wage setting by corrupt wage earners. The mechanisms by which corruption would raise prices and wages are quite similar: The wage earner or the seller would bribe — or perhaps influence — the buyer into paying a higher price for goods or services. In fact, the sale of jobs is a widespread practice in developing countries, and reformers attempting to reduce corruption by raising wages should be aware that this practice might undermine the effectiveness of reform. Higher wages are thought to reduce corruption for two reasons: first, a public servant with a higher wage can more easily afford to be honest, and second, dismissal carries larger costs in

terms of foregone wages. The sale of jobs would undermine the first effect as the wage would get capitalized in the price of the job. The second effect depends on there being a non-trivial — though not necessarily high — probability of detection and dismissal. In fact, Jaen and Paravisini do find that greater accountability reduces two forms of corruption: theft and unjustified absenteeism. Their results on absenteeism, however, suggest an important caution: In hospitals with higher detection rates there was less unjustified absenteeism but more justified absenteeism. Raising the probability of detection for unjustified absences may simply induce people to find better justifications for being absent. In general terms, giving incentives based on one outcome is likely to improve performance on that particular outcome without necessarily improving overall service delivery; this is a broad implication of the multi-tasking literature.

### **Transparency and Accountability in**

**Argentina's Hospitals.** Ernesto Schargrodsky, Jorge Mera, and Frederico Weinschelbaum (pp. 95–122) find that prices did fall following enactment of a law on sending price information to the center, but that prices rose after agents realized that the price information was not being used for sanctions. This reminds us of a theoretically clear postulate: raising the probability of detection or the size of salaries is only going to deter corruption if sanctions are actually implemented.

**Induced Demand for Caesarian Operations in Peruvian Hospitals.** L. Alcazar and P. Andrade (pp. 123–162) find interesting, if disturbing, evidence of increases in Caesarian deliveries before weekends and holidays, signaling that doctor's convenience rather than patient's need was driving medical decisions. In fact, most of these Caesarian deliveries took place in private hospitals, indicating the possibility of greater corruption in the private sector. Private ownership and the appropriability of profits creates incentives, and

these incentives may well create some more effective treatments — which patients can easily evaluate — and a better bedside manner, but they also create incentives for doctors over-prescribing their own or the hospital's services. Alcazar and Andrade also found that doctors on fixed terms who can be disciplined more easily than permanent staff are more careful about prescribing Caesarians — further evidence that *accountability* reduces corruption.

***Purchase Prices in Bogota Hospitals.***

Ursula Giedion, Luis Gonzalo Morales, and Olga Lucia Acosta (pp. 163–198), analyzing variations in purchase prices, find a relationship between non-permanent staff and integrity — hospitals with more non-permanent staff pay lower prices. They also find that hospitals with female purchase managers pay lower prices for purchases, which resonates with other studies showing that women disapprove more of corruption than men in most countries and

that countries with more women in parliament have lower levels of corruption. Gideon et al. also find that the existence of formal hierarchical controls increases purchase prices, suggesting evidence that hierarchical controls create a vertical chain, where at each link of the chain a bribe must be paid.

***Policy Implications.*** The following can help prevent corruption in health institutions:

- *participation by community representatives in oversight of medical units;*
- *accountability for all medical personnel;*
- *higher wages/salaries — but only if accompanied by adequate accountability; and*
- *private ownership and profits — but only if accompanied by adequate accountability.*

## II.C.6 Corruption and Pharmaceutical Systems

Jillian Clare Cohen, James A. Cercone, and Roman Macaya. "Improving Transparency in Pharmaceutical Systems: Strengthening Critical Decision Points against Corruption." Prepared for the Latin America and Caribbean Human Development Department, World Bank, October 2002.

*This article details a new assessment methodology to evaluate, both quantitatively and qualitatively, the vulnerability of the pharmaceutical sector to corruption in a developing country. The authors divide the pharmaceutical value chain into five "decision points": registration, selection, procurement, distribution, and service delivery. Focusing primarily on the first four points, they employ surveys of relevant public officials and seek corroboration for their answers in procedural documents and by surveying other stakeholders. They test their framework by applying it to the pharmaceutical system in Costa Rica. Investigations of this sort allow policymakers to prioritize which decision points require anticorruption scrutiny most urgently.*

**Motivation and Methodology.** The authors argue that pharmaceutical systems are especially vulnerable to corruption for theoretical reasons — principal/agent relationships, weak incentives, and information asymmetries — and also for practical ones. Their methodology attempts to quantify this vulnerability at crucial junctures, or decision points, in the pharmaceutical system. Public officials are interviewed using yes/no questions. Answers must be substantiated by legal or procedural documents and evidence of their consistent application. Corroborated yes responses are then aggregated into a score (with a possible range of 1 to 10) for each decision point. These scores are subjected to additional cross-checking by surveying the perceptions of the system among pharmaceutical firms, health care practitioners, and end users.

The authors describe in considerable detail the corruption vulnerabilities at each stage of the pharmaceutical supply system. *Drug registration or licensing* can be corrupted if there are insufficient institutional checks on officials responsible for registration, who may be paid by suppliers to register drugs without the requisite information or to slow down registration of a drug to favor other suppliers (or to solicit payment from a supplier). Similar dangers exist in the process of *drug selection* for inclusion on an insurance-supported essential drug list. Likewise, at the stage of *procurement*, bribes may be paid by suppliers to officials responsible for procurement in order to gain monopoly positions in the tender process, to be paid a higher price, or to cut corners on quality control. At the *distribution* stage, a major vulnerability is possible theft from warehouses and other transport terminuses and "leakage" from storage facilities in hospitals and pharmacies; corruption in connection with such abuses may come about through (for instance) use of political appointees in management positions of medical storage facilities. Finally, at the stage of *service delivery*,

prescription of drugs may be influenced by payments to doctors by suppliers (or by patients for whom the drugs would otherwise not be prescribed), and patients may be subject to extortion by retail suppliers of drugs. In all these cases, opportunities for corruption can be reduced by following carefully formulated procedures, in a transparent manner, subject to monitoring and with appropriate, well-enforced penalties for improper behavior.

**Results from a Pilot Study.** The authors' methodology is employed in a pilot study of the pharmaceutical system in Costa Rica. The lowest scoring decision point is procurement; its score of 5.7 indicates "moderate" vulnerability to corruption. Procurement procedure is faulted for lacking clear internal documentation on prices paid and bidding criteria and also for failing to adequately track the performance of drug suppliers. Surveys of pharmaceutical firms and health care professionals substantiate this vulnerability; they report malfeasance in the bidding process and also an artificially prolonged purchasing cycle. The Costa Rican system receives high scores (9.4 for each) in the registration and selection of drugs and a moderate score of 6.9 in distribution. However, the high score in registration is not backed by the survey responses of firms and health care professionals; they claim substantial variation in the process of registering drugs due to preferential treatment and cite the wide availability of unregistered drugs. A survey of end users in Costa Rica reveals that shortages of drugs at public pharmacies are commonplace; some 32 percent of respondents have knowledge of theft in these pharmacies.

**Policy Implications.** The flexible methodology detailed above allows for quantitative analysis within a country, but it can also be applied to cross-country comparisons. If scores are generally corroborated by surveys of other stakeholders in the pharmaceutical process,

they permit an “actionable” gauge of the vulnerability to corruption at crucial points in that process. With the most vulnerable points identified, policy-makers can focus their attention on specific, corrupt practices and employ the most feasible reforms to combat

them. In Costa Rica, for instance, feasible recommendations to improve its faulty procurement system include public availability, possible via the Internet, of bids for drug contracts and of internal audits into procurement decisions.

## II.C.7

### Corruption in the Serbian Customs Administration

Boris Begovic, Bosko Mijatovic, Robert Sepi, Mirjani Vasovic, and Slobodan Vukovic. "Corruption at the Customs: Combating Corruption at the Customs Administration." Belgrade: Center for Liberal-Democratic Studies, 2002.

*This article details corruption in the customs administration of present-day Serbia via surveys of both customs officials and business clients. Corruption is a substantial problem in this area, but has abated somewhat in recent years. The authors offer detailed reform strategies to further promote a reduction in corruption.*

#### **Background and Methodology.**

Corruption in the customs procedures of Serbia is of interest, first, because of the important functions of the customs agency: facilitating foreign trade, controlling illicit or dangerous materials, and collecting a major source of government revenue. The Serbian customs administration was plagued by a wave of corruption during the Milosevic administration, especially during the period of international embargo. The authors explore the extent and form of this corruption and investigate whether it has declined since 2000.

From a survey of nearly 300 customs officials, the authors find evidence of inadequate knowledge of customs regulations and substantial discretion in their application, ambivalent or inconsistent attitudes toward corruption, and a lack of consistent disciplinary procedures. Respondents also indicated that the surest way to motivate better performance among customs employees was to increase their salary.

Another survey, this time of 290 firms with regular interactions with customs officials, provides an additional viewpoint. The respondent firms give the customs administration generally positive marks on its efficiency and indicate

that this efficiency has improved in the past three years. While there is reluctance among respondents to comment on corruption — evidenced by fluctuations in those admitting to bribery or refusing to answer — evidence of substantial corruption in customs procedures can be unearthed. Nearly a third of all firms indicate that customs officials demand or expect bribes. This figure is corroborated by 36 percent of firms stating that businesses of their sort must offer bribes in the customs process at least occasionally. Again, firms indicate that corruption has improved in the past three years.

**Policy Implications.** The authors utilize their findings to outline a detailed plan to further curtail corruption in Serbia's customs administration. Among the compelling measures to be implemented in the short term are reorganizing the customs labor force to shed Milosevic-era employees, strengthening internal controls and disciplinary procedures, and increasing salaries. Of greatest importance in the long run, according to the authors, is a general liberalization of foreign trade, accompanied by "computerization and automatization of customs procedures."



## II.C.8 International Dimensions of Anticorruption Programs

Kimberly Ann Elliott. "Corruption as an International Policy Problem: Overview and Recommendations." In Kimberly Elliott (ed.), *Corruption and the Global Economy*. Washington, DC: Institute for International Economics, 1997.

*In a globalized world economy, anticorruption initiatives often involve an international dimension. After reviewing the taxonomy and structural causes of corruption, the author elaborates on the different international mechanisms for supporting anticorruption initiatives that are undertaken by national governments.*

**Definitions and Concepts.** Corruption is often defined as "the abuse of public office for private gain" (Klitgaard 1991, Transparency International 1995, and Shleifer and Vishny 1993); the author argues, however, that this definition omits corruption in the private sector and is open to various interpretations. She uses the interaction among three entities — Elected Officials and Politicians, the Private Actors, and Non-Elected Officials — in order to illustrate the various types of corruption that exist. When these sectors or spheres interact, corruption can emerge in one of three forms: petty corruption (between the lower-level, non-elected officials and the private sector), influence peddling (between the elected officials and politicians and the private actors), and grand corruption (which involves all three entities at the highest level). However, because there are no universal standards on which transactions between the entities are licit or illicit, the definition and level of corruption have to be determined on a case-by-case basis.

Types of political, social, or economic factors that may lead to corruption include:

- *Size of government.* The larger the government (measured in percentage of GDP), the greater the potential for bureaucratic red tape, the larger the share of national income that passes through government hands, and the greater the opportunity for corruption.
- *Activities of government.* For example, a government that restricts economic competition through state-owned enterprises, and thereby creates economic rents, will produce opportunities for rent-seeking corruption.
- *Absence of mechanisms for holding public officials accountable.* This can be measured in media freedom, the rights of citizens to express their opinion through protest, and the ballot box.

- *Low wages.* If public sector wages are low and cannot cover subsistence, then officials will be expected to try to find "supplemental incomes."
- *Social attitudes.* Attitudes conducive to corruption can be found especially in post-colonial states, where the idea of national interest is weak and therefore the incentives and institutions for enforcing anticorruption laws are weak.

Elliott provides a *framework for analyzing the consequences of corruption*, based on the type of corruption (petty or grand) involved. For example, petty corruption can result in environmental degradation, threats to worker safety, reduced government efficiency when hiring is based on favoritism, and shortages of subsidized necessities. Against this, the consequences of grand corruption can influence the level of foreign direct investment or international donor assistance, and even shake the political foundations of an entire region. The reason for this is because if corruption and its consequences cannot be controlled, then the credibility of government suffers, the security of property rights erode, and the level of uncertainty and risk in the economy increases.

The Inter-American Convention against Corruption (IACC) was the first international document to provide sanctions against domestic and transnational bribery and "illicit enrichment." The convention pledged that all signatories would cooperate in both the investigation and the prosecution of any guilty parties, and made it illegal for banks in the participating countries to withhold any pertinent information. Elliott, however, points out that, although the convention introduced measures for dealing with specific incidents of corruption, there are no clauses that aim at preventative measures such as institution building. Also, no system exists for the OAS or any other body to review the processes once they are put in place, which could lead to further problems in

the future. Similar initiatives that have been ratified by the OECD in conjunction with the International Chamber of Commerce (ICC) have criminalized transnational bribery — for example, bribes by multinational corporations — but have not yet installed means of adjudication or punishment. The World Trade Organization adopted its government procurement agreement (GPA), which accepts the fact that when bids are entertained, governments openly intervene on behalf of domestic suppliers and encourage the participating countries to abide by rules that will prohibit corruption when competing for funding.

***Policy Implications.*** *Individual countries* can take action either unilaterally, as the United States did in 1977 with the passing of the Foreign Corrupt Practices Act in an attempt to prohibit U.S. firms from engaging in illicit activities overseas, or through institutional reform. As an

example of institutional reform, Klitgaard recommends punishing “big fish,” that is, prosecuting upper-level business and government officials. Prior to reaching this stage, laws and policies that promote transparency must be adopted, and an honest and independent judiciary established.

*International financial institutions* such as the World Bank and IMF help deter corruption by funding economic and institutional reform programs, such as privatization of state-owned enterprises and strengthening their regulation in uncompetitive markets. Elliott suggests that such funding be accompanied by an efficient audit system to ensure that the money is used for its desired purpose and not misallocated. Another anticorruption weapon is the proper implementation of international competitive bidding when the World Bank or other donors provide funds for government procurement.

## II.C.9 Are Democratization and Political Reform Compatible with Corruption?

Susan Rose-Ackerman.

*Corruption and Government: Causes, Consequences, and Reform.* Cambridge and New York: Cambridge University Press. Chapters 7–9, pp. 113–174.

*In these chapters, Rose-Ackerman shows that democratization and political reform do not guarantee lack of corruption and discusses what further steps are needed to ensure and improve governmental integrity.*

**Corruption and Politics.** The fundamental issue is whether the government or the private sector has monopoly power when dealing with the other. The extent to which a political regime disperses power among its own officials affects the likelihood of private interests being able to purchase political benefits. Similarly, a public official with monopoly power may extort money and benefits from a private individuals or firms with little bargaining power. Thus a low-corruption regime requires the creation of competitive private markets as well as the establishment of a competitive political system.

**Corruption in a Kleptocracy.** For kleptocrats, the regulatory state is a source of personal profits. Regulations and licensing requirements may be enacted solely to “create a bottleneck that firms will pay to avoid,” providing revenue for corrupt officials.

Corruption at the top of the government reduces morale and the psychological constraints on lower-level officials. Low-level corruption that involves many political officials may generate excessive demands on the private sector to pay bribes. One cannot claim with confidence that corruption at the top is worse than corruption at the bottom. Furthermore, corruption can exist under various types of governmental organization.

**Corruption and Democracy.** Democracy can limit corruption by providing public officials with the incentives to act more truthfully and offer the citizenry an opportunity to express their discontent with the government. But democracy does not guarantee the disappearance of rampant corruption. The incidence of corruption in a democracy depends on the ability of wealthy groups to obtain political benefits, the temporal stability of political coalitions, and the availability of narrowly focused benefits available for political distribution. Each of these factors influences the willingness of a politician to accept a bribe, the accept-

ance of corruption by the general populace, and the willingness of wealthy groups to offer bribes. The incentives for corruption in democracies depend on the organization of the electoral and legislative processes: some electoral systems favor corruption more than others. For example, a democratic system that supplies concentrated benefits to interest groups with political clout may encourage attempts to purchase political benefits. A politician may attempt to supply legislation that narrowly benefits her constituents while selling the contracts to those groups with political influence.

Ethnic, religious, and ideological divisions further complicate the relationship between political regime and corruption. For example, a majority politician may publicly declare that certain groups harm society while accepting bribes from the demonized group in order to allow them to not be persecuted. Societies with a wide range of policy views may lead to unstable coalitions; and if no coalition expects to retain power for a significant time period, then they may sell political favors rather than govern responsibly.

Campaign finance laws in democracies also influence the relationship between corruption and political regime. Interest groups that give funds to elected officials expect to receive preferential treatment from the legislative process. Legal fundraising without public disclosure inhibits the ability of the electorate to punish corrupt officials. They do not know who “paid” for specific legislative acts and who did not.

Corruption can be controlled by constraining political power through two institutional devices: governments that include multiple veto players and numerous sources of administrative and political power (that is, checks and balances) and allowing the citizenry to complain about government actions. Nevertheless, federalism may increase corruption by allowing politicians to

restrict transaction across jurisdictions within a country, and federal systems may allow local governments to be more easily captured by local elites than a central government, though this may be mitigated by the threat of exit by citizens to a less corrupt jurisdiction. Judicial independence may limit the ability of either the executive or legislative branch from enacting legislation arising from corrupt transactions, but in some instances an independent judiciary may also enforce corrupt deals.

Political accountability requires provision of information to the public. Government agencies must inform the citizenry of the statutes and rules of society, legislative activity, and a consolidated budget. Statutes that mandate that the government provide information regarding their operation, similar to the Freedom of Information Act in the United States, further enhance such accountability. A privately owned media offers a complementary institution to improve openness, accountability, and public discussion. In order to be effective, the populace must be literate and not be fearful of political repercussions associated with criticism of the government. Laws that reduce the costs of

forming private watchdog groups further enhance accountability.

**Policy Implications.** Successful political reform requires systematic changes in expectations and in government behavior to move from a high- to a low-corruption equilibrium, which is not an easy task. Introducing democracy does not in itself necessarily reduce corruption; neither do judicial independence and federalism, in and of themselves, offer a panacea to fight corruption. Key reforms, regardless of the political regime, must include:

- limiting the ability of the wealthy and those with political clout to purchase political benefits,
- maintaining a privately owned media and laws that protect citizens from being punished by the government for criticism,
- establishing competitive private markets by securing property rights, and
- limiting corruption from campaign finance by shortened campaigns, stronger disclosure rules, limits on individual donations, and alternative sources of campaign funding from the public sector.

## II.D NATIONAL & REGIONAL ANTICORRUPTION CASE STUDIES

The knowledge-building called for by the USAID ACS not only requires deeper understanding of corrupt practices and corruption vulnerabilities in specific sectors — discussed in the previous section — but also the country-specific and region-specific character of these problems, which are deeply rooted, reflecting historical path dependencies that go back decades, if not centuries.

National and regional studies of anticorruption activities in the E&E region are necessarily rather recent, given the fact that an acknowledged public need for such activities dates back no further than 1989, and in some cases is much more recent. The record of corruption and of initiatives to defeat it have been documented in two ways: broad surveys of households and businesses and careful investigations of developments in specific institutions. In several instances documented in this *Reader*, NGOs that are dedicated to anticorruption work have undertaken surveys and studies of what the situation is on the ground, before undertaking comprehensive initiatives for improved governmental integrity.

Three examples from the Balkan region are summarized in this section: the *Southeast European Legal Development Initiatives* (II.D.4); the *Bulgarian Working*

*Group for the Partners in Transition II Conference* (a group whose members were closely related to Coalition 2000) (II.D.2); and the *Serbian Centre for Liberal-Democratic Studies* (II.D.3). Each of these studies found their societies riddled with corruption in all sectors and at all levels; these societies are faced with the daunting task of formulating a comprehensive anticorruption strategy, with some difficult problems of sequencing and of tackling certain issues (like cross-border smuggling) on the regional level.

After fifteen years of post-communist governments — but in many cases a far shorter period of concerted efforts in the government integrity area — outside organizations have begun the task of drawing lessons from anticorruption efforts thus far. A recent study sponsored by the *European Bank for Reconstruction and Development* (II.D.1) concentrates on the effects of anticorruption initiatives on the business environment and finds that adherence to international convention and omnibus anticorruption programs have less impact than legislative action targeting specific areas. The World Bank report *Anticorruption in Transition 2* (I.A.4) addresses similar questions, although it is much less specific about different ways in which corruption in the business environment can be attacked by government action.

## II.D.1 Effects of Anticorruption Programs on the Business Environment in Transition Countries

Franklin Steves and Alan Rousso.  
“Anti-Corruption Programmes  
in Post-Communist Transition  
Countries and Changes in the  
Business Environment, 1999–2002.”  
Working Paper No.85, European  
Bank for Reconstruction and  
Development, October 2003.

*This paper analyses the anticorruption activities of 24 transition countries in the period 1999–2002. It presents a new measure for determining the extent of anticorruption activity undertaken, dividing the activities into the following three categories: omnibus anticorruption conventions, legislative reform aimed at tackling corruption, and adherence to international anticorruption conventions.*

**Three Aspects of Fighting Corruption.** Over the past decade, an integrated, comprehensive approach to fighting corruption has been advocated across the globe. This approach typically has three aspects: introducing new or amended legislation aimed at reducing public officials’ opportunities for rent seeking; building alliances with other governments in the struggle against corruption by signing international anticorruption covenants and participating in anticorruption transnational organizations; and the implementation of an omnibus anticorruption program.<sup>10</sup> The justification for encouraging countries to adopt these measures has been to develop an integrated framework for policy and institutional reforms as well as to launch a process in which key stakeholders can build a consensus on a strategy for fighting corruption and holding governments accountable for implementing the strategy. Additionally, governments are able to send the message to domestic and foreign audiences that they are committed to battling corruption.

In many transition countries, the development and implementation of anti-corruption programs is still at an early stage. This paper analyzes the effectiveness of the anticorruption activities of 24 of the 27 countries, asking the following central questions: Have the three types of anticorruption programs been associated with reductions in the levels of administrative corruption and state capture in the period 1999–2002?<sup>11</sup>

What types of anticorruption programs have been most closely associated with reductions in levels of both administrative and grand corruption?

**Main Findings.** Transition countries with low levels of administrative corruption have been more likely to adopt intensive anticorruption programs than coun-

tries with high levels of administrative corruption. However, the authors also found that countries with high levels of state capture are almost as likely to adopt anticorruption programs as low capture countries.

At the same time, the authors find that omnibus anticorruption activity and membership in international anticorruption conventions have not resulted in reductions in the level of administrative corruption. Results, in fact, indicate that countries that have undertaken more intense work in these areas have actually experienced an increase in the reported levels of administrative corruption. However, new anticorruption legislation aimed at reducing the opportunities for rent seeking in areas such as financial transactions and political party finance are correlated with lower levels of some forms of administrative corruption.

Finally, the findings suggest that omnibus and legal anticorruption programs and membership in international anticorruption conventions are not linked to reductions in state capture.

The authors point out that these initial findings are based on only two surveys covering a relatively short time period, and must remain preliminary.

**Policy Implications.** The authors explicitly discuss three policy implications drawn from their analysis:

- Of the three types of anticorruption programs assessed in the paper, omnibus initiatives and adherence to international conventions may be of less importance than the implementation of specific legislative reforms for reducing the incidence and perception of corruption by businesses.

10. Omnibus anticorruption programs generally consist of some combination of a concept document, an anticorruption law, a dedicated agency or inter-ministerial commission, an action plan to implement the program, and a monitoring mechanism.

11. The authors use “state capture” to refer to the “capture” of the state by private firms or individuals or the establishment of conditions of undue influence over the institutions of the state by private entities in order to serve the private interests of those entities at the expense of the broader polity.

- The evidence indicates that signing international covenants and joining anticorruption related transnational organizations are unlikely to have a direct, near-term impact on levels and perceptions of corruption. However, the indirect effect of participation in these bodies, particularly for a country's reputation in the international community and among foreign investors, could still be significant.
- If further research confirms that high-profile omnibus programs are not especially effective in reducing levels of administrative corruption and state capture, bilateral and multilateral donors will need to adjust their policy advice and lending strategies accordingly.

## II.D. 2 A Multi-Pronged Attack on Corruption in Bulgaria

Bulgarian Working Group for Partners in Transition II Conference. "Corruption in Transition: The Bulgarian Experience." Sofia, Bulgaria: Bulgarian Working Group for Partners in Transition II Conference, 2001.

*In Bulgaria, the anticorruption efforts were sparked by Coalition 2000, a USAID-supported NGO dedicated to a TAPEE-related effort attacking a number of different sectors where corruption is prevalent. The authors of this paper are associated with Coalition 2000.*

The main problem areas of corruption in Bulgaria are:

- *General legal and institutional environment.* The public administration is inefficient and over-bureaucratized and is characterized by excessive discretionary power, non-transparency, and lack of clear lines between the public and private sectors. Legislation has been passed attacking parts of this problem, and Bulgaria has acceded to international anticorruption conventions, but there is still no uniform legal base for fighting and preventing corruption, and major enforcement problems remain.
  - *The judiciary.* Administration of justice is plagued by slow court proceedings, deliberate backlogging of cases connected to vested interests, insufficient transparency, poor staffing and training, and lack of an anticorruption policy. A new judicial reform initiative (run jointly by NGOs, the state, and international organizations) and a draft amendment to the judiciary act signal possible relief.
  - *Political parties.* Party and campaign financing remains a major source of corruption, but the Law on Political Parties that became effective in 2001 contains some anticorruption provisions.
  - *Local government.* Non-transparency, low income of officials, and complex licensing and permit procedures together create ample opportunities and incentives for corruption at the municipal level — especially in such areas as municipal property management, public contracts and procurement, management of commercial companies with municipal participation, and issuing licenses. To curb these abuses, some municipalities have undertaken various steps to increase transparency and citizen participation and have adopted ethical codes.
- *Barriers to business.* Privatization has been marked by an increasing number of licensing, permit, and registration regimes, characterized by excessive discretionary powers of public officials and corrupt practices. There were some reforms in 1999 but the number of new types of permits continues to rise, and costs of compliance with the regulatory regime greatly exceed the costs of non-compliance.
  - *Public opinion.* A recent survey shows that Bulgarians regard corruption as one of their most serious problems, with customs officers, Parliamentarians, policemen, judiciary staff, municipal officials, bankers, and business representatives seen as most corrupt. Public criticism has shifted from low-level to grand corruption — for example, nepotism, influence trading, privatization of large enterprises, and government budgets.
  - *Media.* Journalists often base their stories on weak evidence, and existing legislation both prevents journalists from access to information about government practices and makes it easy to prosecute journalists for libel.

Current best practices in Bulgaria include:

- *Public-private partnerships.* Coalition 2000, an anticorruption initiative based on cooperation among NGOs, government, and individuals, and aimed at public advocacy, expert study, and watchdog activities, has drafted an Anticorruption Plan for Bulgaria, run an extensive public awareness campaign, and developed a Corruption Monitoring System.
- *Local government one-stop shops.* At these service centers, the applicant for a permit declares compliance with established regulations, and if the permitting agency fails to issue justification for refusal within a certain period, the permit is assumed granted.



- *National Audit Office.* This body audits all government budgets, and government-connected revenues and debt, as well as overseeing financial activities of the political parties and issuing auditing standards.
- *Magistrate Training Center.* This has operated since 2000, and as of writing of the report (in late 2001) had trained over 17,000 judges. In a related step, the Bulgarian Union of Judges was at that time drafting a Code of Judicial Conduct.

**Policy Implications.** Future priorities include:

- *Strengthening public administration,* through a number of steps that include increasing internal controls, changing regulations to permit removal of corrupt public employees, transferring some state functions to NGOs, establishing an anticorruption agency, and increasing transparency in a number of areas.
- *Introducing stronger legislation,* for example, criminalizing demands for bribes and influence peddling, better defining conflicts of interest and transparency in government, regulating lobbying, and differentiating penalties for parties involved in corrupt transactions.
- *Reforming the judiciary.* There is, inter alia, need for a new system of education for judges and other personnel, performance-based hiring and promotion for judicial and prosecutorial staffs, and a specialized unit for investigation of corruption cases in the judiciary.
- *Reforming political parties.* There is need to eliminate for-profit activities of the parties, publish donor lists and annual financial reports of parties, enforce sanctions for non-compliance, and reintroduce a mixed constituency majority/party list system.
- *Reforming local government.* A broad variety of reforms includes introducing clear financial procedures and audits, simplifying permit/license regimes, giving greater information access to the public, requiring officials to declare their income and their personal interest in particular issues to be resolved, encouraging greater public involvement and feedback in municipal affairs, and establishing independent bodies for monitoring anticorruption violations.
- *Developing participation of business, civil society, and the media in anticorruption initiatives.*

## II.D.3 Anticorruption Reform in Serbia

Boris Begovic and Bosko Mijatovic. *Corruption in Serbia*. Belgrade: Centre for Liberal-Democratic Studies, 2002.

*This report is a comprehensive analysis of corruption in present-day Serbia that includes an examination into the roots of corruption, the results of a detailed survey of public perceptions of corruption, an inquiry into the causes and effects of corruption in particular sectors, and a suggested anticorruption strategy.*

Well-written and translated, and funded by the Center for International Private Enterprise, the report makes clear that corruption stems from the interplay of a wide variety of social, economic, and political conditions that cause individuals to depart from arms-length transactions. The report devotes several pages to showing how the notion that “every task is easier completed if the ‘thing is oiled’” is a fixture in Serbian history and folklore, as well as a sense that bribe-givers are more likely to suffer for their deeds than bribe-taking public officials. Still, the report notes that at no time is corruption viewed as other than fundamentally dishonorable.

One of the keener insights of the report is the observation that corrupt transactions can be temporally and thematically detached, so that an individual’s “net social capital” can include a very wide diversity of services that an individual expects to receive, decreased by the sum of services that the individual is to provide in the future. Reflecting a rigorous econometric perspective that pervades the report, the authors emphasize the degree to which state intervention in the economy — both in Socialist Yugoslavia and in the Milosevic regime — provided a rich environment for rent seeking.

Two surveys were undertaken as part of the study; a public opinion survey and a business survey. The *public opinion survey* was based on a stratified sample of 1,632 adults, intended to gauge perceptions of corruption in a wide variety of contexts. There are few surprises about the significance of corruption as a problem; its perceived pervasiveness as most extreme in the areas of the judiciary, law enforcement, and customs; and the willingness of the public to engage in low-level corrupt transactions in certain circumstances (for example, where obtaining medical care is involved). One interesting result — perhaps reflecting the inaccuracy of such surveys — was the very low ranking of corruption

causes accorded state intervention in the economy: last out of 14 identified factors, such as low state salaries, human nature, and immorality (although to be sure, the survey included closely overlapping choices of “economic system” and “inheritance of the previous communist system”).

The *business survey* included a stratified sample of 327 private shops and companies. Here too, the results are generally unremarkable, but reveal a variety of country-specific problems suggesting priorities for economic reform and anticorruption initiatives: courts, infrastructure (roads, power, and telecommunications, in particular), and exchange rate problems present the biggest headaches for entrepreneurs. The one very interesting finding was that tax collection, usually a huge problem in other countries, was the lowest-ranked problem for businesses out of 13 different factors.

The chapters of the report dealing with descriptive treatment of corruption in various sectors are well-written and contain interesting anecdotal information. This includes widespread evidence of problems with case and judge assignments in the judiciary (which is inadequately regulated); payment of “speed money” for health care (one out of four citizens is reported to have given some kind of bribe to a doctor); party-organized corrupt procurement processes at the local government level (involving relatively small sums, but very systematic), and customs schemes involving two checkpoints, where false documents are issued by the first (for example, saying goods are bound for another country) and then examined and found to be satisfactory (when they in fact are not) by the second.

**Policy Implications.** The anticorruption strategies suggested by the report are balanced and generally preventive in nature, focusing on (1) reducing the role of the state, (2) increasing various accountability and transparency

mechanisms, and (3) changing incentive systems through a combination of better pay, improved performance and promotion systems, and effective punishments for wrongdoing. The report also discusses political party finance reform, ethics laws, public procurement and public budgeting reform, transparency mechanisms, judicial reform (principally through better judicial selection and qualification), reform of the

legal profession (through more stringent qualifications and conflict of interest limitations on former judges who become lawyers), and comprehensive regulatory streamlining. Although the report concludes with an “Action Plan,” it consists simply of a three-page non-prioritized checklist of activities without any discussion of sequencing, tactics, or interconnections among them.

## II.D.4 A Regional Anticorruption Initiative in Southeast Europe

Southeast European Legal Development Initiative (SELDI). *Anticorruption in Southeast Europe: First Steps and Policies*. Sofia, Belgrade: SELDI, 2000.

*This report is the product of research and surveys conducted in 2000–2001 by SELDI, a joint venture of the Center for the Study of Democracy (CSD), a Bulgarian policy institute, and the International Development Law Institute (IDLI), a training and consulting NGO headquartered in Rome. The specific contribution of the SELDI project for Coalition Building and Monitoring for Anticorruption in Southeast Europe is to introduce a region-wide institutional framework for public-private cooperation in countering corruption in the Balkans. SELDI, building on the momentum of the Coalition 2000 process in Bulgaria, has sought to raise awareness of corruption in the region and encourage the establishment of formal and informal norms to address the problem.*

The SELDI report is the product of in-depth research and two sets of representative public surveys conducted in February 2001 and February 2002. The report begins with an exceptionally insightful narrative description of the main forms of corruption in the region, and then proceeds to describe, country by country, the legal and institutional framework for dealing directly with corruption, as well as an institutional inventory of those governmental and nongovernmental organizations that are equipped to provide or promote good governance. This background narrative description provides just the kind of holistic, nuanced account of corruption problems in the region that is appropriate to the topic. In particular, the description shows how intertwined are the corrupt and criminal activities engaged in by public and private players. The institutional inventory chapters, by contrast, are quite formalistic and mechanical in their approach and seldom offer anything resembling analysis or interpretation.

Interspersed through the report — but invariably unaccompanied by any interpretive analysis — are various quantitative assessments of the depth of corruption in various public agencies based on the results of the two public surveys. Unfortunately, the report does not contain any description of the survey methodology, making it impossible to interpret any of the numbers or relative magnitudes utilized in the findings. Indeed, even in the SELDI web site (<http://www.seldi.net/indexes.htm>), the description of the methodology is so abbreviated that it is impossible to assess critically how the surveys were designed and implemented. Apparently, four questions (or perhaps groups of questions) were asked regarding attitudes toward corruption, corrupt practices, the spread of corruption, and corruption-related expectations. Apparently also, a 10-point scale was utilized, with 10 signifying a perception of severe corruption and 0 indicating an

“approximation to the ideal of a ‘corruption-free’ society.” Presumably, based on the assessment results (indices) featured in the report and on the web site, the questions or groups of questions were posed relative to as many as 16 different institutions or professions in each country, ranging from teachers to bankers to police officers. There is, however, no description of the precise questions utilized, how they were grouped or sequenced, whether each respondent answered all questions relating to each of the institutions/professions (although it appears that respondents were simply asked some variant(s) of the four questions and requested to provide a response on a 10-point scale), what sampling methodology was used, or whether biases were analyzed.

All of this being said, the content of the report is intriguing. The background section describes in great detail how cross-border transactions in the region have created an intricate web of corrupt economic transactions that fully integrate customs, border police, and a wide range of regulatory and law enforcement officials in organized criminal activity that amounts in aggregate terms to as much as two thirds of the GDP for some countries in the region. Although trends are changing, the legacy of the socialist economies and Yugoslav wars was to create a wide range of state-sanctioned and state-controlled corruption utilizing the private sector — rather than a “state capture” model of corruption. Much of this activity arose from the smuggling of fuel, weapons, and other contraband to the various combatant states in the Yugoslav wars, and created corrupt supplier societies in Albania, Bulgaria, Macedonia, and, to a lesser extent, Romania. The attractive profits to be made through cross-border smuggling dwarfed those captured through legitimate economic activity in economies struggling to grow a legal private sector. The objects of smuggling during the war — principally

war-related materiel — gave way to a wide range of other products and commodities following the war, utilizing the same networks and channels. The major commodity flows at present, in terms of magnitude of profits, include excise goods that evade taxes and other duties (for example, food, fuels, raw materials, and cigarettes), illicit drugs, human beings, and the so-called “suitcase trade,” which involves the mass smuggling by thousands of ordinary individuals of various items to elude the various countries’ customs regimes.

***Policy Implications.*** It is disappointing that, despite the richness of description

in this report, the chapters describing the various legal and institutional means of addressing these corrupt phenomena in each country are quite sterile and lacking in analytical depth, and no recommended action plan arises from this work. There is simply a statement of facts about each institution, and then citation of the survey results regarding the potential corruption taking place in these institutions. It would have been far more helpful and interesting to have subjected this data to a political economy analysis, followed by an approach to building integrity that assessed the potential capability and remediability of the institutions involved.

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