

2 Understanding Corruption and Governance

[S]tate sectors [are unable] to finance needed expenditures on new investment and maintenance. Many power utilities are financially distressed because of their poor governance environment comprising endemic corruption, rampant theft of power, political interference, and an inability by stakeholders to work toward long-term solutions. In the middle-income developing countries, power supply has been scaled up to the extent that the financing and management needs of the sector have generally outgrown the capacity of state institutions.¹

Studies have found that corruption is pervasive in the electricity sector, and has significant costs. For example, Gulati & Rao (2006) estimate that annual electricity sector losses to corruption in developing countries are equal to US\$8 billion in capital expenditure and US\$33 billion in electricity theft (involving staff colluding with consumers).² Clearly, developing effective strategies to reduce corruption is as important as it is difficult.

An effective strategy for detecting and deterring corruption must be built on a solid understanding of what it involves, why it takes place, and how improvements in governance can reduce corruption. This section aims to help practitioners develop such an understanding, by presenting a framework for thinking about corruption in the electricity sector. It defines corruption and discusses the factors that influence its incidence and perpetuate a corrupt “equilibrium”. Finally, the framework indicates how corruption can be reduced through targeted actions to improve governance.

2.1 Definition of Corruption

Corruption means different things to different people. Examples of definitions used by leading institutions and academics are summarized in Table 2.1.

Table 2.1: Definitions of Corruption

ADB	Abuse of public or private office for personal gain.
Leys (1965)	Behavior that breaks some rule, written or unwritten, about the proper purpose to which a public office/institution has been put.
Transparency International	Corruption involves behavior on the part of officials in the public sector, whether politician or civil servants, in which they improperly and unlawfully enrich themselves, or those close to them, by the misuse of the public power entrusted to them.
World Bank	Corruption is the abuse of public funds and/or office for private or political gain.

¹ Besant-Jones, J. (2006) “Reforming Power Markets in Developing Countries: What Have We Learned?” Energy and Mining Sector Board Discussion Paper No. 19, Washington, DC: The World Bank.

² Gulati, M. & Rao, M. (2006). “Corruption in Electricity Sector”. Presentation to World Bank staff, April 2006. <http://www1.worldbank.org/publicsector/anticorrupt/bbagdetails.cfm?ID=262>

This Sourcebook adopts the World Bank definition, namely that “*Corruption is the abuse of public funds and/or office for private or political gain*”.

In this definition, “abuse” of office can be taken as equivalent to breaking the written or unwritten rules of how the powers of public office should be exercised. This emphasis on “rule-breaking” is intended to provide a bright line that distinguishes corruption from other kinds of poor governance. For example, corruption is clearly distinct from interest group and pork-barrel politics (forms of poor governance which do not generally involve rule-breaking, and may be tolerated in many countries).

The Sourcebook further distinguishes between two kinds of corruption: “personal” and “campaign finance”. **Personal corruption** is behavior on the part of officials in the public sector³ in which they improperly and unlawfully enrich themselves or those close to them (or both), or induce others to do so, by misusing the position in which they are placed. **Campaign finance corruption** is the abuse of public funds or public office (or both) for political party financial gain.

Related concepts: probity and good governance

When thinking about corruption, it helps to focus not just on the “negative” behavior that needs to be deterred and reduced, but also on the positive behavior that needs to be encouraged and increased. This means it is important to define the opposite of corruption.

Useful antonyms for corruption are **probity** and **integrity**—in other words, honest, proper, fair, and ethical conduct. As Box 2.1 explains, once practitioners have identified that corruption exists and needs to be addressed, there are important marketing benefits to using a strategy that focuses on probity improvements. Accordingly, Sections 10 to 13 of this Sourcebook focus on improving probity and integrity.

Box 2.1: Focusing on Probity

Using the term “pro-probity” in place of the term “anti-corruption” has two important benefits:

- **It highlights a positive attribute to aspire to**, rather than an unsavory act to avoid. Government officials may feel more confident in supporting “pro-probity” measures than “anti-corruption” activities, as the latter implies the existence of corruption. For example, many government and international institutions have chosen to institute a “probity unit” or “integrity division”; fewer have an “anti-corruption team”.

Similarly, Vittal (2002) explains that the use of the term “probity perception index” was important in his work in India, because:

...there was a feeling of hesitation that openly branding and listing government organisations, banks and public sector undertakings under the corruption perception index would have a counterproductive effect. It may demoralise public servants...It was therefore decided not to use the word ‘corruption’ but look at the positive side and call the index as the probity perception index.⁴

Although corruption is—and should be—widely recognized as a problem, it is still a politically sensitive topic

³ Private sector behavior is not corruption, unless it also involves rule-breaking by a public official. Employees of private corporations may also steal company funds or abuse their position—this is wrong, but not corruption on our definition

⁴ Extract from speech delivered at Probity Perception Index Seminar by N. Vittal, Kolkata, 2002.

▪ **It helps shift the conceptual focus from an absolute elimination of corruption to a gradual improvement of probity.** This is important from both a public opinion and an economic perspective. Taking an anti-corruption stance implies zero-tolerance for corruption (that is, success will be attained when the system is no longer corrupt); this is admirable, but not practical in the context of deeply institutionalized corruption. Furthermore, the optimal amount of corruption, from an economic view point, is unlikely to be zero. The marginal cost of reducing corruption may increase as the level of corruption falls, while the marginal benefit of reducing corruption may decrease as the level of corruption falls. The optimal amount of corruption reduction will be where the marginal costs and benefits of reduction are equal, which may be at some low level of corruption, rather than at a point of no corruption at all. Taking a pro-probity stance provides a more reasonable yard-stick for measuring progress—success will be attained if continuous and incremental improvements in probity are made.

A similar, but broader concept to probity is good governance. Good governance can be defined as the presence of:

- General adherence to rule of law
- Transparency, predictability, and accountability in government decision making
- Decision-making that consistently achieves effective and efficient outcomes for society
- Decision-making processes that consistently allow for public participation, responsiveness, consensus orientation, equity, and inclusiveness.

Box 2.2 lists some definitions of governance from the literature. Obviously, achieving good governance will solve more problems than just corruption. However, it is still a central concept for any anti-corruption effort, as improvements in governance will usually promote probity.

Box 2.2: Governance in the Literature

Governance has been defined as:

- “The people, policies and processes that provide the framework within which managers make decisions and take actions to optimize outcomes related to their spheres of responsibility.” (Australia Government Department of Finance and Administration-website)
- “The exercise of political, economic and administrative authority in the management of a country’s affairs at all levels...a neutral concept comprising the complex mechanisms, processes, relationships and institutions through which citizens and groups articulate their interests, exercise their rights and obligations and mediate their differences.” (World Health Organization, based on UNDP definition)
- “The process by which stakeholders articulate their interests, their input is absorbed, decisions are taken and implemented, and decision-makers are held accountable.” (Bakker, 2003)
- “The extent to which governments are responsive to citizens and provide them with certain core services, such as secure property rights and, more generally, the rule of law; and the extent to which the institutions and processes of government give government

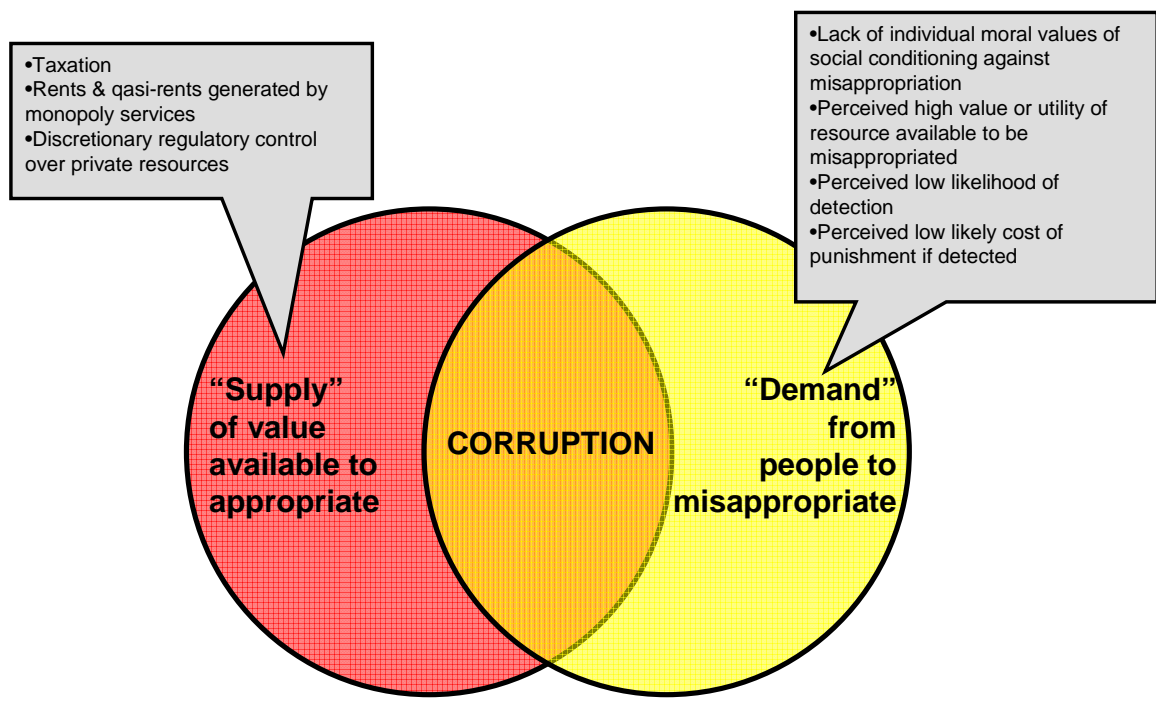
decision makers an incentive to be responsive to citizens.” (Keefer, 2004)

2.2 Dynamics of Corruption

The conclusion that “corruption is bad” has led many governments, advocacy groups, and international agencies to dedicate substantial resources to identifying, and deterring, corruption. However, a focus on addressing the causes of corruption has often been lacking.

Understanding the factors that perpetuate corruption is critical for formulating an approach to reducing it. Infrastructure sectors, including electricity supply, have natural monopoly characteristics. These monopolistic characteristics, together with government willingness to provide tax-payer funding and governmental powers to essential services, create a “supply of value” available for appropriation. This supply of value leads to corruption when it interacts with a social “demand” to wrongfully extract that value for private or political purposes. This interaction between supply and demand is illustrated in Figure 2.1.

Figure 2.1: Understanding Causes of Corruption



Supply of value

As Figure 2.1 indicates, valuable resources can flow into public sector control through taxation, the rents and quasi-rents that monopoly services generate, and discretionary regulatory control over private resources. This creates a supply of appropriable value. For example:

- Economies of scale in power generation are such that efficient, grid-provided power generally costs only a half or a quarter as much as it would a customer to generate their own power. The gap between the cost of grid-provided power and

the cost of alternatives is a monopoly rent—people will pay more than the efficient cost of supply, and since the extra they pay is not necessary to cover the cost of the service, it can be skimmed-off through corruption

- Governments often use budgetary resources (raised from taxpayers) to pay for the big capital goods electricity supply needs, such as power plants and transmission lines. The budgetary resources become a source of appropriable value—if the cost of the power plant can be inflated a few percent, the taxpayer will pay the few percent without necessarily noticing, and a government minister or official can skim off the inflated cost for himself
- Tax-payer resources are often pledged to support the electricity sector not just for large capital projects, but more generally to keep the price of power down overall—since power prices rises are generally politically sensitive. Perversely, this policy can in effect give the power company the ability to incur excess costs in the knowledge the government will eventually foot the bill. In this way, taxpayers supply more value to the sector, which officials and decision-makers can then appropriate through corruption.

Demand for value

Having a supply of value to misappropriate is not enough to prompt corrupt behavior—there must also be people who want to misappropriate this value. People are more likely to try to wrongly appropriate this value if:

- They believe that the benefits to them outweigh the costs. This entails that:
 - They value the resource available to be stolen
 - They believe they are unlikely to be detected
 - They believe that the likely cost of punishment if detected is low.
- There are few individual moral values (or little social conditioning) against such appropriation.

Corruption often involves a “moral slippery slope”—if a person breaks a rule once, she or he finds it less morally difficult to break the rule again. The initial rule-breaking may be stimulated by a sense of need (such as particularly low salaries, which make the benefits of corruption particularly high), or greed (desire to accumulate more and more wealth and power), while later rule-breaking may be reinforced by the development of cultural norms—if others are corrupt, then the potential costs of corruption are low for an individual, whereas the cost of honesty may be high.

Obviously, these conditions of “demand” are likely to vary significantly from country to country, even where the conditions of “supply” within any country’s electricity sector are similar.

2.3 Persistence of Corruption

The simple “supply meets demand” explanation of corruption’s causes, presented above, seems to suggest equally simple solutions. These simple solutions could include:

- Reducing the supply of value available to be misappropriated by reducing the resources and powers of the public sector to a necessary minimum
- Reducing the demand to misappropriate value by:
 - Developing stronger social mores against corruption
 - Increasing the likelihood that misappropriation of resources will be detected
 - Increasing the severity of punishment when such misappropriation is detected.

Although each of these approaches can be effective in certain contexts, stopping corruption is seldom easy. There are at least three factors that make corruption difficult to stop, namely:

1. The benefits of corruption are typically concentrated on relatively few, while the costs of corruption are spread across many. This means that those who benefit from corruption each individually have a powerful interest in perpetuating it, while each individual who suffers from corruption will rationally (because their individual suffering is small) invest little in fighting corruption
2. Corruption flows from the powers of public office. It follows that those who benefit from corruption are often among the most powerful, while those who suffer from it are typically less powerful
3. Corruption can take many forms, most of them difficult to detect. So any move to reduce corruption can often be circumvented by those who benefit, and this circumvention may go unnoticed by the reformers fighting corruption.

Thus, practitioners need to understand the practical difficulties of applying theoretically-sound “solutions” to corruption. Countries with high levels of corruption are often at a stable (corrupt) equilibrium that has evolved over time. Such equilibrium will be supported by power relations and social context as well as economic incentives. To move from this corrupt equilibrium to an equilibrium in which less corrupt behavior is the norm, practitioners and country governments need to identify points in the system where it is possible to make sustainable changes.

2.4 To Reduce Corruption, Improve Governance

A review of the history of anti-corruption efforts shows that many externally imposed solutions are not sustainable. For example, donor-imposed rules on procurement, accounting, and auditing may be effective in increasing probity and integrity during the period that the donor is monitoring compliance, but often fall into abeyance once donor-leverage and scrutiny is removed. Similarly, such rules may be applied to donor resources in a specific project; but because these donor resources constitute only a small share of total sector resources, the project-specific rules do little to ensure good financial management at the sector level (that is, throughout the sector and beyond the project boundaries).

While a temporary increase in integrity may be better than nothing, the goal is to establish systems that sustain integrity and probity. This means that reformers must consider the forces that make a governance system stable or shift it from one state to another.

The fact that electricity is a service with monopolistic characteristics and great social importance is at the heart of governance problems in the sector. In markets for normal goods and services, competition makes providers directly accountable to customers. If a

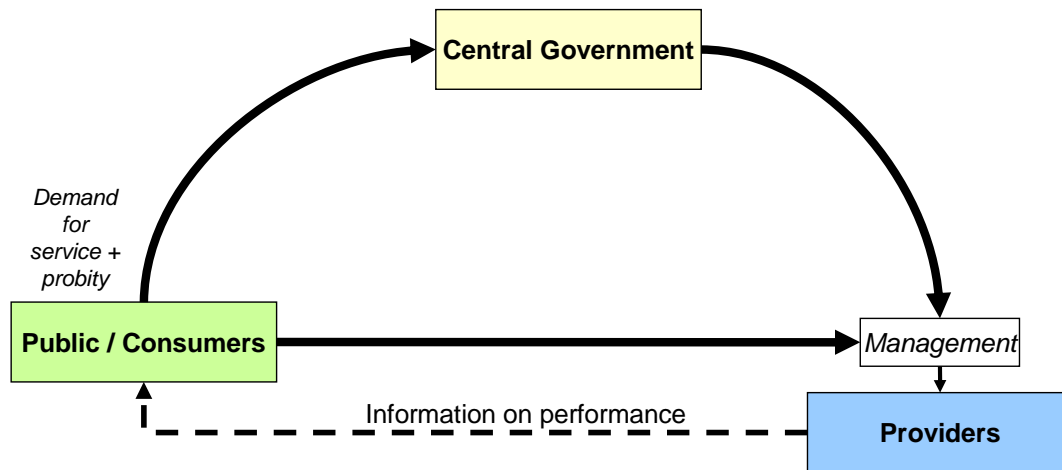
baker offers poor quality bread, most people will switch to another baker. If a vegetable supplier over charges, customers will seek out another, more reasonably priced supplier. Customers choose between competing suppliers, and in this way ensure that all suppliers either provide good service at efficient cost, or go out of business.

This direct route of accountability works less well in electricity. In many countries, a single company is the sole electricity supplier, so customers cannot hold one provider accountable by threatening to switch to another. In response, some countries have made their power markets competitive, partly in an attempt to improve governance in the sector. For instance, competition can help overcome one of the biggest governance problems in the electricity sector, namely the difficulty in really assessing the performance of generation plant operators.

However, even in these reformed markets, distribution and transmission remain regional monopolies. Especially for households, real choice between electricity suppliers remains rare, while in almost all countries government control over the electricity sector continues to be substantial.

As Figure 2.2 indicates, where direct accountability through competition fails, customers must rely on the “long route” of accountability through government to try to get the services they desire, at reasonable prices.

Figure 2.2: The Long Route of Accountability in the Electricity Sector



Source: Based on World Development Report 2004 framework “Paths of Accountability”

For this “long route” of accountability to work well, at least four elements are needed:

1. A public that demands accountability, probity, and good infrastructure services from their leaders and electricity providers
2. Political actors or utility operators who are motivated to respond to this demand
3. Sufficient information for the public to gauge the levels of service and probity being delivered by political actors and utility operators

4. Functional “feedback” systems through which the public can reward (or punish) political actors and utility operators according to their behavior. Good governance will inevitably break down without “effective mechanisms and institutional arrangements in the country to hold administrators accountable for their actions.”⁵

When these conditions hold, a virtuous cycle of probity can develop: people increasingly demand probity, can see whether or not it is delivered, and can reward the political actors that deliver probity. Without these conditions, apparent “solutions” such as externally mandated procurement rules, will simply be circumvented or allowed to lapse. Section 12 returns to this question, showing how project and provider level rules need to be embedded in a governance system that rewards senior decision-makers for delivering probity.

This understanding of corruption, and its essential link to governance, suggests a good practice approach for practitioners to follow when intervening in country electricity sectors. This approach is fleshed out in Parts II and III of this Sourcebook, which focus on first identifying corruption risks, and then on reducing these risks through well-designed approaches to improve probity and governance.

2.5 Four Levels of Governance Analysis

Accountability arrangements at the sector level are crucial for good governance, but governance issues range all the way from how individual projects are procured to national level decisions on how citizens hold their government accountable. Table 2.2 illustrates one approach used in this Sourcebook to make this analysis tractable, given the complex issues. The four rows of the matrix represent four different levels of analysis:

- **Country level**—analysis and recommendations across multiple sectors
- **Sector level**—analysis and recommendations targeted to a specific sector, and applying broadly across that sector⁶
- **Provider level**—analysis and recommendations targeted to a specific service provider, applying to the provider’s structure and the full range of that provider’s activities and interactions.
- **Project level**—analysis and recommendations specific to a particular project and to specific project activities (regardless of whether the project is acting at the provider, sector or country level).

The four columns of the matrix represent four different aspects or stages for assessing and addressing weak governance and corruption:

- **Assessing risk**—assessing the likelihood and severity of corruption risk, what types of corruption occur, and who suffers from corruption (and how much)
- **Understanding the problem**—analyzing how corruption happens (for example, who pays whom, for what, and when), how it is sustained, and why it is difficult to stop

⁵ Myint (2000)

⁶ Sector level means the level where the ministry responsible for energy, the electricity regulator, the planning agency, and so on, play a role.

- **Promoting probity**—specific interventions to increase probity
- **Reviewing progress**—clearly identifying how the impacts of governance interventions are to be assessed, and the strengths and weaknesses of past interventions (“lessons learned”).

The cells offer examples of how practitioners can look for and reduce corruption. For instance, at the sector level, looking for corruption will focus on sector level indicators such as coverage, or the ways in which senior sector officials are appointed. At the provider level, the focus would be on utility indicators, such as system losses, or the relations between customers and utility staff. Similarly, for reducing corruption, sectoral level recommendations would focus on topics such as how the government holds providers accountable, while provider level recommendations might focus on improved commercial systems, or better procurement procedures.

Table 2.2: A Sectoral Focus and Process

	Assessing risk	Understanding the Problem	Promoting Probity	Reviewing Progress
Country level	<ul style="list-style-type: none"> ✓ Review Governance Indicators ✓ Identify at risk sectors ✓ Complete surveys ✓ Estimate costs 	<ul style="list-style-type: none"> ✓ Discuss underlying causes of poor governance and corruption at this level 	<ul style="list-style-type: none"> ✓ Improve public expenditure and accounting ✓ Improve public procurement rules ✓ Introduce anti-graft rules and commission ✓ Increase disclosure requirements ✓ Align decision-making and accountability 	<ul style="list-style-type: none"> ✓ Assess impact of activities on general governance
Sector level	<ul style="list-style-type: none"> ✓ Review indicators relevant to this level (for instance, coverage, blackouts, prices) 	<ul style="list-style-type: none"> ✓ Map “hotspots” ✓ Discuss underlying causes of poor governance and corruption at this level 	<ul style="list-style-type: none"> ✓ Align decision-making and accountability ✓ Reduce multiple layers of approval ✓ Create accountability for service standards ✓ Promote more customer information ✓ Separate roles and define roles clearly ✓ Competition/regulation (for efficient costs) 	<ul style="list-style-type: none"> ✓ Assess success of sector reforms in increasing probity
Provider level	<ul style="list-style-type: none"> ✓ Review indicators relevant to this level (for instance, losses, blackouts) 	<ul style="list-style-type: none"> ✓ Discuss underlying causes of poor governance and corruption at this level 	<ul style="list-style-type: none"> ✓ Strengthen utility procurement procedures ✓ Improve financial management and require thorough, clean audit ✓ Improve commercial management and planning ✓ Improve human resources management 	<ul style="list-style-type: none"> ✓ Assess success of utility reforms in improving governance and performance
Project level	<ul style="list-style-type: none"> ✓ Review indicators relevant to this level 	<ul style="list-style-type: none"> ✓ Discuss underlying causes of poor governance and corruption at this level 	<ul style="list-style-type: none"> ✓ Project supervision and capacity building ✓ Procurement and financial controls 	<ul style="list-style-type: none"> ✓ Assess success of specific project interventions

Each of the four “levels” of action is important. However, in general, anti-corruption work at the country level and the project level has been more developed. This has, up to now, resulted in a “missing middle”, with inadequate attention paid to reducing corruption through sector and provider-level arrangements to improve governance.

A review of World Bank operations carried out as background for this Sourcebook found, for example, that in 100 percent of the cases reviewed the country-level strategy developed by the World Bank contained measures intended to promote probity and good governance, and similarly 100 percent of projects had measures intended to ensure probity in project implementation. However, 30 percent of the cases reviewed had no measures intended to improve probity at the sector level, while 63 percent had no measures intended to increase probity at the provider level.

This suggests that sector practitioners should work within an overall country framework, applying the tactics and insights developed at the country level, and adapting these to the electricity sector. Figure 2.3 provides an example of how infrastructure sector governance targets were embedded within a comprehensive, governance-focused Country Assistance Strategy (CAS) developed by the World Bank and the Government of Bangladesh. Further sources on country-level governance and anti-corruption strategies are provided in Source List 2.1 on page 19.

Figure 2.3: Embedding Sector Governance Targets within a Country Strategy: Example from Bangladesh

Longer term development agenda for Bangladesh-PRSP		Outcomes influenced by the CAS Program during the 4-year period		World Bank and Development Partners' Assistance
Development Outcomes (PRSP)	Issues and Challenges	CAS Outcomes	Milestones/Intermediate Indicators	World Bank Group, ADB, DFID, Japan
1.B Remove Trade Restrictions and Reduce Administrative Barriers				
Improve access to and infrastructure services, by strengthening sector governance and encouraging greater private sector participation	Improve governance and efficiency in infrastructure services			WORLD BANK GROUP: Ongoing IDA Lending Private Sector Infrastructure Development (closes in FY07); Rural Electrification Renewable Energy Development (closes in FY08); Bangladesh Telecommunications TA (closes in FY08); Rural Transport Improvement (closes in FY09); Power Sector Development TA (closes in FY09) Proposed IDA Lending: Road Sector Reform (Reserve); “Crash Power Rehab” (incl. Siddhirganj (FY07); South Zone Power (FY08); Bangladesh Railways (Reserve); Dhaka Chittagong Sewerage & Drainage (FY07); Export Infrastructure Development (FY08); Inland Water Transport (FY09); Rural Electrification and Renewal Energy II (Reserve); Padma Bridge (FY09) IFC: Loans/equity investments and advisory services as opportunities arise Proposed AAA: Urban Strategy (FY07);
	<ul style="list-style-type: none"> ▪ Large unmet demand for critical infrastructure services-power, transport, water supply, and telecom ▪ Infrastructure provision dominated by state monopolies with low quality service and weak financial positions ▪ Weak regulatory and distorted price environment that deters private investment ▪ Urban congestion and over-concentration in Dhaka, leading to high transaction costs and negative productivity 	<ul style="list-style-type: none"> ▪ A regulatory and pricing framework more conducive to greater private sector participation established ▪ Progress toward corporatization and commercialization of public utility agencies, and publicized service delivery standards and performance targets in power, telecom, and water sectors ▪ Private sector participation in infrastructure provision increased ▪ Dhaka-Chittagong Transport Corridor 	<ul style="list-style-type: none"> ▪ Progressive alignment of domestic energy prices and power prices adjusted to reflect changes in underlying costs ▪ Bangladesh Power Development Board restructured and successors corporatized ▪ Conclude at least two deals for new privately financed base-load power plants following competitive and transparent procurement and applying the generation financing strategy ▪ New Mooring Container Terminal in Chittagong Port completed and 	

	<ul style="list-style-type: none"> improved ▪ Urban planning and management improved 	<ul style="list-style-type: none"> concessioned for the private sector ▪ Increased quality and number of urban municipal investments implemented 	<p>Inland Water Transport ((FY07); Legal & Judicial Review (incl. Land Policy and Admin. (FY07); Urban Transport Financing and Management Study (FY08)</p> <p>ADB: Dhaka Clean Fuel; Gas Sector Dev't Project I; Gas Sector Development Project II; Dhaka Power System Upgrade; West Zone Power Development Project II; Dhaka Power System Upgrade; West Zone Power Development; Power Sector Development Program II; Power Sector Development Program III; Southwest Road Network Development; Road Network</p>
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Source: Reproduced from the World Bank “*Bangladesh Country Assistance Strategy*” (2006), Washington, DC: The World Bank

2.6 Dealing with Second (and Third) Best Solutions

The foregoing sections may appear to offer a counsel of perfection—as though to say “*Reform the electricity sector to improve the accountability of governments to people, and make providers more accountable to government, all within an overall country strategy for improving governance, that joins up seamlessly from the level of national politics down to village level projects.*”

In the real world, such perfection is seldom attainable. More often, practitioners must strive to make incremental improvements within their limited sphere of influence.

The comprehensive framework for thinking about corruption and governance presented earlier is not meant to suggest that all initiatives to increase probity must be equally comprehensive. Rather, it aims to help practitioners to judge which of the changes they *are* able to effect would be most likely to contribute to better governance over time. In making this assessment, practitioners need to consider:

- Their sphere of influence
- The capacity of sectoral institutions to implement reforms
- The political economy that may support or nullify any given reform initiatives (as shown in Figure 14.2 on page 219).

This means considering second best solutions:

- In a country where much of the political power is held by a small number of interest groups, who between them control many of the nation’s resources, attempts to create and empower civil society organizations may be doomed to fail (at least in the short term). Yet governance can be improved, and corruption reduced, if the leading families or business organizations can come to see that they all benefit from better electricity services, and can be given the monitoring role that (in a first-best solution) might be held by a broader consumer organization
- Many electricity utilities have powerful unions dedicated to protecting utility employees. Anti-corruption reforms that target utility workers engaged in petty corruption, without tackling corruption at managerial or political levels, may be resisted as an attack on workers. An approach that involves unions and workers through consultation, and even-handed treatment of corruption at all levels, may be more likely to succeed. Reforms may even give workers and unions an interest in the success of the utility—for example through performance-based bonuses for staff, contracting out services to labor-owned businesses, or granting shares in the utility to employees. Such changes can enlist workers and unions efforts to reduce or resist corruption and so improve utility performance
- A donor working with a single local utility may lack the influence or standing at a national level to improve governance structures. Yet, by supporting reform of information systems, and the provision of more information locally, the donor may have put in place one key building block for a better accountability system. The provision of such information locally may indeed help to spur increased local demand for accountability, which in time may achieve what the donor, with its limited influence, was not able to.

The Sourcebook returns to the notion of second-best solutions—workable responses given the constraints of limited influence, capacity, and political will—in Section 13. Source List 2.1 sets out further readings on the concept of second best in policy reform generally, and electricity sector governance in particular.

Source List 2.1: Framework for Thinking about Corruption

Source	Description
<p>Schliefer, A. and Vishny, R. (1993) “Corruption” <i>Quarterly Journal of Economics</i> 108 (3) 599–617</p>	<p>This article puts corruption into an economic framework, explaining corruption as a product of individual incentives. It shows how different ways of organizing government may lead to different types and levels of corruption. It also provides a framework for thinking about which kinds of corruption are most damaging. It provides an explanation for why in corrupt environments officials may prefer unnecessarily advanced technologies. It also suggests increasing competition in government services as a fruitful avenue to explore in reducing corruption.</p>
<p><i>Placing the Sector within a Country Governance Strategy</i></p>	
<p>Castalia (2007) “<i>Survey and Assessment of World Bank Practice</i>”</p>	<p>A review of World Bank practice in helping its client country governments reduce corruption and poor governance in the water, electricity, and transport sectors. It serves to point staff towards existing good practices and advises on adopting new strategies and approaches. Reviews country reports, cross-sector reports, and project-specific documents for the following eight countries: Azerbaijan, Bangladesh, Chile, Colombia, Indonesia, Lesotho, Philippines, Romania, Tanzania, and Vietnam</p>
<p>Country-level Anti-Corruption Strategies</p>	<p>Many countries have national anti-corruption strategies. These typically describe the problem of corruption in a given country, and the rules, regulations, and policies in place to promote probity. Some examples include:</p> <ul style="list-style-type: none"> ▪ Estonia¹ ▪ Ghana² ▪ Pakistan³ ▪ Sierra Leone⁴ ▪ Tanzania.⁵
<p>Doig, A. and Riley, S. (1998) “<i>Corruption and Anti-Corruption Strategies: Issues and Cases from Developing Countries</i>”, <i>Corruption and Integrity Improvement Initiatives in Developing Countries</i>, United Nations Development Program</p>	<p>Using case studies from Botswana, Ecuador, Hong Kong, Tanzania, Mali, and Senegal, this section of the UNDP guide illustrates the ways in which universal approaches can fail, and the improved results that can be obtained by using individually-tailored strategies.</p>

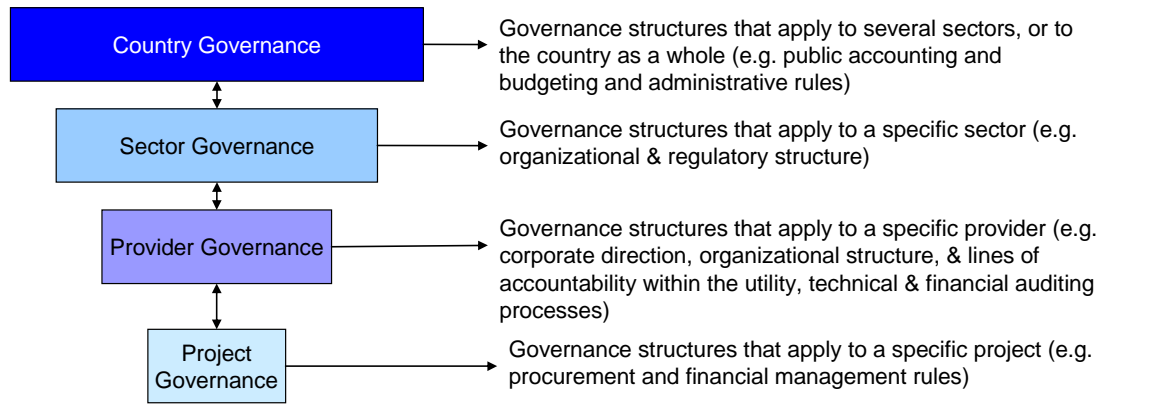
Source	Description
<p>Pope, J. (2000) <i>“Confronting Corruption: The Elements of a National Integrity System”</i>, Transparency International</p>	<p>This paper describes the need for national anti-corruption strategies, and the elements necessary for this strategy to be effective. It begins with an analytical framework (Part I), followed by the needed institutional pillars of a national integrity system (Part II). Part III lists the rules and practices for the institutional pillars, and Part IV, the lessons learned. Part V describes emerging best practice in combating corruption.</p>
<p>World Bank, (various dates) <i>Country Assistance Strategies with specific anti-corruption plans</i></p>	<p>These three Country Assistance Strategies incorporate comprehensive anti-corruption plans:</p> <ul style="list-style-type: none"> ▪ Bangladesh Country Assistance Strategy, 2006–2009 ▪ Indonesia Country Assistance Strategy, 2003–2007 ▪ Philippines Country Assistance Strategy, 2006–2008.
<p>World Bank Institute (not dated) <i>“Country-Specific Technical Assistance to Develop Anticorruption Strategies”</i>, Washington, DC: The World Bank</p>	<p>A guide for assisting countries to develop national anti-corruption action plans. Describes the different stages of developing and implementing national anti-corruption strategies.⁶</p>
<p><i>Second Best and Political Economy Strategy</i></p>	
<p>Levy, B. (2007) <i>“Governance Reform: Bridging Monitoring and Action</i>, Washington, DC: The World Bank</p>	<p>Lays out a broad framework for analyzing and monitoring governance in developing countries. Lists fourteen core indicators for governance monitoring (both broad measures of overall patterns and specific “actionable” measures that can be used to guide reforms and track progress). Highlights improvements in transparency as a relatively low-cost method for deepening government accountability to civil society.</p>
<p>Rodrik, D. (2007) <i>“One Economics, Many Recipes: Globalization, Institutions and Economic Growth”</i> Princeton University Press</p>	<p>For a good background on second best policies in development generally, see Chapter 1, which sets out how the “Washington Consensus”—a comprehensive set of reforms often considered to be “first best”—could be adapted to develop reform paths that were both more politically sustainable and effective, in countries as varied as China and Mauritius. As in Levy (2007), the focus is on identifying binding constraints and fixing those, rather than reforming everything in line with preconceptions of best practice. Chapters 5 and 6 consider institutions of economic governance generally, again demonstrating the merits of developing tailored institutional solutions that are responsive to local conditions and political economy constraints, in particular the need to ensure that reforms do not create a set of powerful losers who will unite to undermine reforms that would otherwise increase welfare overall.</p>

Source	Description
<p>Rose-Ackerman, S. (1978) “Corruption: A Study in Political Economy” Institute for International Economics</p>	<p>A good overview of the political economy of corruption, including a discussion of the economic opportunities of corruption, and some “solutions” for preventing corruption. Rose-Ackerman concludes that second best solutions may be the only realistic option:</p> <p><i>Corruption can never be entirely eliminated. Under many realistic conditions, it will simply be too expensive to reduce corruption to zero. Furthermore, a single-minded focus on corruption prevention can have a negative effect on personal freedoms and human rights. Such a focus could produce a government that is rigid and unresponsive. Thus, the aim is not to achieve complete rectitude but rather a fundamental increase in honesty—and the efficiency, fairness, and political legitimacy—of government.</i></p>
<p>World Development Report (1997) Summary, The State in a Changing World, Washington, DC: The World Bank</p>	<p>This summary of 1997’s World Development Report focuses on the evolving role of the state. Chapters that are particularly relevant to the information in this Sourcebook include building institutions for a capable public sector, restraining arbitrary state action and corruption, brining the state closer to the people (particularly through elections), and the challenge of initiating and sustaining reforms.</p>

Part I Assessing Corruption Risks

Practitioners want to put their effort into fixing the serious problems, while supporting what works well. One needs to know how serious corruption may be, and where it occurs. Figure 2.4 illustrates the four levels at which practitioners may review governance arrangements and the associated risk of corruption.

Figure 2.4: Levels of Corruption Risk Assessments



This section outlines methods and indicators that can be used to assess governance and the risk of corruption. These methods and indicators cascade down the levels of:

- **Country**—A country level scan looks at governance and corruption risk across multiple sectors, or across the country as a whole. **Section 3** identifies indicators that can assist in assessing risk at the country level
- **Sector**—A sector level scan considers these issues across the electricity sector as a whole). Governance and corruption risks in this sector may differ from those in other sectors, or from the level and severity of risk identified for the country as a whole. **Section 4** identifies sources and indicators practitioners can use to see where in the sector corruption may be occurring. These include:
 - Sector performance indicators such as system losses (Section 4.1)
 - Complaints from, and dialogue with, stakeholders (Section 4.2), and
 - Sector surveys (Section 4.3).

Section 4.5 outlines how practitioners can use information gathered from the sector scan to map out “corruption hotspots”

- **Provider**—**Section 5** discusses assessments targeted to a specific service provider. Such assessments can include the provider’s structure, and the full range of the provider’s activities and interactions, including:
 - Fuel procurement (Section 5.1)

- Suppliers and contractors (Section 5.2)
 - Commercial operations (Section 5.3), and
 - Human resources (Section 5.4), and
 - Company property and money (Section 5.5).
- **Project**—Capital projects can offer particular opportunities for corruption, and so merit special attention. **Section 6** suggests ways of detecting corruption risk in capital projects, and identifies factors that can influence the level of risk in relation to capital projects.

Sections 7, 8, and 9 discuss the implications of different sector structures for corruption risk. Most of the discussion in this Part of the Sourcebook assumes a “typical” electricity utility—a publicly owned corporate entity. In reality, the extent of corruption risk—and where these risks lie—will differ under different sector structures, for example where:

- The electricity utility is run by a private operator, through some form of private participation arrangement
- Electricity services are provided by a government department or other non-incorporated entity
- The electricity sector is vertically and horizontally disaggregated, with some form of competition for generation or wholesale power.

3 Country Level Scan for Corruption Risk

In assessing corruption risk in the electricity sector, it is useful to start by looking at the country as a whole. A picture of the quality of governance and corruption at a national level can indicate whether corruption is likely to be a serious problem in the electricity sector. In other words, perceptions of corruption at the country level will often set initial assumptions—or “priors”—for sector level corruption risks.

Various development banks and non-governmental organizations (NGOs) have developed tools to assess corruption risks and how to tackle corruption (Box 3.1).

Box 3.1: Country Assistance Strategies and Corruption Risks

World Bank CASs increasingly include information on corruption risks at a country level. For instance, the latest CAS for Indonesia includes sections dedicated to “The Special Problem of Corruption” and “Managing Risks”. Because of Indonesia’s high country-wide corruption risk, the CAS translates these risks into a requirement for specific anti-corruption strategies for each project.

CASs can draw attention to high levels of corruption risk in a given country, and even to specific risk areas. If the relevant CAS indicates high country-level corruption risks, it would be sensible to assume that the electricity sector is also at risk of corruption.

World Bank CASs are available from the World Bank web site (go to <http://worldbank.org/>, select the “Countries” section, and click on the particular country of interest).

Other agencies—such as the Asian Development Bank (ADB) or Inter-American Development Bank (IDB)—also have “country strategy” documents that cover these issues.

Development institutions and NGOs have developed country-level governance and corruption indicators that are easily accessible (see Source List 3.1 beginning on 26). As Box 3.2 explains, there is some evidence suggesting that national level indicators of corruption are correlated with indicators of electricity utility inefficiency.

Box 3.2: Correlation of Country Corruption and Electricity Utility Inefficiency

A study of 80 electricity distribution firms from 13 Latin American countries for the years 1994 to 2001 found that more perceived corruption in the country is strongly associated with more inefficient firms, in the sense that they employ more (labor) inputs to produce a given level of output. The study also applies a model where efficiency is measured in terms of operation and maintenance expenditures, rather than in terms of labor. The significant negative association between perceived corruption and efficiency persists.

The economic magnitude of the effect is large. For example, if the median country in the sample (Brazil) had the corruption level of the country perceived to be least corrupt in the sample (Costa Rica), the firms in the former country would use 18 percent fewer workers.

Source: Dal Bó, R. and Rossi, M. (2006) “*Corruption and Inefficiency: Theory and Evidence from Electric Utilities*”, University of California at Berkeley

That said, the interpretation of national indicators needs to be treated with care. Many country-level indicators and surveys are not based on objective measures. Transparency International's Corruption Perception Index—the best known of the country level surveys—is often criticized because it is perception based, and is not based on objective or observable data.

Box 3.3: Changing Political Economy and Changing Perceptions in Indonesia

Corruption perceptions (as recorded by the Political Risk Services Corruption Assessment) rose in Indonesia with the advent of democratic elections on June 7, 1999 and the demise of the Suharto government. The paradox here is acute: the Suharto regime was widely regarded as among the most corrupt in the world, and no observer doubts that the absolute value of bribes going to the government has fallen precipitously, despite worsening corruption perceptions.

One explanation for this paradox is that corrupt transactions became less credible after Suharto's departure, suggesting that voice and accountability (at least as generated by new and imperfect democracies) may also diverge from government credibility. Under Suharto, businesses believed that if they paid a \$1,000,000 bribe they would get a high return on their investment because the underlying agreement was credible (in another governance indicator term, political stability was high). They could be confident that they would, in fact, receive the rents conferred by the monopoly or regulatory privilege provided in exchange for the bribe. The political uncertainty of the post-Suharto era lowered the credibility of these transactions. Consequently, even if the bribe-price of entry or regulatory privileges fell since the end of the Suharto regime, the effective value of the privileges may have fallen by even more. Although total corrupt payments may have fallen, the perceived damage of corruption might have risen.

Source: Keefer, P. (2004). "A review of the political economy of governance: From property rights to voice," World Bank Policy Research Working Paper 3315, May 2004

The link between national corruption perceptions, sector-specific corruption perceptions, and sector-specific corruption realities is also somewhat obscure. The evidence we have suggests a weak relationship between national level perception measures and survey evidence recording either petty corruption in utility provision or grand corruption in construction. In turn, evidence on petty corruption appears to be weakly related to sector structure and other elements we would expect to influence the extent of corruption.⁷

Measures of accountability and the quality of governance are often subjective, and there is always a risk that the formal structures that can be observed by outsiders do not reflect real practice.

Source List 3.1 summarizes some of the useful country indicators, as well as articles that discuss their limitations.

⁷ Kenny, Charles (forthcoming) "Is There an Anticorruption Agenda in Utilities?", *Utilities Policy*, available now from: <http://charleskenny.blogspot.com/weblog/files/up.pdf>

Source List 3.1: Country Level Governance Indicators and their Limitations

Source	Description
<i>Useful country-level indicators</i>	
Cavill, S. and Sohail, M (not dated) “A note on Research Methodology for Combating Corruption”	<p>This document describes a research methodology that can be used for custom surveys of corruption in infrastructure. It outlines the research process, and describes research techniques for detecting and assessing corruption including interviews, informal discussion, and focus groups. The note provides examples of the following research instruments: corruption diary; observation checklist, guide for focus group discussions, semi-structured interviews for service providers, and a household questionnaire.</p>
Kalnins, V. (2005) “Assessing Trends in Corruption and Impact of Anti-Corruption Measures”, the Anti-Corruption Network for Transition Economies, OECD	<p>This paper discusses various methods for detecting and measuring corruption, and both a national and provider level. These include “direct” measures of corruption (for instance, perception, experience, beliefs and values, service and sector assessments, and governance indicators) as well as “indirect” measures of corruption (such as risk assessment, checklists, statistics and formal reporting, analysis of governments’ implementation of anticorruption measures). The document includes a number of useful real world examples.</p>
Political Risk Services Group, International Country Risk Guide	<p>The Guide includes a corruption index that focuses on political-level corruption, for over 100 countries, with a long time series.⁷</p>
Transparency International, Corruption Perception Index	<p>The most well-known of the various corruption surveys and indicators is Transparency International’s Corruption Perception Index (CPI). The CPI ranks 180 countries by their perceived levels of corruption, as determined by opinion surveys. The CPI combines multiple surveys from different institutional sources, allowing it to draw on a larger pool of respondents. Like other perception surveys, the CPI cannot precisely identify corruption with any degree of precision, but rather serves as a useful “red flag” that corruption may be occurring.⁸</p>
World Bank, Country Policy and Institutional Assessment indicators	<p>Country Policy and Institutional Assessment (CPIA) rates countries that are eligible for IDA-funds against 16 criteria under four headings. The fourth heading, “public sector management and institutions”, includes the criterion of “transparency, accountability, and corruption in the public sector”. This assesses “the extent to which the executive can be held accountable for its use of funds and the results of its actions by the electorate and by legislature and judiciary, and the extent to which public employees within the executive are required to account for the use of resources, administrative decisions, and results obtained. Both levels of accountability are enhanced by transparency in decision-making, public audit institutions, access to relevant and timely information, and public and media scrutiny”. A low accountability score might indicate a higher susceptibility to corruption, and certainly suggests poor governance generally.⁹</p>

Source	Description
United Nations Development Programme (not dated) “Sources for Democratic Governance Indicators”	This document was prepared for governance practitioners in the United Nations Development Program’s Country offices, and can be used by anyone working on governance and development issues. It provides a user-friendly overview of internet-accessible governance indicators and what each of these means. ¹⁰
World Bank and International Finance Corporation, “Doing Business” & “Enterprise Surveys”	The “Doing Business” surveys provide objective measures of business regulations and their enforcement across 178 countries and selected cities at the sub-national level. The economies are then ranked on the ease of doing business (from 1 to 178, with 1 being the best). In 2009, both “infrastructure” and “transparency” are expected to be added as topics. The “Doing Business” results are useful for thinking about corruption risks, since the red-tape and bureaucratic discretion that make doing business difficult are often breeding grounds for corruption. ¹¹ The World Bank’s “Enterprise Survey” is a cross-country business survey that analyzes key investment climate data in emerging markets and provides indicators on the quality of the business environment. This includes a number of specific indicators of corruption, such as the percentage of firms expected to offer a payment to get things done, or to secure a government contract; and percentage of firms who see corruption as a major obstacle for their business. Fifty-five country profiles are available on the “Enterprise Surveys” website. ¹²
World Bank Institute, Worldwide Governance Indicators	The WBI’s Worldwide Governance Indicators report aggregate and individual governance indicators for 112 countries, based on six dimensions of governance: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption. These are based on the perceptions or views of enterprises and citizen and expert survey respondents in both developed and developing countries, and can be useful red flags that corruption may be occurring. ¹³
World Bank and EBRD, Business Environment and Enterprise Performance Survey	The Business Environment and Enterprise Performance Survey (BEEPS), developed jointly by the World Bank and the European Bank for Reconstruction and Development, is a survey of over 4000 firms in 22 transition countries conducted since 1999-2000 that examines a wide range of interactions between firms and the state. Based on face-to-face interviews with firm managers and owners, BEEPS is designed to generate comparative measurements in such areas as corruption, state capture, lobbying, and the quality of the business environment, which can then be related to specific firm characteristics and firm performance. ¹⁴

Source	Description
<i>Limitations of country-level indicators</i>	
<p>Arndt, C. and Oman, C. (2006) <i>“Uses and Abuses of Governance Indicators”</i>, OECD Development Centre</p>	<p>Chapter 4 analyses the World Bank Institute’s World Governance Indicators. It outlines four core problems with these indicators:</p> <ol style="list-style-type: none"> 1. Likelihood of correlation of errors among the 37 sources from which the WGI is constructed limits its statistical legitimacy 2. Unable to compare over time 3. Biased sample 4. Insufficient transparency.¹⁵
<p>Galtung, Fredrik (2005) <i>“Measuring the Immeasurable: Boundaries and Function of (Macro) Corruption Indices”</i></p>	<p>Galtung reviews and critiques Transparency International’s Corruption Perception Index. He argues that the failings of the Corruption Perception Index can be grouped under six general headings:</p> <ul style="list-style-type: none"> ▪ Only punishing the takers, not the givers or abettors ▪ Irregular and uncontrolled country coverage ▪ Biased sample: more than 90 percent of the world is missing ▪ Imprecise and sometimes ignorant sources ▪ Too narrow and imprecise a definition of corruption ▪ Does not measure trends and so cannot reward genuine reformers.
<p>Kenny, C. (2007) <i>“Construction, Corruption, and Developing Countries”</i> World Bank Policy Research Working Paper 4271</p>	<p>Kenny uses country-level indicators (like Transparency International’s CPI and the Business Environment and Enterprise Performance Survey) to examine corruption in the construction industry. He describes variations in measures of corruption at the country and sector level, concluding that “general country level corruption indicators may be poor tools to uncover particularly corrupt construction industries, but also that corruption within the industry may differ markedly by sub-sector or location within a country”.</p>
<p>Kenny, C. (2006) <i>“Measuring and reducing the Impact of Corruption in Infrastructure”</i>, World Bank Policy Research Working Paper 4099</p>	<p>This paper investigates the different tools or approaches that are used to identify and measure corruption. Kenny argues that perception measures are not good indicators of corruption in the infrastructure sector, mainly because these perception surveys mostly measure petty, not grand, corruption. Kenny argues that survey evidence is more reliable than perception measures, but still not reliable enough to guide policy recommendations. The paper then recommends some priorities for infrastructure corruption research, in particular regarding disaggregated and actionable indicators of weak governance and corruption.¹⁶</p>
<p>Soreide, T. (2006) <i>“Is it wrong to rank? A critical assessment of corruption indices”</i>, CMI Working Paper</p>	<p>Provides a useful discussion of information about corruption, and of the limitations of measures such as the Corruption Perception Index (for instance, the expectation that perceptions are reliable).</p>

Source	Description
<p>UNDP (2007) <i><u>"Governance Indicators: A User's Guide"</u></i></p>	<p>Guide to understanding assumptions behind indicators, how data is collected, and how to best use data for various purposes. On how to use the data, the guide recommends three "golden rules":</p> <ol style="list-style-type: none"> 1. Use a range of indicators 2. Use an indicator as a first question—not a last 3. Understand the indicator before you use it.¹⁷