

On Private-Public Corruption Nexus: *From Inconvenient Facts to Questioning*

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www.worldbank.org/wbi/governance

**Background Handout for Presentation at the Workshop
on Corruption and the Private Sector: *Research trends,
Empirical Methods and Measurement Challenges,*
sponsored by the World Bank Institute, Wharton
Business School, and the Hills Program on Governance
*Washington, DC, June 18th, 2007***

Private Sector and Corruption: some Issues

- **Context--progress within continuum *vs.* ‘re inventing wheel’**
- **Analytics & Insights from Wharton 3‘06 & Brussels 3‘07**
- **On the Empirics: Aggregate to Disaggregate**
- **Private side of corruption: crucial yet under-measured**
- **Inconvenient empirics challenge received wisdom?**
- **Initiatives, Innovations – which offer promise?**
- **Implications for our work...**

Workshop: Research on Corruption and Its Control - The State of the Art

- **Took place At the Wharton School of Business --
March 3-4, 2006**
- **Objective: identify research gaps in the public-private
nexus of corruption and prioritize concrete actions**
- **Audience: academics, experts, representatives of
multilateral development banks (MDBs)**
- **Focus topics: corruption & economic development;
human behavior, trust & corruption; political
corruption; and business & corruption**

Some Research Gaps identified at Wharton Conference

- **Gaps on indicators and tools vis a vis objectives**
- **heavy reliance on few indicators and sources**
- **Further focus on private-public sector nexus of corruption, political corruption, its psychology**
- **Limited involvement of MDBs in research on this**
- **MDBs should focus more on corruption prevention**

Some Recommendations from Wharton Conference

- **Continue to improve and innovate existing diagnostics**
focus on sector/microeconomic studies of corruption
- **Identify motives behind corruption**—*more research on psychology of corruption, moral development & social expectations*
- **More focus on incentives and prevention** – *MDBs should move from reactive to proactive model (disclosure, sanctions), improve country diagnostics*
- **Further research on effectiveness of anti-corruption programs** - *experiment with randomized field experiments*

Main Messages from Brussels Conference

- **Good governance starts at home; tackle supply side**
- **Private Sector Corruption: can tackle through self regulation?**
- **Innovative approaches by some multinationals: does A-C pay?**
- **Donor support for anti-corruption initiatives**
- **Make data available on corruption more easily available**
- **Business should be partner in anti-corruption initiatives**
- **Transparency and accountability within the private sector are necessary to fight corruption**
- **Collective Action worth it: voluntary initiatives like the EITI**

The experience of Volkswagen
presented by Gerhard Prätorius, Sr. Manager

- **Establish & empower effective anti-corruption system and corporate value guidelines**
- **Strong leadership is required against corruption**
- **Volkswagen established a high level anti-corruption officer reporting directly to the Board of Directors**
- **Set up Ombudsman system to help staff reveal sources of corruption and established whistleblower protection system**
- **Importance of data & monitoring to ensure adherence to corporate culture**
- **Rewarded 40 best practices company-wide to prevent and tackle corruption.**

Experience of BP, presented by Graham Baxter, VP, CSR

- **Create culture that does not accept bribery and corruption**
- **BP established a compliance based culture, with great emphasis on ethical behavior**
- **BP: investing in anti-corruption is good for business**
- **BP has programs to support**
 - **Local government - help establish transparent systems and emphasize accountability**
 - **Civil society – help organize them to monitor corrupt practices in society**
 - **Small businesses – work with local enterprises to encourage ethical business practices**
- **BP strongly supports the EITI**

Shell Oil, presented by Hans van der Loo, Head EU Liaison

- **Energy industry called on to operate in fragile states**
- **Not a question of ‘if’ but ‘how’**
 - **International Oil Companies - standards, expectations and external scrutiny**
 - **National Oil Companies/service providers -different pressures and paymasters**
- **Shell and how it operates in weak governance zones and fragile states**
 - **Respect for national and international laws and sanctions, policies, guidelines**
 - **Dilemmas persist - continual monitoring, assessment and engagement. Shell Group Business Principles - opportunities to act as force for good**

Empirical Frameworks: from aggregate to disaggregate

- **The Macro-Aggregate Level, e.g. WGI, TI, CPIA**
- **The Mezzo Level, e.g. WEF, BEEPS, DB, CSR indices**
- **The Micro, in-country, in depth diagnostic, e.g. WBI
GACs, scorecards (Bangalore), randomized
experimental projects (Indonesia/Oken)**
- **Complementarities and Hybrids**

Six Dimensions of Governance

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

- **The process by which those in authority are selected and replaced**
 - **VOICE AND ACCOUNTABILITY**
 - **POLITICAL STABILITY & ABSENCE OF VIOLENCE/TERRORISM**
- **The capacity of government to formulate and implement policies**
 - **GOVERNMENT EFFECTIVENESS**
 - **REGULATORY QUALITY**
- **The respect of citizens and state for institutions that govern interactions among them**
 - **RULE OF LAW**
 - **CONTROL OF CORRUPTION**

Governance Data

- **Data on governance from over 30 different sources from dozens of organizations**
- **Data sources include cross-country surveys of firms, commercial risk-rating agencies, think-tanks, government agencies, international organizations, etc.**
- **Hundreds of variables/questions capturing various dimensions of governance**
- **Organize these measures into six clusters corresponding to definition of governance, for five periods: from 1996 to 2006**

Recent new features of the Worldwide Governance Indicators (WGI): Key Features

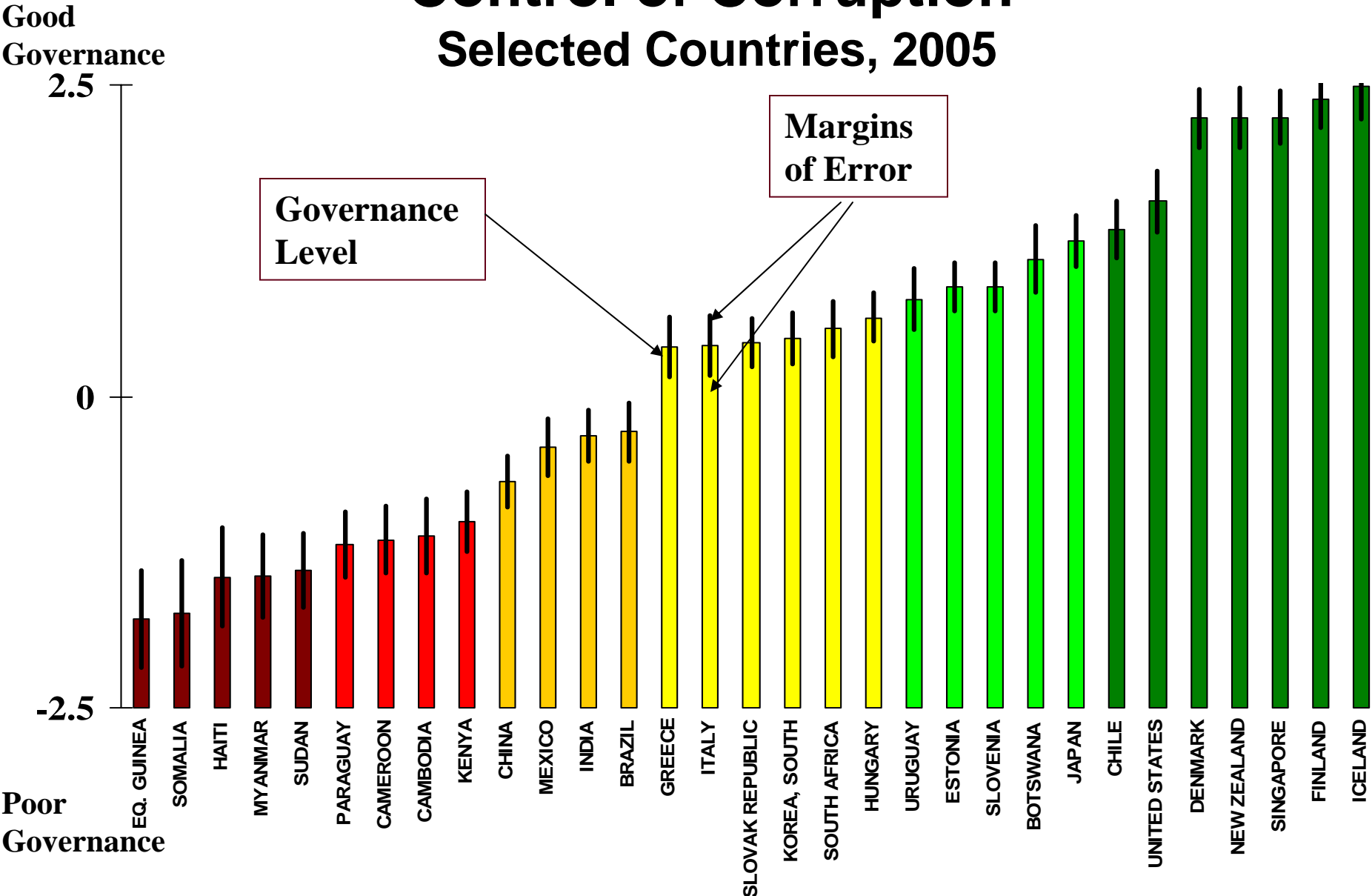
- **Move to annual data**
- **Access to disaggregated data underlying aggregate indicators**
 - **hundreds of individual indicators over past decade**
 - **one of the largest on-line governance data resources at www.govindicators.org**
 - **permits exploring possible indices of private sector corruption by reviewing existing data sources**

Sources of Governance Data

- **Cross-Country Surveys of Firms:** Global Competitiveness Survey, World Business Environment Survey, World Competitiveness Yearbook, BEEPS
- **Cross-Country Surveys of Individuals:** Gallup International Voice of the People, Latinobarometro, Afrobarometer
- **Expert Assessments from Commercial Risk Rating Agencies:** DRI, PRS, EIU, World Markets Online, Merchant International Group, IJET Travel Consultancy, PERC
- **Expert Assessments from NGOs, Think Tanks:** Reporters Without Borders, Heritage Foundation, Freedom House, Amnesty International, Bertelsmann Foundation, Columbia University, International Research and Exchanges Board
- **Expert Assessments from Governments, Multilaterals:** World Bank CPIA, EBRD, AFDB, ADB, State Dept. Human Rights Report, Trafficking in Persons Report

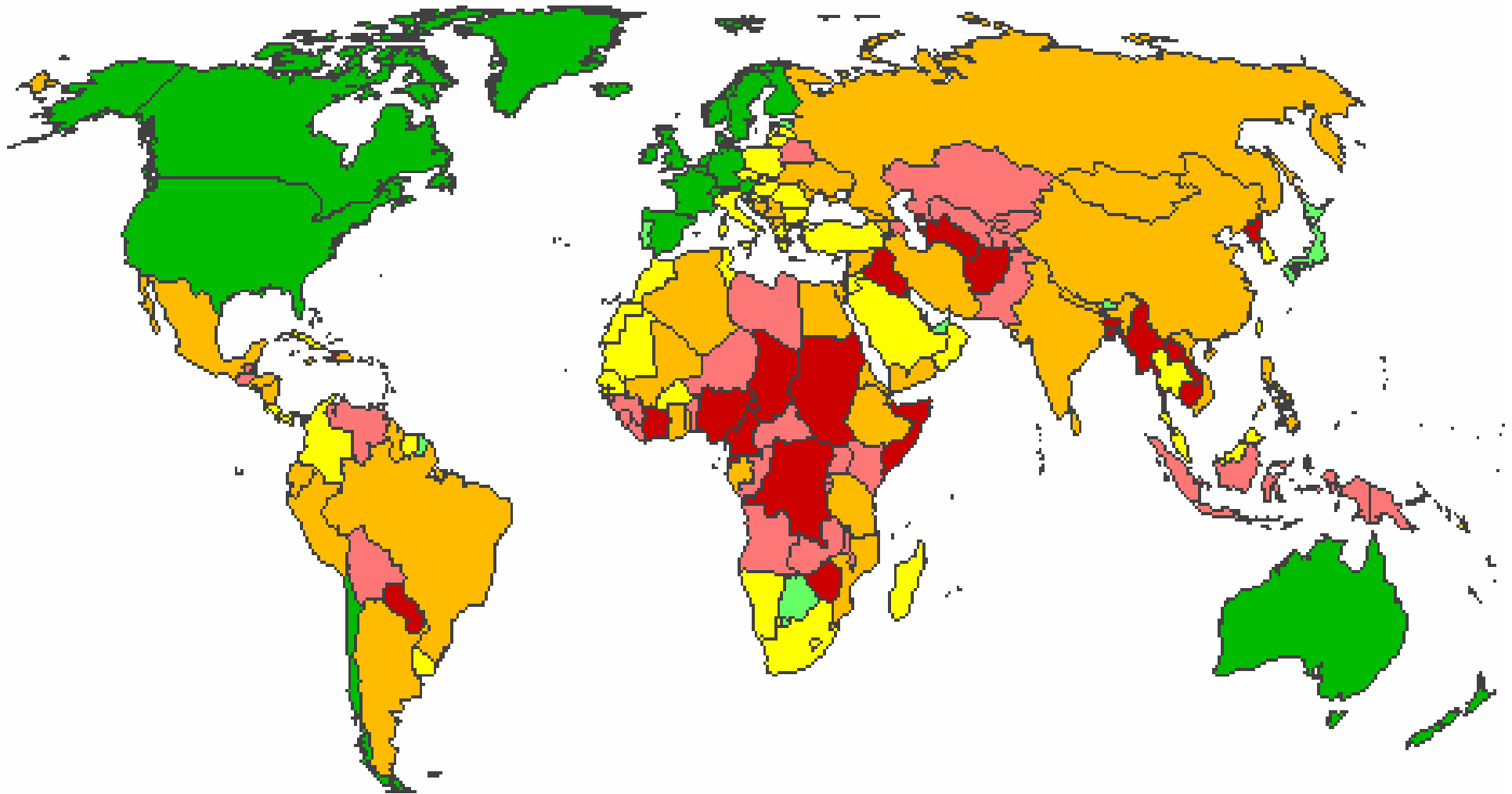
Control of Corruption

Selected Countries, 2005



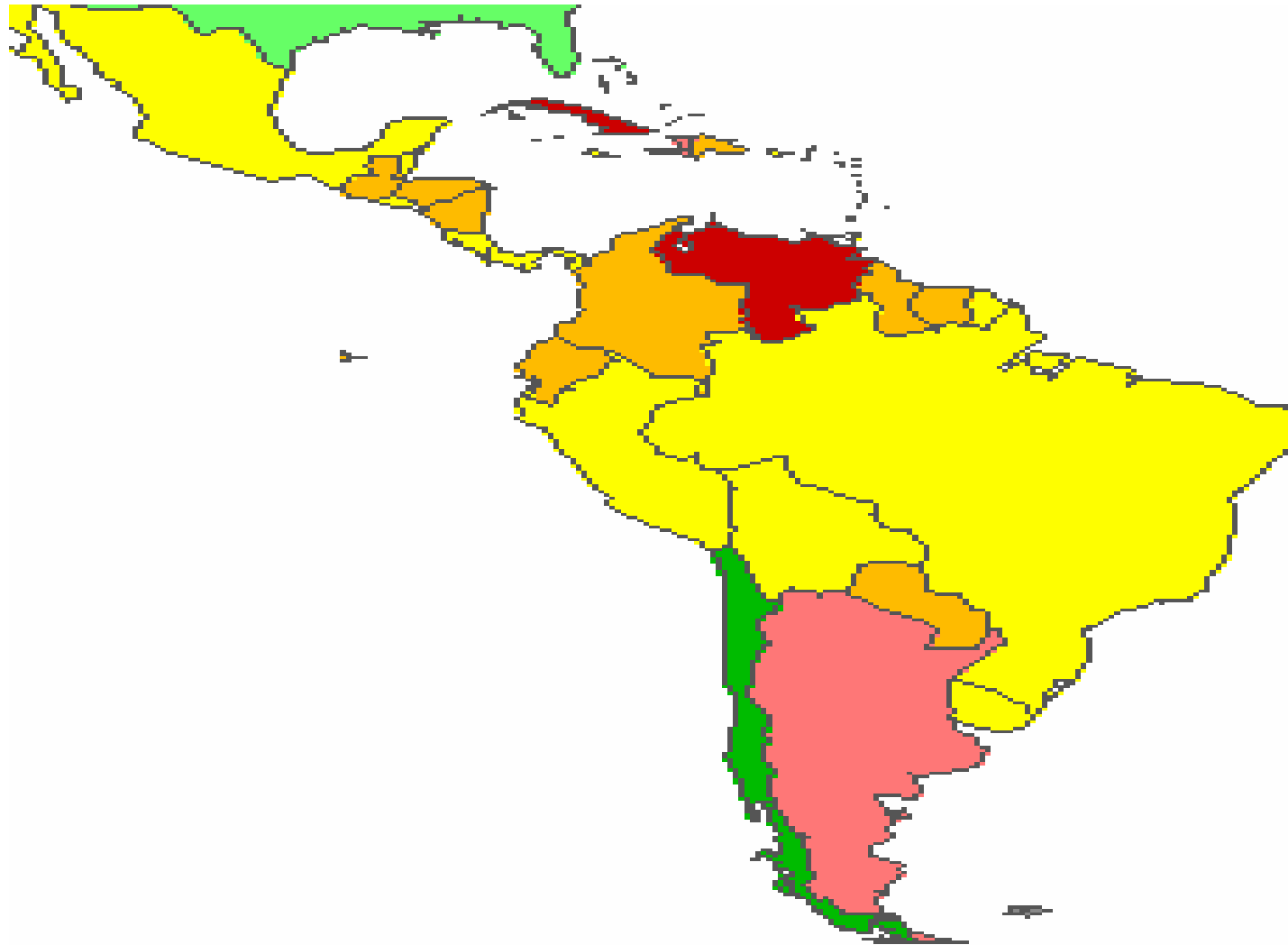
Source for data: 'Governance Matters V: Governance Indicators for 1996-2005', D. Kaufmann, A. Kraay and M. Mastruzzi, September 2006.
 Note: Colors are assigned according to the following criteria: Dark Red, below 10th percentile rank among all countries in the world; Light Red between 10th and 25th; Orange, between 25th and 50th; Yellow, between 50th and 75th; Light Green between 75th and 90th; Dark Green above 90th.

World Map: Control of Corruption, 2005



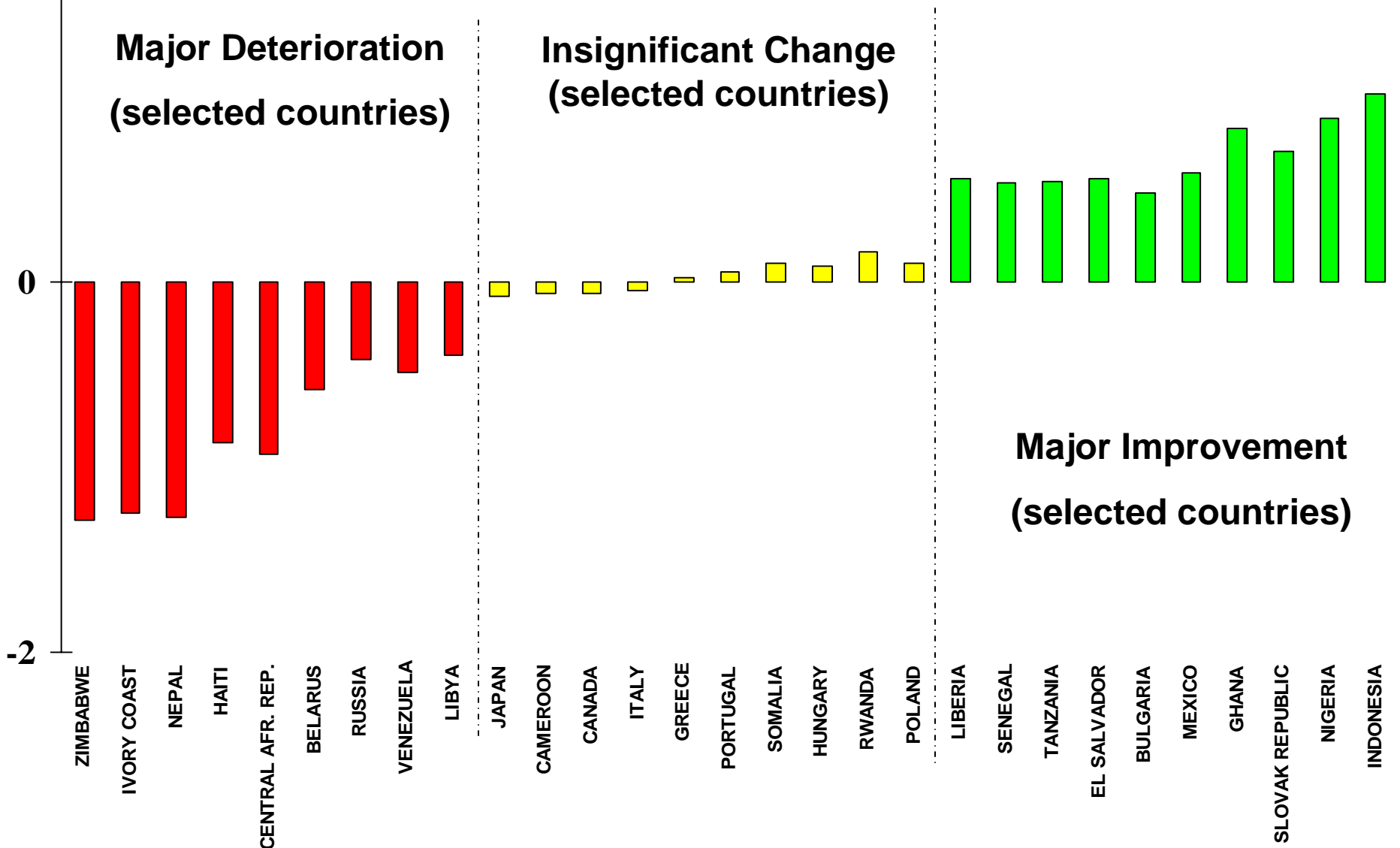
Source for map: 'Governance Matters V: Governance Indicators for 1996-2005', by D. Kaufmann, A.Kraay and M. Mastruzzi, September 2006 - www.govindicators.org. Colors are assigned according to the following criteria: Dark Red: country is in the bottom 10th percentile rank ('governance crisis'); Light Red: between 10th and 25th percentile rank; Orange: between 25th and 50th percentile rank; Yellow, between 50th and 75th; Light Green between 75th and 90th percentile rank; and Dark Green: between 90th and 100th percentile (exemplary governance). Estimates subject to margins of error.

Regulatory Quality, 2004: Latin America & Caribbean



Source for data: : 'Governance Matters IV: Governance Indicators for 1996-2004', D. Kaufmann, A. Kraay and M. Mastruzzi, (<http://www.worldbank.org/wbi/governance/govdata>); Colors are assigned according to the following criteria: Dark Red, bottom 10th percentile rank; Light Red between 10th and 25th; Orange, between 25th and 50th; Yellow, between 50th and 75th; Light Green between 75th and 90th; Dark Green above 90th.

Changes in Voice & Accountability, 1996-05



Changes were calculated on the basis of the differences in country estimates from 1996 and 2005. Classification for major deteriorations and improvements were based on 75% confidence interval. Source for data: 'Governance Matters V: Governance Indicators for 1996-2005', by D. Kaufmann, A. Kraay and M. Mastruzzi, September 2006 - www.govindicators.org

Three Principles for Using Governance Indicators

1. All indicators have measurement error

- rely on variety of data sources**
- reduce noise by aggregation**

2. There are no silver bullets

- subjective/perceptions vs. objective/statutory**
- aggregate vs. individual indicators**
- regular cross-national monitoring/research vs. detailed country diagnostics/country policy advice**
- Complementarity (vs. substitutes)**

3. Links from policy actions to outcomes are complex

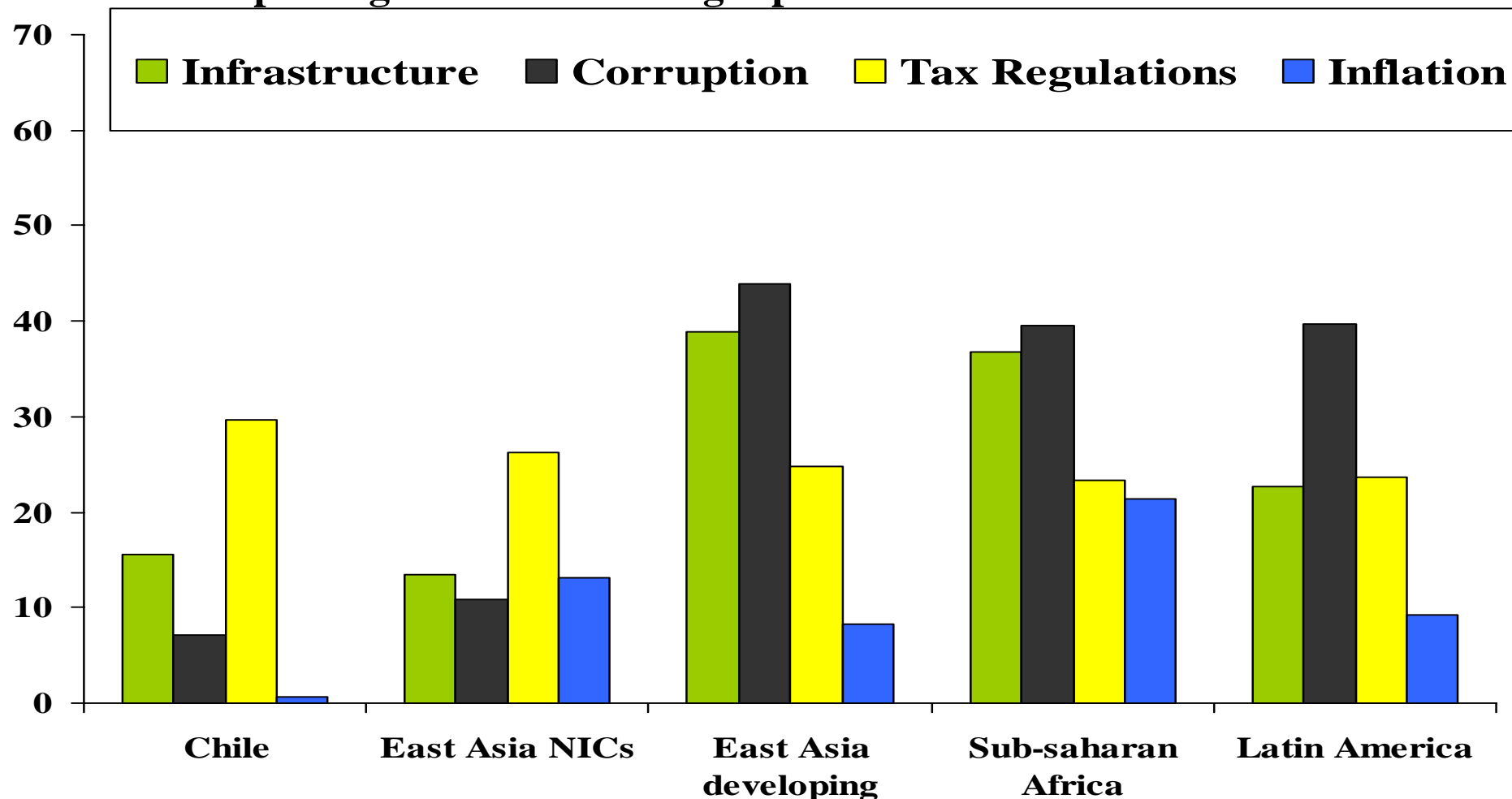
- “actionable” versus “action-worthy” indicators¹⁹**

The Mezzo Level

- **Cross-country surveys of firms/managers (e.g. WEF, BEEPS, etc)**
- **Relying on legal/regulatory experts (e.g. Doing Business)**
- **Hybrid: TI's BPI**

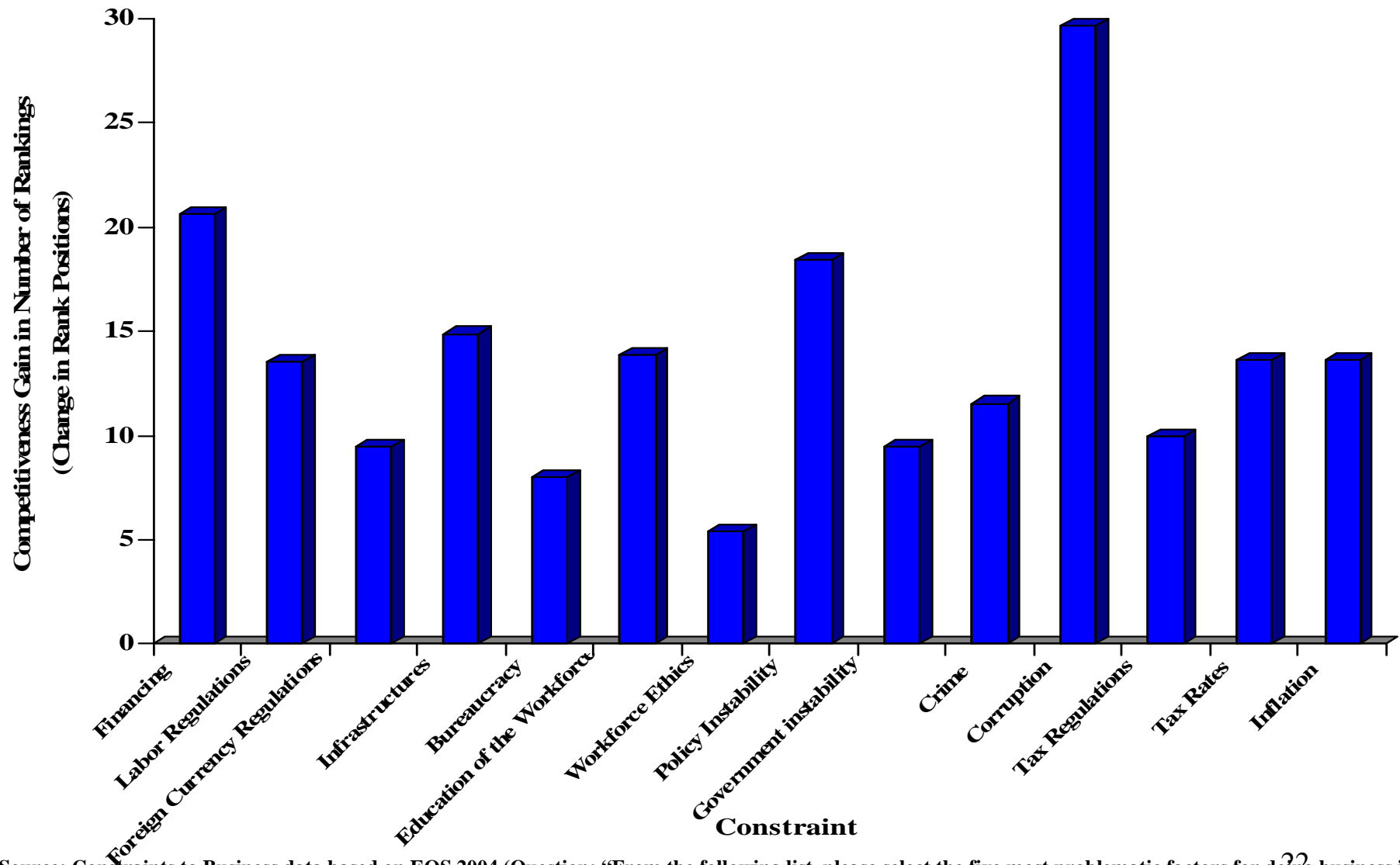
Some Key Constraints to Business, by Region, Responses from the Firm in EOS 2005

% firms reporting constraint among top 3:



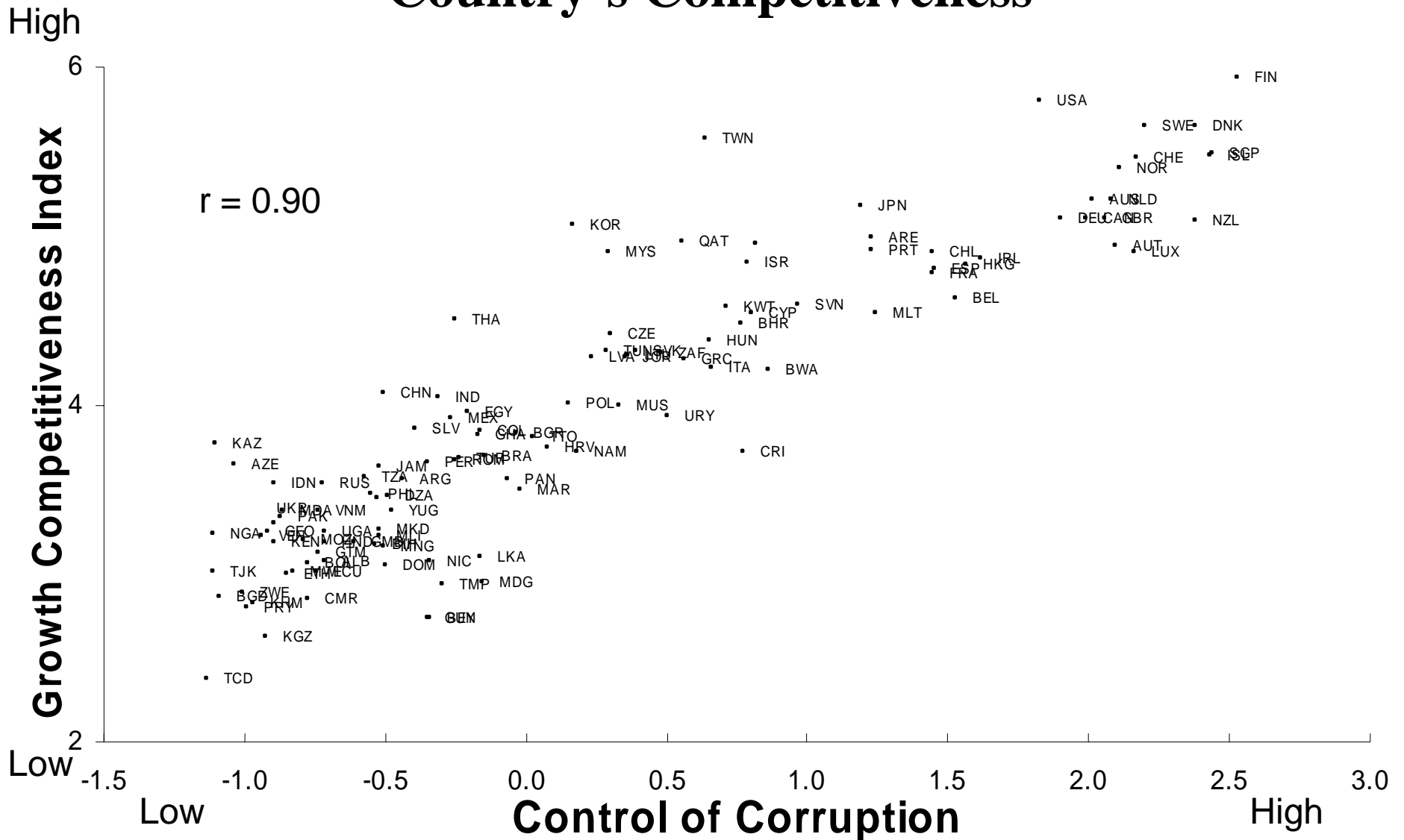
Source: EOS 2005. The question posed to the firm was: Select among the above 14 constraints the five most problematic factors for doing business in your country. Note that the overall EOS sample covers 120 [CHECK] countries, and in some regions –particularly in the Middle East, Africa and the FSU, many countries are not surveyed. Thus, regional averages need to be interpreted with caution, since typically countries not surveyed tend to rate lower in governance than those surveyed.

Impact on Global Competitiveness Index (GCI) Rank of Improvement in Constraint to the Firm



Source: Constraints to Business data based on EOS 2004 (Question: "From the following list, please select the five most problematic factors for doing business in your country, and rank them from 1 to 5."); GCI based on GCR team calculations for 2004/2005 Report; GDP per capita from World Bank. Calculations based on regression estimates of the impact on the GCI of an improvement in the constraint by one standard deviation.

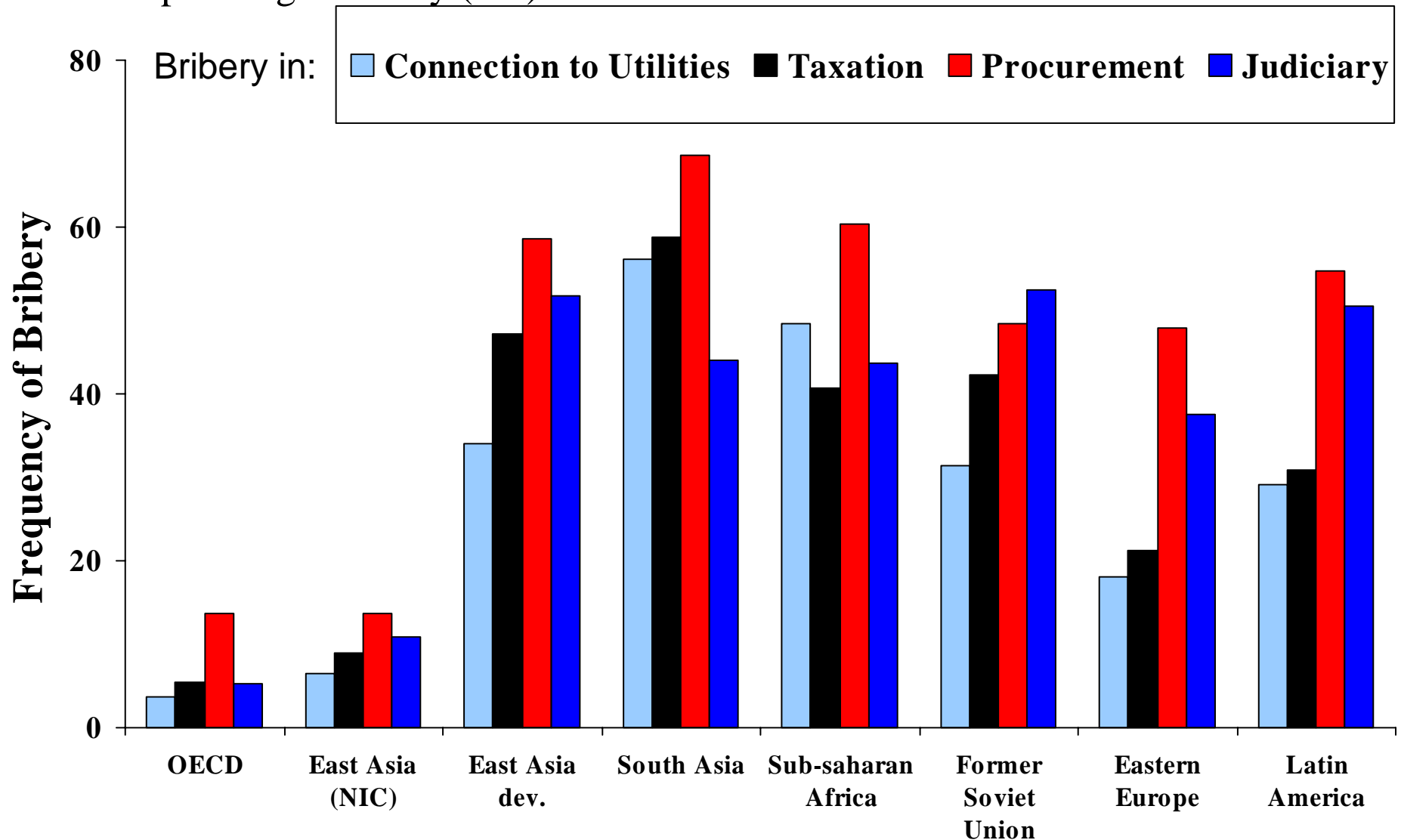
Better Governance is Associated with Higher Country's Competitiveness



Sources: GCI drawn from EOS firm survey, WEF 2005 – 117 countries; Control of Corruption from Kaufmann, Kraay and Mastruzzi, 'Governance Matters IV: Governance Indicators for 1996-2004'.

Frequency of Bribery, Responses by Firms 2005

% Firm Report High Bribery (1-3)



Source: EOS firm survey, WEF2005 – 117 countries. Question: In your industry, how commonly firms make undocumented extra payments or bribes connected with permits / utilities / taxation / awarding of public contracts / judiciary? (common...never occurs).

State Capture

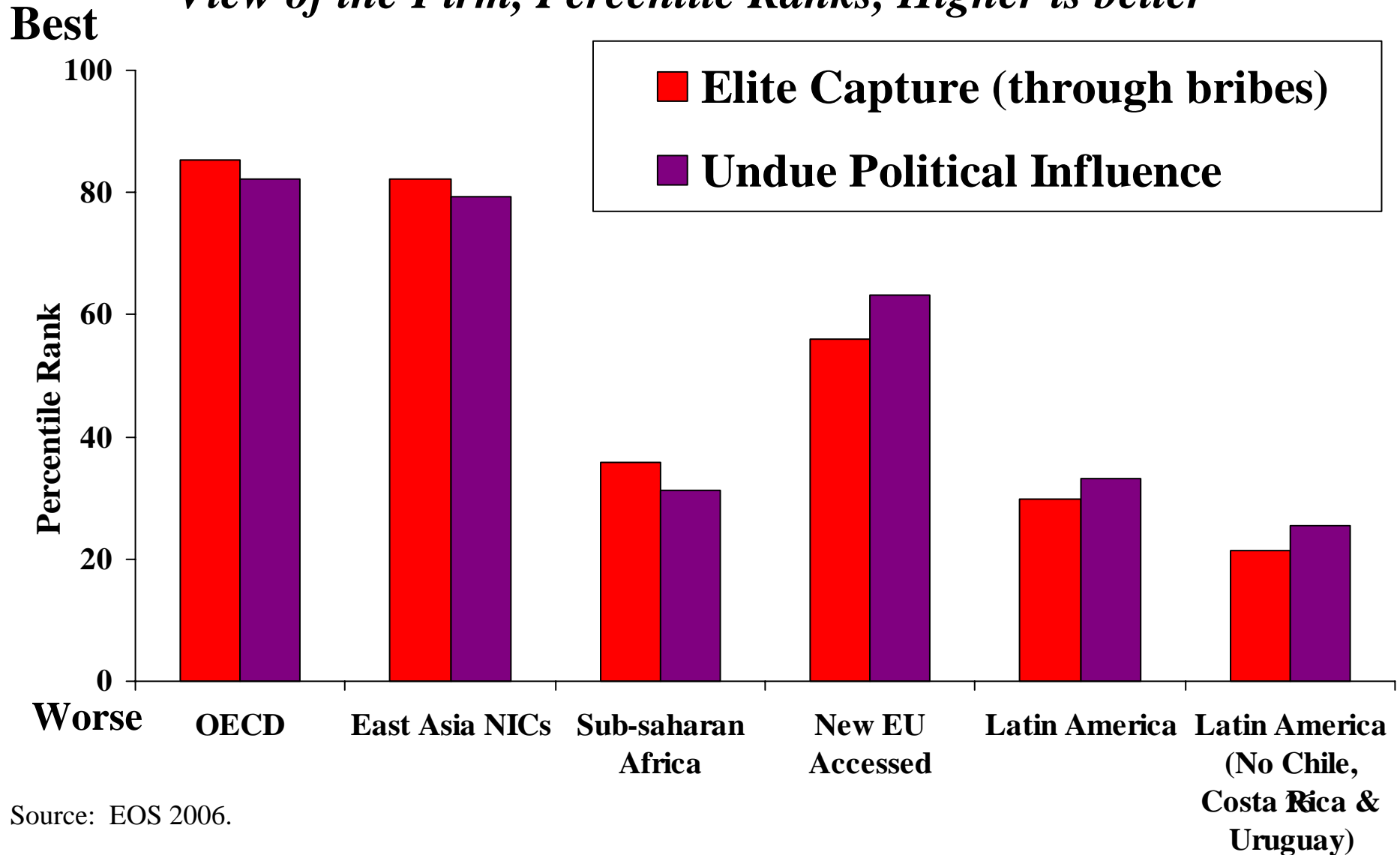
Firms shape the legal, policy and regulatory environment through *illicit, non-transparent* provision of private gains to public officials

- **Examples include:**

- *private purchase of legislative votes*
- *private purchase of executive decrees*
- *private purchase of court decisions*
- *illicit political party financing*

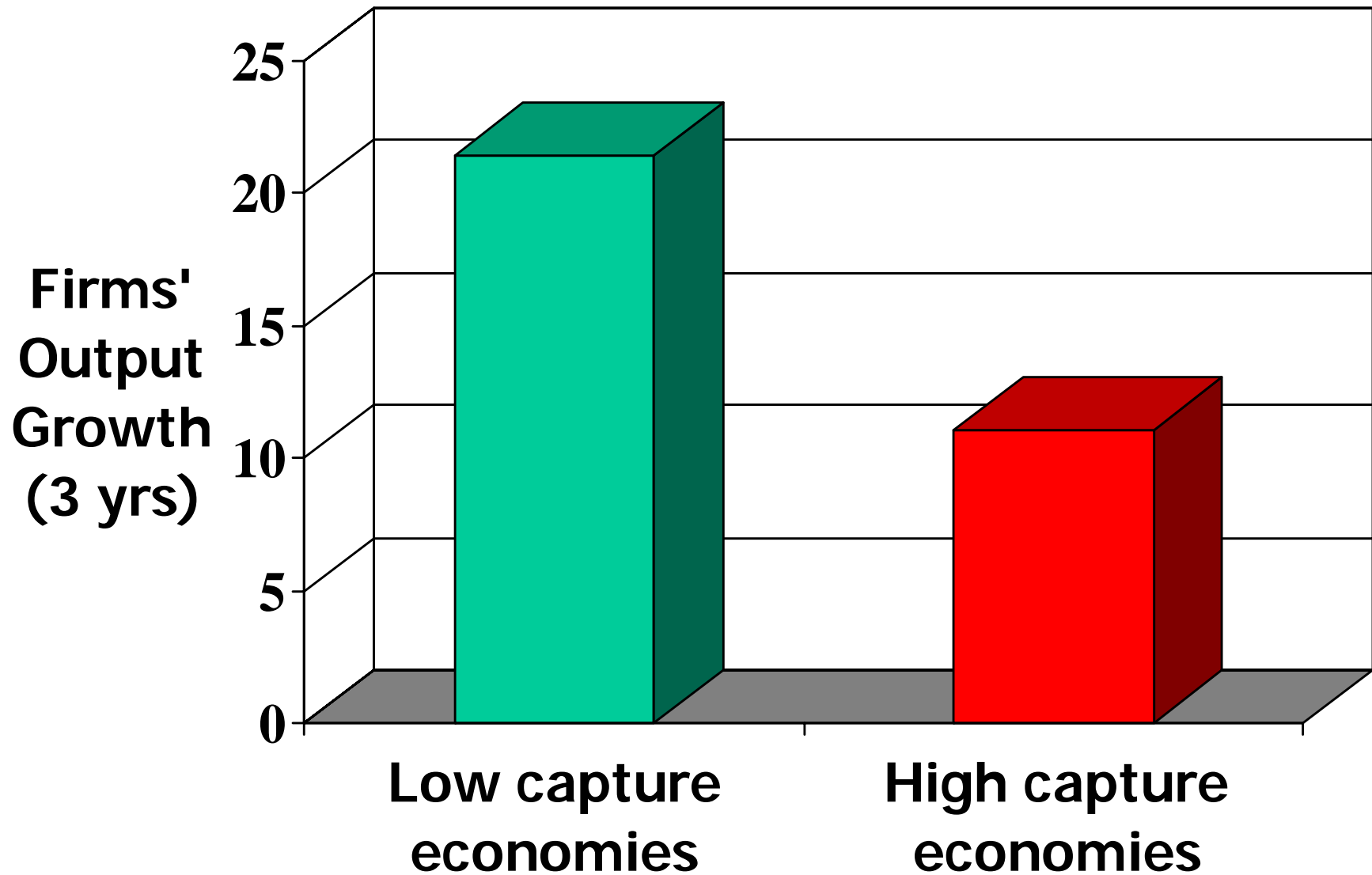
Elite Capture, Political Corruption and Inequality of Influence in Latin America

View of the Firm, Percentile Ranks, Higher is better



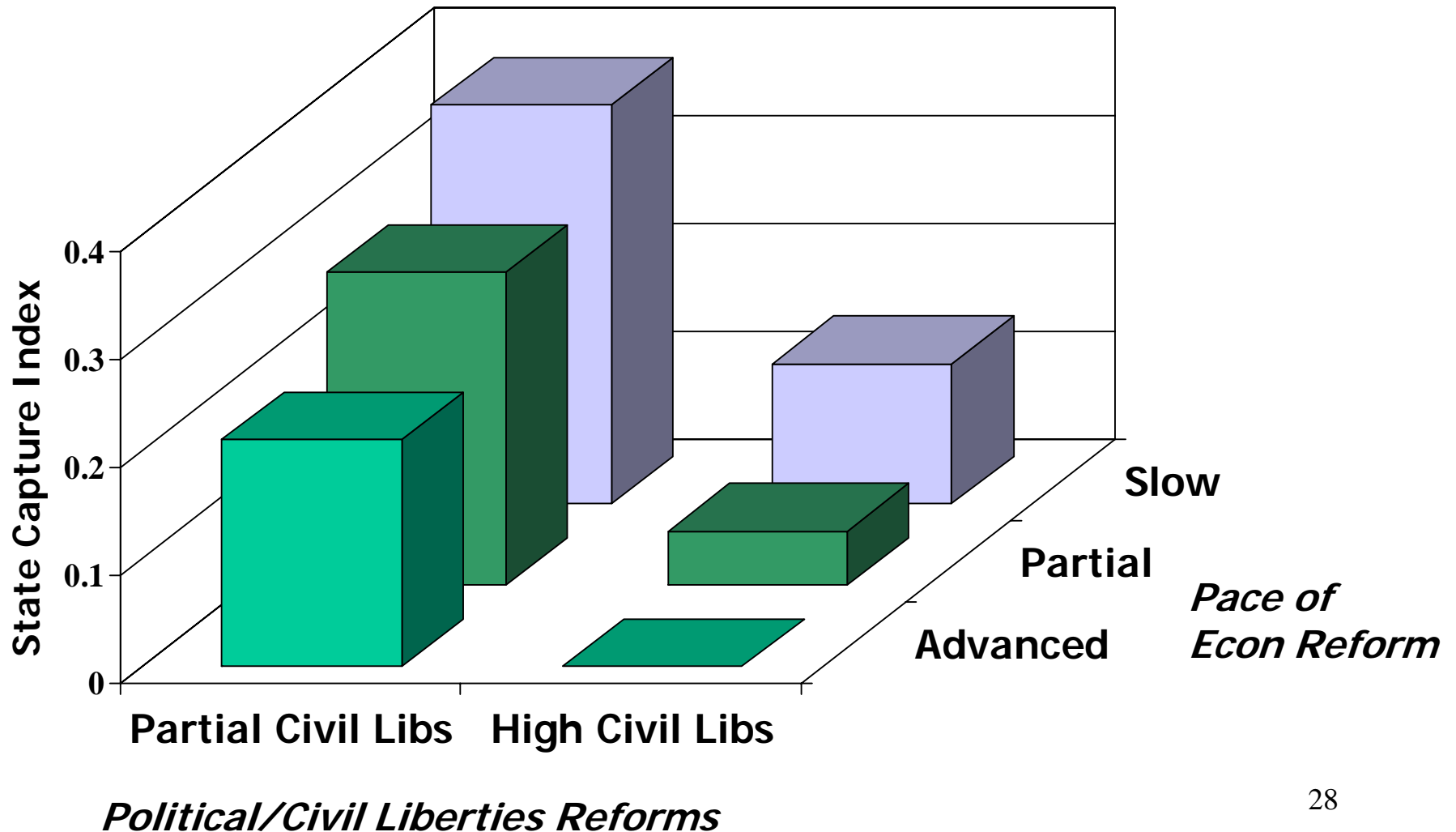
Source: EOS 2006.

Economic Cost of Capture for Growth



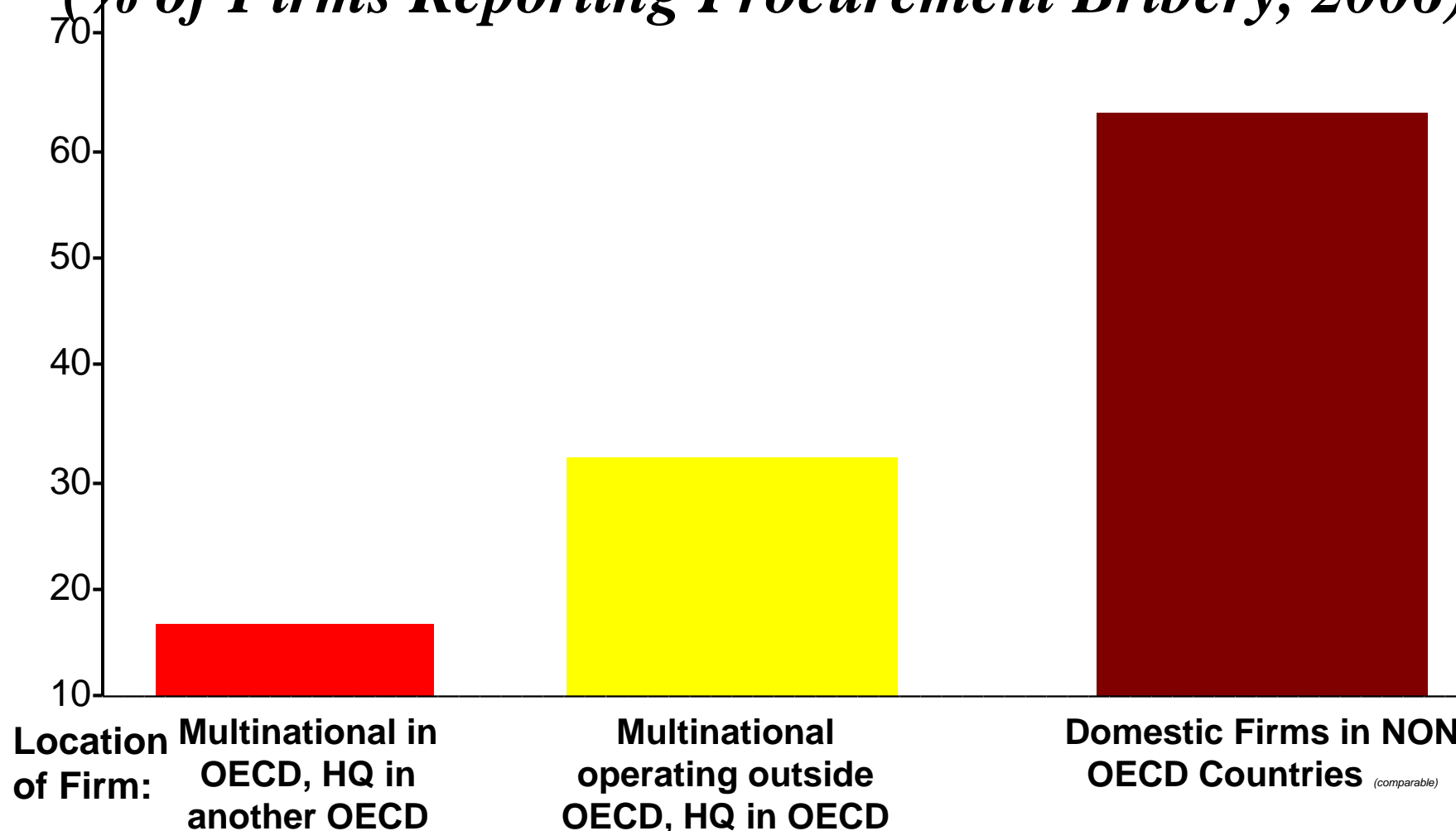
Based on survey of transition economies, 2000

Addressing Capture: Economic Reform, Political Competition & Voice/Civil Liberties Matter



Responsibility of the Private Sector & Multinationals on Anti-Corruption

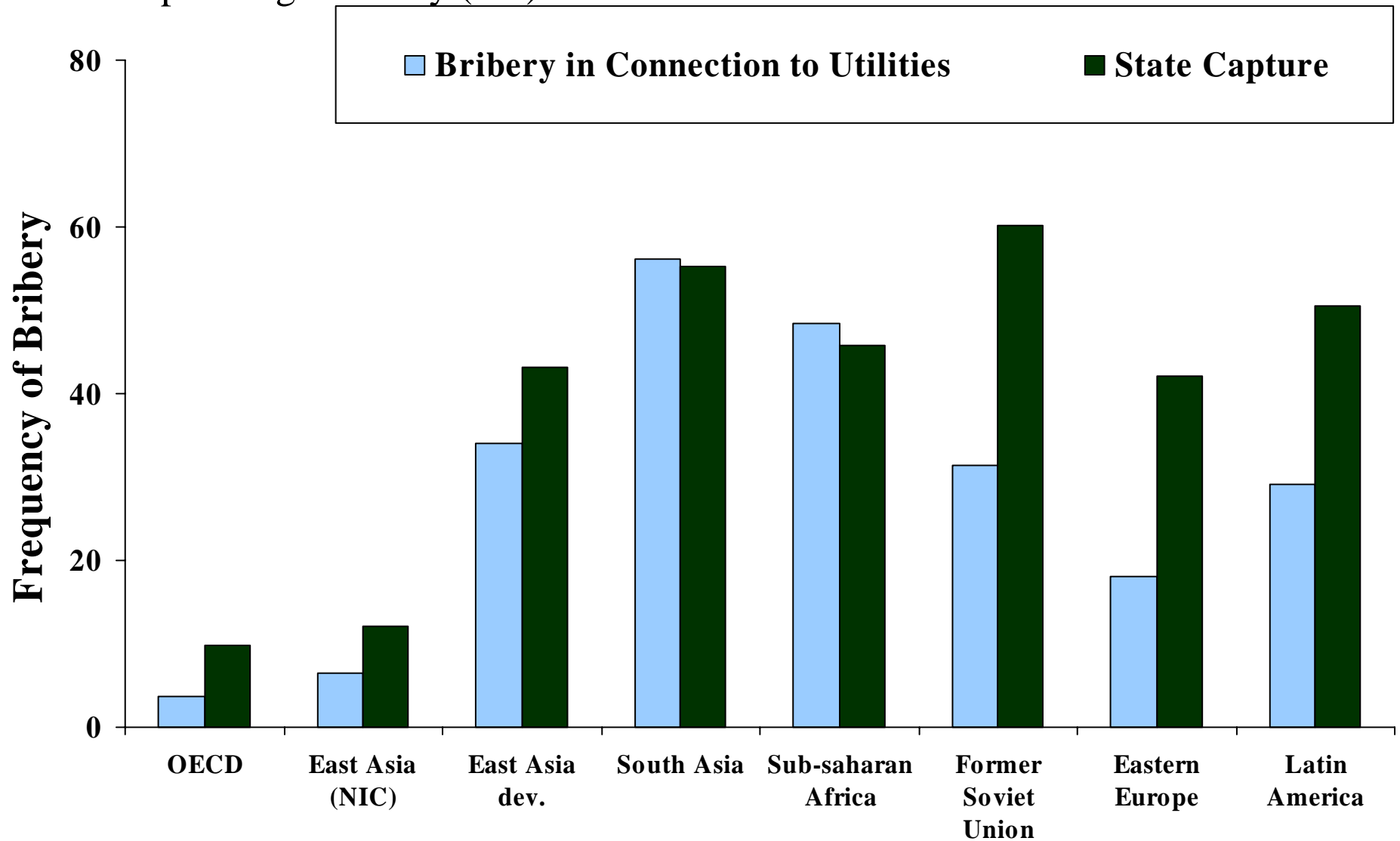
(% of Firms Reporting Procurement Bribery, 2006)



Source: EOS2006. Questions: When firms like yours do business with the government, how much of the contract value must they offer in additional payments to secure the contract? Y-axis shows percentage of firms who admitted paying bribes. Last bar excludes small with less than 50 employees.

Frequency of Bribery, Responses by Firms 2005

% Firm Report High Bribery (1-3)

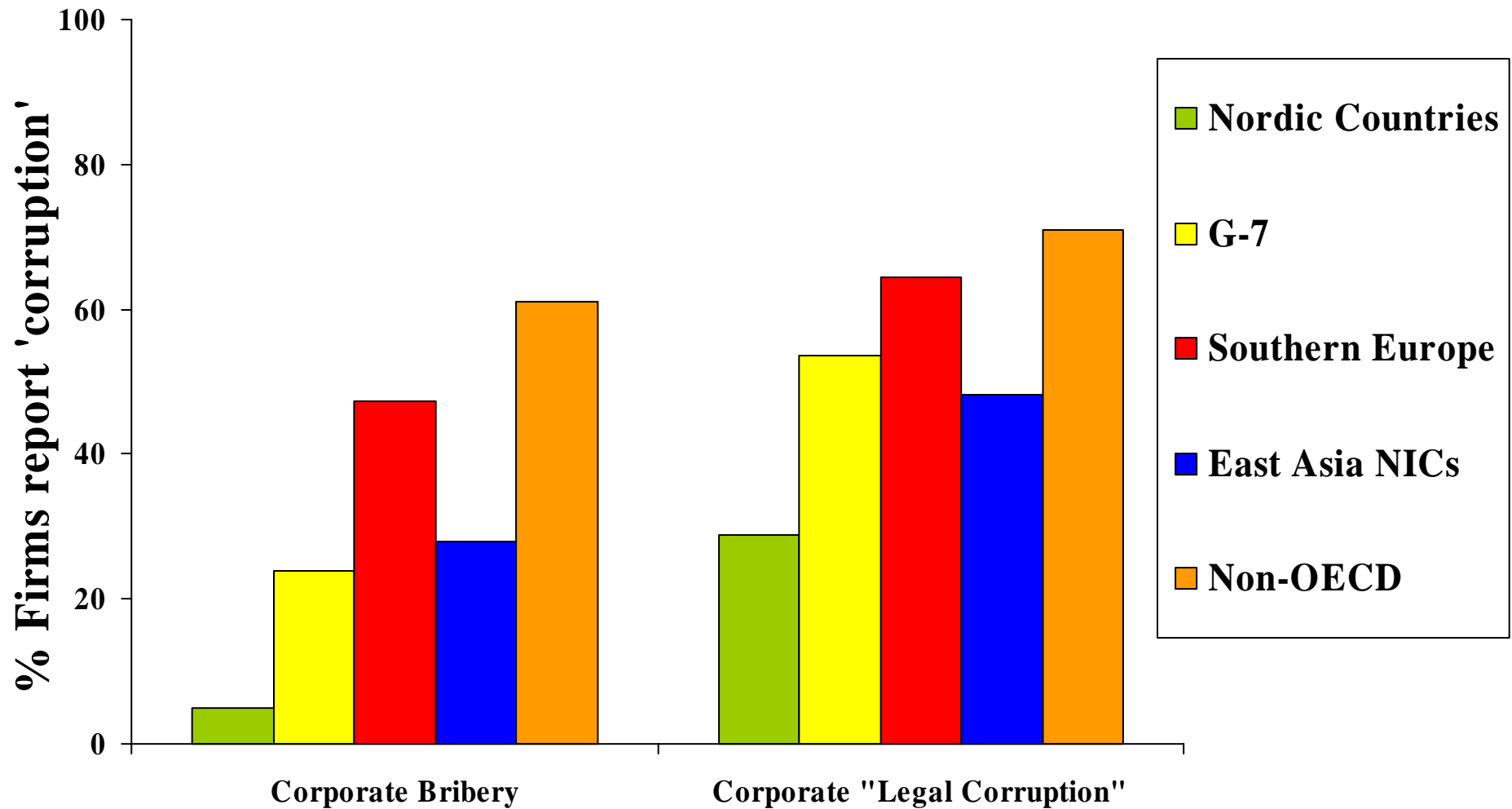


Defining, Measuring and Analyzing Legal Corruption

- **Old, traditional definition of corruption:**
‘Abuse of public office for private gain’
- **Problems – i) interpreted in terms of legality of act (illegal = corrupt; legal = non-corrupt?);**
ii) onus is on the public official (asymmetry), and,
iii) measurement bias towards ‘petty corruption’
- **Alternative: ‘Privatization of public policy’ (e.g. *‘undue influence by private interests on public policy actions’*)**
- **This implies that, strictly speaking, some actions may be legal, but illegitimate, inconsistent with standards and/or corrupt**
- **These legal forms of corruption can be measured** ³¹

Corporate Corruption, 2004

% Firms report corruption type (1-4)



Source: Author's calculations based on EOS 2004.

Towards a Systematic Taxonomy of Approaches

1. **Voluntary Approaches**, incl. codes of conduct: reliant on self-verification–*Global Compact, Integrity Pacts, PACI*
2. **Rule of Law Enforcement**: legislation & enforcement, judiciary oversight, etc., a la SOX
3. **Disclosure to Raise Reputational Cost – Naming**: publishing blacklisted firms–*INT-WBG, Global Witness*
4. **Data Power**: Corruption diagnostics (surveys, etc.), corporate corruption indices, BPI, etc

Spectrum from purely voluntary actions through to public shaming and penalties, with hybrid variants between that combine approaches

10 related Questions for debate?

- 1. Away from Narrow & Legal definition of Corruption?**
- 2. Private sector not just the ‘investment climate *taker*’, vs. public sector as the sole ‘investment climate *maker*’...**
- 3. Thus, away from sole focus on administrative corruption -- *ignores influence peddling and state capture by firms***
- 4. Focus on supply side of corruption, but public sector needs to deliver as well: *case for collective action***
- 5. Away from over-regulating as A-C response**
- 6. Why would ‘voluntarism’ deliver?**
- 7. CSR under challenge? One bottom line, vs. 3 or 4?**
- 8. Then, focus on lessening B2G corruption > B2B?**
- 9. Incentives, incentives and incentives... Primary driver?**
- 10. A framework for prioritization & evaluation of initiatives?**

Challenging Ourselves to go to the Next Level

- **World Bank Group:** *Project Design, Selectivity & Signal, Investigation, Sanctions, Public Disclosure, cross-listing w/all MDBs? -- more Data/Indices on private sector corruption? Partnering initiatives; more w/IFC; Action Learning; Promoting Voluntary Codes of Conduct? Experimental/Randomized, Etc.?*
- **NGOs, such as TI:** *Posting cross-lists of firms?, Challenging firms and gov'ts in rich countries on implementation of OECD, UN conventions? Mediating info from corrupted to corruptor*
- **Private Sector:** *Acceptance of transparency standards (incl. banking) & MDBs/gov't public sanctions; business associations*
- **Academic Business Schools, Think Tanks:** *beyond traditional CSR and ethics, beyond conferences -- towards cost-benefit analysis of different incentives (incl. reputational risks); innovations; engaging with business associations*

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

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

Further materials & access to interactive data:

General: www.worldbank.org/wbi/governance

Data: www.govindicators.org