

Governance and Corruption: *Evidence and Implications*

Francesca Recanatini and Daniel Kaufmann

Meeting with future Russian Leaders,

The World Bank, October 25th, 2002

Governance and Poverty Nexus

**Lower
Investment
and Growth**



- **Unsound economic/institutional policies due to vested interests**
- **Distorted allocation of public expenditures/investments**
- **Low human capital accumulation**
- **Elite corporate interests capture laws and distort policymaking**
- **Absence of rule of law and property rights**
- **Governance obstacles to private sector development**

**Lack of Health
and Education**



- **Low human capital accumulation**
- **Lower quality of education and health care**

Cont...

Governance and Poverty, cont.

**Poor have
Smaller share
in Growth**



- **State capture by elite of government policies and resource allocation**
- **Regressiveness of bribery “tax” on small firms and the poor**
- **Regressiveness in public expenditures and investments**
- **Unequal income distribution**

**Impaired Access
to Public
Services**



- **Bribery imposes regressive tax and impairs access and quality of basic services for health, education, and justice**
- **Political capture by elites of access to particular services**

Emerging Findings and Debate Issues

- **Beyond Anti-corruption ‘Campaigns’:**
 - Towards “Good & Clean Government”* (good governance)
- **Broader framework of analysis and strategic formulation**
- **Costs and Determinants of poor 'governance' internationally**
- **Specific governance challenges in Transition Economies?**
- **The Power of Empirics-Information: Diagnostics in country**
- **What kind of Capacity Building priorities?**
- **The role of Civil Society, Parliaments and Social Contract?**
- **Subnational/Municipal Level reforms**
- **Role and Responsibility of the Corporate Sector and FDI**
- **Role of the International Donor Community**

Governance: A working definition

- *Governance is the process and institutions by which authority in a country is exercised:*
 - (1) S -- the process by which governments are selected, held accountable, monitored, and replaced;
 - (2) E -- the capacity of gov't to manage resources and provide services efficiently, and to formulate and implement sound policies and regulations; and,
 - (3) R -- the respect for the institutions that govern economic and social interactions among them

*Operationalizing Governance:
Unbundling its Definition into Components that
can be measured, analyzed, and worked on*

*Each of the 3 main components of Governance
Definition is unbundled into 2 subcomponents:*

- **Voice and External Accountability**
- **Political Stability and lack of Violence&Terror**
- **Quality Regulatory Framework**
- **Government Effectiveness**
- **Control of Corruption**
- **Rule of Law**

*We measure these six
governance components...*

Broadening our Perspective: *Assessing Governance*

- **Control of Corruption (or Graft)**
- **Rule of Law**
- **Lack of Regulatory Burden**
- **Government Effectiveness**
- **Voice and Accountability**
- **Political Stability and lack of Violence**

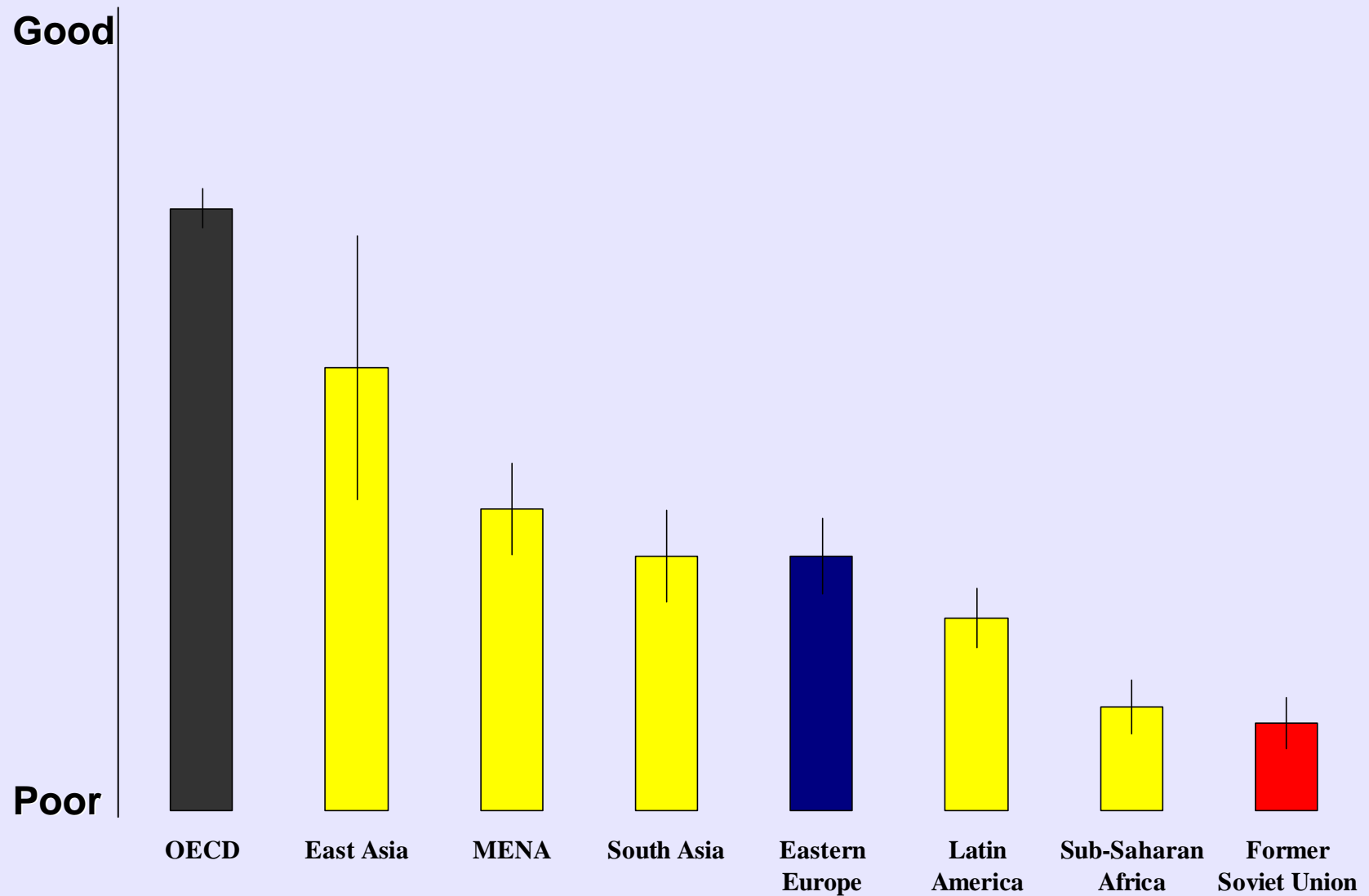
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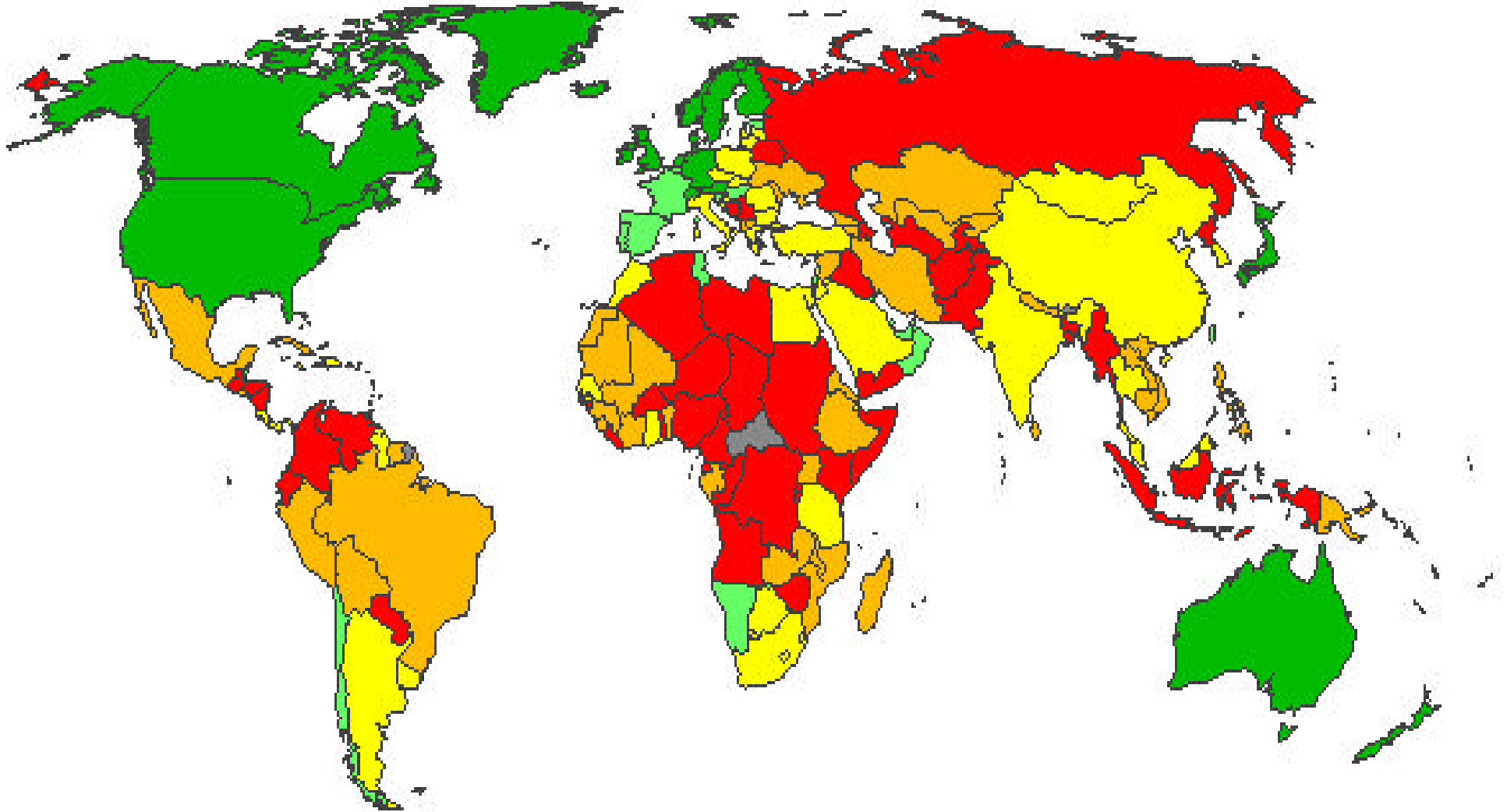
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Quality of Rule of Law by Region



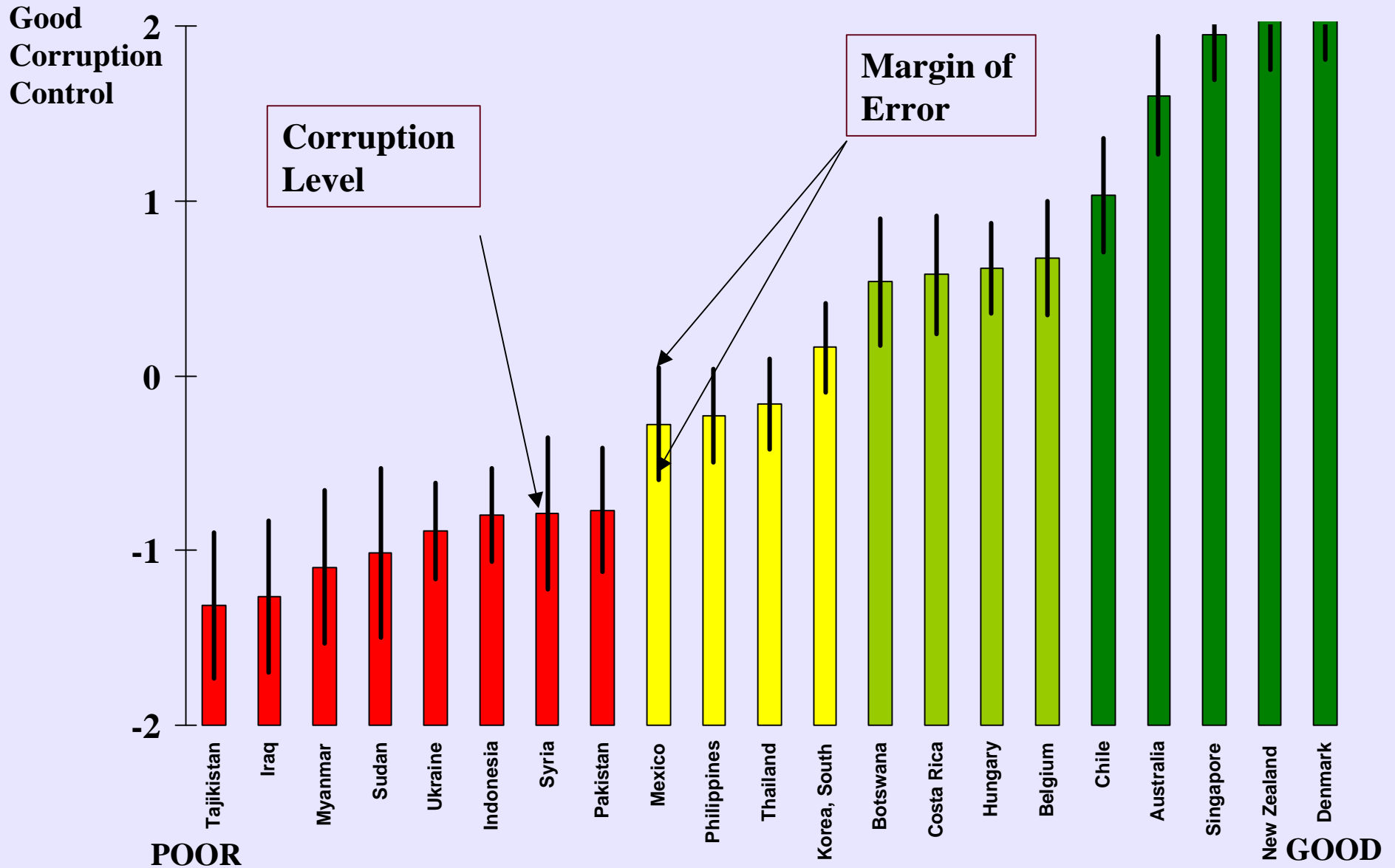
'Traffic Light' Map: Rule of Law, 2000/01



Source for data: <http://www.worldbank.org/wbi/governance/govdata2001.htm> ; Map downloaded from : <http://info.worldbank.org/governance/kkz/gov2001map.asp>
Colors are assigned according to the following criteria: Red, 25% or less rank worse; Orange, between 25% and 50%; Yellow, between 50% and 75%; Light Green between 75% and 90% ; Dark Green above 90%

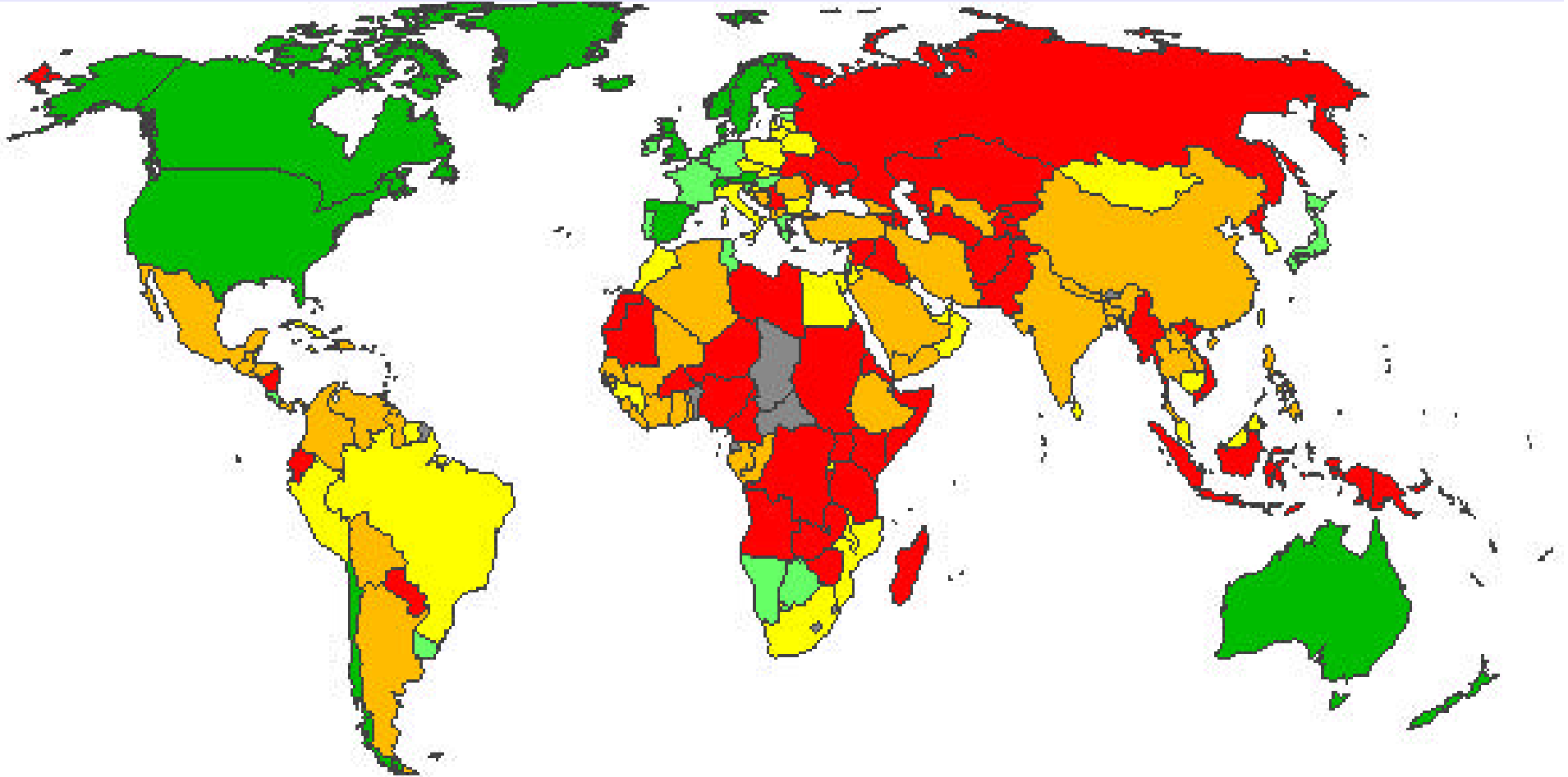
Control of Corruption: one Aggregate Indicator

(selected countries from 155 worldwide, for illustration, based on 1998 research data)*



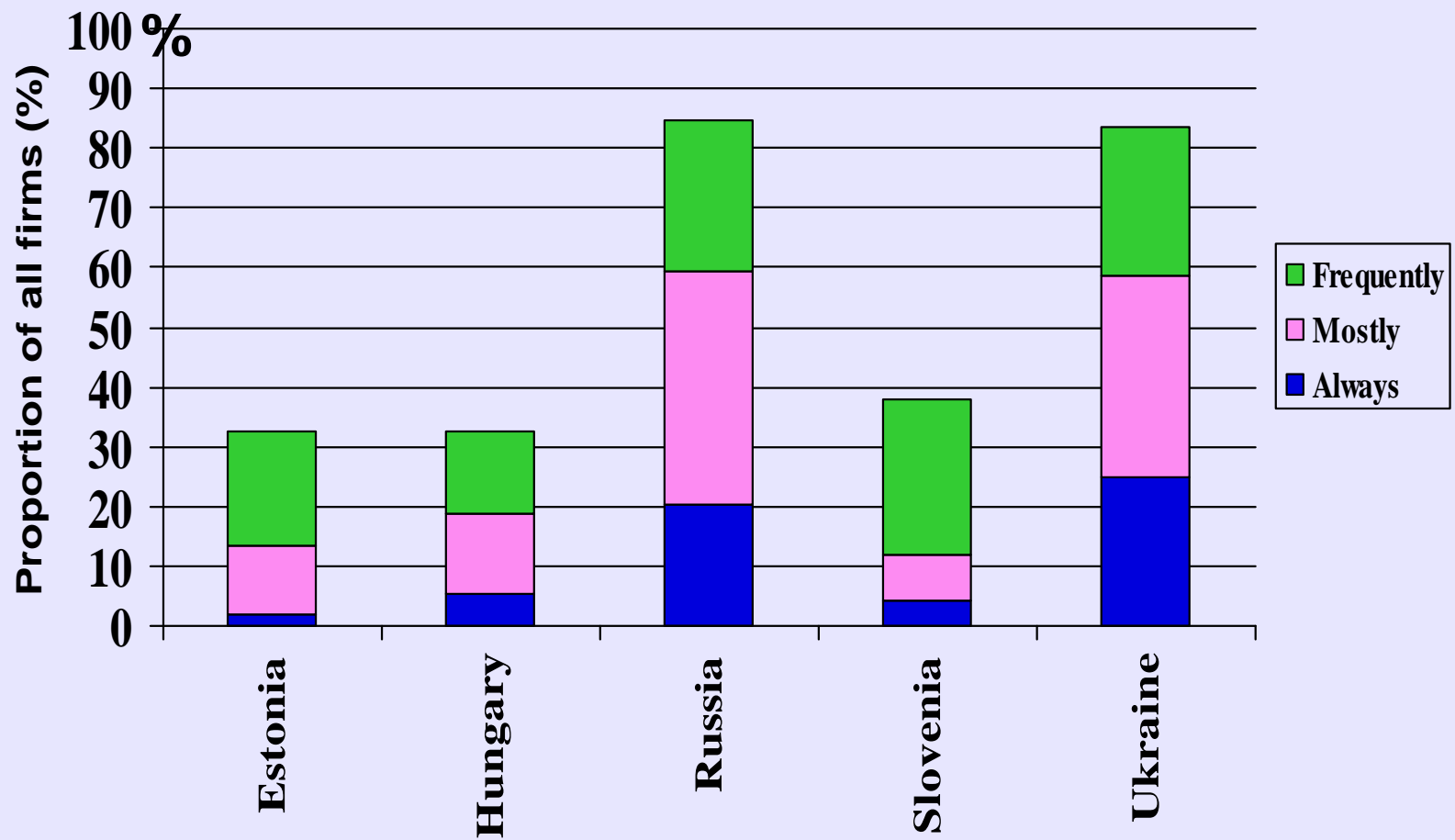
Source: 'Governance Matters', 1999, PRWP 2196 by Kaufmann, Kraay and Zoido. <http://www.worldbank.org/wbi/governance/>

‘Traffic Light’ World Map Control of Corruption – 2000/01

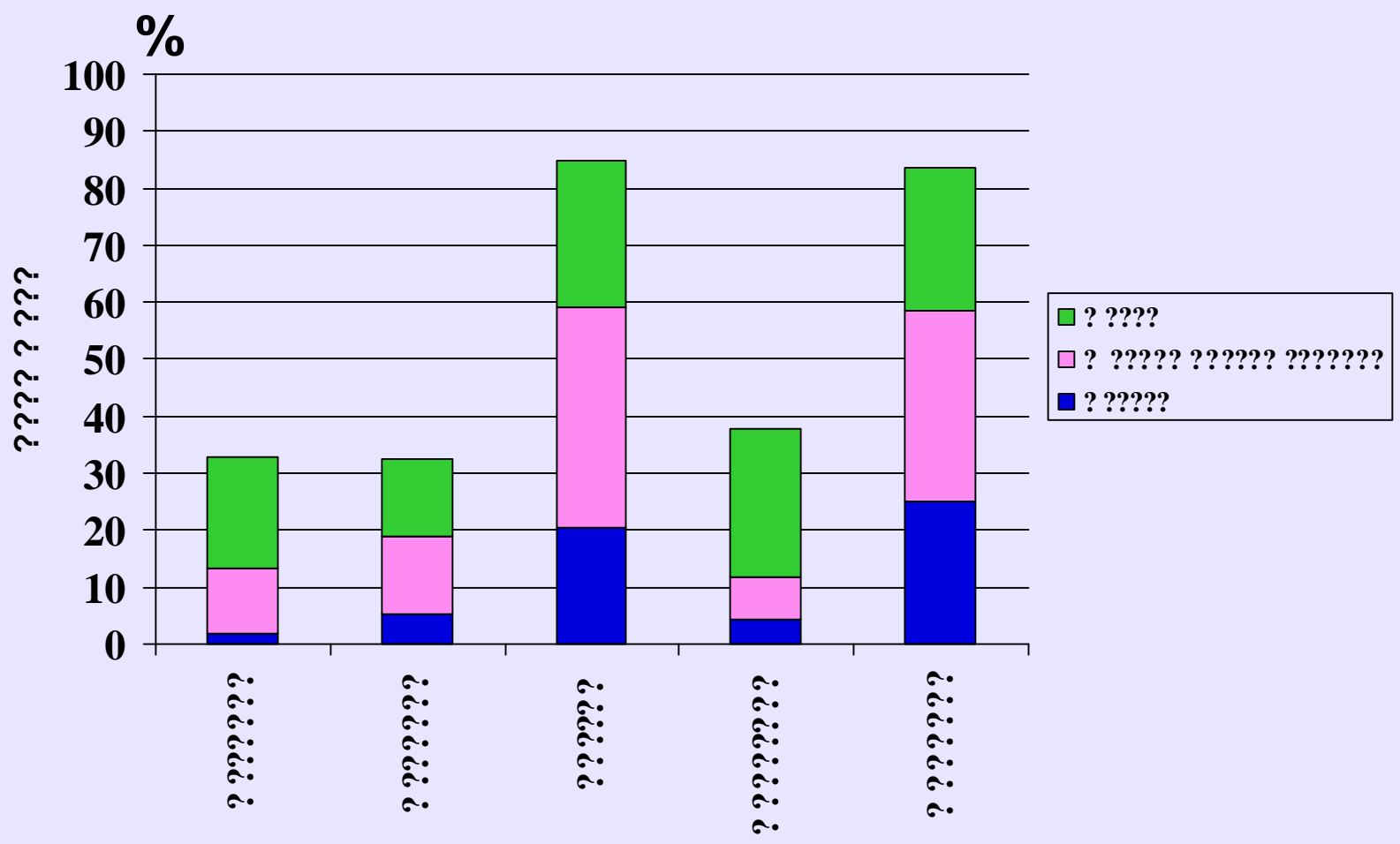


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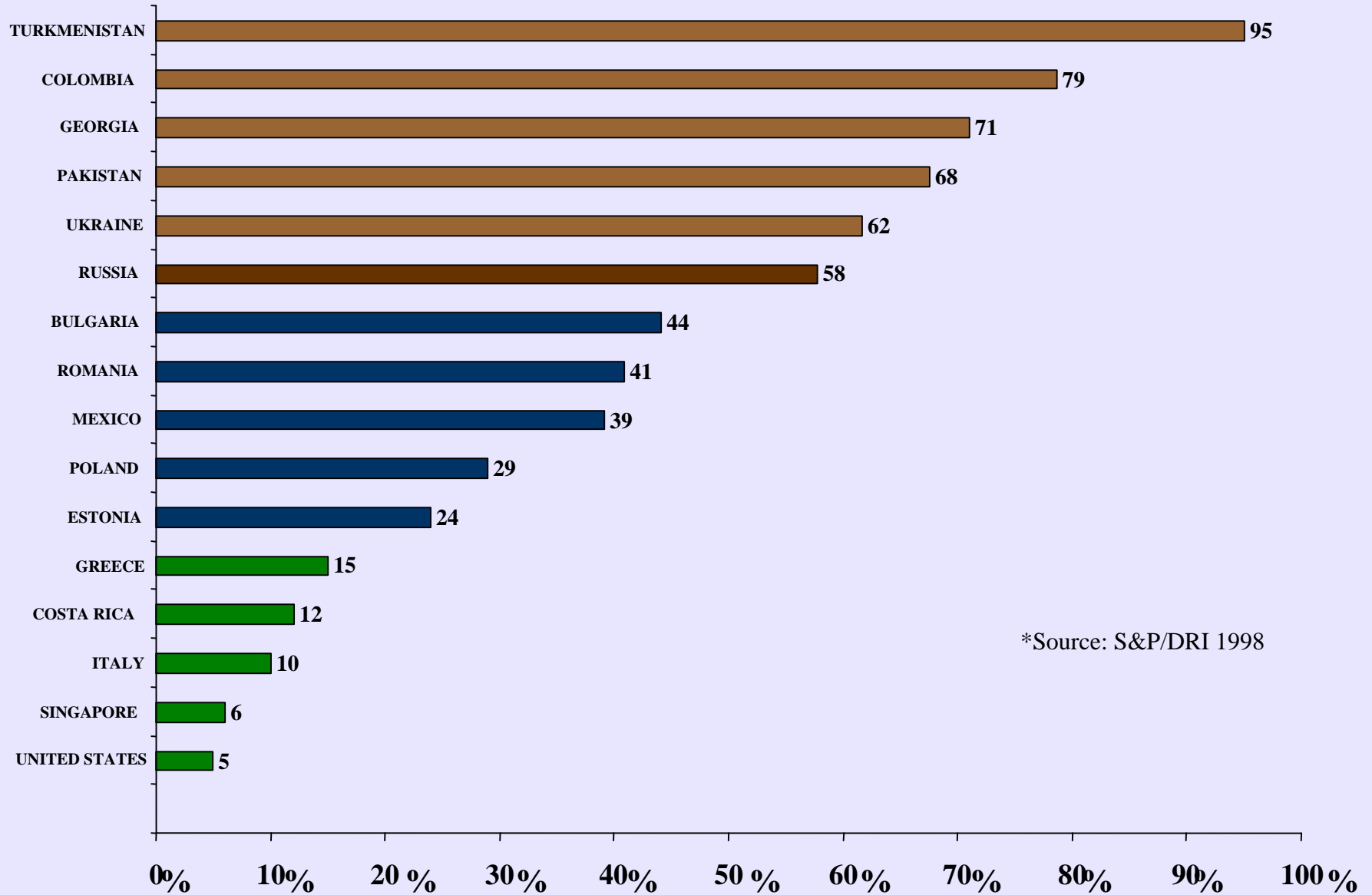
Legal "Misgovernance" in Transition: Share of firms report Corrupt Legal System



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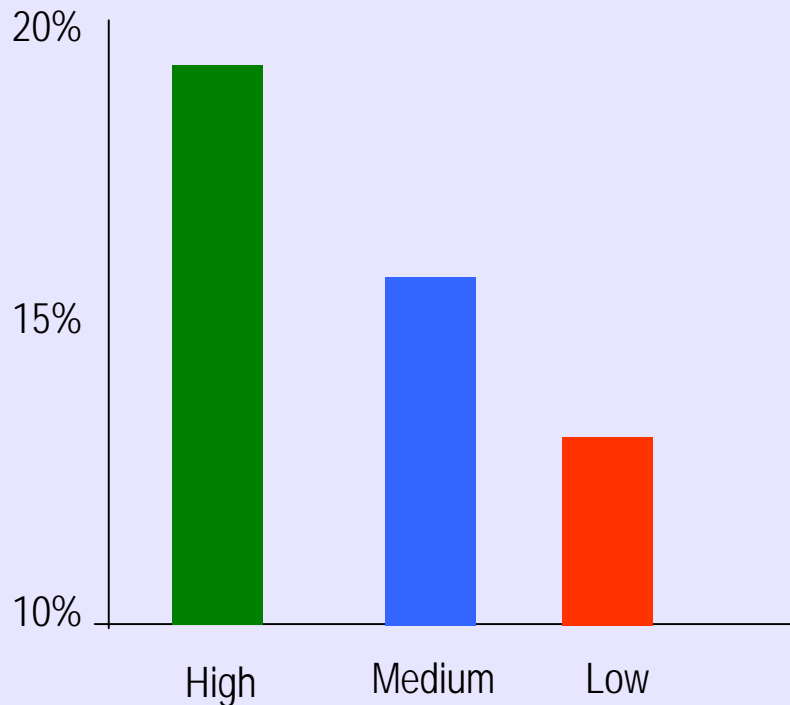
CORRUPTION DETERS FOREIGN INVESTORS: *Probability of Investment Loss due to Corruption (within 5 years)*



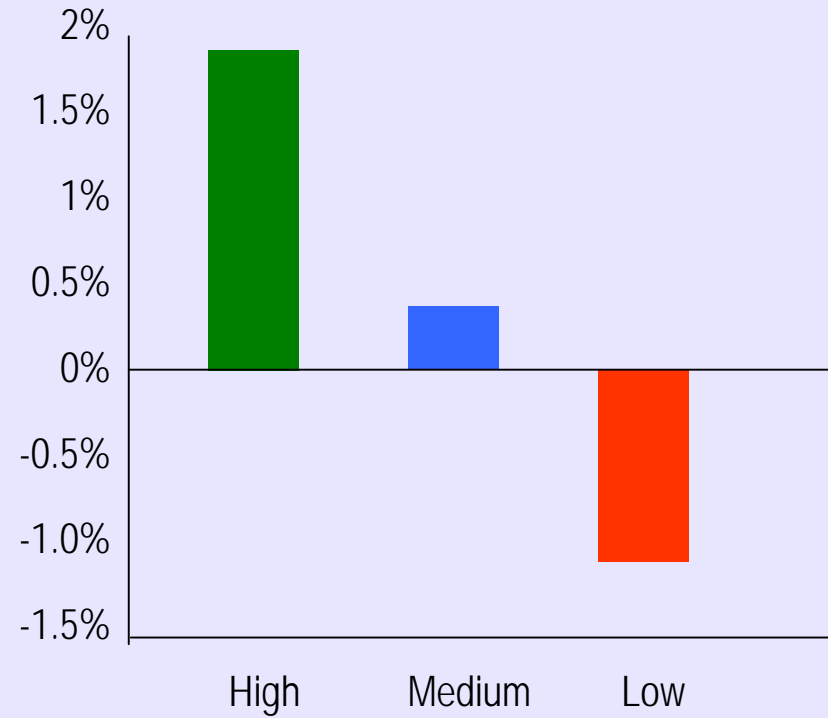
*Source: S&P/DRI 1998

Impact of good government on investment and growth

% Investment share in GDP

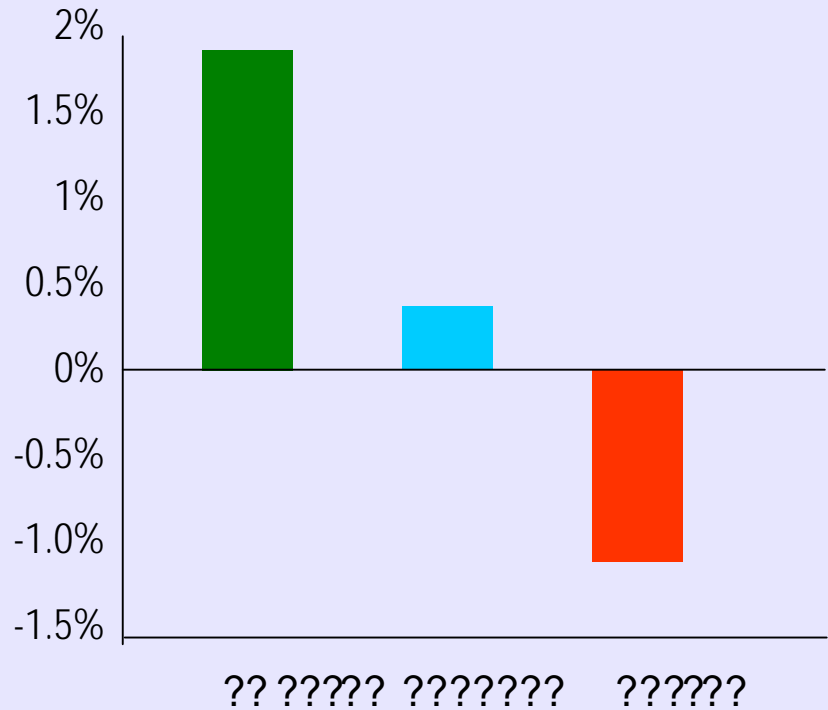
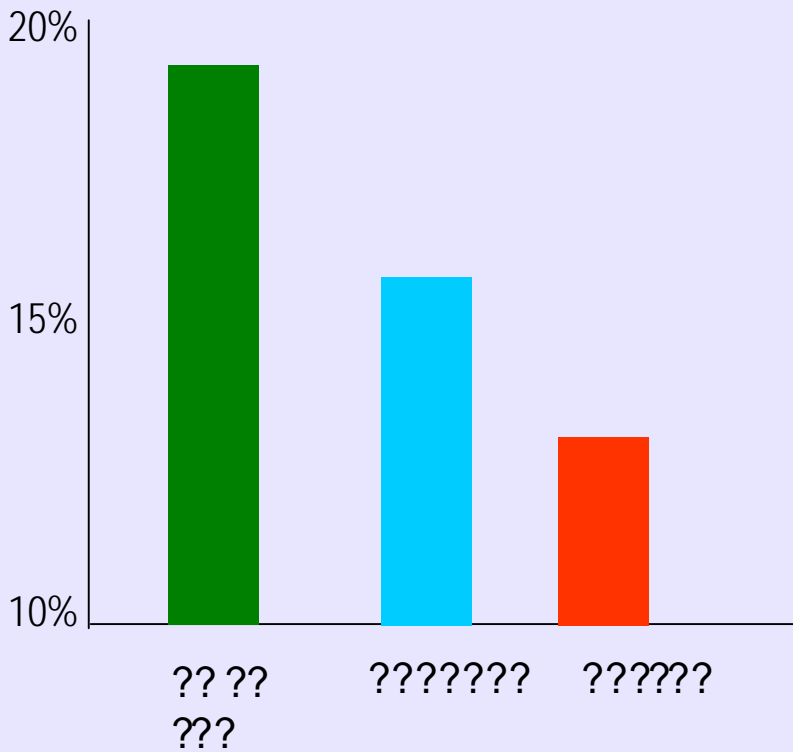


Income per capita Growth Rate



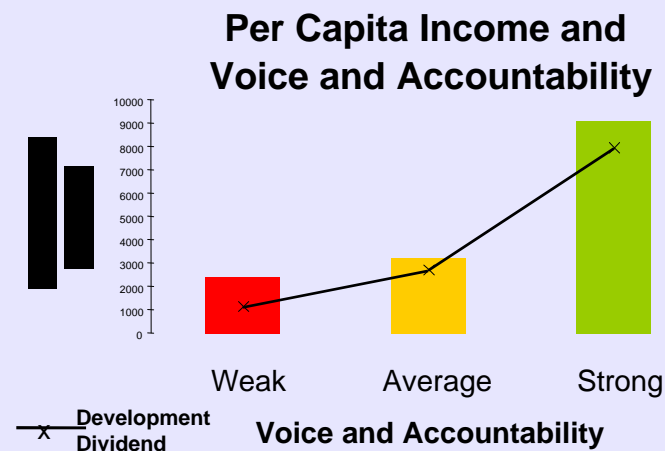
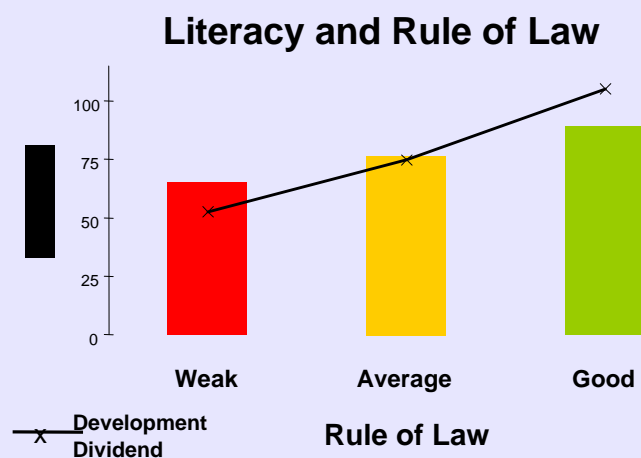
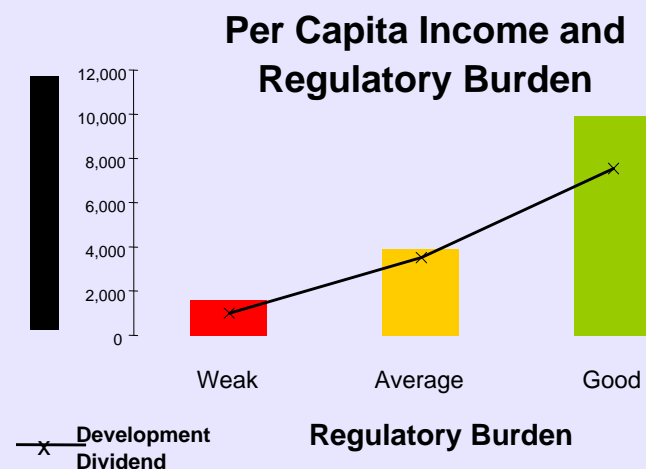
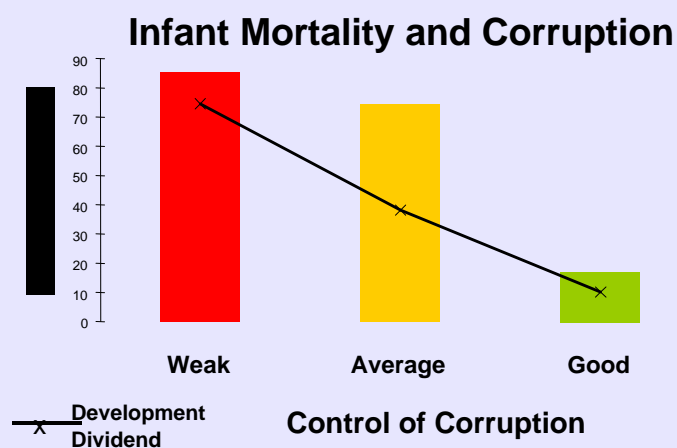
Government Quality

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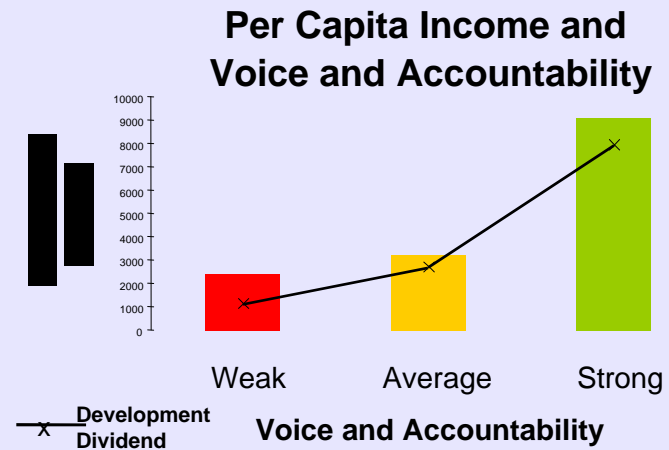
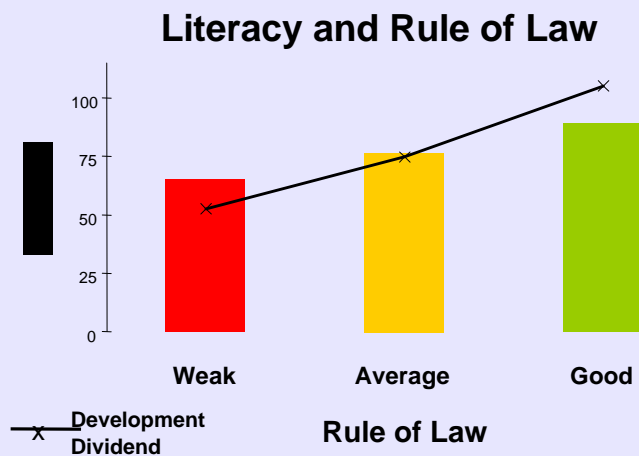
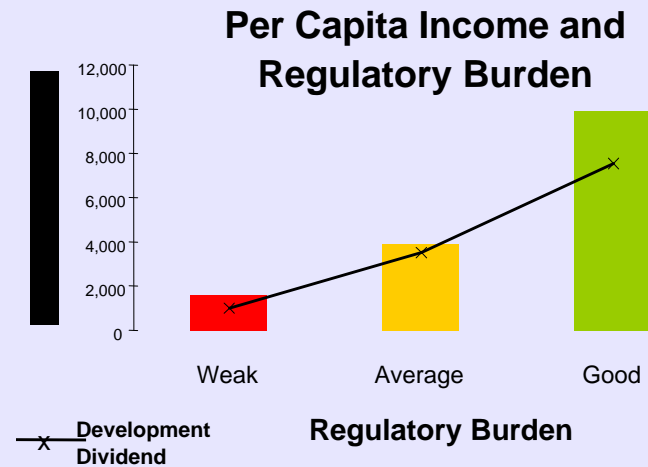
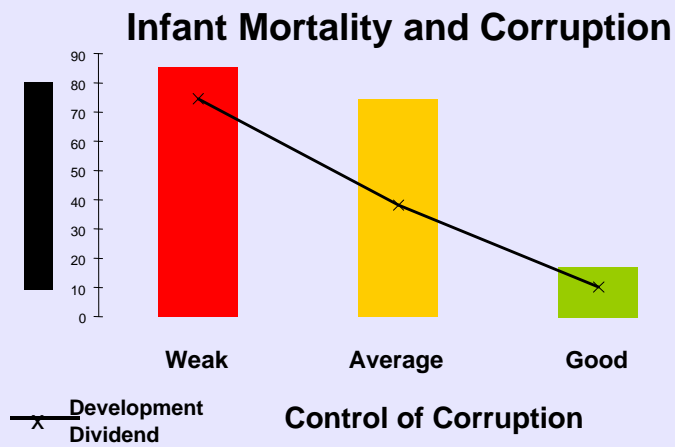
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The 'Dividend' of Good Governance



Note: The bars depict the simple correlation between good governance and development outcomes. The line depicts the predicted value when taking into account the causality effects ("Development Dividend") from improved governance to better development outcomes. For data and methodological details visit <http://www.worldbank.org/wbi/governance>.

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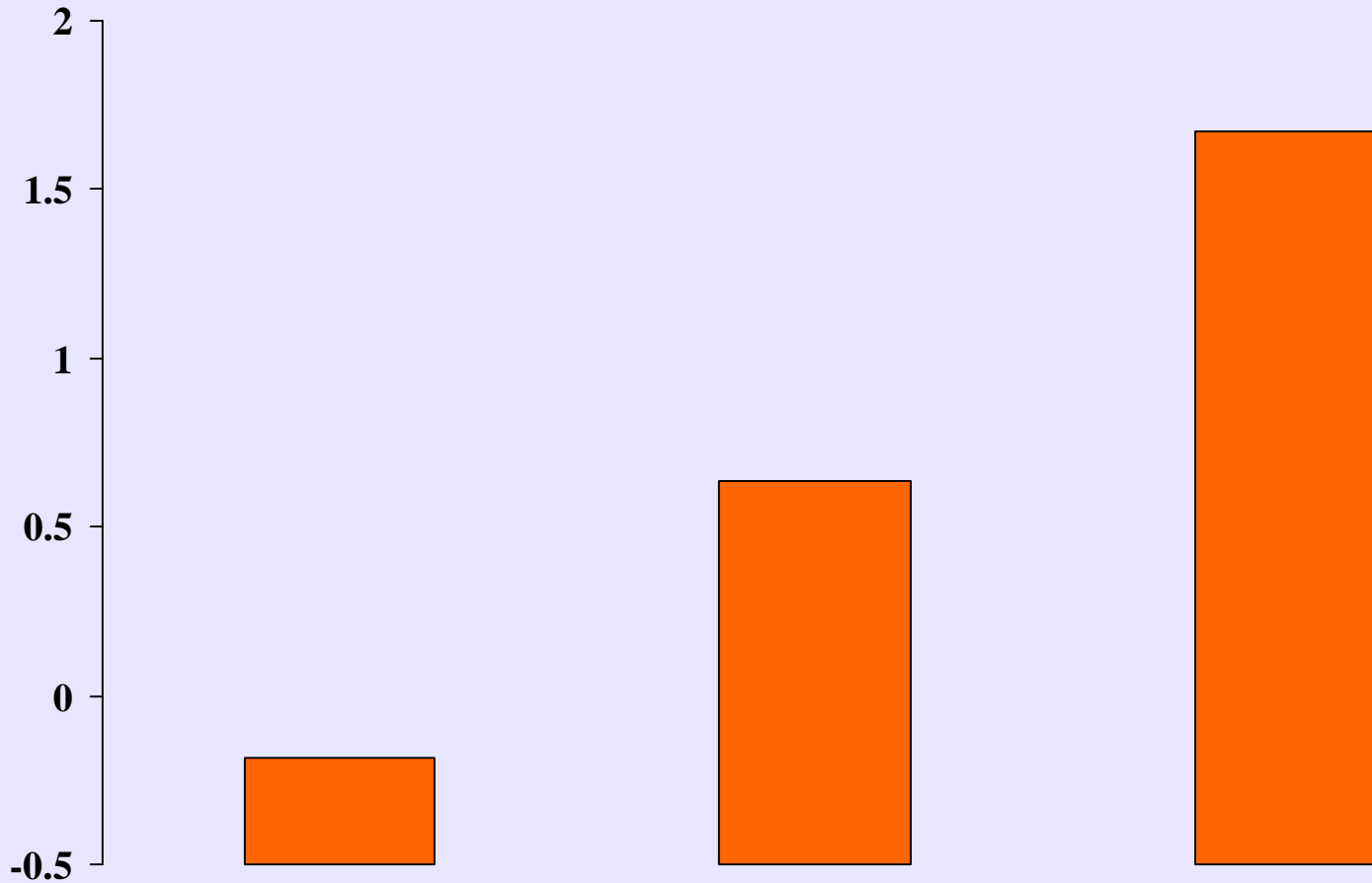
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Corruption & Bureaucratic Discretion

High

Corruption

Low



Low

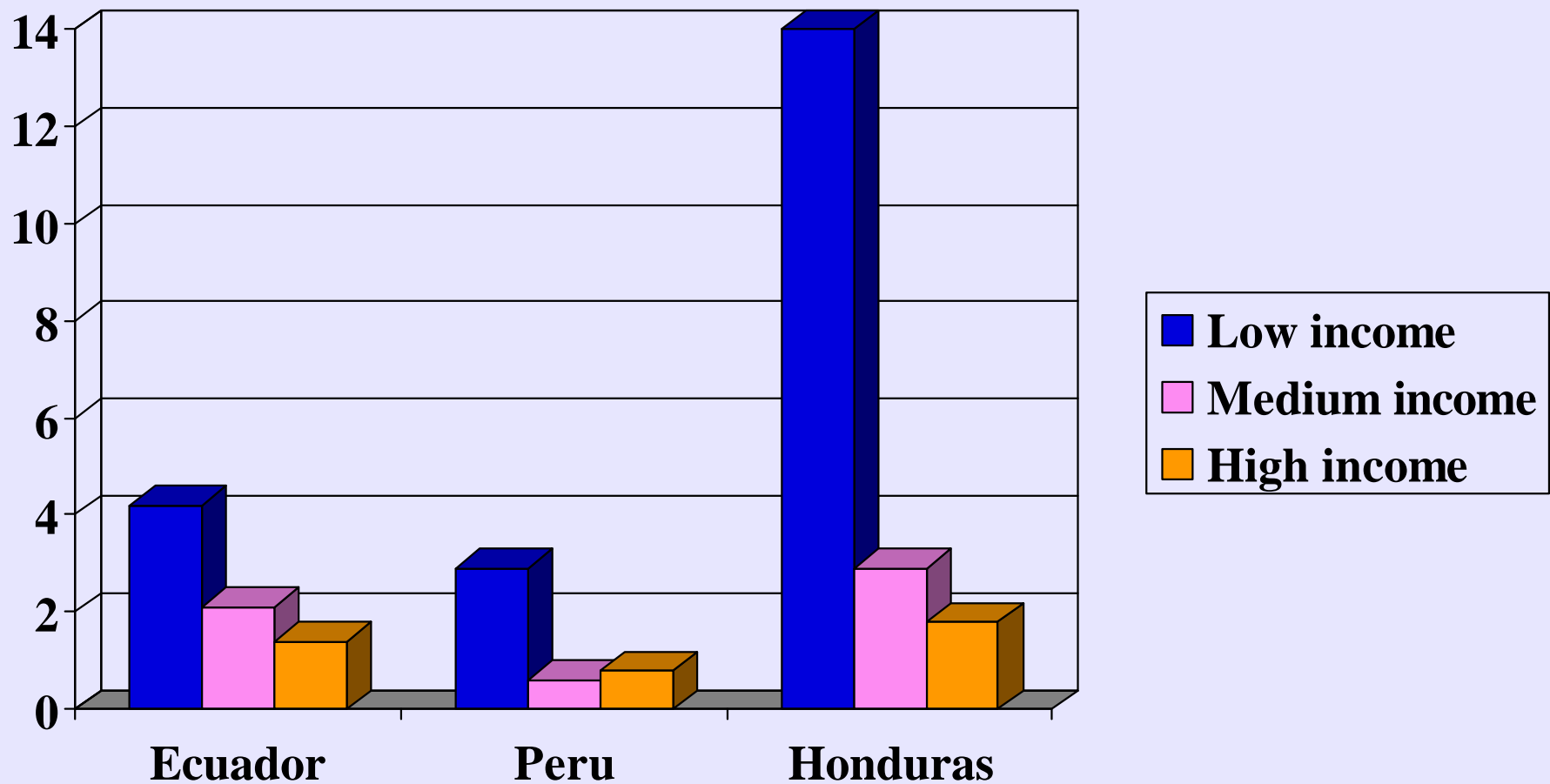
Medium

High

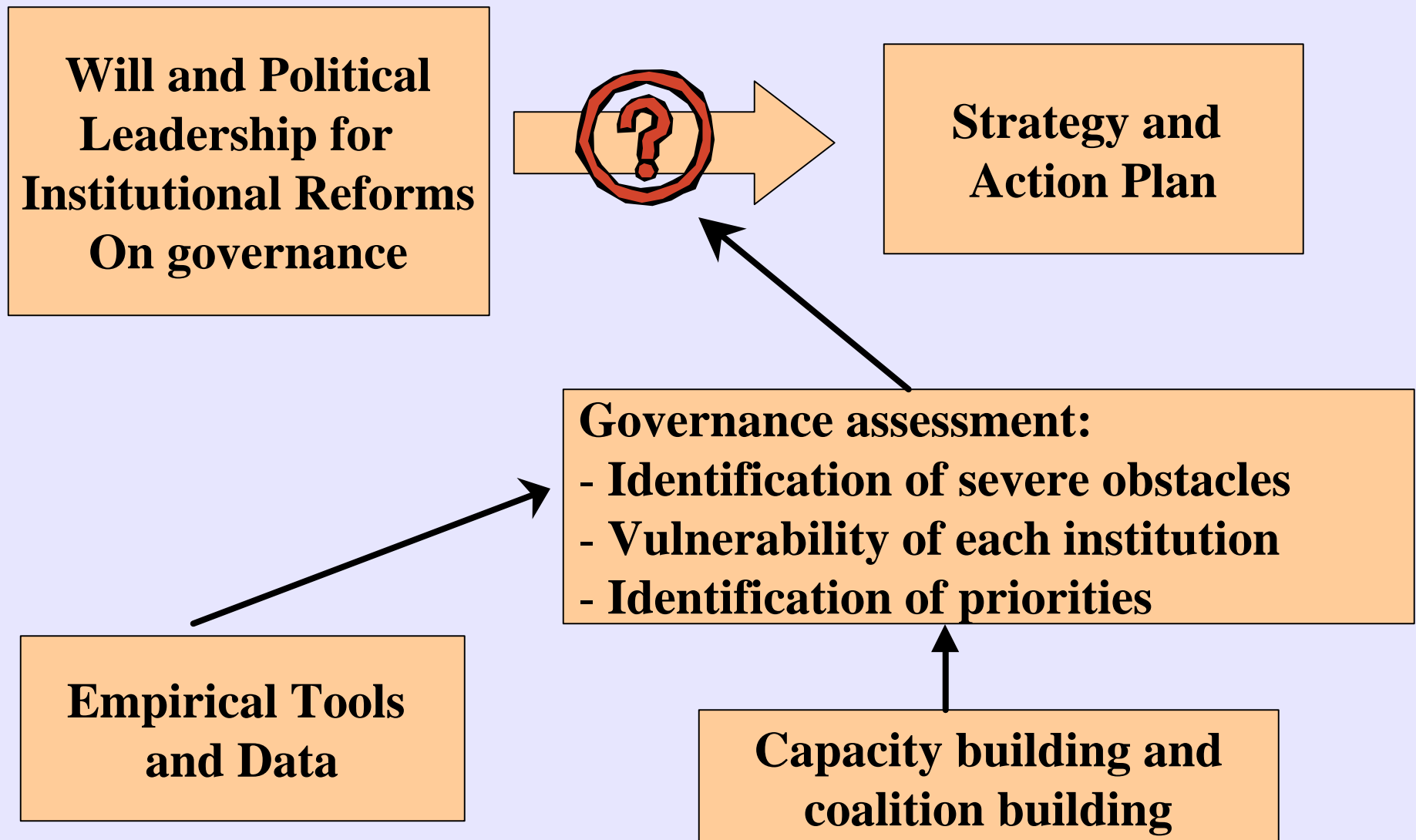
Bureaucratic Discretion

Corruption penalizes especially lower income users

(% of income paid in bribes, as reported by all users that requested public services)



The role of governance assessments



Salient Features of New Governance Diagnostic Tools

- ***Multi-pronged surveys of: households, firms and public officials [‘triangulation’]***
- ***Experiencial questions (vs. ‘opinions’/generic)***
- ***Specially designed and tested closed questions***
- ***Conceptual framework: Incentive Structure behind Governance; focus on development***
- ***Rigorous technical requirements in implementation***
- ***Local Institution Implements, with WB Collaboration***
- ***Recognizing Multidimensionality of Governance***
- ***Focus on Service Delivery: Input for Action and Change***

Key dimensions to analyze

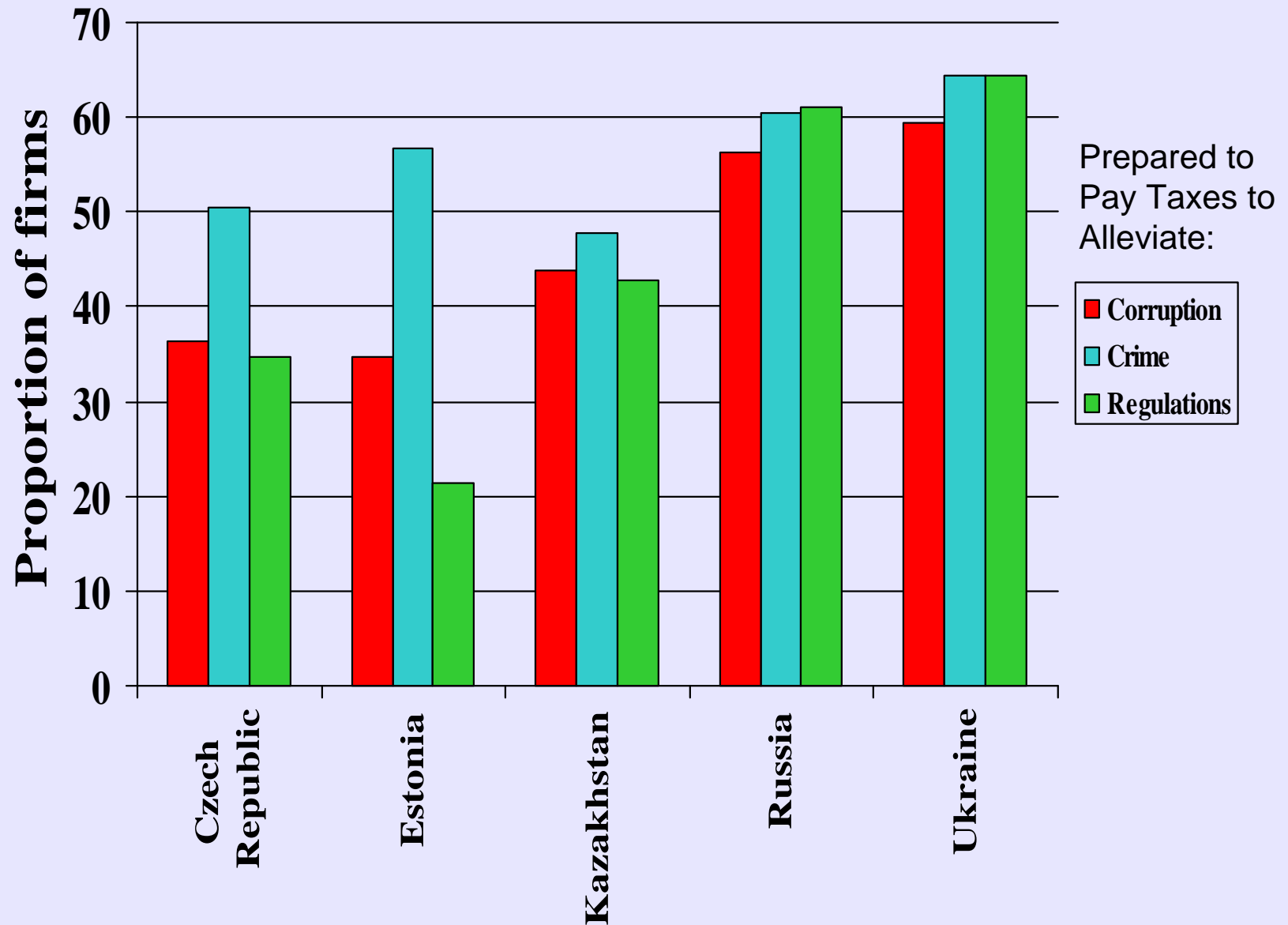
- Extent of mis-governance
- Type of mis-governance
- Quality of services
- Link with service provision
- Link with institutional determinants

Corruption can manifest itself in many different forms

- A. Bribes to facilitate transactions and administrative processes.
- B. Bribes to public officials to influence the legislative process, judicial and regulatory decisions (Capture of the State)
- C. Bribes to win public contracts
- D. Leak/losses in budget and mis-allocation of funds and resources
- E. Purchase of public administration positions and nepotism

Enterprises are Prepared to be Taxed for Better Government:

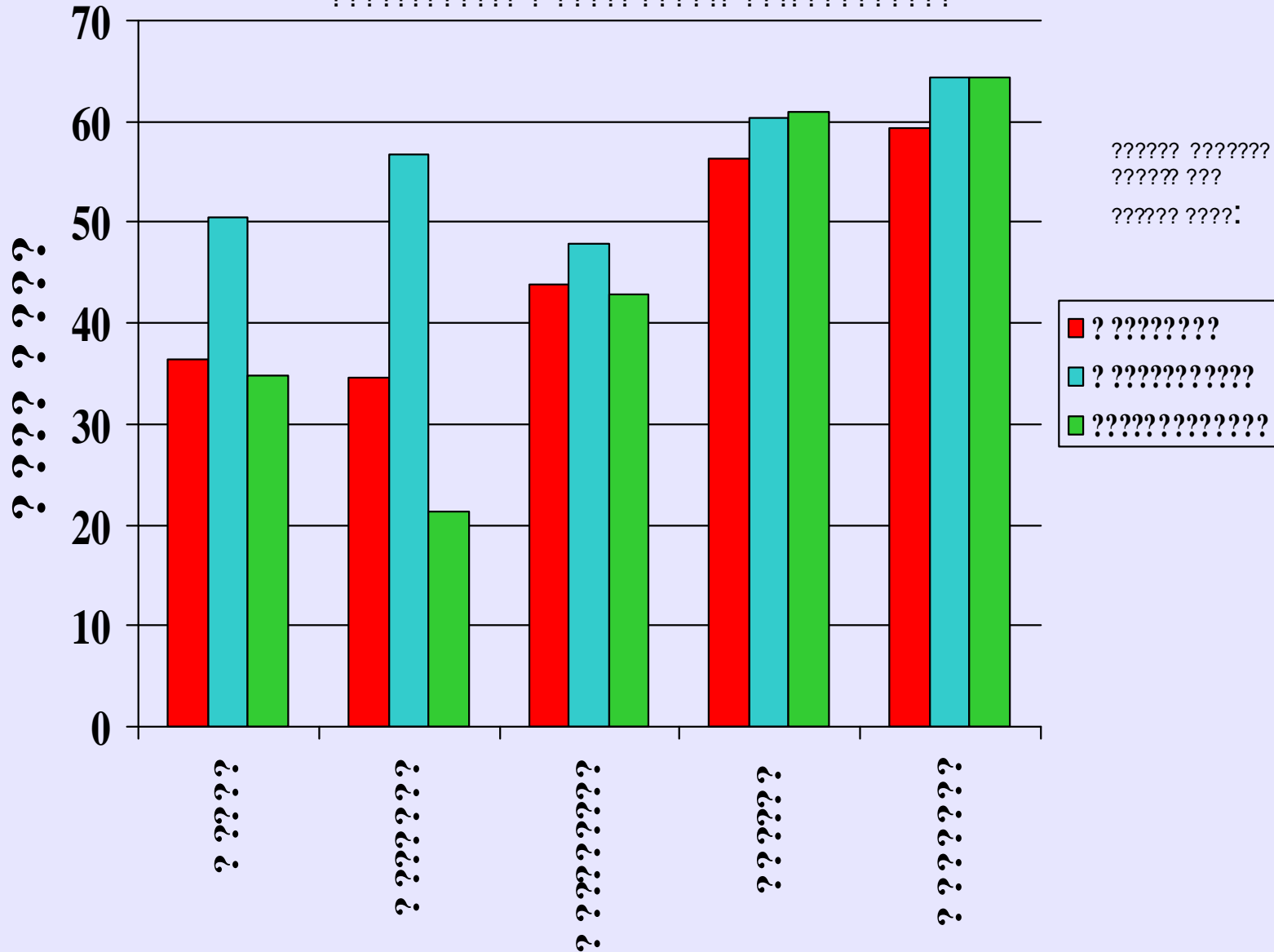
Share of Firms that would pay additional taxes to eliminate corruption, crime and excessive regulations



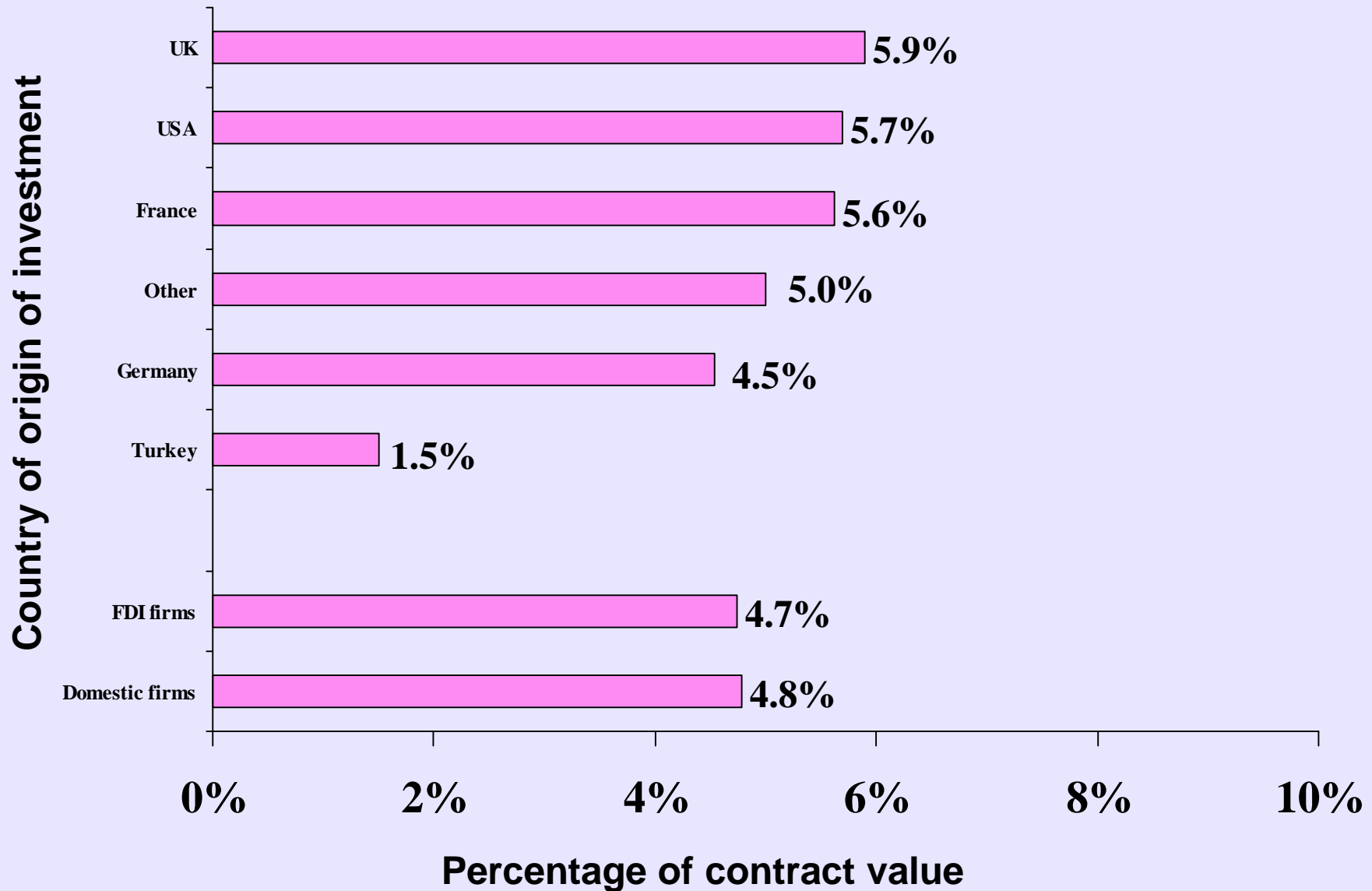
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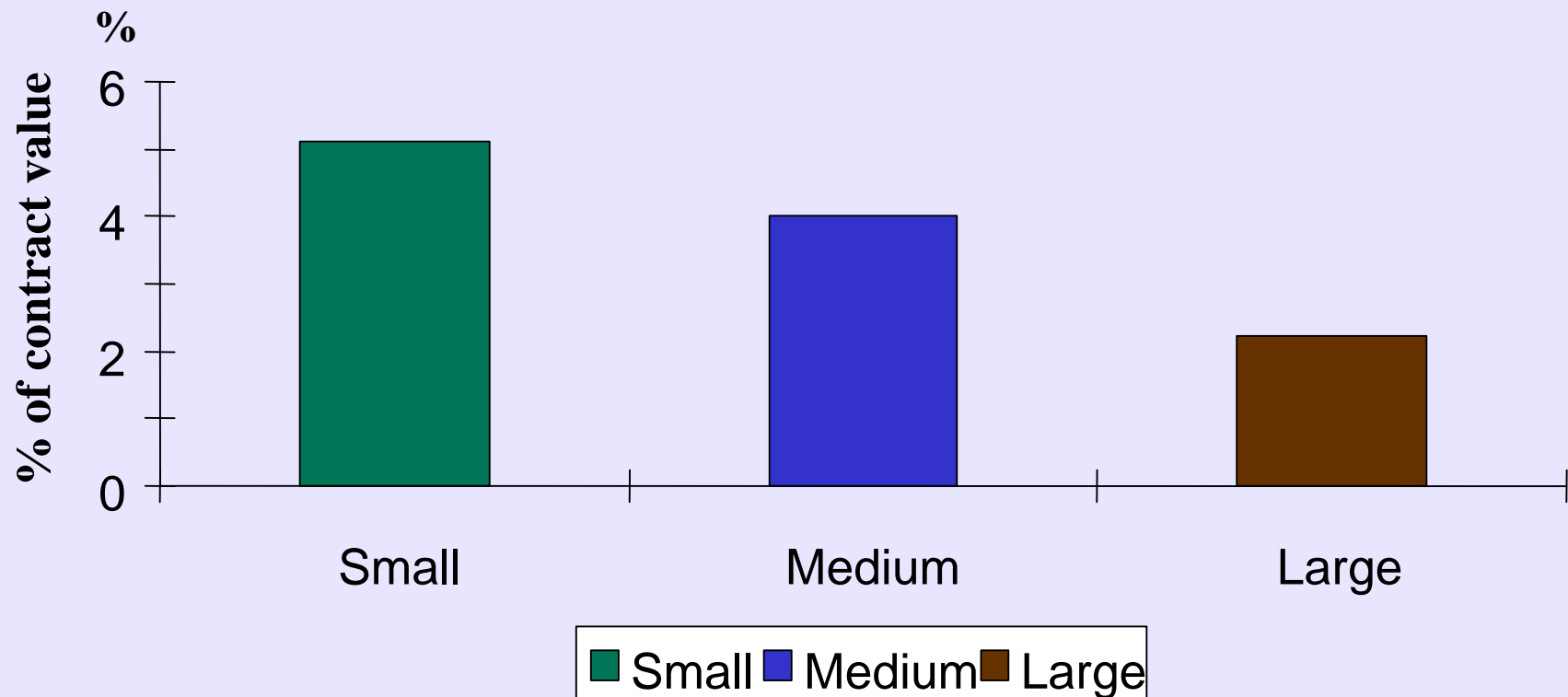


% bribe 'cut' by Firms with FDI for public procurement contracts (avg., mid-99; beeps prelim)



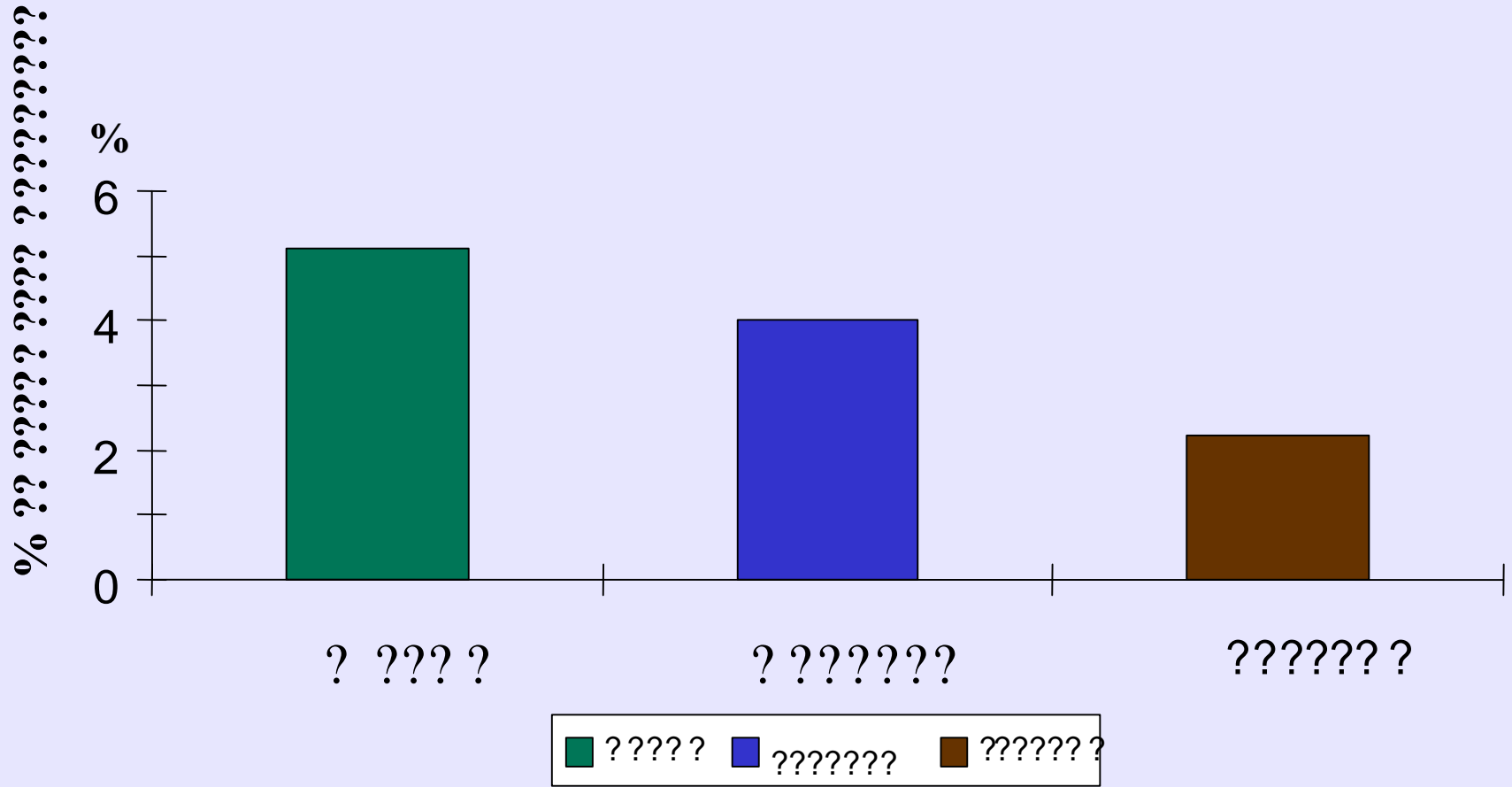
Smaller Firms Are Hit Harder by Corruption in Russia and in Transition Economies

**Bribes to secure public procurement bids
(% of contract value)**



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(% ?? ?????? ????? ??????????)



‘State Capture’ as particular manifestation of grand corruption and misgovernance

Defining State Capture: *Influential firms that shape the formation of rules of the game (laws, regulations and policies of the state) to their advantage -- through illicit, non-transparent private payments to officials/politicians*

Includes the following measurable manifestations:

- purchase of legislative votes*
- purchase of executive decrees*
- purchase of major court decisions*
- illicit political party financing*
- Illicit influence on Central Bank policies/regulations*

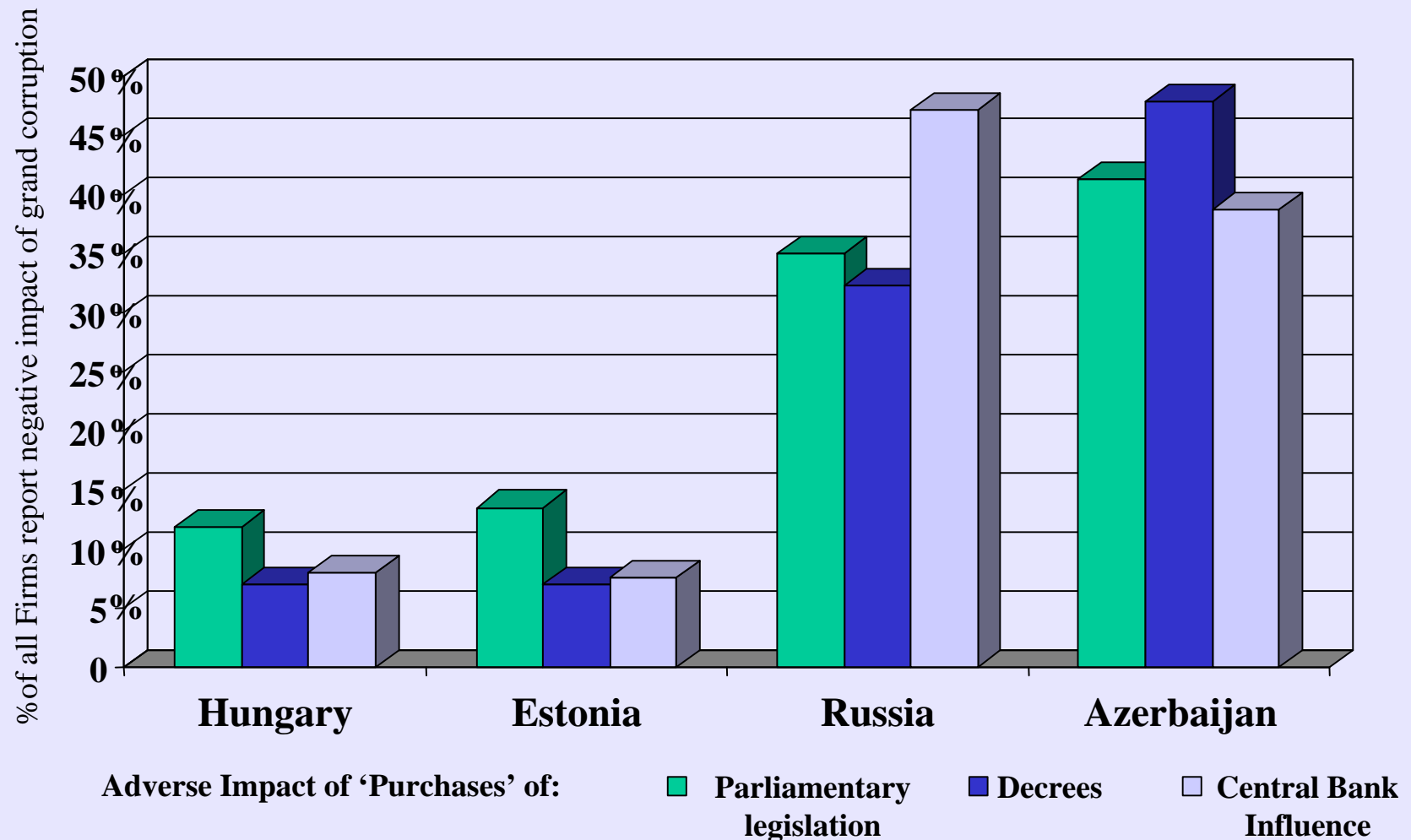
Extent of State Capture in Transition

Country	Parliamentary legislation (%of firms)	Presidential decrees (%of firms)	Central Bank (%of firms)	Criminal Courts (%of firms)	Party finance (%of firms)	Capture index (%of firms)	Capture Classification
Albania	12	7	8	22	25	16	Low
Armenia	10	7	14	5	1	7	Low
Azerbaijan	41	48	39	44	35	41	High
Belarus	9	5	25	0	4	8	Low
Bulgaria	28	26	28	28	42	28	High
Croatia	18	24	30	29	30	27	High
Czech Rep	18	11	12	9	6	11	Low
Estonia	14	7	8	8	17	10	Low
Georgia	29	24	32	18	21	24	High
Hungary	12	7	8	5	4	7	Low
Kazakhstan	13	10	19	14	6	12	Low
Kyrgyzstan	18	16	59	26	27	29	High
Latvia	40	49	8	21	35	30	High
Lithuania	15	7	9	11	13	11	Low
Moldova	43	30	40	33	42	37	High
Poland	13	10	6	12	10	12	Low
Romania	22	20	26	14	27	21	High
Russia	35	32	47	24	24	32	High
Slovakia	20	12	37	29	20	24	High
Slovenia	8	5	4	6	11	7	Low
Ukraine	44	37	37	21	29	32	High
Uzbekistan	5	4	8	5	4	6	Low
Overall	24	21	25	18	20	22	

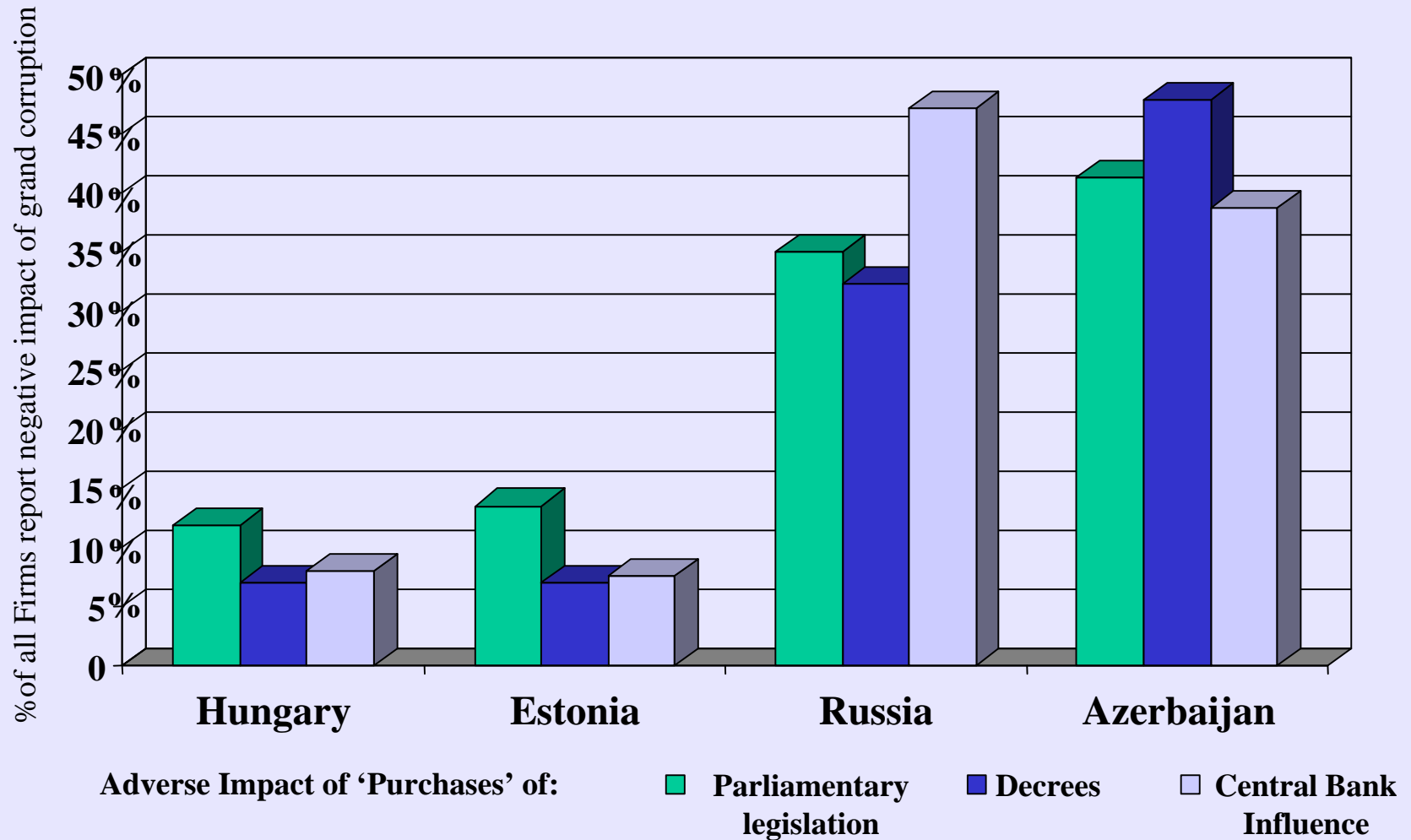
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Poland	13	10	6	12	10	12	Low
Romania	22	20	26	14	27	21	High
Russia	35	32	47	24	24	32	High
Slovakia	20	12	37	29	20	24	High
Slovenia	8	5	4	6	11	7	Low
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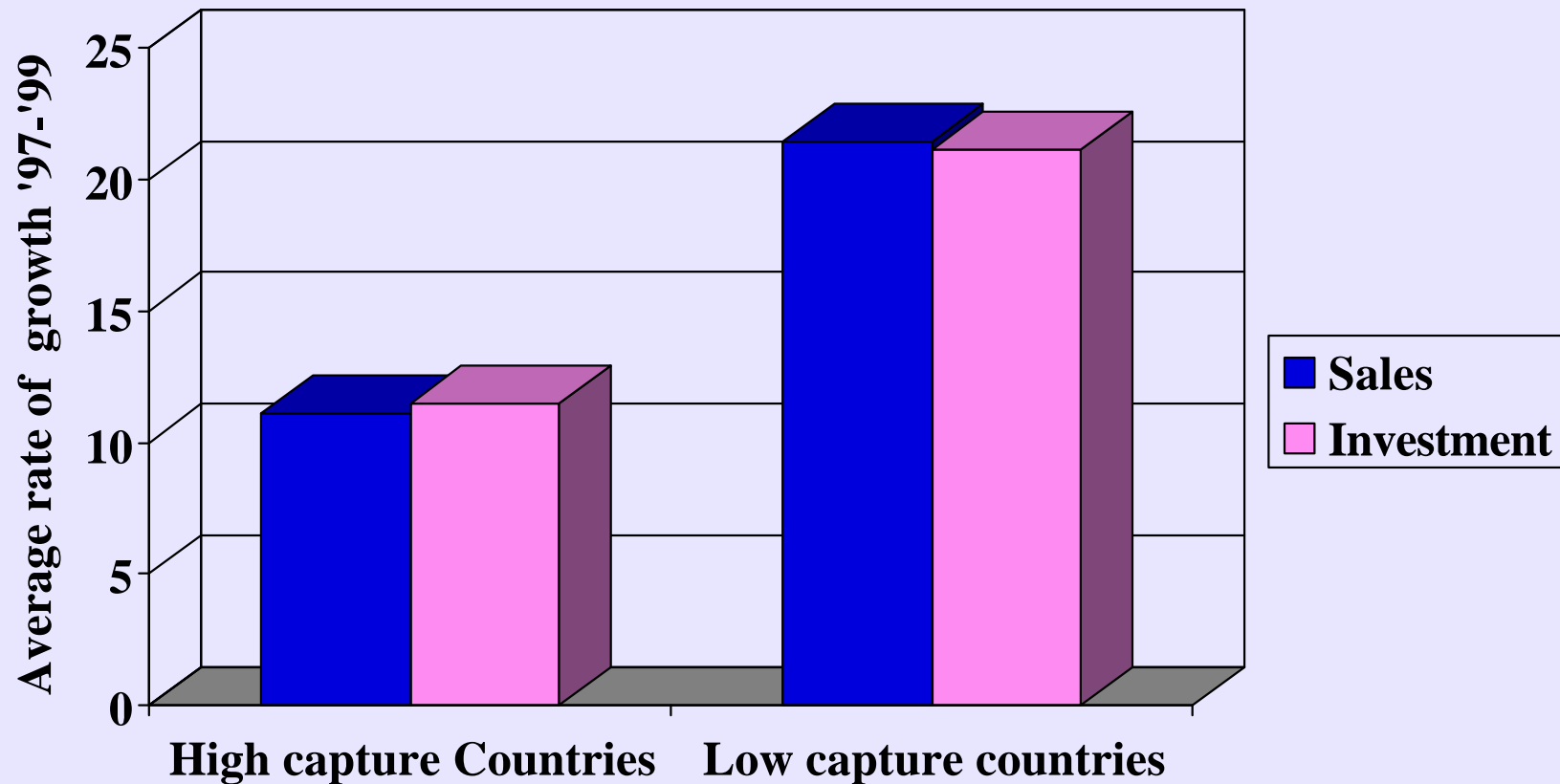
Differences in Transition Countries on the Extent of State Capture



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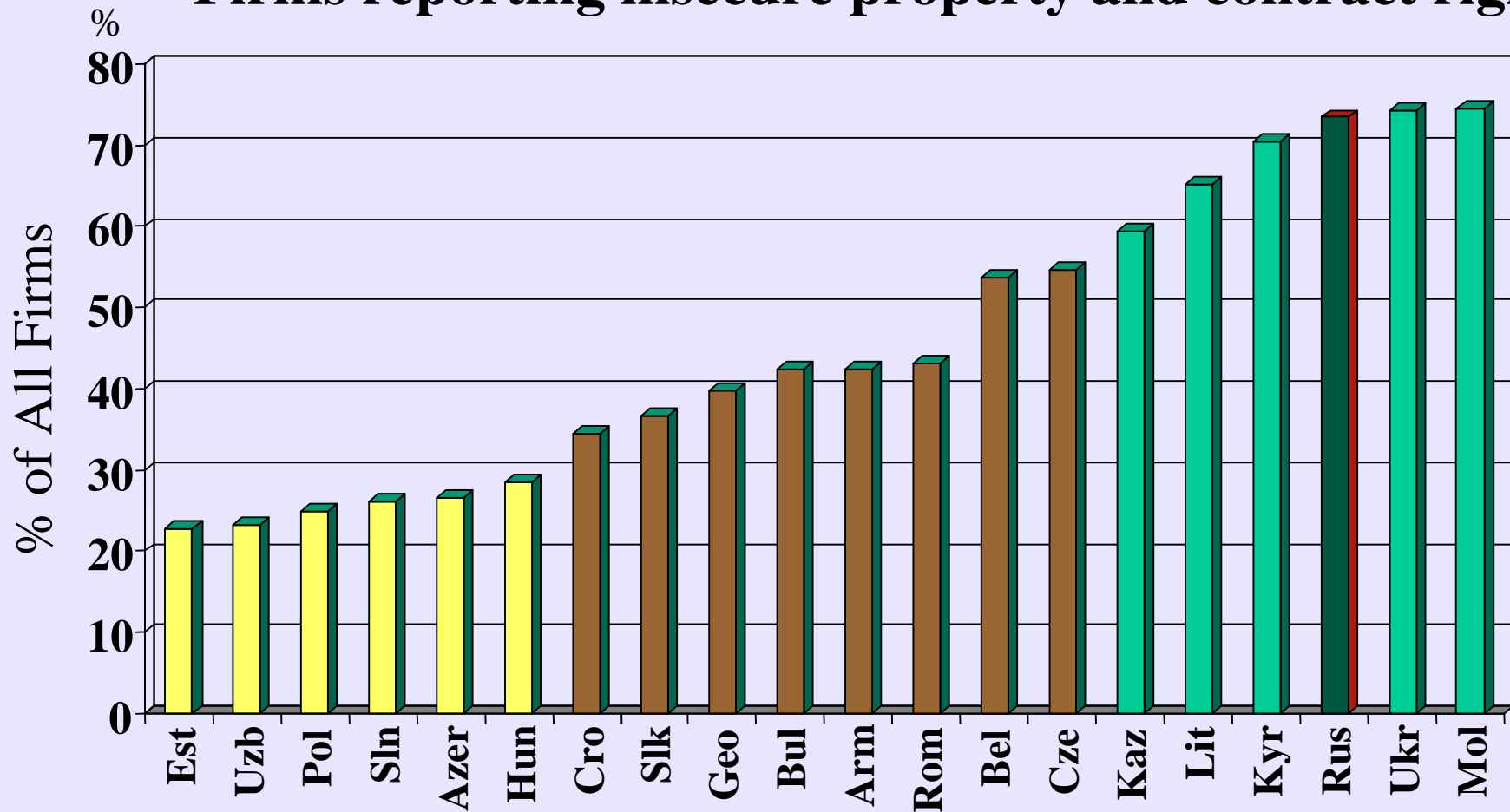


Enormous Socio-Economic Costs of State Capture by Oligarchs and Vested Elite Interests: Business sector grows much slower, lacks investments and insecure property rights



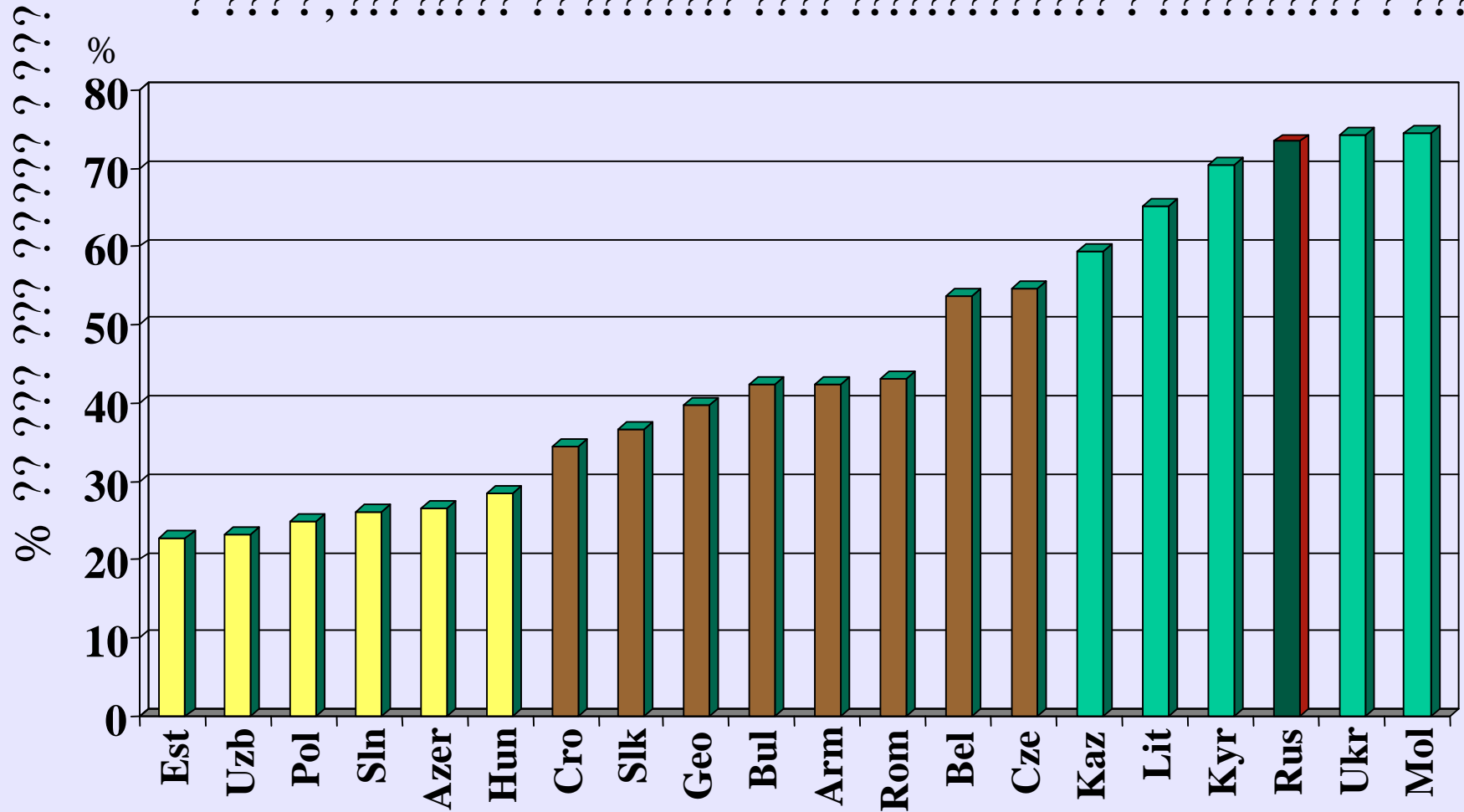
The result: weak property rights

Firms reporting insecure property and contract rights

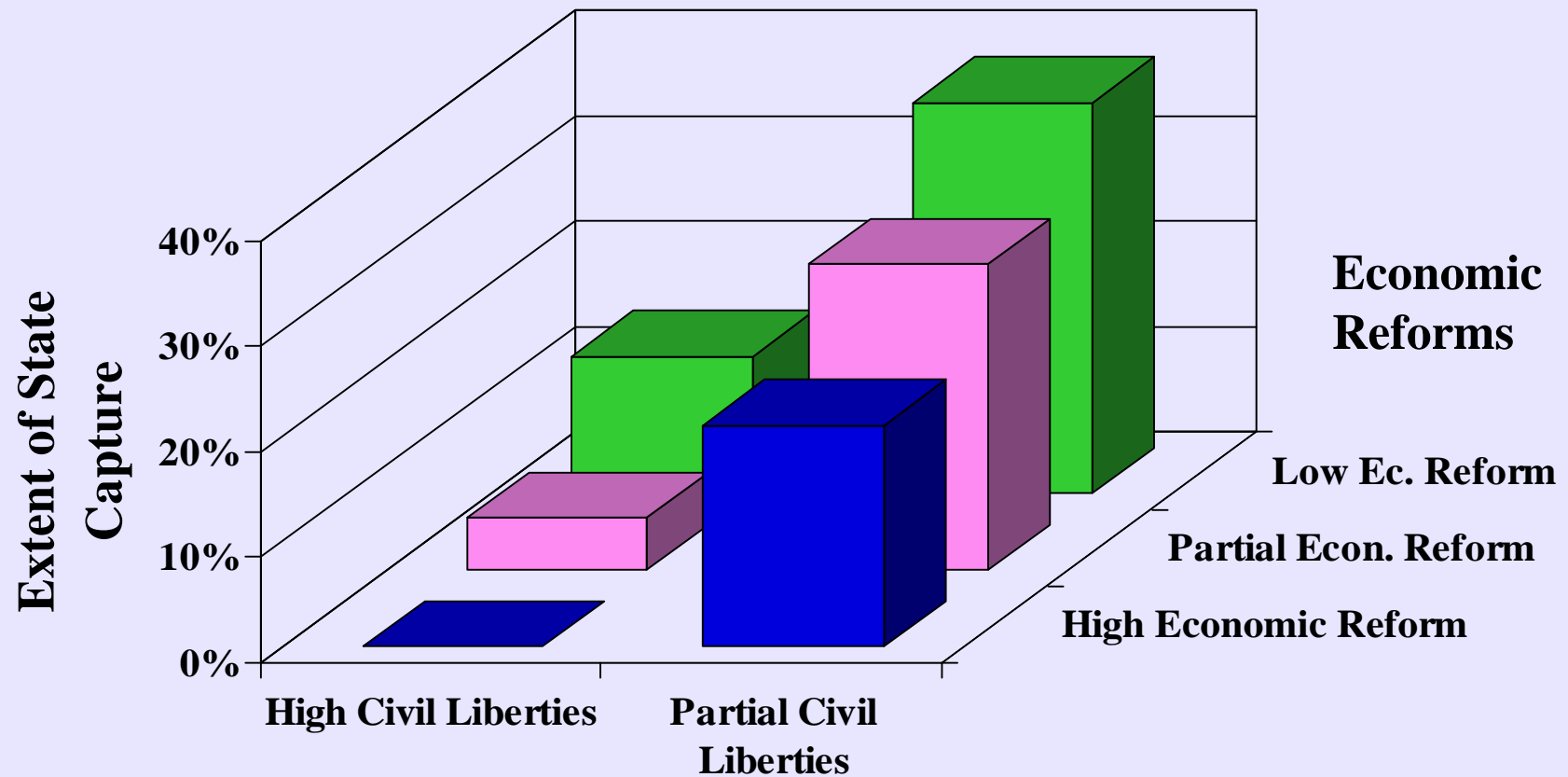


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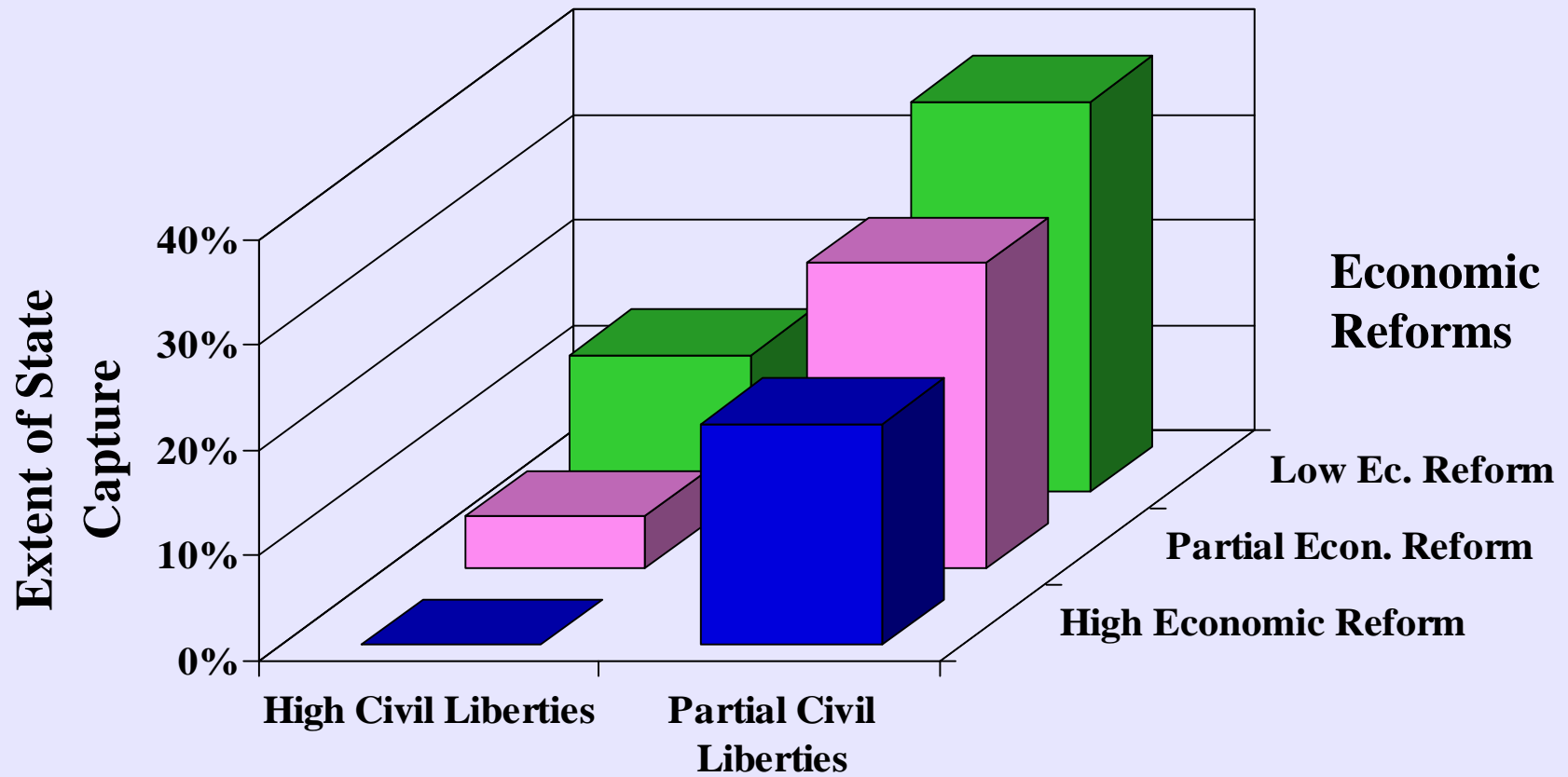
State Capture exists where partial Civil Liberties and slow Economic Reforms



Degree of Civil Liberties in Transition Economies

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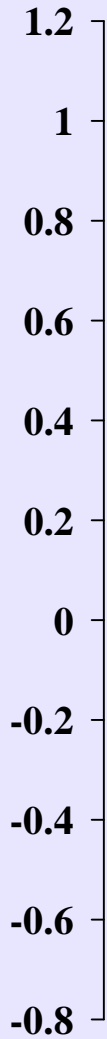
Degree of Civil Liberties in Transition Economies

Civil Liberties Help Control Corruption

(Worldwide Evidence, 150 countries)

High

Corruption



Low

Not Free

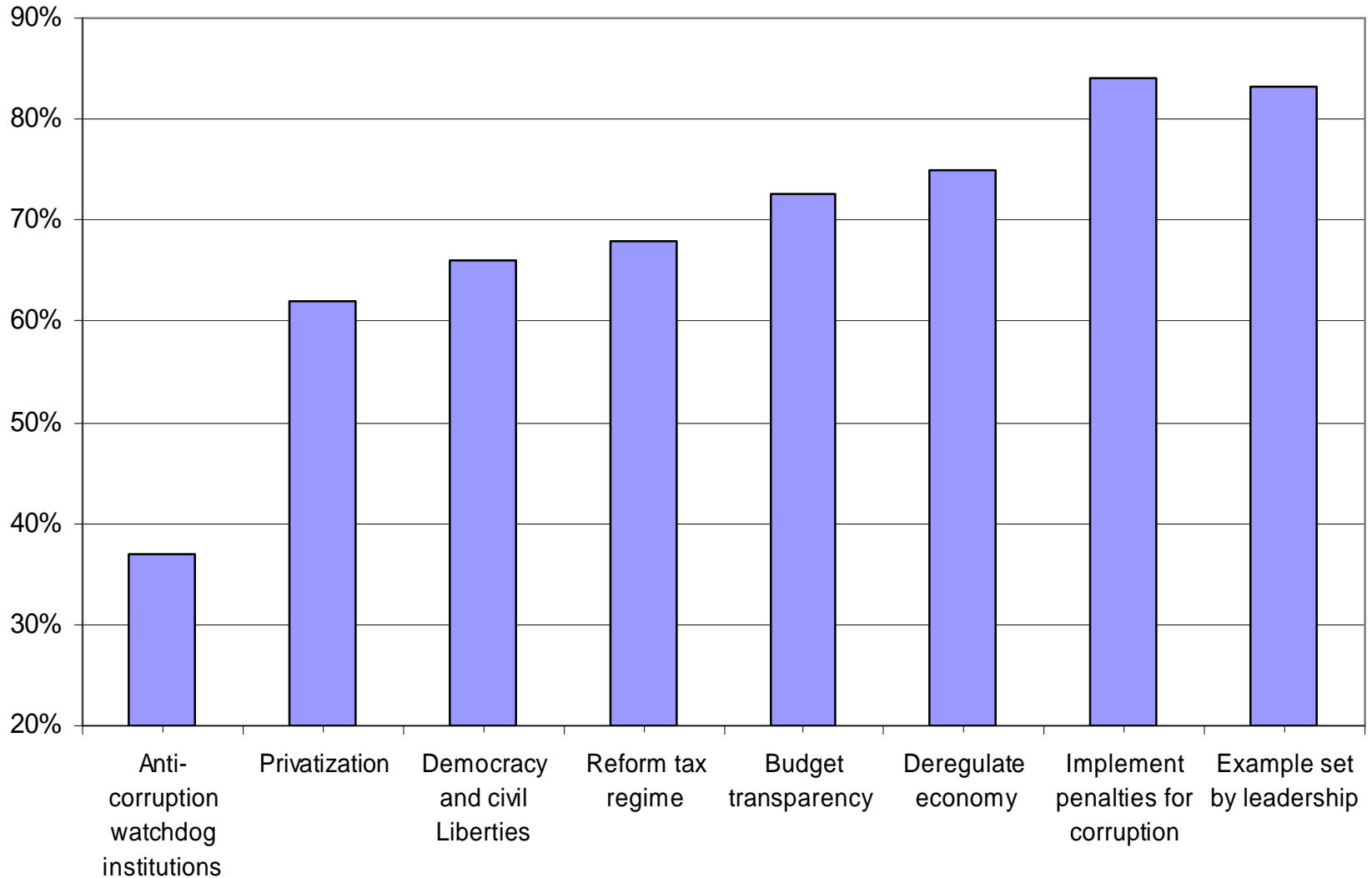
Partly Free

Free

Civil Liberties

What to Do About Corruption: Responses from Officials In 62 Countries

Percentage of respondents assigning high rating



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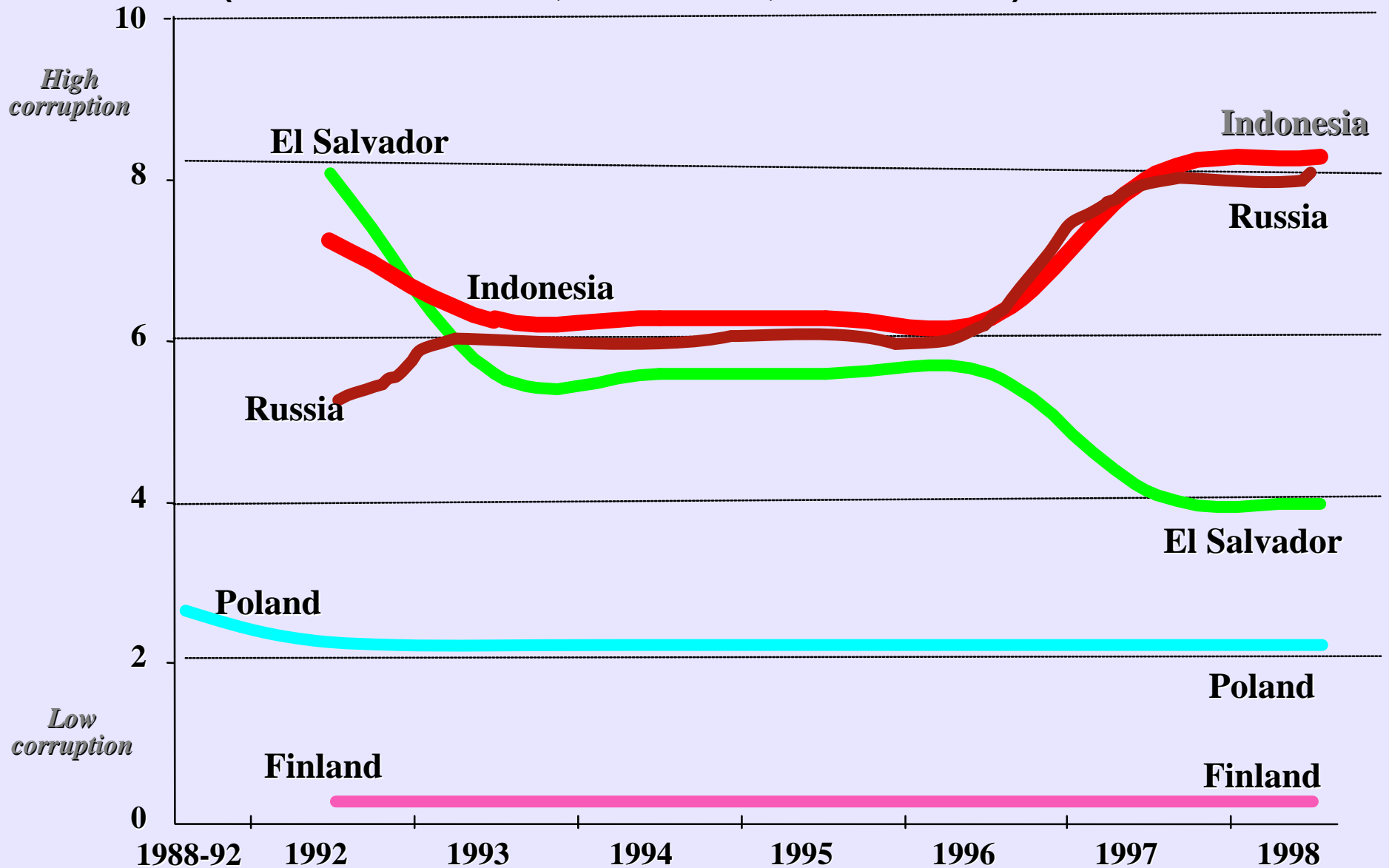
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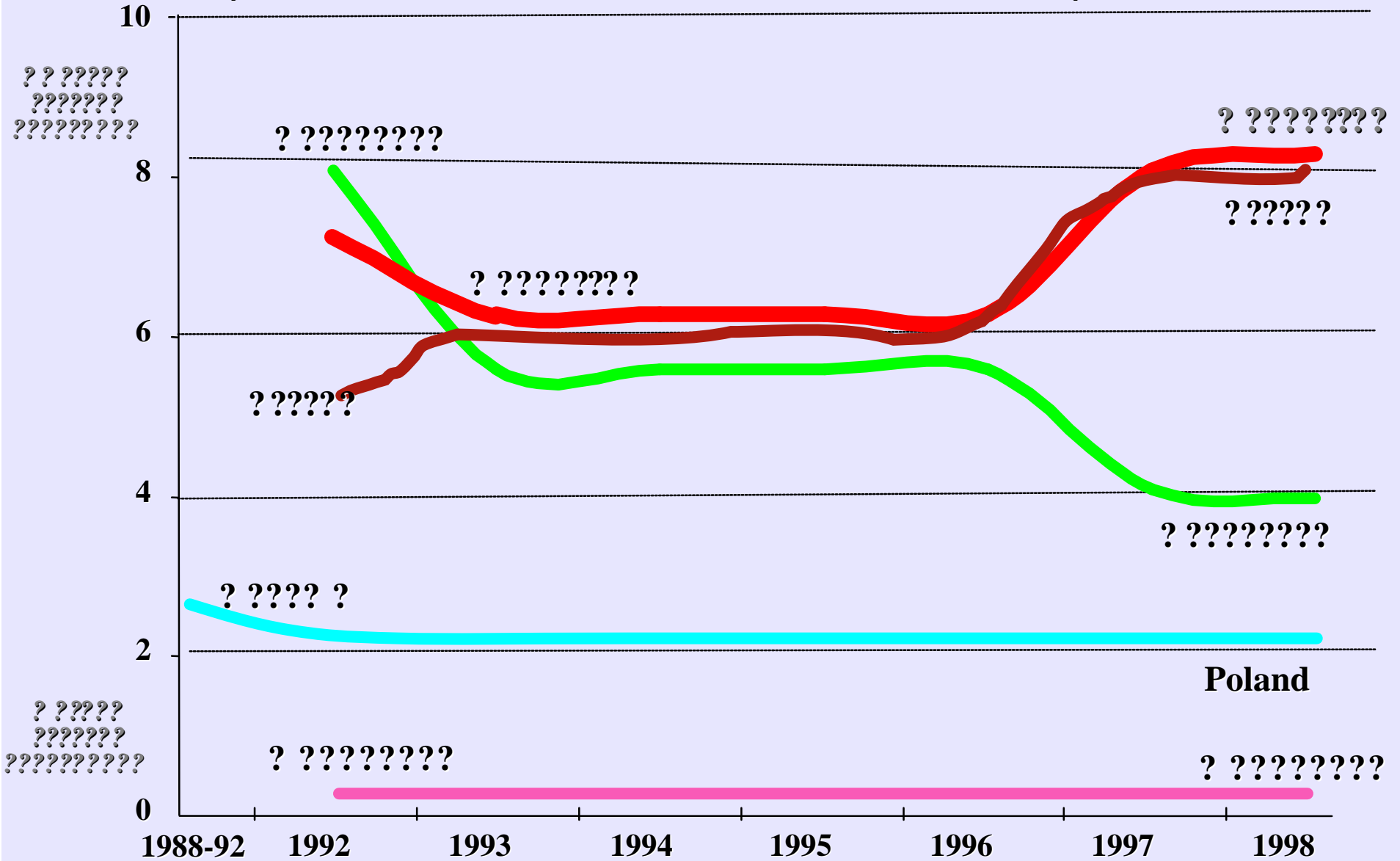
Overall Corruption Over Time

(Selected Countries; ICRG index, rescaled 0-10)



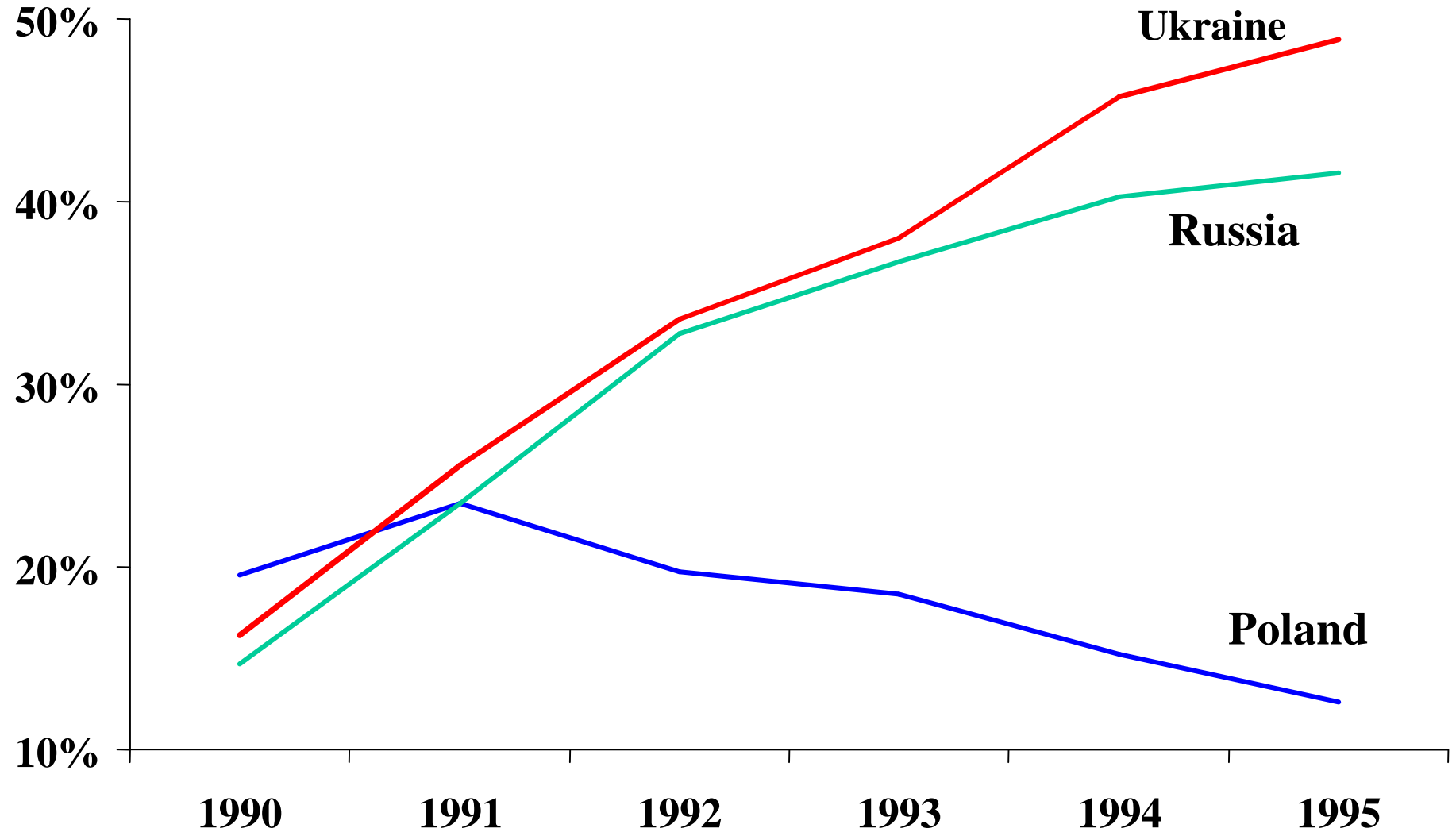
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The Underground Economy in Transition

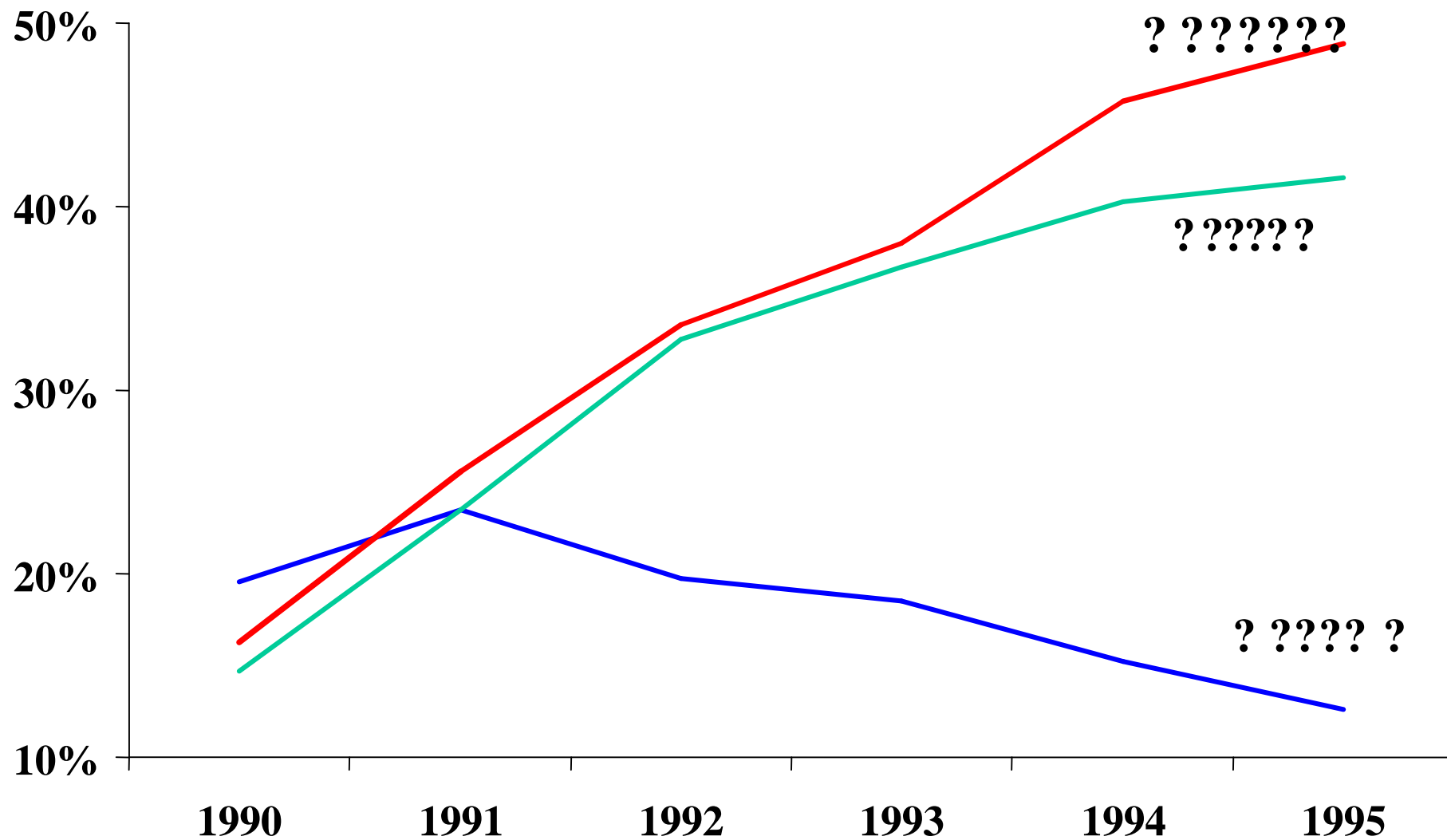
**% Unofficial
GDP/total GDP**



Source: Johnson, Kaufmann and Shleifer, 1997

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% ??????? ???
GDP/ ??????? ???



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Source: Johnson, Kaufmann and Shleifer, 1997

Strategy for Good Government and Anticorruption

Checks and Balances:

- Independent and effective judiciary
- Decentralization with accountability

Accountability of Political Leadership:

- Disclosure of parliamentary votes
- Transparency in party financing
- Asset Declaration, Conflict of Interest Rules

Civil Society Oversight:

- Freedom of information
- Public hearings of draft laws
- Monitoring by media/NGO's

Good and Clean
Government



Competition & Entry :

- Competitive restructuring of monopolies
- Regulatory simplification

Public Administration and Public Finance:

- Meritocratic civil service
- Transparent, monetized, adequate remuneration
- Accountability in expenditures (Treasury, Audit, Procurement)

Misgovernance and Corruption is Enormously Costly for Growth, Poverty Alleviation, Investment and PSD

For a Good Government & Anti-Corruption (GGAC) Strategy:

TIP Synthesis -- Integrating 4 Process Components

International Experience: **GGAC = TK + IP + LE + CA**

- i) **TK**: *Transparent Information & Knowledge* -- rigorous diagnostic, empirical analysis and monitoring; w/ IT
- ii) **IP**: *Incentives for Prevention* -- meritocracy within institutions, transparency/disclosure; civil service reforms, external accountability; enforcement...
- iii) **LE**: *Leadership*: example from the top
- iv) **CA**: *Collective Action* -- participatory and consensus-building approach, with all key groups in society, inside and outside government (*including private sector*)

National Governance: Challenges in Integrating Anti-Corruption Into a Strategy of Institutional Change

A simple Formula synthesizing Governance/Anticorruption:

$$\text{IG and AC} = \text{KI} + \text{LE} + \text{CA}$$

Improving Governance and Anti-Corruption =
= Knowledge/Info.Data + ...
...+ Leadership (incl. Political) + ...
... + Collective Action (change)

Data for Analysis and informing Policy Advise, not for Precise Rankings

The data contained in this presentation originates from various enterprise surveys (as well as outside expert rating agencies) and are subject to a margin of error. The purpose is therefore not to present precise comparative rankings across countries, but instead to illustrate characteristics of governmental and corporate performance in order to assist in drawing implications for action. No ranking of countries is intended in presenting results from these external sources by either the presenter of this work, the World Bank or its Board of Directors.

