GOVERNANCE AND ANTICORRUPTION

Just as it is impossible not to taste honey or poison that one may find at the tip of one's tongue, so it is impossible for one dealing with government funds not to taste, at least a little bit, of the King's wealth.

—Kautilya, *The Arthashastra*

Written in ancient India more than 2,000 years ago, the *Arthashastra* is a detailed vision of a society that weaves together socioeconomic, institutional, and political variables. In contemporary development writing, such notables as Hirschmann, Myrdal, Coase, Stiglitz, North, Olson, and Williamson provided a broad view of the interplay of institutions and conventional economic variables. In recent years, increasing attention has turned to corruption, starting with Rose-Ackerman and Klitgaard, in some measure due to the growing awareness of its dire consequences for development. However, most contemporary economic development work

---

The work in this chapter draws from a number of collaborative initiatives between the chapter's author and World Bank staff on governance issues, including Aart Kraay, Sanjay Pradhan, Randi Ryterman, and Pablo Zoido; as well as collaboration with Joel Hellman and Geraint Jones at the European Bank for Reconstruction and Development and Luis Moreno Ocampo of Transparency International, and the invaluable inputs of the World Bank Institute's Governance Team and the Bank's Public Sector Group. The data used in this chapter originate from various research projects and surveys (as well as outside expert rating agencies) and are subject to a margin of error. Their purpose is not to present precise comparative rankings across countries, but to illustrate characteristics of government performance. Hence, no ranking of countries is intended by either the chapter author, the World Bank, or its Board of Directors. For further details on the empirical "unbundling" of governance and corruption, the data, and methodological issues, see annex 6 and visit http://www.worldbank.org/wbi/governance.

has underestimated the primacy of governance, broadly defined, for growth and development. Missing too often is the recognition that an effective and transparent government, operating within a framework of civil liberties and good governance, is vital for sustained welfare gains and poverty alleviation. Also missing is an integrated view of governance and corruption. Indeed, corruption ought to be seen as a symptom of the state's fundamental weaknesses, not some basic or single determinant of society's ills.

This chapter does not present an all-encompassing approach to the study of governance and corruption. Instead, we dissect the notions of governance—and of corruption and state capture—and present aspects relevant to the growth and development of nations to derive insights for strategies to improve governance. We lack many of the answers; the emerging lessons of success and failure are being distilled. Nonetheless, advances have been made in the conceptual, empirical, and practical understanding of these issues. Some of this progress pertains to the sharpening and "unbundling" of the notions and measurements of governance and corruption. This unbundling permits a better understanding of the causes and consequences of misgovernance, helping provide improved policy advice.

Governance Affects the Quality of Growth

Worldwide evidence suggests that a capable state with good and transparent government institutions is associated with higher income growth, national wealth, and social achievements. Higher incomes, investment, and growth, as well as longer life expectancy, are found in countries with effective, honest, and meritocratic government institutions with streamlined and clear regulations, and also where the rule of law is enforced fairly, where the policies and legal framework has not been captured by the vested interests of the elite, and where civil society and the media have an independent voice enhancing the accountability of their governments. International and historical experience also tells us that capable and clean government does not first require a country to become fully modernized and wealthy. The experience of such industrializing countries as Botswana, Chile, Costa Rica, Estonia, Poland, and Slovenia, as well as evidence over the past 20 years from economies like Singapore and Spain, illustrate this lesson.

Previous chapters emphasized the need for policies, regulations, and public resources to promote market-oriented development and to mitigate the negative impacts of externalities and market failures. With an emphasis on poverty and income distribution, they examined those factors that adversely affect human capital and the environment. A key role for the state involves delivery of public services and goods vital to achieving sustained growth and thus reducing poverty. Also, governments need to set up effective policymaking structures, market-friendly policies, and efficient and streamlined regulatory frameworks, as well as eliminate unnecessary regulations on enterprises, such as price controls, trade restrictions, enterprise licensing, and bureaucratic harassment.

Often, however, governments have paid insufficient attention to regulations governing child labor, worker safety, infrastructure monopolies, financial sector supervision, and the environment. Moreover, in many settings there has been a bias in the size, composition, and delivery of public expenditures and investments to benefit elite interests, frequently resulting in underinvestment in human capital and in outcomes harming the poor. Such elite interests often also lead to legal, regulatory, and policy anticompetitive capture. The study of governance and inadequate institution building is essential to understand these outcomes.

A political process determines public policies and the allocation of public benefits and expenditures. Its success depends on accountable government, community participation, and a strong voice for people and competitive enterprises. Effective adoption and use of policies and expenditures requires good governance. Enterprises need to operate within a legal and contractual framework that protects property rights, facilitates transactions, deters attempts by elite enterprises to capture the state, allows competitive market forces to determine prices and wages, and lets firms enter and exit the market. The public sector can do much to lower the transaction costs for farms and firms by supporting them with information and institutions and by rooting out misgovernance and corruption.

Defining and Unbundling Corruption and Governance

Corruption is commonly defined as the abuse of public office for private gain. Notwithstanding the debates about whether certain activities can be classified as corrupt or not and the need to unbundle corruption, the vivid day-to-day illustrations in the press and in conversation circumscribe the discussion of what constitutes corruption. However, governance is a much broader concept than corruption. We define governance as the exercise of authority through formal and informal traditions and institutions for the common good. Governance encompasses the process of selecting, monitoring, and replacing governments. It also includes the capacity to formulate and implement sound policies, and the respect of citizens and the state for the institutions that govern economic and social interactions among them.

From this notion, we can divide governance into *six* components, organized around three broad categories as follows (a) *voice and accountability*, which includes civil liberties and freedom of the press, and *political* *stability*; (b) *government effectiveness*, which includes the quality of policymaking and public service delivery, and the *lack of regulatory burden*; and (c) *rule of law*, which includes protection of property rights and independence of the judiciary, and *control of corruption* (Kaufmann, Kraay, and Zoido-Lobatón 1999a,b).

Therefore, in unbundundling governance, we posit that corruption is one among six closely intertwined governance components. Governance affects welfare and the quality of life through complex direct and indirect channels that we do not yet fully understand. An improvement in one governance component, such as civil liberties, *directly* enhances the quality of life for a country's people even when all other socioeconomic factors remain constant. Thus, governance can be a direct input into the well-being of the population.

However, important *indirect* effects are also at play. For example, misgovernance can hurt the growth rate of incomes and human capital, and increase the rate of natural resource depletion—often the result of the vested interests of politicians and the elite. Furthermore, misgoverned states tend to exhibit a distorted set of economic and institutional policies that blunt factor productivity, growth, and poverty alleviation. Therefore, via complex direct and indirect mechanisms, effective and clean government is vital for implementing and sustaining sound economic and institutional policies and for promoting human capital development and poverty alleviation.

Empirical Measures of Governance

Recent empirical studies suggest the importance of institutions and governance for development outcomes. Knack and Keefer (1997) found that the institutional environment for economic activity determines, in large measure, the ability of poor countries to converge to industrialized country standards. In turn, La Porta and others (1999) investigate the determinants of the quality of governments and, inter alia, find that the type of legal regime matters, as well as other historical factors.

The definition of governance, as presented in the previous section, is broad enough that a wide variety of cross-country indicators might shed light on its various aspects. Applying such a broad definition, Kaufmann, Kraay, and Zoido-Lobatón analyzed hundreds of cross-country indicators as proxies for various aspects of governance. These indicators came from a variety of organizations, including commercial risk-rating agencies, multilateral organizations, think tanks, and other nongovernmental organizations (NGOs). They are based on surveys of experts, firms, and citizens and cover a wide range of topics: perceptions of political stability and the business climate, views on the efficacy of public service provision, opinions on respect for the rule of law, and reporting on the incidence of corruption.[1] (See annex 6 for a description of Kaufmann, Kraay, and Zoido-Lobatón's methodology.)

Skeptical reactions naturally arise regarding the wealth of data on governance. Are the data informative? What can business analysts on Wall Street possibly know about corruption in Azerbaijan, Cameroon, Moldova, Myanmar, or Niger? Are the data coherent? Do reported ratings by enterprises about pressures from civil servants and their waiting times for customs clearances tell us something about the government's effectiveness in general, or do they measure totally different things? Are the data comparable? Can a score of 3 (out of 4) in transition economies be compared with a score of 7 (out of 10) in Asian countries? In addition to meeting these criteria, can the data be useful for rigorous econometric analysis of corruption or for policy advice purposes?

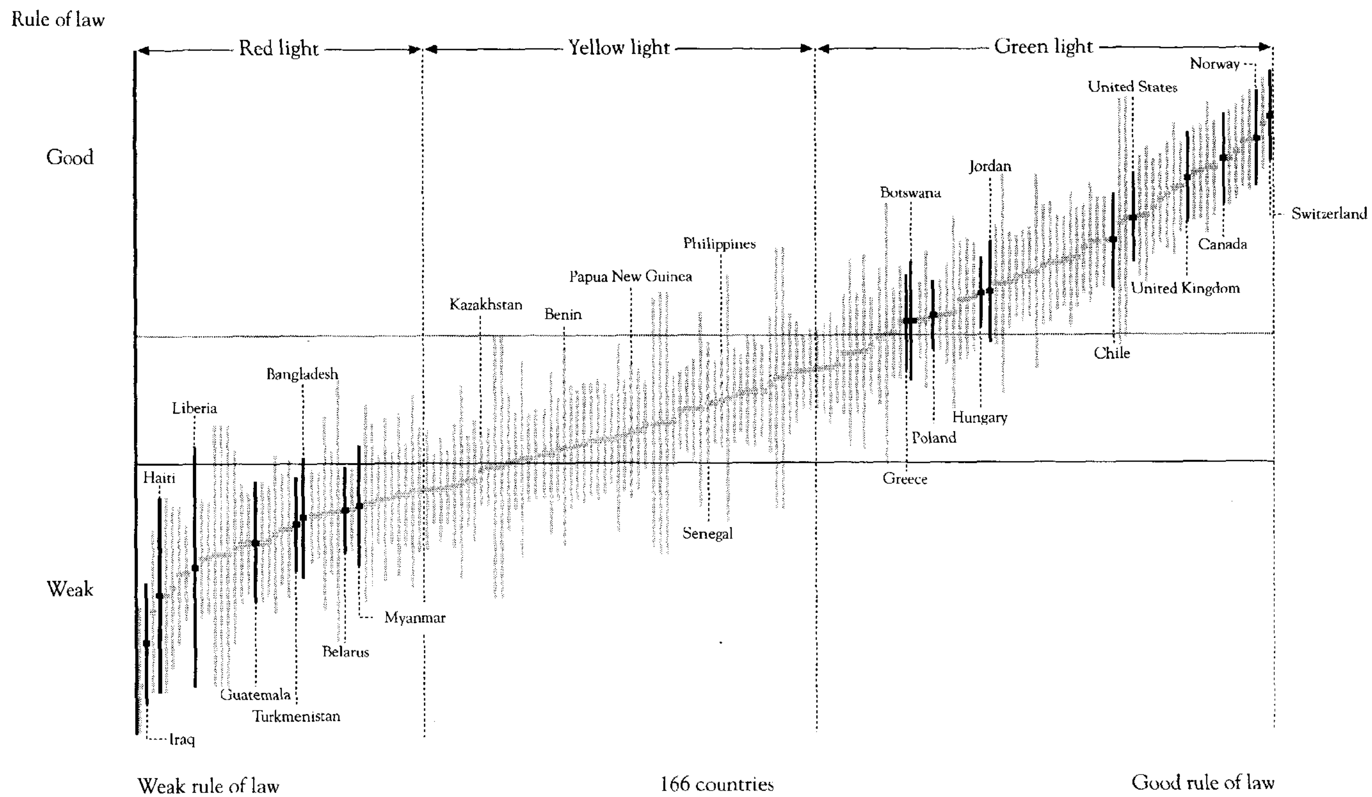
These questions, addressed in detail in the two references and in annex 6, motivate the empirical strategy for measuring governance: the data are mapped to the six subcomponents of governance and expressed in common units. The data are informative, within measurable limits, but the imprecision in the estimates requires care in their presentation and use for policy advice. These six distinct aggregate governance indicators are then developed, imposing some structure on available variables and improving the reliability of the measured governance component, which significantly exceeds the accuracy of any single governance measure.

For illustration, we first consider the measurement issues for one of the six composite governance components: rule of law. In figure 6.1, the vertical bars depict country-specific confidence intervals for the estimated ("point estimate") levels of governance. The confidence intervals (vertical lines) reflect the disagreement, or margin of error (among the original individual sources provided by the various external organizations) about the application of rule of law.[2]

The differences among more than 160 countries are large for rule of law, as well as for the other five measures. Countries are ordered along the horizontal axis according to their (admittedly imprecise) rankings, while the vertical axis indicates the estimates of governance for each country. The margins of error for each country, depicted by each thin vertical line, can be considerable. Thus, it is misleading having countries "run" in seemingly precise worldwide "horse races" to ascertain their ranking on various governance indicators. Instead, the following approach that groups countries into three broad categories akin to a traffic light for each governance dimension is more appropriate and statistically warranted:

- *Red light:* Countries in this category could be considered to be in governance crisis in that particular component. In fact, despite the

Figure 6.1. Quality of Rule of Law Indicator: The "Traffic Lights" Presentational Approach



Note: This figure shows estimates of the quality in the application of rule of law for 166 countries based on 1997–98 data, with selected countries indicated for illustrative purposes only. The vertical bars show the likely range of the governance indicator for each country, and the mid-points of these bars show the most likely value. The length of these ranges varies with the amount of available information for each country and on the extent to which different sources' perceptions of corruption coincide. Countries with solid black vertical bars (in the red light area) or dark green vertical bars (in the green light area) are those for which the governance indictor is statistically significantly in either the bottom third (right light) or the top third (green light) of all countries. Countries with light green vertical bars (in the yellow light area) fall into neither of the two previous groups. Countries' relative positions are subject to significant margins of error and reflect the perceptions of a variety of public and private sector organizations worldwide. Thus, no precise ranking can be preformed. The country ratings in no way reflect the official views of the World Bank.

Source: Kaufmann, Kraay, and Zoido-Lobatón (1999a,b). For details, including the overall data set and methodology, see http://www.worldbank.org/wbi/governance. For a synthesis paper, see Kaufmann, Kraay, and Zoido-Lobatón (2000) at http://www.imf.org/fandd.

margins of error in the available data, it is still the case that a group of approximately 30 to 40 countries exhibit an extremely high probability of being in crisis where rule of law (or other governance measures) is assessed.

- *Yellow light:* Countries are vulnerable or at risk of falling into a governance crisis in a particular governance component.
- *Green light:* Countries have better governance and are not at risk

In moving away from a false sense of precision common in indexes that rank countries internationally (which are subject to considerable margins of error), this alternative approach of broad categorical groupings can flag vulnerabilities where a country falls into the red light or yellow light groups. For another governance component, in this case measuring control of corruption (also based on data from the late 1990s), selected countries are presented within such an illustrative traffic light framework in figure 6.2.

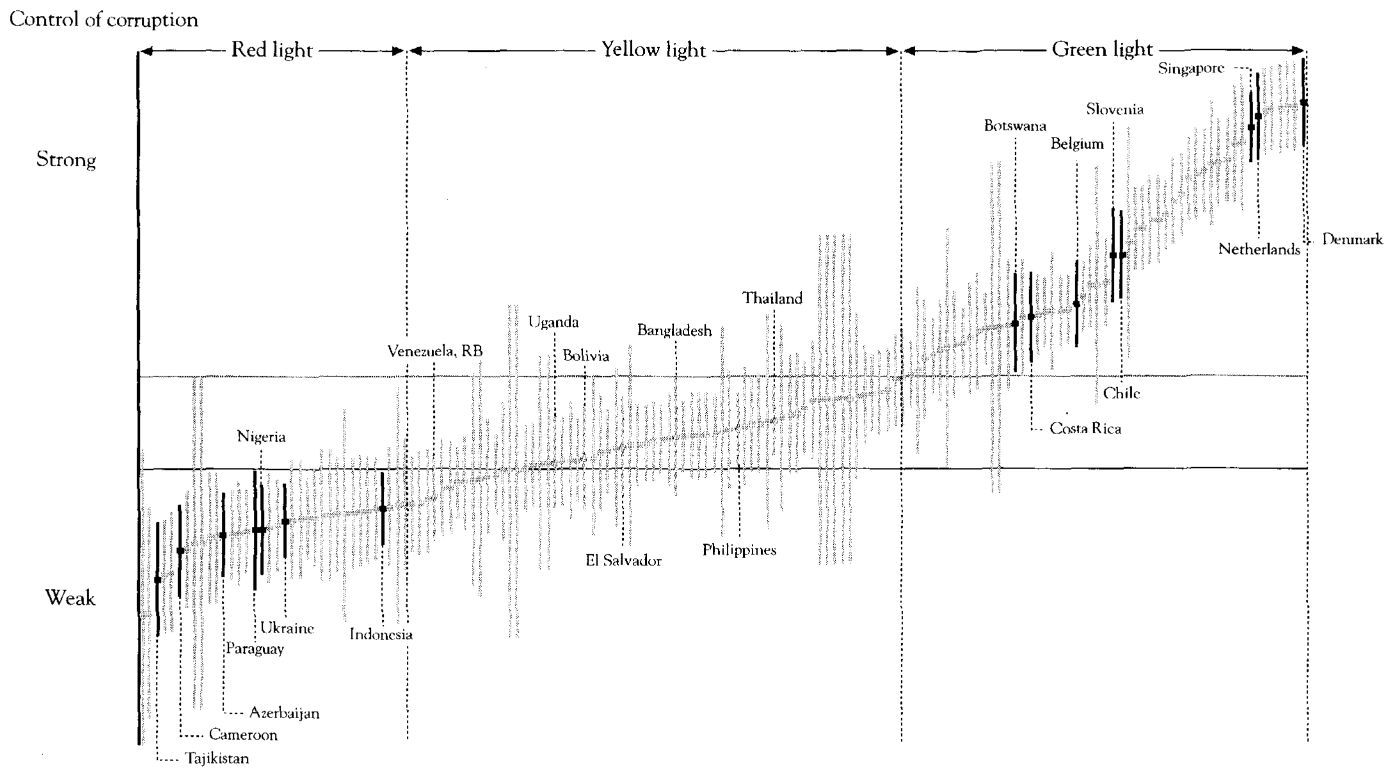
Effects of Governance

The cross-country data indicate a significant simple correlation between governance and socioeconomic outcomes. To explore the effect of governance on socioeconomic variables, we estimated a two-stage least squares regression of a socioeconomic variable (for example, per capita income) on a constant and on the governance component, using historical indicators as instruments (following the approach of Hall and Jones 1999). Within such an approach, concerns about measurement error and omitted variables were also addressed (see Kaufmann, Kraay, and Zoido-Lobatón 1999b for details). The evidence challenges the argument that only rich countries can afford the luxury of good governance.

The empirical analysis suggests a large direct effect going from better governance to better development outcomes. Consider an improvement (of one standard deviation) in the rule of law from the low levels in the Russian Federation today to the middling levels in the Czech Republic or a similar reduction in corruption from that in Indonesia to that in Korea. In this framework, it increases per capita incomes two to four times, it reduces infant mortality by a similar magnitude, and it improves literacy by 15 to 25 percentage points in the long run. And consider that the differences in governance for these two pairs of countries are not very large. Much larger improvements in government effectiveness from the levels in Tajikistan (in the red light group) to those in Chile (in the green light group) in this framework would nearly double the development impacts just mentioned.

The relationships between development outcomes and four measures of governance are illustrated in figure 6.3. The heights of the vertical bars show

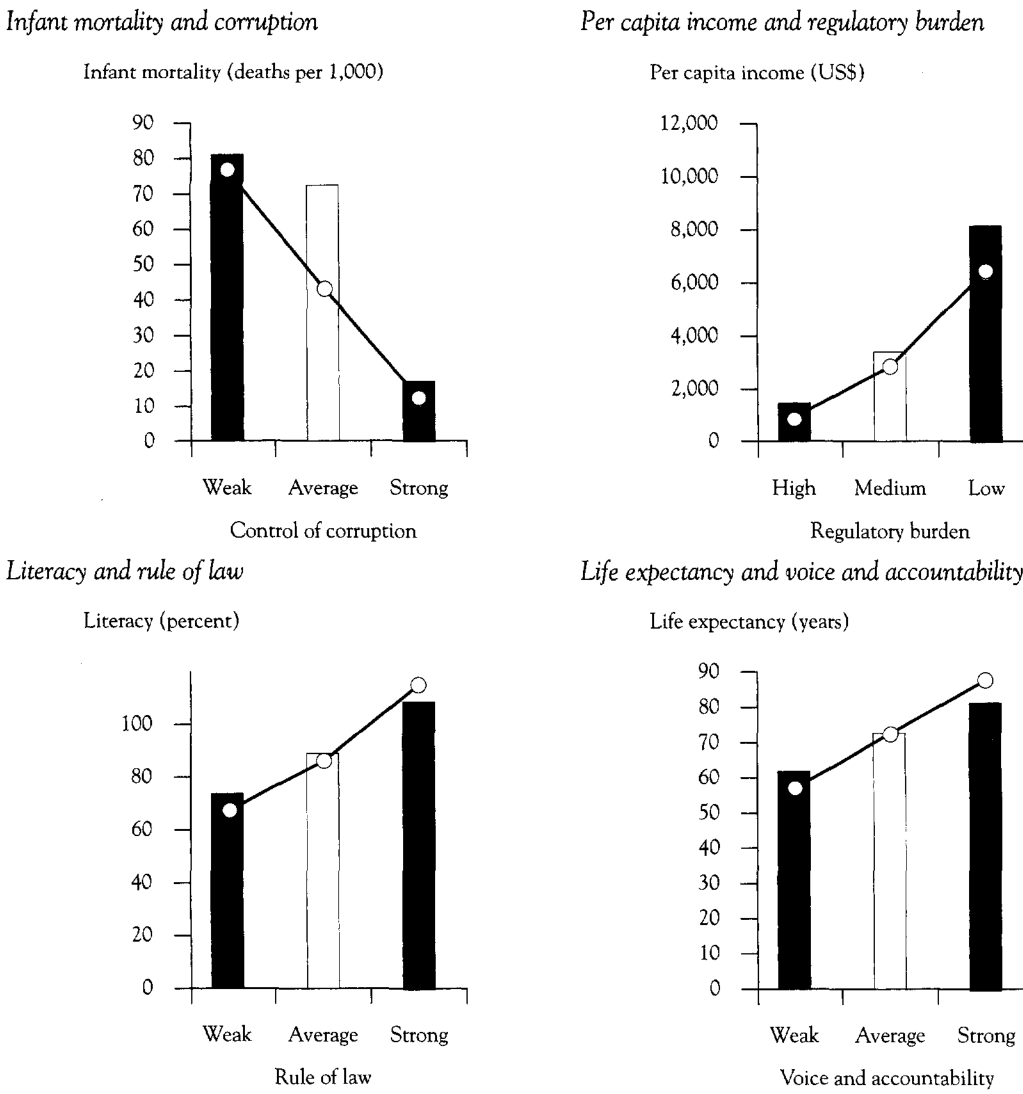
Figure 6.2. Control of Corruption: The "Traffic Lights" Presentation Approach



Note: This figure shows estimates of control of corruption for 155 countries based on data from 1997–98, with selected countries indicated for illustrative purposes. The vertical bars show the likely range of the governance indicator for each country, and the mid-points of these bars show the most likely value. The length of these ranges varies with the amount of available information for each country and on the extent to which different sources' perceptions of corruption coincide. Countries with solid black vertical bars (in the red light area) or dark green vertical bars (in the green light area) are those for which the governance indictor is statistically significantly in either the bottom third (right light) or the top third (green light) of all countries. Countries with light green vertical bars (in the yellow light area) fall into neither of the two previous groups. Countries' relative positions are subject to significant margins of error and reflect the perceptions of a variety of public and private sector organizations worldwide. Thus, no precise ranking can be preformed. The country ratings in no way reflect the official views of the World Bank.

Source: Kaufmann, Kraay, and Zoido-Lobatón (1999a,b). Details of the overall governance dataset in Kaufmann, Kraay, and Zoido-Lobatón (2000), http://www.imf.org/fandd/2000/06/Kauf.htm; and http://www.worldbank.org/wbi/governance.

Figure 6.3. The Development Dividend of Good Governance



Note: The heights of the vertical bars show the differences in average development outcomes in countries with weak, average, and strong governance. The solid lines show the estimated effect of governance on development outcomes. See endnote 3 in this chapter and table A6.1 in annex 6 for details on econometric tests (synthesized in the solid lines).

Source: Kaufmann, Kraay, and Zoido-Lobatón (1999b, 2000); http://www.imf.org/fandd.

the differences in development outcomes in countries with weak, average, and strong governance and illustrate the strong correlation between good outcomes and good governance. After controlling for reverse causality and for the effects of other, nongovernance factors on development, the solid lines represent the estimated impact of governance on development outcomes: the "development dividend" of improved governance.[3]

Composite indicators of governance, based on multiple, outside sources of data, powerfully draw attention to governance issues. They are also indispensable for cross-country research into the causes and consequences of misgovernance.

For instance, this large data set debunks the notion that larger countries are more corrupt (a statistical construct resulting from tests with a smaller number of countries). However, these new governance indicators provide only a first and rough benchmark of where countries stand relative to each other on governance issues and make a blunt tool for informed action to improve governance. To make composite indicators more specific and useful within a country, one needs to know much more about how perceptions of and data about misgovernance are reflected in policy and institutional failures. In-depth governance diagnostic tools are needed within a country to provide meaningful data and information for formulation of governance reforms. Against this background, the rest of the chapter addresses the following questions: How do corruption and misgovernance undermine development? What are the underlying causes of corruption? What kind of insights can be derived by unbundling corruption into distinct components? What kinds of diagnostic tools and strategic approaches can best serve a country intent on making progress toward good and clean government?

Corruption Undermines Growth and Development

Many studies have shown the pernicious effect of corruption on development. Mauro (1997) showed that corruption slows the growth rate of countries. He found that if Bangladesh reduced corruption to equal the level in Singapore and the growth rate was 4 percent a year, Bangladesh's average annual per capita GDP growth rate between 1960 and 1985 would have been 1.8 percentage points higher, a potential gain of 50 percent in per capita income.

The following are some of the many channels whereby corruption can weaken economic growth:

- Misallocation of talent (Murphy, Shleifer, and Vishny 1991), including underutilization of key segments of society, such as women
- Lower levels of domestic and foreign investment (Mauro 1997; Wei 1997)
- Distorted enterprise development and growth of the unofficial economy (Johnson, Kaufmann, and Zoido-Lobatón (1998)
- Distorted public expenditures and investments and deteriorated physical infrastructure (Tanzi and Davoodi 1997)

- Lower public revenues and less provision of the rule of law as a public good (Johnson, Kaufmann, and Shleifer 1997)
- Overly centralized government (Fisman and Gatti 2000)
- State capture by the corporate elite of the ("purchased") laws and polices of the state, thereby undermining growth of output and investment of the enterprise sector (Hellman, Jones, and Kaufmann 2000a; see annex 6 for details).

Lower Investment

Evidence from a large cross-section of countries suggests that corruption significantly reduces domestic and foreign investment. If the Philippines could reduce its corruption to the much lower level of that in Singapore, it would raise its investment-to-GDP ratio by 6.6 percentage points (Mauro 1997). By looking at bilateral FDI in the early 1990s from 14 source countries to 41 host countries, Wei (1997) found evidence that corruption discourages investment. Reducing corruption to the low level in Singapore would have the same effect on foreign investment for a corrupt country as reducing the marginal corporate tax rate by more than 20 percentage points. Many countries afflicted by corruption also offer substantial tax incentives to lure multinational firms. By controlling corruption, they could attract at least as much foreign investment without such tax incentives.

Misallocation of Public Expenditures

Some of the pioneers in the study of the economics of corruption have highlighted corruption's effect on the allocation of public finances (Klitgaard 1988; Rose-Ackerman 1989). Tanzi and Davoodi (1997) found that corruption increases public investment because it creates opportunities for manipulation by dishonest high-level officials. It also skews the composition of public expenditure away from needed operations and maintenance spending and directs it toward new equipment purchases, thereby reducing the productivity of public investment, especially in infrastructure. Under a corrupt regime, public officials shun health programs because they offer less scope for rent-seeking. Corruption may also reduce tax revenue, because it compromises the government's ability to collect taxes and tariffs.

Drawing on the findings of Tanzi and Davoodi, Wei (1997) showed that an increase in corruption, comparable to the corruption level of Singapore rising to that in Pakistan, would increase the public expenditure-to-GDP ratio by 1.6 percentage points and reduce the government revenue-to-GDP ratio by 10 percentage points. In addition, an increase in corruption would reduce the quality of roads and increase the incidence of power outages, telecommunication failures, and water losses.

Johnson, Kaufmann, and Zoido-Lobatón (1998) also showed that corruption reduces tax revenue, mainly through the growth of the unofficial economy. Overburdened by red tape and associated rent-seeking in the official economy, firms move to the unofficial economy and pay fewer taxes. Such reduced tax revenue is associated with a lower provision of key public goods, such as rule of law, further increasing the unofficial economy and impairing public finances.

Impact on the Poor

Where corruption prevails, growth is impaired, and this has an enormous effect on poverty. Furthermore, the poor receive fewer social services, such as health and education. Corruption biases infrastructure investment against projects that aid the poor and impairs the use of small-scale entrepreneurial means to escape poverty. Worse, corrupt regimes often prefer defense contracts over rural health clinics and schools, a policy bias that worsens income distribution and diverts resources from the countryside to the cities.

Gupta, Davoodi, and Alonso-Terme (1998) show that corruption increases income inequality and poverty through channels such as lower growth, regressive taxes, less effective targeting of social programs, unequal access to education, policy biases favoring inequality in asset ownership, reduced social spending, and higher investment risks for the poor. As suggested in figure 6.3, Kaufmann, Kraay, and Zoido-Lobatón (1999b) also found that corruption increases infant mortality and reduces life expectancy and literacy. Furthermore, when analyzing the UNDP's Human Poverty Index, the data suggest that it is negatively associated with the various indexes of governance and corruption even after controlling for GDP per capita. The mechanisms through which governance affects poverty are varied, complex, and still not fully understood. The matrix in table 6.1 suggests some of the complex effects of corruption on poverty through a variety of channels.

Country analyses using new governance diagnostic tools illustrate how regressive corruption is as a tax. For instance, poor households in Ecuador must spend three times more in bribes as a share of their incomes than higher income households for access to public services (figure 6.4). Similarly, in various diagnostic surveys of public officials in Latin America in the late 1990s, bureaucrats in those agencies rife with corruption and lacking in meritocracy were found to discriminate against the poor by limiting access to basic services and by failing to pursue poverty alleviation—in contrast with the better access to the poor by agencies with less corruption and meritocracy (figure 6.5).

Table 6.1. A Synthesis Matrix: Corruption and Poverty

"Immediate" causes of poverty	*How corruption affects "immediate" cause of poverty*
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
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
Lack of health and education	Low human capital accumulation Lower quality of education and health care

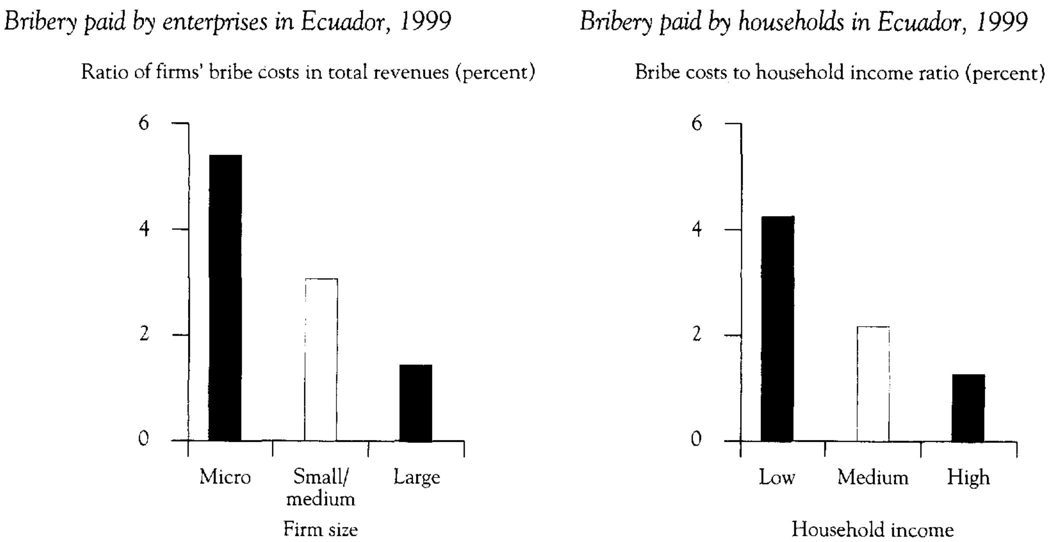
Source: Author.

Impact of Corruption on Commerce and Corporate Influence on National Governance

A common argument found in the literature contends that bribes to circumvent bad government controls are like unofficial deregulation and can have positive effects, such as promoting enterprise development (Huntington 1968; Leff 1964; Liu 1985). This view—bribery as grease on the wheels of commerce—may hold conceptually only in a very narrow sense if bad regulations are fixed independently of the behavior of public officials. Yet in reality, officials often have discretion in the type and amount of harassment and regulations inflicted on individual firms. Tax inspectors can overreport taxable income (Hindriks, Keen, and Muthoo 1999), and fire inspectors can decide how many times to check a firm for safety "violations." Using data from two independent surveys on more than 6,000 firms in 75 countries, Kaufmann and Wei (1999) showed that firms that pay more administrative bribes waste more time with bureaucrats than those firms that do not pay bribes.

Thus, the empirical evidence suggests that a firm engaging in petty or administrative bribery (for example, for licenses or red tape) does not necessarily benefit from paying bribes; neither does the business community or society more generally. Research evidence on the costs of corruption for overall business development is growing. For example, Fisman and

Figure 6.4. Corruption Is Regressive: Results from Diagnostic Surveys



Note: Estimates subject to a margin of error.
Source: World Bank (2000e).

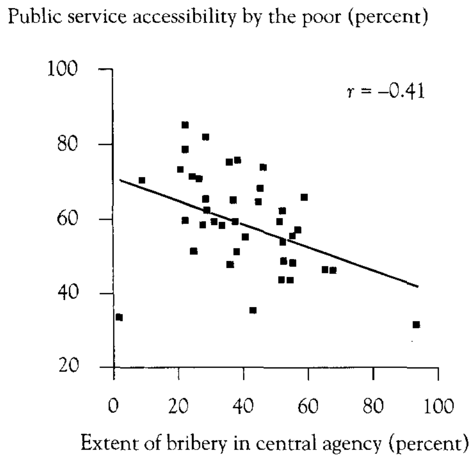
Svensson (1999) found that in Uganda, administrative corruption reduces a firm's propensity to invest and grow, and Hellman, Jones, and Kaufmann (2000a) found that in those economies in transition where "grand" corruption is more prevalent, the growth and investment rate of the enterprise sector is much smaller, while security of property rights is impaired.

Corruption not only hobbles dynamic enterprise development, but it affects smaller firms and new entrants in particular. Newer and smaller firms tend to bear the brunt of the bribery "tax," as evidenced by a recent analysis of 3,000 enterprises in transition economies.[4] Accordingly, smaller firms are prepared to pay significantly more taxes than their larger counterparts for their bribes to be reduced.

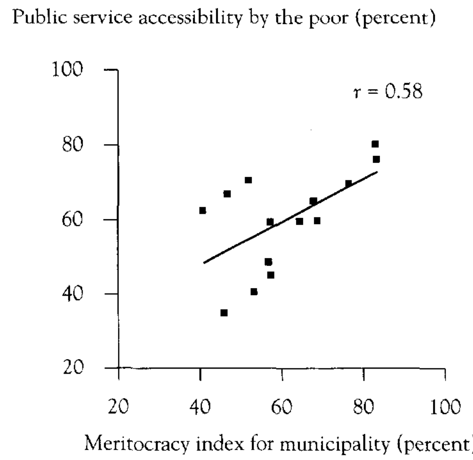
This research on transition economies also provides insights into the link between political influence, grand corruption (more specifically, state capture), and enterprise performance. In a number of countries in the former Soviet Union, the survey finds that firms (including many with FDI) that purchased parliamentary laws, presidential decrees, and influence in central banks do benefit in the short run (in terms of revenues and the firm's own investment). Yet as stated earlier, their actions inflict a large indirect cost on the development of the rest of the enterprise sector. These findings demonstrate that while individual firms engaging in state capture may benefit privately (in contrast with administrative corruption—figure

Figure 6.5. Corruption and Absence of Meritocracy in Public Agencies Impair Access to Services to the Poor: Results from Public Officials' Diagnostic Surveys

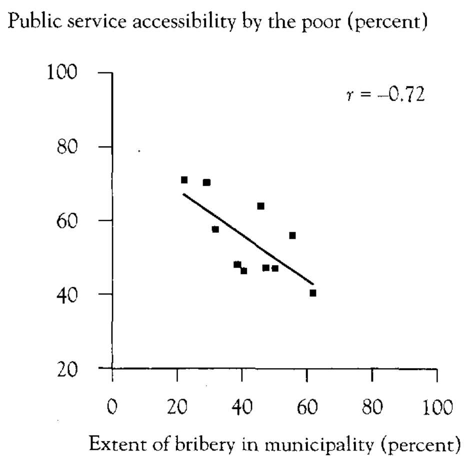
Corruption control in central agencies in Paraguay and access to services by the poor



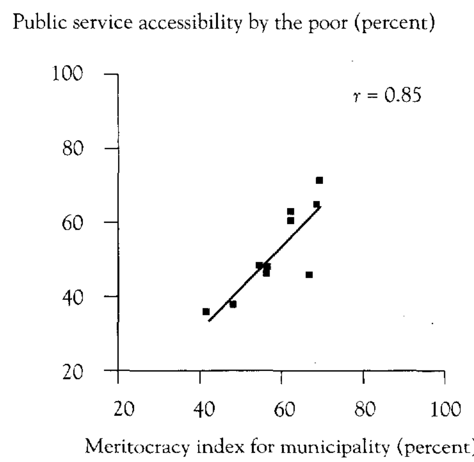
Civil service meritocracy in municipalities in Paraguay and access to services by the poor



Corruption control in municipalities in Bolivia and access to public services by the poor



Civil service meritocracy in municipalities in Bolivia and poverty alleviation impact of public services



Notes: Each depicted observation (dot) represents a central agency or municipality in the pertinent country. Based on public officials survey on governance, "Poverty alleviation impact" represents the percentage of cases in which the public services delivered are helpful to reduce poverty and "Accessibility to the poor" represents the percentage of cases in which the public services delivered are accessible to the poor, as reported by public officials in the diagnostic survey.

Sources: World Bank (2000e).

6.6), such a form of grand corruption imposes a particularly pernicious social cost on enterprise development. (See annex 6 for details on the unbundling of the measurement of corruption into state capture, public procurement kickbacks, and administrative corruption).

Causes of Corruption

Empirical studies of the causes of corruption are fairly new. Yet, the emerging evidence suggests that some determinants are important. The available research supports the notion that corruption is a symptom of deep institutional weaknesses.

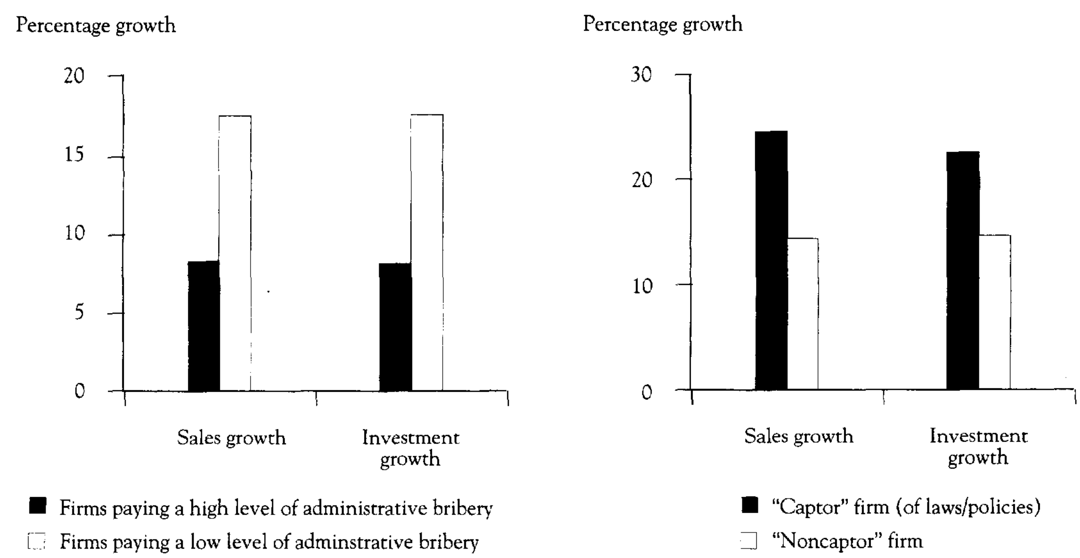
Absence of Political Rights and Civil Liberties

Political rights, which include democratic elections, a legislature, and opposition parties, and civil liberties, which include rights to free and independent media and freedom of assembly and speech, are negatively correlated

Figure 6.6. "Petty Bribery" versus State Capture: Does Engaging in Corruption Benefit the Firm?

Administrative corruption does not benefit the firm (averages from all transition countries)

State capture through purchase of policies and laws benefits the captor firm



Source: Hellman, Jones, and Kaufmann (2000a). Details in annex 6 and at http://www.worldbank.org/wbi/governance.

with corruption. Figure 6.7 shows the high correlation between civil liberties and freedom of the press with corruption. Increasing evidence points to the empowerment of civil society in effectively addressing corruption (figure 6.7). Furthermore, the enterprise survey evidence from transition economies suggests that the capture of state policies and laws by corporate interests is associated with the absence of full civil liberties (Hellman, Jones, and Kaufmann 2000a). The worldwide empirical evidence also suggests that the inclusion of women, whether measured in terms of parliamentary representation or social rights, does help achieve such empowerment (Kaufmann 1998). Devolution, such as fiscal decentralization (Collier 1999; Fisman and Gatti 2000), under the right circumstances may also help control corruption. In addition, evidence points to a significant correlation between corruption and the rule of law.

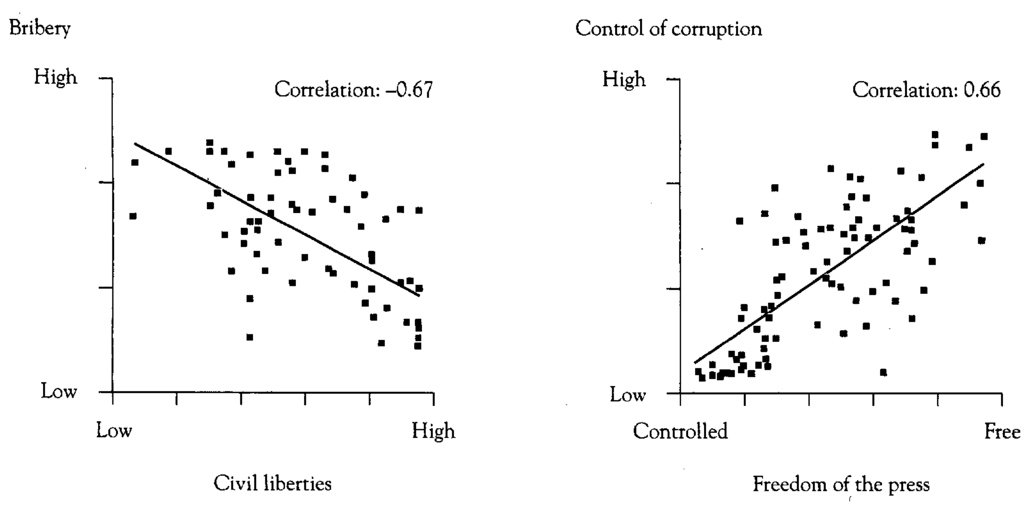
Public Finance and Regulation

Corruption is higher in countries with a high degree of state ownership in the economy, excessive business regulation and taxes, arbitrary application of regulations, and trade restrictions. Monopolized economies also tend to have more corruption.

Civil liberties and a free press can help control corruption

Figure 6.7. Corruption and Civil Rights

Civil liberties and bribery | *Press freedom and control of corruption*



Source: Kaufmann (1998).

Civil Service

Civil service professionalism, which includes training, hiring, and promotion systems, is also associated with less corruption. Contrary to conventional wisdom, the evidence on civil service pay is often ambiguous. Better public sector salaries on their own may not explain a significant reduction in corruption. For example, Ecuadorian public sector agencies that offer better pay to employees do not have a lower incidence of corruption. In many settings, a few of the more senior politicians or government officials often cause the most damaging corruption. While in some countries raising salaries of selected key civil service personnel may be warranted, this is unlikely to bear fruit without complementary measures. Among these, meritocracy in hiring, promoting, and firing within an agency is associated with less corruption (figure 6.8). The contrasting results between the low impact of higher salaries, on the one hand, and the significant effect of meritocracy, on the other, exemplify the need to conduct in-depth, empirical diagnostics within countries intent on formulating serious anticorruption programs.[5]

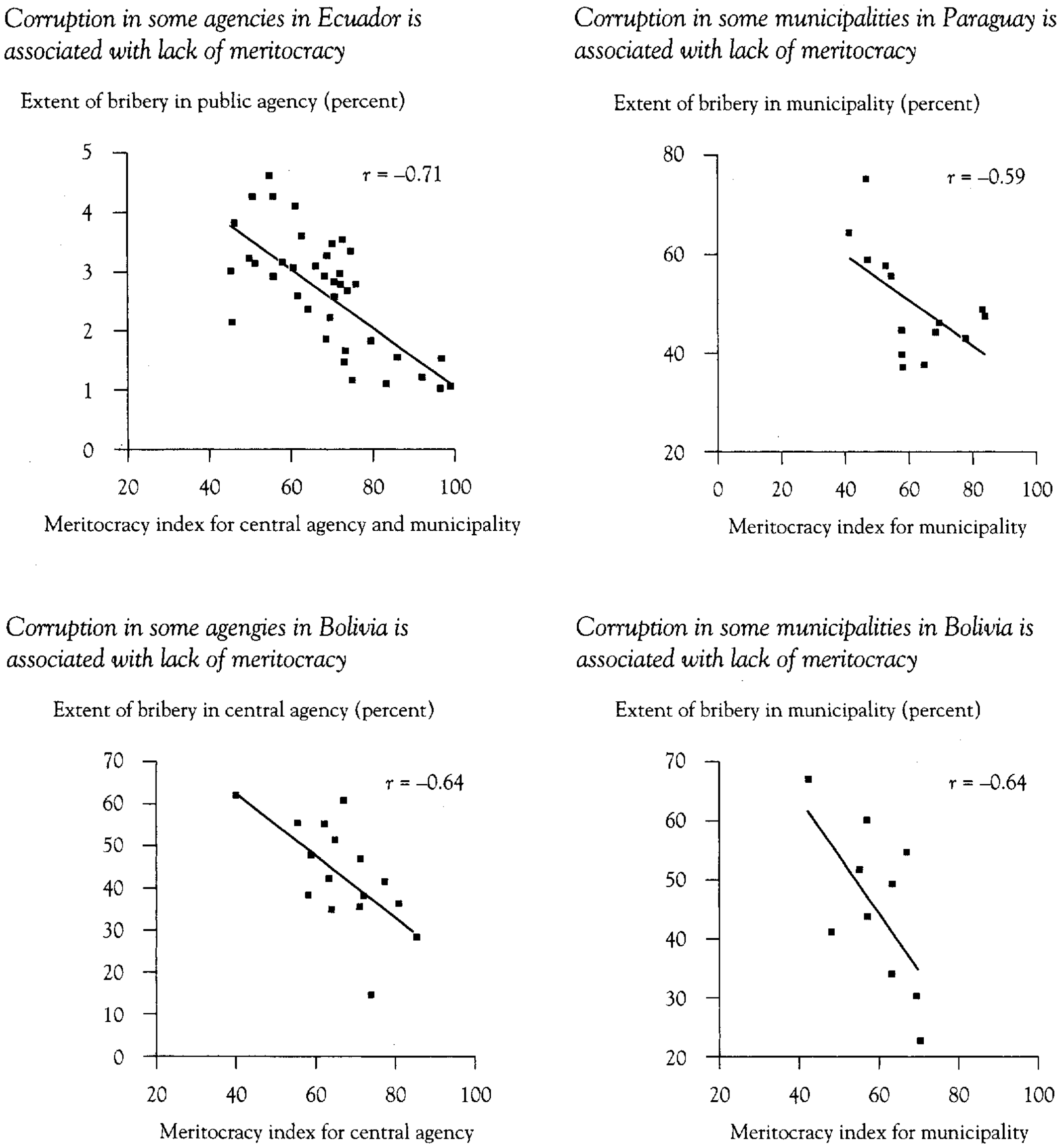
A Multifaceted Anticorruption Strategy

Given what is known about the main determinants of good governance and corruption, what kinds of programs may have an impact?[6] Improving governance requires a system of checks and balances in society that restrains arbitrary action and bureaucratic harassment by politicians and bureaucrats, promotes voice and participation by the population, reduces incentives for the corporate elite to engage in state capture, and fosters the rule of law. Futhermore, the ongoing research on state capture highlights the need to place checks and balances on the "elite" corporate sector through promoting a competitive market economy and an active civil society. A meritocratic and service-oriented public administration is another salient feature of the strategy.

Key Reforms

Figure 6.9 synthesizes the strategy of key reforms for improving governance and combating corruption. However, how to combine and sequence these reforms to achieve the greatest impact on corruption is a particularly daunting challenge, as is the task of detailing and adapting a strategy to each country-specific reality. For instance, a country that has been subject to state capture by the corporate elite will require a different strategy than a country where the main source of misgovernance originates in political structures or in bureaucracy. Specific questions about governance reforms

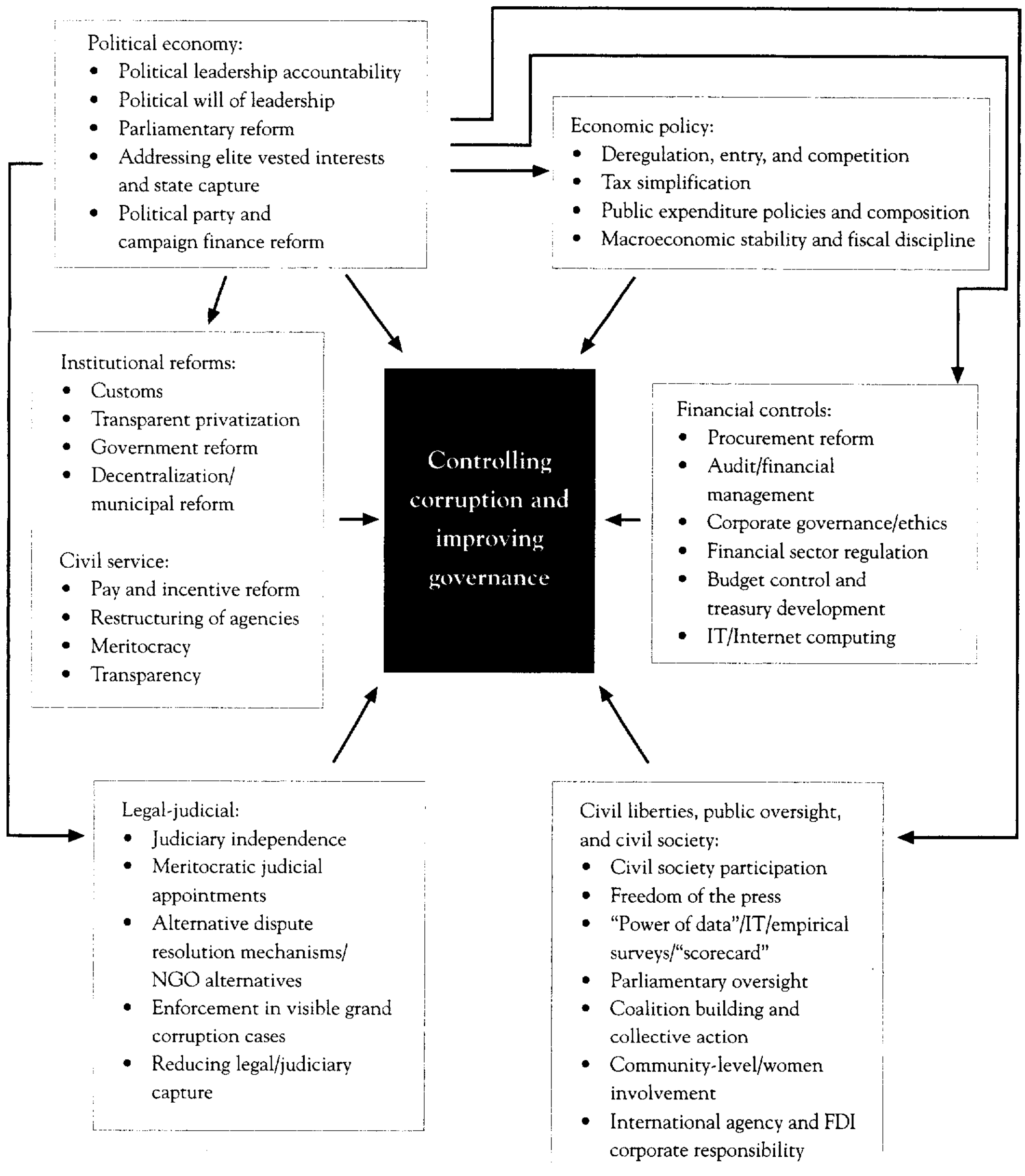
Figure 6.8. Meritocracy Can Reduce Corruption: Evidence for each Agency from Surveys of Public Officials in Three Countries



Note: Each depicted observation (dot) represents a central agency or municipality in the pertinent country. Extent of bribery is measured by the reported percentage of public services and contracts that are affected by bribery in a central agency or municipality. The meritocracy index (0–100) is constructed using the survey questions related to personnel management in a central agency or municipality, as reported by public officials.

Sources: World Bank (2000e); the contributions of Ed Buscaglia, Maria Gonzalez de Asis, Turgul Gurgur, Akiko Terada, Youngmei Zhou, and Pablo Zoido-Lobatón to this line of research on public officials are acknowledged.

Figure 6.9. Multipronged Strategies for Combating Corruption and Improving Governance: Recognizing the Political Economy



IT Information technology.
Source: Author, in collaboration with the World Bank's Public Sector Group.

therefore include what types of changes are feasible under what political conditions and how reforms should be prioritized within the political, civil society, and corporate realities of each country setting.

Competition and Entry. In some transition and developing countries, a source of grand corruption is the concentration of economic power in monopolies that then wield political influence on the government for private benefits. The problem is particularly acute in countries rich in natural resources, where monopolies in oil, gas, and aluminum, for instance, wield considerable economic and political power that leads to different forms of corruption: nonpayment of taxes, nontransparent offshore accounts, purchasing licenses and permits, and purchasing votes and decrees that restrict entry and competition. Demonopolization, deregulation, facilitation of entry and exit (through liquidation of assets and effective bankruptcy procedures), and promotion of competition are vital.

Accountability of the Political Leadership. Measures are being implemented in various countries that provide checks and balances for the political leadership and senior officials in their commitment to good governance and anticorruption through public disclosure and transparency of their own actions, finances, income, and assets. In several countries this has entailed the following:

- Public disclosure of votes in parliament
- Repeal of unconditional parliamentary immunity
- Public disclosure of sources and amounts of political party financing
- Public disclosure of incomes and assets of senior public officials and their key dependents
- Regulations against conflicts of interest for public officials
- Protection of personal and employment security for public officials who reveal abuse of public office by others (whistleblower statutes).

Meritocratic and Service-Oriented Public Administration. Recruiting and promoting on merit, as opposed to political patronage or ideological affiliation, is positively associated with both government effectiveness and control of corruption. Reforms in this area have included creating independent, professional institutions with checks and balances (for example, a civil service recruitment commission) and introducing a comprehensive performance management system with pay and promotion linked to performance. In Malaysia and Thailand, this led to increased recruitment and retention of managerial and professional staff and to increased effectiveness in civil service performance. In addition, allowances and noncash benefits often need to be simplified, monetized, and made transparent. Care needs to be exercised in avoiding wholesale salary increases as a panacea.

Transparency and Accountability in Public Expenditure Management.[7] Basic systems of accountability in the allocation and use of public expenditures constitute a fundamental pillar for good governance. Accountability in public expenditure management requires the following: (a) a comprehensive budget and a consultative budget process, (b) transparency in the use of public expenditures, (c) competitive public procurement, and (d) an independent external audit.

The budget must first have comprehensive coverage of a government's activities. Many countries face problems of budgetary transparency, where major areas of budget expenditure do not pass through the treasury system, and there is substantial recourse to extrabudgetary funds and no effective system of controlling expenditure commitments. Several countries in transition, such as Hungary and Latvia, have made progress in addressing these problems with comprehensive treasury reform programs.

Second, disclosure matters. Many industrial countries (for instance, Australia and the United Kingdom) publish frameworks for public expenditure strategies, which are both a major tool for clarifying strategic choices and a means of enhancing the transparency of the policy objectives and the output targets underpinning annual budgets. More recently, South Africa has developed the Medium-Term Expenditure Framework, revised annually and published on the web, as a means of clarifying strategic choices and establishing publicly accountable objectives for public expenditure.

Third, transparent and competitive public procurement is key to clean government. Reducing corruption requires adhering to strict discipline in terms of transparent and competitive bidding of major contracts, maximizing the scope of public oversight and scrutiny. The information technology revolution is proving to be a catalyst. Indeed, to make the process of government procurement more efficient and curb corruption, three Latin American countries (Argentina, Chile, and Mexico) have recently adopted electronic government acquisition systems. All procurement notices and their results are placed on a publicly available web site. Other important innovations related to activist external monitoring are taking place as well. NGOs are increasingly playing a role in spearheading public audiences to have a greater voice in establishing rules of the game for large-scale procurement projects (such as in the subway system in Buenos Aires) and throughout the transparent bidding process itself (where NGOs such as

Transparency International have innovated). The World Bank has also taken an active role in aggressively pursuing firms engaged in misprocurement in projects; for instance, delisted firms that have been barred from bidding in Bank-funded projects for having engaged in corrupt procurement are publicly available on the Bank's web site.

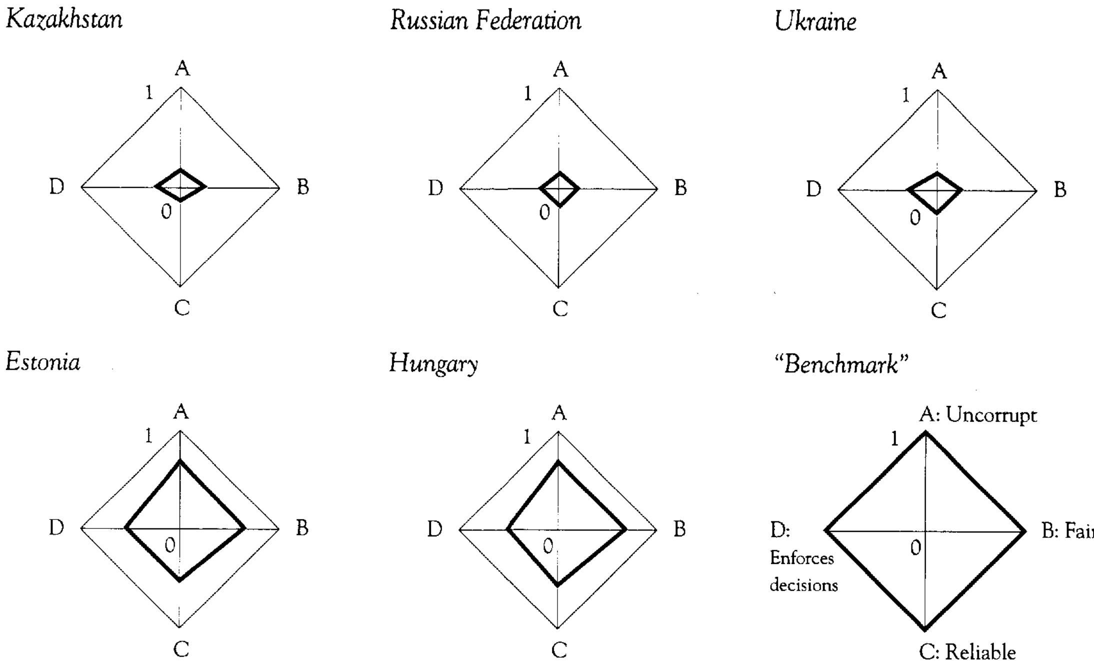
Fourth, establishing independent external audits matters. Several transition and emerging economies, such as the Czech Republic and Poland, have established supreme audit institutions, which are genuinely independent and have a constructive impact on public financial management systems. In the Czech Republic, audit reports are published, presented to the legislature, and discussed in the cabinet, along with a proposed plan for corrective actions, in the presence of the supreme audit institution and relevant ministers.

Promoting the Rule of Law. According to the *New Palgrave Dictionary of Economics and the Law*, the rule of law is defined by opposing it to the rule of powerful men or women. This summarizes the challenge in many countries, where powerful politicians, leaders, elite interests, or oligarchs often influence the practical operations of the parliament, judiciary, and legal enforcement institutions such as the police. These countries often have an adequate set of laws on the books, yet the failure is in their effective application and enforcement. And in some countries such laws have been captured by elite interests. The evidence from a vast array of worldwide data (synthesized in figure 6.1) suggests that there is a rule of law crisis in many countries of the former Soviet Union and in Africa, as well as in some in Latin America. The institutional dysfunction in such countries stands in sharp contrast to others, where, however imperfectly, the capacity of legal and judiciary institutions is improving. Illustrating the performance of courts in different countries, figure 6.10 shows how honest, reliable, and fair courts are reported to be by the enterprise sector in Estonia and Hungary. By contrast, in countries like the Russian Federation and Ukraine, they are seen as corrupt, very partial and unfair, unreliable, and nonenforcing.

Misgovernance in the judiciary and legal institutions does not always originate solely in the public sector. In some countries elite corporate interests exert corrupt pressures as well, as also gleaned from the recent enterprise survey in transition countries and illustrated in figure 6.11, which suggests the extent of capture (by enterprises including FDI) of the legal and judiciary system in some countries.

Thus, even if the legal institutions are fully staffed by trained judges and personnel, they can be subject to capture by politicians or corrupt corporate interests. In this context, the public sector legal institutions are an integral

Figure 6.10. High Variation in the Quality of Courts in Selected Economies
(view of the corporate sector on four dimensions; a larger inner diamond means a better performing court)



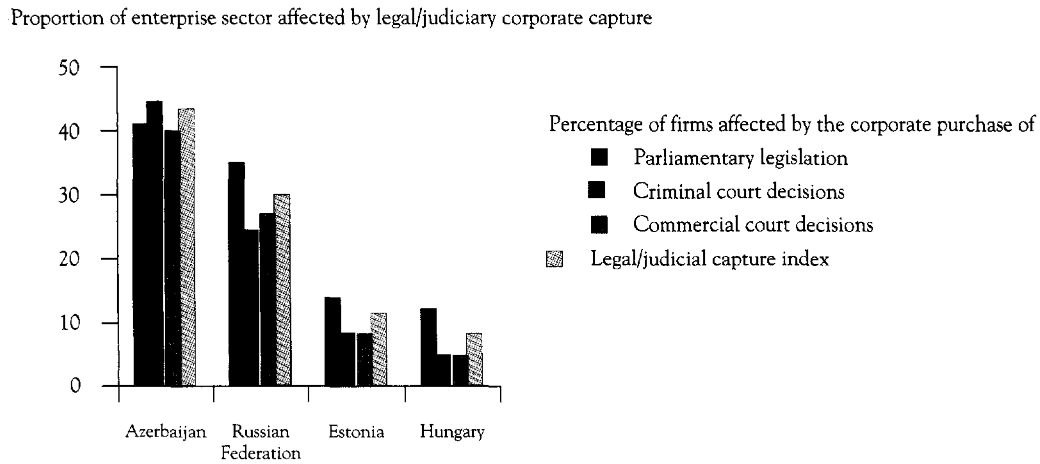
Quality dimensions of courts measured:
A Uncorrupt.
B Fair.
C Reliable.
D Enforces decisions.

Note: Four-pronged diamond on a scale of 0–1, where 1 indicates 100 percent of firm respondents giving highest rating in each relevant court quality dimension. The lower right corner panel is a hypothetical ideal benchmark, if 100 percent of firms would give perfect scores.

Source: Hellman and others (2000); see also annex 6. Based on a 1999 enterprise survey in transition economies.

part of the governance problem, and not part of the solution. This reduces the relevance of conventional advice on improving governance through the creation of institutions within the public sector (such as an ethics office and anticorruption department) passing anticorruption laws, providing technical assistance in the form of computers or other hardware, or sending sitting judges to training or "study tours." Instead, innovative mechanisms to improve governance are often needed, such as alternative dispute resolution mechanisms, providing for more systematic involvement by NGOs and other alternative institutional arrangements, dissemination strategies through the media, and exploiting more fully and transparently the power

Figure 6.11. Legal and Judicial Capture by the Corporate Sector in Selected Transition Economies



Note: The legal/judicial capture index is the simple average of the firms reporting the effect of corporate purchase of parliamentary legislation, of criminal court decisions, and of commercial court decisions. Estimates subject to margin of error.

Source: Hellman, Jones, and Kaufmann (2000a,b); see also for details columns 1, 4, and 5 in table A.6.1 in annex 6. Data from 1999.

of data and information within and outside the public sector. Equally important, the major challenge of addressing legislative capture in many countries would often require parliamentary and political reforms, such as public disclosure of all parliamentary votes, scaling back immunity laws for members of parliament, and political finance reform.

Survey Diagnostic Tools for In-Country Governance Assessment

The collection, analysis, and dissemination of country-specific data on corruption are altering the policy dialogue on corruption and empowering civil society through collective action. Yet important challenges remain, including the ongoing refinement of methods that transform survey evidence into reform priorities and how best to complement in-depth empirical diagnostic surveys with in-depth focus group methodologies—fully involving stakeholders on the key governance challenges within the country. A key challenge involves the development of an effective strategy for implementing the reform agenda. Once survey data and their analysis are available, countries where political will is present must begin the more difficult task of prioritizing measures according to the country reality and introducing reforms to root out the sources of corruption.

Sustaining the reform effort with broadly based participation involving all government branches, civil society, and the business community constitutes another challenge to the anticorruption and governance-improvement agenda (box 6.1). With cooperation from the private sector and NGOs, the government can leverage reform by allowing private competition alongside public provision of some services; for example, the adoption of private forms of alternative dispute resolution to compete with the judiciary or private provision of garbage collection at the municipal level. In-depth governance and anticorruption survey diagnostics (and their concomitant data analysis) need to be institutionalized, so that statistics on agency-specific corruption can be monitored and acted upon periodically. Broad dissemination of the vast amounts of statistics being generated through diagnostic surveys and studies of governance and capture can further empower stakeholders to strengthen and sustain institutional change.

The design and implementation of agency-specific, in-depth diagnostic surveys for public officials (figures 6.5 and 6.8), households or users (figure 6.4), and enterprises (figures 6.4 and 6.11) constitute an innovation that provides tangible inputs for countries committed to implementing capacity building and institutional change programs. New survey instruments can collect detailed information on behavior in even the most dysfunctional government agencies and on the delivery of specific services. For example, comparisons of the price of saline purchased by different hospitals, after accounting for transport and other idiosyncratic costs, can show whether corruption exists in public hospitals. Used with other empirical devices, such diagnostic surveys can focus the political dialogue on concrete areas for reform and rally civil society behind reform efforts.

Such country self-diagnostic data, used by a variety of in-country stakeholders and disseminated through participatory workshops, have mobilized broader support for consensus building and collective action for institutional reforms. Countries such as Albania,[8] Bolivia, Georgia, and Latvia have progressed from using diagnostics to taking concrete action. Bolivia is emphasizing civil service and procurement reforms. Latvia has given priority to tax and customs reforms. In Georgia, following the abysmal survey results regarding the state of the judiciary, President Shevardnadze decided that all judges had to be retested, which was broadcast live on television. Two-thirds of the judges failed the examination and were replaced.

In other countries, similar governance improvement efforts are taking place at the *municipal* level. For instance, in a number of Ukrainian cities specific actions to improve the effectiveness of local government in delivering public services are being carried out following diagnostic surveys. Pioneered in Bangalore, India, in the early 1990s, the now well-known

Box 6.1. Governance and Survey Diagnostic Tools: The Power of Empirics

The first set of in-depth governance and corruption diagnostic surveys of public officials, firms, and citizens was carried out in Albania, Georgia, and Latvia in 1998. More recently, implementation of refined and expanded versions of these diagnostic surveys has been carried out in other countries, focusing more broadly on the complex governance of key agencies in the country and assessing the main institutional determinants of misgovernance and corruption there. Challenging conventional wisdom, the new surveys of public officials, enterprises, and citizens find respondents willing to provide detailed information on misgovernance that they have observed and experienced (as opposed to merely indicating their vague perceptions about countrywide corruption, for instance).

Survey respondents report on embezzlement of public funds, theft of state property, bribery to shorten processing time, bribery to obtain monopoly power, and bribery in procurement. For instance, in 1998 in Georgia embezzlement of public funds and judiciary corruption, inter alia, was identified as a serious problem. At that time theft of state property was identified as a particular problem in Albania. Bribery in procurement and customs is a common challenge in most settings where these diagnostic surveys have been implemented. Weakness in the judiciary was identified as one of the primary causes of corruption in Albania, while regulatory failures are much less important there than in Georgia and Latvia, for instance. In these diagnostic surveys, detailed statistics are collected on the frequency and cost of bribes paid by enterprises to regulators in different agencies as well as the shortcomings of public service delivery and other performance and effectiveness indicators. A multiplicity of governance dimensions is included in these diagnostics, permitting an in-depth analysis of issues such as meritocracy, discretionality, budgetary transparency, and poverty alleviation focus and impact. The analysis of these statistics then serves as a vital input for prioritizing in the formulation of a governance improvement reform program.

A significant share of administrative bribes is paid to officials to avoid taxes, customs duties, and other liabilities to the state. Some bribes—such as kickback payments to public officials, for lawmaking and judicial decisions, or for public procurement—are found to be particulary costly. The survey results indicate that agencies and activities viewed by public officials as particularly corrupt command the highest price for securing jobs, suggesting that securing such public positions is viewed as a private investment with a significant expected private return.

When the data were presented in workshops to members of the business community, major civil society, and the executive and legislative branches, the policy debate abruptly changed from vague, unsubstantiated, and often personalized accusations to one focused on empirical evidence and systemic weaknesses that needed to be addressed. Action programs were formulated and implementation of institutional reforms began.

Source: Kaufmann, Pradhan, and Ryterman (1998). For a detailed governance and anticorruption diagnostic implementation guide see http://www.worldbank.org/wbi/governance.

citizen "scorecard" user surveys allow citizens to evaluate the quality of local government services (box 6.2). In Campo Elias, Venezuela, thanks to the leadership of the mayor, a courageous woman who believes in the power of governance data to inform and mobilize for action, the reported incidence of corruption has been halved (Gonzalez de Asis 2000).

Box 6.2. "Voice" as a Mechanism to Enforce Transparency and Accountability

Client and citizen surveys that incorporate feedback from citizens have helped to improve public sector performance in many countries. The scorecard method pioneered by Sam Paul in Bangalore, India, embodies this approach. It entails periodic citizen evaluations of local municipalities and their accounts of public services, bribery, and extortion. Evidence exists that public agencies in Bangalore have taken concrete steps to improve service delivery.

In Mendoza, Argentina, citizens have participated in crafting transparent rules related to public procurement. A number of localities throughout the world have embraced similar participatory processes. As part of its pioneering system of participatory budgeting, Porto Allegre, Brazil, holds citywide assemblies where expenditure priorities for education, health, transport development, taxation, city organization, and urban development are discussed. The assemblies then elect members to a citywide participatory budgeting council, which decides the city's investment plan. Preliminary evidence shows that more roads have been paved and the number of students enrolled in primary and secondary school has doubled.

Increasingly, voice- and transparency-enhancing reforms are being furthered via the Internet revolution, and not only in areas such as procurement, discussed previously. In Chile, just during the past year, the share of the tax paying population filing tax returns over the Internet increased from 5 to 30 percent. Furthermore, the combination of the latest statistical, computing, and Internet technology is also promoting greater accountability in political elections, as witnessed recently in the extremely efficient, accurate, and speedy counts in Argentina, Chile, and Mexico, in sharp contrast with elections in a number of other countries.

Thus, data are powerful in mobilizing support for reforms, but the obstacles presented by grand corruption and state capture by vested interests resisting such reforms are also powerful. Therefore, political leadership, civil society, private sector investors, and the donor community need to build on the insights and momentum generated by the diagnostics and utilize and disseminate statistics in conjunction with promoting civil liberties and media involvement, and resulting in higher accountability and actions against corruption.

Transparency through Voice and Participation

Corruption can yield to knowledge and an informed citizenry. Indeed, the empowerment of civil society with more rigorous and reliable information is a key pillar of reform. Transparency is an important component of public empowerment and voice. As a result, policymaking and large public projects should be predicated on incorporating the voice and participation of stakeholders in development (see box 6.2 for a discussion of transparency and governance). Indeed, World Bank research shows that the greater the participation of beneficiaries in project design and implementation, the better the project and service performance.

Civil Liberties Matter

In previous sections in this chapter, we presented the close association between civil liberties and freedom of the press on the one hand, and control of corruption and state capture on the other (figure 6.7). Yet the paramount importance of civil and political liberties transcends its worth in lowering corruption, or merely as an "input" to a developmental outcome: it is a basic good that enhances welfare per se. At the same time, assessing whether civil liberties do matter as an input in developmental and financial outcomes is of relevance within the debate in the aid community regarding fiduciary responsibilities to make aid effective.

Evidence from more than 1,500 World Bank–financed projects suggests that civil liberties and citizen participation are important factors for development outcomes. Researchers focused on measuring the impact of participatory and civil liberties variables on project performance and found consistent, statistically significant, and empirically large effects of civil liberties on project rates of return. Depending on the measure of civil liberties used, if a country were to improve its civil liberties from the worst to the best, the economic rate of return of projects could increase by as much as 22.5 percentage points (table 6.2). Because these civil liberty indexes use different scales, a more standard method of comparison is to calculate how much the economic rate of return would increase if each index category were improved by one standard deviation. As seen in the last column of table 6.2, this still gives significant results, suggesting an impact of citizen voice on government performance. Moreover, the report *Assessing Aid* (World Bank 1998a) found that while both civil liberties and electoral democracy have beneficial effects on government performance, the main channel of influence is likely to be the availability of civil liberties.

In Rajasthan, India, a people's organization called Mazdoor Kisan Shakti Sanghathan held a public hearing where it exposed misappropriation by local governments of development funds intended for local workers. This generated village demand for further investigation into the government. Local governments, being under public and press scrutiny, were compelled to oblige. Corruption was reduced. The government of Rajasthan recognized the people's right to official documents and enacted landmark legislation (Bhatia and Dréze 1998) (see box 6.3).

Governments and citizen groups can elicit voice through surveys and data collection in more systematic ways. Client surveys can cast light on citizens' experiences with government services and identify suggestions for performance improvement. Follow-up surveys can be used to ensure accountability and ensure that improvements are in the desired direction.

Table 6.2. Impact of Civil Liberties on Project Socioeconomic Rates of Return

Civil liberties variable	*Specification on independent variables*				*Effect on economic rate of return of one standard deviation increase in civil liberties*
	With exogenous control variables only	*With regional dummies*	*With policy variables*	*With regional dummies and policy variables*	
Freedom House Civil liberties (1978–87)[a]	1.81	1.16	1.71	1.07	1.57
(N = 649)	(0.0005)	(0.079)	(0.002)	(0.114)	
Humana (1982–85)	0.290	0.299	0.296	0.289	5.19
(N = 236)	(0.003)	(0.007)	(0.002)	(0.013)	
Media pluralism (1983–87)	4.61	4.45	3.66	3.43	3.12
(N = 448)	(0.0001)	(0.002)	(0.001)	(0.026)	
Freedom to organize (1983–1987)	3.17	1.81	2.41	–0.26	2.70
(N = 448)	(0.0001)	(0.184)	(0.006)	(0.854)	

N = number of observations.

Note: Standard error is in parentheses. Average economic rate of return on projects is in the range of 12–16 percent.

Source: Isham, Kaufmann, and Pritchett (1997).

Generating data and disseminating them widely are potent instruments to mobilize civil society and apply pressure on political structures. For example, simple comparative charts illustrating findings on corruption can help mobilize and give voice to previously silent and disparate citizenry groups.

Toward a Social Contract: Facilitating Civil Society Oversight and Participation

Civil society oversight and participation over the decisionmaking and functioning of the public sector has been a crucial counterweight and instrument for combating corruption and improving governance. This involves making the state transparent to the public and empowering the citizenry to play an active role. While a few OECD countries have been in the forefront in transparency reforms, in many of the transition and emerging economies the public sector culture is still one of secrecy of decisionmaking. Often, parliamentary votes are not publicly disclosed, public access to government information is not assured, and judicial decisions are typically not available to the public. Moreover, despite a growing civil

Box 6.3. Millions of "Auditors" Improve Transparency and Governance in Budgetary Accounts and Beyond

Transparency means empowering the citizenry to become millions of auditors in society, providing voice and access to a free press. It enables the flow of timely and reliable economic, social, and political information about private investors' use of loans and the creditworthiness of borrowers, government service provision, monetary and fiscal policies, and the activities of international institutions. By contrast, a lack of transparency means that someone, such as a government minister, public institution, corporation, or bank, is deliberately withholding access to or misrepresenting information.

In general, a lack of transparency increases the scope for corruption by creating informational asymmetries between the regulators and the regulated entities. Corruption affects all major areas of public administration: revenue collection as a means of raising public funds and revenue allocation as a means of providing public goods. It affects public regulation as a means of mitigating information failures in markets, particularly capital markets. Recent empirical research of financial crisis episodes indicate that the likelihood of such crises was significantly larger where transparency was absent. In-depth governance diagnostics of public agencies discussed earlier within a country also suggest that agencies with transparent flows of information tend to exhibit lower corruption and better governance and performance overall.

society, the government typically does not involve NGOs in the monitoring of its decisionmaking processes or performances. Concentrated media ownership and recent restrictions on reporting have weakened the ability of the media to ensure accountability of the public sector.

Consequently, changing the culture to one of transparency involves a fundamental change in the way decisions in the public sector are made. The types of transparency reforms that have been demonstrated internationally to be effective include the following:

- Ensuring public access to government information (freedom of information)
- Requiring certain types of government meetings to be open to public observation
- Conducting public hearings and referenda on drafts, decrees, regulations, and laws
- Publishing judicial and legislative decisions and keeping a registry
- Ensuring freedom of the press by prohibiting censorship, discouraging use by public officials of libel and defamation laws as a means for intimidating journalists, and encouraging diversity of media ownership
- Involving civil society to monitor its performance in areas such as anticorruption and large-scale public procurements bidding

- Utilizing the new web-based tools on the Internet for transparency, disclosure, public participation, and dissemination.

Civil society's role ought to be seen as dynamic and providing an opportunity to political leaders intent on building the credibility of the state through its potential in coalition building and collective action. For instance, new activities in many countries where the World Bank provides assistance involve supporting the collective teamwork of civil society, the media, experts, the private sector, and the reformists in the executive and legislative branches in formulating governance and anticorruption reform programs. The process of involvement by the key stakeholders in civil society creates a momentum toward ownership and sustainability of the reforms and builds credibility, as is taking place in some countries in Eastern Europe, Africa, and Latin America, for instance.

Conclusions

Governance needs to be understood in a broader context than merely addressing corruption, which is a key symptom of more fundamental institutional weaknesses. Both governance and corruption need to be rigorously unbundled and understood analytically and empirically. Misgovernance distorts policymaking and the allocation of factors of production, which in turn slows income and welfare growth and increases poverty. The many failed capacity building approaches in the past did not pay enough attention to fostering good governance, to controlling corruption, to improving the bureaucracy and civil service, to promoting civil liberties and participatory approaches, to understanding the origins and consequences of state capture, or to furthering knowledge about the political economy of institution building. Governance needs to enter center stage in capacity building and institutional change strategies. Understanding of particular vested interests by different influential groups is needed—including the corporate sector (both domestic and FDI)—as is the recognition that *incentives, prevention, and systemic-change* challenges within institutions vitally affect governance, and are at least as important as traditional law enforcement aspects.

Governance, voice, and participation will be key for an improved approach to technical assistance and capacity building in the future. Improving governance should be seen as a process integrating three vital components: (a) knowledge, with rigorous data and empirical analysis, including in-country governance diagnostics and transparent dissemination, utilizing the latest information technology tools; (b) leadership in the political, civil society, and international arena; and (c) collective action via systematic participatory and consensus building approaches with key stakeholders in society (for which the technology revolution is also assisting). Collective responsibility also implies that transnational corporations, the domestic private sector, and international agencies need to collaborate with national governments and leadership intent on improving governance.

The evidence points to the need for a more integrated and comprehensive approach to provide a climate for successful development. Economic institutions and policy measures, such as the budget and the nature of public investment programs, are important, as are civil liberties and participation, with which they interact. This underpins the case for a more holistic approach to development that links economic, institutional, legal, and participatory variables.

Participation and voice are vital in increasing transparency, providing for the necessary checks and balances, and ameliorating state capture by the elite's vested interests. It is not enough to get basic economic policies right on paper; the political economy forces at play must also be recognized. These forces will vary from country to country. In some countries addressing legal, regulatory, and procurement reform will be necessary to improve governance and control corruption. In others, where state capture by the corporate elite and when there is weaker political will to reform, civil society oversight, enterprise competition, and working to improve property right protection could be key.

For an enhanced focus on poverty alleviation, a concerted approach that integrates rigorous empirical understanding of the governance challenges within a country, encourages active involvement by all key stakeholders, tailors it to the country's own realities, and is championed by the country's leadership is likely to bear fruit.

Notes

1. The plethora of indicators measuring various aspects of governance are ordinal; that is, they have a qualitative or subjective element. The data are nonetheless relevant. First, for some aspects of governance, these are the only kind of data available (and it is now possible to disentangle the "noise" from the "signal"). Almost by definition, hard data (numerical-cardinal) have until now been virtually impossible to obtain in a systematic format, and for those few governance dimensions where such cardinal data exist, they are accompanied by a large margin of error and/or methodological questions. Second, for many aspects of governance, survey results (even if they contain an element of perception) do matter at least as much as official data. For instance, if a

country's business sector regards the judicial system as an arm of the government and avoids using the courts, it will think twice about investment decisions. See annex 6 for details.

2. The asymmetry of the horizontal bars is explained by the differences in the variance inside each quartile. While differences in between countries are small in the first two quartiles, the differences are larger in the third and fourth.
3. The econometric methodology and its empirical application suggest that governance variables do affect different socioeconomic variables such as infant mortality, literacy, and income per capita in a *causal* way. However, having established that governance variables *jointly* do matter significantly for socioeconomic outcomes, care needs to be exercised in disentangling the independent causal impact on developmental variables of each single subcomponent of governance. Given the existence of multicolinearity among the various subcomponents of governance, it is possible that the observed impact of voice on infant mortality, for instance, is picking up by proxy other governance determinants such as corruption or rule of law. See also annex 6 for methodological details.
4. Hellman and others (see http://www.worldbank.org/wbi/governance).
5. Other factors in the empirical work on causes of corruption also appear to be important. As expected, income per capita and education are correlated with lower corruption when other factors are held constant. General developmental variables are often proxies for more specific determinants of corruption, such as the quality of public sector institutions or the rule of law (see Ades and Di Tella 1999 for a useful review).
6. Much of this section is owed to collaborative work with Sanjay Pradhan, Randi Ryterman, and the Public Sector Group. See also World Bank (2000h).
7. We owe much of this section on Public Expenditure Management to the work of Allistair Moon, Sanjay Pradhan, and Gary Reid.
8. In 1998 the head of government, cabinet members, and hundreds of civil society stakeholders participated in Albania's national governance workshop, which took place at the same time as the semifinals of soccer's World Cup in France. The workshop featured the main findings of in-depth diagnostic results and a debate on the priorities for action. It concluded with a commitment by the leadership to a progovernance program. Exemplifying the importance ascribed to it by the nation, on the next day the front pages of all the newspapers in Tirana featured charts showing the results of governance diagnostics, while the World Cup soccer results were relegated to the back pages. Albania is carrying out an anticorruption program, including judicial and customs reform, with support from the World Bank.