



Good Governance, Aid Modalities and Poverty Reduction: Linkages to the Millennium Development Goals and Implications for Irish Aid

**Research project (RP-05-GG) of the Advisory Board for Irish Aid**

The Advisory Board for Irish Aid  
An Bord Comhairleach do Chúnamh Éireann



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## Working Paper 3

# Corruption, Anti-corruption Efforts and Aid: Do Donors Have the Right Approach?

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## List of acronyms

ACA	Anti-corruption Agency
ACC	Anti-corruption Commission
AfDB	African Development Bank
BEEPS	Business Environment and Enterprise Performance Survey
BMZ	German Ministry for Economic Cooperation and Development
CEO	Chief Executive Officer
CPI	Corruption Perceptions Index (TI)
CPIA	Country Policy and Institutional Assessment (World Bank)
CRS	Creditor Reporting System (OECD)
CSO	Civil Society Organisation
DAC	Development Assistance Committee (OECD)
Danida	Danish International Development Agency
DFID	UK Department for International Development
DGCD	Belgian Directorate-General for Development Cooperation
EC	European Commission
EITI	Extractive Industries Transparency Initiative
GBS	General Budget Support
GDP	Gross Domestic Product
IDA	International Development Agency
IFI	International Finance Institution
IMF	International Monetary Fund
INT	Department of Institutional Integrity (World Bank)
IP	International Partner
KKZ	Kaufmann, Kraay and Zoido-Lobaton (WBI's governance index)
LIC	Low-income Country
MCA	Millennium Challenge Account
MP	Member of Parliament
NEPAD	New Partnership for Africa's Development
NGO	Non-governmental Organisation
Norad	Norwegian Agency for Development Cooperation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PEFA	Public Expenditure and Financial Accountability Programme (OECD)
PETS	Public Expenditure Tracking Survey
PISA	Programme for International Student Assessment (OECD)
PFM	Public Financial Management
PGBS	Partnership General Budget Support
PMU	Project Management Unit
SAP	Structural Adjustment Programme
SDC	Swiss Agency for Development and Cooperation
Sida	Swedish International Development Cooperation Agency
SSA	Sub-Saharan Africa
TI	Transparency International
TRA	Tanzania Revenue Authority
UK	United Kingdom
UN	United Nations
UNCAC	UN Convention against Corruption
US	United States
USAID	US Agency for International Development
VAT	Value-added Tax
WBI	World Bank Institute
WEF	World Economic Forum

# Executive summary

## 1. Introduction

This paper is an output from a two-year research project on the linkages between Good Governance, New Aid Modalities and Poverty Reduction for the Advisory Board for Irish Aid. The desire to improve aid effectiveness has meant that both governance and aid modalities have moved to the centre of development debates during the past decade. This has also led to corruption becoming more prominent in donor policies and programmes. This paper reviews the literature on corruption, anti-corruption efforts and aid, with a focus on: (i) tools for measuring corruption; (ii) the social science literature on the country-level causes of corruption and its relationship to poor governance; (iii) donor approaches to reducing corruption – both specific anti-corruption interventions and broader governance measures; and (iv) the debates and evidence on aid modalities and corruption.

## 2. Corruption: What is it and why is it a problem?

Corruption is the abuse of public office or entrusted power for private gain. In addressing corruption, it is useful to distinguish between various forms of corruption, such as political and bureaucratic corruption, and important to develop a clear understanding of how it relates to adjacent terms, such as rent-seeking. At the core of the concept of corruption is a moral and ethical dimension, which may be translated into legal provisions in various ways. Abuse of entrusted power as a principle tends to be recognised as a problem all over the world – as is reflected in a range of public opinion surveys *inter alia*. However, the actual practice of relating to corruption can vary, as is discussed in Section 4.

The effort to combat corruption can be based on different rationales – the drive for greater aid effectiveness and domestic legitimacy of aid and/or an understanding of corruption as ethically undesirable. In the current development policy discourse, a consequentialist approach is generally dominant. This focuses on the negative effects of corruption on growth on the one hand, and on distribution or poverty on the other hand (e.g. greater exclusion of the poor as a result of petty corruption). However, denouncing corruption exclusively because of its bad consequences makes the anti-corruption agenda vulnerable to partial – and possibly shifting – interpretations of empirical results.

An alternative is to take a duty-based approach, viewing corruption as wrong in itself. Corruption involves deception and undermines the moral and rational capacities of citizens and societies. Thus, even if substantial corruption were not undermining economic growth or poverty reduction, there is still considerable cause to combat the phenomenon. Corruption undercuts the moral fabric of society; this is reflected in the fact that societies all over the world tend to regard corruption as fundamentally wrong – even if it is accepted as a fact of life. Such an enhanced understanding of corruption can add justification to and inform anti-corruption policies in important ways.

## 3. Measuring corruption

Important advances have been made in measuring corruption over the past 10 years. The best known measures – Transparency International's Corruption Perceptions Index and the World Bank Institute's KKZ indicator Control of Corruption – are quantitative aggregates. They reflect the

overall degree of corruption perceived to exist in a country, and provide a degree of cross-country and inter-temporal comparability.<sup>1</sup>

While broad measures are useful for informing the policy debate and for enabling quantitative research on the causal chains around corruption, they are by themselves insufficient to inform the operational work of donors in the field of governance and anti-corruption. Thus, more detailed qualitative information is needed, both to help validate quantitative indices and, more importantly, to support specific anti-corruption activities. However, thus far, the qualitative information needed to inform operational work has remained scarcer. There are as yet few frameworks available for collecting such information in a systematic way.

Furthermore, it is important that donors are well informed about what the various corruption measures actually capture, and what their limitations are. This is also important for assessing the validity of studies showing some causal relations between corruption and development outcomes (see also Work Package 5 on other governance indices). If this caution is not exercised, there is a risk of drawing sweeping policy conclusions from studies with relatively uncertain empirical bases.

There can be important contradictions between different corruption indices. In particular, ‘facts-based’ indices, such as the Global Integrity Index, can come to conclusions that are quite different from ‘perception-based’ measures. ‘Perception-based’ indices are better at capturing ‘how things really work’; facts-based assessments can be misleading in this regard, as they are strongly focused on the formal institutional environment. Nonetheless, ‘facts-based’ analysis of corruption is important as well, in particular providing information about what formal anti-corruption instruments are in place in a country.

In general, looking at measured corruption, it is quite clear that donors have to work in relatively corrupt environments if they are to work in very poor countries at all. At the same time, donors cannot set aside corruption as part of the ‘inevitable context’ of providing aid. Work Package 5 of this series explores how governance and corruption indices can and are being used to guide aid allocation decisions.

#### **4. Causes of corruption**

A triangulation of perspectives from political science, anthropology and economics is highly useful in identifying key challenges for anti-corruption efforts. Although the focus of the three perspectives is different, a great deal of convergence emerges between the disciplines in their understanding of the main drivers of corruption. The political science and economic perspectives on corruption both stress the importance of institutions and incentives, suggesting that corruption thrives in conditions where there is too little accountability and where actors have too much monopoly and discretion. Political science and anthropology both emphasise the importance of informal institutions and practices in shaping corruption outcomes. The importance of social norms in relation to corruption is studied by both anthropology and recent economic research.

The combined literature supports the view that the causes of corruption are complex and multifaceted, providing the underlying message that anti-corruption strategies will also need to be so. The main messages are summarised below.

1. The impact of institutions on opportunities, incentives and corrupt behaviour is highlighted by political science as well as by economic theories. Consequently, anti-corruption programmes have emphasised the importance of institutional reform that increases political and economic competition (e.g. democratisation and economic liberalisation) and strengthens accountability and the enforcement of rules (e.g. public financial management (PFM), civil service reform,

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<sup>1</sup> As is discussed in Section 3, the issue of inter-temporal comparability is particularly problematic, owing to changes in methodologies and the density of underlying data over the years.

support to societal or state watchdogs, rule of law, etc.) However, this focus on formal institutions may be too limited.

2. Political economy analyses suggest that the dysfunction of formal institutions is principally explained by their suffusion with informal norms and practices, such as personalism, clientelism and other forms of social exchange and obligations. This multiplicity of incompatible rules increases the opportunity for corruption and, in some circumstances, its perceived need and legitimacy. Informal practices, including personalism, appropriation of state resources and patronage, have played a key role in elite strategies for maintaining power and legitimacy. There is evidence that, by making elites less secure, political liberalisation has increased reliance on political clientelism and corruption. Elites will generally only support reform processes – including the consolidation of formal institutions – if they do not undermine their ability to retain power, and will instrumentalise reform processes that do not serve this purpose. It is therefore important to identify reforms that provide political gains for government as well as benefiting society. The systemic drivers of corruption that link petty and grand corruption also mean that public sector reform is unlikely to be effective in countries where there is entrenched political corruption.
3. Furthermore, empirical evidence suggests that corruption tends to become more prevalent in countries undergoing political and economic transition (relative to authoritarian regimes or more mature democracies). It is thought that this is because formal institutions – such as those underpinning vertical, horizontal, societal and public management accountability – are not functioning as intended and are weakly integrated in a situation of major change. The opportunity for corruption is increased when authoritarian controls are not replaced with effective democratic checks and balances in transition and/or hybrid regime situations.
4. Anthropology provides key insights into socio-cultural norms, their relationship to corruption and their relevance for the everyday strategies of citizens in sub-Saharan Africa and poor countries in other areas. Ethnographic evidence suggests that informality is common in some African administrations. The uncertainty this creates forces all actors to adopt defensive strategies based on personalisation and social networks and exchange to meet their material and social needs. These conditions favour corruption because they blur the boundaries between public and private spheres and influence perceptions regarding legitimate behaviour. The widespread nature of informality also creates a culture of indebtedness that marginalises reformers and makes working within formal rules costly. Tackling petty corruption requires addressing the informal counterculture and hierarchies prevalent in such bureaucracies. Anthropology suggests that socio-cultural norms are dynamic, changing alongside other processes of economic and political transformation. However, anthropological accounts of corruption are long on description and short on prescription. More research is required to understand how norms change, but directly influencing them is likely to be difficult.
5. The role of private agents in corruption has been neglected relative to public officials. As indicated in Section 2, a main problem with corruption is that it distorts the choices of economic agents. Decisions about whether to engage in rent-seeking/corruption or productive activities (such as starting a business) are influenced by their relative profitability. An implication is that effective anti-corruption efforts may be less about governance and more about private sector development (e.g. protecting property rights, easing entry and expansion of firms, improving financial institutions, increasing market size, etc.) In other words, the traditional donor focus on corruption as a problem of accountability and poor governance may be too limited. Although most donors already have large private sector programmes, these are not designed explicitly to curb corruption.
6. The lack of attention given to private agents – both companies and private citizens – means that the supply side of corruption has also been neglected. Donor country initiatives, in the areas of corporate social responsibility generally and anti-corruption specifically, have tended to emphasise voluntary initiatives and laws, which will likely produce only modest results. The

next generation of measures to improve corporate social responsibility and reduce corruption should focus on incentives, through policies that directly affect the bottom line of companies. For instance, coordinated procurement policies where corrupt companies are barred from bidding would make it costly for companies to be corrupt, and hence have a tangible effect on corporate conduct.

## **5. Anti-corruption and governance reforms**

A range of donor-supported reforms are aimed at improving governance in general and reducing corruption in particular. The specific reforms covered in this report include: democratisation, public financial management (including revenue and expenditures), grassroots monitoring and support for civil society, and support to the media. These types of reform can be viewed as attempts to improve vertical, horizontal and managerial, and societal accountability, respectively. This could, in principle, have an effect on corruption.

Several points emerge:

1. The reforms pursued have often had rather disappointing effects on corruption. In fact, the limited impact on corruption of the specific interventions discussed here is closely linked to the perspectives drawn up in Section 4. Donors have tended to focus on technical reform to formal institutions, paying too little attention to the interests, incentives and informal interactions of implementing parties. When not in the interests of local elites, reform is implemented partially or not at all, and frequently circumvented. PFM reform is a case in point, with exemptions to taxes and formal procurement procedures being all too common.
2. There are a number of gaps and disparities in current donor efforts in the areas of governance and anti-corruption. Efforts at improving PFM are assumed to reduce corruption but, within many PFM activities, corruption is not explicitly addressed as an issue. This is also reflected by diagnostic tools, such as the PEFA framework, which do not explicitly capture corruption and tend to focus on formal institutions.
3. Work on democratisation and anti-corruption should be more closely integrated, as the fields can be mutually influential. In a neopatrimonial context, certain types of reform can also have unintended consequences. Incomplete democratisation processes may increase corruption, owing to increased patronage to acquire or maintain power, or costly election campaigns that invite corruption. At the same time, political liberalisation can be an important enabling condition for other anti-corruption efforts.
4. It is challenging for donors to address the informal dimensions and practices (e.g. patronage networks) that contribute to problematic governance environments. There are emerging efforts at the international level that aim to influence norms (such as the World Ethics Forum organised in 2006). More imaginative and innovative approaches can be sought at country levels. Supporting grassroots monitoring also aims to change practices on the ground.
5. In considering a specific area of reform, it is important to assess whether the conditions are in place that would make it effective in reducing corruption. Notably, grassroots monitoring and civil society are more effective when directed at private rather than public goods, and when broadly representative rather than captured by local elites. For instance, in the case of road-building in Indonesia, strengthening managerial accountability (introducing more effective audits) proved a stronger deterrent for overall corruption than grassroots monitoring.
6. The various efforts to reduce corruption are likely to be complementary. For example, promoting media freedom can help to foster civil society scrutiny of government activities; PFM reforms can help to make government accounts clearer and more accessible. Democratisation in turn creates the public space for civil society to become engaged. Anti-

corruption agencies (ACAs) are likely to be more efficacious if judicial sectors can be reformed in parallel than in a situation where ACAs are 'on their own'. At the same time, those pursuing anti-corruption efforts may want to think about priorities and opportunities related to corruption in specific areas.

7. Donors need to invest more in evaluating and understanding 'what works'. Across all areas of anti-corruption efforts, there is a lack of systematic study of effectiveness. This issue is explored to some degree with regard to ACAs (which have been found to be rather ineffective) and to the emerging general proposition that democratisation as such is insufficient for reducing corruption. There is still considerable need for careful evaluation and lesson-learning, for example, around the effects of public procurement reform, or ways to support the media in such a way as to make it an efficacious player in governance reforms.

Overall, while the idea of various forms of accountability (vertical, horizontal, societal, managerial) is conceptually well developed and has increasingly found its way into aid policies, the actual strengthening of these various forms of accountability still poses considerable challenges.

## **6. Corruption and aid modalities**

Budget support is preferable to other aid modalities if it more effectively promotes development and/or institutional reform in partner countries. This section reviews the information that analytical arguments and empirical studies provide on: (i) the prevalence of corruption in relation to various aid modalities, and the degrees to which corruption distorts the developmental impact of different aid modalities; and (ii) whether aid modalities affect the governance environment and corruption in a country differently.

In summary, the conclusions are:

1. From a theoretical perspective, for countries in which aid is fully fungible, the choice of aid modality does not affect aid allocation or accountability. If budget support saves on transaction costs, it is therefore a better choice than project support, regardless of the level of corruption.
2. Where aid is imperfectly fungible, donors have some more control over aid allocation with project than with budget support. Where this is the case, *and* corruption is high, there are three reasons for not choosing budget support as an aid modality: the reputational risk (and the increased likelihood that budget support would have to be suspended at some point), the higher risk of budget allocation decisions being driven by rent-seeking motives, and the fact that making budget support available regardless of performance reduces the incentive character of budget support. However, there is little clear guidance available with regard to cut-off points (i.e. at which level of corruption do the risks outweigh the benefits).
3. The challenge facing donors is to draw a line between countries that are considered 'too corrupt' and those that have 'acceptable' levels of corruption. For most donors, the overall governance situation – including respect for human rights, civil and political freedom, commitment to development – will be decisive, rather than corruption on its own.<sup>2</sup> Most developing countries fall into the bottom third of the most widely used governance indices (WBI/KKZ and TI/CPI); the level of corruption is not the only dimension that matters in the decision matrix (so its weighting relative to other factors is also an issue). Developing guidance is important; such guidance could be reviewed as further/better evidence becomes available.

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<sup>2</sup> The MCA uses level of corruption as an overriding criterion, i.e. a country is ineligible for MCA funds if it falls into the bottom half with respect to corruption among its 'peer group' (defined in terms of income level). However, the MCA is designed as an 'additional' amount of aid, or an 'incentive tranche' (in EC jargon), and thus the mechanisms it uses could not be transferred one-to-one to aid in general.

4. Available evidence suggests that the corrupt misuse of aid (and of budget) funds is a risk when project aid is used and when budget support is being used. Thus, when project aid is being used as a preferred modality in highly corrupt environments, sound but sensible corruption safeguards will certainly be necessary (e.g. ensuring that results are being achieved; introducing effective controls without over-bureaucratising the aid disbursed through projects).
5. The claim that budget support is likely to increase domestic accountability needs to be revisited (part of this research is covered in Work Package 6). The effect on domestic accountability appears to depend on the strength of the government compared with the groups and institutions that hold it to account. Budget support seems most problematic in countries that are highly corrupt and have an oppressive government – in such cases, there is the greatest risk that allocation decisions are driven by rent-seeking motives, and that budget support enhances the power of the incumbent government in ways that may reduce rather than enhance domestic accountability.
6. Budget support increases government ownership over aid resources. At the same time, budget support can increase external accountability with regard to the budget as a whole. Whether greater government ownership over aid leads to better overall accountability and less misuse of funds appears to depend on the domestic political economy landscape and the strength of the various components of the domestic accountability system (vertical, horizontal, societal and managerial – as discussed in Section 5) as well as on the political economy of the aid relationship.
7. On aid modalities and anti-corruption efforts, donors providing budget support may have a greater incentive to support the reform of country PFM systems and of wider country governance (because these are essential to ensure that their aid will be used well, and because of the greater reputational risk to donors). Recipient countries may have an incentive to ‘show’ effort (to ensure the receipt of budget support), but not necessarily to follow through. Available evidence suggests that budget support has been associated with progress on technical issues, such as PFM reform. At the same time, it seems unlikely that budget support can ‘buy reform’ not in the interests of domestic actors. Further progress on reforms may be related to the balance of effects on domestic accountability. This underscores the points made in Section 4, about the importance of analysing interests and informal interactions rather than just formal institutions.
8. The increasing emphasis in the donor community on budget support has not been matched by similar efforts to evaluate empirically the impact and effectiveness of this type of aid. In particular, there are no empirical studies that systematically and thoroughly evaluate the implications of corruption for the effectiveness of different aid modalities. Further research is needed to address these issues systematically, which would produce more information on ‘cut-off points’ and the relative importance of corruption compared with other aspects of governance.

# 1. Introduction

This paper provides a review of the literature relating to corruption, anti-corruption efforts and aid. The past decade or so has seen corruption move to the centre of the development arena, with debate intensifying more recently. In general, donors can attempt to reduce corruption in four key ways: through (i) direct support to anti-corruption efforts, (ii) support to wider reform efforts and change processes, (iii) ways of providing aid (aid allocation, choice of aid modalities, controls and accountability linked to aid), and (iv) support for activities at the international level (including the national level in donor countries).

This paper focuses on the first three of these and is structured as follows. Section 2 introduces the debate, reviewing key definitions and typologies of corruption and discussing why donors should be concerned. Section 3 looks at existing tools for measuring corruption, both quantitative (indices) and qualitative. Section 4 discusses how different strands in the social sciences (political science, anthropology and economics) look at the causes of corruption. Section 5 is devoted to various approaches that donors have adopted to help reduce corruption in developing countries. It looks both at specific anti-corruption interventions and at broader efforts to improve governance focusing on democratisation, public financial management (PFM) reforms, grassroots monitoring and civil society and the media. Section 6 explores the relationship between aid modalities and corruption. It focuses specifically on how considerations of corruption should affect the choice of budget support as an aid modality, summarising existing arguments and relevant empirical evidence. Section 7 concludes, distilling some of the implications relevant for donor policy and areas where further analysis is needed in order to develop more evidence-based policy.

Some limitations should be noted. Firstly, and importantly, the report focuses on corruption issues within developing countries and does not discuss the wider international context – that is, (iv) above. Actions taken by developed countries, both individually and as part of the international community (for instance, those which address the relevant incentives and controls in donor agencies or the role of Northern-based banks and tax havens), are extremely important if corruption within developing countries is to be curbed, but are beyond the scope of this paper. Nevertheless, the Advisory Board for Irish Aid may want to take a stance on Ireland's own treatment of corruption and its efforts to tackle the bribery of foreign officials. Ireland's record of implementing the OECD's (Organisation for Economic Co-operation and Development) Anti-bribery Convention has been patchy and it has signed, but not yet ratified, the UN's Convention against Corruption (UNCAC).<sup>3</sup>

Secondly, this is not a detailed study of donor interventions in country. The paper highlights the desirability of field-based assessments of donor anti-corruption approaches but, in defining the scope of this research, it was decided to carry out only a desk-based study. Thirdly, where relevant, the paper has more of a focus on Africa than other regions, because this is where all but one of Irish Aid's partner countries are situated.

Finally, with regard to policy implications, it is important to keep in mind that drawing these from a review of existing studies and knowledge is challenging in itself, and needs to be done with care (this is not always the case). For example, although a more liberal media is correlated with lower levels of corruptions, a simple donor intervention – such as promoting a liberal media law – may not have much effect. Crucially, there need to be interactions across the social and political system (free media may need to be complemented by a civil and political society willing and able to follow up on allegations): several conditions have to change before there is a noticeable impact on corruption. Furthermore, many donor interventions aiming to achieve changes in formal institutions (media laws, procurement laws, asset declaration laws etc.) are often not implemented in practice as intended, or are in tension with prevalent informal institutions. Therefore, even though it may be

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<sup>3</sup> See the recent OECD report at [http://www.oecd.org/department/0,2688,en\\_2649\\_34859\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,2688,en_2649_34859_1_1_1_1_1,00.html) and also [http://www.unodc.org/unodc/crime\\_signatures\\_corruption.html](http://www.unodc.org/unodc/crime_signatures_corruption.html).

possible to develop a better understanding of the *features associated with* lower levels of corruption, this does not automatically translate into knowledge on how a society arrives at these conditions, let alone how donors can help in this process in a particular country at a particular time.

This paper is part of a wider research project commissioned by the Advisory Board for Irish Aid to consider linkages between Good Governance, Aid Modalities and Poverty Reduction. Other aspects of governance are discussed in Work Package 1 (on the role of donors in democratisation), Work Package 2 (on the impact of domestic neopatrimonial politics on public sector reform/decentralisation) and Work Package 5 (on measuring governance), as well as Work Package 4 (on NEPAD). Some of the themes of this paper will be picked up on and explored further in the synthesis report.

## 2. Corruption: What is it and why is it a problem?<sup>4</sup>

### 2.1 Definitions and typologies of corruption

In order to be able to analyse corruption, the phenomenon must first be defined and delimited. The dimensions we choose to include in the concept of corruption affect the causes and preconditions that need to be considered, and therefore the responses that may be required. As a result, how corruption is defined, i.e. what is included and/or excluded, has important implications for approaching the problem and for the profile and priorities of policies to address it.

A standard definition of corruption, endorsed and applied by the World Bank (World Bank/IMF, 2006), among others, is the abuse of public office for private gain. This definition covers various forms of interaction between public sector officials and other agents. Sometimes, money is involved, such as in bribery or kickbacks for public procurement contracts. In other cases, private gain can be non-monetary, as in cases of patronage or nepotism. The definition also covers acts where there is no interaction with external agents, or where external agents are not explicitly implicated, such as the embezzlement of government funds, or the sale or misuse of government property.

An alternative definition, used by Transparency International (TI), sees corruption as the misuse of entrusted power for private gain.<sup>5</sup> In contrast with the former definition, which includes only acts involving public sector officials, the TI definition also covers similar acts in the realm of the private sector. For example, if a subcontractor bribes an official of another company to obtain a contract, this would count as corruption. In addition to public sector corruption, then, the TI definition includes private-private corruption. This type of corruption is highly understudied, despite the fact that it may reduce private sector efficiency and hence slow development. In addition, the implications for donors of this type of corruption have not been adequately explored. Unfortunately, these issues lie outside the scope of this paper, which must deal purely with corruption involving public sector officials.

Corruption and rent-seeking are not the same, although the two terms are often used interchangeably. Rent-seeking is the socially costly pursuit of rents (Svensson, 2005), for instance monopoly rents or rents from natural resources. There is a degree of overlap, whereby some acts of rent-seeking would also qualify as corruption. However, rent-seeking does not necessarily entail misuse of position or power. In some borderline cases, activities may entail a legitimate pursuit of a more equitable distribution of available rents, for instance.

The definition of corruption as abuse of public office has been criticised as excessively legalistic and as based on a Western ideal of separation of the public and private that does not fit the cultural context of many developing countries. In regard to the former criticism, the idea of abuse of office certainly implies deviation from a standard; however, it does not follow from the definition itself that the standard is a legal one. The standard could just as well be a moral one, whereby the proper role of office holders is derived from fundamental ethical principles. The definition therefore does not in itself depend on legal rules which may be incomplete or incidental.

The second criticism is a matter of application rather than substance. Certainly, the way the definition is applied by donors has sometimes been informed by a Western idea of public office. However, the definition does not in itself refer to a specific idea of public office. In general, any well functioning society must see some productive allocation of tasks if it is to reap the benefits of organisation and specialisation. This implies, *inter alia*, the assignment of responsibilities to some individuals to look after and pursue the interests of other individuals. In principle, abuse of public

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<sup>4</sup> This section was written by Ivar Kolstad.

<sup>5</sup> See [http://www.transparency.org/news\\_room/faq/corruption\\_faq](http://www.transparency.org/news_room/faq/corruption_faq).

office or entrusted power can refer to deviations from behaviour consistent with these assignments of responsibility: insufficient weight is given to the interests of others compared with the self-interest of the individual appointed to promote the interests of others. Corruption can in this sense be viewed as a violation of the basic characteristics of any well ordered society.

Various typologies of corruption have been suggested. For the purposes of this paper, the commonly used distinction between political corruption and bureaucratic corruption is helpful.

Political corruption takes place at the highest levels of political authority (Andvig and Fjeldstad, 2001). It involves politicians, government ministers, senior civil servants and other elected, nominated or appointed senior public office holders.<sup>6</sup> In other words, political corruption is abuse of office by those who make the rules of the game, e.g. decide on laws and regulations and the basic allocation of resources in a society. Political corruption may include tailoring laws and regulations to the advantage of private sector agents in exchange for bribes, granting large public contracts to specific firms, or embezzling funds from the treasury. The term 'grand corruption' is often used to describe such acts, reflecting the considerable sums of money that are frequently involved.

Bureaucratic corruption takes place at the implementation end of public policies. It involves appointed bureaucrats and public administration staff at the central or local level. In simple terms, it entails corrupt acts among those who implement the rules made by top officials. This includes interaction with private agents, such as demanding extra payment for provision of government services, speed money to expedite bureaucratic procedures, or bribes to allow private actions that violate rules and regulations. It also includes interactions within the public bureaucracy, such as bribes or kickbacks to obtain posts or secure promotion, or mutual exchanges of favours. This type of corruption is often referred to as 'petty corruption', reflecting the small payments often involved, although in specific cases and in aggregate the sums may be large.

Political corruption and bureaucratic corruption are clearly interrelated. There is evidence that corruption at the top of a bureaucracy increases corruption at lower levels (Chand and Moene, 1999). However, there are differences between the causes and consequences of political corruption and those of bureaucratic corruption. The priorities and means with which to approach each type may therefore be different.

## ***2.2 Why should donors care about corruption?***

Why should donors care about corruption in developing countries? And why should they commit scarce resources to combating it? There are at least two ways to approach these questions. One is to argue that it is in the interest of aid agencies to take an active stance on corruption. In other words, donors should pay attention to corruption issues for instrumental reasons. Another approach is to argue that corruption is ethically wrong and hence undesirable from a social point of view. In this case, the argument for donor anti-corruption efforts is fundamental rather than instrumental.

### **2.2.1 Corruption is bad for donor business**

The instrumental case for donor anti-corruption efforts is fairly straightforward. In the domestic debate on international aid, corruption in partner countries is frequently used as a reason to cut aid budgets. The following excerpt comes from the public debate in Ireland, but similar sentiments are voiced in most donor countries (John O'Shea, Irish Times, 9 December 2004):<sup>7</sup>

Giving millions to regimes known to be corrupt and with dreadful human rights records is, at the very least, a waste of taxpayers' money and sometimes tantamount to collusion in criminal activity.

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<sup>6</sup> See <http://www.u4.no/themes/political-corruption/main.cfm>, also for a more extensive discussion of definitions.

<sup>7</sup> See <http://www.globalpolicy.org/nations/laundry/general/2004/1209aidcorrupt.htm>.

On the one hand, these types of arguments may appeal to the selfishness and xenophobia of voters, and are basically populist in nature. On the other hand, they point to some real dilemmas involved in giving aid to countries whose governments are non-benevolent. When aid ends up in undeserving hands, its effectiveness is reduced. This may result in legitimate questions on optimal aid levels and effective use of domestic taxes. In any case, aid agencies that require public funding for their continued existence would be well advised to take issues of corruption seriously.

Ultimately, though, aid agencies should pay attention to corruption because it is the right thing to do, rather than just the smart thing to do. The fundamental legitimacy of donor anti-corruption efforts derives from the perspective that corruption is ethically wrong. Unfortunately, the ethics of corruption is an understudied area. Nevertheless, some inferences about the ethics of corruption can be drawn from basic theories of ethics. Here, it is instructive to focus particularly on consequentialist ethics and duty-based ethics, which have been dubbed 'the great contending tribes of modern moral philosophy' (Goodin, 1988).<sup>8</sup>

### **2.2.2 Corruption has bad consequences**

From a consequentialist perspective, an action or practice is ethically wrong if it has bad consequences. According to this perspective, one should thus pursue actions and practices that produce the best possible state of affairs, and avoid actions and practices that prevent this state of affairs from being attained. There are several types of consequentialism, which differ in their views of what are bad and good consequences, and how to characterise the best state of affairs. The best known consequentialist theory is perhaps utilitarianism, which judges an action or practice according to its impact on the sum of happiness or utility across all individuals.

From a consequentialist point of view, then, corruption is wrong if it has bad consequences. The argumentation of the donor community in relation to corruption seems to be based primarily on this line of thinking. Corruption is perceived to be an undesirable phenomenon because it retards development. Corruption is believed to reduce investment and growth and to have a disproportionate effect on the poor. More generally, corruption may create serious distortions in the economy. In particular, 'corrupt officials distort public sector choices to generate large rents for themselves', resulting in 'too many of the wrong kind of projects' (Rose-Ackerman, 2002).

Whether corruption actually has such undesirable consequences is an empirical question. A number of empirical studies have been conducted on the consequences of corruption, with varying results. An important set of studies considers the effect of corruption on economic growth. Micro-level econometric studies and case studies suggest that corruption can seriously reduce growth. For instance, in two studies of Ugandan firms, (i) Svensson (2003) finds that corruption increases costs by on average 8%, and (ii) Fisman and Svensson (2007) find a significant negative relation between bribery payments and firm growth. Macro-level econometric studies do not, however, find a robust relationship between corruption and growth, and are therefore inconclusive (Svensson, 2005). There seems to be a significant gap between micro- and macro-level studies on the effects of corruption, making it hard to draw general conclusions in this area.

Although it is likely that corruption has bad consequences, it is harder to prove causal effects and to reveal the more complex interaction between factors that link corruption to development outcomes. There are different ways to interpret cross-country variations in terms of corruption and its relationship with income. Khan (2004) argues that the correlation between level of corruption and growth on a cross-country basis does not capture the historical path of development for most nations. He therefore suggests that 'good governance – in the sense of less corruption and deeper democracy – is typically an outcome of successful economic development' rather than a

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<sup>8</sup> Arguments against corruption can also be found in virtue ethics and in social contract theory, as expounded by Dunfee and Donaldson (2002) and Rose-Ackerman (2002).

precondition of growth. This hypothesis has yet to be subjected to rigorous empirical testing (which could in principle be done with time series data).

These different theoretical views and the partial inconclusiveness of empirical studies underline some of the implications of using consequentialist arguments as a basis for donor anti-corruption efforts. Firstly, identifying the impacts of corruption is an ongoing process, with gradual accumulation of knowledge as new empirical evidence is added to the mix. In addition, there will be disagreements as to how to weight and interpret different pieces of evidence. More credit may be given to individual studies than their scientific quality merits. The basic point is that policies based on consequentialism must be based on empirical evidence. If evidence is incomplete, or subject to errors of interpretation, manipulation or fads, the resulting policies to combat corruption may be inconsistent, time-varying and fickle.

There are also more fundamental objections to a consequentialist approach to corruption. Consequentialism essentially implies that the end justifies the means. If new evidence turned up saying that corruption had good consequences, we might tolerate or even encourage it. Moreover, this perspective implies a trade-off of consequences – permitting bad consequences if they are accompanied by or outweighed by good consequences. So, in principle, a policy that leads to massive corruption could be justified if it leads to a marginal improvement for the poor. Those are implications that go against the moral intuition of many people.

### 2.2.3 Corruption is wrong in itself

Duty-based, or deontological, ethical theory takes a quite different approach. According to this perspective, actions or practices are ethically right or wrong depending on the characteristics of the actions themselves, rather than their consequences. Stated differently, duty-based theories argue that certain actions are wrong in and of themselves, irrespective of their consequences. The best known duty-based theory is perhaps Kantianism. The test of whether an action is permissible under Kantian ethics is called the categorical imperative, which comes in three versions, the second of which is: 'Always treat the humanity in a person as an end, and never as a means only'.

This implies that one should refrain from actions that involve coercion or deception, and that one should act in ways that contribute to developing the rational and moral capacity of others (Bowie, 2002). In simple terms, for the members of a society to be able to make moral decisions, their thought and action should not be constrained through force or deception, and their capabilities for making moral and rational decisions should be enhanced.

Corruption is by its nature hidden, and therefore involves a form of deception. Public officials abusing their position deceive the public whose interests they are elected or appointed to secure. Firms that bribe public officials similarly deceive the public or competing firms. Some forms of corruption, such as extortion of the private sector, also involve a degree of coercion. With a prevalence of hidden agendas and arbitrary decisions, the rationality of decision-makers is also undermined. And since corrupt acts by definition mean giving priority to the self-interested over the 'other-regarding', the ability of agents to make moral choices may also be impaired.<sup>9</sup>

Within a duty-based perspective, one can thus argue that agents have a duty to refrain from corrupt acts. This duty is based on corruption being wrong in itself, not on the existence of adverse consequences. It entails absolute restrictions on behaviour: corruption cannot be tolerated or traded off for some other end. On the face of it, these arguments imply that only *participation* in corrupt acts is wrong: donors should take care not to be implicated in such types of acts. But do donors also have a duty to address the corrupt acts of others?

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<sup>9</sup> See Williams (1993) for a refutation of the position that self-interest can be a basis of ethical theory.

In the literature on rights, it is pointed out that, for rights to be secure, there need to be correlative duties of two kinds: (i) negative duties – not to violate rights through one’s own actions, and (ii) positive duties – to create and contribute to schemes of rights protection and to aid those deprived of their rights (Shue, 1980). Negative duties are universal, and correspond here to the idea that everyone has a duty not to coerce or deceive others. Positive duties correspond to the duty to develop the moral and rational capacity of citizens and decision-makers in developing countries. These positive duties fall primarily to developing country governments. However, where governments fail to fulfil these obligations, other agents, including the donor community, have a secondary to step in. To promote the ability of the populations of ‘corrupt countries’ to make rational and moral choices, donors should therefore support efforts to combat corruption.

In contrast with consequentialist accounts of corruption, the duty-based evaluation of corruption does not depend on empirical evidence. By implication, it provides a basis for a stancher, more consistent position on corruption, one that is less vulnerable to manipulation. These advantages notwithstanding, the choice of an ethical basis for donor anti-corruption efforts may ultimately be a question of outlook. However, the consequentialist position that donors implicitly assume should at least be questioned, and the alternatives considered. Changing basic perspectives on why corruption may be ethically objectionable would also entail changes in priorities in anti-corruption policies. It is, however, beyond the scope of this report to explore these in detail.

#### **2.2.4 Is corruption a relative thing?**

The argument is sometimes made that what is morally right depends on context. Corruption, it is suggested, is acceptable in countries where it is a commonly practised or culturally permitted. The following quote presents an extreme version of this argument (John Hembry of Saxmundham, Suffolk, Letters to the Editor, Daily Telegraph (UK), 26 June 2000).

Having been involved in exporting to various countries in the Middle and Far East and in Africa, I have bribed government ministers and officials of all grades, in the form of cash payments, commissions, introductory fees, new cars, hospital treatment and so on for more than 40 years. If I were not now retired I would continue to do so. That is the way one does business in those places ... We expect people from overseas to conduct their business affairs in this country according to our laws and customs; it is both grossly impertinent and extremely naïve to suggest that we should not then respect their customs and conduct ourselves in their country as they would wish ...

This is a grossly oversimplified representation of corruption, based on a weak ethical argument. It is commonly accepted in ethics that one cannot derive an ‘ought’ from an ‘is’; in other words, just because people act in a certain way, one cannot infer that they are right to do so. So existing cultural practices are not necessarily a good ethical guide. In fact, they may in certain cases be a particularly poor one. Custom and practice are often defined and shaped by the powerful in a society, who may be more or less representative of and accountable to the population in general. The way in which a particular society works can therefore reflect the interests of the rich and powerful rather than any reasonable conception of the common good. This is a particularly apt description of many countries with a high level of corruption, where the rules and practices have been expressly designed to allow the elite to siphon off society’s riches. The relation between the customary and the morally right is therefore too flimsy to provide a defence for corruption. Moreover, the idea that ‘they’ would wish corrupt acts to take place is also unjustified; corruption is widely unpopular even where it is common.<sup>10</sup>

These matters can also be discussed with more explicit reference to ethical theory. Consequentialist and duty-based theories have been criticised as being too demanding. These theories in principle ask that everyone be treated equally, that everyone be afforded an equal

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<sup>10</sup> The puzzle presented by corruption being denounced in word rather than deed and in others rather than in oneself (cf. Sardan, 1999) is considered in more detail in Section 4.3.

standing in moral calculations, or that everyone be awarded equal rights. They thus abstract from personal attachments or relations of any kind. This critique has given rise to communitarian ethics, which sees humans as 'partly defined by [their] relationships and the various rights, obligations, and so forth that go along with these, so these commitments themselves form a basic element of personality' (Miller, 1988). In other words, we are embedded in a social and cultural setting to such an extent that reducing the level of commitment to one's community would be similar to changing one's identity.

The implication drawn from these arguments is that it may be permissible for us to give certain individuals preferential treatment, i.e. we may have special duties towards certain individuals that we do not have to others. For such preferential treatment to be legitimate, however, it must be given to people with whom we are in a certain kind of relationship, a relationship that is an essential component of our identity. Only certain types of relationships therefore have moral significance. Miller (1988) argues that the relationship or, more generally, the community in question be 'constituted by the shared beliefs of a set of people' that: (i) they belong together, (ii) their association is neither transitory nor instrumental, (iii) their community has distinctive characteristics, and (iv) there is loyalty in the sense of willingness to sacrifice personal gain to advance the interests of the community.

By extension, practices that are essential to upholding relationships constitutive of our identity must also presumably be permissible. So certain types of interaction may be ethically legitimate, even though they do not take into account the interests of people outside the relationship or community in question. A convincing case has yet to be made that corruption is one such type of practice or interaction that would be morally legitimate by reference to identity-bearing relationships. Some types of corruption would certainly not be legitimate, such as embezzlement or extortion, as they do not affirm any type of essential relationship.

More generally, corruption is by definition an instrumental practice, and signifies the opposite of loyalty in terms of sacrificing the interests of a community for personal gain. Corruption would therefore appear the antithesis to practices essential to upholding the type of community that Miller sees as morally significant. Sardan (1999) points out that corruption in Africa is partly driven by certain types of cultural logics, such as gift-giving. Although these may be essential to local identities, this does not imply that all practices spurred by these logics are essential. The logics of gift-giving would and could presumably be pursued through other types of exchange.

Communitarian ethics can also be criticised at a more fundamental level. The emphasis on relationships that take precedence over duties to others implies a breach of the principle of impartiality, which many see as a cornerstone of ethics. Importantly, those individuals who are not included in relationships and communities suffer particularly from practices that affirm existing communities. And, as we know, poverty is often related to discrimination and exclusionary practices, which implies that those in most need may be highly vulnerable to communitarian practices. Following Sen (2006), one can also argue that we all have multiple identities, and the concept of identity may therefore be too indeterminate to serve as the basis for practical ethics.

## **2.3 Summary**

Corruption is here defined as the abuse of public office for private gain. It is useful to distinguish between various forms of corruption, such as political corruption and bureaucratic corruption, and to develop a clear understanding of how corruption relates to other terms, such as rent-seeking. At the core of the concept of corruption is a moral and ethical dimension, which may be translated into legal provisions in various ways. Abuse of entrusted power as a principle tends to be recognised as a problem all over the world – as is reflected in a range of public opinion surveys *inter alia*. However, how people understand corruption and actual practice can vary, as will be discussed in Section 4.

The effort to combat corruption can be based on different rationales – the drive for greater aid effectiveness and domestic legitimacy of aid; and/or an understanding of corruption as being ethically undesirable. In the current development policy discourse, a consequentialist ethical approach is generally dominant, focused on the negative effects of corruption on growth on the one hand and on distribution or poverty on the other (e.g. greater exclusion of the poor as a result of petty corruption). However, denouncing corruption exclusively because of its bad consequences makes the anti-corruption agenda vulnerable to partial – and possibly shifting – interpretation of empirical results.

An alternative is to take a duty-based approach and view corruption as wrong in itself. Corruption involves deception and force, and undermines the moral and rational capacities of citizens and societies. Thus, even if substantial corruption in China may not be fundamentally undermining economic growth or poverty reduction, there is still considerable cause to combat the phenomenon. Corruption fundamentally undercuts the moral fabric of society, which is also reflected in the fact that societies all over the world tend to regard it as something that is fundamentally wrong – even if it comes to be accepted as a fact of life. Such an enhanced understanding of corruption can add justification to and inform anti-corruption policies in important ways.

Building on this conceptual basis, Sections 3 and 4 look at available measures of corruption and review the literature to probe into the underlying causes of corruption. Chapter 5 then considers various strategies and change processes that donors have supported in the hope of reducing corruption.

### 3. Measuring corruption<sup>11</sup>

#### 3.1 What corruption measures exist? Categorisation and limitations

Corruption (and governance) indicators are a growing field. The most widely known measures are TI's Corruption Perceptions Index (CPI) and the World Bank Institute's (WBI) indicator Controlling Corruption (one of its six governance indicators). In addition to the CPI, TI has developed the Bribe Payers Index and the Global Corruption Barometer (public opinion survey). The best known private sector index is the International Country Risk Guide (ICRG) (corruption sub-indicator). Beyond these international measures, many corruption surveys are undertaken in individual countries or in specific regions (e.g. the BEEPS (Business Environment and Enterprise Performance Survey) for Eastern Europe). Furthermore, many surveys that measure wider governance and/or the business climate include some questions on corruption, although corruption is not their main focus.

Table 1 provides an overview of the best known corruption (or corruption-related) indicators and their methodology and country and period coverage in brief.

**Table 1: Overview of corruption indices**

Organisation and index	Methodology and range	Country and period coverage
TI CPI	<ul style="list-style-type: none"> <li>• Index that aggregates existing surveys</li> <li>• Ratings range from 1 = (most) highly corrupt to 10 = free from corruption</li> </ul>	<ul style="list-style-type: none"> <li>• 163 (2006)</li> <li>• Annual since 1995</li> </ul>
TI Global Corruption Barometer	<ul style="list-style-type: none"> <li>• Commissioned public opinion survey undertaken by Gallup</li> <li>• Total of 59,000 respondents (2006)</li> <li>• Various ratings</li> </ul>	<ul style="list-style-type: none"> <li>• 62 (2006)</li> <li>• Annual since 2003</li> </ul>
TI Bribe Payers Index	<ul style="list-style-type: none"> <li>• 2006: Executive Opinion Survey carried out by WEF; 11,232 respondents</li> <li>• 2002: 835 interviews: with senior executives, top executives of chartered accountancies, representatives of chambers of commerce, national and foreign banks, commercial law firms</li> <li>• Range: from 10 = best to 0 = worst</li> </ul>	<ul style="list-style-type: none"> <li>• Focus on 30 major exporting countries; surveys undertaken in 125 countries (2006)</li> <li>• Focus on 21 major exporting countries; surveys undertaken in 15 emerging market countries (2002)</li> <li>• First BPI in 1999</li> </ul>
WBI Indicator 'Control of Corruption'	<ul style="list-style-type: none"> <li>• Aggregate indicators based on 31 data sources (commercial risk rating agencies (23), governments, multilaterals organisations, NGOs); median number of sources per country for CC: 8</li> <li>• Defined as 'the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests'</li> <li>• Ratings range from -2.5 = worst to +2.5 = best; and are converted also into a percentile scale (ranging from 1 to 100th percentile)</li> </ul>	<ul style="list-style-type: none"> <li>• 204 (2005)</li> <li>• Bi-annually 1996–2004; annually since 2005</li> <li>• Since 1996</li> </ul>

<sup>11</sup> This section was written by Verena Fritz.

Global Integrity Category 6: 'Anti-corruption mechanisms and rule of law'	<ul style="list-style-type: none"> <li>• The category looks at anti-corruption laws, the country's ACA, rule of law and access to justice (including law enforcement)</li> <li>• Ratings range from &lt;60 = very weak to &gt;90 = very strong</li> </ul>	<ul style="list-style-type: none"> <li>• 43 (2006)</li> <li>• 2 rounds: 2004 and 2006</li> </ul>
ICRG; Corruption component (of political risk)	<ul style="list-style-type: none"> <li>• By PRS Group; ratings awarded by international experts</li> <li>• Fee-based access</li> <li>• Ratings from 1 (bad) to 6 (good)</li> </ul>	<ul style="list-style-type: none"> <li>• 140 countries</li> <li>• Updated monthly</li> <li>• Data for some countries going back to 1980</li> </ul>
World Bank CPIA/IDA Resource Allocation Index	<ul style="list-style-type: none"> <li>• Countries rated by World Bank experts; with strong process to ensure systematic treatment of countries; (but) direct link to IDA funding allocations</li> <li>• Sub-indicator #16 'Transparency, accountability, and corruption in the public sector'</li> <li>• Ratings range from 1 = lowest to 6 = highest; with 0.5 increments</li> </ul>	<ul style="list-style-type: none"> <li>• Only data for IDA countries is currently published, and only for 2005</li> <li>• Initially developed in the 1970s; revised in 2004</li> </ul>

As Table 1 reflects, there are several key ways of measuring corruption: (i) public opinion surveys, (ii) surveys among (business) elites, (iii) ratings carried out by experts (national or international), and (iv) ratings based on 'facts' – such as having anti-corruption legislation, the number of prosecutions, etc. The best known indices (that also have the widest country coverage) use aggregates of data generated using one of these methods.

The limitations of corruption (and other governance) indices have attracted considerable attention in recent years (see Galtung, 2005; Søreide, 2006; Svensson, 2005; Knack, 2006). Five main issues are raised:

1. The measurement errors are wide. This means that changes in scores may happen without any changes in the underlying reality. Kaufmann et al. (2006) have reported that measurement errors have declined as more indicators have become available for more of the countries they cover. However, this claim is based on the assumption that measurement errors of different sources are independent from each other; this is unlikely to be the case in reality, as experts are influenced by available information (including ratings for previous years).
2. Most corruption indices measure corruption in countries but do not measure corruption extending from countries (i.e. resident firms bribing officials in other countries; the Bribe Payers Index is the notable exception).
3. A number of countries are not covered by existing indices and these may in fact be the most corrupt (rather than those at the bottom of the indices which receive much negative attention); however, coverage is improving, and the white spots on TI's map are few in most recent rounds.
4. Any measure of corruption is imprecise, partly because corruption is a multifaceted phenomenon and most measures only cover some aspects and not others (e.g. corruption affecting businesses, corruption experienced by citizens using public services, etc.)
5. The most widely used and publicised indices, such as the CPI and the KKZ (Kaufmann, Kraay and Zoido-Lobaton) Control of Corruption (CC) indicator for the WBI, tend to be poorly interpreted by users, which translates into questionable effects in country. For example, the media often focus on changes in rankings without paying sufficient attention to the fact that these may be spurious: rankings may improve simply because those of other countries are

worsening. While most corruption indices are quite closely related to each other, there is a divide between ratings based on perceptions (various methodologies) and ratings based exclusively on 'observable facts', as used by the Global Integrity Index.<sup>12</sup>

Of these criticisms, (1) and possibly (5) are probably the most important. Criticism (1) has implications for aid policy, since imprecision in measuring corruption may mean that countries are unduly excluded from aid allocations (or may unfairly benefit from additional allocations) when corruption performance is taken into account (as it is in International Development Association (IDA) allocations and for the Millennium Challenge Account (MCA) and, more implicitly, also by some bilateral donors using the Country Policy and Institutional Assessment (CPIA)). Criticism (5) is also important. One potential benefit of country rankings/league tables is the generation of discussions and incentives for change inside countries (this is also the logic, for example, of the Programme for International Student Assessment (PISA) league tables issued for education achievements in OECD countries).<sup>13</sup>

Furthermore, with regard to the rating of countries, some issues arise that are similar to those raised in Work Package 5 on governance assessments. Poor developing countries tend to perform worse on levels of perceived corruption, and hence to cluster at the bottom of corruption indices; OECD countries cluster at the top. Within the lower half of ratings there is some differentiation between developing countries that are rated relatively better – a large number clustered around the developing country average – and then the five to 10 countries that make up the bottom range. This means that corruption indices as such offer no easy guidance, for example with regard to the question of aid allocations (since there are few poor but particularly well governed countries).

While such criticisms have an important role in making users more aware of limitations, they should not distract from some fundamentals. Having indices that cover an ever larger number of countries is important because they provide an improvement relative to general statements about 'corrupt' or 'highly corrupt' countries. Furthermore, corruption indices hopefully will help over time with observing change and/or stagnation. Thus far, to the extent that they are comparable over time, the indices indicate that corruption has been stagnating over the past decade, despite considerable efforts by internal and external actors to reduce it in a number of countries and contexts. Nevertheless, there is considerable scope to develop more finely tuned corruption assessments and/or to use existing assessment methodologies on a wider set of countries or other regions (e.g. the BEEPS, which thus far has covered transition countries only). This also raises questions about how best to finance corruption surveys and indicators, since fine-tuned assessments of a large number of countries are costly.

### ***3.2 Corruption measures and assessments of Irish Aid partner countries***

Table 2 provides an overview of corruption data for Irish Aid partner and potential partner countries, drawing on the two indices with the widest coverage (WBI/CC and TI/CPI). Several issues are worth noting. Firstly, the rating of countries can vary considerably over a decade, both for the better (e.g. Tanzania) and for the worse (e.g. Zimbabwe as the most extreme example). There are also several cases of countries where the situation deteriorated (Ethiopia, Mozambique, Malawi) but later improved. At the same time, however, as discussed above, not all changes observable in the data are statistically significant.<sup>14</sup> Secondly, as reflected in Figure 1, nearly all African countries are significantly affected by corruption (as are most low-income countries (LICs)).

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<sup>12</sup> See presentation given by D. Kaufmann, 15 March 15 2007: [http://www.improvinggovernance.be/upload/documents/measurement\\_kaufmann.pdf](http://www.improvinggovernance.be/upload/documents/measurement_kaufmann.pdf), Slide 26.

<sup>13</sup> See [http://www.pisa.oecd.org/pages/0,2987,en\\_32252351\\_32235731\\_1\\_1\\_1\\_1\\_1,00.html](http://www.pisa.oecd.org/pages/0,2987,en_32252351_32235731_1_1_1_1_1,00.html).

<sup>14</sup> Importantly, the latest (2007) data from the WBI show some trends that are the opposite of those shown in earlier versions of the series.

Lesotho is perceived as a relatively stable and better performing country, but the majority of countries fall into the bottom 2 or 3 deciles of the ratings.<sup>15</sup>

Thirdly, swings are more pronounced in the WBI/CC ratings than in the TI/CPI and, although the two ratings are relatively closely correlated (this also holds for the entire datasets), there are observations (country/year) that differ substantially, such as Malawi in 1998 and 2000 and Mali in 2004 and 2005. Mali and Malawi receive almost the same rating from TI in 2005, but the rating by WBI/CC is 24 percentiles higher for Mali than Malawi. Such inconsistencies in the measurement of perceived corruption are another reminder to use indices and particular data points cautiously.

**Table 2: Corruption ratings for Irish aid partner and potential partner countries, WBI and TI**

		1996	1998	2000	2002	2003	2004	2005	2006
<b>Partner country</b>									
Ethiopia	WBI	7.3	33.5	39.3	38.8	30.6	29.6	26.2	36.9
	TI		..			2.5	2.3	2.2	2.4
Lesotho	WBI	..	53.9	52.4	49	48.1	51.5	53.9	57.8
	TI	..	..	..	..	..	..	3.4	3.2
Mozambique	WBI	37.9	26.2	29.6	31.1	30.1	28.6	35.9	35.4
	TI	..	..	..	..	2.7	2.8	2.8	2.8
Tanzania*	WBI	9.7	12.6	9.2	14.6	18.9	30.6	29.1	43.2
	TI	..	1.9	2.2	2.7	2.5	2.8	2.9	2.9
Timor Leste	WBI	..	..	..	37.9	37.9	37.9	25.2	19.9
	TI	..	..	..	..	..	..	..	2.6
Uganda*	WBI	31.6	19.4	15	15	27.2	23.3	19.4	26.2
	TI		2.9	1.9	2.1	2.2	2.6	2.5	2.7
Vietnam*	WBI	27.7	29.6	28.2	32.5	32.5	24.8	26.7	29.1
	TI		2.5	2.6	2.4	2.4	2.6	2.6	2.6
Zambia*	WBI	12.1	18.9	19.4	17.0	20.9	19.4	22.8	22.8
	TI		3.5	2.5	2.6	2.5	2.6	2.6	2.6
Median PC (WBI/CC)		19.9	26.2	28.2	31.8	30.35	29.1	26.45	32.25
Average PC (WBI/CC)		21.1	27.7	27.6	29.5	30.8	30.7	29.9	33.9
Average for SSA		30.7	30.4	32.1	32.3	30.9	29.6	29.3	30.3
<b>Potential partner country</b>									
Kenya*	WBI	8.7	8.7	13.1	12.6	20.4	23.8	17.0	16.0
	TI		2.5	2	1.9	1.9	2.1	2.1	2.2
Mali	WBI	40.8	32.0	30.6	46.6	41.7	43.2	45.6	36.4
	TI			..	..	..	3.2	2.9	2.8
Malawi*	WBI	34.0	40.8	39.8	18.0	24.3	22.3	21.8	25.7
	TI		4.1	3.2	2.9	2.8	2.8	2.8	2.7
Niger	WBI	40.8	14.6	14.1	10.2	12.6	18.9	22.3	16.5
	TI		..	..	.	..	2.2	2.4	2.3
Sierra Leone	WBI	1.5	17.0	12.6	27.7	19.4	20.4	12.6	6.8
	TI		..	..	..	..	2.3	2.4	2.2
Zimbabwe*	WBI	51.9	39.3	17.5	4.4	6.3	6.8	6.3	3.9
	TI		4.2	2.9	2.7	2.3	2.3	2.6	2.4
Median PPCs (WBI/CC)		37.4	24.5	15.8	15.3	19.9	21.4	19.4	16.3
Average PPC (WBI/CC)		29.6	25.4	21.3	19.9	20.8	22.6	20.9	17.6

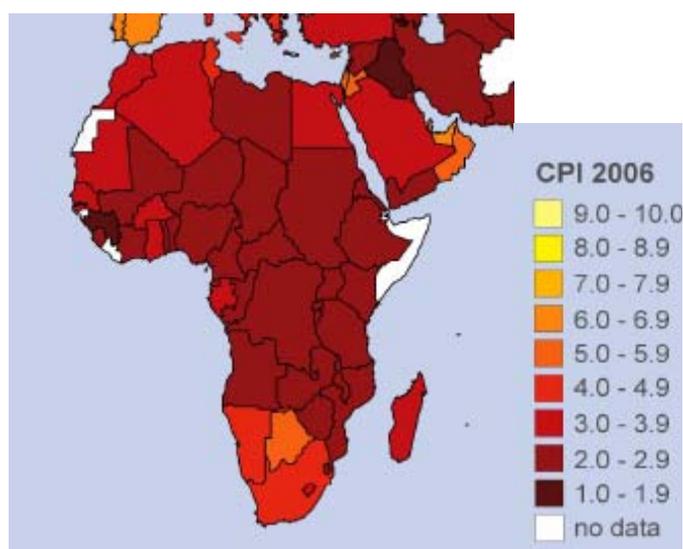
\* Data for 2000: TI for 2001.

Note: CPI: 10 = free from corruption, 1 = highly corrupt; CC: 100 = free from corruption, 0 = highly corrupt.

Source: Data from latest WBI (note that the WBI data published in 2007 differ significantly from earlier data).

<sup>15</sup> Work Package 5 of this series (Court and Fritz, 2007) notes that most developing countries fall into a 'muddled middle' with regard to governance ratings. In the case of corruption ratings, we may call this more precisely the 'muddled bottom third', with relatively few stable good performers.

**Figure 1: Transparency International map of perceived corruption, Africa 2006<sup>16</sup>**



As Table 2 shows, current Irish Aid partner countries are perceived as controlling corruption slightly better on average than LICs in general, whereas proposed partner countries are currently perceived as performing slightly worse on average but with a considerable spread between perceived ‘good’ and ‘bad’ performers.<sup>17</sup> Further qualitative information about corruption in Irish Aid partner countries and potential partner countries is available from the following sources (Table 3).

**Table 3: Qualitative corruption assessments and reports**

Country	Available assessments
<b>Ethiopia</b>	<ul style="list-style-type: none"> <li>• Global Integrity (corruption timeline; description of laws and court cases, etc.; 2006)</li> <li>• World Bank: Ethiopia Anti-Corruption Report (1998)</li> </ul>
<b>Lesotho</b>	<ul style="list-style-type: none"> <li>• Fiona Darroch, ‘The Lesotho Corruption Trials – A Case Study’, (ca. 2002), report prepared for TI: <a href="http://www.ipocafrika.org/cases/highlands/funding/darroch.pdf">http://www.ipocafrika.org/cases/highlands/funding/darroch.pdf</a></li> </ul>
<b>Mozambique</b>	<ul style="list-style-type: none"> <li>• Global Integrity (corruption timeline; description of laws and court cases, etc.; 2006)</li> <li>• USAID Corruption Assessment (2005/2006)</li> </ul>
<b>Tanzania</b>	<ul style="list-style-type: none"> <li>• Global Integrity (corruption timeline; description of laws and court cases, etc.; 2006)</li> <li>• World Bank, ‘Support to the Government of Tanzania’s Anti-Corruption Program’ (1998)</li> </ul>
<b>Timor Leste</b>	<ul style="list-style-type: none"> <li>• World Bank: Reducing the Risk of Corruption (ca. 2006): <a href="http://siteresources.worldbank.org/INTTIMORLESTE/Resources/Strengthening-Institutions-Corruption-9.pdf">http://siteresources.worldbank.org/INTTIMORLESTE/Resources/Strengthening-Institutions-Corruption-9.pdf</a></li> </ul>
<b>Uganda</b>	<ul style="list-style-type: none"> <li>• Global Integrity (corruption timeline; description of laws and court cases, etc.; 2006)</li> <li>• TI, National Integrity Systems report (2003)</li> <li>• Tangri and Mwenda, ‘Politics, Donors and the Ineffectiveness of Anti-corruption Institutions in Uganda’, <i>Journal of Modern African Studies</i> 44(1) (2006)</li> </ul>
<b>Vietnam</b>	<ul style="list-style-type: none"> <li>• Global Integrity (corruption timeline; description of laws and court cases, etc.; 2006)</li> <li>• TI, National Integrity Systems report (2006)</li> </ul>
<b>Zambia</b>	<ul style="list-style-type: none"> <li>• TI, National Integrity Systems report (2003)</li> </ul>

<sup>16</sup> The full world map can be viewed at [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2006](http://www.transparency.org/policy_research/surveys_indices/cpi/2006).

<sup>17</sup> As discussed in Work Package 5, and as will also be highlighted in the synthesis report, allocating aid to countries with more difficult governance conditions and particularly high levels of corruption can be a deliberate policy choice – for example with regard to aiding the populations of countries with ‘oppressive governance’ (Zimbabwe) or providing aid for state-building processes (Sierra Leone).

<b>Kenya</b>	<ul style="list-style-type: none"> <li>• Global Integrity (corruption timeline; description of laws and court cases, etc.; 2006)</li> <li>• TI, National Integrity Systems report (2003)</li> <li>• TI Kenya, 'Kenya Bribery Index' (published regularly since 2001, latest: 2006)</li> </ul>
<b>Mali</b>	<ul style="list-style-type: none"> <li>• World Bank, 'Recommandations Visant à Renforcer le Programme Anti-corruption (2006)</li> </ul>
<b>Malawi</b>	<ul style="list-style-type: none"> <li>• TI, National Integrity Systems report (2004)</li> <li>• World Bank, 'Support to the Government of Malawi's Anti-Corruption Program' (1998)</li> <li>• World Bank, 'Governance and Corruption Baseline Survey' (2006)</li> </ul>
<b>Niger</b>	<ul style="list-style-type: none"> <li>• De Sardan and Blundo, 'Everyday Corruption and the State: Citizens and Public Officials' (2006a)</li> </ul>
<b>Sierra Leone</b>	<ul style="list-style-type: none"> <li>• TI, National Integrity Systems Report (2004)</li> </ul>
<b>Zimbabwe</b>	<ul style="list-style-type: none"> <li>• Global Integrity (corruption timeline; description of laws and court cases, etc.; 2006)</li> </ul>

As Table 3 reflects, there is a higher 'density' of qualitative information for some countries (such as Uganda, Kenya and Vietnam) than for others (e.g. Lesotho). Other sources include academic publications (articles and monographs) on particular countries (which frequently cover corruption as one aspect among broader reviews), newspaper coverage and similar types of publications.<sup>18</sup> However, such sources tend to be too diverse and scattered to be of direct use for aid policy at the international level (although they may be of good use to individual country teams).

Looking at the table, and considering the great interest in corruption over the past decade, it is actually quite surprising to find that, to date, relatively few well developed diagnostic tools exist and that donors have used these rather sporadically. The region which is by far the best covered in terms of corruption assessments is Eastern Europe and Central Asia (Knack, 2006; World Bank, 2006b). Thus far, USAID (the US Agency for International Development) is the donor agency that has developed the most rigorous diagnostic tool focused specifically on corruption. However, in the current context of heightened concern about governance and corruption, other donors are planning to follow suit (e.g. the Netherlands is in the process of undertaking Strategic Governance and Corruption Assessments in their partner countries and the World Bank intends to roll out Governance and Anti-Corruption Assessments).<sup>19</sup> Ideally, as recommended by the OECD Development Assistance Committee (OECD-DAC) (2005 and again in 2007), several donors should pool their efforts, as they have done for assessing PFM with the PEFA (Public Expenditure and Financial Accountability) methodology, This would spare countries a donor-mandated 'assessment overload' while ensuring that a large number of countries are covered in a fairly systematic way. The modalities of how donors undertake corruption assessments require further consideration (e.g. joint commissioning of studies by research organisations versus in-house; depth and focus of the analysis, etc.)<sup>20</sup>

### 3.3 Summary

Important advances have been made in measuring corruption over the past 10 years. The best known measures – TI's CPI and the WBI's KKZ CC indicator – are quantitative aggregates. Thus, they reflect the overall degree of corruption perceived to exist in a country and provide a degree of cross-country and inter-temporal comparability (with the necessary caveats especially for the latter, as pointed out by Arndt and Oman, 2006).

<sup>18</sup> A few such sources are included in the table, in particular for countries where no standard sources are available, but this list is not exhaustive.

<sup>19</sup> See [http://siteresources.worldbank.org/INTGOVANTICORR/Miscellaneous/21519459/GAC\\_ImplementationFinal\\_Oct2007\\_English.pdf](http://siteresources.worldbank.org/INTGOVANTICORR/Miscellaneous/21519459/GAC_ImplementationFinal_Oct2007_English.pdf).

<sup>20</sup> An initial attempt at a multi-donor corruption assessment (involving six bilaterals, the OECD and the World Bank) was recently made in Cameroon. See <http://www.oecd.org/dataoecd/40/51/37687235.pdf>.

While broad measures are useful to inform the policy debate and to enable quantitative research on the causal chains around corruption, they are by themselves insufficient to inform the operational work of donors in the field of governance and anti-corruption support. Thus, more detailed qualitative information is needed, both to help validate quantitative indices and, more importantly, to support specific anti-corruption activities. However, thus far the qualitative information needed to inform operational work has remained scarce; there are, as yet, few frameworks available for collecting such information in a systematic way.

Furthermore, it is important that donors are well informed about what the various corruption measures actually capture, and what their limitations are. This is also important for assessing the validity of studies showing some causal relations between corruption and development outcomes (see also Work Package 5 on other governance indices). If this caution is not exercised, there is a risk of drawing sweeping policy conclusions from studies with relatively uncertain empirical bases.

There can be important contradictions between different corruption indices. In particular, ‘facts-based’ indices, such as that of Global Integrity, can come to conclusions that are quite different from ‘perception-based’ measures. ‘Perception-based’ indices are better at capturing ‘how things really work’, whereas facts-based assessments can be misleading if they focus primarily on the formal institutional environment. Nonetheless, ‘facts-based’ analysis of corruption provides important information about what formal anti-corruption instruments are in place in a country.

The corruption indices show that, if donors are to work in very poor countries, they will need to work in relatively corrupt environments. At the same time, as discussed in Section 2, donors cannot set aside corruption as part of the ‘inevitable context’ of providing aid. Work Package 5 of this series explores how governance and corruption indices can and are being used to guide aid allocation decisions. The final two sections of this paper discuss donor efforts to reduce corruption (Section 5), and the interaction between different aid modalities and corruption (Section 6). Firstly, however, Section 4 will explore the causes of corruption, as these are important for determining the types of anti-corruption interventions that are likely to be effective and for helping to explain those that are not.

## 4. Causes of corruption: A review of political, anthropological and economic explanations<sup>21</sup>

There is a growing literature covering the potential causes of corruption. This literature might be divided into two types. The first is more focused on the generation of hypotheses, frequently in the form of country case studies. The second is more focused on the testing of hypotheses, most commonly via large N cross-country comparisons, but also through qualitative comparative work.<sup>22</sup>

No single overriding cause of corruption has yet been detected or is likely to be detected, if we assume that corruption emerges as a result of underlying governance malfunctions. Furthermore, it is important to keep in mind that findings from cross-country studies have often been contradicted by later studies using somewhat different datasets and methodological approaches. As Lambsdorff (2005) points out, it is important to distinguish clearly between causal linkages suggested by a single study and those confirmed by several studies (and using a range of datasets and empirical specifications).

This section discusses the causes and preconditions of corruption from the perspectives of three different social science disciplines; political science, anthropology and economics. The analysis of corruption in political science has proceeded from a discussion of more formal institutional arrangements (Section 4.1) to an emphasis on informal interactions behind the formal system (Section 4.2). In anthropology, corruption is understood and studied as a phenomenon deeply embedded in cultural logics and social relations (Section 4.3). Finally, the economic literature on corruption traditionally considers the economic incentives of agents. More recent developments have stressed the importance of economic psychology and social norms in the evolution and persistence of corruption (Section 4.4). A triangulation of the three perspectives offers a richness of information that allows us to see some general patterns in what causes corruption. It also identifies idiosyncratic features of different societies and situations. While the perspectives are different, there are important complementarities and similarities in the lessons offered, which are explored in the section summary (Section 4.5).

### 4.1 Political science: Formal institutions and organisational issues

There are a number of hypotheses regarding the features of political systems that increase or reduce corruption. These include claims that discretion, monopoly and insulation/autonomy increase corruption. Discretion refers to 'room' to decide; monopoly is assumed to increase power – for example, over the allocation of an export license – and consequently the power to extract bribes. This is summarised by Robert Klitgaard (1988) as *Corruption = Monopoly + Discretion - Accountability*.

Conversely, tight rules (limiting discretion), (political and economic) competition (as opposed to monopoly) and accountability (effective systems of monitoring, oversight and sanction) are assumed to limit corruption – at the individual, organisational and system-wide level. Based on these assumptions, it has been proposed that greater economic and political competition should serve to limit corruption (Ades and di Tella, 1999; USAID, 2005c).

An increase in political and electoral competition (i.e. democratisation) has widely been assumed to help reduce corruption. However, as Lambsdorff (2005) summarises, the empirical evidence yields a more differentiated and somewhat counterintuitive picture. Intermediate levels of political competition (i.e. the hybrid regimes discussed in Work Package 1) often show worse levels of

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<sup>21</sup> This section was written by Verena Fritz, Ivar Kolstad and Tam O'Neil.

<sup>22</sup> The empirical literature is affected by measurement problems, as discussed in Section 3, i.e. the results of such studies are affected by data quality and underlying methodologies for measuring concepts such as corruption and governance.

corruption than either fully democratic or fully authoritarian regimes (Montinola and Jackman, 2002; see also Fritz, 2007). Costly election campaigns (particularly in immature populist phases of democracy) can contribute to increases in corruption through patronage and vote-buying, while political liberalisation as such can mean that more politicians can become involved in acts of corruption (these issues are explored further in Section 4.2 and Section 5).

Countries that have had democratic systems of government for a long time do tend to have lower levels of corruption (but it is difficult to distinguish clearly between greater prosperity and longer histories of democratic regimes, as the two tend to go hand in hand). Furthermore, a free press and a (*de facto* not just *de jure*) more independent judiciary are associated with lower levels of corruption (Brunetti and Weder, 2003; Voigt et al., 2004; Sung, 2002; for a more pessimistic view about the role of the media see Vaidya, 2005).

Furthermore, a few 'meta-hypotheses' have sought to link levels of corruption to broad structural factors, such as religious/cultural traditions, ethno-linguistic fragmentation and colonial tradition (Treisman, 2000). This follows in the spirit of the democratisation literature, which sought to explain why some countries democratised whereas others did not (or did so much later) based on fundamental structural characteristics of countries. Although a number of such factors seem relevant, these explorations are not conclusive with regard to their relative importance.

Treisman in particular has explored whether greater decentralisation is associated with lower levels of corruption (which could be based on more direct accountability links and more interregional competition). He finds that, in fact, *federal* states are more corrupt than centralised ones, but also that the relationship is insignificant when including other variables (such as controlling for the clarity of jurisdiction between different levels of government) (Treisman, 1999). Gerring and Thacker (2004) also find that federalism has a negative impact on levels of corruption. However, it should be kept in mind that federalism is a rather specific form of decentralisation. Work Package 2, which explores decentralisation in the context of neopatrimonial structures, finds – based on two case studies and a review of the literature – that decentralisation may be associated with more, or at least more decentralised forms of, corruption because institutional hybridity and weak accountability mechanisms are also prevalent at local level.

An organisational aspect under research is the question of the relationships between corruption and wage levels in the public sector. Evans and Rauch (2000) show that merit-based recruitment is associated with lower levels of bureaucratic corruption. Rijckeghem and Weder (2001) also find an association between wage levels and corruption. Other studies indicate that this relationship is not robust. So far, these studies have suffered from the fact that up-to-date data on wage levels in developing countries are not consistently available, thus compounding the measurement problems related to observing corruption. This issue is reflected in the recent World Bank strategy on Governance and Anti-Corruption (World Bank, 2007a): 'Low pay can contribute to corruption within a public administration, particularly when total remuneration fails to pay a living wage, as is often the case in many African countries. [...] [However, c]hanges in compensation levels can only work if they are part of a package to reform public servants' behavior. Other elements are essential to reducing corrupt practices.'

Accountability has become a very popular concept in recent years. However, it is difficult to measure the degree of (*de facto*) accountability that exists in a country; it is not well captured by existing governance indicators. The WBI KKZ CC tends to equate accountability with freedom of expression, i.e. 'voice'. However, in many new democracies there is relative freedom of expression but the voices of many people can nonetheless be easily ignored by state and political elites. Others are using broader measures of the presence of elections combined with an assessment of the actual functioning of checks and balances (ICRG). This seems to fit the concept better, but may be weak with regard to the state–society dimension of accountability.

As set out in Work Package 1, the political science literature distinguishes between three forms of accountability: (i) vertical (elections), (ii) horizontal (i.e. within government – such as supreme audit

institutions, and (iii) societal (e.g. NGOs with watchdog functions; control exercised by a free press). In addition, the literature on public administration emphasises (iv) managerial accountability, i.e. accountability of lower levels of public administration to higher levels.<sup>23</sup> Most likely, in countries where all these forms of accountability are well developed, corruption is kept in check. However, the challenge is that, despite democratisation processes in many developing countries, these accountability structures have not yet ‘taken off’ (as discussed in Work Package 1). A reliable measure of accountability would need to include all four dimensions as sub-components.

In principle, all four forms of accountability would be expected to have limiting effects on corruption if they are well functioning and, in particular, if they are well integrated. For example, (continuous) societal accountability will have greater weight if it is supported by vertical accountability exercised through free and fair elections – and ideally elections that are focused on policy/programmes and performance rather than patronage or populist appeal. Managerial accountability is an essential form of accountability for containing corruption and for maintaining a well functioning bureaucracy, regardless of whether the political system is more democratic or more authoritarian. Horizontal accountability can be both narrow – limited to specialised institutions within government – or broad, extending to effective checks and balances between the executive, the legislative and the judiciary.<sup>24</sup> Singapore and Hong Kong are prime examples of reducing corruption largely based on strengthened managerial and (rather narrow) horizontal accountability. However, well designed structures of managerial and horizontal accountability are also important for vertical and societal forms of accountability to be effective: voters have to be able to discern which minister is responsible when certain public services are corrupt. Similarly, it is easier for CSOs (civil society organisations) or the media to exert societal control if there are clear lines of subordination and accountability within government and the public administration.

Overall, various forms of accountability need to be developed and ‘driven’ by real commitment of the various actors in order for corruption to be contained effectively, a condition dependent on the incentives structures in operation. Finally, there is also an external dimension to accountability. Signatories to the UNCAC or to the OECD Anti-bribery Convention have made commitments at the international level to reduce corruption (although peer pressure is the main form of leverage). For aid-recipient countries, accountability to donors also matters; this issue is playing a larger role in the context of budget support, where donors become closely associated with the overall governance situation in a country.

A specific proposition has been that larger governments involve more corruption and that the way this is measured is as the share of government revenue to GDP (LaPalombara, 1994). However, this assumption has since been refuted; in fact, the inverse may be true – that higher revenues are associated with countries that have lower levels of corruption (there could be various causal linkages for this observed correlation – such as the inability to tax in highly corrupt environments and the fact that high revenues are a mark of greater trust between citizens and their state) (Lambsdorff, 2005).

Other forms of extended government activity – such as more extensive or particularly intrusive regulation – may be associated with higher levels of corruption, particularly in poorer countries. However, it has been difficult to explore this link empirically, as the intensity of regulation has only recently begun to be measured on a more rigorously comparative basis (see IFC, 2006). Also, similar types of formal regulation may entail different ‘reactions’ in terms of corruption, depending on the wider country context (e.g. in OECD countries, extensive and complex regulation is not necessarily associated with corruption).

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<sup>23</sup> Only democratic or semi-democratic governments will comprise any such forms of accountability; however, many authoritarian governments do have some elements of horizontal accountability (e.g. Vietnam and China both established supreme audit institutions in the 1990s).

<sup>24</sup> Although, even in mature democracies, the effective control of the legislature over the executive is often limited, owing to various forms of overlap and interdependencies of interests.

## 4.2 Political science: Informal institutions and neopatrimonialism

Section 4.1 suggests that certain political and bureaucratic structures are more conducive to curbing corruption. During the past 20 years, in response to donor pressure, Africa has undergone significant political liberalisation, resulting in formal democratic institutions and freedoms. There has also been an attempt to rationalise African public sectors and institutionalise bureaucratic norms and a public ethic. Yet African countries, including Irish Aid's partner countries, continue to experience high levels of corruption (see Table 2). The desire to better understand the functioning of African states and their reform trajectories has led some donors to invest in political economy analyses.<sup>25</sup> These find that the incentives created by informal norms and practices, such as clientelism, are as important in shaping individual, group and organisational behaviour as those created by formal institutions.

These donor-driven analyses draw heavily on the academic literature to frame their understanding of the nature of African states and the role of informal institutions.<sup>26</sup> In particular, they have used the concept of neopatrimonialism to understand how the African state 'works' and the impact of this on its ability to generate and manage development.<sup>27</sup> This literature identifies three characteristics common to neopatrimonial states: (i) the weak separation of the public and private spheres, which results in the widespread private appropriation of public resources (Medard, 1982; Amundsen, 1999), (ii) the primacy of vertical (e.g. patron–client) and identity-based (e.g. kinship, ethnicity, religion) relationships over horizontal relationships (Sandbrook, 1985), and (iii) personalism or 'big man' syndrome, reflected both in the presidential style of leadership and in the patron–client relations replicated throughout society. It is argued that these characteristics provide fertile conditions for the systemic clientelism and corruption found within African states.

There is also consensus in this literature that structural features of African societies explain why the distribution of patronage, both horizontally among the elite and vertically through clientelist networks, has been a core elite strategy for gaining and retaining control of the state and legitimising its authority. African economies are largely pre-capitalist, and few opportunities exist for accumulating wealth independent of the state. National identity is weak in Africa and societies tend to be organised along vertical lines based on kinship or ethnicity, rather than on horizontal interests (e.g. class). These structural features have two consequences for corruption. Firstly, this has led to the 'extractive capacity of a corrupted state apparatus ... [to be] one of the *rasions d'être* of holding power' (Amundsen, 1999). Secondly, personalism and clientelism are among the few effective political tools available to African elites (Eisenstadt, 1973; Clapham, 1982; Chabal and Daloz, 1999; Sandbrook, 1985). This has meant that appropriation of state resources has been not simply a means of amassing personal wealth but also crucial to the ability of elites to service the patronage networks that keep them in power (Mwenda, 2006). Although clientelism and the exchange of favours are not in themselves corrupt practices, they are directly related to corruption when public office is used as a private resource.

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<sup>25</sup> These include DFID's Drivers of Change exercises and Sida's 'power analyses'. Agencies such as USAID and the World Bank have also been undertaking forms of political economy/governance analyses for some time and these are being joined by a new tranche of planned governance assessments, such as DFID's Country Governance Assessments and the Dutch Foreign Ministry's Governance and Corruption Assessments, which are more time-bound and involve less historical analysis of change processes.

<sup>26</sup> For example, Chabal and Daloz (1999), Hyden (2005), Bratton and van de Walle (1999), van de Walle (2001) and Lockwood (2005). These in turn draw on an older literature, such as Clapham (1982), Eisenstadt (1973), Le Vine (1980), Sandbrook (1985) and Scott (1972).

<sup>27</sup> Neopatrimonialism describes 'hybrid political systems in which the customs and patterns of neopatrimonialism co-exist with, and suffuse, rational legal institutions' (Bratton and van de Walle, 1997). Neopatrimonial states are institutional hybrids within which informal patrimonial norms are dominant and widespread and free ride on formal legal–rational institutions. A more thorough discussion of neopatrimonialism is provided in the Work Package 2 on neopatrimonial politics and decentralisation.

Evolving economic and political conditions in Africa also have implications for the form and scale of corruption, and its use by elites. Two reform processes are of particular interest.

Firstly, democratisation has affected the role of patronage in elite competition for power. The association of representation and accountability with providing particularistic access to public resources has implications for the demands placed on members of parliament (MPs) (Chabal, 1992). Regular and open competition for power on the basis of direct appeals to the electorate is also thought to have led to an increase in political clientelism and corruption whereby favours are exchanged for votes.<sup>28</sup> Research on neopatrimonial politics in Malawi and Uganda for Work Package 2 has found that incumbents are responding to the threats posed by new democratic institutions by using both formal and informal institutions (including patronage) to preserve their position. This is often taking the form of intra-elite reform bargains (which has more implications for coherent policy-making than corruption) but also includes, for instance, the offer of ministerial posts to entice opposition candidates (and therefore their networks) to join the ruling party. There is also evidence, however, that democratic political competition can have a positive influence on patronage politics (see Section 5.2). In Ghana, Booth et al. (2004) argue that formal party competition is producing a more benign 'pork barrel' form of patronage, which may be compatible with the emergence of more issue-based parties, as opposed to those driven purely by personality or sectarian interests. They also suggest that a vibrant media has increased the political costs of corruption and the more pernicious types of patronage.

Political liberalisation has also had an impact on levels of petty or bureaucratic corruption in some countries (Booth et al., 2006b, 2004; Duncan et al., 2003). In Malawi, for instance, fear and repression restricted the misuse of public resources to a small circle around President Banda in the post-Independence period. Following the introduction of political and civil liberties in 1994 and the weakening of discipline at the top, however, there has been a 'democratisation of appropriation' and corruption throughout the civil service (Anders, 2005, Booth et al., 2006b).

Second, processes of economic liberalisation have provided new opportunities for the appropriation of public resources and accumulation of wealth. Van de Walle (2001: 159) describes a 'partial reform syndrome' – economic crisis forced African elites to accept that structural reform was unavoidable but its implementation has been uneven and instrumentalised by leaders who understood that it 'would provide them with new kinds of rents, as well as with discretion over the evolution of rents within the economy'. This type of rationale has been evident during processes of privatisation, which have provided opportunities for kickbacks and enrichment and the means to reward supporters and exclude opponents (Tangri and Mwenda, 2001).

This discussion (together with 4.1) has three implications for policy. First, donors need to understand how formal and informal institutions work together to influence incentives, behaviour and outcomes. Informal institutions – such as patronage and clientelism – have a profound effect on the formal rules of the game in Africa. New institutions that are introduced rapidly are likely to be given meaning by existing embedded institutions.<sup>29</sup> In practice, this has meant existing informal institutions have been in tension with, rather than supporting, the functioning of new democratic institutions.

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<sup>28</sup> However, current evidence about the actual dynamics of vote buying is thin, for instance the degree to which politicians and party machines are able to monitor their 'clients' voting behaviour (van de Walle, 2003). Socpa (2000, cited in Blundo, 2006b) finds that, for the Cameroonian electorate, 'the obligation of reciprocity no longer works in certain circumstances' as when they accept gifts but do not cast a vote for that particular party. Robinson et al. (2006) argue that offers of employment are more credible than other forms of patronage, such as cash handouts, and involve a greater commitment on the part of both patron and client since the cost of reversal is higher. However, a politician is obviously able to reach a greater number of voters through the offer of cash than jobs.

<sup>29</sup> Sindzingre (2002) calls this a 'compositional approach' to institutions. An example of this is the concept of political accountability and representation. In democratic systems, individual citizens are able to elect a political representative based on a programmatic party platform (embodying the party's ideology and objectives), who represents the interests of their constituents but also acts according to the national good (e.g. in overseeing legislation, holding the executive in check, etc.). In many developing countries, however, informal norms and practices favour particularism, communalism and personalism and this produces a different understanding of accountability and representation.

Secondly, the ability of leaders to negotiate complex reforms depends on structural and institutional features. Political elites often rely on informal institutions to generate support for reform and compensate potential losers through the distribution of patronage (Goetz, 2004). They are also likely to resist reforms that undermine their ability to maintain power and will instrumentalise reform processes so that they serve their personal interests. It is therefore important to identify reform processes that promote the public good but also provide political gains for government (Robinson, 2006). This means working with actual conditions and supporting those that are conducive to development outcomes, even if unconventional, being opportunistic (for instance when there is new leadership or social upheaval) and taking controlled risks (Robinson, 2006; Unsworth, 2007; Williams et al., 2007; USAID, 2005c). Tactics might include the sequencing of reforms to generate early winners and diffuse resistance, incremental reform that creates institutions rather than wholesale reform that demolishes failing ones, which is likely to attract more resistance and 'reform by stealth', in which leaders use patronage networks to negotiate and compensate societal groups behind the scenes (Robinson, 2006; Goetz, 2004).

Thirdly, while corruption always entails private gain, this does not necessarily equate to individual self-interest. Amundsen (2001) makes the distinction between private and collective corruption, with the latter indicating that resources have been extracted for the benefit of a wider group.<sup>30</sup> There is disagreement in the literature regarding the extent to which neopatrimonialism is an expression of elite power struggles over access to the state and its resources (van de Walle, 2001) or a moral economy that functions to redistribute resources to wider society,<sup>31</sup> although the latter remains particularistic (Chabal and Daloz, 1999). These different representations have implications for policy, not least because a moral economy would suggest that clientelism, and associated forms of corruption, enjoys some degree of social legitimacy. These are therefore likely to be more resistant to reform and require more indirect approaches (see Section 4.4). It is difficult to assess the relative strength of these positions because they are often based on a generic model of the African state, unsupported by empirical evidence about its actual functioning and its relationship with African citizens. This includes their perception of informal norms and practices and their participation in these (Blundo, 2006b). Anthropological research methods – see next section – are important for generating this type of knowledge, particularly for understanding the operation of petty corruption but also for embedding an understanding of all forms of corruption within wider social practices and the everyday strategies of Africans.

### ***4.3 Anthropological approaches: Social relations and culture***

Commentators have suggested that anthropological methods, and in particular ethnography,<sup>32</sup> have much to offer to the study of corruption (Blundo and Olivier de Sardan, 2006c; Sissener, 2001; Harrison, 2003; Booth et al., 2006a). Ethnography can provide insights into localised meaning, perceptions and practice, and their relationship to social networks and power structures. These can strengthen both qualitative approaches and the policy recommendations that result from these, by providing greater understanding of the complexity of local realities and better abstraction for quantitative work and triangulation (Booth et al., 2006a). Difficulties in extracting generalisable policy from ethnographic accounts (usually single site) and paucity of research on the actual functioning of African administrations have limited the contribution of anthropology to current policy

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<sup>30</sup> Although, as corruption involves the appropriation of public resources, it will always mean the community in the widest sense suffer losses.

<sup>31</sup> This redistribution can be of a less tangible nature than material assets; for instance, a community may value the accumulation of wealth and status by their representative because this reflects well on the community as a whole, even if they do not directly benefit in material terms (Chabal and Daloz, 1999).

<sup>32</sup> Ethnography refers to a method based on extended fieldwork where the researcher seeks to provide a detailed 'thick' description of everyday life and practice, in order to understand cultural representations and their relationship with human behaviour from the 'insiders' perspective.

debates.<sup>33</sup> Two recent studies address this gap – Blundo and Olivier de Sardan’s comparative study on the functioning of public administrations in West Africa<sup>34</sup> and Anders’ study of Malawian civil servants. This section will therefore draw heavily on these.

Blundo and Olivier de Sardan’s (2006a) approach seeks to acknowledge the importance of socio-cultural norms and practices for understanding corruption, while avoiding the ahistoricism of previous approaches.<sup>35</sup> The authors stress that culture is a dynamic social construct, which interacts with the broader political and economic environment. They therefore recognise that social behaviour, including the boundaries of what is perceived as legitimate behaviour (Sissener, 2001),<sup>36</sup> must be understood in context, without suggesting that corruption is an exclusively African phenomenon.<sup>37</sup> This position demonstrates the possibility of arguing that socio-cultural norms and practices are important for understanding the incentives that shape and give rise to corrupt practices, without making normative judgements about these or adopting a position of cultural determinism or relativism that reduces corruption simply to cultural practices.

Four main messages or findings emerging from this recent ethnographic research on the functioning of African public administrations are summarised below. These are taken from Blundo and Olivier de Sardan (2006a) and supplemented by other research where relevant.<sup>38</sup>

Firstly, there is evidence that the *public sector in some sub-Saharan African countries is undergoing a process of ‘informal privatisation’*, to the extent that it is possible to refer to a ‘generalised dysfunction’ in its everyday operation. Rather than signifying an absence of rules, this informalisation is characterised by their excess – the existence of complex *de facto* rules that guide behaviour based on tacit codes and norms that are at odds with formal public and legal norms. This means that actors need to be adept at navigating between formal and informal rules, depending on the particular circumstances.<sup>39</sup> This hybridity creates an environment of distrust and uncertainty for both public officials and service users, forcing them to adopt defensive strategies (such as investment in social relations, as discussed below), which has the effect of deepening dysfunction and uncertainty. By blurring the boundaries between licit and illicit practices, informalisation also provides opportunities for corruption, to the extent that it becomes part of the ‘normal’ functioning of administrations. Blundo and Olivier de Sardan argue that this informalisation is decentralised, resulting from ‘localised negotiations and arrangements’ rather than being entrenched in a ‘classical clientelist pyramid linking the centre with the periphery’.<sup>40</sup>

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<sup>33</sup> TI’s 2001 Global Corruption Report estimated that only 2% of research on corruption is ethnographic. Much of this has been undertaken in India (Harrison, 2003).

<sup>34</sup> Blundo and Olivier de Sardan (2006b) adopt a comparative approach to research on the everyday functioning of public services (legal sector, customs/transport and local public procurement) in Benin, Niger and Senegal.

<sup>35</sup> See Blundo (2006b) for further discussion of the two broad schools of thought that have previously dominated debates: ‘continuists’, who perceive corrupt practices as being endogenous and the continuation of traditional practices in the modern context, and ‘rupturists’, who argue that corruption is exogenous and resulted from the importation of the colonial state. In contrast, Blundo and Olivier de Sardan argue that current practices have resulted from the complex interaction of traditional, colonial and post-colonial norms.

<sup>36</sup> This does not mean that the individuals involved do not recognise that it is corrupt but that they may feel the act is legitimised by particular circumstances (e.g. if it is necessary to access a service or job).

<sup>37</sup> In fact, Blundo and Olivier de Sardan (2006b) argue that corruption is prevalent in all countries. However, they suggest that differences in scale, style and forms of legitimisation mean that it is possible to discern a qualitative threshold beyond which the state is fundamentally different in nature.

<sup>38</sup> To be clear, unless the reference indicates otherwise, the following is taken from Blundo and Olivier de Sardan (2006a) and standalone page references relate to this.

<sup>39</sup> The need for Africans to move between formal and informal logics or rules has also been found in Tanzania (Kelsall, 2004) and Malawi (Anders, 2005).

<sup>40</sup> Chabal and Daloz’s (1999) discussion of corruption in sub-Saharan Africa, which emphasises the systemic and decentralised nature of corruption and the social imperatives that drive it, is generally consistent with Blundo and Olivier de Sardan (2006a). However, Chabal and Daloz do not support their argument with empirical evidence regarding the actual functioning of administrations and their argument therefore lacks the nuance of Blundo and Olivier de Sardan’s analysis. In fact, Blundo and Olivier de Sardan see Chabal and Daloz’s work as adopting the type of ‘culturalist’ position that they seek to avoid, because it relies on ‘references to vague notions based on “cultural registers” and native “idioms” divorced from empirical data’.

### Box 1: Corruption in transport and customs in West Africa

The institutionalised nature of this informalisation and privatisation emerges clearly from Arifari's (2006) ethnographic research on the operation of the transport and custom systems in Benin, Niger and Senegal. The informal system has its own set of predictable rules that are 'known' by participants (traders, drivers, customs officials, brokers, police and gendarmes). The drivers are aware of the type of check (e.g. driver's identity, status of their vehicles and goods) operating at each control point and border crossing along their regular routes and the going rates for the illicit charges they will incur. For instance, in Benin, gendarmes receive 1000 CFA francs and other types of officers between 200 and 500 CFA francs. These charges are often in the form of outright extortion, such as payment to forgo the unloading of their trucks to check their goods, but also include payments for a service (e.g. expedite a process, turn a blind eye).

Two features of this system are of note. Firstly, officials are able to use their discretionary powers to exploit the cost of delay to traders. For instance, rates of corruption rise by up to 1000% on Friday afternoons because of the cost to traders if their goods are held over the weekend. Traders will therefore often engage in bribery even when their affairs are in order. Secondly is the role of the unpaid informal brokers – the auxiliary customs agents – who monitor the deals that are taking place for the custom officials and receive payment either through commission on seizures or from their cut from tacitly authorised extortion, in which they act as the intermediary between the customs official and trader. In this system, dishonest behaviour is that which is 'greedy' and operates outside the boundaries of informal norms.

Secondly, *corrupt practices are situated within wider strategies and everyday practices within and beyond public administrations* that are not corrupt but which facilitate and, in some circumstances, legitimise corruption. Blundo and Olivier de Sardan use the concept of a 'corruption complex' to describe how corrupt practices are nested within other practices and contexts, claiming that corruption cannot be understood without reference to these. They argue that corruption is part of the individual strategies adopted by public officials, who work within management and operational practices that 'accommodate and foster corruption'. Public administrations are themselves embedded within a wider social, political and economic context and are influenced by the 'logics' to which these give rise. Elsewhere, Olivier de Sardan (1999) has argued that these social imperatives include the need to 'invest through showing generosity', a culture of gift-giving, kinship and other social obligations.

**Table 4: Components of the corruption complex**

Basic forms of corruption	Strategies in which corrupt practices are integrated	Functioning of administration/public sector	Wider social, political and economic 'logics' or context
'Commission' paid to officials by users for illicit services, e.g. advantages, exemptions or discounts. Mostly related to negotiated transactions i.e. %, but can also be in the form of a rent to supervisors for appointment to posts that give access to illicit benefits. <i>Unwarranted fees</i> for public services/internal privatisation. 'Gratuity' in the form of	<i>Corrupt investments</i> , e.g. gift to public servant to create debt. <i>Formation of enduring relationships</i> , i.e. attempt to transform corrupt relations into stabilised social/patron-client relations. <i>Rapid accumulation of wealth</i> through public position given environment of uncertainty. <i>Mutualisation of corruption</i> between state	Institutionalisation of <i>voluntary work</i> and recourse to <i>administrative brokers</i> (e.g. lobbyists, canvassers of clients) because of lack of competent personnel needed to fulfil main functions of the state. <i>Division of the administration</i> in terms of the unrepresentative nature of formal hierarchies (in relation to actual practice) and	<i>Normative pluralism</i> that necessitates navigation between different systems of rules and fosters negotiation of the rules of the game. No clear separation of private/public and formal/informal rules. Pervasiveness of <i>relational networks</i> and exchange of services. Pervasiveness of <i>intermediation and brokerage</i> in social activities.

<p><i>ex-post</i> 'fee'. 'String-pulling' or favouritism (e.g. cronyism, nepotism etc.) <i>Levy</i> or 'toll' that is extorted rather than related to a service/transaction. 'White-collar' theft/'sideline' i.e. use of work premises and resources for private ends. <i>Misappropriation</i> (rather than private use) of public resources in which public origin of the commodity is concealed.</p>	<p>and auxiliary agents through hierarchical chain/redistribution of benefits. <i>Manipulation of regulatory regimes.</i> <i>Discursive strategies</i> based on strong element of bargaining/negotiation about sums and rules.</p>	<p>categorisation of posts as 'lucrative' or 'dry'. Deliberate creation of <i>queues/bottlenecks.</i> <i>Personalisation</i> of administrative relationships. <i>Impunity</i> and collective indebtedness. Absence of controls. <i>Privilegism.</i></p>	<p><i>Gifts, ostentation and over-monetisation</i> as source of financial pressure.</p>
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Source: Blundo and Olivier de Sardan (2006c).

The corruption complex means that the boundaries between corrupt practices and other behaviour or actions are often difficult to define.<sup>41</sup> Blundo and Olivier de Sardan found that components of this complex were remarkably similar across West Africa (see Table 4), although scale differed between the three countries. Two important conclusions they drew were that: (i) the corruption complex means that it is 'costly' for individuals to act 'honestly' or according to the formal rules,<sup>42</sup> and (ii) the integration of corruption in the ordinary functioning of the administrative system means that reformers are inherently marginalised. More research is required on bureaucratic conditions that alter the balances of incentives and enable 'principled agents' (Robinson, 2007) to resist informal internal and external pressures. Offsetting peer or social disapproval may require a combination of organisational measures that include remuneration, improved sense of mission, renewed professionalism and improved social status (Goetz, 2004). What is clear is that it is not sufficient to focus solely on punitive control measures, as these can be subverted.

Thirdly, *relational networks are a pervasive feature of the social landscape in Africa and are an essential element of the everyday strategies* adopted by those working in and using public administrations and services. The importance of social networks has two roots. The first relates to the normative importance of social ties – the moral imperative to help one's kin (Harrison, 2003). In his study of civil servants in Malawi, Anders (2005) describes how they are subject to a 'cultural dualism', based on the tension between their 'modern' middle-class aspirations and the continued strength of social obligations towards their kin and expectations emerging from the 'traditional' realm. The second is the importance of investing in and maintaining social networks to Africans' material strategies in the context of uncertainty and a dysfunctional state. Blundo and Olivier de Sardan's research portrays an administrative landscape where anonymity in dealings with the state equates to poor or non-existent service.<sup>43</sup> Personalisation of relationships with public officials is therefore a preventative strategy, one which necessitates continual investment in the form of

<sup>41</sup> Blundo and Olivier de Sardan (2006b) give the example of the fine distinction between the solicited *ex-ante* fee and the unsolicited *ex-post* gift or gratuity, arguing that 'the simple fact of an official doing his or her work with diligence and, moreover, without making request for payment in advance is generally exceptional and thus merits a reward ... only makes sense in the same administrative universe as that which creates the unwarranted fee.'

<sup>42</sup> As Blundo and Olivier de Sardan (2006b) note, this is not to suggest that broader socio-cultural norms cannot be compatible with 'honest' behaviour but that they contribute to the high cost of operating within the formal rules.

<sup>43</sup> Booth et al. (2006a) also make the point that, in many African countries, poverty is defined by the absence of networks and contacts. However, they also argue that Africans expect little official state assistance and may actively avoid contact with the state because it is perceived as being exploitative. Golooba-Mutebi (2005) also found that poor state services and distrust of public officials have led Ugandan service users to an everyday strategy of withdrawal and reduction of their dependence on the state.

material and non-material gifts to provide insurance against future needs (see also Sissener, 2001 on similar findings in China and Russia).

The resonance between social norms and material strategies explains the pervasiveness of the exchange of favours in African private and public life and the difficulty of isolating the public sphere from these.<sup>44</sup> These exchanges can be either horizontal (for instance, the mutually beneficial exchange between equals that occurs within public procurement, see Box 2) or vertical (for instance, corruption within unequal power relationships that occurs in the customs and transport sector corruption, see Box 1). Individuals are usually part of a number of networks with a range of sources, giving rise to multiple obligations relating to personal debts, familial or regional networks and those pertaining to political affiliation (Blundo and Olivier de Sardan, 2006b). While bribery is an act of last resort, signifying the absence of social connections (Sissener, 2001), the difference between a gift and a bribe can be subtle and is related to familiarity of the parties – for instance, a ‘gift’ may be used to establish a relationship with someone who is known through a third party. The difference between market corruption (monetary transaction) and parochial corruption (in a context of personal and reciprocal relationship) is therefore not always absolute (Medard, 1982).

Situating some forms of corruption within social exchange challenges the simplistic caricature of corrupt public officials seeking private gain (Sissener, 2001). Amundsen’s (1999) distinction between extractive and redistributive corruption<sup>45</sup> is useful for understanding the power relationships underpinning forms of petty, as well as grand, corruption and is a reminder that informal arrangements are often initiated and sustained by external actors. However, redistributive corruption needs to be disaggregated further to also distinguish forms of petty corruption that benefit predictable groups of society – for instance, the benefits derived by local political and business elites from corruption in public procurement – and more *ad hoc* and individualised corruption which enables ordinary Africans to access a level or quality of goods and services that they are entitled to but would not otherwise receive – for instance the ‘*ex-post* fee’ or ‘gratuity’.

### **Box 2: Corruption in local public procurement in West Africa**

In his ethnographic research on public procurement processes in decentralised administrations in Benin, Niger and Senegal, Blundo (2006a) found widespread horizontal and negotiated exchange between ‘equals’ (public decision-makers and private business), which produces corruption that is more ‘regulated’ than in other sectors. Decision-makers are able to create illegal revenue by paying higher than market prices for goods and services, thereby creating an excess to be shared with the contractor, who pays the decision-maker a commission (10%). The decision-maker biases the process towards ‘his’ contractor by influencing the transparency, competitiveness and impartiality of the process (e.g. diction of tender information, abuse of discretionary powers or the formation of *tontines* that take it in turns to ‘win’). These practices are often able to assume the appearance of legality through lax interpretation of regulatory texts, such as those allowing for direct negotiated contract with a specific supplier or contractor, and the creation of mechanisms to waive procurement regulations. Corruption takes places at all stages of the procurement process, from the negotiated commission at the beginning of the contract to the supplementary costs associated with

<sup>44</sup> This view is supported by Rund’s ethnographic research in India. He presents networking as being part of the survival strategies of Indians but also a practice that enjoys widespread cultural acceptance. Like Blundo and Olivier de Sardan, he suggests that (i) corruption is embedded in other social practices that are a part of daily life, and (ii) there is a blurring of the boundaries between the state or public realm and the private one, making insulation of the state from these practices difficult (cited in Harrison, 2003).

<sup>45</sup> Extractive corruption is characterised by the flow of resources from society to the state/elites and redistributed by the flow from state to sections of society. Amundsen (1999) argues that redistributive corruption is inherently particularistic, particularly damaging for the poor, who are unable to influence the flow of resources, and leads to erosion of state legitimacy and capacity. Chabal and Daloz’s (1999) claim that there is no separation of state and society in neopatrimonial states muddies this distinction between extractive and redistributive corruption. Their position would suggest that, rather than collective extraction by an undifferentiated elite, what takes place is elite extraction for distribution through vertical networks and, when this system functions, this affords the state legitimacy. However, as discussed earlier, there is insufficient evidence regarding the operation of vertical networks, including how these link the centre and the periphery and who is able to benefit from them.

inspections and payment. These practices are so much the norm that contractors usually factor such costs into their budgets. This is a closed system, constructed on personal relationships between decision-makers and contractors, necessitating continual invest in these.

Given the choice, Africans may prefer a state that is predictable and universalistic and, under these circumstances, social norms that facilitate corruption might wane over time (Sissener, 2001). In the absence of predictable state behaviour, however, personal networks constitute a key strategy for overcoming uncertainty and accessing goods and services. This leads to a vicious cycle, because personalism and favouritism reproduce the particularism of public services and therefore the perceived necessity of informal practices. Impunity is a direct result of this pervasive clientelism and social exchange, because it binds all within a culture of indebtedness and isolates those who seek to implement regulations as intended or expose those who do not (Blundo and Olivier de Sardan, 2006b; Anders, 2005). This makes reform difficult because ‘the sanctioning of one individual represents a threat to the entire system’ and means that the strong incentives for public officials to manipulate or act outside formal rules are not counterbalanced by incentives to act with probity and diligence, particularly in the absence of strong organisational incentives arising from supervision and other accountability mechanisms.<sup>46</sup>

Fourthly, *whether or not a corrupt practice is perceived as being legitimate is context-dependent and relates to both scale and circumstances* (Blundo and Olivier de Sardan, 2006b; Anders, 2005; Sissener, 2001; Harrison, 2003). Blundo and Olivier de Sardan (2006b) argue that corruption has two faces. The first is overtly illegal and broadly condemned. The second is legitimised by social practices, tolerated and sometimes unofficially encouraged (see Table 5). Actors adopt ‘situational morality’ depending on the position of the actor and the circumstances they are operating within. Favouritism in public services is widely denounced, but is perceived to have social legitimacy, as shown by the disapproval that results from non-conformity. Illegitimate corruption is therefore often that which transgresses socially defined boundaries relating to excess, greed or selfishness (i.e. where benefits are not redistributed) (Chabal and Daloz, 1999; Olivier de Sardan, 1999; Blundo and Olivier de Sardan, 2006b; Sissener, 2001), or corruption that involves theft of private, rather than public, resources. For instance, while theft and misappropriation are viewed negatively, they ‘become more acceptable when the perpetrator is known and when the “victim” is abstract, such as a public body’. In contrast, extortion, which involves theft of private resources, is universally perceived as being illegitimate (see also Section 5.4). Material needs can also influence how corrupt acts are perceived. For instance, white-collar theft, or the ‘sideline’, is recognised as being illegitimate but is tolerated because of the decline in wages (Blundo and Olivier de Sardan, 2006b; Anders 2005) (see Sections 4.1 and 5.3.1 for further discussion of the impact of wage reform).

**Table 5: Basic forms of corruption and degree of legitimacy**

Forms of corruption	Type of interaction	Degree of legitimacy
Gratuity	Spontaneous transaction	Legitimate
Commission for illicit service	Negotiated transaction	Highly ambivalent
String-pulling, favours, nepotism	Spontaneous transaction	Legitimate
Unwarranted fee for a public service	Negotiated transaction or extortion	Predominantly illegitimate
Levy or toll	Extortion	Illegitimate
White-collar crime, sideline	Appropriation	Predominantly illegitimate
Misappropriation	Appropriation	Highly ambivalent

Source: Blundo and Olivier de Sardan (2006b).

<sup>46</sup> Blundo and Olivier de Sardan (2006b) found a general absence of control in the sectors they researched: ‘Each official lives in a kind of bubble, which he sometimes shares with one or two others ... He does not have to provide detail reports on his work .. So long as there is no threat to the comfortable existence of colleagues or superiors, there is no accountability to them.’

Structural drivers place political and bureaucratic corruption on the same continuum, even if these are differentiated by scale and impact (Olivier de Sardan, 1999).<sup>47</sup> As discussed in Section 4.2, political systems in African are also characterised by a multiple, but often contradictory, rules. This hybridity provides opportunity for corruption, and moral ambiguity about the legitimacy of this, and unpredictable state behaviour (both political and bureaucratic). The notion of the 'corruption complex' can therefore be used to understand both political and bureaucratic corruption, its relationship to the everyday strategies of elites, bureaucrats and citizens, and the situating of such strategies within the functioning of the state system and wider social and material imperatives and norms. This also explains why efforts to reform bureaucracies in countries where elites engage in widespread political corruption have had limited success. Senior civil servants are unlikely to enforce laws and regulations and monitor behaviour in countries where senior politicians act with impunity and instrumentalise reform processes.<sup>48</sup> USAID (2005c) advocate that interventions should be sequenced and that direct anti-corruption measures and bureaucratic and regulatory reform are only supported in countries where there is the genuine high-level commitment (evidenced by the absence of entrenched grand corruption) that is required to make such reform effective.<sup>49</sup> Understanding the conditions that provide incentives for leaders to monitor corrupt bureaucratic behaviour is therefore crucial to increasing the efficacy of anti-corruption measures.

Anthropological studies add to the understanding of corruption as highly context-dependent. This points to the necessity of tailoring corruption reform to local realities in developing countries. The blurred public–private divide and partially perceived legitimacy (or inevitability) of corruption, and its embeddedness in social practices and relations, also imply that corruption may be highly resistant to change in certain settings. The main problem with anthropological accounts of corruption is that they are long on description and short on prescription. Topics such as the exact meaning of tailoring reform to local conditions, and whether local norms and practices could in certain cases be leveraged for anti-corruption reform, are scarcely addressed and need further research.

#### **4.4 Economic models of corruption**

The economic literature on corruption is vast, and the number of articles published on the subject has exploded in recent years (for reviews, see Svensson, 2005; Jain, 2001; or Andvig and Fjeldstad, 2001). The literature consists of theoretical work analysing the decisions of potentially corrupt agents and attendant consequences. It also consists of empirical studies, typically econometric studies using cross-country data or micro-data on companies, officials or households, which estimate the importance of different factors for the level of corruption.

This section makes no attempt to summarise this literature comprehensively. Rather, it aims to identify some major developments whose implications have not found their way into donor thinking and practice to any substantial degree. In other words, it is an attempt to think outside the box of current perspectives and practices and to draw implications from recent research that can expand and augment donor anti-corruption policies.

For the purposes of the discussion, it is useful to distinguish between two different sets of models that have been explored in the economic literature on corruption. One set of models seeks to

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<sup>47</sup> Political corruption and bureaucratic corruption are also be linked through the importance of leadership style, both in terms of setting an example and for supervision. For instance, Githongo (2006) stresses the importance of presidential accountability and, as noted below, the experience of political liberalisation in Malawi has shown that a culture of impunity can spread through the state hierarchy when conditions allow. The linkage between grand and petty corruption can be more literal when politicians, civil servants, businessmen and security officials are involved in 'embedded corruption networks'.

<sup>48</sup> Similar observations could be made on the need to be attendant to the broader political environment that firms operate within and the incentives they face as a consequence.

<sup>49</sup> In the absence of these conditions, USAID suggests that a combination of high-level diplomatic pressure and a broader governance approach, which increases economic and political competition and strengthens civil society, is more advisable (USAID, 2005c).

analyse the choice of agents between different lines of work or activity. In particular, the focus is on whether agents choose to engage in rent-seeking activities (including corruption) or productive activities (e.g. starting a private business). How many and which agents choose to be rent-seekers depends on the relative profitability of rent-seeking versus productive activity. Another set of models takes an agent's position or occupation as given, and discusses the incentives for the agent to commit or refrain from corrupt acts. The two perspectives are obviously linked, since the profitability of becoming a rent-seeker depends on the incentives to commit corrupt acts. Nevertheless, the policy implications of the two perspectives are qualitatively different, and the following sections therefore explore the two perspectives in turn.

#### **4.4.1 Rent-seeking and the importance of private sector development**

Corruption can distort incentives for career choices. Svensson (2005) recounts the following statement by the chief executive officer of a Thai firm: 'I hope to be reborn as a customs official'. As Svensson remarks, 'when a well-paid CEO wishes for a job with low official pay in the government sector, corruption is almost surely a problem.' The statement also illustrates another important point. When talented or skilled individuals gauge the attractiveness of different jobs and occupations, the material and other payoffs of the available options are compared. Where public positions offer substantial scope for boosted income through extraction of bribes or other rent-seeking activities, these positions become relatively more attractive, drawing in skilled individuals.

The choice between rent-seeking and productive activities made by talented individuals is analysed theoretically by Murphy et al. (1991). Recall that rent-seeking is not the same as corruption, but that the two overlap. In this context, rent-seeking refers to costly activities to appropriate existing wealth (as opposed to creating wealth), which also includes lobbying, litigation and other ways of acquiring a larger slice of a given pie. By contrast, productive activities capture wealth-creating endeavours that add to the total size of the pie, such as entrepreneurship in the form of starting and running a business.

Murphy et al. (1991) show that, where rent-seeking activities are sufficiently profitable relative to productive activities, the most talented people choose rent-seeking professions rather than entrepreneurship. Since those who choose to be entrepreneurs in this case are not the most highly skilled, productivity and innovation in the private sector suffers, which further reduces economic growth. Even in the case where productive activities are profitable relative to rent-seeking, drawing the most able people into productive enterprise, the mere presence of rent-seeking reduces the level of income. This happens because some people (although low skilled) choose to be rent-seekers rather than entrepreneurs, because rent-seeking activities absorb unskilled labour that would otherwise be used productively, and because rent-seeking amounts to a tax on productive activity, thereby reducing the latter.

Murphy et al. provide a set of factors that influence the relative attractiveness to talented people of rent-seeking and production. Their overview is reproduced in Table 6. Rent-seeking can be particularly profitable in countries where the government controls or has access to great wealth and resources, in the form of either national ownership or poorly protected property rights, which makes expropriation or appropriation of private wealth possible. Similarly, where the authority of rent-seekers is large, they have the ability to further expand their operations unchecked by law or custom. The extent to which rent-seekers can keep their collected rents is also a factor, as Murphy et al. point out 'in many countries official positions come with a territory of being able to collect bribes.' Conversely, productive activities are relatively attractive in countries where entrepreneurs have access to large markets for goods. The business climate is crucial, in terms of easy entry and expansion of firms in private markets, which includes the ease with which private firms can be started. For entrepreneurship to be profitable, property rights and patents must be sufficiently secure so as to allow entrepreneurs to harvest the proceeds from their investments.

**Table 6: Factors favouring rent-seeking and entrepreneurship**

	<b>Factors making rent-seeking an attractive choice</b>	<b>Factors making entrepreneurship an attractive choice</b>
<b>Market size</b>	Large resources go to 'official' rent-seeking sectors, such as the government, army or religion. Poorly defined property rights make wealth accessible to 'unofficial' rent-seekers. Large wealth that is up for grabs, especially relative to smaller goods markets.	Large markets for goods. Good communications and transportation that facilitated trade.
<b>Firm size</b>	Substantial authority and discretion of rent-seekers (such as government officials, army, etc.) enable them to collect large sums unhindered by law or custom.	Easy entry and expansion, few diminishing returns in operations, access to capital markets.
<b>Contracts</b>	Ability to keep a large portion of collected rents. In firms, observability of output that yields appropriate rewards.	Clear property rights, patent protection. No expropriation of rents by rent-seekers. Ability to start firms to collect quasi rents on talent.

Source: Murphy et al. (1991).

Although a problem in many developing economies, the misallocation of talent into rent-seeking activities and corruption is particularly glaring in countries rich in natural resources. The presence of large resource rents that can be appropriated provides a particularly fertile ground for rent-seeking. Towards a more general discussion of the implications of these perspectives for donors, it is instructive to consider recent evidence on how natural resource incomes and domestic institutions interact to influence development in such economies.

Natural resources can be a curse rather than a blessing for a country. There is ample evidence that countries rich in natural resources on average grow more slowly than countries without such resources, an observation that has been called the 'resource curse' (Sachs and Warner, 1995). Early studies attributed this to so-called Dutch disease effects, whereby an appreciating currency causes a contraction of the manufacturing sector, through which important spill-over or learning effects are forgone. Increasingly, however, the resource curse has been identified as a problem of natural resources and poor institutions leading to rent-seeking and corruption (Sala-i-Martin and Subramanian, 2003; Bulte et al., 2005; Mehlum et al., 2006).

The resource curse literature offers two primary perspectives on how institutions affect the development impact of natural resources. Mehlum et al. (2006) construct a rent-seeking model of the kind discussed above, whereby skilled individuals choose between rent-seeking and productive activities. By contrast, Robinson et al. (2006) model an incumbent politician seeking to secure re-election through patronage, i.e. the allocation of state resources and positions to clients to buy their votes and support. Both types of models suggest that corruption plays an important part in creating or averting the resource curse. The type of corruption involved is different, however. In the perspective of Mehlum et al. (2006), all corrupt acts that allow agents to capture a piece of the pie are included. Robinson et al. (2006) focus more narrowly on patronage, or the use of political power over state resources to secure one's political position.

Both models predict that natural resources are detrimental to economic development only in countries where institutions are poor. In terms of which institutions matter for avoiding a resource curse, however, the two perspectives differ markedly. The rent-seeking perspective of Mehlum et al. highlights the importance of institutions that govern the efficiency of the private sector, such as the rule of law, property rights and the quality of public services. Improving these *private sector institutions* increases the relative profitability of private enterprise over rent-seeking, and is therefore crucial to avoiding the resource curse. By contrast, the patronage perspective of Robinson et al. (2006) emphasises *public sector institutions* governing resource use and appointments in the public sector. The important thing here is to have institutions that reduce discretion and increase accountability in the use of public resources.

There is evidence to suggest that one type of institutions is more important for economic development than the other. Mehlum et al. (2006) provide empirical evidence that private sector institutions affect the development impact of natural resources. Similarly, Robinson et al. (2006) provide case study evidence for the importance of public sector institutions, and Damania and Bulte (2003) provide econometric evidence to the same effect. Neither of these studies, however, tests the importance of private and public sector institutions jointly. Such a test is performed by Kolstad (2006). The result is that, once both sets of institutions are included, only private sector institutions have a significant effect on the development outcome of natural resources. This suggests that private sector institutions are relatively more important than public sector institutions, particularly in economies highly susceptible to rent-seeking.

The importance of institutions that make the private sector work points to an important omission in the donor anti-corruption agenda, in both resource rich countries and elsewhere. A dominant portion of donor anti-corruption efforts has tended to focus on the public sector. The rent-seeking perspective outlined above suggests that we need to look beyond public sector reform and the accountability of public sector officials. To curb corruption, it is vital that we also create lucrative outside options for potentially corrupt agents. This requires an expansion and rebalancing of the governance agenda of donors, to give more emphasis to developing and improving public institutions governing the private sector, to secure property rights, the rule of law, ease of entrepreneurship and so on.

A further implication is that effective anti-corruption efforts may be less about governance and more about private sector development. In other words, the traditional focus on corruption as a problem of poor governance may be too limited. In addition to public institutions that affect private sector profitability, there are a number of further determinants and preconditions of lucrative private sector options (see Table 6). For instance, the existence of well functioning financial institutions is one important factor. Another could be the presence of private sector associations facilitating entrepreneurship. The size of the private sector market is of importance, with implications for policies on trade. In sum, considering the factors that make skilled individuals choose between rent-seeking and productive activities has implications that go far beyond the traditional governance agenda, and encompasses measures that are not usually associated with anti-corruption efforts

It is revealing to consider the anti-corruption strategies and principles of the World Bank and the OECD-DAC in view of these perspectives. The OECD-DAC Draft Principles for Donor Action in Anti-Corruption (OECD, 2005) do not include any passage capturing the importance of enhancing private sector development. The World Bank's draft strategy on governance and anti-corruption takes a fairly wide view of governance and includes institutions for the delivery of public services, infrastructure and a sound investment climate (World Bank/IMF, 2006). Creating a competitive and responsible private sector is also included as important in anti-corruption efforts. On closer inspection, however, the reasons given for including the private sector do not capture the arguments presented here, which suggests that the World Bank strategy in this area is incomplete.

The main reason for developing the private sector given in the World Bank strategy is that it can be a source of demand for better governance. It is not obvious that this is always the case. More importantly, as explained above, the key reason for developing the private sector in the context of corruption is to provide profitable alternatives to rent-seeking for skilled individuals. In other words, the main objective should be to reduce the supply of corrupt agents rather than increase demand for better governance. This implies that the strategy falls short in two ways. Firstly, omitting the main argument and focusing on a more vague idea of demand for governance entails too little emphasis on the importance and centrality of developing the private sector. Secondly, the priorities in developing the private sector will be different if there is a focus on demand for governance rather than supply of corrupt agents. If the aim is to create demand for governance, the focus would be on improving conditions for those parts of the private sector that can most effectively influence the government. If the aim is to reduce the supply of corrupt agents, the focus would be on improving

conditions in the private sector, such as increasing profitability in non-rent-seeking activities. Simplistically put, while more lawyers might increase demand for governance reform, more engineers would be preferable to reduce rent-seeking. There can also be a direct contradiction between the two approaches. If the agents who can most effectively petition the government are more likely to pursue rent seeking activities (lawyers are a case in point), the relative profitability of rent-seeking goes up rather than down.

The importance of creating valuable outside options for skilled individuals thus also has implications for strategies of private sector development more generally. In highly corrupt societies, the emphasis should not be on creating favourable conditions for just any private enterprise. What are not needed are more lobbyists, middlemen and influence brokers. Rather, the focus should be on improving those institutions and conditions that specifically draw skilled people out of rent-seeking activities.<sup>50</sup> Which specific institutions and conditions are most important in doing so, and should therefore be given priority, is open to further empirical analysis.

Similarly, there are implications for donor support to civil society. Organisations that are mere vehicles of rent-seeking activities should not be facilitated. This is an obvious problem in countries where a substantial number of NGOs represent private commercial or political interests.

#### **4.4.2 Incentives for private sector firms and public sector officials**

Another part of the economic literature on corruption focuses on incentives for individuals or agents who are in a given position or occupation. The basic economic model of corruption in these cases assumes that, in deciding whether or not to be corrupt, an agent calculates the expected payoff of the corruption. Specifically, the agent gauges the benefits of corruption (e.g. the size of the bribe or amount embezzled) versus the risk of being caught and the ensuing punishment (including both fines/imprisonment and forgone wages from losing one's job). If the benefits outweigh the risks in this calculation, the agent chooses corruption over clean conduct.

According to this line of thinking, then, one can reduce corruption by decreasing the benefits thereof, or increasing the probability of being caught and the consequences thereof. In other words, if the value of the decision a given agent makes is reduced, for instance by reducing his discretion over public funds or in other decisions of public priority, this would make bribes or embezzled amounts lower, which would reduce corruption. Similarly, if it is possible to increase the risk of being caught through increased monitoring, an agent would be more likely to be found out and incur a loss, which would reduce corruption. Finally, if the punishment for corruption were to increase, either through harder sanctions or through the loss of a more high-paying job, the agent would get a lower net payoff from corruption, which would consequently decrease.

The basic economic model of corruption has a great deal in common with the political science perspective reviewed above in Section 4.1. Factors such as discretion and monopoly may increase the value of an agent's decisions, increasing the gains from and hence the level of corruption. Similarly, increased accountability, in the sense of the ability of other parties to monitor and sanction misbehaviour, increases the risk and costs of corruption, and would therefore reduce it. There is a degree of interdisciplinary consensus here, which has also to some extent found its way into donor practice.

Nevertheless, there are important aspects and extensions of this perspective that have not been adequately adopted by the donor community. Here, we focus on two such aspects. Firstly, donor interventions have tended to focus on the behaviour of bureaucrats and others in partner countries, i.e. those on the receiving end of bribes. Less attention and focus has been given to what we might term the supply side of corruption, i.e. the incentives of firms and individuals that offer bribes to

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<sup>50</sup> This also marks the difference between this view and the position that one should focus on economic development rather than anti-corruption (Khan, 2004). Here, the point is to develop the economy specifically to address corruption.

affect the decisions of public officials. Secondly, economic incentive theory has advanced considerably from the basic model explained above. In particular, the field of behavioural economics, which combines economics and psychology, has generated findings that have elaborated on, nuanced and at times contradicted the simple implications offered by the basic economic model. The following two sections address these issues in more detail.

### ***Corporations should face clearer incentives***

Supply-side issues, and in particular the importance of making the corporate sector more responsible in terms of refraining from bribery, have begun to receive attention. However, the profile of interventions by donor countries towards creating a more responsible and less corrupting private sector has relied on measures that are not sufficiently effective. To understand how this is the case, this section first reviews the factors that influence the conduct of the private sector, and the types of measures that are available to counteract irresponsible corporate behaviour.

Corruption, and the responsibility of corporations more generally, can be affected by a number of different factors. The nature and characteristics of a company's activities and product is one factor. For example, technologically advanced products can be hard to subject to standardised procurement procedures, and may require more interaction between buyer and seller, which can increase the scope for corruption. A number of factors external to the firm may affect the scope and profitability of corruption. For instance, negative reactions from customers to corruption reduce the profitability thereof.<sup>51</sup> Similarly, a firm may incur a loss from corrupt dealings if workers or investors are ethically minded.<sup>52</sup> Moreover, the level of competition in the market may affect the profitability of corruption.<sup>53</sup> These factors all suggest that corruption varies considerably between sectors, which empirical study confirms (Søreide, 2006). In addition, factors internal to the firm have an effect on the level of corruption. These include the system of corporate governance, organisational structure and management characteristics.<sup>54</sup>

Donor agencies, and donor country governments more generally, can primarily influence the external environment of firms. A number of initiatives have been taken by donor countries to increase corporate social responsibility and reduce corruption by corporations. The initiatives taken can be assigned to four broad categories, as presented in Table 7. The former two categories capture initiatives aimed at eliciting voluntary action by corporations. These can be divided into two types, uncoordinated and coordinated.

The uncoordinated case describes measures to encourage voluntary corporate social responsibility by corporations, such as verbal or political backing of these types of corporate actions. The coordinated case includes measures to solve collective action problems among firms, where all firms benefit from increased responsibility, but where the gains to each firm do not outweigh the costs of acting unilaterally. Examples of such initiatives may be Global Compact, or the Extractive Industries Transparency Initiative, although it is not obvious that their only aim is to address these types of collective action problems.

A third type of initiative aims to increase the costs of being irresponsible, thus focusing on creating greater economic incentives for responsible behaviour among firms. There are various ways in which to do this. One is to refrain from investing in irresponsible companies. For instance, the Norwegian petroleum fund excludes companies involved in serious corruption from its investment universe. Procurement policies can be used in the same way: notably, the World Bank has a policy of blacklisting companies that violate a set of anti-corruption regulations, where companies are barred for a period of time from Bank purchases. Donor country governments may also use tax

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<sup>51</sup> See Kolstad and Søreide (2006) for a discussion and analysis of how corporate social responsibility is affected by consumer reactions and market conditions.

<sup>52</sup> See Brekke and Nyborg (2004) for an analysis of how responsible firms may attract more efficient workers.

<sup>53</sup> See Shleifer (2004) and Kolstad and Søreide (2006).

<sup>54</sup> See Kolstad (2007a) for an analysis of how organizational structure affects social norms in an organization.

instruments to make undesirable conduct more expensive, environmental taxes being a case in point.

A fourth type of initiative focuses on legal remedies. The objective of these types of initiatives is to promote the introduction of anti-corruption legislation, in donor and/or partner countries. Examples include unilateral measures such as the US Foreign Corrupt Practices Act, and multilateral processes such as the OECD anti-corruption convention.

**Table 7: Measures to improve corporate social responsibility**

Type of measure	Examples	Role of donor countries
Voluntary initiatives, uncoordinated	Company CSR policies	Motivator
Voluntary initiatives, coordinated	Global Compact, Extractive Industries Transparency Initiative	Facilitator
Economic incentives	Norwegian Oil Fund, World Bank blacklisting, environmental taxes	Purchaser, investor, tax collector
Laws and regulations	US Foreign Corrupt Practices Act, OECD anti-corruption convention	Regulator

Source: Kolstad (2007b).

Donor country initiatives in the areas of corporate social responsibility generally and anti-corruption specifically have tended to emphasise voluntary initiatives and laws, while neglecting the use of incentives. In other words, donor countries have acted primarily as motivator, facilitator or regulator of corporate action. While this approach will likely bring some results, these will be modest in terms of changing corporate behaviour. A major shortcoming of voluntary initiatives, whether uncoordinated or coordinated, is that they leave companies to pursue whatever policies are in their interests. In other words, companies can implement policies against corruption only to the extent that they profit from them, and nothing more. It is not generally in the interest of companies to be progressive on the issue of corruption; companies do not necessarily profit from a strong anti-corruption stance nor from being generally responsible.<sup>55</sup> Some companies whose profits are particularly vulnerable to reputation effects, e.g. companies with strong brand names in consumer markets such as Nike or Coca-Cola, may profit from avoiding corruption. Other types of companies lead a far more anonymous existence insulated from consumer reactions, and will not face these types of effects. In some cases, a company can achieve important strategic results in terms of market position by means of corruption, which means that the gains from corruption in terms of profits may be large, even in the long run. In other words, policies that focus on eliciting voluntary action against corruption are likely to have very limited results.

There are shortcomings to the legal approach to the supply side of corruption as well. Although legislation has a place, not all types of conduct can or should be regulated by law. Putting absolute limits to behaviour to be enforced through a legal system can be a costly strategy in terms of administration and resulting economic inefficiencies. For laws to have an effect, sufficient resources must also be dedicated to monitoring and enforcement, which is not always the case. There is also the problem of jurisdiction: companies located in countries with lax anti-corruption laws are not affected by this type of legislation, and may in this way gain a strategic advantage.

The next generation of measures to improve corporate social responsibility and reduce corruption should therefore focus on incentives. By making it costly for companies to operate by means of corruption, the company bottom line will reflect society's objectives, and corruption will be effectively reduced. For donor agencies, the most obvious means to create better incentives for

<sup>55</sup> See Kolstad (forthcoming) for a review of the empirical literature on corporate social responsibility and corporate profits.

corporations are procurement policies.<sup>56</sup> If corrupt companies are barred from bidding for donor-funded activities, this would directly cut into their bottom line. If these types of measures were adopted in donor country procurement policies as a whole, the effect would be even more pronounced. Better yet, a coordinated policy of procurement screening across countries could be highly effective. Profit-maximising companies understand the language of money. If a company risked being barred from public procurement in the European Union, it would think twice before becoming complicit in corruption. These types of incentives also avoid the problem of jurisdiction, as all companies, whatever their origin, would be subject to these types of sanctions.

It is easy to understand why policy-makers have favoured voluntary initiatives. These types of measures can be introduced with a minimum of political controversy. By contrast, adopting policies that explicitly punish companies for untoward behaviour can be much more demanding politically. In one sense, however, it may be easier to implement incentives in terms of procurement policies than anti-corruption legislation. While legislation may raise fears in domestic industries of being at a competitive disadvantage to firms from countries without similar legislation, incentives affect all companies regardless of origin and, therefore, to some extent, at least preserve a level playing field.

In terms of creating incentives for companies to avoid corruption, the World Bank appears to play a progressive role through its sanctioning policies of companies caught in corruption. Debarment by the World Bank appears to be restricted to corruption related to Bank-funded activities, which makes the policy somewhat limited. More generally, whether the World Bank policy in this area is a model to be followed needs further evaluation.

### ***Making individuals behave cleanly can be demanding***

While the basic economic perspective outlined above has been taken to mean that individuals think in a largely self-interested way, and can be easily influenced by monetary incentives, the relatively recent field of behavioural economics has offered a new and expanded view of what motivates individuals and what this motivation implies in terms of incentives. Behavioural economics expands the motivational assumptions of the basic economic models by including preferences that are social in nature and by studying how the framing and context of incentives affect their impact on individual behaviour. For instance, behavioural economics provides evidence to the effect that individuals, in addition to being self-interested, are influenced by considerations of fairness (see Konow, 2000). In other words, at times, individuals are prepared to give up personal gain to promote a more equitable distributional outcome. Another strand of behavioural economics finds support for the idea that individuals are influenced by perceptions of reciprocity (see Fehr and Falk, 2002). This means that they will respond with hostility or low effort to offers or treatment that appear hostile or unfriendly, and with high effort to treatment that is friendly and trusting. A third strand suggests that intrinsic motivation for tasks may be affected by monetary incentives (Frey, 1997).

The existence of these types of motivations has important implications for the use of incentives in organisations and bureaucracies. The example of reciprocity is perhaps the most telling (Fehr and Falk, 2002). In experiments conducted to test the theory of reciprocity, individuals are given different kinds of monetary incentives; their responses in terms of work effort are recorded. In particular, the following two incentive schemes have been compared. In one treatment, individuals get a basic pay of  $x$  euros, and an additional  $y$  euros if their effort is high. In another treatment, individuals get a basic pay of  $x + y$  euros, but  $y$  euros are deducted if their effort is low. Notice that the outcomes for the individual are the same in both cases, they get  $x$  euros for low effort, and  $x + y$  euros for high effort. However, the framing of the incentives is different. In the first case, individuals get a reward for high effort; in the second they are punished for low effort. Although the outcomes are equivalent, there is a measurably higher effect of incentives on effort in the case where they are presented as a reward compared with where they are presented as punishment.

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<sup>56</sup> A move from project to budget support, or use of local systems more generally, may in this case leave donors with fewer options in addressing the supply side of corruption.

These types of findings suggest that the way in which economic incentives are given and presented is important for their effect on individual behaviour. This insight has found its way into the literature on corruption only to a very limited extent, and the implications for donor policy have scarcely been discussed. For instance, empirical studies of the impact of increased civil service pay and corruption commonly do not make these types of distinctions (see van Rijckeghem and Weder, 2001). Nor have donor reviews of wage reforms paid much attention to these issues (see OECD, 2003). Consequently, there is still a great deal to learn about the impact of economic incentives in reducing corruption, in terms of both research which integrates these perspectives into the study of corruption and application to public policy. Corruption is clearly a moral choice on the part of individual agents, and the interaction with norms of fairness, reciprocity or intrinsic motivation is potentially important. It is highly likely that these types of effects are greater for individual decision-makers (e.g. civil servants) than for organisations or collectives (e.g. firms), whose objectives are highly monetised and subject to more standardised and routine decisions. Even this is open to further study.

These types of arguments also indicate that the frame of reference of individual agents is important in determining their behaviour. What is considered just and equitable, friendly and hostile, acceptable and unacceptable, depends on persistent patterns of behaviour or what others are doing. In other words, social norms are important in determining the extent of corruption and the effect of incentives in reducing corruption. It is well known that, where corruption is widespread, social norms against corruption are weak, which implies that individuals have few qualms about corrupt behaviour, making the high level of corruption persistent and resistant to reform (Andvig and Moene, 1990). In other cases, anti-corruption efforts may have an effect on social norms related to corruption, favourable or unfavourable. For instance, if increased wages in the civil service induce more individuals to be rent-seekers, social norms against corrupt behaviour may be undermined. It is therefore important to consider the impact of anti-corruption efforts on social norms and practices.

It is interesting that these developments in economics have in one sense resulted in a convergence with the perspectives of the other disciplines reviewed above. Both economics and anthropology would see norms and the logics within which individuals act as important in the understanding of corruption. Similarly, clear links to the importance of informal structures and interaction are highlighted by the political science perspective. However, it is one thing to point out that norms and informality are important in understanding corruption. It is more important to find out how norms, cultural logics and informal structures work, how social norms are formed, what makes them persist or evolve. This would also provide a better understanding of how to tackle corruption effectively. Further research is needed to examine these issues more thoroughly.

## **4.5 Summary**

This section has explored the causes of corruption from three disciplinary perspectives within the social sciences: political science, economics and anthropology. A triangulation of these three perspectives is highly useful in identifying key challenges for anti-corruption efforts. Although the focus of the three perspectives is different, a great deal of convergence emerges between the disciplines in their understanding of the main drivers of corruption. The political science and economic perspectives on corruption both stress the importance of institutions and incentives, suggesting that corruption thrives in conditions where there is too little accountability and where actors have too much monopoly and discretion. Political science and anthropology share an emphasis on the importance of informal institutions and practices in shaping corruption outcomes. The importance of social norms in relation to corruption is studied by both anthropology and recent economic research.

The combined literature supports the view that the causes of corruption are complex and multifaceted, providing the underlying message that anti-corruption strategies will also need to be such. The main messages are summarised below.

1. The impact of institutions on opportunities, incentives and corrupt behaviour is emphasised by political science and economic theories. Consequently, anti-corruption programmes have emphasised the importance of institutional reforms that increase political and economic competition (e.g. democratisation and economic liberalisation) and strengthen accountability and the enforcement of rules (e.g. PFM, civil service reform, support to societal or state watchdogs, rule of law, etc.) However, empirical evidence suggests that corruption tends to be more prevalent in countries undergoing political and economic transition (relative to authoritarian regimes or more mature democracies). It is thought that this is because formal institutions – such as those underpinning vertical, horizontal, societal and public management accountability – are not functioning as intended and are weakly integrated. The opportunity for corruption is increased when authoritarian controls are not replaced with effective democratic checks and balances.
2. Political economy analyses suggest that the dysfunction of formal institutions is principally explained by their suffusion with informal norms and practices, such as personalism, clientelism and other forms of social exchange and obligations. This multiplicity of incompatible rules increases the opportunity for corruption and, in some circumstances, its perceived need and legitimacy. Informal practices, including personalism, appropriation of state resources and patronage, have played a key role in elite strategies for maintaining power and legitimacy. There is evidence that, by making elites less secure, political liberalisation has increased reliance on political clientelism and corruption. Elites will only support reform processes – including the consolidation of formal institutions – if they do not undermine their ability to retain power, and will instrumentalise reform processes that do not serve this purpose. It is therefore important to identify reforms that provide political gains for government as well as benefiting society. The systemic drivers of corruption that link petty and grand corruption mean that public sector reform is also unlikely to be effective in countries where there is entrenched political corruption.
3. Anthropology provides key insights into socio-cultural norms, their relationship to corruption, and their relevance for the everyday strategies of Africans. Ethnographic evidence suggests that informality is common in some African administrations; the uncertainty this creates forces all actors to adopt defensive strategies based on personalisation, social networks and exchange to meet their material and social needs. These conditions favour corruption because they blur the boundaries between public and private spheres and influence perceptions regarding legitimate behaviour. The widespread nature of informality also creates a culture of indebtedness that marginalises reformers and makes working (exclusively) within formal rules costly. Tackling petty corruption requires addressing the informal counterculture and hierarchies prevalent in African bureaucracies. Anthropology suggests that socio-cultural norms are dynamic and change alongside other processes of economic and political transformation. However, existing anthropological accounts of corruption are long on description and short on prescription. More research is required to understand how norms change; directly influencing them is likely to be difficult.
4. The role of private agents in corruption has been neglected relative to that of public officials. As indicated in Section 2, and analysed further in Section 4.4.1, a main problem with corruption is that it distorts the choices of economic agents. Decisions about whether to engage in rent-seeking/corruption or productive activities (such as starting a business) are influenced by their relative profitability. An implication is that effective anti-corruption efforts may be less about governance and more about private sector development (e.g. protecting property rights, easing entry and expansion of firms, improving financial institutions, increasing market size, etc.) In other words, the traditional donor focus on corruption as a problem of

accountability and poor governance may be too limited. Although most donors already have large private sector programmes, these are not explicitly designed to curb corruption.

5. The lack of attention given to private agents – both companies and private citizens – means that the supply side of corruption has also been neglected. Those initiatives that do exist (in the areas of corporate social responsibility generally and anti-corruption specifically) have tended to emphasise voluntary initiatives and laws, which will likely produce only modest results. The next generation of measures to improve corporate social responsibility and reduce corruption should focus on incentives, through policies that directly affect the bottom line of companies. For instance, coordinated procurement policies where corrupt companies are debarred would make it costly for companies to be corrupt, and hence have a tangible effect on corporate conduct. Introducing such measures presents important political and practical challenges. Although limited, World Bank debarment policies provide an interesting initial testing ground.

## 5. Anti-corruption and governance reforms<sup>57</sup>

As the preceding section on the causes of corruption clearly indicates, fighting corruption is not an easy task. Corruption is the outcome of a variety of interdependent factors and, accordingly, there is no easy solution. As we have seen, corruption does not depend only on the state of governance in partner countries. Imperfections of formal institutions are only a partial explanation. The phenomenon is also closely linked to the coherence of formal and informal institutions and, in particular, whether informal interactions and norms undermine rather than support the formal system. Moreover, the governance agenda has tended to focus narrowly on public sector accountability issues but, as the previous sections show, effective anti-corruption action requires a broader conception of governance. It is also necessary to go beyond governance to include other measures that address private sector development, supply-side issues and donor practices.

Nonetheless, governance reforms are a key starting point, and they have been the key pillar of donor anti-corruption strategies thus far. This section focuses on the types of governance reform that donors can support and have supported in addressing corruption in partner countries. It starts with a general overview of the possible strategies and entry points, and then goes on to discuss reform in four particular areas.

### ***5.1 Anti-corruption and governance: An overview***

The term governance captures a number of different institutions, relationships and processes. For instance, the World Bank (2007a) defines governance as follows: 'Governance refers to the manner in which public officials and public institutions acquire and exercise the authority to provide public goods and services'. Accordingly, Figure 2 captures common approaches or entry points to governance reform, as enumerated by the World Bank.

The various entry points can be viewed in relation to the four dimensions of accountability commonly employed (see Section 4.1). Vertical accountability of political leaders to citizens through electoral channels relates largely to the political accountability box at the top of Figure 2. Horizontal accountability, where some government agencies oversee, control, redress and sanction other government agencies, is related to the left-hand box of formal oversight institutions. Managerial accountability concerns the centre box of public sector management and its relationship with the political level of government. Societal accountability, where civil society and the media monitor and address actions of the state, is largely reflected by the bottom and right-hand boxes.

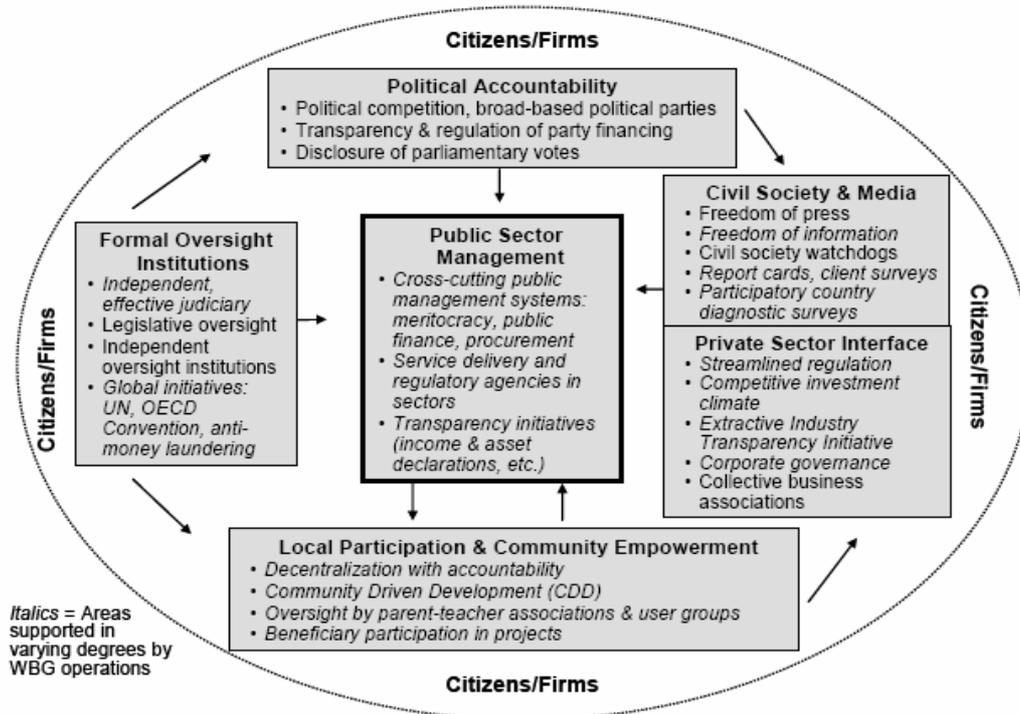
To a large extent, donor-supported anti-corruption efforts in developing countries have focused on creating and improving institutions of horizontal accountability, such as anti-corruption commissions, audit institutions and so on. The effect of these types of interventions in terms of reducing corruption has been rather disappointing (Svensson, 2005). A main sticking point has been the unwillingness of corrupt governments wholeheartedly to implement reform that reduces their own opportunities for enrichment.

A case in point is represented by the independent anti-corruption commissions that have been set up in a number of countries. Outside of Hong Kong and Singapore, these have not been a success. In particular, a study of anti-corruption commissions in five African countries argues that 'the ability of any ACC to tackle contemporary, very high level political corruption is ... in question' (Doig et al., 2005). Similar findings are repeated in other studies on the subject (Meagher, 2004; Hutchinson, 2005). As a consequence of the limited results arising from efforts to improve horizontal accountability, donors have begun to emphasise reform that strengthens other types of accountability relationships, such as societal accountability through CSOs and the media.

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<sup>57</sup> This section was written by Verena Fritz, Ivar Kolstad and Tam O'Neil.

**Figure 2: World Bank entry points for governance reform**



Source: World Bank (2007a).

Moreover, numerous donors have recently increased the profile of their governance and anti-corruption strategies (World Bank, 2007a; DFID, 2006; European Commission, 2006; USAID, 2005c; Ministère des Affaires Étrangères/France, 2006). This is likely to translate into (i) more analytical work on governance and anti-corruption and (ii) more donor activities on anti-corruption (as well as governance more broadly).

It is beyond the scope of this paper to give a full review of all governance interventions that have been used in the fight against corruption. Below, we focus on four areas. Section 5.2 on democratisation and corruption addresses vertical or electoral accountability. Section 5.3 on PFM addresses managerial and horizontal accountability. Section 5.4 on grassroots monitoring and civil society and Section 5.5 on the media look at societal accountability. The focus is on the conditions under which donor attention to these areas can have a significant impact on corruption in partner countries, and lessons from previous experience in these areas (to the degree that these are available). The four areas have been chosen partly because of the evolving emphasis in anti-corruption thinking as outlined above, but also because of preferences expressed by Irish Aid.

## **5.2 Democratic reform**

In accordance with Klitgaard's definition (referred to in Section 4.1 above), there has been an expectation that greater competition both in the economic and in the political sphere will lead to lower levels of corruption. This view also informs public perceptions in aid-providing countries, that aid is most at risk when given to 'corrupt dictatorships'. There are several assumed mechanisms by which a democratic system of government would limit corruption: (i) regular elections: politicians who have to face elections at regular intervals have an incentive to deliver public goods, and to be seen as 'clean' so as to enhance their chances for re-election ('vertical accountability'); (ii) in democratic systems, there are more internal checks and balances within government (primarily of the legislature and the judiciary, as well as certain specialised organs such as ombudsmen and

audit offices on the executive) ('horizontal accountability'); and (iii) when society is free to organise, groups will emerge that hold the government to account and there will be a free press to expose corruption ('societal accountability' – addressed in greater detail in Sections 5.4 and 5.5).

Furthermore, comparative data (including developed as well as developing countries) show that democratically governed countries have lower levels of corruption than those with less democratic regimes (Shen and Williamson, 2005). At least in part, donor support for democratisation has been motivated by the expectation that changes in the political regime will have positive spill-over effects for wider areas of governance, including a reduction in the levels of corruption.

However, while a democratic system as such may be good for limiting corruption, available evidence points to the fact that *democratisation processes* do not automatically translate into a reduction in corruption and may in fact be associated with increasing corruption (Johnston and Kpundeh, 2004; Doig and Theobald, 2000). Some authors have posited that this may be related to a J-curve, in which initial democratisation, and democratisation processes resulting in hybrid and unconsolidated democratic regimes (as discussed in Work Package 1), lead to higher corruption, while the consolidation of a democratic system would then be associated with a reduction of corruption (see Lambsdorff, 2005; Shen and Williamson, 2005).

A number of studies – focusing on single cases as well as comparative ones – point to the association of hybrid/unconsolidated democracies with increased levels of corruption. For example, the Drivers of Change study on Malawi states: 'Under Muluzi, there was also a "democratisation of corruption" – that is, a slightly more inclusive co-optation of potential opponents. During the Banda era corruption was highly centralised. Those, such as Muluzi, who were accused of stealing from the MCP or the state were imprisoned. In contrast, during the Muluzi regime corruption with impunity became widespread, starting at the top and reaching down to the lowliest public servant' (Booth et al., 2006b). Similar findings emerge from studies on other African countries, for example Mozambique in the post-1990 democratisation period (Stasavage, 2000). As Moran (2001) indicates, the association between democratisation and increasing corruption is not limited to African countries, but has also been observed in East Asia and Latin America. Furthermore, the single and comparative case studies in particular suggest that both petty and grand forms of corruption can expand during democratisation processes.

Several mechanisms have been identified as possibly contributing to an expansion of corruption in the context of (incomplete) democratisation processes (see Section 4.1). Democratic political processes are costly and the financing of election campaigns is a potential 'driver' of corruption in developed as well as developing countries (TI, 2005a; 2005b; Doig and Marquette, 2005; Fritz, 2007). As the Drivers of Change study on Malawi (Booth et al., 2006b) points out, democratisation can lead to a weakening of former top-down control systems which, in turn, allows the spreading of corruption within the government and the public administration. Furthermore, in semi-democratic systems, corruption (linked to patronage) and selective anti-corruption campaigns can be tools for maintaining power and/or for legitimising current power-holders (prosecution of corruption of previous governments, prosecution of potential political competitors, etc.) As Johnston and Kpundeh (2004) and others have emphasised, the presumed mechanisms for accountability and for limiting corruption as outlined above often remain weak in incomplete democracies, for example, civil societies remain weak and fragmented, whereas parliaments and the judiciary often remain subordinate to top leaders of the executive.

Beyond the narrow link between democratisation and corruption, the wider context in which democratisation processes take place also plays a role: democratisation in Africa took place in the context of structural adjustment programmes (SAPs) (and in the wake of a building-up of economic crisis) which frequently weakened the state and were associated with sharp reductions in civil service salaries.<sup>58</sup> In transition countries, democratisation took place against the background of

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<sup>58</sup> The literature is inconclusive on the issue of whether and how civil service salaries are associated with levels of corruption; some relationship is likely to exist (Section 5.3.1).

large-scale economic changes and privatisation, where potential benefits to be reaped from corrupt transactions were enormous (receiving valuable assets at low prices). The link between democratisation and corruption may also be affected by factors such as natural resource booms, which are widely assumed to carry high risks for accountability and 'clean' governance (Robinson et al., 2006; Fritz, 2007) (see also Section 4.4).

There is some evidence that democratic consolidation may be associated with an eventual lowering of corruption. To date, available evidence on this comes more from transition, middle-income countries than from African countries. As reflected in Table 2 in Section 3, the limited progress with further democratisation in Africa over the past decade has not been associated with any decline in levels of corruption among Irish Aid partner or potential partner countries (and the situation is similar for the group of sub-Saharan Africa and LIC countries as a whole). The degree of democratic consolidation that could lead to lower levels of corruption is unlikely to be achieved in most sub-Saharan African countries in the short to medium term.

For some transition countries, a decline in levels of perceived corruption has occurred, as measured by various indicators and surveys (TI/CPI; BEEPS).<sup>59</sup> The 2005 BEEPS survey found improvements particularly in the Slovak Republic and Georgia and (to a lesser degree) in Bulgaria and Romania.<sup>60</sup> All four are countries in which a deepening of democracy took place between the late 1990s and the mid-2000s. Corruption continued to be highly problematic in countries such as Kyrgyzstan, Albania, Serbia and Montenegro and Russia. Interestingly, not all forms of corruption related to the government-business relationship decreased equally: corruption related to government inspections and services (fire, safety and health, customs and taxation, utilities) decreased markedly, but corruption related to courts and to government contracts showed increases between 2002 and 2005 across the transition countries (World Bank 2006b).

Work Package 1 studied the various ways in which donors support democratisation in developing countries: (i) support to the 'demand side' (civil society, media), (ii) support to political institutions and processes – elections, parliaments and political parties, and (iii) support to the judicial sector. Several of these are assumed to have close linkages with efforts to reduce corruption. However, closer scrutiny suggests that the potential of these activities for improving governance overall is not reaped in full at present.

As Michael and Kasemets (2007) have pointed out for the realm of parliamentary support, donor programmes have been largely technically focused, and have assumed that there is a lack of 'technical' capacity among parliamentarians and their support staff in developing countries with regard to corruption. As a consequence, donor support for democratisation and anti-corruption through support to parliaments has failed to take into account the incentives which parliamentarians face (i.e. what would motivate MPs to engage in anti-corruption and to do so in a public-goods oriented fashion, rather than for short-term political gain).

In principle, efforts to strengthen the demand side for democratic governance (civil society, media) should be fully compatible with strengthening the voice of citizens, also with respect to anti-corruption (but see Sections 5.4. and 5.5. for a more nuanced view). Similarly, efforts to strengthen the judicial sector should play an important role in entrenching democratic norms and practices, as well as helping reduce corruption – if these efforts are effective in the face of two frequent challenges, the politicisation of the judicial sector and the prevalence of corruption within it.

Moreover, as Johnston (2005) has pointed out, historically, in most democratisation processes 'checks against various abuses were not so much schemes for good governance as political

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<sup>59</sup> The BEEPS is a joint survey by the World Bank and the European Bank for Reconstruction and Development that surveys local firms in transition countries. Three rounds of the BEEPS have been conducted (1999, 2002 and 2005).

<sup>60</sup> These findings are not fully consistent with data from the CPI – e.g. Georgia improved somewhat between 2002 and 2006 – from 2.4 to 2.8; Bulgaria remained at 4.0. However, as 'primary data', the BEEPS may be picking up changes earlier than the CPI. Clearer improvements are reflected in the CPI for strong reform frontrunners, such as Estonia.

settlements – rules that contending interests could live with and could enforce by political means'. Thus, democratisation and anti-corruption efforts are most likely to be mutually reinforcing where there is a strong opposition that has a real social power base.

Overall, promoting the liberalisation of political systems and the ending of authoritarian forms of rule as such do not appear to translate automatically into reducing corruption (and may even be associated with increasing corruption). Rather, where democratisation has started but remained incomplete, the challenge is to support specific reforms that can help to make democratic accountability actually work. This can include, but need not be limited to: (i) supporting rules and practices that help to 'clean' party and campaign financing; (ii) limiting executive dominance; (iii) enhancing checks and balances (e.g. through constitutional arrangements that limit terms as well as appointment powers of the head of state; support to the strengthening and professionalisation of the judicial sector; enhanced opportunities and incentives for parliament to check the power of the executive); and (iv) opening up government for societal scrutiny and policy inputs.

In policy terms, it may be useful to promote a closer integration of work on democratisation (often carried out by US and European foundations – see Rakner et al., 2007) with work aimed at improving governance and reducing corruption (often carried out by donors directly and/or through consultancy companies). The two strands of work are often separated in developing countries. However, a link is important precisely because democratisation does not automatically lead to benefits in terms of reduced corruption, and pervasive corruption can undermine democratic systems (as occurred in Bangladesh in winter 2006/2007). This may imply *inter alia* a greater focus on those aspects of democratic systems that can help to contain corruption, such as: reforms of electoral systems and incentives, or party financing reform; working with parliaments with respect to their budget oversight function; and general efforts to strengthen incentives for governance in the interest of the public at large and a more effective and broad-based civil society.

### **5.3 Public financial management**

In terms of public finances, corruption affects both the revenue available to the state and the way in which it is used as expenditure for different ends. Corruption that affects revenue collection also affects the expenditure side because there are fewer resources available for public sectors such as health and education; a country may be more aid-dependent as a consequence. Similarly, corruption on the expenditure side may make reform of revenue collection less effective because expenditure ultimately decides the development impact of reform. Although the two are interlinked in this way, corruption in relation to revenues and expenditures will be discussed below in turn.

#### **5.3.1 Revenues<sup>61</sup>**

Tax evasion and corruption in the tax system is a huge problem in many developing countries. In Guatemala, tax evasion was estimated at more than two-thirds of revenues collected in 2003 (Mann, 2004). In Ecuador, value-added tax (VAT) and business income tax evasion were estimated to be 21% and 43% respectively in 2001 (Fjeldstad, 2005). Customs is a sector that has been seen as particularly vulnerable to corruption, e.g. estimates from Tanzania show that official import statistics underreported their value by 70% in the mid-1990s (Fjeldstad, 2003). Besides lost revenue, corruption in revenue administrations also produces serious distortions in the economy. Corruption increases costs and can in these cases limit the extent of economic activity in the

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<sup>61</sup> This section focuses on the national tax system. Less attention is given to local government revenue and various fees and fines collected by other governmental ministries and bodies, such as education fees and police fines. This does not mean that corruption is not a problem in these cases. A state may also receive revenues from state-owned corporations. This is not covered here, although corruption is a problem in these cases, in particular in relation to natural resources.

private sector.<sup>62</sup> Moreover, it can shift activities from areas vulnerable to extortion by tax officials, to areas where taxes can more easily be evaded, for instance in the informal sector. This can lead to a suboptimal allocation of resources in the private sector which hampers economic development (and in turn lowers state revenues from taxation). Recent contributions also stress the link between taxation and governance, arguing that the absence of tax payments may lead citizens to make fewer demands on government performance and get less involved in the democratic process (Moore, 2004).

To address corruption in the tax system of a country, it is important to know the forms corruption takes and the specific causes of corruption in this area. After presenting forms and causes, this section discusses reform of the tax system. Note that the tax system of a country consists of tax policy and tax administration. Tax policy basically specifies tax bases, i.e. what is to be taxed and at what rate. Tax administration is the organisational implementation of tax policy through revenue collection bureaucracies.

The integrity of a country's tax system can be violated in a number of ways (see Table 8). Businesses or wealthy individuals can influence the formulation of tax policy through lobbying or bribery of government officials and parliamentarians. In this way, they can obtain reductions in what is considered taxable income or profits, lower tax rates or outright exemptions. In some cases, the makers of tax policies and the subjects of taxation are one and the same, as when politicians have major ownership shares in corporations.

Individuals or companies can also attempt to pay less tax than they should according to tax law. This is called tax evasion. Tax evasion can be achieved without the involvement of officials in the tax administration, such as in cases of smuggling, underreporting of tax bases such as income or profits or the value of goods, and misspecification of goods in relation to customs. Strictly speaking, this form of unadulterated tax evasion is not covered by the definitions of corruption, unless you count being a taxpayer as having been entrusted a form of authority which is abused. In many cases, however, tax evasion is conducted with the involvement of government or tax officials. At a high level of government, politicians or officials may intervene to give tax exemptions, in breach of codified tax policy. At lower levels, collusion between tax administration officials and taxpayers may facilitate underreporting of taxable income, underreporting of value or misspecification of goods, and so on. Corruption in relation to taxation can also spill over into other sectors, such as when cases of tax evasion are brought before the judiciary. This type of collusive tax evasion would count as corruption.

**Table 8: Typologies of tax evasion and corruption**

No.	Type of tax evasion/corruption	Mechanism of integrity violation	Stakeholders/patrimonial networks involved
<b>1.</b>	<b>Tax evasion (without involvement of tax officers)</b>		
1.1	Taxable income/transactions not reported or underreported in accounts	Several ledgers often used, including one for taxation purposes that may show a deficit	Business taxpayers
1.2	Underreporting of turnover	Common in retail and wholesale sectors	Business taxpayers
1.3	Overreporting of expenditures	Accounting trick to reduce tax burden	Business taxpayers

<sup>62</sup> In a business survey from Uganda from 1998, 43% of firms reported paying bribes to tax officers and 38% to customs officials (Gauthier and Reinikka, 2001). Several studies point to a negative relation between corruption and firm activity: see Fisman and Svensson (2007) on Uganda and Fjeldstad et al. (2006) on micro-enterprises in Tanzania.

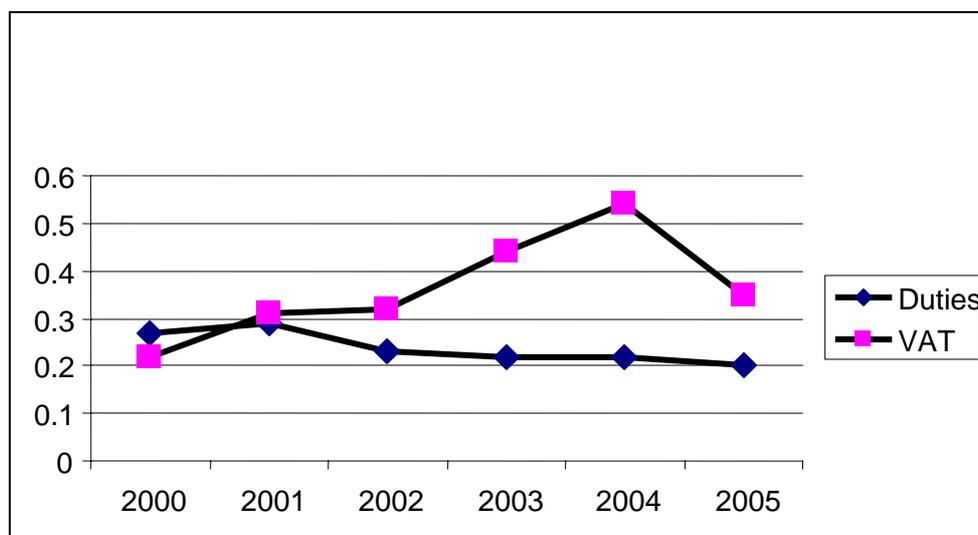
<b>2.</b>	<b>Collusion between revenue officers and taxpayers</b>		
2.1	Tax exemptions	In some cases, taxpayer is not registered but pays lower tax 'privately' to collectors	Taxpayers, tax officers, politicians
2.2	VAT fraud	Falsified claims for VAT refunds occur with collaborators in the tax administration	Taxpayers, tax officers, fictitious companies
<b>3.</b>	<b>Corruption without direct involvement of taxpayers</b>		
3.1	Extortion	Taking advantage of incomplete knowledge of tax legislation, revenue officers (and eventually politicians) threaten taxpayers to pay above rates	Tax officers, politicians
3.2	Embezzlement of collected revenue	Revenue officers steal money collected; may take place with collusion of bank employees and/or auditors in tax administration	Tax officers, bank employees, patrimonial networks
3.3	Fraud	Falsifying tax receipts is common	Tax officers, authorised printing house
3.4	Corrupt inspectors/auditors	Internal auditing may be inefficient and corrupt; exacerbate problems of corruption since it undermines credibility of monitoring policy, yet tax officers in this area may be supported by management and politicians	Tax officers, politicians, patrimonial networks

Source: Adapted from Fjeldstad (2005).

Corruption in taxation may also occur without the direct implication of taxpayers. Tax officials may extort taxes from taxpayers, owing to superior knowledge of tax codes. Falsifying tax receipts and embezzling tax revenue is another approach. Within the tax administration, internal auditors may be paid by tax officials to look the other way. Given the substantial opportunities for private enrichment, positions in the tax administration are highly attractive targets of rent-seeking, and hiring and promotion decisions are therefore frequently influenced politically or financially.

According to Fjeldstad (2005), the motivation for evasion by tax payers can be traced to opportunities for evasion, benefits and costs of evasion, and the behaviour of government and other taxpayers. Opportunities for tax evasion are related to the often very complex tax systems of developing countries and the extensive discretion of politicians and officials in granting exemptions. For Tanzania, Figure 3 illustrates duty and VAT exemptions as a percentage of gross collections from 2000 to 2005, where duty exemptions have been falling steadily to 20% while VAT exemptions have been growing, from 20% in 2000 to 25% in 2005. High taxes and cumbersome regulations and procedures make evasion and bribery attractive. Customs clearance is a case in point. The average number of days for customs clearance in Zimbabwe was 23 in 2000, which makes bribery to speed up the process attractive (see also Box 1). The expected costs of corruption in terms of detection and punishment are often low, since the judiciary is one of the most corrupt institutions in many countries. Moreover, a failure of government to provide services, or tax evasion by others, undermines perceptions of fairness and tax compliance. Extensive exemptions that are perceived as unfair have a negative effect in this respect.

**Figure 3: Duty and VAT exemptions as share of gross collection, Tanzania 2000-2005**



Source: Tanzania Revenue Reports, provided by Tanzania Revenue Authority (TRA).

To politicians, the tax system is a tempting tool for rent appropriation and patronage. Decisions on tax bases, rates and exemptions have large financial implications for taxpayers, and may therefore invite high bribes. The tax system can also be used to increase the support for government and its chances of staying in power, by granting exemption or awarding attractive positions in the tax administration to supporters, or by using audit to harass opponents.

For officials in the tax administration, part of the corruption story are opportunities created by complexities and implicit discretion in the tax regulation, low expected costs owing to ineffective or corrupt internal control mechanisms and low wages, and the corrupting influence of corruption elsewhere in the system. Fjeldstad (2005) also points out, however, that officials are often part of corrupt networks, which reduces transaction costs of corrupt behaviour, and that former tax officials often become middlemen, which has implications for corruption policy. The importance of patrimonial networks is also stressed: with more influential positions comes the expectation that the proceeds must be distributed to families and networks, sometimes to the extent that forgoing corrupt payments is viewed as foolish, and subject to social sanctions.

Since a complex tax system has given tax officials great discretion in making decisions, and made bribery beneficial for private agents, a key area of reform has been simplification of the tax system in partner countries. Simplification has been attained in a number of countries (see e.g. Fjeldstad et al., 2003 on Tanzania), although the tendency to use the tax system to fulfil a number of different objectives is still a source of complexity.<sup>63</sup> In addition to simplification, there have been efforts to broaden the tax base in developing countries. From a corruption perspective, this may reduce tax-motivated behaviour, as there are fewer opportunities for evasion; reduced overall rates may also reduce the benefits from corruption. This type of broadening has proven difficult, however and, in many countries, reform has done little to expand the tax base. Exemptions continue to be a huge problem. For instance, a number of goods are exempted from VAT. Some of these exemptions may be codified, for instance in the case of NGOs, religious organisations or donor agencies. In other cases, it is within the power of government officials to grant exemptions. In Tanzania, for instance, exemptions can be awarded by the Ministry of Finance. It is also likely that the number of registered taxpayers has been reduced in many developing countries because of increased thresholds for income tax and VAT registration.

<sup>63</sup> As discretion is a significant source of income for many tax officials, simplification has not always proved easy. There are examples of a tax code being made more rather than less complicated through reform that aimed at simplification.

One attempt to limit opportunities for political interference in tax matters has been the establishment of revenue agencies outside the Ministry of Finance. The semi-autonomous position of these agencies has freed them from the constraints of the civil service in terms of remuneration and hiring and firing. Experiences with these types of agencies have been mixed. One observation is that the establishment of these types of agencies need not lessen political interference (Devas et al., 2001). On the contrary, Fjeldstad (2006) argues that, in the case of the Uganda Revenue Authority, 'generous remuneration ... and substantial budgets .... [have] made the revenue administration a more attractive target because the authority offers both relatively well paid jobs and considerable rent seeking opportunities.' He cites the 1997 appointment of the Uganda Revenue Authority's commissioner general by President Museveni as a particularly conspicuous example of a politically motivated appointment.

Reform in revenue collection agencies has attempted to reduce opportunities and incentives for corruption. In addition to simplification of tax policies, simplification of organisation and procedures is important to reduce the discretion of tax officials. Recent reform in VAT refund systems in Bolivia has shown some promise in this respect. By partially replacing inspection and auditing procedures previously performed by tax officials with automated systems using information technology, the discretion of tax officials has been decreased, and (falsified) VAT refund claims have been reduced (Zuleta et al., 2006). These conclusions need independent and thorough evaluation, however, and the extent to which they are transferable to other countries must be analysed further.

In terms of changing incentives for tax bureaucrats, various measures have been suggested, from increasing monitoring and punishment, increasing wages or using bonuses, to the privatisation of tax collection (tax farming). The idea behind increased monitoring and punishment is to make corruption less attractive by increasing its costs. Recent empirical observations and theoretical studies have cast some doubt on the effectiveness of some of these policies, at least when viewed in isolation. In particular, it has been pointed out that fired tax officials in countries like Tanzania have found new employment as middlemen offering services to taxpayers.<sup>64</sup> The existence of this type of alternative employment greatly complicates the analysis of incentives. Bjorvatn et al. (2005) show that 'in an imperfect institutional environment, firing more corrupt tax officers and increasing the punishment for corrupt crimes may be counterproductive. These measures may increase the demand for middle-man services and thereby create a market for middle-men, which allows "corruption as usual" to continue through new channels.' Similarly, Hasker and Ökten (2004) show that increased monitoring and punishment can increase corruption in the presence of middlemen. Interestingly, they suggest that corruption in this context can be effectively addressed by regulating or reducing the role for middlemen.

Empirical studies of the effect of civil service wages on bureaucratic corruption show mixed results. Van Rijckeghem and Weder (2001) find that countries with higher civil service wages exhibit less corruption, but do not find a similar effect within countries, indicating that increasing civil service pay does not decrease corruption in the short run. Besley and McLaren (1993) show that a given pay increase has less of an impact on corruption if bribe levels are high and the risk of being caught low, which means that wage reform may in certain situations not be cost effective, or would have to be accompanied by increased monitoring and punishment to be effective. As argued by Fjeldstad (2005; 2006), wage reform is also more effective under some conditions than others. In some cases, increased wages may simply mean that positions in the tax bureaucracy are auctioned off at higher prices. Social norms may also mean that having a higher-paying job simply comes with greater obligations and expectations of redistribution (Anders, 2005).

Performance-related bonuses is one way of eliciting more effort on the part of tax officials; however, as discussed earlier, these must be considered in light of employee perceptions of

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<sup>64</sup> Blundo and Olivier de Sardan also emphasise the role of middlemen/intermediary brokers in customs (and the value of their knowledge of the complicated customs system including the informal system e.g. rates of bribes etc.)

fairness and reciprocity, as well as more general concerns of multitasking problems.<sup>65</sup> One particular way of providing incentives for tax collectors is to auction the right to collect certain taxes off to private collection agencies, i.e. tax farming. According to Fjeldstad (2005), recent experience with tax farming from Africa, for instance in Mozambique, shows that it has had few lasting results. Moreover, Iversen et al. (2006a) argue that attempts to outsource collection of local taxes in Uganda have simply shifted corruption from the collection point to the administration of the tender process. In other words, bribes play a significant role in awarding the right to collect taxes (see Box 2 in Section 4 on procurement in West Africa).

Donors have often pursued a relatively technocratic approach to reforming tax systems, as exemplified by attempts to build capacity in revenue administrations. Fjeldstad (2005) points out that '[d]espite extensive resources spent on capacity building and training of tax officers, recent years have experienced substantial setbacks in the fight against corruption in revenue administrations ... [d]onor approaches have often overlooked the fact that reforming a revenue administration –although it has important technical aspects, is also a social and political phenomenon driven by human behaviour and local circumstances.' Neopatrimonialism is one aspect of this, and some countries have attempted to reduce patronage by appointing expatriates in key management positions of the revenue administration. Experiences from the Zambia Revenue Authority show that expatriate senior advisors and top managers, who are in place for a limited period of time, can contribute to effective change by building integrity and professionalism in the organisation through systemic changes (Fjeldstad et al., 2003). Experiences in other countries, such as Uganda, are more mixed (Fjeldstad, 2005). In considering these kinds of options, one should take into account concerns about the effectiveness of technical assistance and expatriate advisors, notably in terms of local capacity building and sustainability.

### 5.3.2 Expenditures

Corruption decreases the developmental impact of public expenditures in two ways. Firstly, scarce resources are allocated to the wrong activities. Corrupt politicians and public officials are more likely to allocate funds to projects that generate substantial bribes and kickbacks than to projects that benefit the public or the poor. Preference is given to activities that involve capital- and technology-intensive products whose purchase is highly discretionary and which can be more easily concealed from public scrutiny. There is empirical evidence that corrupt governments over-invest in public infrastructure and under-invest in its maintenance (Tanzi and Davoodi, 1997; Esty and Porter, 2002). Corruption also leads to less government spending on education (Mauro, 1998) and more on the military (Gupta et al., 2001a).

Secondly, for given government activities, corruption leads to inefficiencies in the public sector. Corruption in government procurement of goods and services leads to the selection of bidders based on bribes rather than the bid that offers the highest quality for the lowest price. In some cases, public contracts are awarded to companies owned by government officials. In staffing matters, positions in the public sector are sometimes allocated to the highest bidder or to family or political supporters rather than based on qualifications. The result is that the productivity of the public sector suffers, since the quality of public investments is reduced, and staff are unproductive. Empirically, Tanzi and Davoodi (1997) present evidence that corruption reduces the quality of public infrastructure (roads and power supply). Gupta et al. (2001b) find a negative impact of corruption on the quality of government services in health and education.

Opportunities for corruption in the allocation and deployment of public expenditure are related to how the budget process of a country works. In an attempt to identify major corruption risks in the budget process, Isaksen (2005) breaks the process into its various stages and discusses the level and nature of corruption risk at each stage. Figure 4 presents an overview of this categorisation of corruption risk into high-risk areas (red), medium-risk areas (yellow) and low-risk areas (green),

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<sup>65</sup> For a more in-depth discussion, see Fjeldstad et al. (2003).

where the main stages of the budget process are presented left to right and their various sub-stages top to bottom. When viewed in isolation, there is less risk of corruption in the initial stages of planning and formulation than in subsequent stages of adoption (budget being passed by parliament), execution (when funds pass from the ministry of finance and are translated into government activities), and control/oversight. Nevertheless, Isaksen stresses that '[a]lthough corruption primarily manifests itself in certain sub-stages of the execution process, the various stages relate to each other and imperfections in one stage may create corrupt opportunities in another stage.'

**Figure 4: Corruption risk in the budget process**

Planning	Formulation	Adoption	Execution	Control, audit
	Macro Basis		Financial planning	Internal audit
	Budget policy outline		Distribution of allocations to spending units	External audit
	Expenditure targets		Commitment control	Parliamentary oversight
			Verification	
			Payment orders	
			Cash management	
			Debt management	
			Revenue management	
			Accounting	
			Fiscal reporting	

Source: Based on Isaksen (2005).

In order to identify institutional weaknesses in the public expenditure system of partner countries, donors have used a variety of diagnostic tools. A harmonised framework for assessing fiduciary risk has now been developed by a PEFA working group, which a number of donors have begun to employ. The PEFA framework consists of 31 high-level indicators that assess the operational performance of partner country PFM systems, processes and performance against six critical objectives: credibility of the budget; comprehensiveness and transparency; policy-based budgeting; predictability and control in budget execution; accounting, recording and reporting; and external scrutiny and audit.

The PEFA framework was not explicitly designed to capture corruption, nor does it include any indicator of corruption in the PFM system. It does, however, contain some indirect indicators of corruption. Some of the PFM characteristics captured by the framework will in part determine whether corruption will flourish or not. Comprehensiveness and proper classification of the budget and fiscal information implies that officials will find it harder to divert or misuse public funds. Transparent and good fiscal information available to the public will make misuse easier to detect and increase the accountability of public officials to the general public. The effectiveness of internal and external control clearly influences the possibility of detecting corruption.

Nevertheless, the PEFA framework falls short of adequately capturing corruption. Important determinants of corruption are left out and the indicators are therefore insufficient to judge whether corruption is likely to be high or low in the country assessed. In particular, the indicators of central government accountability focus largely on the characteristics of control mechanisms rather than the ability of other agents to sanction government officials where misuse of funds occurs (see Kolstad, 2005). The PEFA framework is by and large a technical summary of the PFM system of a country. It therefore also leaves out political and cultural characteristics that may influence

corruption. An assessment of corruption in partner countries should therefore be conducted in addition to a PEFA analysis.<sup>66</sup>

The absence of political and cultural factors in the PEFA analysis also illustrates a general problem in donor approaches to improving public expenditure management in partner countries. Diagnostic tools tend to focus on identifying weaknesses in the formal institutions, and donors have often sought to address these through technical assistance and capacity building. Although improving formal institutions is important, it is often informal processes behind the scenes that determine how public funds are allocated and actually spent. A study from Malawi points out, for instance, that the budget process provides no realistic estimate of revenue or spending; rather, it is a theatre that masks real distribution and spending (Rakner et al., 2004). The informal processes frequently undermine the functioning of the formal system, and therefore also reduce the effectiveness of interventions to improve how the formal system works. In many cases, these informal interactions will include corrupt dealings. Both to improve the general effectiveness of allocation processes, and to address the problem of corruption, it is therefore important to analyse the interests and interactions that actually drive allocation of expenditures in a partner country.

So far, we have discussed the budget process and expenditure allocation as a whole. One particular area of the public expenditure system that requires particular attention in relation to corruption is procurement. Government procurement of goods and services is important in terms of size, representing over 18% of world GDP (OECD, 2002). World Bank estimates of bribery amounts are at about US\$200 billion per year, which is about 3.5% of global procurement spending.<sup>67</sup> However, the major costs of corruption in procurement are the inefficiencies that are introduced when contracts are not awarded to the best bidder.<sup>68</sup> These costs have been estimated at between 1.2 and 2.88 times the annual amount of bribes, i.e. between 4% and 10% of global procurement spending (Auriol, 2006).

Corruption in procurement takes a number of forms. At the early stages of the procurement process, procurement officials may take bribes to tailor the product specification or procurement process towards a particular bidder, which is called predestination, or to forgo a competitive bidding process altogether. Alternatively, specifications of products or the process may be vague and lack transparency, so as to have discretion that permits extractions of bribes later in the process and evade critical scrutiny. During a bidding process, officials may take bribes to provide inside information on the process or the other bidders, extort bribes from firms anxious to stay in the running or be short-listed, or take payments to favour certain bidders (see Box 2). In ensuing control and audit phases, officials may be bribed not to address deviations from procedure.

To reduce corruption in procurement, a number of technical measures have been suggested that limit officials' opportunities and incentives for taking bribes. Contracts above a certain size should be subject to competitive bidding, at least where competition is forthcoming. In preparing and conducting a bidding process, corrupt officials benefit from a lack of transparency, so means to make criteria, tender and subsequent justification of selection decisions publicly available are important. In setting the criteria, products should be standardised where possible, and international standards used. Standard international bidding procedures should be implemented and extra-procedural decisions avoided.

As in other parts of the civil service, pay and economic incentives should promote clean behaviour, and hiring and firing should be based on merit. Auriol (2006) suggests that providing bonuses based on what has been saved relative to the allocated budget, used in the UK, has wider applicability. One should, however, apply this with caution in a developing country context, where

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<sup>66</sup> Existing corruption assessment frameworks, such as TI's National Integrity System or USAID's framework, are not closely geared towards assessing corruption in PFM.

<sup>67</sup> [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2006/12/14/000016406\\_20061214120802/Rendered/PDF/wps4099.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2006/12/14/000016406_20061214120802/Rendered/PDF/wps4099.pdf) .

<sup>68</sup> Not counting the costs of the wrong projects being chosen for tender in the first place.

quality requirements are sometimes not followed up on and the size of bonuses may be small compared with bribes. The organisation of procurement can also be important. One idea to limit political interference and increase professionalisation is independent procurement units. Staff rotation can reduce dependence of important decisions on a limited number of officials. Control and follow-up of decision is important to keep decisions accountable and, as in the case of revenues, there is probably some potential for making these types of controls more systematic and automatic. A key aspect of this is the ability of bidders to appeal decisions and report malfeasance.

It is important, however, to look beyond the technical specification of the procurement process itself. Many of the corruption problems in the procurement process arise from decisions at higher levels on sector allocations, where bribe-generating sectors and projects are preferred. As in other parts of the public expenditure system, it is also important to look beyond the formal structures, to the interests and interactions of those who run the process. It was found that procurement reform had taken place in three West African countries, including subjecting large contracts to competitive tender, but that officials were able to get around these by using exemptions (Blundo, 2006a). In addition, the supply side of corruption should be addressed (Section 4.3 and 4.4). One important aspect of this is that firms can benefit from collusion: through cooperating they can reduce competition and get better terms. This suggests that the existence and integrity of a competition authority is an important precondition for efficient public procurement.

Procurement reform has been rather high on the priority list of donors in principle, but in practice progress has often been limited. Assessing procurement systems across countries is still lagging behind the assessment of PFM systems in general.<sup>69</sup> A joint World Bank/OECD-DAC Procurement Roundtable initiative has led on the effort among aid agencies to develop international standards and good practices for reform. In December 2004, the Johannesburg Declaration was issued, which committed signatories to 'utilise common strategies, approaches, and tools for strengthening procurement system capacities'.<sup>70</sup> This was followed by the issuing of the New Common Benchmarking and Assessment Methodology for Public Procurement Systems (Version 4) by the OECD-DAC in July 2006, currently being tested in 22 countries.<sup>71</sup> This assessment methodology is rather comprehensive, in the sense that it addresses problems across the procurement chain, considering more formal legal aspects as well as indicators for effective anti-corruption and anti-fraud control. These assessments follow a wave of procurement legislation reform in many developing countries in recent years. However, thus far, there has been little systematic study of the impact of such reforms (Evenett and Hoekman, 2005). The 2006 Paris Declaration Baseline Survey (OECD, 2007b) revealed great variation in the use of country procurement systems by donors and across countries, thus signalling a continued considerable degree of distrust.<sup>72</sup> The DAC's assessment methodology will hopefully contribute to a better evidence base about the state of procurement in developing countries, and provide a better grasp of what kinds of further improvements are most needed to tackle corruption risks in procurement.

## **5.4 Grassroots monitoring and civil society**

Increased societal accountability can have an effect on corruption, at least under certain conditions. In terms of societal accountability, two approaches are commonly discussed separately, although clearly related. One strand of the literature focuses on citizen enforcement, or grassroots monitoring, where the basic idea is, that by providing information to citizens, they will be able to address misconduct by public officials, which will reduce corrupt behaviour. This pertains in particular to citizen oversight over government service delivery and the use of public funds for particular projects or more generally.

<sup>69</sup> For the 2006 Paris Declaration Baseline Survey, Indicator 2b on procurement could not be assessed, for example, since no international comparative data was available.

<sup>70</sup> See <http://www.oecd.org/dataoecd/46/3/34269704.pdf>.

<sup>71</sup> See [http://www.oecd.org/department/0,2688,en\\_2649\\_19101395\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,2688,en_2649_19101395_1_1_1_1_1,00.html).

<sup>72</sup> In most participating countries, 20% to 45% of aid was channeled using country procurement systems – with great variation among donors. In some countries, the ratio is as low as 5% or 6% (e.g. Albania, Dominican Republic).

Another strand of the literature proceeds from a higher level of organisation, by discussing the role of civil society in reducing corruption, where the focus is typically on NGOs. These types of organisation can also play a role in terms of addressing governmental misconduct in service delivery or the use of public funds. In addition, they can play a role in influencing governance reform at a more general level.

There is a limited literature on the effectiveness of grassroots monitoring and civil society in reducing corruption. The available empirical studies of grassroots monitoring are relatively more sophisticated in using econometric techniques, whereas the evidence on civil society effectiveness is predominantly based on case studies. Nevertheless, some of the arguments and emerging conclusions related to the two types of approaches are fairly similar or related. The approaches are also related in attempting to increase accountability from the bottom up. Below, we discuss these conclusions for the two approaches in turn, focusing on the conditions under which they are likely to be effective anti-corruption instruments.

The rationale behind grassroots monitoring is that the people who benefit from public services are in a good position to hold public decision-makers to account, since it is in their interest to do so. A couple of studies from Uganda indicate that grassroots monitoring can be effective in combating corruption and in improving the quality of public service delivery. In a public expenditure tracking survey (PETS) of the education sector in Uganda, Reinikka and Svensson (2004) find that on average only 13% of disbursed grants from the central government reached the schools in the mid-1990s. In other words, the greater part of the funds was captured by local officials, which could reflect either corruption or diversion to ends other than intended. To remedy this situation, the government started to publish monthly grants to districts in newspapers. This had a substantial effect on the amounts that schools received, with more than 80% of grants on average reaching schools in 2001. Reinikka and Svensson (2005) find that the effect of access to this information on grants received was statistically significant. Moreover, they point to a significant effect of the campaign on school enrolment and learning.

Another study of corruption in a wider set of sectors in Uganda by Deininger and Mpuga (2004) uses data from a household survey to gauge the importance of information on reporting procedures. In the survey, almost 30% of households reported having paid bribes in the previous six months. Only 4.5% of respondents had ever reported a case of corruption, however. And only about 20% of respondents indicated that they had knowledge on how to go about reporting a case of corruption. Interestingly, Deininger and Mpuga find a significantly negative relationship of knowledge on reporting procedures and the probability of paying bribes. In other words, people who know how to report corruption are systematically less subjected to it. The implication Deininger and Mpuga draw is that improving the knowledge on reporting can reduce the incidence of corruption.

Although grassroots monitoring has been found to reduce corruption in the above cases, an important qualification to the impact of such monitoring has been identified in a study by Olken (2004). He uses data from a field experiment in Indonesia, studying 600 village road projects. In some villages, participation of the local community was increased through invitations to village-level meetings or anonymous comment forms. Interestingly, increased participation only changed the form of corruption, not its overall level. In the villages where participation was increased, there was reduced theft of villagers' wages, but this was offset almost completely by a corresponding increase in the theft of building materials.

This points to an important distinction in the likely effectiveness of grassroots monitoring between private and public goods. Wages are clearly a private good to villagers, in the sense that they accrue to them only and not to a larger group of individuals. A worker whose wages are embezzled has a clear interest in reporting and sanctioning the shortfall, since the benefits of doing so accrue completely to himself. By contrast, building materials that should have been used to build a road have more of a character of a public good, where some benefits fall on all villagers but where the

benefits to each villager of reporting theft may be smaller than the private costs of doing so. Moreover, each villager would prefer not to report and sanction theft, given that others do, which means that there may be substantial free-riding problems for public goods. Grassroots monitoring is therefore likely to be effective for government activities that provide private goods, such as subsidised food, education and health care, whereas it is relatively ineffective in the provision of public goods such as infrastructure.<sup>73</sup> In the provision of public goods, other types of interventions are more effective in reducing corruption. In the Indonesian case, Olken (2004) shows that government audits were remarkably effective in reducing theft, even in a situation where corruption was widespread.

There are also further conditions that need to be in place for grassroots monitoring to be effective. One is that information about the use of funds can be effectively diffused; for instance, using newspapers requires a certain level of literacy among the citizenry. In other cases, different strategies need to be used. Another important condition is that there exists an organised system of feedback to and sanctioning of public officials that is accessible to citizens. The literature on decentralisation and local capture also offers some important lessons for these types of initiatives (see Bardhan and Mookherjee, 2005). Grassroots monitoring is intended to empower local stakeholders, but it matters a great deal which local stakeholders are empowered. If the way in which these monitoring schemes are implemented favours local elites, by giving them relatively greater access to information or clout, capture of funds or resources may actually increase. This suggests that grassroots monitoring may be less appropriate in communities where there is a high degree of socioeconomic inequality and heterogeneity, or whose social organisation is highly clientelistic.<sup>74</sup>

Civil society in the form of NGOs is sometimes involved in the monitoring of public service delivery and use of funds discussed above. In addition, these types of organisations have an advocacy role in terms of improving governance more generally, including anti-corruption reform. The OECD (2003) synthesis of lessons learned in fighting corruption concludes, however, that there is little formal evaluative work on the anti-corruption effect of CSOs. This appears to be the case also after 2003. We thus have limited systematic knowledge about how well CSOs function in reducing corruption.

One clear conclusion drawn by the OECD (2003) synthesis is that 'coalitions are key, and there are many examples that they work and get results'. Newer studies have, however, cast significant doubt on, or at least heavily modified, this conclusion. Tisne and Smilov (2004) conduct a review of 20 donor-supported anti-corruption projects in Albania, Bosnia and Herzegovina, Bulgaria and Macedonia. They argue that the desire to build broad coalitions in the fight against corruption has had a negative effect on the sustainability of reform efforts. Since progress on anti-corruption has been slower than expected and coalition members have seen few benefits from their efforts, 'projects generally failed to create a self-sustaining constituency to further their work'. In the worst case, Tisne and Smilov suggest, the anti-corruption strategy may have fuelled public distrust in government and democracy, thus effectively reducing vertical accountability. They do not, however, provide compelling empirical evidence that the coalition projects were counterproductive in this manner.

Accordingly, the debate on civil society coalitions has moved on, from the idea that coalitions are necessarily effective, to the question of how to design sustainable and effective coalitions. Tisne and Smilov (2004) argue that, instead of broad coalitions one should mobilise 'well-defined constituencies behind focused governance reforms that have a clear impact and benefits for those involved'. In a similar vein, Johnston and Kpundeh (2004) suggest that 'early recruitment of support should focus on potential stakeholders who suffer immediate and tangible costs of corruption and

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<sup>73</sup> There is a clear link here to the finding by Blundo and Olivier de Sardan (2006a) that theft of a public good is seen as a victimless crime and therefore more acceptable (see Section 4.3).

<sup>74</sup> See Veron et al. (2006) for an account of community monitoring of poverty alleviation schemes in India. See also Iversen et al. (2006b) on local capture of forestry rents in Nepal.

have resources they can mobilise against it.’ The coalition also needs to be run in a way that provides incentives, material or otherwise, for members to stay on during its various stages of development. This line of thinking is related to the above distinction between private and public goods; if individuals or organisations perceive substantial private gains from being part of a coalition, they are more likely to remain there than if the gains are shared and the efforts of one participant increases the gains of others. As pointed out by Johnston and Kpundeh (2004), however, even coalitions that are focused in this sense require a conducive environment to be effective: ‘if the regime is repressive, openly exploitative, or skilled at using its resources to undermine the coalition and co-opt its members, the most determined efforts may come to naught.’

Several other issues also reduce the effectiveness of enlisting civil society in fighting corruption. Civil society is often weak in poor countries, and the capacity and management of organisations insubstantial. While donor support may have contributed to improving capacity and technical skills of Southern NGOs, it is a common observation that aid has failed to make these organisations economically sustainable. These are general problems which pertain to the effectiveness of using NGOs as development partners, and are not pursued in detail here. Of more interest is how a corrupt environment affects the nature and motivation of the organisations that actually exist. In a country where corruption is widespread and endemic, one can question how easy it is to find NGOs that are clean. The OECD (2003) synthesis notes that there are CSOs ‘with dubious affiliations to those who are part of the corruption problems’ and ‘CSOs ... that have been created as personal income-generating projects for people who have a limited interest in fighting corruption’. This is related to the rent-seeking and local capture literature discussed earlier, where NGOs are established with the express purpose of capturing a greater proportion of public resources, including foreign aid.

A number of studies note that societal accountability through grassroots monitoring or civil society advocacy requires other types of accountability to be effective, in particular vertical accountability. In a study of community monitoring in India, Veron et al. (2006) argue that ‘when ... vertical accountabilities are weak, ... accountability structures between local civil society and officials can mutate into networks of corruption in which “community” actors become accomplices or primary agents’. Similarly, Tisne and Smilov (2004) argue that, in the Balkans, the most successful civil society anti-corruption projects ‘were confrontational and thus political’, which implies that the ‘main rationale of future activities should be on encouraging political parties to become active anticorruption players’. There is also a relationship between different types of societal accountability. For example, the effectiveness of civil society advocacy depends on the state of the media (Rose-Ackerman, 2007).

## **5.5 Media**

A free and active mass media can play an important role in reducing corruption. It is one of the fundamental checks on the exercise of power by both elected representatives and public officials in liberal democratic societies (White, 2000). The media has two functions that are essential for tackling corruption (Stapenhurst, 2000).<sup>75</sup> Firstly, the media is a mechanism for the exercise of societal accountability. It monitors and reports on government and state activities and provides a channel for the demands of citizens and organised groups. Secondly, the media is an important source of information and is therefore integral to public awareness and informed debate (Peters, 2003). In performing both of these roles, the media also enables civil society and public watchdog bodies to fulfil their own accountability functions.

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<sup>75</sup> Stapenhurst (2000) cites Klitgaard’s proposition that the reduction of corruption requires the simultaneous reduction of officials’ monopoly and discretionary power and an increase in their accountability, and Kaufmann’s proposition that anti-corruption efforts require knowledge and information, alongside leadership and collective action. The media has a clear role to play in both formulations.

The evidence about the effect of the media on corruption consists of two main types. The first uses economic methods to explore the relationship between the media and levels of corruption. Statistical analysis shows a strong association between greater press freedom and less corruption (Stapenhurst, 2000), a correlation that is robust to alternative measurements and sample variation, as well as to variations in other control mechanisms (such as the quality of the bureaucracy and the rule of law, GDP and education). The data also suggests that the direction of causality is from more press freedom to less corruption (Brunetti and Weder, 2003).<sup>76</sup> The number of newspapers per person has also been negatively associated with corruption (Adsera et al., 2000, cited in Lambsdorff, 2005). Suphachalasai (2005) also identifies a correlation between media competition and reduced corruption, which he claims is more significant than media freedom.<sup>77</sup>

Others have used economic models to predict the likely relationship between the media and corruption. For instance, Suphachalasai (2005) uses a model of bureaucratic corruption and mass media to predict that greater press freedom and competition will affect the production and employment decisions of media firms, making them more effective at detecting corruption, which therefore acts as a deterrent to corrupt behaviour.<sup>78</sup> He also refers to a broader modelling literature (e.g. Stromberg, 2001; Besley and Burgess, 2002) that examines how the availability of information affects government behaviour, for instance by making it more responsive and less likely to adopt policies associated with higher rents and corruption.

Although quantitative approaches show correlations (with some robustness when holding the level of GDP constant), it is evident that a relatively liberal and vibrant media can co-exist with high levels of corruption, e.g. Nigeria or Mongolia. The second type of evidence, which emerges from case studies, can help to understand why this is the case. Case studies are used to describe how media stories or campaigns, or improvements in either the media or its operating environment, have influenced the incidence of, or propensity for, corruption in a specific country. Case studies can provide general guidance about the conditions under which the media can make a difference, as well as the factors that explain their inability to do so. However, it can be difficult to draw generic policy conclusions from such case studies, particularly across regions. It is perhaps revealing that the majority of the 'success' stories in the literature come from developed and Latin American countries, which have longer democratic traditions and more active civil societies. Conversely, much of the evidence regarding constraints on media activity comes from Asia and Africa.

Case studies enable identification of the specific ways in which the media can help to reduce or prevent corruption. Stapenhurst (2000) provides a useful typology that distinguishes between the direct and indirect impact of the media. *Direct* or tangible linkages between the media activity and corruption include incidences where media stories or campaigns lead to the impeachment of particular individuals or their removal from office.<sup>79</sup> These stories can also provide the catalyst for formal investigations by public watchdog bodies, such as anti-corruption commissions. By disseminating the findings of horizontal accountability institutions, the media can also reinforce their legitimacy and independence, thereby promoting public confidence and deterring

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<sup>76</sup> Brunetti and Weder (2003) conclude that the direction of causality is likely to flow from higher freedom to less corruption because journalists have incentives to uncover corruption and it is unlikely that all journalists can be made to cooperate in corrupt arrangements. The exception may be highly repressive regimes, which they therefore exclude from their sample but find that the results remain the same.

<sup>77</sup> However, Suphachalasai (2005) cautions that the quality of the data means that the results should be interpreted with care and that there is likely to be an interaction between media freedom and competition. Interestingly, these regressions identify other significant correlations, such as the relationship between ethno-linguistic factionalism and increased corruption.

<sup>78</sup> He speculates that media competition and freedom induce the government to increase public wages to control corruption, further deterring public officials from engaging in corrupt activities because of the higher potential foregone wage income if they are caught (Suphachalasai, 2005).

<sup>79</sup> Staphenhurst (2000) notes that this has sometimes required additional support from international institutions, as was the case when the IMF put pressure on the Kenyan government to remove the minister for health following press reporting of his involvement in corrupt procurement activities.

governmental interference.<sup>80</sup> Conversely, the media can support reform processes by exposing weaknesses in watchdog bodies, which can themselves be susceptible to capture, as well as laws and regulations that facilitate corruption. Finally, raising public awareness of corruption can be decisive during elections.

Alongside this direct influence, Stapenhurst argues that the media can have a more *indirect* or intangible impact, through its contribution to strengthened democratic culture and a social climate characterised by pluralism, public debate and heightened accountability among public officials and institutions. The media can be an important countervailing force, particularly in countries that lack strong opposition parties, through the presentation of alternative viewpoints and its ability to foster debate and citizen participation and champion civil liberties, such as the freedom of expression.

The media is therefore able to influence the incentive structures around corruption through its monitoring and reporting/dissemination functions. The specific way it does this, however, varies according to the particular form of corruption. For instance, elected officials may be deterred from engaging in political corruption by the possibility that the media will report such activities and that this will influence voters. Although bureaucrats and frontline service providers are not elected, the media can also act as a deterrent to petty corruption by promoting public awareness of regulations and entitlements.<sup>81</sup> Reinikka and Svensson (2005) describe a newspaper campaign in Uganda that was able to reduce local capture by providing schools and parents with information about a large education grant programme, thereby enabling them to monitor local officials. However, Brunetti and Weder (2003) also discuss how monitoring and reporting has a different impact on incentives depending on whether corruption is extortive (that is, the public official demands payment from a private agent for a service or goods to which they are entitled) or collusive (that is, where the private agent is a willing participant in the corrupt act because it is mutually beneficial). They argue that a free and active media can influence extortive corruption by lowering the costs of complaint for private agents, who are therefore more likely to resist. In cases of collusive corruption, however, the private agent has no incentive to report corruption, because it is mutually beneficial. Nevertheless, even in these cases, Brunetti and Weder argue that the media is important because it is one of the few agents with an incentive to investigate collusive corruption, particularly given that managers and peers may also be benefiting from corruption and internal control mechanisms are therefore likely to be compromised.

The ability of the media to perform these control and deterrence functions is clearly dependent on the nature of the media and the conditions under which it operates. Paramount among these is the degree to which the media is free and independent (see Table 9). A regulatory or legal framework that protects the media's right to monitor and report on government and state activities is a prerequisite for this (Vaidya, 2005). This includes laws that protect the safety of journalists and those governing access to and disclosure of public information. Many developing countries retain draconian libel and sedition laws or use an expansive definition of national security to block the flow of information, a trend that has become more prevalent in the context of the 'war on terror' (Peters, 2003). However, it is argued that, even when an adequate regulatory framework is in place, the media's ability to act independently can still be proscribed. This is because, while independent journalists have a strong incentive to investigate and uncover stories (Brunetti and Weder, 2003), impartial reporting is made difficult in conditions where journalists are subject to harassment and formal institutions, such as the judiciary, are weak or subject to political interference. In these circumstances, the consistent application of the rule of law and *de facto* freedom of expression are undermined and the costs of investigative journalism are likely to be greater than the expected gains, leading to self-censorship (Vaidya, 2005).

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<sup>80</sup> In theory, the media and public watchdogs, such as anti-corruption bodies, have a symbiotic relationship because it is in the interest of one to have stories and the other to have their findings reported (Stapenhurst, 2000).

<sup>81</sup> Stapenhurst (2000) notes that corruption flourishes in environments where knowledge, for instance about government decisions, is restricted to a small circle of public officials, and Blundo and Olivier de Sardan (2006a) describe how bureaucratic corruption is facilitated by circumstances in which public officials have privileged information about regulations and are therefore able to manipulate these.

**Table 9: Press freedom in Irish Aid partner countries<sup>82</sup>**

	1998	2000	2002	2004	2006	2007
Ethiopia	62	62	61	66	75	77
Lesotho	58	56	46	40	42	42
Mozambique	48	48	48	45	43	40
Tanzania	48	49	49	50	50	51
Timor Leste	–	–	21	29	39	42
Uganda	40	40	42	44	52	54
Vietnam	71	75	82	82	79	77
Zambia	60	62	65	63	64	64

Note: Freedom House ranks press freedom in countries on a scale of 0 to 100, categorising those between 0–30 as Free, 31–60 as Partly Free and 61–100 as Not Free.

Source: [www.freedomhouse.org](http://www.freedomhouse.org).

Another factor influencing the effectiveness of the media is ownership patterns. State ownership can create a conflict of interest for journalists (who may be concerned about their safety)<sup>83</sup> and owners (who may be concerned about their profit), making the constraints discussed above particularly acute (Stapenhurst, 2000).<sup>84</sup> This has led to privatisation being championed as a means of increasing media independence (White, 2000). However, privatisation may not provide a palliative in conditions where such processes are captured by business elites with close ties to politicians (Stapenhurst, 2000), or where the state controls publishing, is the primary source of advertising revenue or retains regulatory power, for instance the issuing of licenses (White, 2000).<sup>85</sup> Therefore, it is not simply a question of whether ownership is public or private; diverse ownership and competition are also important for limiting political influence and capture (Brunetti and Weder, 2003).<sup>86</sup> Competition can also provide an effective guard against corruption within the media by increasing the risk of exposure by a rival (White, 2000).

Other factors affecting the effectiveness of the media include the quality of the communications infrastructure and literacy levels. Another is the quality of journalism, which is dependent on professional standards and the existence of a cadre of journalists with the requisite research, analytical and communication skills (Stapenhurst, 2000; Peters, 2003). Also, despite the credibility of the media depending on its capacity and willingness to present the news fairly and accurately, it cannot be assumed that the media will act accountably and responsibly.<sup>87</sup> Vaidya (2005) suggests that a more complex relationship between the media and the state may exist than that which

<sup>82</sup> According to Freedom House data, the press was less free in 2007 than in 1998 in all of the partner countries except Lesotho and Mozambique.

<sup>83</sup> Of the 68 confirmed cases of murders of journalists in 2001, nearly a quarter were related to investigative work on corruption (Peters, 2003).

<sup>84</sup> The World Bank found that state-owned media are less effective at monitoring government (in Peters, 2003); Besley and Prat (2001, in Suphachalasai, 2005) find that greater state ownership implies less press freedom. Stapenhurst (2000) claims that the state is more likely to have a monopoly of broadcasting media, which has a greater reach in countries with high levels of poverty and illiteracy, but often also retains a monopoly of sections of the print media.

<sup>85</sup> For instance, while the media in Tanzania may appear independent and pluralistic, the chairman of Tanzania's Association of Journalists and Media Workers complained that it was effectively a government mouthpiece because of the government's control of licensing and the existence of 'media moguls who use their power to shield corruption' (in Stapenhurst, 2000). In Malawi, the only paper not aligned with a political party, *The Chronicle*, was forced to close in 2006 because of loss of advertising revenue and the 'poaching' of journalists by other papers able to pay better wages. Peters (2003) and White (2000) describe how the need to seek private sources of advertising can undermine independent journalism because journalists can be bribed not to report activities or private companies or individuals.

<sup>86</sup> Vaidya (2005) claims that media monopoly is more likely in LICs because media competition and diverse information sources are not encouraged. Limited sources of income are likely to be another contributory factor. The emergence of media 'cartels' serving political interests is therefore increased (White, 2000; Stapenhurst, 2000).

<sup>87</sup> Press councils, such as the Ghanaian National Media Commission, can encourage the media to act more responsibly by providing a forum for public complaint. However, experience to date is not encouraging; the success of such councils depends on the degree to which they are independent and, as importantly, are seen to be independent (Stapenhurst, 2000; White, 2000).

simply places the media as a counterweight to state power. Rather than using evidence to hold the government to account, the media may use it as a bargaining tool in order to gain access to rents. She also questions how effective a deterrent the media can be in countries where the government is able to mount convincing counter publicity campaigns, such as when they have access to significant media outlets, or where the media may be motivated by profit to concoct false allegations, meaning that even honest governments can be subjected to scandal. Peters (2003) also cautions that underpaid journalists may themselves be susceptible to bribery, particularly in an industry where the 'freebies' from clients are extensive.

Assistance to the media emerged as a component of democracy assistance in the 1990s; between US\$600 million and US\$1 billion is now estimated to be spent on media assistance projects each year, mostly provided by bilateral donors, in particular, USAID (Rakner et al., 2007). The largest media activity funded by donors is training to improve the investigative skills and professional standards of journalists and editors, with support for the establishment of free and independent media outlets (such as newspapers, TV, radio stations) through the provision of finance or equipment as the second largest. Other frequent activities within media programmes include support for legal/regulatory reform, training judges and legislators in media law or public officials in media awareness, providing legal defence funds for journalists, strengthening infrastructure (printing presses, internet sites, etc.) and support for media watchdog groups, particularly as part of broader anti-corruption efforts (ibid). However, the range of activities and focus will vary according to the donor; for instance, the largest component of Danida's media programme during the 1990s was funding for radio projects, and strengthening local networks through the funding of a press centre was the third largest (Danida, 1999). Also, as noted by DFID (2001), an assessment about whether media assistance is appropriate or likely to be effective should be made on the basis of specific country conditions.<sup>88</sup> Rakner et al. (2007) also highlight the issue of appropriate sequencing, suggesting that media liberalisation may produce undesirable outcomes in the absence of other institutional requirements.

More recently, the importance of supporting the media has been reinforced by donor debates about how best to improve governance and domestic accountability in the context of new aid modalities. In the latest governance policies and strategies produced by donors there is therefore an emphasis on the need to engage with non-state as well as state actors, particularly those who can strengthen accountability, such as public and citizen watchdogs and the media (O'Neil et al., 2007). Support for the media and improving the conditions under which it operates is also included in donors' corruption policies (USAID, 2005c; UNDP, 2004), although, for many, the media is mentioned as part of a more generic focus on strengthening societal accountability mechanisms (see, for instance, BMZ, 2002).<sup>89</sup> It is not clear whether support to the media will increase as a result of these policies or whether it implies new types of activities. Interestingly, an analysis of almost 90 voice and accountability projects from seven donors<sup>90</sup> revealed that the recognition of the need to engage more with non-state actors to strengthen governance and accountability has yet to be reflected in practice, with donors continuing to engage mainly with traditional state actors (63%). However, the analysis did show that the media is the only societal actor that this group of donors is really working with outside their engagement with NGOs (16% and 56% of non-state actors respectively) (Foresti et al., 2007).

There have been few attempts to evaluate assistance to the media at donor or multi-donor level. Rakner et al. (2007) argue that there is a need for more systematic evaluation of media assistance because the attempts to date have been disjointed and have shown that the impact of such assistance is variable. They suggest that, rather than concentrating on privatisation and urban print-based media, donors should support pluralism and diversity by supporting public media and media outlets in more rural areas. However, while it may be possible to measure the effectiveness of media support programmes in terms of immediate objectives, the evaluations of media

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<sup>88</sup> This guide provides a checklist of the type of questions that should be asked in making this assessment (DFID, 2001).

<sup>89</sup> The media also does not feature in some anti-corruption strategies, e.g. the World Bank's (World Bank, 2007a).

<sup>90</sup> BMZ, Danida, DFID, DGCD, NORAD, SDC and Sida.

assistance that do exist, as well as those in related areas, suggest that donors find it difficult to relate these results to more intermediate or broader outcomes, such as better governance, reduced corruption or deepened democracy (O'Neil et al., 2007).<sup>91</sup>

## 5.6 Summary

This section has discussed a range of donor-supported reforms aimed at improving governance in general and reducing corruption in particular. The specific reforms covered include: democratisation, PFM (including revenue and expenditures), grassroots monitoring and support for civil society, and support to the media. Section 5.1, furthermore, provided a brief look at the most focused anti-corruption activity – the development of anti-corruption agencies (ACAs). These types of reform can be viewed as attempts to improve vertical, horizontal and managerial, and societal accountability; these could, in principle, have an effect on corruption

Several points emerge:

1. The reforms pursued have often had rather disappointing effects on corruption. In fact, the limited impact on corruption of the specific interventions discussed here is closely linked to the perspectives drawn up in Section 4. Donors have tended to focus on technical reform to formal institutions, paying too little attention to the interests, incentives and informal interactions of implementing parties. When not in the interests of local elites, reform is implemented partially or not at all, and frequently circumvented. PFM reform is a case in point, with exemptions to taxes and formal procurement procedures being all too common.
2. There are a number of gaps and disparities in current donor efforts in the areas of governance and anti-corruption. Efforts at improving PFM are assumed to reduce corruption but, within many PFM activities, corruption is not explicitly addressed as an issue. This is also reflected by diagnostic tools, such as the PEFA framework, which do not explicitly capture corruption and tend to focus on formal institutions.
3. Work on democratisation and anti-corruption should be more closely integrated, as the fields can be mutually influential. In a neopatrimonial context, certain types of reform can also have unintended consequences. Incomplete democratisation processes may increase corruption, owing to increased patronage to acquire or maintain power or costly election campaigns that invite corruption. At the same time, political liberalisation can be an important enabling condition for other anti-corruption efforts.
4. It is challenging for donors to address the informal dimensions and practices (e.g. patronage networks) that contribute to problematic governance environments. There are emerging efforts at the international level that aim to influence norms (such as the World Ethics Forum organised in 2006). More imaginative and innovative approaches can be sought at country levels. Supporting grassroots monitoring also aims to change practices on the ground.
5. In considering a specific area of reform, it is important to assess whether the conditions are in place to make it effective in reducing corruption. Notably, grassroots monitoring and civil society are more effective when directed at private rather than public goods, and when broadly representative rather than captured by local elites. For instance, in the case of road-building in Indonesia, strengthening managerial accountability (introducing more effective audits) proved a stronger deterrent for overall corruption than grassroots monitoring.

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<sup>91</sup> For instance, an evaluation of Danish assistance to the media during the 1990s concludes that while media freedom increased in the countries in which Danida was working it is difficult to assess the actual contribution of Danida-supported media projects to democratisation and human rights (Danida, 1999).

6. The various efforts to reduce corruption are likely to be complementary; for example, promoting media freedom can help to foster civil society scrutiny of government activities and PFM reforms can help to make government accounts clearer and more accessible. Democratisation, in turn, creates the public space for civil society to become engaged. ACAs are likely to be more efficacious if judicial sectors can be reformed in parallel than in a situation where they are 'on their own'. At the same time, those pursuing anti-corruption efforts may want to think about priorities and opportunities related to corruption in specific areas.
7. Donors need to invest more in evaluating and understanding 'what works'. Across all areas of anti-corruption efforts, there is a lack of systematic study of effectiveness. This issue is explored to some degree with regard to ACAs (which have been found to be rather ineffective) and to the emerging general proposition that democratisation as such is insufficient for reducing corruption. There is still considerable need for careful evaluation and lesson-learning, for example, around the effects of public procurement reform, or ways to support the media in such a way as to make it an efficacious player in governance reforms.

Overall, while the idea of various forms of accountability (vertical, horizontal, societal, managerial) is conceptually well developed and has increasingly found its way into aid policies, the actual strengthening of these various forms of accountability still poses considerable challenges.

## 6. Corruption and aid modalities<sup>92</sup>

The introduction of ‘new’ aid modalities, and in particular general budget support (GBS), has increased the interest in the relationship between corruption and aid modalities. This section provides an overview of available arguments and evidence. The issue will be explored further in the synthesis paper.

It needs to be emphasised that corruption is one of several considerations that are relevant when deciding whether or not to use budget support; other important issues include the degree of aid dependence or the fragmentation of aid flowing to a country, as well as the degree of political commitment to development in the political leadership (which can be distinct from the prevalence of corruption) (see also Work Packages 6 and 8). Furthermore, the primary hinge between corruption and budget support is the management of public expenditures, discussed in some detail in the previous sections. At the same time, it needs to be born in mind that ‘the budget is not everything’, i.e. important fields of corruption may be associated with privatisation or with licensing regimes and hence are not directly associated with how budget funds are being handled. However, as will be discussed in Section 6.3, cases of high-level corruption can affect budget support, even if there is no claim of a direct misuse of public funds.

At the outset, it is important to recognise that little evidence or even clearly set out arguments are available with regard to: (i) the prevalence of corruption in relation to various aid modalities, and the degrees to which corruption distorts the developmental impact of different aid modalities; and (ii) whether aid modalities affect the governance environment and corruption in a country differently. No comprehensive studies seek to address these issues, but it is possible to identify relevant arguments and material. Furthermore, some of the studies which are relevant have been sponsored by donor agencies – and hence may reflect the diverging views among donors regarding the desirability of budget support.

This section proceeds as follows. Section 6.1 provides a backdrop by looking at the relationship between total aid and corruption. Section 6.2 briefly reviews the key rationales that have been proposed for providing budget support. Section 6.3 addresses some of the theoretical arguments that are relevant to issues of corruption and the choice of aid modalities. Section 6.4 summarises empirical evidence which, though not always addressing the questions posed directly, can offer some initial clues. Section 6.5 concludes.

### **6.1 Donors as a potential cause of corruption**

In principle, there are two ways of looking at how donors may affect the level of corruption in partner countries. In the first case, more corruption may result from actions that donors take than in their absence. These are acts of commission. In the second case, more corruption may result from actions donors do not take, compared with those they could have taken. These are acts of omission. This distinction is useful in reviewing the literature on donors and corruption, and the two are discussed in turn below.

#### **6.1.1 Acts of commission**

Several studies have examined how aid flows affect the level of corruption in partner countries. A basic theoretical rationale for these types of studies is that aid is a type of windfall, which may cause groups and individuals to vie for a portion, resulting in increased rent-seeking activities and corruption. So far, there is no consistent evidence from cross-country econometric studies that aid causes corruption. Knack (2001) finds that aid is positively related to corruption. Tavares (2003),

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<sup>92</sup> This section was written by Verena Fritz and Ivar Kolstad.

using a more sophisticated approach to the question of causality, finds instead that aid decreases corruption. Dalgaard and Olsson (2006) find that aid decreases corruption at low aid levels, but increases corruption at high aid levels.

Although there is little consistent evidence that aid increases corruption on average, there is evidence that aid may cause corruption in countries with certain characteristics, and that specific donor practices can induce corruption. Svensson (2000a) performs a cross-country study in which aid is interacted with the level of ethnic fractionalisation in a country. He finds that aid increases corruption in countries whose population is highly fractionalised, whereas aid reduces corruption in more homogeneous countries. In other words, where there are many distinct groups fighting for the extra resources that aid represents, aid appears more likely to have a detrimental effect in terms of rent-seeking and corruption.

Similarly, more case-by-case material suggests that there is little doubt that certain donor practices have led to corruption. There are a number of cases of corruption in aid projects. Moreover, well intended conditions imposed by donors have had seriously negative consequences in terms of corruption. A frequently used example is donor-induced rounds of privatisation, which domestic elites have taken advantage of and rigged in order to enrich themselves. Lax donor control and follow up that characterise much humanitarian aid also increase opportunities for corruption (Schultz and Søreide, 2006). And donor behaviour or privileges in partner countries – such as donor tax exemptions – may also in some cases undermine social norms, rather than help build tax compliance.

### **6.1.2 Acts of omission**

It has been suggested that by not taking an active stance on anti-corruption, and by continuing to give aid and support to corrupt governments, donors are contributing to corruption. Studies of aid flows have corroborated the view that corruption is not necessarily a deterrent to aid. Alesina and Weder (2002) find, for instance, that more corrupt countries do not receive less aid. But there are also differences among donors. Scandinavian countries give more aid to less corrupt countries, whereas the US gives more aid to more corrupt countries.

Some studies of aid to African countries argue that these types of acts of omission are important. In a study of Mozambique, Hanlon (2004a) suggests that, in order to obtain other objectives, donors have in effect turned a blind eye to corruption. In his view, 'donors are rewarding what they see as "good performance" by allowing, and thus effectively encouraging, corruption and state capture'. Tangri and Mwenda (2006) present a similar argument for the case of Uganda, where 'by giving large amounts of aid to a corrupt and quasi-authoritarian government, as well as being reticent in their public criticism of abuse of power and corruption, donors have abetted the actions of Uganda's leaders in weakening those bodies that hold them responsible for abusing their public positions.' Moreover, Mwenda and Tangri (2005) argue that 'aid (has) provided the government with public resources to sustain the patronage basis of the regime ... propping up a corrupt government in Uganda.' Van de Walle (2001) argues that SAPs allowed neopatrimonial leaders to remain in power by providing external scapegoats and at the same time a source of revenue in the context of severe economic crisis. Incumbent leaders engaged in just enough reforms to ensure the aid flow, while often instrumentalising and/or stalling the reform process. These studies relate the actions of donors to their need for success stories, in order to justify large amounts of aid. The pressure in donor agencies to disburse aid has been noted by Easterly (2002), but if the above arguments are correct, disbursement pressure and the need for success stories also have detrimental effects in terms of corruption. The implication is that, in addition to governance reform in partner countries, there is also a need for reform to change the incentives in donor agencies.

The degree of omission of due care among donor agencies is also reflected, for example, in the fact that the World Bank created an internal watchdog institution, the Department of Institutional Integrity or INT, only in 2001, and that this institution is finding quite a number of unsavoury

practices regarding how World Bank funds are being used. The fact is that the Bank is in 2007 gaining 'a deeper and growing understanding of the nature of vulnerabilities to corruption in Bank-financed projects' but that 'knowledge of the frequency, scope and depth of the problem is less certain' because 'the allegations INT receives are only a subset of the entire universe of corrupt activities, but also because INT has a finite ability to actively investigate all the allegations it receives' (World Bank 2007b). This implies that corruption risks associated with World Bank operations have been rather neglected for almost 60 years of the Bank's existence. Other international financial institutions (IFIs) and bilateral donors appear to be in a similar situation.

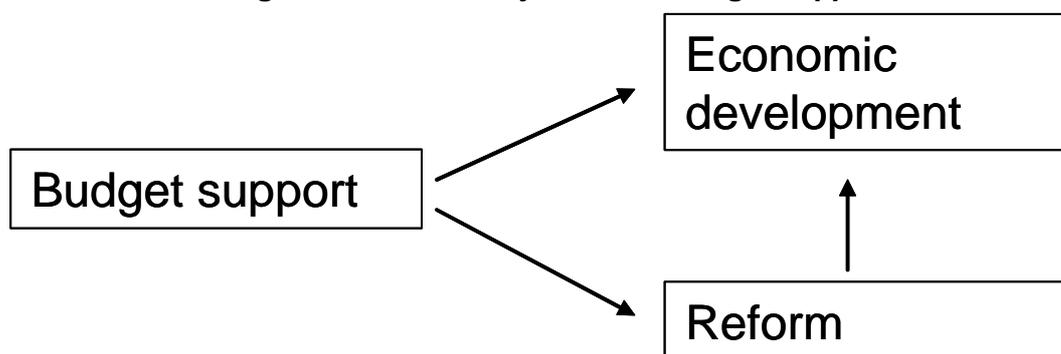
## 6.2 Budget support, development and governance

Budget support is aid transferred to a partner government's national treasury to be managed by means of the beneficiary's budgetary procedures (see also Work Package 6). In contrast, project support is aid transferred to fund predetermined projects, such as building schools and infrastructure or capacity building. Budget support can be GBS, disbursed in support of the general national budget, or sector budget support, which is channelled towards specific sectors, such as education or health. We focus here on generic issues with regard to budget support and do not discuss specifics related to sector budget support.<sup>93</sup>

In reality, both budget support and projects are broad categories, lumping together a wide variety of actual practices of aid provision. For example, there can be much variation on the degree of predictability of support under both modalities. Projects can range in size from small (e.g. US\$100,000) to large (e.g. US\$50 million and more). Furthermore, there is considerable variation with regard to actual use of budget support among donors. Some donors – such as DFID or the EC – have been (strongly) supportive, other donors – such as the US, Japan, or Germany – have been more cautious (Strategic Partnership with Africa, 2007).<sup>94</sup> Finally, it is important to keep in mind that the choice between budget support and project support need not be a binary one and, in practice, a mix of aid modalities is used. The Paris Declaration (OECD, 2007b) revealed that, for the 34 countries included in the survey, direct budget support accounted for 20.7% of all aid.<sup>95</sup>

Budget support is usually policy-based aid and comes with conditions (and/or a policy dialogue) attached,<sup>96</sup> which partner countries are expected to follow (for an in-depth discussion of aid modalities and conditionalities see Work Packages 6 and 8; also White and Dijkstra, 2003). Accordingly, the objectives of budget support can be illustrated as follows.

**Figure 5: Twofold objectives of budget support**



Source: Based on White and Dijkstra (2003).

<sup>93</sup> For a discussion of different types of budget support see Lawson and Booth (2004).

<sup>94</sup> Differences in approach are not related exclusively to the relative merit of different aid modalities, but also to donor interests and institutional legacies.

<sup>95</sup> The Baseline Survey included many countries with more advanced aid management arrangements. Hence the percentage of budget support for all aid recipient countries is likely to be lower.

<sup>96</sup> Both project and budget support can be linked to reforms (e.g. in economic or state governance), but budget support is often viewed as a way of addressing reform at a more aggregate level.

Firstly, budget support has the objective of directly increasing economic development. Budget support is argued to be beneficial compared with other aid modalities for several reasons. Budget support is believed to reduce transaction costs in aid delivery. Moreover, if recipient country governments are more informed about specific in-country conditions relevant to aid effectiveness, or more likely wholeheartedly to implement policies in which they have ownership, funds channelled as budget support may be allocated and used more efficiently. In addition, budget support can be one way of improving donor coordination, thus reducing transaction costs for partner countries and the 'institutionally destructive effects from the proliferation of donor projects' (White and Dijkstra, 2003). It can also facilitate long-term planning by providing stable and predictable financial flows.<sup>97</sup>

Secondly, budget support is intended to contribute to the strengthening of recipient country institutions and to generate reform in those institutions or policies that can have a positive effect on development. It is argued that budget support may help to improve domestic accountability in partner countries, by using local systems to channel funds and underscoring the budget as the tool and expression of policy, thus facilitating review by local stakeholders (public accounts committees in parliament; external audit offices, see also Work Package 6) and increasing government accountability to the population in the use of public resources. Budget support is also assumed to support a more intensive policy dialogue between donors and recipient countries, more effective use of conditions, and more intense efforts to improve recipient country systems (mainly PFM and procurement systems). The shift towards providing more budget support has been accompanied by increases in donor expenditure on the reforms of such systems.<sup>98</sup>

### **6.3 Corruption and budget support: Theoretical arguments**

Concerns have been raised about giving budget support to countries where corruption is high (see also Work Package 5 with regard to more general governance concerns and budget support). Unwin (2004) argues that '[a]t present, many of the African countries receiving budget support from donors are widely described by international agencies as being 'corrupt'. [...] Donors are therefore taking an immense leap of faith in believing that they can somehow change this system in a couple of years through the use of budget support [...]' Unwin concludes that GBS is likely to be a transient feature of official development assistance (ODA). He does not, however, provide a detailed analysis into the relationship between corruption and aid modalities.

From a donor perspective, a frequently raised concern is that budget support associates donors more closely and more comprehensively with the actions of recipient governments, and consequently involves a greater 'reputational risk'. Thus, when cases of 'grand corruption' hit national or international headlines, budget support comes under greater pressure for (immediate) suspension than project support. This could cause disruptions in aid flows that make aid less reliable and less effective.

From an analytical perspective, two main concerns with regard to corruption and budget support have been raised. Firstly, budget support gives partner country governments greater discretion in the allocation of aid, which could increase rent-seeking and corrupt misallocation, reducing the development impact of aid. For instance, there is evidence that corruption leads to less government spending on education and more on the military (Mauro, 1998). Such allocative incentives could also affect the use of budget support. Secondly, budget support may increase the resources at the disposal of a government and, as a consequence, increase the power of an incumbent government relative to other groups in the partner country. Instead of increasing domestic accountability of a government, budget support could then reduce domestic

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<sup>97</sup> However, in reality there can be considerable variation with regard to the predictability of budget support.

<sup>98</sup> The total spending of donor agencies on public sector financial management jumped from US\$6m in 1990 to US\$150m by 1995, and US\$800m by 2001 (OECD, Creditor Reporting System; in 2002 prices).

accountability and retard reform.<sup>99</sup> Sections 6.3.1 and 6.3.2 examine these two concerns in greater detail. Section 6.3.3 deals with effect of budget support on external accountability, i.e. of partner country governments to donors.

### **6.3.1 Aid modalities, corruption and fungibility**

Fungibility means that partner country governments can reallocate their own resources in anticipation of aid. For instance, if donors grant US\$1 million to education in a partner country, the government can redirect these funds to other purposes by reducing their own spending on education by US\$1 million. Although the schools nominally funded by aid are built, they would have been built without aid. Aid therefore does not result in more schools being built. Another way to put it is to say that even earmarked aid simply relaxes the general budget constraint of the government.

Aid is more fungible under certain circumstances than under others. The degree of fungibility of aid depends in particular on how much a government would have spent on the activity for which aid is earmarked, compared with the amount of aid given. Aid is less fungible the more aid-dependent a country is, i.e. the greater is the amount of aid compared with government domestic revenues. Furthermore, aid is less fungible the higher the level of aid to sectors favoured by donors compared with government spending. Where aid is small compared with government resources, aid is highly fungible. Where aid funds activities a government would not spend any money on, aid is completely inflexible.

As mentioned in Section 5.3.2, cross-country studies show that high levels of corruption are associated with less government spending on education (Mauro, 1998) and more on the military (Gupta et al., 2001a). Moreover, corrupt governments have been found to over-invest in public infrastructure and under-invest in its maintenance (Tanzi and Davoodi, 1997; Esty and Porter, 2002). This would suggest that, to the extent that budget support leaves more discretion for partner country governments, we would expect the funds to be less effectively allocated, in terms of productivity and growth as well as poverty reduction, when a government is more corrupt. The extent to which budget support entails a real increase in discretion depends, however, on the fungibility of aid.

Where aid is completely fungible, earmarked aid or project aid will result in the same allocation of funds across activities and sectors as budget support. Giving aid as project aid will in this case not have any effect on how aid is actually spent. By implication, assuming that the transaction costs of project support are higher than for budget support, budget support is the modality of choice when aid is highly fungible, even in highly corrupt countries.

In countries where aid makes up a large share of public spending, fungibility of aid is generally lower. In aid-dependent countries, donors can exercise greater control over the actual allocation of funds (including aid), in particular through earmarking aid. Where governance is relatively good, the international aid policy debate argues that donors should give greater ownership of the use of funds to governments (see the Paris Declaration, OECD, 2007b). However, where governance is poor and corruption is high, donors may want to exercise control by providing aid through projects or otherwise in earmarked ways (Radelet, 2005). At the same time, as Box 3 below reflects, while the lower fungibility of project aid may be desirable in these cases, donors should not assume that the choice of aid modality alone suffices to ensure that aid is not wasted owing to misallocation and corruption.

In highly aid-dependent countries which are highly corrupt, project or earmarked support would lead to lower fungibility of resources than budget support. The expansion of budget support in

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<sup>99</sup> However, it may be difficult to distinguish empirically whether this effect is generally associated with the influx of large amounts of aid, or whether it is specific to situations where significant shares of aid are provided as budget support.

recent years has been accompanied by a simultaneous growth in donor efforts to ensure that government funding is channelled towards service delivery. Furthermore, sectoral budget allocations are monitored – and PEFA assessments are used to keep track of whether the sectoral breakdown is actually maintained during budget execution (and not just stated in budget plans). In the way that it has actually been provided, this type of aid has taken a form closer to sector budget support than GBS. If aid is imperfectly fungible, this limits opportunities for governments to shift budget support to other sectors. However, discretion remains in allocation within sectors, which highly corrupt governments can use to choose activities that generate higher rents.

### **6.3.2 Budget support and domestic accountability**

Theoretical arguments concerning the effect of budget support on domestic accountability are conflicting. On the one hand, it is argued that budget support increases domestic accountability, by bringing aid on budget and thus underscoring the government budget as the statement and tool of policy, and by stressing the idea that government is responsible for allocative decisions. A government that receives budget support becomes more clearly responsible for how the aid it receives is used and is being accounted for. There is a more clear-cut transfer of ownership of resources from the donor to the government. In the case of project support, ownership by the aid donor and the aid recipient overlap; this unclear ownership may result in aid being treated as a ‘free resource’ from which it is ‘legitimate’ to divert. On the other hand, it is argued that budget support may decrease accountability, by giving more resources and hence more power to the central government relative to the agents that hold it to account.

Again, fungibility plays a role – where aid of any form is completely fungible, the aid modality used would generally neither influence the power of the government to allocate funds nor affect the relative power between government and other groups in the country. Where fungibility of project aid is more limited, the choice of aid modality may have an impact. Budget support gives the government more of a say in allocative decisions compared with project support, and its decisions may therefore be subject to more scrutiny and reaction. However, this positive contribution for greater accountability may be counteracted if budget support significantly shifts the balance of power in favour of the government. Whether the net effect is to increase or reduce accountability is therefore unclear, and depends on the wider governance context.

Where groups and institutions supposed to hold a government to account are weak and marginal, budget support should not be expected to change this situation. Hence, greater ownership of aid by the recipient country government may not result in greater accountability. Moreover, in these types of situations, budget support may even make a government less accountable by increasing its relative power. Both Kolstad (2005) and USAID (2005b) argue that budget support gives greater funds and hence greater power to central governments. Consequently, the USAID report in particular argues that budget support requires complementary projects to strengthen actors that potentially demand accountability. Furthermore, project support can provide one option of providing aid without propping up a government that is corrupt as well as oppressive towards opposition groups.

### **6.3.3 Budget support and external accountability**

In principle, the choice of aid modality may influence accountability of partner country governments to donors in several ways. One way is to change the interests of donors in demanding reform. The other is to make available more effective means of promoting reform in partner countries. A third question is the ways in which aid funds are being accounted for and audited. In terms of donor interests, a key argument used in favour of budget support is that only by using government systems will donors seriously be concerned with pursuing their reform. This argument is widely used with regard to improvements in PFM and procurement systems (also in the context of the Paris Declaration, OECD, 2007b); it can also be applied to corruption.

To matter, a potential increase in interest has to be coupled with effective means of inducing reform. Donors, broadly speaking, promote reform in two ways: through supportive measures such as capacity building, and through incentives such as conditionality and sanctions/rewards (e.g. withholding aid). It is possible that budget support, through increased donor coordination, makes for more concerted and hence more effective capacity building and incentive practices. However, as donors have found with regard to PFM and procurement reform, external inducements and incentives for reform can have limits where commitment to change of key stakeholders in country is low. Moreover, even where governments are broadly supportive of strengthening PFM systems, they may be less supportive of serious action against corruption – in particular, forms of corruption that are linked to party financing and similar, which are linked to the maintenance of the political system (e.g. in Uganda, see next section).

As for conditionality, budget support is unlikely to remedy the basic commitment problem that limits its effective use. There is substantial disillusionment with the degree to which *ex-ante* conditionality can be an effective means to promote reform, that aid can ‘buy’ reform (see Svensson, 2000b and Work Package 8). Where partner countries have failed to implement the reforms promised, donors have still found it in their interest to provide aid (often called the Samaritan’s dilemma), and a threat to withhold aid is therefore not credible. The alternative is to use *ex-post* conditions, which entails giving aid only after a country has reached a certain quality of governance. This is to some extent being tried, the US MCA being a prominent example. This type of conditionality does solve the commitment problem to some extent, by replacing donor discretion with an absolute standard that must be met before aid is provided. However, the commitment problem is not necessarily overcome completely, as the standard may be subject to change.

Regarding external accountability, in projects, financial audits can provide a direct form of accountability, but one which is focused on rule-following rather than results. This has often proven to be highly imperfect (see Box 3). In the case of budget support, this route is more limited (once it has been verified that the transfer has gone to the intended accounts). It is really recipient country institutions – of controlling, reporting on, accounting for and auditing the use of budget funds – that matter.

Uganda provides a recent interesting case: the Global Fund had provided project support to Uganda’s health sector, managed by a dedicated project management unit (PMU). In August 2005, serious mismanagement and corruption was alleged, leading to a large-scale investigation which found that money had been mishandled.<sup>100</sup> In early 2007, an agreement was reached between the Ugandan government and the Global Fund to resume funding, now using government systems rather than a PMU. The undersecretary of the Ugandan Ministry of Health argued in this context: ‘At first the GF in Uganda was treated as a project and that is why it ended badly because it was not subjected to government scrutiny’ (*The Daily Monitor*, 2 April 2007). Thus, the responsibility for the funds and for accounting and auditing was shifted from mixed – and blurred – ownership to full government ownership, which now becomes responsible for accounting for the use of these resources in the health sector. Whether this will solve the issue remains to be seen.

### **Box 3: Corruption and project aid**

Corruption has been discovered in numerous aid projects over the past years and decades. Furthermore, corruption also has been found to be internal to international agencies (especially the UN system, EC, AfDB); there is increasing attention also to corruption in humanitarian relief (Ewins et al., 2006). Several donors have guidelines about how to prevent corruption in project aid – indicating that corruption is considered a risk (Aguilar et al., 2000).

For project assistance, the prevalence of corruption is driven by the nature of the projects that agencies typically deal with (size, sector, etc.) and the quality of internal processes and of processes for interacting

<sup>100</sup> See [http://www.theglobalfund.org/en/media\\_center/press/pr\\_060602b.asp](http://www.theglobalfund.org/en/media_center/press/pr_060602b.asp).

with countries, and of systems for audit and follow-up on allegations of corruption. These systems have been relatively weak until recently in many agencies, as numerous alleged cases of corruption concerning aid projects attest (Uganda: Bujagali Dam; Kenya: Kutip transportation project; Lesotho: water project, to name just a few examples). A number of donors have strengthened their systems in recent years. We may assume that corruption risks associated with aid projects are declining as a result of these efforts, but no evidence of the degree of such a decline (if any) is available.

Kenny (2006) takes a specific look at the developmental impact of corruption in the infrastructure sector. He emphasises that the development impact of corruption depends more strongly on the selection of projects, quality of inputs used, and subsequent maintenance, and only to a lesser extent on the bribe paid in the context of a contract. Based on (anonymous) interviews with contractors with substantial experience in sub-Saharan Africa, Hobbs (2005) provides a detailed description of how corruption has occurred in World Bank contracts. He claims that: (i) bribes are standard in procurement contracts (at a rate of 10% to 15% of the contract value), and (ii) World Bank procurement procedures and audits were unable to detect these standard forms of corruption.<sup>101</sup> His report also indicates that, relative to the large number of contracts annually handled by the World Bank (40,000), only a very small share had traditionally been subjected to in-depth auditing (26 in 1999). In 2001, the Bank created the INT, which has since led to a higher number of investigations, but staff numbers and costs of investigations are limiting factors. Hobbs concludes that full micro-level control of projects would be prohibitively expensive; hence, focusing on strengthening country systems in principle is useful.

## **6.4 Empirical studies of corruption and budget support**

There are few quantitative studies that disaggregate aid into subcategories. Even fewer of these test how governance affects the effectiveness of the various aid modalities. No study has yet addressed the question of how corruption affects the developmental impact of budget and project support. Initial studies on the evaluation of budget support have not addressed issues of corruption in depth (IDD and Associates, 2006). One reason for this is that data disaggregated by aid modality have been scarce or not very reliable. This gap is beginning to be filled, including by the results of the Paris Declaration Baseline Survey (OECD, 2007b), and by the results of the three rounds of the Survey of Budget Support in Africa (Strategic Partnership with Africa, 2007).

There are a few econometric cross-country studies on the relationship between governance, aid and growth which have used data disaggregated by aid modality (drawn from the OECD's Creditor Reporting System (CRS)). Furthermore, there are a number of case studies where budget support to individual countries has been examined, and these provide an informative yet scattered picture. Several donor evaluation reports, including the Joint Evaluation of General Budget Support 1994–2004 (IDD and Associates, 2006), to varying degrees address the question of corruption. Below, we review the findings from these three types of studies in turn. As set out above, we currently know very little from empirical research about corruption and budget support. Further studies into this nexus should be conducted.

### **6.4.1 Cross-country studies**

There are two econometric cross-country studies of the effectiveness of different aid modalities under different governance conditions (of which we are aware). Cordella and Dell'Ariceia (2003) expand on the analysis of Burnside and Dollar (2000) by distinguishing between programme aid (which in addition to budget support includes import support and debt relief) and project aid flows. The policy measure used by this study is a composite index of inflation, budget surplus and openness. It is thus a measure of macroeconomic governance. The study finds that the growth

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<sup>101</sup> Audit and control procedures may have been further tightened recently but, still, many forms of routine bribery would be difficult to detect; especially if a large number of firms builds the value of bribes into their bid, thus suggesting a 'standard' market price that is actually higher than it would be without any bribes.

impact of budget support is more sensitive to the policy environment than project support. It finds that budget support has a relatively greater impact on growth in countries with good macroeconomic policies, whereas project support is more beneficial for growth in countries with poor macroeconomic policies. Aid disaggregation is based on OECD/CRS data, and the years covered are 1974 to 1993 – i.e. before more current generation forms of budget support were used.

Ouattara and Strobl (2006) criticise Cordella and Dell’Ariccia (2003) for using data on aid commitments rather than actual disbursements of aid. Basing their aid modalities data also on the OECD’s CRS, but calculating shares in disbursement from these and using a time series reaching to 2001 and running a similar analysis, Ouattara and Strobl find that project support on average affects growth positively, whereas programme support has no effect or a negative effect. Furthermore, in their analysis, the effect of the various aid modalities does not depend on partner country governance (again measured by an index of macroeconomic conditions). In sum, the findings from the two studies are conflicting; the implications for the wider debate about governance are uncertain.

No econometric study has to date addressed the question of how corruption affects the relative developmental impact of budget and project support. More studies – drawing on better underlying data for aid modalities used – should be conducted as more and better data become available.

#### **6.4.2 Case studies and evaluations**

The case studies and evaluations of budget support that exist, to the extent that they address the issue of corruption, tend to focus on the impact of budget support on corruption more than the effect of corruption on developmental impact.

A set of evaluation studies performed by USAID (2005b) in five countries suggests that corruption may have been a factor in country differences in the success of budget support. In particular, the Malawi evaluation points to serious problems with budget support, and relates these in part to the problem of political corruption. It further argues that there has been ‘an unwillingness by the government to deal decisively with corruption’ (USAID, 2004b). By contrast, ‘[d]onors interviewed for the Tanzania study do not believe that the increased use of GBS has been associated with more corruption. However, corruption may become more apparent as financial systems are strengthened, regardless of whether more funds are actually diverted’ (USAID, 2005b).

Devarajan and Shah (2006) consider budget support to South Asia. They conclude that corruption and budget support are a concern with regard to politics in donor countries, but not to aid effectiveness as such:

The general problem here is one of perceptions. Of course, providing budget support to a country that Transparency International has labelled the most corrupt in the World [Bangladesh] “looks bad”. But if the decision has already been made to transfer some money to Bangladesh, then the question is, what type of instrument will produce the best results? As we have argued above, by focusing on the whole of the public sector and providing incentives for economy-wide reform, budget support operations have a better chance of addressing the very governance problems that plague a country. [...] Moving the debate from these perceptions to the reality of results on the ground is the biggest remaining challenge for budget support operations in South Asia.

Devarajan and Shah stress that ‘[i]n those instances where politics discouraged early adoption of reforms, analytical work done as a part of a knowledge partnership underlying potential budget support has facilitated domestic debate and the creation of a climate of reform.’ They argue that weak governance is therefore not a reason not to give budget support. They appear, however, to contradict this conclusion by the observation that ‘[m]any of the conditions for making budget

support operations feasible in Punjab (strong government commitment to reform, relatively good financial management practices, monitoring and evaluation capacity) do not exist in Balochistan.'

White and Dijkstra (2003) perform an analysis of Swedish programme aid to eight different countries plus Dutch/World Bank programme aid to Ghana.<sup>102</sup> In terms of the impact of programme aid on reform, they conclude that 'domestic political considerations are the prime factor in determining economic and political reform: most countries have initiated reform without donors, and have carried out some measure of reform not required by them, while ignoring others that have been required.' They thus find support for an 'emerging consensus that money can't buy policy'. On Bangladesh, they take a view different from Devarajan and Shah (2006), noting that 'donors have been pushing for the usual reform agenda in Bangladesh during the 1990s. Official compliance with donor demands has been strong, but actual implementation has lagged far behind.' Interestingly, however, they note that 'bilateral donors also seem to have some influence on the dialogue without actually giving programme aid.'

In a study of budget support to Tanzania, Lawson et al. (2006) argue that macroeconomic management and PFM have been improved. They find that '[f]undamental progress has been driven by internal political commitment to change in these areas. But it could have been considerably more difficult if there had not been donor budget funding, together with the associated dialogue and other inputs – or if such funding had been channelled through other aid modalities.' There are however, 'few signs of improved efficiency of public spending', and the challenge function in the budget process remains weak, mainly for political reasons. The study concludes that an impact of budget support on accountability is not automatic; it can at most facilitate change induced by domestic actors. Williamson (2006) mirrors this sentiment in a study of Tanzania and Uganda, arguing that 'it is attractive to believe that [general budget support] can cause improvements in PFM systems, but [general budget support] only supports and facilitates these improvements, political support and technical leadership are more important.'

A country that is of particular interest with regard to new aid modalities and corruption is Mozambique. The issues and dynamics are set out in Box 4.

#### **Box 4: Budget support and corruption in Mozambique**

Mozambique is of particular interest because it has received large amounts of aid since the 1990s and has 'become a model and a testing ground for so called "new aid modalities"' (de Renzio and Hanlon, 2007), with 18 donors by now participating in budget support, and because there has been an intense debate with respect to aid and corruption. As Hanlon (2004b) and others have argued, corruption was relatively low in the 1970s in Mozambique. Since the end of the civil war in 1992, Mozambique has received large amounts of aid, first under the paradigm of 'structural adjustment' and since the late 1990s under the paradigm of 'poverty reduction'. During this period, corruption has spread and this process continues. By TI, Mozambique was rated 3.5 in 1999 and 2.8 in 2006, reflecting an increase in corruption even during the period when donors began to focus on combating corruption more intensively (after a major banking scandal that was rooted in corrupt deals in 2000/2001). A qualitative study by USAID confirmed the picture of high levels of corruption and found little commitment by the ruling elite to combat the situation (USAID, 2005a).

Macamo (2006) has analysed the relationship between programme aid and political governance in Mozambique. He argues that programme aid (including budget support) has had several flaws and unintended consequences – especially strengthening the dominant party. Macamo furthermore points out that, while programme aid/budget support in principle creates an enabling condition for greater domestic accountability in terms of financial flows, in practice the policy dialogue related to budget support has tended to create a close government–donor relationship, which has been detrimental to the policy dialogue between government and society. Also, programme aid as it has been provided has continued to set up systems (such as sector working groups) that have operated parallel to government. Nonetheless, Macamo argues

<sup>102</sup> In their book, 'programme aid' is defined as import support, debt relief (collectively also known as balance of payment support) and budget support.

that it has the potential to bring substantial improvements over a situation where all aid is given as project aid.

A USAID (2004a) evaluation points to similar problems in improving accountability: 'in Mozambique, the press, parliament, and civil society are no match for the government – they have a difficult time improving accountability or reducing corruption ... GBS cash transfers are at high risk in such an environment and may not be effective.'

De Renzio and Hanlon (2007) argue that, thus far, donors have accepted the continuation of significant levels of corruption alongside the provision of high levels of aid, and of budget support in particular. Several studies on governance and corruption have been commissioned, but with little in-depth follow-up. At the same time, the government has not openly resisted the donors' governance agenda, but has sought to agree in principle yet without undertaking changes in earnest.

In a recent World Bank review of budget support, NORAD makes the following case about providing budget support to Mozambique (World Bank, 2006a): 'In the international debate, donors were criticised by some (including Hanlon, 2004b) for not adequately addressing the issue of corruption, allegedly because they wanted to maintain the donor "success story" of Mozambique. Under the previous agreement with the Mozambican government (2001–2003), Norway, like other donors, decided to disburse its programmed budget support, despite the banking crisis. The possibility of putting pressure on the Mozambican government by holding back budget support was, however, discussed in the donor group, with Norway and Sweden as the main advocates for this view. In April 2001, when the Banco Austral crashed, the budget support providers collectively decided to keep back disbursements for a period. In the Consultative Group meeting of October 2001, the Mozambican government committed itself to four follow-up actions related to the banking crisis: (1) prosecute wrongdoing in the financial sector to the full extent of the law, (2) make purposive and equitable efforts to recover outstanding debts, (3) divest the government's interests in banks, and (4) strengthen banking supervision. The donor community regarded these commitments as a satisfactory response to the banking crisis, and donor funds were released as planned.'

The Joint Evaluation of General Budget Support 1994–2004 includes a section on corruption in its synthesis report and in each of the seven country reports. This evaluation has, however, devoted less attention to the subject of corruption than to other issues related to budget support, and hence deals with corruption only in a summary way. There is little information in the evaluation on how corruption may have affected the development effectiveness of budget support, but more on how budget support may have affected governance reform and corruption. The results on this appear to be rather mixed. On the effectiveness of aid modalities in the context of corruption, the synthesis report concludes that '[t]here was no clear evidence that budget support funds were, in practice, more affected by corruption than other forms of aid' (IDD and Associates, 2006). However, given the focus of the report, this is more of a suggestion than an empirically well evidenced statement. The evaluation concludes that it does not make sense to think of systematic thresholds which countries have to meet in order to be eligible for GBS, either in terms of corruption or with regard to other issues. However, it does regard a relationship of trust between donors and development partners as essential (this theme is also echoed in Work Packages 6 and 8).

The country studies of Mozambique and Vietnam suggest that project support is more easily misused than budget support, or that there is no more or less leakage from budget support than from projects support, based on donor perceptions and 'reasonable' beliefs (Batley et al., 2006; Bartholomew et al., 2006). The Malawi country study, by contrast, sees corruption as more of a problem for the effectiveness of budget support. It notes that 'over-optimism concerning progress on issues of political governance and the nature of patronage politics combined with the fluidity of Malawian politics, has been a major problem for aid management. This may have been more serious for PGBS [partnership general budget support] aid than for project support because of PGBS' direct reliance on partner governance competence' (Claussen et al., 2006). The Uganda country study suggests that 'budget support may be more vulnerable than other forms of aid when the quality of the relationship between government and IP [international partners] deteriorates and

the IP wishes to distance itself from the regime' (Lister et al., 2006), thus speaking to the concern about the greater reputational risk for donors that is associated with budget support.

In terms of reform, the evaluation emphasises the positive effect budget support has had on dialogue and engagement (on sector policies, as well as governance, including PFM and corruption issues), and on technical aspects of economic management. In particular, the synthesis report points out that budget support 'plays a valuable role in strengthening public financial management' which is 'a means of limiting the scope of corruption' (IDD and Associates, 2006). The Uganda country study points out, however, that budget support 'provides an avenue of communication, and there is progress at technical levels and where there is a strong constituency for reform on the [government] side... but budget support cannot 'buy reforms' or ensure government behaviour that meets [donor] standards of democracy when the governing regime feels that its fundamental interests and ultimate survival are at stake' (Lister et al., 2006). The Uganda study also states that, technical progress notwithstanding, some donors have been disappointed at the lack of progress in reducing corruption.

The lack of government commitment to reform is commented on in several country studies. The Mozambique report states that, while there has been progress in formal statements of intent, corruption remains an area of concern (Batley et al., 2006). Similarly, the Burkina Faso report points to calls from donors for more tangible and concrete government commitment in fighting corruption (Lanser et al., 2006). On the effect of budget support on domestic accountability, several reports suggest that there may be little effect. The Nicaragua study sees little evidence of more inclusive dialogue or a transparent and shared performance assessment system as a result of budget support (Gosparini et al., 2006). The Mozambique study states that the parliament's capacity to exercise its role is weak, as is the political process. It argues that the deeper factors underlying these matters are 'largely beyond the influence of donors and [budget support]' (Batley et al., 2006). The Uganda study similarly calls for 'realism about the speed and depth of change that can be brought about through what are essentially technocratic means', and argues that, though dialogue may strengthen participation and accountability in government processes, 'donor intervention in sector and budget processes can drown out domestic voices, whether of Parliament or civil society ... and distract from the need to provide domestic stakeholders with information that will enable them to hold the state to account' (Lister et al., 2006).

The evaluation notes that donors that provide GBS are often prominently engaged in anti-corruption activities (although, as for any other purported effects, the evaluation grapples with the issue of attribution). The Rwanda country report, for instance, states that 'it is not clear whether [donors'] access to dialogue over political governance stems from [budget support] or from an established relationship of trust at a high level' (Purcell et al., 2006). As set out above, as budget support exposes donors to greater reputational risks, it is likely to be an important part of their motivation – but this may not necessarily have the desired results. The evaluation argues – in line with the findings of this report (Section 5) – that the anti-corruption activities that donors have supported may have been ineffective. Overall, the report sees support for PFM reforms and capacity building as the most promising avenue for mitigating risks and ultimately also for reducing opportunities for public sector corruption.

Overall, existing empirical research and evaluations provide a mixed and inconclusive picture of the implications of corruption for the choice of aid modalities. No econometric study has to date tested the impact of corruption on the relative effectiveness of budget support. Studies of this kind should receive priority as better data on disaggregated aid become available. Country case studies and evaluations differ on how corruption affects the relative effectiveness of budget and project support. The Joint Evaluation is a case in point, where the synthesis report does not see budget support funds as more affected by corruption; some individual country reports (e.g. Malawi) suggest the opposite. What a number of case studies and evaluations do suggest is that budget support may have enhanced dialogue and engagement, and had some effect on technical aspects of economic management, in particular in the area of PFM. At the same time, several studies are sceptical that budget support can 'buy reform' not in the interests of ruling elites, and the effect on

domestic accountability is also questioned. Given that questions about budget support and corruption are of considerable policy relevance for donors, it would seem worthwhile investigating these questions further as part of future budget support evaluations and/or country research and evaluations.

## **6.5 Summary**

Budget support is preferable to other aid modalities if it more effectively promotes development and/or institutional reform in partner countries. This section has reviewed the information that analytical arguments and empirical studies provide on: (i) the prevalence of corruption in relation to various aid modalities, and the degrees to which corruption distorts the developmental impact of different aid modalities; and (ii) whether aid modalities affect the governance environment and corruption in a country differently. In summary, the conclusions are:

1. From a theoretical perspective, for countries where aid is fully fungible, the choice of aid modality does not affect aid allocation nor accountability. If budget support saves on transaction costs, it is therefore a better choice than project support, regardless of the level of corruption.
2. Where aid is imperfectly fungible, donors have some more control over aid allocation with project than with budget support. Where this is the case, and corruption is high, there are three reasons for not choosing budget support as an aid modality: the reputational risk (and the increased likelihood that budget support would have to be suspended at some point), the higher risk of budget allocation decisions being driven by rent-seeking motives, and the fact that making budget support available regardless of performance reduces its incentive character. However, there is little clear guidance available with regard to cut-off points (i.e. at which level of corruption the risks outweigh the benefits).
3. The challenge facing donors is to draw a line between countries that are considered 'too corrupt' and those that have 'acceptable' levels of corruption. For most donors, the overall governance situation – including respect for human rights, civil and political freedom, commitment to development – will be decisive, rather than corruption on its own.<sup>103</sup> Most developing countries fall into the bottom third of the most widely used governance indices (WBI/KKZ and TI/CPI); the level of corruption is not the only dimension that matters in the decision matrix (so its weighting relative to other factors is also an issue). Developing guidance is important; such guidance could be reviewed as further/better evidence becomes available.
4. Available evidence suggests that the corrupt misuse of aid (and of budget) funds is a risk when project aid and budget support are being used. Thus, when project aid is being used as a preferred modality in highly corrupt environments, sound but sensible corruption safeguards will certainly be necessary (e.g. ensuring that results are being achieved; introducing effective controls without over-bureaucratising the aid disbursed through projects).
5. The claim that budget support is likely to increase domestic accountability needs to be revisited (part of this research is covered in Work Package 6). The effect on domestic accountability appears to depend on the strength of the government compared with the groups and institutions that hold it to account. Budget support seems most problematic in countries which are highly corrupt and have an oppressive government – in such cases, there is the greatest risk that allocation decisions are driven by rent-seeking motives, and that budget

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<sup>103</sup> The MCA uses level of corruption as an overriding criterion, i.e. a country is ineligible for MCA funds if it falls into the bottom half with respect to corruption among its 'peer group' (defined in terms of income level). However, the MCA is designed as an 'additional' amount of aid, or an 'incentive tranche' (in EC jargon), and thus the mechanisms it uses could not be transferred one-to-one to aid in general.

support enhances the power of the incumbent government in ways that may reduce rather than enhance domestic accountability.

6. Budget support increases government ownership over aid resources. At the same time, it can increase external accountability with regard to the budget as a whole. Whether greater government ownership over aid leads to better overall accountability and less misuse of funds appears to depend on the domestic political economy landscape and the strength of the various components of the domestic accountability system (vertical, horizontal, societal and managerial – discussed in Section 5) as well as on the political economy of the aid relationship.
7. Donors providing budget support may have a greater incentive to support the reform of country PFM systems and of wider country governance (because these are essential to ensure that their aid will be used well, and because of the greater reputational risk to donors). Recipient countries may have an incentive to ‘show’ effort (to ensure the receipt of budget support), but not necessarily to follow through. Available evidence suggests that budget support has been associated with progress on technical issues, such as PFM reform. At the same time, it seems unlikely that budget support can ‘buy reform’ not in the interests of domestic actors. Further progress on reforms may be related to the balance of effects on domestic accountability. This underscores the points made in Section 4, about the importance of analysing interests and informal interactions rather than just formal institutions.
8. The increasing emphasis in the donor community on budget support has not been matched by similar efforts to evaluate empirically the impact and effectiveness of this type of aid. In particular, there are no empirical studies that systematically and thoroughly evaluate the implications of corruption for the effectiveness of different aid modalities. Further research is needed to address these issues systematically, which would produce more information on ‘cut-off points’, and the relative importance of corruption compared with other aspects of governance.

## 7. Conclusions

This paper has taken a broad view of the issues. It has sought to tackle five challenging areas: (i) the motivation for donors to address issues of corruption (Section 2); (ii) challenges related to measuring corruption in a way that is sufficiently reliable to feed research efforts as well as policy decisions (Section 3); (iii) an extensive review of social science strands of thinking about the causes of corruption (Section 4); (iv) a review of the impact of donor anti-corruption efforts (Section 5); and (v) available evidence regarding the interaction between corruption and the choice of aid modalities (Section 6).

The findings of this paper are based on an extensive review of existing evidence and an advancement of the conceptual agenda. However, in several areas the paper concludes that existing evidence base is limited, and needs to be complemented by further primary research.

One conceptual advance of the paper is the argument that donors should reconsider their rationale for thinking combating corruption is important (Section 2). Denouncing corruption exclusively because of its perverse consequences leaves the anti-corruption agenda vulnerable to partial – and possibly shifting – interpretations of empirical results; it also misses important dimensions of why people in developing countries care about corruption. An alternative would be to base donor policies on duty-based ethics, where corruption is judged to be wrong in itself because it undermines the moral and rational capacity of people, hence preventing the emergence of more just societies. Such an enhanced understanding of corruption could inform anti-corruption policies in important ways.

Governance and corruption indices have received increased attention and have become increasingly sophisticated over the past 10 years (Section 3). While they represent a concerted and welcome effort, many imperfections remain, some of which may not be fully resolvable. It is important that donors recognise the limitations of quantitative indices and are conversant about the potential limitations of the various indices that have proliferated in recent years. Without this, there is a risk of drawing sweeping policy conclusions from studies with relatively uncertain empirical bases. Furthermore, more detailed qualitative information – which donors need to inform their concrete efforts to address corruption in general and across sectors and levels of government – remains relatively scarce and few frameworks are available for collecting qualitative data in a systematic way. This requires greater attention, given the prominence of concerns about corruption.

Section 4 offers an extensive review of various key strands of social science literature (political science, anthropology, economics) regarding the causes of corruption. This literature increases our understanding of the *features* associated with lower or higher levels of corruption. It suggests that understanding of the political economy of a given context or sector, and how ‘sets’ of (formal and informal) institutions and incentives work together, is indispensable if donors are to respond more effectively to corruption and poor governance. Such analyses emphasise the importance of informal socio-cultural norms to well functioning formal institutions, as well as their resistance to change. Reducing corruption is therefore likely to require changes across the social, political and economic spheres.

More research is needed on the choices that actors face and the conditions that make working within the formal rules more or less costly for both elected and bureaucratic officials. Attempts to control the behaviour of public officials need to be matched by greater understanding of the ‘supply-side’ of corruption – the economic and social incentives that lead companies and private agents (including service users) to take part in corrupt transactions. Moreover, the governance and corruption agenda should be broadened to include support for an environment conducive to private sector development, drawing skilled agents out of rent-seeking and into productive activities.

Donor approaches to reducing corruption have focused on increasing competition and accountability (Section 5). The various entry points can be viewed in relation to the four dimensions of accountability commonly employed and which involve increasing: (i) *horizontal* accountability within government; (ii) *vertical* accountability of political leaders to citizens; (iii) *managerial* accountability; and (iv) *societal* accountability. Donor-supported approaches to corruption have focused on strengthening horizontal accountability mechanisms, such as anti-corruption commissions and audit institutions. The effect of these types of interventions on corruption has generally been disappointing. Partly as a consequence of limited results from efforts to improve horizontal accountability, governance discourses within donor agencies have begun to emphasise the anti-corruption dividends from broader governance reforms (which cover all four forms of accountability).

While there has been limited systematic lesson-learning thus far, the case study evidence that does exist suggests that:

1. Governance reforms have had limited impact in many areas because they have been poorly implemented and enforced (e.g. simplification of tax systems and procurement rules; establishment of semi-autonomous revenue agencies; reform of civil services and budget processes; strengthening of parliaments and judiciaries). Such reforms are therefore unlikely to have impacted positively on corruption, as suggested by continuing high-levels in many countries.
2. Donors have often taken a technocratic approach to governance reform that focuses on formal institutional gaps but has not explicitly recognised or influenced the political and socio-cultural dimensions of reform processes relating to governance and corruption.
3. Societal oversight and monitoring (e.g. grassroots, NGOs, media) can be effective *but only in specific conditions*, relating to the: (i) nature and capacity of societal organisations, e.g. issues of infrastructure, literacy levels, levels of professionalism, economic independence, information asymmetries/elite capture, etc.; (ii) conditions under which they operate, both the formal institutional framework and its actual operation, e.g. the independence of the media may be proscribed despite appropriate legal framework because of repression or ownerships patterns; and (iii) nature of the issue addressed, in particular whether there are collective action problems in addressing the matter at hand.

The introduction of 'new' aid modalities, and in particular GBS, has increased the interest in the relationship between corruption and aid modalities (Section 6). Greater emphasis in the donor community on budget support has not been matched by similar efforts to empirically evaluate the impact and effectiveness of this type of aid, however. Given the limited evidence and existing conceptual work, three points emerge. Firstly, from a theoretical perspective, the fungibility of aid appears as an important consideration in the choice of modality. Only where aid is not fully fungible may donors gain additional control by using projects rather than budget support.

Secondly, there is a need to revisit assumptions about the positive impacts of budget support on domestic accountability. The effect on domestic accountability appears to depend on the strength of the government compared with the groups and institutions that hold it to account. Budget support seems most problematic in countries that have an oppressive government and are highly corrupt. In such cases, there is the greatest risk that financial allocation decisions are driven by patronage or rent-seeking motives, and that budget support enhances the power of the incumbent government in ways which may reduce rather than enhance domestic accountability.

Thirdly, regarding the question of where to use which modalities, there is as yet little clear guidance available with regard to thresholds or cut-off points. Most developing countries fall into the bottom third of the most widely used governance indices.

Over the past 10 years or so, corruption has moved to the centre of development debates. Progress has been made with regard to measuring and understanding the causes of corruption. However, the surprising finding is that far less progress on what to do has been made. Knowledge about how to combat corruption effectively remains limited; insights that might be operationally relevant to donors are still surprisingly scarce. There are as yet few analytical tools for in-depth assessments of corruption, and these have been applied to few countries. Most types of reforms that have been advocated – whether those that are more narrowly focused on corruption, such as ACAs, or broader reforms, such as pursuing PFM reforms, democratisation and strengthening societal monitoring activities – have not brought the hoped-for results. Despite such efforts, many developing countries remain characterised by high levels of corruption. An important finding is that the evidence suggests that corruption may increase in countries undergoing political and economic transition (relative to authoritarian political systems or consolidated democracies).

If donors are really committed to acting against corruption, they need to invest more in understanding what works. Governance reforms are assumed to have a positive impact on levels of corruption, but the causal relationships and processes by which this occurs are poorly defined. Anti-corruption measures need to be designed with specific types of corruption in mind, and need to respond to specific causes and conditions. In addition, effectively combating corruption will require changes to take place within the economic and social, as well as political, spheres. Donors should not view their anti-corruption programme in isolation, but instead capitalise on opportunities to influence drivers of corruption throughout their country programmes. This does not mean, however, that donor objectives and programmes are necessarily complementary, particularly in the short to medium term (e.g. political and economic liberalisation may increase corruption).

Possible directions for further analysis could include:

- Understanding should be increased on how corruption is ‘embedded’ in social and political relationships. Socio-cultural norms are also often intimately related to corruption and, in some circumstances, influence its perceived legitimacy. Such norms can be difficult to influence and slow to change (in tandem with economic and political processes), and too little is currently known about how norms form and evolve. Some anti-corruption programmes are more likely than others to gain broader support within development countries. A pragmatic approach would be to tackle those practices that have least perceived legitimacy, such as bureaucratic and political extortion and predatory behaviour, and which therefore present opportunities for alliances among donors, reformers and activists. Nevertheless, an approach of principled pragmatism should also include long-term strategies to address unjust power structures underlying all forms of corruption.
- Political economy considerations suggest that donors need to think realistically and innovatively about how to approach corruption in developing countries, focusing on the interests and incentives of key actors and seeking to influence these over the long term. The evidence suggests that reforms that are perceived to undermine power-holders will not be implemented and/or enforced, or will be manipulated so as to serve dominant interests. Effective reform processes therefore require an understanding of their impact on key players, including domestic governments. This would permit identification of reforms that entail political gains for government as well as societal benefits. Where reforms are not in the interest of key actors, the aim should be to find ways of altering their incentives to make reform feasible.
- The current focus on how different accountability mechanisms influence the incentives that public officials face should be complemented by an understanding of the material and social incentives that motivate private agents to be party to corrupt transactions. Moreover, donors should broaden the governance and corruption agenda to include support for an environment that is conducive to private sector development, providing incentives for productive (rather than rent-seeking) activities.

- More systematic research is needed to understand the relationship between corruption and different aid modalities. However, given that donors will continue to want to provide general budget support where possible but also need to be accountable to their own taxpayers and end beneficiaries, guidance on cut-off points and 'bottom lines' is urgently needed.

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