

Corruption and Good Governance |

Discussion paper 3

Management Development and Governance Division
Bureau for Policy and Programme Support
United Nations Development Programme

New York July 1997

Copyright © 1997
by the United Nations Development Programme
1 UN Plaza, New York, New York 10017, USA

Contents

Foreword	v
Executive Summary	vii
Introduction	xi
1. Economic Causes of Corruption	1
Payments that Equate Supply and Demand	6
Bribes as Incentive Payments for Bureaucrats	13
Bribes that Reduce Costs	17
Payments to Obtain Major Contracts, Concessions and Privatised Firms	23
Bribes that Buy Political Influence or Votes	30
Payments for Judicial Decisions	33
2. The Costs of Corruption for Economic Development and Poverty Reduction	35
Economic Growth	35
Organised crime	40
Poverty	45
3. Domestic Reform Strategies	51
Reducing Incentives for Payoffs	52
Enforcing Anticorruption Laws	59
Reforming the Civil Service	65
Instituting Checks and Balances	73

4. The Role of the International Community	89
Controlling Corruption in Project Loans and Grants	90
Supporting Reform Programmes	93
Limiting Corruption in International Business	96
Controlling Money Laundering and International Criminal Enterprise	101
Conclusions	105
Notes	110
References	117
Boxes	
1. Corruption in Pakistan	4
2. The Commercial Real Estate Market in Russia	10
3. Corruption in Ukraine	14
4. Evasion of Taxes and Customs Duties	20
5. Rent Seeking and Political Transformation in Algeria	41
6. Fighting Corruption in Botswana	48
7. The Promises and Risks of Privatisation in Latin America	54
8. The Elusive Pursuit of Absolute Integrity in New York City	63
9. Fighting Systemic Corruption in Hong Kong and Singapore	66
10. The United Kingdom's Audit Commission and the Paradox of Self-Monitoring	76
11. Public Opinion About Corruption and Service Delivery	82
12. International Efforts to Control Corruption	98

Foreword

The challenge facing all societies is to create a system of governance that promotes, supports and sustains human development. But the search for a clearly articulated concept of governance in market economies has only just begun. *Reconceptualising Governance*, our second discussion paper published in January 1997, defines governance as the exercise of political, economic and administrative authority to manage a nation's affairs. It is the complex mechanisms, processes, relationships and institutions through which citizens and groups articulate their interests, exercise their rights and obligations, and mediate their differences. Governance embraces all of the methods—good and bad—that societies use to distribute power and manage public resources and problems.

Sound governance, taken a step further, is a subset of governance wherein public resources and problems are managed efficiently and in response to the critical needs of society. Effective democratic forms of governance rely on public participation, accountability and transparency.

Public accountability covers the spectrum of approaches and practices used by governments to ensure that activities and output meet intended goals and standards. While realisation of the government's goals and objectives is a subject of complex and long-standing debate, financial accountability presents an urgent challenge that requires an immediate and practical solution, especially given the rising concern for transparency and responsible governance.

The perceived absence of integrity in governments severely weakens the credibility of democratic institutions. Improving integrity, or developing and implementing strategies for the prevention or control of corruption, is an integral part of ensuring accountability. Corruption,

be it in the public or private sectors, results in the misuse of scarce resources that greatly affects the entire economy. Particularly in areas supported by external assistance, corruption can devalue the reputation and efforts of international development agencies.

The adoption of the United Nations General Assembly resolution requesting that the Secretary General assist Member States in designing strategies to prevent and control corruption on January 28, 1997, provides greater impetus for UNDP to more systematically approach the issue of corruption. *Corruption and Good Governance* is a contribution to this effort. The third in the series of UNDP discussion papers on governance, this study is intended to further clarify and articulate the concept of governance. The first paper examined the relationship between public sector management and governance. The second paper provided a conceptual framework for analysing governance issues.

I am grateful to Professor Susan Rose-Ackerman of Yale University who prepared this study, and to the UNDP technical advisory team—Fred Schenkelaars, Maria Zwanikken and Pauline Tamesis—who prepared the initial outline of the paper and facilitated its production. Useful comments were provided by the staff of the Management Development and Governance Division, Bureau of Policy and Programme Support and the members of the Publication Committee of the Department of Public Affairs.

The views expressed in the paper are not necessarily shared by UNDP's Executive Board or the member governments of UNDP.

G. Shabbir Cheema

Director

Management Development and Governance Division

Bureau for Policy and Programme Support

UNDP

New York, July 1997

Executive Summary

Corruption is a symptom of something gone wrong in the management of the state. Institutions designed to govern the relationships between citizens and the state are used instead for the personal enrichment of public officials and the provision of benefits to the corrupt.

The United Nations General Assembly, concerned about the seriousness of the problems posed by corruption, adopted a resolution on January 28, 1997 requesting that the Secretary General assist Member States in designing strategies to prevent and control corruption. This essay is a contribution to that effort. It complements the ongoing work of the United Nations Development Programme (UNDP) that has begun to emphasise improved governance as a condition for sustainable human development. UNDP has become increasingly interested in corruption as part of the work of its Management Development and Governance Division (MDGD). Programmes that explicitly attempt to reduce malfeasance in government are complementary to the MDGD's broader mandate to help countries reform their institutional structures.

This review begins by isolating the underlying economic causes of corruption in industrial and developing countries. Clearly, history, culture and individual moral scruples also matter and will be important sources of variability across national borders and within individual countries. Nevertheless, the desire for financial enrichment is a powerful motivating force throughout the world. Thus whatever other factors influence the incidence of corruption, potential benefits and costs matter as well.

But is corruption costly in the developing world, or is it simply a reasonable way to cope with a rigid and poorly operating state? Corruption is, at most, a second-best response to a government failure.

At worst, it is a highly distortionary method of public choice. A state with endemic corruption can be especially brutal to the very poor, who have no resources to compete with those willing to pay bribes.

Corruption restricts investment and holds back economic growth. It undermines programmes designed specifically to aid the poor. The poor are harmed by systemic corruption, but the causes of poverty seem more fundamental and deep-seated. It is difficult to document a simple relationship between the distribution of income and the level of corruption. Furthermore, in states with no social safety net and few economic opportunities for the very poor, the bribes collected by civil servants can perform a redistributive function, albeit one that is very inefficient and inequitable. Poor families that have a relative in the government benefit, while others are made worse off.

The study next assesses options for combating corruption. When corruption is endemic, piecemeal reform efforts are unlikely to be worthwhile. Partial solutions can be marginally productive in countries with strong clean-government traditions. Other countries need more fundamental reforms because they are caught in a “corruption trap”, in which corruption feeds on itself producing more corruption. This section suggests possible reforms and considers how they can be carried out in a sustainable way. Unfortunately, the history of anticorruption efforts is filled with programmes that succeeded at first, only to be undermined by subsequent governments or by economic and political crises. In some cases, though, reforms have become institutionalised. There are no quick or certain fixes, but the reform experiences of a number of countries suggest some important lessons. The section discusses both generic reforms designed to increase the risks of engaging in corrupt activities and specific reforms to reduce incentives for corruption in particular programmes.

The concluding section considers the role of the international lending and donor communities in supporting systemic reform and in assuring the integrity of the projects they finance. It also evaluates other international efforts to combat corruption. A serious anticorruption-

tion initiative requires “ownership” by a country’s leaders. No comprehensive reform programme can be credible without support from a country’s political and economic elite. Narrowly focused cleanups may lack legitimacy if they simply help a corrupt ruler to more efficiently extract economic gains from society. With respect to projects funded by donors’ grants and loans, one important issue is conditionality. Clearly, donors want to avoid corruption in their own projects. If they cannot, projects should not be approved or should be cancelled if they have already begun. A number of international efforts are underway to discourage corruption in business dealings. These are worthy, but they cannot succeed unless they are complemented by concentrated efforts within individual countries.

Introduction

Corruption is a symptom of something gone wrong in the management of the state. Institutions designed to govern the relationships between citizens and the state are used instead for the personal enrichment of public officials and the provision of benefits to the corrupt. The United Nations (UN) General Assembly, concerned about the seriousness of the problems posed by corruption, adopted a resolution on January 28, 1997 requesting that the Secretary General help Member States design strategies to prevent and control corruption.¹ A cooperative effort is envisaged in which the UN works with other intergovernmental and non-governmental organisations to develop an implementation plan. This study is a contribution to that effort. Its recommendations must, of course, be combined with detailed information about individual countries in order to produce operational strategies for particular cases.

One goal of this paper is to determine when price mechanisms, so often a source of economic efficiency and a contributor to growth, can, taking the form of bribery, undermine the legitimacy and effectiveness of government. In the words of the General Assembly resolution, corruption “may endanger the stability and security of societies, undermine the values of democracy and morality and jeopardise social, economic and political development” (Resolution 51/59).

Sometimes, of course, it does make sense to allocate scarce public services to the highest bidder. When foreign exchange is rationed or imports are restricted by quotas, it will generally be efficient to auction off such scarce benefits. Similarly, when a country wants to privatise a state firm, an auction is an effective way to raise revenue and also to ensure that the firm goes to the buyer who values it most.

Nevertheless, the wholesale use of price mechanisms in the public sector is not justified. Corruption cannot be eradicated simply by legalising payments and transferring public functions to the private sector. Corrupt tax and customs officials undermine the ability of the state to raise revenue. Procurement contracts that are obtained corruptly may be inflated in value to reflect the bribes paid. Corrupt privatisations rob the government treasury of needed funds. Corruption of the legislature and the judiciary undermines the goals of democratic choice and impartial legal decision-making. Vote-buying by political candidates can turn electoral contests into bidding wars.

Many public benefits are designed to be allocated to specific, deserving groups. In particular, the benefits of antipoverty programmes should obviously not be allocated on the basis of willingness-to-pay. But in-kind redistributive programmes to provide health care, housing, education or food for the poor could be converted into voucher systems. Markets can sometimes be harnessed to improve poverty programmes, but only if beneficiaries are chosen without bribery and favouritism.

The General Assembly resolution recognises that the fight against and prevention of corruption ought to be part of any serious attempt to reform the governance institutions of developing and transition states. It calls on the Secretary General to work with Member States in developing national anticorruption strategies. This request fits well with the United Nations Development Programme's (UNDP's) existing programme on governance. UNDP defines governance as "the exercise of political, economic and administrative authority in the management of a country's affairs at all levels. Governance comprises the complex mechanisms, processes and institutions through which citizens and groups articulate their interests, mediate their differences and exercise their legal rights and obligations" (UNDP 1997a: iv). Governance includes the performance of state institutions, as well as interactions among government, the private commercial sector and civil society, including non-profit and volunteer groups.

UNDP stresses that improved governance is a condition for sustainable human development (UNDP 1995, 1997a, 1997b). It supports targeting assistance to promote governing institutions such as legislatures and the judiciary, public and private management, civil society institutions as advocates and monitors, and decentralisation of government. It emphasises the importance of transparency, accountability and the rule of law—features of government that can check self-seeking behaviour by public officials and those with whom they deal. One of its priorities is to help non-governmental organisations and governments interact fruitfully. Another is to help improve the legal and regulatory environment in which these organisations operate (UNDP 1997a).

UNDP views corruption control as relevant to the work of its Management Development and Governance Division (MDGD). In 1989 the UN joined with the Dutch government to sponsor an international seminar on “Corruption in Government”. In more recent years UNDP has cooperated with the international non-profit organisation, Transparency International, which is committed to fighting corruption world-wide, to sponsor meetings in Latin America. Many of the MDGD’s projects on accountability and electoral reform can reduce corrupt incentives.²

This study demonstrates why a reduction in corruption will improve the prospects for sustainable human development. It begins with a review of the economic roots of corrupt incentives, canvasses the costs of systemic corruption for growth and poverty reduction, and concludes with an outline of reform proposals for both individual countries and the international community. There is a broad complementarity between the anticorruption strategies discussed here and the broader governance improvement programmes that are already a focus of UNDP projects. Many of the policies central to the UNDP governance effort can play an important role in reducing corrupt incentives.

