

## RESTRAINING ARBITRARY STATE ACTION AND CORRUPTION

**A**N EFFECTIVE STATE CAN CONTRIBUTE POWERFULLY to sustainable development and the reduction of poverty. But there is no guarantee that state intervention will benefit society. The state's monopoly on coercion, which gives it the power to intervene effectively in economic activity, also gives it the power to intervene arbitrarily. This power, coupled with access to information not available to the general public, creates opportunities for public officials to promote their own interests, or those of friends or allies, at the expense of the general interest. The possibilities for rent seeking and corruption are considerable. Countries must therefore work to establish and nurture mechanisms that give state agencies the flexibility and the incentive to act for the common good, while at the same time restraining arbitrary and corrupt behavior in dealings with businesses and citizens.

Chapter 5 focused on building the capability of the public sector. Many of the reforms discussed there will contribute to reducing arbitrariness and corruption. Particularly useful toward that end are instilling a rule-based culture in public institutions, and curbing patronage in the civil service. This chapter broadens that discussion to look at mechanisms to restrain arbitrary state action and corruption more generally.

The chapter examines first the formal checks and balances that need to be built into the structure of government, including judicial independence and the separation of powers. These promote credibility and accountability. But formal instruments of restraint are seldom enough, particularly in countries where corruption has become well entrenched. Therefore this chapter also analyzes the options for these states and others seeking to make a dent in corruption, by examining its root causes. One important lesson is that anticorruption efforts must proceed along many fronts, to reduce the opportunities for, and

the payoffs from, corruption while raising the price and the probability of being caught.

### Formal checks and balances

*In framing a government to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself.*

— James Madison, *Federalist* No. 51 (1788)

Restraining the potential use and abuse of state power is a challenge for any country. Harder still is doing it without depriving state agencies of the flexibility they need to do their job. The misuse of state power creates serious problems of credibility, whose effects linger long after the event. The expropriation of property and the harassment of entrepreneurial Asian minorities in Uganda under Idi Amin left a legacy of distrust, which initially posed enormous problems when the current administration tried to attract private investment. But arbitrary and capricious state action undermines more than credibility. It undermines the rule of law itself, by weakening the force of whatever rules the state has set in place. And it fosters conditions that encourage state officials to place themselves above the law and tempt the rest of society to do the same. Development, in these circumstances, hits a brick wall.

### Instruments of restraint

Sustainable development generally calls for formal mechanisms of restraint that hold the state and its officials accountable for their actions. To be enduring and credible, these mechanisms must be anchored in core state institutions; if these are too weak, external mechanisms such as international adjudication may substitute temporarily. The

two principal formal mechanisms of restraint are a strong, independent judiciary and the separation of powers.

**JUDICIAL INDEPENDENCE AND EFFECTIVENESS.** To prosper, economies need institutional arrangements to resolve disputes among firms, citizens, and governments; to clarify ambiguities in laws and regulations; and to enforce compliance. Societies have devised a broad array of formal and informal mechanisms to do this, but none more important than the formal judiciary. It alone has access to the coercive authority of the state to enforce judgments. And it alone has the formal authority to rule on the legality of actions by the legislative and the executive branches. This special relation to the rest of the state puts the judiciary in a unique position to support sustainable development, by holding the other two branches accountable for their decisions and underpinning the credibility of the overall business and political environment. Yet judiciaries can play this role only when three core conditions are met: independence, the power to enforce rulings, and efficient organization.

Independence from the rest of government is the most important of these. Whatever the precise character of judicial relations with the legislature and the executive, all industrial countries—and many developing countries—rely on the judiciary to hold the executive accountable under the law and to interpret and enforce the terms of the constitution.

Judicial independence has been repeatedly compromised in some countries, and in no country has the judiciary been immune from political efforts to override its decisions. Legislatures and executives have used a variety of gambits to rein in their judiciaries:

- Judges of the superior court in Malta were suspended one hour before a case challenging executive actions was to be heard.
- A succession of Pakistani governments in the past appointed temporary judges, whose lack of tenure made them more vulnerable to political influence.
- Although Ukraine's constitution declares that the courts are independent of the executive, judges remain largely dependent on local authorities for their housing. Judges who have ruled against city officials appear to be particularly susceptible to long delays in getting housing.

The effectiveness of the judiciary also depends on its decisions being enforced. In practice that means that other branches of the government must consent to provide the resources needed for enforcement, including personnel authorized by law to serve court documents, to seize and dispose of property, and to turn the proceeds over to the winning party. In many countries this enforcement capability is constrained. In Poland, for instance,

bailiffs are not under the control of judges but are employed by the Ministry of Justice. Thus, although judges are competent and reasonably efficient, enforcement is slow and often ineffective because the number of bailiffs has not kept pace with the rising caseload.

Developing relationships among the judiciary, legislature, and executive that ensure judicial independence and reliable enforcement is a gradual process. Studies show that private sector confidence in the rule of law increases with each year a stable regime remains in place. More broadly, as Box 6.1 illustrates for Peru, the success of third-party mechanisms for enforcement depends in large part on citizens viewing those mechanisms as legitimate. In countries where judicial institutions are weak, it may be at least as important to demonstrate to citizens and firms the potential benefits of a well-functioning judiciary, and to win support for good laws and impartial enforcement, as it is to proceed with wholly technocratic programs of judicial reform.

The third component of judicial effectiveness is organizational efficiency, which is needed to avoid long delays in clearing cases. The average case takes 1,500 days to clear in Brazil and Ecuador, but only 100 days in France. Long delays raise the transactions costs for dispute resolution and may block access for some potential users; however, the internal efficiency of the judiciary is less critical than its independence and its enforcement authority. As discussed in Chapter 3, even when saddled with cumbersome and costly procedures, judicial systems can strengthen credibility in countries as long as their decisions are perceived to be fair. Any state beginning from a weak institutional base should consider building this aspect of judicial performance its first priority.

**SEPARATION OF POWERS.** Judiciaries may be capable of enforcing rules, but if the public has little faith in those rules remaining stable, the state's credibility can still be compromised. The classic constitutional mechanism for restraining constant legislative changes is the horizontal and vertical separation of powers.

Power can be divided horizontally among the judiciary, the legislature, and the executive, and vertically between central and local authorities. The patterns of a country's political party organization—which can range from a small number of highly disciplined parties to a large number of parties whose members only loosely abide by a party line, and that can govern only by forming multi-party coalitions—also influence the extent to which political power is concentrated or diffused.

The broader the separation of powers, the greater will be the number of veto points to be navigated to change any rule-based commitments. Thus the separation of powers increases confidence in the stability of rules. Multiple veto points can be a double-edged sword, however:

### Box 6.1 How popular participation improved property rights and dispute resolution in Peru

Until 1989 most Peruvians living in marginal urban settlements and rural areas did not enjoy the security provided by formal ownership of their real property (70 percent of the population in urban areas and 80 percent in rural areas). The traditional system of property registration was run by the Ministry of Justice, and conflicts were resolved by the judiciary. The system was perceived by poor urban and rural property owners as a system for the rich, who could better afford the high transactions costs.

In the early 1980s the Institute of Liberty and Democracy (ILD), an NGO, began a campaign to improve the property rights of poor Peruvians. The ILD began by holding extensive public hearings to gather complaints, identify reasons why citizens did not formally register their property, and publicize the potential benefits and costs of registration and secure property. The group coupled this participatory process with a study of the laws and regulations governing property registration and enforcement. Based on the resulting diagnosis, the ILD then developed concrete proposals for reform. These were publicly debated and fine-tuned starting in 1986. Although the professional

monopolies that held a stake in the old system, such as lawyers' associations and notaries, strongly opposed the proposed reforms, community-level support carried the day.

In 1989 a new property registration system was enacted into law. The new system dramatically reduced transactions costs and uncertainty by reducing the power of the professional monopolies. Instead the system uses community norms, such as neighbors vouching for a party's ownership claim, to establish property rights and resolve conflicts. Subject to administrative requirements specified by the law, any lawyer may serve as a third-party verifier, sign the property titles, and resolve conflicts in the field. Contested or complicated cases are resolved by the new system's chief registrar, who is appointed by the Ministry of Housing, not the judiciary. Only after these mechanisms have failed can the conflict be taken to a judge.

By 1994 the new system had registered nearly 120,000 entities, and between 1994 and 1996 it registered an additional 170,000. Spurred by its demand-driven design, the system continues to evolve, and initiatives are under way to expand it nationwide.

they make it just as hard to change harmful rules as to change the beneficial ones.

Many developing countries, including some with formal separation of powers, have few effective checks and balances on the actions of political leaders. In some countries legislative oversight is weak because of poor capacity and inadequate information. In others the executive dominates a compliant legislature. But like the development of a well-functioning judicial system, the formal elaboration of constitutional checks and balances, or their more effective institutionalization, is a gradual process.

**EXTERNAL MECHANISMS.** To some extent, extraterritorial and international restraints can substitute for limitations on the ability of national institutions to enforce rules or to signal credibly that the rules will remain reasonably stable over time. One option is to use extraterritorial adjudication to underpin the domestic judicial system. Confidence in the Jamaican judicial system is buttressed by the fact that the United Kingdom's Privy Council serves as its appellate court of last resort. Because of the weaknesses of the Philippine judicial system, many firms, domestic as well as foreign, prefer to adjudicate their contracts offshore.

As Chapter 3 noted, international agreements are a second mechanism for strengthening commitments not

anchored by any domestic institution. On the trade front, both the European Union and the North American Free Trade Agreement have been able to play this role, and many countries will find it an important reason to join the World Trade Organization. Clearly, sovereign countries can still reverse course on, for example, trade policy by withdrawing from such agreements. But they then have to calculate not just the benefits and costs of the policy reversal, but also the broader costs of renegeing on an international commitment for which their partners will hold them accountable. The threat of international censure makes countries less likely to reverse course.

Agreements with multilateral organizations, such as the IMF or the World Bank, often include some degree of policy conditionality: in order to borrow funds, for example, countries undertake certain reforms. This can have a similar benefit for some countries. These conditionalities can be viewed as a sign of national commitment to the policies that are included as conditions. Countries with weak domestic commitment mechanisms can strengthen their credibility by binding themselves to pay a penalty should they violate the agreement. One of the intentions behind World Bank guarantees is to accelerate the flow of private finance to developing countries by underpinning such commitments.

*Building in flexibility*

Instruments of restraint are a vital foundation for sustainable development. But excessive restraint can lead to paralysis. Instruments for restraining government need to be complemented by institutional arrangements that build in flexibility for the executive branch in formulating and implementing policies and adapting to new information and changing circumstances.

As discussed in Chapter 5, countries have tried a variety of institutional arrangements that combine flexibility with restraint. Some arrangements—such as deliberation councils in East Asia and the Administrative Procedures Act in the United States—delegate substantial autonomy to executive agencies to define the substance and undertake the implementation of policy. But they also require these agencies to follow procedures that open their decisions to input and oversight by other arms of the state and by civil society and businesses. Other arrangements rely on mechanisms within the executive branch to promote flexibility within restraints, such as the devolution of managerial authority to executive agencies within set budgets and performance targets.

But even if bureaucracies are embedded in processes that provide ample opportunity for outside input and oversight, the risk remains that officials will pursue personal rather than organizational goals. Self-seeking behavior can degenerate into corruption when private interests wield their influence in illegal and secret ways, circumventing the legal and bureaucratic rules designed to keep them out. Whether public institutions succumb to these and other sources of corruption will depend on the strength of their institutional defenses. How these are built and maintained is the subject of the next section.

**Controlling corruption**

*A Congressional appropriation costs money. . . . A majority of the House Committee, say \$10,000 apiece—\$40,000; a majority of the Senate Committee, the same each—say \$40,000; a little extra to one or two chairmen of one or two such committees, say \$10,000 each. Then seven male lobbyists at \$3,000 each; one female lobbyist, \$10,000; a high moral Congressman or Senator here and there—the high moral ones cost more.*

—A U.S. railroad company owner in Mark Twain and Charles Warner, *The Gilded Age: A Tale of Today* (1877)

Mark Twain's damning tale was a thinly veiled caricature of corruption in the U.S. Congress in the 1870s. Twain's novel followed closely on the heels of the infamous Crédit Mobilier scandal, in which two prominent businessmen brazenly bought their way into the Congress. In India in

1996 a blockbuster movie, *Hindustani*, expressed an extreme form of popular outrage over corruption. The movie depicts horrific tales of callous politicians and bureaucrats willing to let hospital patients die and poor pensioners starve unless they receive their cut.

Fiction thrives on exaggeration. But it is also a mirror that society holds up to itself to reflect entrenched problems. These tales—a century and a hemisphere apart—remind us that corruption is nothing new, nor is it confined to any particular corner of the world. It is a problem that has deeply affected the lives and stirred the resentment of citizens and businesspeople the world over.

Today, citizens everywhere demand greater probity of government officials, and the new transparency in domestic and global markets brings corruption more quickly to the public eye. In the past few years allegations of corruption have contributed to the fall of governments throughout the world. Two former presidents of the Republic of Korea have been prosecuted and indicted. A president of Brazil was impeached on charges of corruption. In October 1996 more than 250,000 people protested the Belgian government's handling of a pedophile ring and alleged corruption in judicial appointments and enforcement. And a fierce debate has erupted over the financing of political campaigns and its influence on public policy in the aftermath of the 1996 U.S. presidential election.

Corruption has been defined in many ways. This Report defines it as the abuse of public power for private gain. Although corruption tends to get the most attention, it is a symptom of a more general problem of perverse underlying incentives in public service. Corruption flourishes where distortions in the policy and regulatory regime provide scope for it and where institutions of restraint are weak. The problem of corruption lies at the intersection of the public and the private sectors. It is a two-way street. Private interests, domestic and external, wield their influence through illegal means to take advantage of opportunities for corruption and rent seeking, and public institutions succumb to these and other sources of corruption in the absence of credible restraints.

Corruption violates the public trust and corrodes social capital. A small side payment for a government service may seem a minor offense, but it is not the only cost—corruption can have far-reaching externalities. Unchecked, the creeping accumulation of seemingly minor infractions can slowly erode political legitimacy to the point where even noncorrupt officials and members of the public see little point in playing by the rules.

Studies have shown a clear negative correlation between the level of corruption (as perceived by businesspeople) and both investment and economic growth. This is confirmed for investment levels by the results of the private sector survey conducted for this Report (Figure 6.1). As we

saw in Chapter 3, the survey identified corruption as one of the major obstacles to doing business in many countries. Yet it is not just a cost of doing business. Other surveys and anecdotal evidence suggest that the greatest victims of petty corruption are usually the poor.

Despite such evidence, many parts of the developing world retain a certain ambivalence toward corruption. A commonly heard view is that corruption merely greases the wheels of commerce, and that without it there would be no transactions and no growth. Apparent support for this argument comes from the fact that some countries that rank high in surveys of the level of corruption have also excelled in economic growth. The predictability of corruption—both that of the amount one has to pay and that of receiving the outcome one has paid for—provides some insights into this apparent paradox. For a given level of corruption, countries with more predictable corruption have higher investment rates (Figure 6.1). But even in these countries corruption has an adverse impact on economic performance. Figure 6.1 also shows that, no matter how high the degree of predictability of corruption in a country, its rate of investment would be significantly higher were there less corruption.

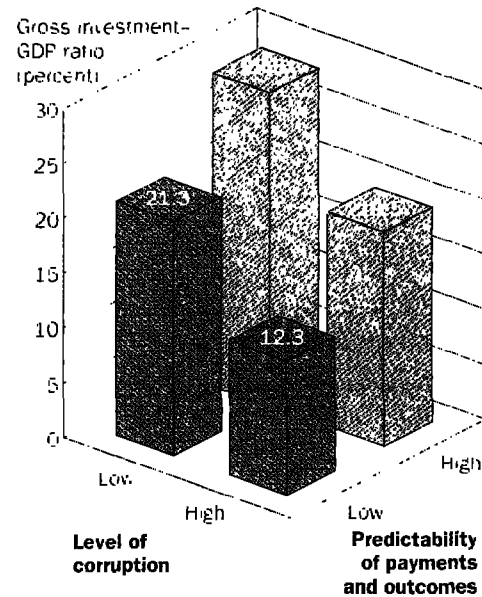
Countries that have so far achieved high rates of economic growth despite serious corruption may find themselves paying a higher price in the future. Tolerating corruption that siphons off payments of, say, 10 percent on average may generate pressures to increase the take to 15 or 20 percent. Corruption feeds on itself, creating a widening spiral of illegal payoffs until ultimately development is undermined and years of progress are reversed. And the very growth that permitted corruption in the past can produce a shift from productive activities to an unproductive struggle for the spoils. Over time corruption becomes entrenched, so that when governments finally do move to contain it, they meet powerful resistance.

#### *Causes of corruption*

Incentives for corrupt behavior arise whenever public officials have wide discretion and little accountability. Politicians, bureaucrats, and judges control access to valuable benefits and can impose costs on private citizens and businesses. Public officials may be tempted to use their positions for private gain by accepting bribes; for their part, private individuals may be willing to make illegal payments to get what they want from government. Thus, a necessary condition for corruption is that public officials have rewards and penalties at their disposal.

Some corruption stems from opportunities generated by the policy environment, at the bottom or the top of the hierarchy. Payoffs are frequent to lower-level officials charged with collecting tariffs, providing police protection, issuing permits, and the like. When corruption is

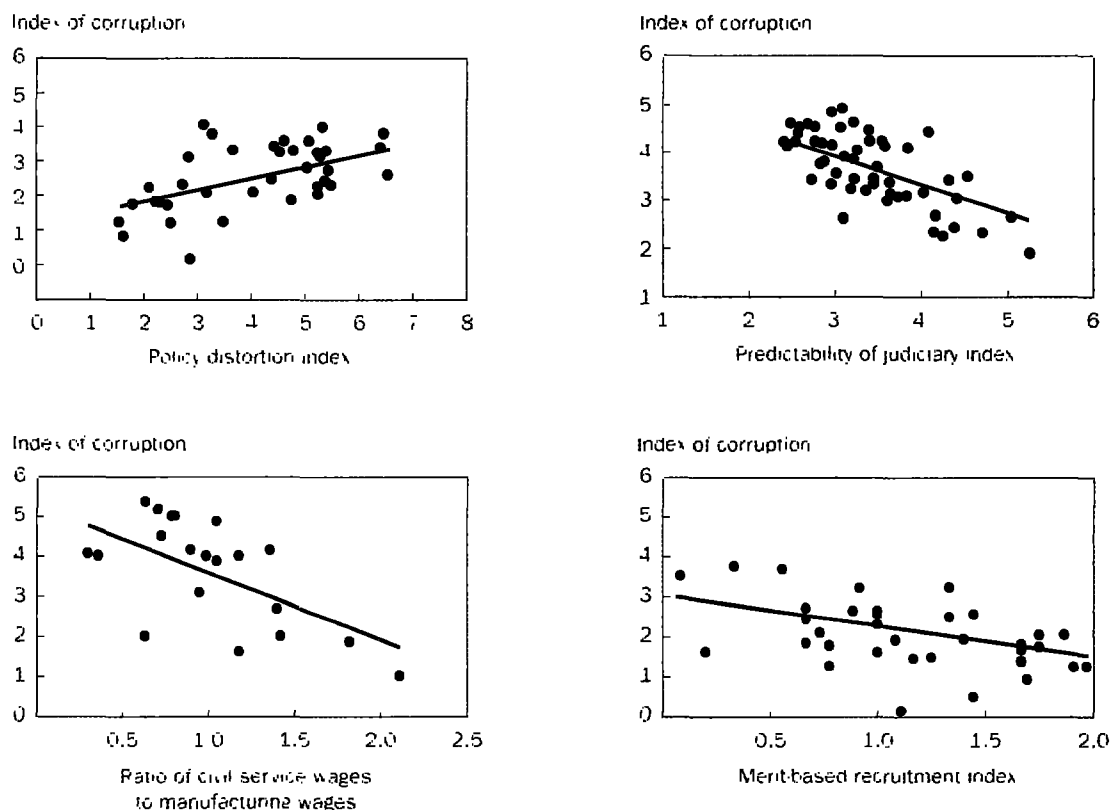
**Figure 6.1 High and unpredictable corruption hurts investment**



Note: Each value is an average for a group of countries. Results are based on a regression using data from thirty-nine industrial and developing countries, controlling for income, education, and policy distortion. See the Technical Note for details. Source: World Bank staff calculations based on data from the private sector survey conducted for this Report.

endemic, these officials may create additional red tape and delays to induce even higher payments. Of course, corruption also occurs at the highest levels of government, in the awarding of major contracts, privatization, the allocation of import quotas, and the regulation of natural monopolies. This helps explain why corruption is more prevalent in countries with highly distorted policies, as measured by variables such as the black market exchange rate premium (top left panel in Figure 6.2). Any policy that creates an artificial gap between demand and supply creates a profitable opportunity for opportunistic middlemen.

The probability of being caught and punished (for the person paying the bribe and for the official receiving it) also affects the level of corruption. Economic analysis of the law suggests that individuals weigh the expected benefits of breaking the law against the expected costs (the probability of being caught and punished multiplied by the level of punishment). Corruption may be high in a country where the government system does little to deter bribes. Lawbreakers may believe that there is little chance of being caught or, if caught, of having to pay the penalty, since they believe that the system of justice itself can be

**Figure 6.2 Some factors associated with corruption**

Note: Data for the top left panel are from thirty-nine industrial and developing countries during 1981–93 (for the policy distortion index) and 1990 (for the corruption index). The top right panel is based on a regression using data from fifty-nine industrial and developing countries during 1990. Data for the bottom left panel are from twenty industrial and developing countries in the late 1950s to early 1990s. The bottom right panel is based on a regression using data from thirty-five developing countries during 1970–90, controlling for income. See the Technical Note to Figure 3. Source: World Bank staff calculations (top two panels); van Rijkelghem and Weder, background paper (bottom left panel); Evans and Rauch 1996 (bottom right panel).

corrupted. Corruption can even persist in countries with substantial press freedom and public resentment against it, if there is little hope of independent judicial resolution of important cases. This Report's private sector survey found a negative correlation between reported levels of corruption and judicial predictability (top right panel in Figure 6.2).

Finally, corruption may thrive if the consequences of being caught and disciplined are low relative to the benefits. Officials frequently control the allocation of benefits and costs whose value far exceeds their own salaries. Corruption becomes especially likely if the wages of public service do not reflect the comparable private wage. Where civil service wages are very low, officials may try to eke out a middle-class standard of living by supplementing their pay with illegal payoffs. The risk of being fired from a low-paying civil service job because of corruption is not

a serious threat if more remunerative positions are available legally in the private sector. Hence corruption is often positively associated with the difference between public and private salaries, or what may be termed the "rate of temptation" (bottom left panel in Figure 6.2). But simply raising civil service salaries may not reduce corrupt behavior. Pay reform must be combined with credible monitoring and law enforcement. Merit-based recruitment and promotion mechanisms that restrain political patronage and create a more impartial public service are also associated with lower corruption (bottom right panel in Figure 6.2).

#### *Reducing corruption*

Several countries have managed to reduce endemic corruption over time. The struggle of the Progressive movement against the power of U.S. urban political machines

of the nineteenth century is a case in point (Box 6.2). Containing corruption requires an understanding of the benefits and costs under public officials' control. Many officials remain honest despite considerable temptation, and many ordinary people and businesses refuse to pay bribes despite the promise of short-term gain. But others succumb. It is unwise to deal with the possibility of corruption by assuming that government officials are of higher moral standing than the rest of the population.

The actual extent of bribery and other corruption depends not just on the potential gains and risks, but also on the relative bargaining power of the buyer and the seller of public favors. Reformers must also consider the fact that anticorruption efforts have marginal costs as well as marginal benefits; the efficient level of bribery will seldom be zero.

Corruption cannot be effectively attacked in isolation from other problems. It is a symptom of problems at the intersection of the public and the private sectors and needs to be combated through a multipronged strategy. Recent reforms in Uganda illustrate such an approach (Box 6.3). One part of the strategy focuses on a major

theme of Chapter 5: creating a rule-based bureaucracy with a pay structure that rewards civil servants for honest efforts, a merit-based recruitment and promotion system to shield the civil service from political patronage, and credible financial controls to prevent the arbitrary use of public resources. Here we focus on the remaining two parts of the strategy. The first is to reduce the opportunities for officials to act corruptly, by cutting back on their discretionary authority. The second aims at enhancing accountability by strengthening mechanisms of monitoring and punishment—using not only criminal law but also oversight by formal institutions and ordinary citizens.

**REDUCING OPPORTUNITIES FOR CORRUPT PRACTICE.** In general, any reform that increases the competitiveness of the economy will reduce incentives for corrupt behavior. Thus policies that lower controls on foreign trade, remove entry barriers to private industry, and privatize state firms in a way that ensures competition will all support the fight. If the state has no authority to restrict exports or to license businesses, there will be no opportunities to pay bribes in those areas. If a subsidy program is eliminated, any bribes that accompanied it will disappear

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### **Box 6.2 Urban political machines in the United States and their reform**

In the late nineteenth and early twentieth centuries many U.S. cities were dominated by political machines, defined by one scholar "as a political party in which a boss oversees a hierarchy of party regulars who provide private favors to citizens in exchange for votes and who expect government jobs in return." Machine-controlled cities also typically made corrupt, collusive deals with private businesses seeking contracts, franchises, or protected markets. The politicians driving these machines operated—and flourished—in nominally democratic environments.

Machines were costly to the communities they dominated. Spending per capita for general administration and for police and fire services—both areas with lots of patronage jobs—was 34 percent and 17 percent higher, respectively, in machine-controlled than in nonmachine cities. To take one extreme case, in Boston the number of city clerks increased by 75 percent between 1895 and 1907, while the population increased by less than a quarter; meanwhile growth in productivity fell by half.

The Progressive movement in the United States had as one of its main goals the reform of machine-dominated cities. Reform frequently meant property tax reform. Seth Low, New York's reform mayor in the early 1900s, was distressed by the favoritism shown to

wealthy property owners and introduced a plan to assess property at market value. The plan increased the assessed value of real estate, lowered the tax rate, and increased revenues. The city's budget was cut by \$1.5 million as patronage appointees were removed from office. Reform mayors in many other U.S. cities followed similar policies.

Reform also involved municipal franchises. In Philadelphia, for example, the machine-controlled city council regularly awarded a gas franchise in return for contributions to the Republican Party. In 1905 reform mayor John Weaver vetoed the franchise bill, appointed a supporter to a key position on the city council to ensure that the veto would be upheld, and had machine adherents arrested on charges of corruption.

Cities dominated by machines paid a high cost in the form of inflated budgets and inequitable tax and spending systems. Although many people benefited from the jobs and patronage dispensed by the machines, the losers were more numerous still. It was they who eventually organized to elect reform candidates in many cities. The wave of reform mayors effected real change, which persisted even when the machines were returned to power, mainly because the reforms were popular and hard to reverse.

### Box 6.3 Fighting corruption in Uganda

Uganda, long plagued by systemic corruption, has launched a multipronged battle against it. The effort enjoys support from the country's leaders, who seem committed to the goal of sound governance.

In the immediate postcolonial period Uganda was a kleptocratic state. By 1967 the regime ruled without holding elections. These beginnings set the stage for Idi Amin's rise to power in 1971. Under Amin, government became little more than a system of organized crime used to extract rents from the public. Their depredations took many forms, including support for economically irrational projects, exorbitant military expenditures, kickbacks on state contracts, extortionate import controls, and expropriation of the properties of Asians. Upon emerging from civil war in 1986, the new Ugandan government under President Yoweri Museveni inherited a weak, underpaid, and overstuffed

civil service (including thousands of "ghost workers") and a thin and porous tax base.

Cleaning up the civil service will take years, but Uganda is making some progress. The effort includes policy reform and deregulation to remove opportunities for rent seeking; civil service reform to streamline the public work force, improve remuneration, provide training, and instill a code of ethics; revival of the Public Accounts Committee of Parliament; a strengthened auditor general's office; and a public relations campaign against and prosecution of corruption, under the authority of an inspector general with powers to investigate and prosecute. Much remains to be done before corruption can be said to be under control. The inspector general, however, has announced prosecutions against common examples of rent seeking (such as customs and procurement fraud), which should have a deterrent effect.

as well. If price controls are lifted, market prices will reflect scarcity values, not the payment of bribes.

Needless to say, reducing official discretion does not mean eliminating regulatory and spending programs with strong justifications. Such programs must be reformed, not eliminated. Abolishing taxes is not a sensible way to root out corruption among tax collectors; a corrupt police force cannot simply be closed down. Several measures have proved effective in reducing official discretion in ongoing programs:

- *Clarify and streamline laws in ways that reduce official discretion.* Mexico's customs reforms cut the number of steps in the process from twelve to four; the remaining steps were streamlined to reduce delays.
- *Contract for services with a private company, possibly a foreign firm with no close ties to the country.* When Indonesia contracted with a Swiss firm for customs preinspection and valuation and for help in collecting import duties, corruption declined. Contracting out monitoring functions is pointless, however, unless the government makes use of the reports it receives—and that does not always happen.
- *Make rules more transparent.* Simpler, nondiscretionary tax, spending, and regulatory laws can limit opportunities for corruption. Sometimes a certain risk of corruption is tolerated because the benefits of a discretionary approach to program administration exceed the costs of corruption. But even then transparency and publicity

can help blunt the incentive to be corrupt. Police officers, for example, must have discretionary authority to make law enforcement decisions on the spot, but public complaints will often restrain any abuses.

- *Introduce market-based schemes that limit the discretion of regulators.* This approach also has the virtue of producing an economically efficient allocation of resources. The sale of water and grazing rights, pollution rights, and import and export licenses can improve the efficiency of government operations while limiting corruption.
- *Adopt administrative reforms that introduce competitive pressures into government.* Open, competitive bidding for public procurement contracts can reduce opportunities for corrupt deals. Creating overlapping, competitive bureaucratic jurisdictions can greatly diminish the bargaining power of individual officials. If clients can turn to a second official when the first demands a bribe, no single official has the power to extract a large payoff so long as applicants are eligible for the service. And if it is the applicants who are seeking something illegal, overlapping enforcement areas can help to check payoffs as well. For instance, when the state wants to control illegal businesses, police officers can be given overlapping enforcement areas to reduce opportunities for corruption.

STRENGTHENING MECHANISMS FOR MONITORING AND PUNISHMENT. Independent watchdog institutions that are



part of the government structure can also curb corruption. Countries have experimented with various approaches:

- Some countries have independent anticorruption commissions or inspectors general that can investigate allegations and bring cases to trial. The most famous is the Independent Commission against Corruption in Hong Kong (China), which reports exclusively to the highest authority and has extensive powers (Box 6.4). Singapore and Botswana have similar institutions.
- Ombudsmen hear citizen complaints and can help increase the accountability of government agencies. Under the Ombudsman Act of 1991, South Africa has established a public protector to investigate alleged improprieties (malfeasance, corruption, human rights abuses) by public officials and to prepare reports, which are usually made public. The office cannot initiate legal actions but will refer cases to offices that can.
- Some public agencies, such as the School Construction Authority in New York City, have established internal

units to root out corrupt contractors and propose ways to reorganize the agency to reduce corruption.

- Whistleblower statutes protect and reward public employees who report the malfeasance of co-workers or government contractors. The United States, for example, has a statute that calls for rewarding workers who report irregularities in government contracts. Such an incentive for reporting is often necessary, since people who report co-workers' misdeeds are frequently ostracized. Such measures are hollow, however, unless prosecutors follow up, courts are incorruptible and efficiently run, and penalties are severe enough to deter potential offenders.

Watchdog organizations should focus not only on those who receive bribes, but also on those who pay them. It takes two to tango, and penalties should be equally severe on both sides—usually a multiple of the bribes received or paid. Penalties for bribe payers should also include the prospect of being barred from contracting

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#### **Box 6.4 Hong Kong's independent commission against corruption**

Corruption was endemic in Hong Kong (China) during the 1960s. Its entrenched character is suggested by expressions popular at the time: people had the choice of "getting on the bus" (actively participating in corruption) or "running alongside the bus" (being a bystander who did not interfere with the system). "Standing in front of the bus" (reporting or resisting corruption) was not a viable option.

Spurred to action by a scandal involving a high-ranking police officer, the then-governor general established the Independent Commission Against Corruption (ICAC) in 1974. The commission reports only to the governor and is independent of the police force. ICAC officials are paid more than other government workers and cannot be transferred to other departments. No one may leave the ICAC to work for senior officers who have been the subject of an investigation. The ICAC has the power to investigate and prosecute corruption cases as well as to sponsor public education campaigns. The government's commitment to reform was further indicated by the appointment of a person of unquestioned integrity as the first head of the commission and by a policy of investigating and prosecuting "big tigers" from the outset.

Early efforts to clean up corrupt syndicates within the police force, however, met with protests. The ICAC

at first backed down and granted an amnesty for offenses committed before January 1, 1977. This setback was harmful to the commission's prestige, but it was able to recover with a vigorous public education campaign. Public surveys carried out between 1977 and 1994 indicate that public perceptions of corruption have fallen significantly. Indirect evidence suggests that active corruption has declined as well.

Still, the ICAC is not without its problems. The main one is that it reports only to the governor. An anticorruption commission reporting to an autocratic ruler could be used as an instrument of repression against political opponents, and the ICAC has not been immune to such charges. The ICAC's broad powers could be abused in systems less committed to the rule of law. A series of oversight committees and an independent judiciary act as a check on the ICAC, but even so the occasional scandal surfaces. As a further control on its power, such an agency might report not to the chief executive but to the legislature, as do Uganda's Inspector General and the U.S. General Accounting Office. A tough, independent anticorruption agency is a potent tool and represents a credible long-term commitment, but there should also be checks on its ability to be misused for political ends.

with the government for a period of years. Industrial countries with strong monitoring capacity can enforce such measures on their multinational companies conducting business overseas. But except for the United States, which adopted the Foreign Corrupt Practices Act in 1977, countries have been reluctant to act unilaterally for fear of subjecting their businesses to more stringent standards than their foreign competitors.

In this context, international organizations provide a forum for agreeing on common standards and coordinating action. Regional organizations such as the Organization of American States have sponsored international conventions making bribery, including international bribery, a crime. A recent initiative by the OECD encourages ending the tax deductibility of bribes and criminalizing the bribing of foreign officials. It makes recommendations to its member countries on how to deal with bribery in international business transactions. International organizations are also working to coordinate the fight against money laundering and, in particular, to expand the list of offenses, including corruption. The forty recommendations of the Financial Action Task Force on Money Laundering include nondrug criminal activities. This opens the way for countries to make illegal the use, deposit, or transfer of money acquired through corruption.

Citizens' groups can also be an important check on the arbitrary abuse of government power—if people can organize, and if they can find out what is happening. Governments should publish budgets, revenue collection data, statutes and rules, and the proceedings of legislative bodies. Financial data should be audited by an independent authority like the U.S. General Accounting Office. Unaudited secret funds or extrabudgetary funds available to chief executives are an invitation to corruption.

Freedom-of-information acts in the United States and a number of European countries are an important tool for public oversight. A recent directive of the European Union requires member states to pass freedom-of-information laws covering environmental information. Such laws enable citizens to obtain government information without having to show how their lives are affected by it. The availability of information helps citizens discipline public officials at the ballot box and through other avenues of protest, such as legal challenges and direct petitions to decisionmakers.

Information is of little value, however, without mechanisms for using the knowledge gained to influence government behavior:

- In democracies, citizens can vote officials out of office if they believe them to be corrupt. This gives politicians an incentive to stay honest and work for the interests of

their constituents. (However, if corrupt payoffs are used to buy benefits for individual voters, knowledge of corruption may do little to stop it.)

- If courts are independent and citizens can sue to force the government to comply with the law, this opens another route to control government malfeasance.
- Public exposure of corruption through the media is another option. Even undemocratic rulers are likely to be sensitive to public opinion, if only because they wish to avoid being overthrown. A free press can be a vital check on abuses of power, especially in countries that lack other means of constraining politicians and bureaucrats.

Yet even if both the necessary information and the means of punishing corrupt practices are available, individual citizens are unlikely to act alone. Laws that make it easy to establish associations and nonprofits can help resolve this collective action problem. Such groups might not only seek information from government, but also supply information to government about citizens' opinions of the quality of public services. As discussed in Chapter 7, the nonprofit Public Affairs Centre in Bangalore is engaged in a promising experiment to publicize the performance of Indian public agencies. An international nonprofit organization, Transparency International, is working to mobilize citizens around the world to fight corruption and to publicize countries' track records. Yet precisely because open information can be so potent in promoting government reform, many countries limit such groups or make it costly for them to organize.

#### **Strategic options: Balancing flexibility with restraints**

Pressures for reform are on the rise everywhere. Private entrepreneurs and firms want the credibility of state actions anchored by a well-functioning system of property rights. Citizens are demanding more responsive and effective delivery of public services and greater probity in the use of public resources. At the same time, globalization is increasing demands for a more agile state, one that can respond quickly to changing circumstances. These pressures have magnified the state's dilemma: how to check arbitrary decisionmaking without building rigidities that inhibit innovation and change. The fundamental challenge is to devise institutional arrangements that sustain a workable balance between flexibility and restraint. Countries with strong institutions or track records of following through on commitments may have room to respond flexibly (even at the cost of some corruption), but countries with dysfunctional and arbitrary governments may not.

States in many developing countries have demonstrated a clear imbalance between flexibility and restraint. They have generally not been credible, accountable, re-

sponsive, or agile. In several countries the capricious exercise of state power coupled with rampant and unpredictable corruption has undermined development. States with too much flexibility and not enough restraint will find that their actions are not viewed as credible, and investment and growth will suffer. These countries need to strengthen the formal instruments of restraint—judicial independence, effective separation of powers—to enhance the credibility and accountability of the state. International commitment mechanisms can serve as a short-term substitute while these institutions are built up.

Yet these actions will not be enough to stop the rot in countries where endemic and entrenched corruption has undermined key functions of the state. Strengthening formal instruments of restraint is only one element of a multipronged strategy to control corruption. Reforming

the civil service (for instance, by raising pay and restraining political patronage in recruitment and promotion), reducing opportunities for officials to act corruptly (for instance, by increasing competition and reducing officials' discretionary authority), and enhancing accountability are other essential steps. Strengthening mechanisms for monitoring and punishment—of the people who pay bribes as well as those who accept them—will require vigorous enforcement of criminal law. But it will also require oversight by formal institutions such as statutory boards and by ordinary citizens (through voice and participation). These efforts can help not only in controlling corruption but also in improving many other functions of the state, such as policymaking and service delivery. The use of voice and participation to reinvigorate public institutions is the subject of Chapter 7.