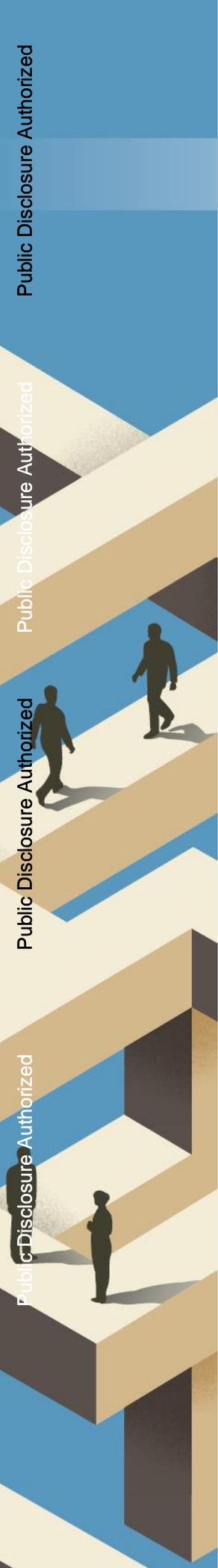


BACKGROUND NOTE

GOVERNANCE *and* THE LAW

Corruption Spotlight

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Background Note for the 2017 World Development Report

Corruption Spotlight

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The weak enforcement of a rule of law is closely related to the prevalence of corruption. Corruption involves different types of rule-violations by bureaucrats, politicians and businesses where power is misused for private benefit. Not surprisingly, corruption is correlated with the weak enforcement of formal institutions in general, including property rights and the formal rules of politics. All of these are in turn strongly correlated with the level of development. Countries that have high levels of corruption are likely to have weak property rights, a weak rule of law, high levels of corruption, informal political rents, and low levels of productive capabilities (even if they sometimes have high per capita incomes as a result of natural resources). These correlations raise important questions and challenges for policy.

Causality clearly runs in both directions. Low levels of development make it difficult to fight corruption and enforce formal rules, for instance because resources and incentives for enforcement are limited. At the same time, high levels of corruption can slow down development by reducing and distorting investments. However, the effects of weak productive capabilities on enforcement and anti-corruption are often underestimated. A proper understanding implies a strategic rethinking of anti-corruption strategies.

Two systemic problems make it difficult to implement top-down anti-corruption strategies in developing and emerging countries. First, formal rules and across-the-board anti-corruption strategies are only likely to be effectively enforced when their enforcement is aligned with the interests of powerful organizations in a country. Countries become more advanced when they have a more diverse set of productive organizations in different sectors and activities. As organizations become more productive, they also become more powerful. They pay more taxes, fund political parties, employ more people and therefore begin to have a greater say in what politicians and bureaucrats do. More of them begin to have an interest in the enforcement of the formal rules required to conduct complex businesses and transactions. In contrast, powerful organizations in less developed societies are fewer in number and less dependent on competitiveness and market transactions for their revenues. They can feasibly interact with each other in informal ways and generate rents through political connections. If the most powerful organizations in a country do not want the enforcement of formal rules, it is unlikely that a rule of law will emerge through enforcement efforts from above.

Secondly, as countries become more productive and diversified, political parties can raise enough revenues through formal taxation and contributions to construct their organizations and constituencies *and* they have to raise revenues from a great diversity of business interests and sectors. This ensures that parties have both the ability to be rule-following and the compulsion to follow rules, because rule-violating parties can lose significant sources of funding. It is not just the quantum of revenue but also the diversity of sources that is important. When many sectors and firms are powerful, special privileges for a few will be effectively resisted by the others. This is why developing countries which have a lot of tax revenue from one or two sources are not necessarily rule-following. In contrast, in

poorer countries, political parties can only raise significant revenues in informal and rule-violating ways, and when in power, the most feasible way of rewarding their supporters is to allow them to violate rules. It is difficult for political leaders to exercise ‘political will’ to enforce rules when their tenure depends on doing otherwise.

In contexts where levels of development and political arrangements do not yet allow the effective enforcement of formal rules, anti-corruption strategies should *sequentially attack corruption at critical points where anti-corruption is both feasible and has a high impact on development*. These bottom-up anti-corruption strategies will enable more productive investments and activities, better developmental outcomes and more inclusive growth, and eventually help to create a more broad-based economy with more power centres interested in the enforcement of formal rules. This in turn will make possible successively more ambitious anti-corruption strategies, ultimately making strategies targeting higher-level institutional characteristics like the rule of law or society-level transparency and accountability more likely to work.

The immediate anti-corruption priorities will depend on the country and the sectors and processes that are most important for inclusive growth. A common error is to equate the impact of corruption with the magnitude of bribes. An activity with relatively small bribes can have a high development impact, for instance if bribes prevent the enforcement of regulations on food adulteration. Other activities with significant bribes may be profit-sharing transfers to politicians with a lower impact on development if the corruption does not distort policy. The high-impact anti-corruption approach therefore has to assess anti-corruption priorities but it also has to be feasible. It has to assess if strategies can be designed to make enforcement easier by aligning with the interests of important stakeholders, or developing new coalitions.

To succeed at this level of detail, the anti-corruption strategy has to identify different types of corruption processes, assess if the interests blocking developmental changes can be taken on in this particular case, and then design combinations of policies and incentives that make the anti-corruption enforcement feasible. The types of corruption that may be feasible to address and have relatively high impact are those that are related to market restrictions, and those that constrain the implementation of particularly important state functions and policies. These two types often overlap in the same processes, requiring strategy combinations to address them. The first is related to the deliberate construction of obstacles that restrict the functioning of the market. This corruption can be addressed by simplifications of rules that enable the desired activities without corruption. This may be feasible if some business and social organizations already exist and can support carefully defined initiatives by keeping up the pressure for their implementation.

Another important type of corruption is that which distorts the implementation of important state functions and policies. For instance state policies to address market failures in skills development or environmental damage can involve regulations or subsidies that have to be managed. Some of these regulations may be excessive (and therefore lead to the first type of corruption). But others regulations and interventions may be necessary. The second type of corruption can distort necessary policies with very significant negative impact. Detailed sectoral analysis is required to redesign policy to address the same market failures with policies that are more difficult to distort, for instance by changing the mechanisms through which subsidies are delivered, or shifting from regulations to incentives. These may also need to be combined with policy support for collective action by business associations or

consumer groups that benefit from implementation to assist the enforcement of specific policies and strengthening *specific* agencies and anti-corruption processes.

Standard anti-corruption strategies get this wrong by assuming that aggregate levels of corruption can be reduced through a top-down combination of policies that i) improve the enforcement of a rule of law, ii) change the expected returns to corruption, for instance through bureaucratic pay increases, greater transparency, or harsher punishments, and iii) simplify procedures to reduce the opportunities for corruption. These strategies have generally delivered modest reductions in corruption in contexts where the configuration of social power does not support the enforcement of generalized rule-following behaviour. Both the incremental (bottom-up) strategies outlined here and the systemic (top-down) approaches to anti-corruption are required, with the systemic anti-corruption strategies gaining in policy relevance with the level of development and the spread of productive capabilities in the economy. However, the priority in less developed countries is likely to be the bottom-up targeted anti-corruption that is based on a sound analysis of the corruption blocking critical and specific development goals.