



CORRUPTION AND GOVERNANCE

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The progress of global anti-corruption efforts

I think it is important to put on the table the fact that there has been progress. First, there is a much more explicit recognition about the costs and consequences of corruption and development and poverty reduction. We know much more also as to the extent to which corruption basically is a brake to development, is a brake to private sector development. We call it the governance or anti-corruption dividend when some efforts and reforms are made. The development dividend, which we have calculated, suggests it's about 300% in terms of income per capita increasing by threefold, if there's an improvement in anti-corruption in a country. Much progress has also been made in acknowledging that the private sector has a major role, a major responsibility in this area, both domestically within countries, but also internationally, in terms of multinationals. The OECD Convention [on Combating Bribery of Foreign Public Officials in International Business Transactions] is just one example among many.

Collective action against corruption

There are many other initiatives including many of the organizations represented here, including the PACI efforts and so on. Collective action in this field matters. It matters enormously. The World Bank has been working with other partners, including the U.N., PACI, and the [Global Corporate Governance] Forum obviously, in this area. So, collective action and recognition of the collective action are crucial and another sign of progress. In fact, in the private sector, the whole area of business ethics has become a higher priority among many, even if it's not yet universal. And it's important to recognize that. More generally, in terms of progress, both public and private sectors have made inroads in taking initiatives and implementing some reforms for improved accountability and governance over the past decade, and for anti-corruption, obviously. We have learned much in the past decade. There are enormous amounts still to be learned, but there have been significant lessons from experience, many of which are being shared today.

Limits to progress in fighting corruption

But at the same time, when we look very carefully at the data, the evidence, and the research that we and others have done, the progress is checkered. It's not universal. It's not yet dramatic in terms of improvement in the area of anti-corruption in general and, in particular, in terms of the interface between the private and the public sectors. Domestic firms are still engaged in, to a significant extent (even if it's not the majority in most



places) in bribery for procurement and for other reasons. The same applies to multinationals. There's still a significant proportion of multinationals that do engage in this type of practices. Again, the evidence suggests that perhaps it's not the majority in emerging economies. And one could argue that that's cautiously good news. But there's still a non-trivial proportion that is engaging in this type of practice, not abetting good governance in that context.

The challenges ahead

So it is worth at this stage to pause for a second and review the challenges ahead. I would not be truthful in saying that I can claim to have the list of what are the main challenges – that's for a much broader discussion among many experts. I would like just to take this opportunity to put a handful or so of challenges before us for further discussion, which should be taken against a perspective of progress that should be acknowledged and that I just mentioned. So let me mention a few areas of challenges that still remain, that are unresolved, that are still open to debate. Let me label the first as “the single bottom line” challenge. And it could be under a rubric of “back to the future.” A lot of talks and writings and initiatives have taken place over the past years on an expansion of the bottom line approach for corporations, from single to double to triple and even beyond that, in terms of not only the profit motive's role in it, but also social and environmental sustainability, corporate social responsibility, and so on.

The importance of a single bottom line

There has been, in some sense, a proliferation of bottom lines. All these issues – such as ethics and sustainability in the environmental sense and corporate and social responsibility – are important. But at the end of the day, let me posit that, in the capitalist world, what rules is the single bottom line. And I think it's useful to go back to the basics and say that ultimately, a company will be accountable to its shareholders, or, if it's a family-owned business, in terms of that principle. Being an economist for whom incentive matters, that is going to be what basically drives their behavior and their major decisions. It could be more in the medium term and towards the longer term. I know it takes only a short-term view. Granted, the issue of the term is important, but still there's a primacy of that single bottom line.

The focus on incentives

That gets us to the second point. If we accept the notion of the single bottom line, we need to give a hard look and, perhaps, a little bit of a real look to the issue of incentives. And there, you can see already my bias as an economist. The question cannot be begged: “Which incentives will matter and which ones may not make the difference in terms of affecting the basic equation of costs and benefits of engaging in a corrupt act for a firm versus not engaging in a corrupt act?” So that hard look at incentives may throw a



somewhat different light in any initiative that we are undertaking in terms of evaluating its potential costs and benefits and also *ex post* in terms of evaluating what worked and what didn't work. For instance, the regulatory environment obviously is very important to altering these equations, assuming of course that the regulations are enforced. So we need more discussion on enforcement because it's relatively easy to suggest yet another set of regulations that need to be adopted by fiat, but very often they go unenforced.

The costs and benefits of anti-corruption regulations

Further, it is important to also ask the question of cost and benefit of an enforced regulation: how to avoid the knee-jerk reaction, particularly following some corruption scandals, from going overboard in regulation. It may backfire not only in terms of private sector development as a whole, but also from the much narrower perspective of more ethical and anti-corruption behavior. Let's keep in mind that excessive regulation can be a breeding ground for additional demands for bribery. So again, a hard-nosed look is always worthwhile from an incentive standpoint.

Greater transparency as the alternative to excessive regulation

Now that gets us to the third point. What could we look at, much more in depth and focus, as an alternative to these reactions of "let's just regulate more when there is a concern about corruption"? That alternative – and that's a third point – is transparency-related reform, which, in my view, has not gotten the sufficient emphasis that it deserves. In some sense, it has been for too long the black sheep of such reforms. For the sake of time, I will not go into details, but we're talking at least at the broad level about three levels. First is transparency at the corporate level. There are a lot of discussions and some initiatives that have been taken in the past few years regarding that, such as stock equity markets requiring more such transparency for a variety of well-known reasons and, similarly, regarding the banking system. So, greater transparency in the corporate and banking sectors is one alternative.

Transparency increases the cost of corruption

Second is about multilateral organizations, including our own [the World Bank]. So it's regarding our own corporate governance and our own disclosure. It is no secret that while we have made some progress over the past five to eight years, we need to make more progress, specifically in terms of initiatives of disclosure. For instance, the full publication (it's all on the web) of the hundreds of corporations and individuals that have been publicly sanctioned by the World Bank for having been involved in inappropriate or corrupt practices in World Bank-funded projects. This type of transparency initiatives and reforms applies to not only multilateral organizations, but also initiatives taken by many NGOs. We have also discussed in the past that Transparency International could take stock of all firms and corporations that are being delisted or put under sanction regime,



publicly, by institutions like the World Bank. Now the EBRD and others are likely to come on board. Some institutions like Transparency International as an NGO could be a depository of all such information. They could have implicitly or explicitly some writings regarding the corporate sector in that context, like they do regarding countries. So, increasing the reputational cost due to corruption is an enormous incentive that could make a big difference. We need transparency reforms with spine, not rhetoric.

The importance of media freedom in fighting corruption

And that gets us to the fourth point I wanted to mention in this area, which is absolutely crucial, but by staying too much at the narrow micro level, we lose the broader perspective. That point is media freedom. In particular, media freedom in how it can relate to corporate and public governance and also how research comes into the fore here. Basically, the capacity of some countries of engaging in a freer way in full disclosure through the media, coupled with the capacity of undertaking investigative journalism, can make a huge difference. That raises enormously the reputational risk and, therefore, the reputational cost for the corporate sector of engaging in these practices. Similarly, it raises the costs for the public sector and the politicians. Many examples, I'm sure, will come up in the context of industrialized countries and some in emerging economies as well. My own country, Chile, is a good example. In fact, there was a very interesting piece of research done recently by Russian researchers that looked into the number of mentions in the press regarding abuses on corporate governance by particular companies. They related it very strongly with more protection in terms of corporate governance for minority shareholders as compared to those that have not been mentioned in the press. So media freedom in this context is very, very important.

The need for critical evaluation of anti-corruption efforts

This gets us to the fifth challenge, all related, that I wanted to put forth, which is the notion that I started with, questioning ourselves very straightforwardly at this juncture. We're already in 2008. Many of us have been at this for quite some time. Let's say for a second that there will be very little broader reforms regarding our media freedom, which is lacking in many countries in the world, and also on transparency-related reforms more broadly, in terms of disclosure of assets by politicians, the whole issue of campaign contributions by the private sector, the whole issue we just referred to in terms of publicly listing firms and so on. If there is very little progress on these broader reforms, let me submit for the sake of debate that the impact of many of the initiatives that are being discussed today and that have been taken in this collective action initiative by many of us – more manuals, publications, voluntary codes of conduct, and so on – may be rather limited.



The challenge of improving a broader governance framework

If we don't implement the broader framework, these initial reforms, for instance in promoting codes of conduct initiatives, may not bear the fruit. In fact, if we take seriously the single bottom line approach rather than being all over the place with three or more bottom lines, if we do think hard about incentives in terms of increasing the cost of corrupt activities, and we abstract for a second from political correctness, why would a voluntary code of conduct by an industry make a big difference in reducing the incentive of a company that does engage quietly in bribery in some countries to continue engaging in bribery in those countries quietly while adopting and signing these codes of conduct? Of course this gets us to the very serious and obvious issues that many of you have been thinking or working on, including Transparency International, which has done excellent work on this, like third-party monitoring. Obviously, if there is third-party monitoring, which is serious and biting, and there are sanctions for non-compliance, then the incentive changes. But if it is totally voluntary, and there is no third-party monitoring, or even if there is, there is little sanction or publicity about that, then there's no reputational cost and little effect.

Overcoming resistance to anti-corruption reforms

The point is that many of these more serious reforms with spine, including in the transparency arena, are resisted by many quarters. We get back to the incentive structure. There are too many vested interests in that. Why is there resistance to third-party monitoring? Why is there resistance to sanctions monitoring? Why is there resistance to these broader disclosure and transparency issues? I think, at this juncture, it is extremely important to discuss this frankly, so that it is not just an issue of continuing to muddle along with more signatories for another code of conduct or more conferences or more publications and more discussions about collective action. We have to figure out: is this making a difference and how are we going to make a difference in the next stage?

Going beyond superficial reforms

To end, these challenges by no means are all-inclusive, nor do I claim that they're all the most important ones, but it's to put some framework for discussion. Let me give one potent illustration from four of the points made earlier as to how important it is to go beyond the easier and perhaps more superficial type of reforms. That's something we have done quite a bit of research on, and this is a challenge of state capture, of capture of the state institutions, state laws, regulations, and policies of the government by private elites. In case that state capture exists – and that's quite prevalent to different degrees in many of the countries around the world – many of these micro type of initiatives that we have been discussing may not make the real difference. Because what may be driving the ultimate outcomes are these overarching issues of state capture. Therefore, one needs to address the question if that is the case in quite a few countries where we are involved.



Addressing the challenge of state capture

How best to address the role of some of the private sector that undermines not only the governance of the public sector, but also undermines the thriving and potentially much more competitive medium- and smaller-scale enterprises, exporters, and so on, of the rest of the private sector in a country? And by no means do I mean to imply that this is just a challenge in many emerging economies or only some of them, but it's also a challenge in some industrialized economies. It's not for a multilateral outside donor organization like the World Bank, IFC, or others to resolve it, but I think in a context of today, where there is more frank discussion about these many issues, they should be brought forward. And whenever we promote new or ongoing initiatives to go forward, we need to ask the question: Against this broader background, will our initiative, where we have put in resources and so on, be making a big difference? Or even a small but non-negligible difference? Or not?

The problem of vested interest in anti-corruption reforms

We need to keep in mind that the vast majority of firms, and particularly the thriving, competitive smaller- and medium-scale sector, the exporters have a vested interest at the end of the day in a collective sense, in a well governed environment, both in the private sector and public sector. So ultimately, they have an interest, but that does not mean that that's the reality today or that every single firm is engaging in that issue. That's the collective action problem that is being faced. Fighting corruption is not necessarily the interests in every setting for every corporation, and particularly for some large vested interests that collude with a few political vested interests.

Thank you very much for this.

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