

World Bank Global Issues Seminar Series

The Cancer of Corruption

By Dr. Vinay Bhargava, Director, International Affairs, The World Bank

In 1996, then-World Bank president James D. Wolfensohn declared that, for developing countries to achieve economic growth and poverty reduction, “we need to deal with the cancer of corruption.” That declaration, the first of its kind by a World Bank president, helped focus the worldwide development discussion, at the national and the international levels, on the fight against corruption.

1. Corruption is commonly defined as the abuse of public or corporate office for private gain. It is present in all countries of the world, although its pervasiveness varies, as is evident from country scores on the Corruption Perceptions Index published by Transparency International (TI) as well as other cross-country governance indicators published by the World Bank Institute.¹ Large-scale corruption frequently involves an international dimension as well, and international action is necessary to combat it.² This chapter will briefly discuss the nature and types of corruption, its causes and consequences, some controversial aspects of the issue, the forces shaping it at the global level, the international initiatives already under way, and what the World Bank is doing to combat corruption in its member countries and in its own operations.

Types of Corruption

2. Corruption can occur in different forms, in different types of organizations, and at different levels within organizations. Because of these differences across several dimensions, the types of corruption defined here often overlap:

3. *Grand corruption* is defined as corruption that involves heads of state, ministers, or other senior government officials and serves the interests of a narrow group of businesspeople and politicians, or criminal elements.

4. *Political corruption* involves lawmakers, such as monarchs, dictators, and legislators, acting in their role as creators of the rules and standards by which a polity operates. Such officials engage in corruption when they seek bribes or other rewards for their own political or personal benefit and in return provide political favors to their supporters at the expense of the public interest.

5. *Corporate corruption* occurs in the relationships between private business corporations and their suppliers or clients. It also occurs within corporations, when corporate officials use the corporation’s resources for private gain, at the expense of the shareholders.

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¹ Scores on the Corruption Perceptions Index can be found at www.ti.org; the World Bank Institute indicators can be found at www.worldbank.org/wbi/governance/pubs/govmatters3.htm.

² TI’s Bribe Payers Index provides an indication of the scale of cross-border paying of bribes.

6. *Administrative corruption* includes the use of bribery and favoritism to allow certain individuals or businesses to lower their taxes, escape regulations, or win low-level procurement contracts.

7. *Petty corruption* involves the payment of comparatively small amounts of money to “facilitate” routine official transactions, such as customs clearance or the issuing of building permits.

8. *Systemic corruption* is corruption that is prevalent throughout all levels of society.

Causes of Corruption

9. Corruption arises in many circumstances: in the purchase or sale of goods and services by the government, in the distribution of subsidies, in the privatization of state enterprises, or in the providing of concessions, such as the operation of a toll road, to name a few.³ Firms or individuals seeking to sell to the government may have various reasons for wanting to pay government officials under the table: for example, to get themselves included among bidders on a contract, to tilt the contract specifications in a manner favorable to themselves, to be selected as winner of the contract, to get inflated prices on the goods or services they sell under the contract, or to be allowed to skimp on the quality of those goods and services. But the presence of certain factors tends to make corruption more likely.

10. Ambiguous laws and regulations. A lack of clear rules governing the public sector and its officials creates loopholes for persons or firms to receive a government benefit to which they might not otherwise be entitled. Opportunities for corruption also arise when one person or firm has a monopoly on information about the government’s practices or plans, or when the rules are clear but allow public sector officials wide discretion in their official actions.

11. Opportunity to abuse power. All governments have the power to impose regulations, levy taxes, and enforce the law and impose sanctions on wrongdoers. Public officials may choose to abuse these powers by harassing the businesses or individuals subject to their regulation, taxation, or law enforcement, or they may treat citizens unfairly by imposing these costs selectively. Even firms and individuals who have done nothing wrong may feel obliged to pay bribes to these officials just to avoid the costs and delay of artificially extended official proceedings. Businesses that are engaged in illegal activities may also pay bribes to avoid prosecution or to obtain preferential treatment.

12. Relatively low income per capita. Measures of corruption and poor governance are negatively correlated across countries with income per capita and with scores on the UN Human Development Indicators. That is, richer countries and countries with higher human development ratings tend to have less corruption and better functioning governments. This might lead one to think that marginal improvements in governance are of questionable value in the absence of increased income per capita, and that good governance is a luxury good that citizens will demand once they are rich enough to care. However, evidence also suggests that poor governance is itself one reason why some countries are poor or have stagnant economies. Thus low income may be both a cause and a consequence of corruption.

13. Poor enforcement of property rights and the rule of law. Weak enforcement of law and order and insecure property rights encourage corruption. When property rights are weakly defined and poorly enforced, the boundaries between public and private ownership become blurred. The resulting ambiguity of ownership not only discourages domestic investment but also deters the inflow of foreign capital. Corruption is also more likely to take place when bureaucratic red tape is excessive and legislative and

³ This section draws on Susan Rose-Ackerman, *Corruption and Government: Causes, Consequences and Reform* (Cambridge: Cambridge University Press, 1999), chapters 1 and 2.

judicial systems are weak. Ironically, the same economic liberalization policies that are an essential part of reform in transition economies may also facilitate corruption, if the necessary reduction in the size of government also reduces its regulatory capacity. Many transition countries in fact witnessed this phenomenon in the 1990s.

14. Closed economic and political systems. A variety of governance indexes suggest that greater political and economic freedom is associated with lower corruption. Closed systems are more prone to social inequalities, which in turn contributes to high levels of corruption through state capture **[explain?]**. Political competition, an active and well-organized political opposition, an independent legislature, and freedom of expression (including free media) are bound to increase transparency and accountability in all parts of society, and so limit the frequency and magnitude of corruption.

15. Historical and cultural factors. The particular historical and cultural characteristics of individual countries also, in some cases, help explain cross-country variances in corruption. For example, gift-giving can be a widely accepted behavior in some cultures, whereas it could be considered an act of corruption in others.

Consequences of Corruption

16. Corruption undermines economic development. Corruption reduces economic growth by reducing incentives for productive investment, both by domestic residents and by foreigners.⁴ Bribes can act as an unpredictable tax, disrupting economic activity and leading to inefficiencies. Corruption can also slow economic growth by lowering the quality of public infrastructure and services, as funds intended for these public goods are diverted to private pockets.

17. Corruption undermines political stability and government legitimacy. As corruption in the provision of public goods and services becomes common knowledge, it can fuel distrust of government among the public. If people have no effective means of removing the corrupt officials through the ballot box, the result can be an erosion of political stability.

18. Corruption undermines the social fabric itself. In the extreme, corruption can make the majority of citizens feel alienated from their government and the electoral process, endangering democracy itself. Widespread corruption also undermines the shared values of the society and the mutual trust that makes social and economic relationships possible.

19. Corruption jeopardizes the allocation of resources to sectors crucial for development. Where corruption is endemic and widespread, the government may develop a preference for allocating resources to those sectors and projects, such as military procurement, where transparency is harder to achieve and secret deals are easy to make. This diversion of resources typically comes at the expense of the less corruptible social sectors, such as health and education, and thus at the expense of the country's development.

20. Corruption encourages and perpetuates other illegal activities. A political environment that has become conducive to corruption strengthens the demand for illegal goods and services. Countries with high levels of corruption can become targets for crime networks, as has happened, for example, in Russia and Ukraine.

⁴ World Bank anti-corruption website. www.worldbank.org/publicsector/anticorrupt/

Controversial Aspects

- 21.** No one disputes that corruption is a bad thing. But some argue that, in some circumstances, corruption may be accepted or at least tolerated.
- 22.** Some claim that corruption is a Western concept, inconsistent with the culture and traditions in some non-Western countries. To seek to eradicate it would amount to imposing an alien value system on these countries.
- 23.** Others see corruption in former European colonies as rooted in the colonial practice of paying below-subsistence wages to civil servants, forcing them to take bribes in order to survive. In this view, corruption may have to be accepted until the country can afford to pay its civil service a living wage.
- 24.** In some cases, it is argued, corruption may actually serve a useful economic purpose. When prices are distorted by government edict, or when the public sector is inefficient at meeting the demand for publicly produced goods, bribes may serve as a mechanism for realigning supply with demand.
- 25.** A case can be made that corruption should not be combated by denying development assistance to corrupt countries: doing so might only worsen conditions for poor people in these countries, leading them to feel victimized not only by their own government but by potential aid donors as well. In this view, even if some foreign aid is siphoned off to corruption and fraud, if the bulk of the funds still reach the intended beneficiaries, it may well be worth the cost.
- 26.** As already noted, corruption frequently has a transnational dimension, involving foreign bribe payers or the provision of political sanctuary abroad for corrupt officials and their illicitly acquired assets. Some argue that developing countries cannot eliminate corruption on their own as long as these overseas practices continue. It is up to the developed countries to take effective action against these practices.
- 27.** Finally, some countries are growing rapidly and reducing poverty despite widespread corruption within their borders. In such cases, some would advise leaving well enough alone, arguing that soon the population will be rich enough to demand an end to the corruption.

Combating Corruption

- 28.** An effective campaign against corruption requires addressing the broader governance and institutional issues that give rise to corruption. A multidimensional approach is typically needed, one that involves actions to improve the legal, judicial, and prosecutorial systems; to give civil society greater voice and participation in government affairs; to strengthen and professionalize public sector management; to enhance the competitiveness of the private sector; and to hold political leaders more accountable for their actions. Within this framework, areas where action is needed often include the following: inadequate pay for civil service workers, opaque rules and regulations, excessive discretionary power given to public officials, inadequate regulation of the private sector, state capture (“purchase of laws and decrees by enterprises”⁵), political corruption, weak disclosure requirements in the public and the private sector, lack of a free media, and limited space for civil society organizations.
- 29.** More broadly, a comprehensive anticorruption campaign can be thought of as attacking the problem on two fronts: demand and supply. Some measures will be designed to increase public awareness of the

⁵ Joel S. Hellman et al. Measuring Corruption, Governance, and State Capture. World Bank Policy Research Working Paper 2312, p. 5. www.worldbank.org/wbi/governance/pdf/measure.pdf

presence of corruption and its costs; these will increase the demand for reform. At the same time, other measures—the reforms themselves—will approach the problem from the supply side.

30. Domestic pressure for reform is crucial for any anticorruption strategy to take root. Nothing lasting can be accomplished if the public is indifferent. Outside actors can help by assisting civil society in monitoring governance reforms, supporting the mobilization of like-minded groups against capture by large vested interests, and backing responsible media. The international community can also exert direct pressure for reform, using both carrots (such as the promise of increased aid) and sticks (such as the reduction of existing aid when reforms are not implemented). Measures to increase the supply of reform include putting information about government services and performance in the public domain, arranging for inclusion and participation in the design and implementation of service delivery projects, promoting social accountability, increasing the access of poor people to justice and to productive assets, and promoting judicial independence and accountability.

31. Strengthening anticorruption institutions is a vital element. The key institutions are the judiciary, the regulatory agencies, an anticorruption commission or agency, a public ombudsman, public prosecutors, vigilance commissions, the media (including investigative journalists), and citizen groups and other nongovernmental organizations. Some of these institutions, such as the judiciary and the media, are—or should be—-independent of the executive branch, while others are part of it. All these institutions require long-term support to become effective, but once securely established they can serve as an excellent force to combat corruption.

Corruption as a Global Development Issue

32. A number of high-profile cases during the 1990s have focused worldwide public attention on the problem of corruption, revealing it as a global phenomenon that can affect any country in the world.⁶ Corrupt governments and corporations have fallen following major scandals. Corrupt ruling parties have been removed from office. Corrupt presidents, prime ministers, parliamentarians, and corporate leaders in developing and developed countries alike have lost their jobs and have been publicly shamed and often jailed.

33. There is also a growing recognition that corruption often crosses national borders. Most large-scale cases of corruption feature the collusion of political leaders and other high government officials with multinational companies, to structure deals that produce personal benefits for the officials and excess profits for the companies. Such corruption typically requires the use of the international financial system to launder the money thus exchanged. In many cases transnational criminal operations are involved. Frequently the corrupt officials themselves cross borders, fleeing their home country with their loot to hide in comfortable foreign sanctuaries. The economic consequences of this corruption also cross borders, reducing incomes and investments around the world.

34. Globalization has increased the risks of corruption, but also the opportunities. Increasing worldwide access to information and the growing influence of the media have enhanced public awareness about corruption and its consequences. They have also increased transparency in public sector management and the public accountability of leaders. At the same time, however, globalization has helped corrupt officials to increase their activity because the blurring of economic boundaries and technological advances have made it more difficult to monitor their practices.

⁶ This section draws on Susan Rose-Ackerman, “The Political Economy of Corruption,” In *Corruption and the Global Economy*, edited by Kimberly Ann Elliott (Washington: Institute for International Economics, 1997), chapter 2, pages 31-56.

35. Corruption was a contributing factor in many of the financial crises in developing countries in the 1990s. These episodes made clear the huge costs that corruption can impose by reducing growth and investment; undermining efforts toward fiscal stability, environmental protection, and poverty reduction; exacerbating income inequality; reducing the effectiveness of aid; and ultimately damaging the legitimacy of the state.

36. In response to the increased awareness of the pervasiveness and high cost of corruption, many international organizations have given the problem much greater emphasis than before. The United Nations, the World Bank and other multilateral development banks, the Organization for Economic Cooperation and Development, the Organization of American States, the International Chamber of Commerce, the World Economic Forum, Interpol, Transparency International, Global Witness, and a number of bilateral aid agencies have placed the fight against corruption high on their agenda. There is a growing realization within the official multilateral institutions that, if they do not effectively confront the diversion of the funds they manage due to fraud and corruption, outside observers may do it for them, in ways that undermine the credibility of these organizations.

37. Public opinion polling in developing countries has destroyed the myth that the general public in any country tolerates corruption, whether on cultural grounds or for any other reason. In many parts of the world the polls showed that the publics want their governments to step-up the fight on corruption.

Globalizing the Fight Against Corruption

38. Action to combat corruption is occurring at the global level on five major fronts:

- **Ensuring that loans and grants to developing countries are used effectively.** All international financial institutions and bilateral donors have adopted measures to prevent fraud and corruption in the projects they finance. Yet half of opinion leaders in developing countries surveyed in a global poll commissioned by the World Bank in 2002 still believed that most foreign assistance is wasted due to corruption.
- **Bolstering donor support for reform.** Bilateral donors are being encouraged to support reform measures, on both the supply side and the demand side, as are national and international organizations and institutions that promote accountability.
- **Reducing the incentives for multinational businesses to pay bribes.** Such measures may include criminalizing bribery, eliminating the tax deductibility of bribery as a business expense, and increasing the transparency and integrity of public procurement.
- **Promoting international programs to control organized crime and the flow of illicit funds.** It is very hard for outside organizations to reduce corruption linked to organized crime, such as money laundering, if such corruption has already become systemic.
- **Improving the institutional framework for resolving international disputes.** A stronger framework is needed to impose and enforce sanctions when nations fail to comply with agreed rules and treaties. The World Court, the International Center for Settlement of Investment Disputes (a World Bank affiliate), and the World Trade Organization are among the institutions available to serve this purpose, although their jurisdiction is not entirely clear in all cases.

Beyond these five major areas, worthwhile measures can include linking aid and trade to good governance; improving corporate governance and corporate social responsibility; strengthening the capacity of global governance institutions, including civil society institutions, in fighting corruption; and increasing access to information.

39. A number of international initiatives have been undertaken recently to combat and prevent corruption. Most of these are voluntary agreements and thus do not have the effect of law. The key initiatives are the following:

- The UN Convention Against Corruption (UNCAC), signed in Mérida, Mexico, on December 9, 2003, is the first truly global anticorruption convention. It is unique not only in its global coverage but also in the extensiveness and detail of its provisions. The convention takes a comprehensive approach, aimed at both preventing and combating corruption. It obliges the signatories to implement a wide range of detailed anticorruption measures, affecting their laws, institutions, and official practices. These measures aim to promote the prevention, detection, and punishment of corruption, as well as to strengthen international cooperation among the signatories on these matters. A key feature of the convention is its asset recovery provisions. UNCAC was initially signed by 111 countries; by September 19, 2005, the number had risen to 133. The 30 ratifications required for the convention's entry into force were reached on September 15, 2005.⁷
- In addition to UNCAC, several regional antibribery conventions have been signed. These include the African Union's Convention on Preventing and Combating Corruption, the ADB-OECD Action Plan for the Asia-Pacific, and the Inter-American Convention Against Corruption.⁸
- The OECD Convention Against Bribery of Foreign Public Officials in International Business Transactions (the OECD Antibribery Convention) went into effect on February 15, 1999. This convention makes it a crime in the OECD member countries to offer, promise, or give a bribe to a foreign public official in order to obtain or retain an international business deal. To date, however, only four countries have prosecuted more than one case.⁹
- The Financial Action Task Force (FATF) is an intergovernmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. Created in 1989, the FATF works to generate the necessary political will to bring about legislative and regulatory reform in these areas. It focuses on three principal areas: setting standards for national anti-money laundering and counterterrorist financing programs; evaluating the degree to which countries have implemented measures that meet those standards;

⁷ The text of the convention is available at www.unodc.org/unodc/en/crime_convention_corruption.html. A list of the countries that have ratified UNCAC, along with more information about the convention, can be found at www.transparency.org/in_focus_archive/30th_ratification/30th_ratification.html#summary.

⁸ The texts of these documents may be found at www.africaunion.org/Official_documents/Treaties_%20Conventions_%20Protocols/Convention%20on%20Combating%20Corruption.pdf, www1.oecd.org/daf/asiacom/ActionPlan.html, and www.oas.org/juridico/english/Treaties/b-58.html, respectively.

⁹ The text of the convention is available at www.oecd.org/document/21/0,2340,en_2649_34859_2017813_1_1_1_1,00.html.

and identifying and studying money laundering and terrorist financing methods and trends. The FATF has published recommendations in order to meet this objective.

40. A number of civil society organizations are also at the forefront of the international fight against corruption. Among the best known are Transparency International, already mentioned, and the Extractive Industries Transparency Initiative (EITI). TI is an international nongovernmental organization devoted to bringing civil society, business, and governments together in a powerful global coalition to combat corruption. The EITI supports improved governance in resource-rich countries through the full publication and verification of company payments and government revenue from oil, gas, and mining. Studies have shown that, when governance is good, the revenue from these resources can foster economic growth and reduce poverty, but that weak governance may instead cause poverty, corruption, and conflict—the so-called “resource curse.” The EITI aims to defeat this “curse” by improving transparency and accountability. So far only 8 countries have implemented the EITI, although 12 more have endorsed it. Other participants include international financial institutions (such as the World Bank), donors, mining and oil companies, and nongovernmental organizations.

The Role of the World Bank in Combating Corruption

41. Over the past nine years, the World Bank has worked with other international groups and civil society to raise the profile of corruption as a development issue. During this time, corruption has become a critical consideration in the Bank’s work with its client countries, in its analysis of economic and social issues, and in its own operations and the projects it supports. The Bank has progressed rapidly from taking an ad hoc, low-visibility approach to instances of fraud and corruption in member countries, Bank-financed projects, and among staff, to assuming a leadership role among the multilateral development banks in all three areas. Box 1 lists some of the important steps that the Bank has taken against corruption to date.

42. The World Bank has a comprehensive and integrated anticorruption strategy in place, and it has taken a clear public stance, based on exhaustive research, that corruption is an impediment to economic growth and poverty reduction. The team of investigators that the Bank has put in place has quickly established a track record of success in uncovering fraud and corrupt practices in Bank projects. The Bank’s approach to combating corruption calls for action on four key fronts:

- Providing assistance to countries that ask for help in curbing corruption
- Making anticorruption efforts a key focus of the Bank’s analysis and lending decisions for a country
- Contributing to international corruption-fighting efforts
- Striving to prevent fraud and corruption in Bank-financed projects

43. The Bank’s anticorruption initiatives related to its own lending portfolio are spearheaded by the Department of Institutional Integrity (INT), an independent unit reporting to the president. INT investigates allegations of fraud and corruption in Bank-financed projects as well as allegations of staff misconduct; it then refers its findings to decision makers such as the Bank’s Sanctions Committee for action. The Bank maintains an international hotline (1-800-831-0463) for anyone wishing to report incidents of corruption; reports can also be made to the INT team online. INT also participates in fiduciary reviews of Bank-funded projects determined to be at high risk for corrupt practices. These reviews, conducted through the Bank’s country offices, are designed to detect corruption by ensuring that proper financial controls and oversight are in place. As of the end of June 2005, INT had 244 open cases; since 1999 it has investigated and closed 2,500 cases of alleged fraud or corruption, such as theft, bid-

rigging, bribes, kickbacks, collusion or coercion by bidders, fraud in contract performance, product substitutions, e-mail and fax scams, and misuse of World Bank funds. As a result of these investigations, more than 330 companies and individuals have been sanctioned.

44. In September 2005 World Bank president Paul Wolfowitz announced the launch of a formal voluntary disclosure program, designed to enable firms to report instances of corruption in which they have been involved. In exchange for coming forward, the reporting firm will receive a reduced sanction but must commit itself to working with the Bank in developing and instituting anticorruption policies and controls.

45. Any institution seeking to assist in controlling corruption worldwide needs to start by setting an example and adopting best practices at home. Recognizing this, the Bank has also looked inward to stamp out conflicts of interest and any possible corrupt practices among its own staff. In 2003 the Bank announced the strengthening of its financial disclosure obligations for senior staff. All the Bank's senior managers are now required to provide an annual statement listing their financial interests and those of their immediate family.

Box 1. Highlights of World Bank Actions on Corruption

- World Bank lending for improved governance, public sector reform, and promotion of the rule of law—all key to poverty reduction as well as control of corruption—totaled \$2.9 billion in fiscal year 2005, or about 13 percent of total new Bank lending in that year.
- The Bank runs a global 24-hour anticorruption telephone hotline.
- The Bank has established a Department of Institutional Integrity to investigate claims of fraud and corruption, whether inside or outside the institution and a Sanctions Committee to adjudicate cases and assess penalties.
- So far more than 330 companies and individuals have been found to have engaged in corrupt practices and excluded from doing business with the Bank. Their names and the sanctions imposed are posted on the Bank's external website.
- The Bank's investigative unit has more than 50 staff; dozens more across the Bank are working with developing countries on anticorruption efforts or on research on corruption and governance issues.
- As of June 30, 2005, the Bank had referred 31 cases of fraud or corruption to its member countries, resulting in 25 criminal convictions.
- The Bank today spends \$10 million a year on investigations and sanctions, more than all other multilateral development banks combined.