Corruption and Development:
An Impolitic View

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It's a great honor to be here today, although a bit daunting. The thought of discussing corruption and development before such an experienced and informed crowd makes me a little nervous. Last time I felt this way was just before my first Bank going-away speech. I was about to expound on why the Bank had mismanaged its support for Indonesia and realized that the entire East Asia management team was sitting in the front row.

I want to put down a few markers before I get started. First, I actually don't like corruption. But, like poverty, not liking it and doing something about it are two quite different things. Second, to argue that corruption's impact on development is a complicated issue and needs to be treated as such is not to defend the corrupt. I have worked in some pretty corrupt countries in my time and with some pretty corrupt people, but I never had trouble sleeping at night. Why? Because I was quite sure the poor of those countries were better off because I was there and because the Bank was there. In countries for which I didn't feel that way, I didn't work.

A starting point

In case you've missed it, I have not been all that supportive of the recent position the World Bank has taken on corruption. It's not that I am forgiving of corruption or not morally outraged, it's just that I don't see condemnation and outrage as especially useful tools in dealing with most corruption.

I have a simple point to make today. Corruption is—like bad infrastructure, poor human capital, weak financial systems—a barrier to development. As with these other barriers to development, no country has the resources to fix all aspects of corruption.

Just as we need to make tough choices on which infrastructure we build in poor countries, we need to make choices on which of the many battle fronts we want to fight corruption. We need to know the likely benefits of reducing a particular aspect of corruption, the likely costs (some sense of rate of return to our efforts), so that we can decide where best to devote our efforts—or more accurately where best to help countries devote their efforts.

This may sound obvious but I don't see this view informing the ongoing debate on how to deal with corruption in the way it should.

I have a modest intellectual meal for you today. The hors d'oeuvres will consist of a few impolitic views on corruption, then for the main course I want to turn to the Bank's still-evolving "new" anti-corruption agenda. Dessert will be light—what I boldly and maybe foolishly call "elements of an approach."

<u>A little impolitic food for thought</u>

Much of my food for thought comes from my time in Indonesia—not a surprise, I am sure, to those of you who know me. But my views also reflect the contrasts I saw as I moved from Indonesia to Vietnam to Central Asia. These perhaps impolitic thoughts all aim at getting us to think about corruption differently—and maybe to question some of the myths that have built up around corruption.

<u>Thought #1: Not all corrupt leaders are alike.</u> There is a Puritan overtone to the current debate on corruption: only bad people do corruption and we don't work with bad people. But are all corrupt leaders created equal? Let's take a look at Transparency International's (TI) top five "rogue's gallery": Suharto of Indonesia, Marcos of the Philippines, Mobutu of Zaire, Abacha of Nigeria, and Milosevic of Serbia/Yugoslovia. Do they belong on the same list? For argument's sake, let's say that TI's numbers are right—although I have very serious doubts about them—and Suharto and his family and cronies squirreled away between $15-30 billion, Marcos, $5-10 billion, Mobutu, $5 billion, Abacha, $2-5 billion, and Milosevic, a measly $1 billion. Does that make Suharto the worst of the bunch?

As with most things in life, the answer depends on the question being asked. Maybe yes, if we believe the numbers and if we look only at amounts accumulated. But definitely no, if we look at these leaders through a development lens, at the value each added to the development process in his respective country.

On the output front, how did each of these leaders fare? During the Suharto era, and here I crib from a very nice two-page CGD Note that Peter Timmer prepared recently, Indonesia went from a $1000 per capita, $100 billion economy to a $3500 per capita, $700 billion economy (all in 1996 PPP terms). I assume we don't need to discuss how well Mobutu, Abacha and Milosevic did in these terms. But even Marcos's development record is no match for Suharto's.

So, Suharto doesn't look too bad as a creator of national wealth, but what about his "take?" Was he overpaid for bringing the world's fourth largest country from near collapse to a functioning state, for creating something on the order of $600 billion of wealth (in <u>flow</u> terms)? We live in a country that believes in paying—hugely—for generating shareholder value. U.S. corporations pay 5-10% of a company's increase in shareholder value to chief executives. By this standard, Suharto and clan, in contrast to many dictatorial leaders, were not unreasonably rewarded.

Am I saying it's okay to be crooked so long as you create value? No, obviously not. Suharto's "management" style may have produced wealth but it did not produce the institutions Indonesia needed to bridge the transition from Suharto to his successor. The Suharto example is meant to remind us that we are in the development business, and that dealing with corruption needs to be seen in that context.

<u>Thought #2: Whether we like it or not, elites run most developing countries.</u> Leadership in developing countries is among the scarcest of resources. It should not therefore come as a surprise that public sector leaders are often private sector leaders. For the most part, few such countries see a conflict of interest in government officials running businesses. Combined with the fact that in most traditional societies the family head is obligated to ensure the success of his children, it should come as no surprise that the children of powerful government officials usually get very rich. But is this so different from Western societies? I won't go down the road of comparing the Suharto clan to the political dynasties in this country, but what about the Wal-Mart clan? Sam Walton made a lot of money, but he also made a lot of money for his kids. Four of the top ten richest people in the world (and these days we are talking seriously rich) are Sam's progeny. So, Suharto, like Walton, helped his kids get rich by putting them first in line for opportunities in a burgeoning economy.

I can almost hear you saying, you can't make that comparison since Sam did it the old-fashioned way through the private sector and Suharto did it through the public sector. But Walton and Suharto may have more in common than first meets the eye. The controversy swirling around Wal-Mart these days is over whether or not Sam made his kids rich on the backs of cheap labor. Those who side with Wal-Mart argue that the company created huge numbers of admittedly low paying jobs and by keeping pay and benefits low brought cheaper goods to American consumers—while making themselves exceedingly, some say obscenely, rich on the rents generated. The same can be said for Suharto. Yes, family and friends got rich but huge numbers of jobs were created—and huge numbers of people were pulled out of poverty. Moreover, in contrast to the Wal-Mart saga, real wages actually went up in Indonesian factories, which may or may not be the case in Wal-Marts. In effect, both Suharto and Sam gave their kids first dibs at the rents to be earned in a booming business environment. Yes, in Indonesia that's corruption, and in some cases it was stupid corruption (son Tommy Suharto's clove monopoly) but much of it also created value for Indonesia—daughter Tutut's toll roads, for example—just as Sam Walton created value for the U.S.

<u>Thought #3: Can the numbers we hear on corruption be right?</u> One thing I have found over the many years I spent in the field is that when it comes to corruption, the extreme tends to become the average, and from there the accepted norm. If people know about a case where half a project was stolen, it's not long before all projects are assumed to lose half their funds to corruption. But the numbers just don't add up for me. Aside from the fact that only something like $100 million of the $15-30 billion Suharto and Co. allegedly siphoned off has ever been found, there is the issue of what was produced with the money. We are told that in Indonesia 30% of all public investment funds went astray and that this was no different for Bank projects. But if a third of all Bank investment resources was lost to corruption, how did the projects get built? The Bank does have a pretty thorough *ex post* review process that looks at whether or not the road or school or whatever was built, to what standards, and at what cost relative to benchmarks. To my knowledge very few of these reviews came to the conclusion that for Indonesia the road was not there or badly done or at a cost that was way out of line with benchmarks. Of

course, these reviews could be flawed, but if not, either the loss to corruption numbers are exaggerated or the Indonesians are among the most efficient producers of infrastructure anywhere. Of course, there are obvious examples where corruption raised the cost of doing business in Indonesia, and seriously so. The well-known Paiton 2 power project is an example where corruption raised the price of generated power by at least 30%—but, by the way, apparently legally, since the U.S. investor beat charges of violating the Foreign Corruption Practices Act.

The Bank and Corruption

I want to turn now to the Bank's most recent effort to reinvent its fight against corruption. That approach, made famous by the recent Showdown in Singapore, begins with seven "Lessons of Experience." This is good because, as we all know but often ignore, if we don't get history's lessons right we are pretty likely to repeat that history. Unfortunately the Bank focuses on the wrong lessons when it looks back over its own experience. The learning launching pad for the Bank's new approach to fighting corruption is the following: history tells us corruption is bad for development; institutional reforms can succeed; governance challenges aren't uniform; there are different possible entry points for dealing with corruption; deep-seated corruption is hard to deal with; red tape, bureaucracy and rules all make excellent breeding grounds for corruption; and accountability of governments to citizens matters. Odd to me that after 40 years of working in corrupt countries these truisms are the best the Bank can do as the keys to the fight against corruption.

So, what do I think are the right lessons? Let me offer the following:

- Reducing corruption through improved governance and development are two sides of the same coin. The resurgence of governance and corruption as centerpieces of the development debate is more than anything a sign of frustration over our failure in too many countries and too many cases to achieve the development successes, especially the institutional building successes, we had hoped for and the taxpayers who support us demand. This is not a new conversation about corruption but the continuation of an old conversation about development.
- History tells us that strong institutions are the ultimate solution to reducing corruption and improving governance, but history also shows that institution building is a decadal if not generational process, not much help for dealing with today's problems.
- Donor strategies that depend on big sticks (or big carrots) haven't worked because the record shows donors are not serious—that in the end, disengagement is seen as an option only for the very worst offenders where the international community cannot get to the poor. With China's entry into the development finance world, Western sticks are looking even more splintery than they used to.
- Because the ultimate solution to corruption is better governance, which takes institutions to deliver, there is a trade-off between dealing with corruption and the pace with which we improve the lives of the poor. The tougher we are on corruption and the corrupt, the less we will improve the lives of the poor today. Put another way, delivering to the poor and building institutions in weak environments are often competing ends.

- The corruption that occurs in World Bank projects may hurt the Bank's reputation, but in terms of effect on development, it is a second order issue and as such should not be the main focus of anti-corruption efforts. Ring fencing a Bank project is like putting a burglar alarm in one among a 1,000 houses. The bad guys will just go elsewhere but they will still be bad. For constituency reasons, the Bank needs to be serious about corruption in its own projects, but it is a mistake to see this as a strategy for reducing the development impact of corruption.
- Most critically and most importantly, outsiders can't fix most corruption. Only citizens can. Either they care enough to push for less corruption where it matters to them, or they don't. The outside can help—and I get to this later—but only if the inside wants it. Of course in some areas the outside has to help, especially with big ticket corruption, but accountability starts at home.

<u>Elements of an approach</u>

To end—and with some trepidation—I want to leave you with eight principles that I believe could be the basis of a new approach to dealing with corruption. In the spirit of thinking positively, I put these principles in the form of three "don'ts" and five "do's".

On the "don't" side of the ledger:

- Don't treat the fight against corruption as an end—a sort of war against immorality. We are in the development business. Corruption is one of many constraints to development. Treat it as such.
- Don't rely on "grand strategy" approaches to fighting corruption. These may make good headlines but they may well be counterproductive when it comes to finding effective interventions.
- Don't suggest that "more of the same, but this time we're serious" is a new strategy for dealing with corruption. There is no evidence that making anti-corruption more prominent in country assistance strategies, increasing supervision budgets or doubling the INT staff will make one bit of difference to the sustainable reduction in the types of corruption that matter most to the development goals we hold dear. The micro management of the fight against corruption by donors has not worked and will not work.

Now to the "do's":

- Do understand at the micro level how the "production processes" we care about work, and where in those processes corruption has the most debilitating effect. Then think about where in these processes relatively simple measures might reduce the pernicious effects of corruption. Focus on enhancing development outcomes and fight corruption where it is feasible and where it will have the greatest impact for the poor in terms of creating economic opportunity.
- Do recognize that ring fencing donor projects is a cop-out when it comes to fighting the corruption that matters. It may make donors feel good, it may be important to keep taxpayers happy, but does not lead to sustainable reductions in corruption.

- Do decide early whether serving the poor now or developing local capacity to do this is the primary, immediate goal. Without clarity on this, we cannot even begin to think about approaches and instruments since the first involves doing for weak countries and the second involves long-term investments in strengthening those countries' institutions.
- Do start focusing on output and performance—and hold governments accountable for these. Don't micro manage, but do insist on results. Worry less about whose brother-in-law or, in rare cases, sister-in-law, gets the contract and more about whether he or she delivered the goods. Move supervision resources to fund independent physical audits that determine what was delivered and at what cost. Be prepared to be tough on those who don't deliver.
- Supporting all these is a final recommendation: do set some simple standards of no-harm transparency that are feasible in most institutional settings (or adjusted to different settings) and that require recipients of development assistance to inform their citizens of how much they got, what it was supposed to do, and what the outcome was. A sort of "publish what you got and did" principle. Keep these standards simple, but make them an essential basis for doing business.

Will these measures cure corruption? Certainly not. But they will move us in the right direction, away from micro-managed, ring-fenced, donor-implemented projects toward slowly increasing sustainable development that will make life better for the poor not just tomorrow but for the long haul.

Thank you.