Corruption: Myths & Realities in a Developing Country Context

Ngozi Okonjo-Iweala

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The Richard H. Sabot Lecture Series

The Richard H. Sabot Lecture is held annually to honor the life and work of Richard "Dick" Sabot, a respected professor, celebrated development economist, successful Internet entrepreneur, and close friend of the Center for Global Development (CGD) who died suddenly in July 2005. As a founding member of CGD's Board of Directors, Dick's enthusiasm and intellect encouraged our beginnings. His work as a scholar and as a development practitioner helped to shape the Center's vision of independent research and new ideas in the service of better development policies and practices.

Dick held a Ph.D. in economics from Oxford University; he was Professor of Economics at Williams College, and he taught at Yale University, Oxford University, and Columbia University. He made numerous scholarly contributions in the fields of economics and international development, and he worked for ten years at the World Bank.

The Sabot Lecture series hosts each year a scholar-practitioner who has made significant contributions to international development, combining, as did Dick, academic work with leadership in the policy community. In 2006, the Sabot Lecture was delivered by Lawrence Summers, Charles W. Eliot University Professor of Economics at Harvard University. We are grateful to the Sabot family and to CGD board member Bruns Grayson for support to launch the Richard H. Sabot Lecture Series.

Ngozi Okonjo-Iweala

Ngozi Okonjo-Iweala is Managing Director of the World Bank, overseeing the bank's Africa region and South Asia, Europe and Central Asia region. From 2003 to 2006, she served first as Finance Minister and subsequently as Minister of Foreign Affairs of the Federal Republic of Nigeria. As Finance Minister, Okonjo-Iweala led the Presidential Economic Team, responsible for implementing a comprehensive home-grown economic reform program that fought corruption, stabilized the macro-economy, and tripled the growth rate to an average of 6 percent per year over three years. She was the lead negotiator in the cancellation of US$18 billion, or 60 percent, of Nigeria's external debt with the Paris Club. Okonjo-Iweala oversaw Nigeria's first ever sovereign credit rating from Fitch and Standard and Poor's—a rating that grouped Nigeria with other emerging market countries such as Vietnam, Venezuela, and the Philippines.

Prior to her role as Finance Minister and Minister of Foreign Affairs, she served 21 years as a development economist at the World Bank, working in the East Asia, Middle East and Africa regions. She held the post of Vice President and Corporate Secretary. She also served as Director of Institutional Change and Strategy (1995–1997). In this post, she assisted with the implementation of the Bank's reform agenda. From 1989 to 1991 she was Special Assistant to the Senior Vice President, Operations, an assignment that enabled her to help formulate World Bank policy for many countries, from China to Burkina Faso.

Okonjo-Iweala is the recipient of numerous honors and awards, including four honorary doctorate degrees, *Euromoney* Finance Minister of the Year 2005, and *Forbes* 100 Most Powerful Women in the World 2006.

Okonjo-Iweala attended Harvard and received a Ph.D. in regional economics and development from the Massachusetts Institute of Technology.

Corruption: Myths & Realities in a Developing Country Context

I am pleased to have this opportunity to deliver the second Richard H. Sabot Lecture at the Center for Global Development. Given his interest in examining diverse issues such as the role of government policy and markets in contributing to the East Asia miracle, Dick Sabot demonstrated that he was very concerned about understanding the conditions needed for growth and development in low-income countries. Indeed it was very fitting that last year Professor Larry Summers delivered the first Sabot lecture, "Harnessing the Development Potential of Emerging Market Reserves." The first lecture focused on an important and pressing public policy issue of the day. Today, I have been asked, or press ganged, by Nancy Birdsall to focus on another critical and pressing public policy issue for developing countries, which I believe Dick Sabot would have approved of: "Corruption—Myths and Realities in a Developing-Country Context."

In this lecture, I would like to take a more in-depth look at corruption, and the way it undermines development in poor countries. In the course of the lecture, I will touch on this idea of myth and reality: What are the easy assumptions on corruption? And what are the realities? Are we focusing adequately on important aspects of corruption? What solutions can one proffer to guide developing countries with very weak institutions such as we find on the African continent? And what can be done and what has been done as good practice to tackle corruption in developing countries?

The Effect of Corruption on Governance and Growth

It is probably best to begin with definitions—and to lay out what is meant by the interrelated terms, corruption and good governance. According to a recent report prepared for the United Nations Development Programme (UNDP) by Professor Rose-Ackerman,

> Corruption is a symptom of something gone wrong in the management of the state. When institutions designed to govern the relationships between citizens and the state are used instead for the personal enrichment of public

[1] UNDP, "Corruption and Good Governance," Discussion Paper 3, Management Development and Governance Division (New York, 1997).

> [*and I would add private*] officials, then you have corruption and the provision of benefits to the corrupt. (UNDP, 1997; pp vii)[1]

The World Bank notes simply that corruption is the outcome of poor governance.

Viewed in its broadest sense, corruption is simply the misuse of public office or public assets for private gains. It is also the misuse of these assets in a way that creates an unlevel playing field and which makes people feel that injustice has been done. Perhaps this is why average citizens in any country—in fact we all—feel so badly about corruption. Corruption may be manifested in various forms such as theft, fraud, bribery, extortion, request for kickbacks, nepotism, patronage, and so on. A distinction is often made between grand and petty corruption. In the case of grand corruption, big businesses are seen greasing the palms of senior state officials to receive favors. And in petty corruption, junior civil servants may be enticed to receive side payments or bribes to facilitate administrative arrangements for their clients. The existence of corruption clearly indicates that something is gone awry. And it is indeed symptomatic of weak governance and more importantly weak institutions. Of course, the desired outcome is that of good governance—a situation in which public institutions are strong and public resources and public goods and services are managed efficiently to address the needs of society.

In the past, some skeptics often provided a rational defense for corruption based on economic efficiency arguments. It was argued that bribes helped in lowering the cost of doing business, in clearing the market, in providing incentive bonuses, and in distributing monopoly rents from a single agent to other officials who collude in sharing a bribe. These are all interesting economic arguments which merit some discussion.

For example, it has been argued that in an environment where there are restrictive or bureaucratic government procedures—such as bottlenecks in paying taxes, burdensome customs procedures, or difficulties in obtaining licenses—bribes could actually provide an efficient way of reducing burdensome transaction costs. Similarly, in cases where a government needs to

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[1] UNDP, "Corruption and Good Governance," Discussion Paper 3, Management Development and Governance Division (New York, 1997).

allocate a scarce resource to various private agents, a bribe payment may help the market to clear more efficiently by allocating the resource to the highest bidder. Bribes could also be explained as a rational incentive bonus to public sector workers whose wages may be artificially depressed. And finally, some scholars have also argued that bribe payments ensure distribution of monopoly rents among other private agents participating, for example, in a large procurement contract or perhaps in the sale of some government asset.[2]

Some literature even showed evidence of growth and economic development in countries with high degrees of corruption (such as Indonesia under Suharto, Bangladesh, and China) as evidence that corruption had a limited or ambiguous impact on growth.

The problem with many of these arguments above is that they point to the microeconomic efficiency of an isolated corrupt event without examining its long-run systemic impacts. In the long run, widespread corruption often creates much larger negative externalities which could hinder the long-term dynamic efficiency of an economy. We understand this in Nigeria and many other countries in Africa where we have long struggled with systemic corruption that has diverted resources, corrupted values, and led to rent-seeking activities in place of productive ones.

Corruption Undermines Growth and Poverty Reduction

Let me share with you four corruption tales to illustrate or illuminate how corruption totally undermines growth and poverty reduction. The first concerns the wholesale theft of public monies and it is the first Abacha tale. In August 2004, Swiss authorities accepted the argument of Nigeria's lawyers that there existed an Abacha criminal organization whose purpose was to engage in the looting and laundering of Nigerian public funds. With this acceptance of a long-fought, five-year battle to prove the criminal origin of corruptly acquired Abacha monies, the Swiss government agreed to repatriate about US$505 million of frozen Abacha funds back to Nigeria in 2005 and 2006. Over the five-year period, from November 1993 to June 1998 of Abacha misrule, an estimated $3 to $5 billion of Nigeria's public assets were looted and sent abroad by Abacha, his family, and their associates.[3]

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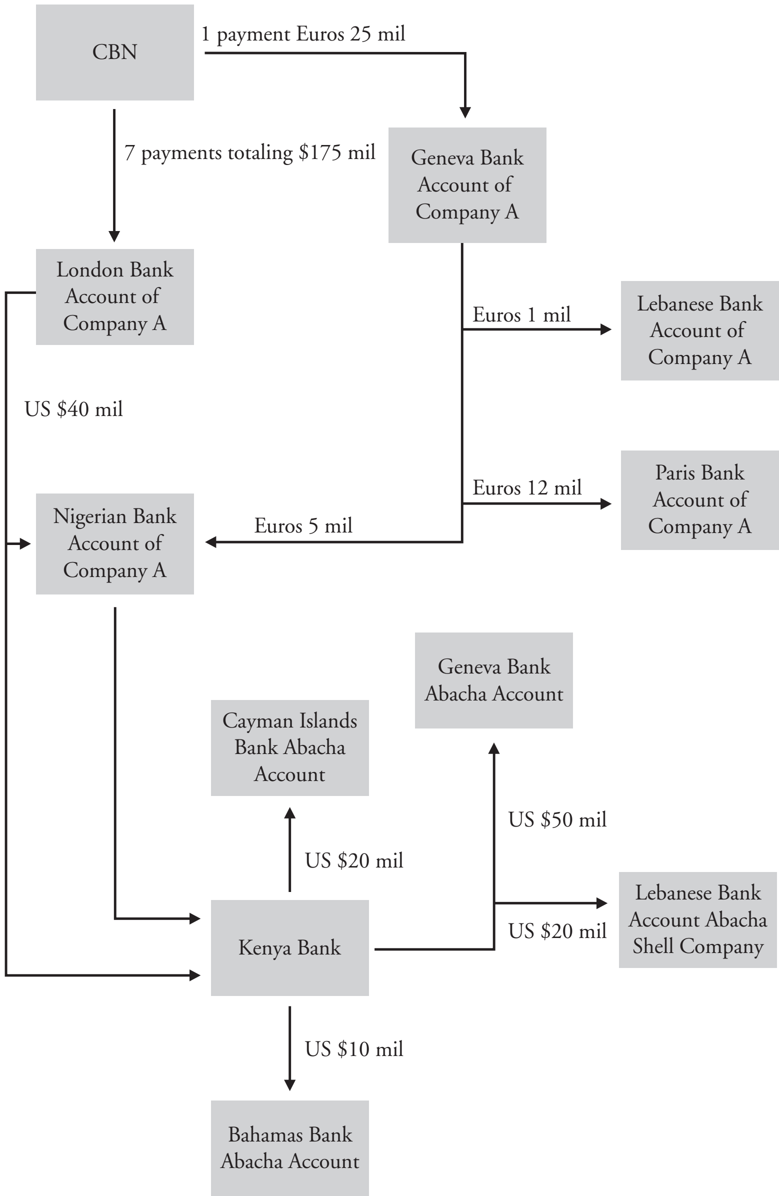
[2] See Chapter 1 of "Corruption and Good Governance."

[3] See Swiss public records (Swiss Federal Court, Decision of 7 February 2005, Public Law Court 1, Presiding Judge Feraud).

Chart 1

Central Bank Nigeria (CBN Payments to Multinational Company A Laundered to Abacha Accounts 1998



These sums represent a substantial amount of Nigeria's public assets by different measures. For example, the estimated sums represent 2.6 to 4.3 percent of 2006 GDP and 20.6 to 34.4 percent of the 2006 federal budget. Another way of viewing this is that at the upper end of the range, the amount stolen is larger than the 2006 education and health federal budgets combined. Using unit cost estimates provided by the World Bank, these amounts could provide antiretroviral therapy for 2–3 million HIV/AIDS infected persons over a ten-year period, or supply insecticide-treated bed nets for over 200 million pregnant women and children.

Of the amount stolen, over US$2.2 billion was largely documented by the Central Bank of Nigeria as stolen from it in truckloads of cash in foreign currencies, in traveler's checks, and other means. Most of these monies were laundered abroad through a complex network of companies, banks, and shell concerns before finding their way into foreign accounts operated by the Abacha family and their cronies. At the peak of their activities, over 70 companies and more than 32 banks, including some of the world's best known banks, had money laundered through them.
The second tale is a subset of the first but involves the inflation of a public health contract. It is another Abacha tale, the main protagonist of which is Mrs. Mariam Abacha. The contract was for Pasteur Merieux vaccines awarded by the Nigerian Family Support Program—a social program designed to benefit poorer families, especially poor women and children in the country—which was headed by Mrs. Mariam Abacha. The contract, for a value of US$111 million, was awarded to Morgan Procurement Ltd., a company belonging to the Abacha family. The true value of the vaccines was $22.5 million, thereby resulting in an $88.5 million profit for the family which was transferred to their various accounts. This subversion of the country's vaccines procurement introduced corruption into a crucial health program. It became almost systemic and undermined the nation's immunization and vaccination programs which harmed Nigerian children.

The third tale is a tale of corruption in education on a small yet worrying scale. It is the tale of Rose, a twenty-one-year-old university student, who finally made it out of her village and family as the first child to get a university education. Rose, from a poor rural family, could not purchase the series of class notes sold by her lecturer to students as part of the reading material for the class. The lecturer, who used these monies to supplement his income, noticed Rose was not purchasing the notes and penalized her through low grades for her work. When she explained she couldn't pay she was asked to make up with other favors which she refused. The failing grade she was given in the course was instrumental in her withdrawal from the university which put an end to her higher education. An individual and entire family lost their hope and pathway to escape poverty. When I followed up on this story, I found that it was by no means an isolated case. It was part of a systemic rot that had befallen what had once been a very good tertiary education system in Nigeria.

And finally, my fourth tale is based on reports by the *Financial Times* in 2004 involving a foreign consortium and a lucrative oil and gas project in Nigeria. Sometime in 1994, the TSKJ consortium—comprised of France's Technip, Italy's Snamprogetti, Japan's JGC, and the Halliburton subsidiary Kellogg, Brown and Root—had made a bid to provide services to a US$12 billion LNG project in Nigeria partly owned by the Nigerian government and the Royal Dutch Shell Group. This initial bid was not accepted. Subsequently, the TSKJ group obtained the services of Tristar Investments, a separate company which was to provide "consultancy" services, to enable the company to win its contract in the LNG project. Finally, in December 1995, TSKJ was awarded a US$2 billion contract in the Nigerian LNG project. Years later, evidence was produced that the TSKJ group had internally discussed making payments of about $180 million to various foreign accounts of Nigerian officials to help TSKJ obtain its lucrative contract in the LNG project. You can surmise that Nigerians collectively paid the price in terms of higher costs for this diversion of contract monies into private pockets.

Corruption Hurts the Poor the Most

These tales are the faces of corruption. They illustrate, from my own country, how corruption of various types can introduce distortions into various sectors of the economy in a way that is damaging of development. Even if corruption is to be viewed as a market response to government failures, it is still a highly regressive and inequitable means of addressing such failures. This is simply because corruption ultimately is most vicious on the poor, and this may occur in various ways:

A. Poor households are likely to be excluded from public services which require grease payments since the *burden of corruption* (i.e. the cost of a bribe as a share of income) for the poor is likely to be disproportionately large compared to that of other wealthier households. In this sense, bribery acts as a form of regressive taxation.[4]

B. Second, in instances when public service delivery is weak due to corruption, the poor tend to be heavily disadvantaged as they may lack resources to obtain private services (e.g. in private clinics or schools). Teachers and lecturers take bribes to pass children on exams. Education, which is the one way for the poor to open up doors of opportunity, is perverted, and such means of upward mobility is closed to them.

C. Third, there is evidence that in a corrupt environment, government spending tends to be diverted away from social expenditures (such as health and education which benefit the poor) towards infrastructure projects such as "roads to nowhere" or electricity projects that do not function. Such projects are heavily transactional, yielding contracts that lend themselves to bribes.[5] When the environment becomes purely transactional with little focus on policy, the impacts on the poor are devastating. In fact, in a corrupt environment, the actions of ministers and civil servants focus heavily on transactions rather than policies. Ample evidence exists in Nigeria of the so-called "juicy government ministries" such as Works, Power, Defense, Agriculture, and Water Resources, which have large procurement budgets each year.

D. Finally, in instances when infrastructure projects are financed, procurement fraud leads to inflated contracts which further divert scarce public resources away from competing pro-poor programs.

A sad thing is that corruption could have even more pernicious non-economic effects on a society. In Nigeria prior to the recent reforms, the culture of impunity and corruption that crept in under non-transparent, authoritarian regimes was so pervasive that it had corroded the psyche and moral fiber of

[4] See World Bank, *World Development Report 2004: Making Services Work for Poor People* (Washington D.C.: The World Bank, 2004).

[5] See Tanzi Vito and Hamid Davoodi , *Roads to Nowhere: How Corruption in Public Investment Hurts Growth*, Economic Issues Series 12 (Washington, D.C: IMF, 1998).

Nigerian society. There was complete invasion of our moral and value system well beyond the economic sphere as illustrated in the corruption examples above. Despite a vigorous fight launched against corruption, Nigeria is still fighting these ills today. It is by no means the only country in Africa or even the developing world struggling with these issues at present.

Curbing Corruption Encourages Growth

There is also now ample empirical evidence which indicates that there are significant development dividends to be obtained from curbing corruption and adopting good governance practices. Just to put some numbers around the subject, Danny Kaufmann and colleagues have argued that tackling corruption and improving governance could yield about a 400 percent governance dividend: basically, countries that improved the rule of law and curbed corruption could (on average) expect about a fourfold increase in per capita incomes in the long run.[6]

Some cross-country empirical evidence suggests that a one-standard-deviation improvement in corruption indicators causes investments to rise by about 5 percent of GDP and can also raise per capita GDP growth by about half a percentage point. It is widely accepted in the economic literature that economic agents and firms view corruption as a form of tax, which must be factored into their investment decisions.[7] For aid-recipient countries, corruption can also have economic costs if it results in misuse or diversion of resources and reduces the effectiveness of aid. Not surprisingly, there is evidence again that aid projects tend to perform much better in environments with stronger institutions and greater transparency.[8]

Corruption Myth and Reality

[6] Kaufmann, Kraay, and Zoido-Lobatón, "Governance Matters: From Measurement to Action," *Finance and Development* 37, no. 2 (2000).

[7] See Paolo Mauro, "Corruption and Growth," *The Quarterly Journal of Economics* 110, no. 3 (1995): 681–712, and Keefer and Knack, "Why Don't Poor Countries Catch Up? A Cross-National Test of an Institutional Explanation," Economic Inquiry 35, no. 3 (1995): 590–602.

[8] See David Dollar and Victoria Levin, "Sowing and Reaping: Institutional Quality and Project Outcomes in Developing Countries," World Bank Policy Research Working Paper 3524 (Washington D.C.: The World Bank, 2005).

Thus far, most of the issues I have raised are frequently discussed among the international development community. In the next few minutes, I want to provoke you by outlining other aspects of the corruption debate which I believe have not received as much attention. Let me examine two issues: political corruption and repatriation of stolen assets.

In doing this, I would like to revisit this theme of myth and reality which I introduced at the beginning of this lecture. In many instances, the corruption debate is centered on economic corruption—on cases of rent-seeking, on procurement fraud, on leakages in government budgets and so on. If you look at the World Bank's Governance and Anti-Corruption Action Plan you will see that it says its focus is on strengthening state accountability and capability. This is interpreted all in economic terms—looking at the area of economic corruption: financial management, budget, procurement, judiciary, etc. Politics and money are mentioned but there is never any elaboration because the Banks' articles forbid it from entering the political arena. Indeed, during my time in government, my colleagues and I worked tirelessly to tackle various forms of economic corruption. Yet, we will all be deluding ourselves if we believed this myth that economic corruption is the key to tackling corruption in developing countries. I want to argue that the big elephant in the room which is often ignored is *political corruption*, and unless tackled this will and does undermine all the focus on fighting economic corruption and improving governance in the economic sphere.

Political Corruption in Developing Countries

Political corruption, particularly relating to political party finance and to campaign finance, is increasingly becoming the major challenge in developing countries. Running a multiparty democracy is becoming an increasingly difficult and expensive business. (As a rough guide, Transparency International reported that in the 1999 democratic elections in South Africa, political parties spent between US$40–67 million. My guess is that political parties in the previous and last elections in Nigeria spent hundreds of millions of dollars on state and federal elections to fund processes and results that the large majority of people in and out of the country deemed to be substandard). The issue is this:

in a poor country that adopts democracy, especially of the American variety, where do resources to finance campaigns and political parties come from?

Well, political parties and the political process in emerging democracies invariably become very prone to corruption. I am worried that political corruption in pernicious forms may be taking hold on the African continent as ways are sought to emulate Western forms of campaign finance but without the strong institutions and safeguards existing in Western democracies. Politicians in Africa have observed that in the UK and United States, big business and wealthy individuals help to finance elections and sometimes develop a symbiotic relationship with those in power. In the absence of big, indigenous businessmen and women, the attempt is to create them by granting special favors, licenses, and concessions in a manner that enables these business people to make huge sums of money—a good deal of which is then kicked back into political finance. This is the new frontier in corruption and the financing of democracy.

Of course, standard methods of inflation of contracts and diversion of state resources to political purposes still exist. However, there is sometimes a schizophrenia in which such activities are frowned upon when they occur in the economic sphere, but overlooked or received with a nod and wink in the political sphere with the comment that *after all one has to be pragmatic! Elections must be fought and won and this requires money.*

What the above approach does is to give the governing parties in a developing-country context overwhelming power to use the instruments of the state to finance themselves to the detriment of the opposition. A second issue is that these corrupt systems of political finance often lead to state capture, as business people who have been favored develop an ever stronger hold on politicians in power.

I think Lee Kuan Yew put it succinctly in his book, *From Third World to First*, in commenting about this practice in Asia. A precondition for an honest government is that candidates must not need large sums of money to get elected, or it must trigger off the cycle of corruption. The bane of most countries in Asia has been the high cost of elections. Having spent a lot to get elected, winners must recover their costs and also accumulate funds for the next election. The system is self-perpetuating. . . . In Thailand, a former government minister described it as "commercial democracy, the purchased mandate" (Yew, 2000: pp 164).[9]

I find it quite ironic that the very practice of multiparty democracy which is intended to strengthen governance of public resources in developing countries could be the same process which undermines good governance in these countries. If unchecked, the long-run result could be dissatisfaction with the political process. Politicians and the political process rapidly lose their legitimacy and credibility—and widespread voter apathy emerges. Even further, this practice leads to the common tendency of ruling parties wanting to perpetuate themselves as they realize re-election may be difficult or almost impossible without public funds or granting of economic favors to private sector cronies who then finance elections.

I must confess that the intermittent eruptions of political corruption in developed countries does not help (witness recent cases in USA and UK) even though the rule of law has led to exposure and punishment of most such cases. It is a bit like the case with international trade negotiations. As long as politicians could spot high tariffs, non-tariff barriers and subsidies in the trade practices of developed countries, they gave reformers—my colleagues and I included—a difficult time in trying to undertake our own trade reforms. It is very difficult to talk of good governance and transparency and be taken seriously if you yourself have not been doing the right thing. In the case of corruption, the occurrence of bad examples in developed countries gives developing-country politicians a cover to do the wrong things.

There are many international institutions which monitor elections in emerging democracies (including the Carter Center, the OSCE, the Commonwealth Secretariat, and so on). Yet very few monitor the process of political party or campaign finance. In fact I am amazed at the limited open discussion on this issue. If organizations like the World Bank cannot venture into this area, then what about bilaterals, the think tanks, and NGOs? I want to challenge CGD to do more work in this area. This is a very important exercise and a gaping hole in the fight against

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[9] Lee Kuan Yew, *From Third World to First, the Singapore Story (1965–2000)* (New York: HarperCollins Publishers, 2000).

corruption. If we do not address this issue, the fight against corruption in Africa and, indeed, in many developing countries will continue to be a fight in delusion.

A related issue concerns immunity for politically exposed individuals. This exists in Nigeria and other developing countries. Why should this be the case? It is often argued that senior political office holders should have legal protection during their tenure in order to prevent frivolous and legally motivated attacks and also to help in preserving the reputation of the office (rather than the office holder). In some cases, notably for heads of state, immunity from prosecution is even broader, and could even extend to lifetime immunity. Legislators in such countries may also be unwilling to revoke such immunity, perhaps out of fear of setting a precedent which could result in their own future impeachment.

Yet, upon reflection on recent cases of corruption by state governors in Nigeria, this notion of immunity for such politically exposed individuals becomes simply indefensible. Any thinking on good governance must require greater accountability from officials occupying such high positions.

How Rich Countries Aid Corruption in Poor Countries

I want to turn now to a second issue which indicates how *developed* countries are also some times implicated in the fight against corruption in the developing world—particularly how developed-country governments may aid and abet corruption by providing sanctuaries for funds looted from developing countries.

An estimated US$20 to US$40 billion is said to have been stolen by corrupt leaders in poor countries, particularly in Africa, and hidden overseas. This matter is under-discussed in international forum. To me, it falls within the category of what Amartya Sen terms as an under-discussed serious problem of global "commission" that must be addressed for elementary global justice.[10] There are a number of important international cases, such as former President Marcos of the Philippines who is alleged to have stolen about US$5 to $10 billion of public funds during his 21 years in power, while as noted above military leader of Nigeria, General Abacha, looted about $3–5 billion from the Nigerian treasury.

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[10] Amartya Sen, Identity and Violence: *The Illusion of Destiny* (New York: W. W. Norton & Co, 2006).

In many instances, developed-country financial centers (and now increasingly those in emerging markets) become recipients of these funds. These funds are often transferred and laundered using complex methods involving layers of transactions to conceal the audit trail of the illicit funds, and also integrating the funds back into the regular formal economy so that they appear sterilized.

Stolen funds are often very difficult to repatriate to their impoverished nations and true owners, as all types of legal and administrative obstacles are put in the way of sending such monies back. Politicians and civil society in developing countries therefore perceive this as hypocrisy: the sanctimonious way in which developed countries preach against corruption yet appear complicit in harboring stolen funds.

Indeed it is only recently with the war on terror that money laundering, corrupt monies and the issue of asset recovery is receiving serious attention from the international community, especially through the work of the United Nations in negotiating a landmark legal framework for asset recovery embedded in the United Nations Convention Against Corruption (UNCAC) legislation. The United Nations Office on Drugs and Crime (UNODC) and the World Bank are following this up through the new Stolen Asset Recovery (StAR) Initiative designed to persuade and support countries to sign, ratify, and implement UNCAC, and also aimed at strengthening support for developing countries engaged in asset recovery.[11] The StAR initiative was recently discussed and endorsed by G-8 finance ministers during their meeting in Potsdam, Germany, in May 2007. Nigeria has had a good experience in getting stolen monies back and this can be replicated for other countries.

The Way Forward

So what is the way forward? And what is to be done about this menace of corruption in developing countries? Let me move to the final section of this paper by offering three suggestions—for developing country governments, for developed countries and for civil society campaigners—on how to fight against corruption in a developing-country context.

What Developing Countries Should Do

[11] See recent report on launch of Stolen Asset Recovery (StAR) Initiative by the World Bank at http://go.worldbank.org/4QNQA2TNA0.

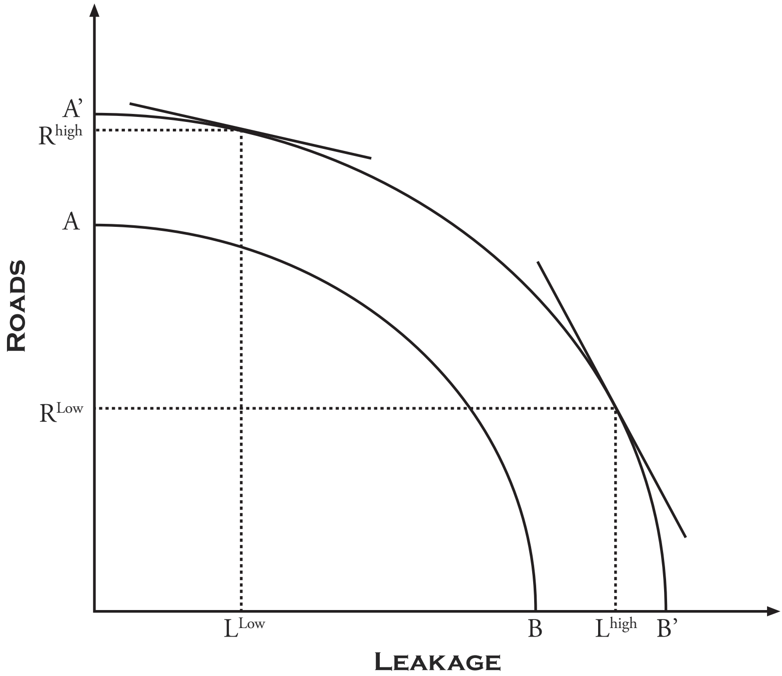
At the end of the day, developing countries need to take ownership of the fight against corruption themselves as they can least afford to be corrupt given their resource constraints. A frontal assault on corruption requires a comprehensive strategy as any piecemeal approaches may only serve to redirect corruption to other sectors of the economy. A comprehensive strategy must be comprised of three components: having a diagnostic survey to assess the dominant areas of corruption; sustaining political will to tackle corruption; and developing institutions to help change incentives (i.e., stronger sanctions for corruption and improved benefits for 'clean' practices). Political corruption must be tackled centrally as part and parcel of the reform and should include reform of electoral cycles and systems as well as political party and campaign finance reform. A move towards use of public monies for political party and campaign finance would facilitate greater transparency and accountability. If we say that democracy and good governance are important pillars of our society then we must be prepared to set aside monies annually from the budget to openly and transparently finance democracies and minimize political corruption.

All this action on corruption should be implemented in the context of a larger economic and political reform program. One cannot, for instance, address corruption in the customs service without a comprehensive review of trade and tariff policies. And similarly, discretionary practices, rent-seeking, and elite capture of government enterprises will continue until government reduces its presence in economic activities it has no business in by transparently privatizing or deregulating some key economic sectors. Failure to address and reform political finance feeds directly back to diversions from the state treasury or creation of private monopolies to help fund elections. Failure to reform the civil service and pay workers a living wage increases temptation to engage in petty corruption.

The issue of institutions is central to this discussion for developing countries, and, clearly, any long-term solutions to address corruption must improve the domestic institutions needed to help change incentives. Rodrik and others have argued that institutions matter big time—and recent empirical studies by Acemoglu and others have demonstrated the importance of institutions in

FIGURE 1

Corruption Possibilities Frontier



explaining long-run growth differences among developing countries.[12] Institutions, systems and processes are particularly needed to support any long-term anticorruption drive—and they must be transparent, have the teeth to sanction corrupt behavior, and also be able to reward or recognize clean practices. Well-functioning law courts and clean judiciary, transparent budgets and fiscal regimes, and clear competitive procurement rules are examples of good institutions and processes. In addition, any new institutions must be backed by appropriate legislation to ensure their long-term sustainability.

In a sense, the relevance of institutions can be underscored from a simple

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[12] See Daron Acemoglu, Simon Johnson, and James A. Robinson, "The Colonial Origins of Comparative Development: An Empirical Investigation," *American Economic Review* 91 (2001): 1369–1401. The success story of Botswana is also discussed by Acemoglu, Johnson, and Robinson in "An African Success Story: Botswana," in *In Search of Prosperity*, Dani Rodrik, editor (Princeton University Press, 2003).

microeconomic illustration of what I have termed a *Corruption Possibilities Frontier* (CPF)—much like a production possibilities frontier. With the discovery of additional natural resources (such as oil), the corruption possibilities frontier expands, say from AB to A'B' as shown in figure 1 above. The public official administering the government budget is faced with the choice of allocating resources between two goods, say a generic public good (e.g., the construction of a road) and corruption. Clearly, the optimal allocation bundle will depend on the relative costs of corruption and of roads in the economy. In turn, the costs of corruption will be a function of the strength of a country's legal environment, the judicial framework, the severity of punitive measures, and so on. If we assume the cost of roads to be fixed, then two countries (A and B) with identical resource envelopes but different institutional environments will have optimal bundles (R^{high}, L^{low}) and (R^{low}, L^{high}) as shown in figure 1 below. Improving the quality of institutions increases the price of corruption and results in the choice of a bundle closer to A'.

As an example, the past Nigerian administration under President Obasanjo began this effort of improving institutions with the establishment of offices such as the Due Process Office (to support transparency in public procurement), the Nigerian Extractive Industries Transparency Initiative (to improve transparency in the accounting of oil revenues), publication of monthly revenues of all tiers of Government, as well as the establishment of the EFCC and ICPC[13] to investigate and prosecute corrupt practices. Establishment of these institutions and processes required a monumental effort. Yet, they are still not far reaching enough, and of course did not extend to the political arena, thereby leaving a disturbing gap in the Nigerian battle against corruption.

So in summary the message for developing countries is that they need to focus on building or improving the quality of all institutions of governance—both economic and political—in order to lower the incentives for corruption. In particular, countries should consider evolving democratic processes that require fewer resources in the way of financing and look at transparent budgeting and payment for

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[13] EFCC and ICPC respectively refer to the Economic and Financial Crimes Commission and the Independent Corrupt Practices and related offenses Commission

campaign finance and elections in a more direct and publicly accountable fashion.

How Developed Countries Can Help

Developed-country governments can also assist in addressing corruption in developing countries in a number of ways.

A. For the case of political corruption, it is not just adequate to focus on election monitoring without examining political party financing. If the West is serious about supporting multiparty democracy in developing countries, then why not look at the issue of campaign finance and funding of political parties? As has been suggested by Transparency International, a key mechanism will be to propose rules on disclosure: money flowing into political parties need to be disclosed and must be clean.[14] And these rules on disclosure must be enforced. Also look at help with designing a shorter, less resource intensive electoral cycle as mentioned earlier.

B. A second area for developed countries is to implement UNCAC by assisting in tracking and repatriating stolen funds which are domiciled in their financial institutions, particularly as proposed under the recent StAR Initiative. This will show corrupt public officials that there is no where for the money to hide.

C. Third, developed countries should ensure that their companies uphold the same high standards of business ethics and integrity, particularly when operating in developing-country environments—and the example of TSKJ above (or more recently, Siemens or BAE Systems) illustrates this point. There is documented evidence of cases where such companies "supply" corruption in countries despite the rhetoric of their own governments about supporting the fight against corruption in developing countries. Developed-country firms need to respect conventions which their countries have signed up to, for example, the OECD Anti-bribery Convention or the UNCAC.

D. But finally, and most importantly, I believe developed countries can assist

[14] See Transparency International's *Global Corruption Report* 2004.

by providing a good example. The moral authority of developed countries in the battle against corruption is weakened when these countries condone corruption in their own countries and yet expect developing countries to tackle corruption more severely. Giving kleptocrats in developing countries an opportunity to point to cases of corruption in the U.S. legislature, or with UK defense contracts, or with German manufacturers, truly undermines the fight against corruption in all our countries!

Finally, I believe civil society in developed and developing countries can also play a part.

A. Many civil society NGOs played a key role in the campaign for debt relief for developing countries. I believe that same energy can be directed at the campaign for repatriation of stolen assets. The benefits of such an exercise could be significant. For example, in the case of Nigeria alone, it is estimated that about US$1 billion of funds looted by the Abacha family is still outstanding. This projected sum is equivalent to the annual savings which the country obtained from debt relief. I will challenge civil society organizations—both in developing countries and also abroad—to join actively in this campaign on asset recovery.

B. Civil society can also assist by pushing for greater transparency in government budgets. There is the example from the Uganda school survey for the period 1991–95.[15] Although the Ugandan government had increased allocations for education, only 13 percent of non-wage funds reached schools. About 87 percent of funds "leaked" either as private payments or were used by local officials for non-education purposes. By publishing education budgets and discussing with parents and teachers, the leakages declined from about 87 percent to 15 percent.

C. Civil society can similarly also support the fight against political corruption by monitoring and pushing for greater transparency in campaign financing. Think tanks can further work on finding solutions to this problem. All this can be greatly aided by an active media.

Let me now conclude by thanking CGD for inviting me here to deliver this

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[15] See Ritva Reinikka, "Recovery in Service Delivery: Evidence from Schools and Health Centers," in *Uganda's Recovery: The Role of Farms, Firms, and Government*, R. Reinikka and P. Collier, editors (Washington, D.C.: World Bank, 2001).

second Richard Sabot Lecture. I have given CGD homework to develop further analysis and solutions to the issue of political corruption. I strongly believe that corruption in developing countries, particularly in Africa, can be reduced if we tackle it aggressively and comprehensively, by building strong institutions and providing incentives and enforcing laws. I believe the African continent can and will transcend the corruption obstacle and regain its image as observed by Winston Churchill (following his visit to Africa in 1908) as a land in which the beauty of the landscape, richness of the soil, abundance of running water and, I might add, resourcefulness and endurance of its peoples were defining characteristics.[16]

Thank you all very much for listening.

[16] See p. 27 of W.S. Churchill, *Never Give In! The Best of Winston Churchill's Speeches* (London: Pimlico, 2003).

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