

International Monetary Fund

Ambrogio Lorenzetti, The Effects of Good Government on the City Life; Fresco; Palazzo Pubblico, Siena (Italy)

CORRUPTION: COSTS and MITIGATING STRATEGIES

PARLIAMENTARY WORKSHOP



Global Context

- ▶ Corruption has been identified as one of the most important problems facing the world today
- ▶ Rising income inequality feeds perception of “rigged” national and global systems
- ▶ Corruption fuels such perceptions and causes moral outrage
 - ▶ Street protests (e.g., Arab Spring, Ukraine, Honduras, Guatemala)

Macro-Economic Impact

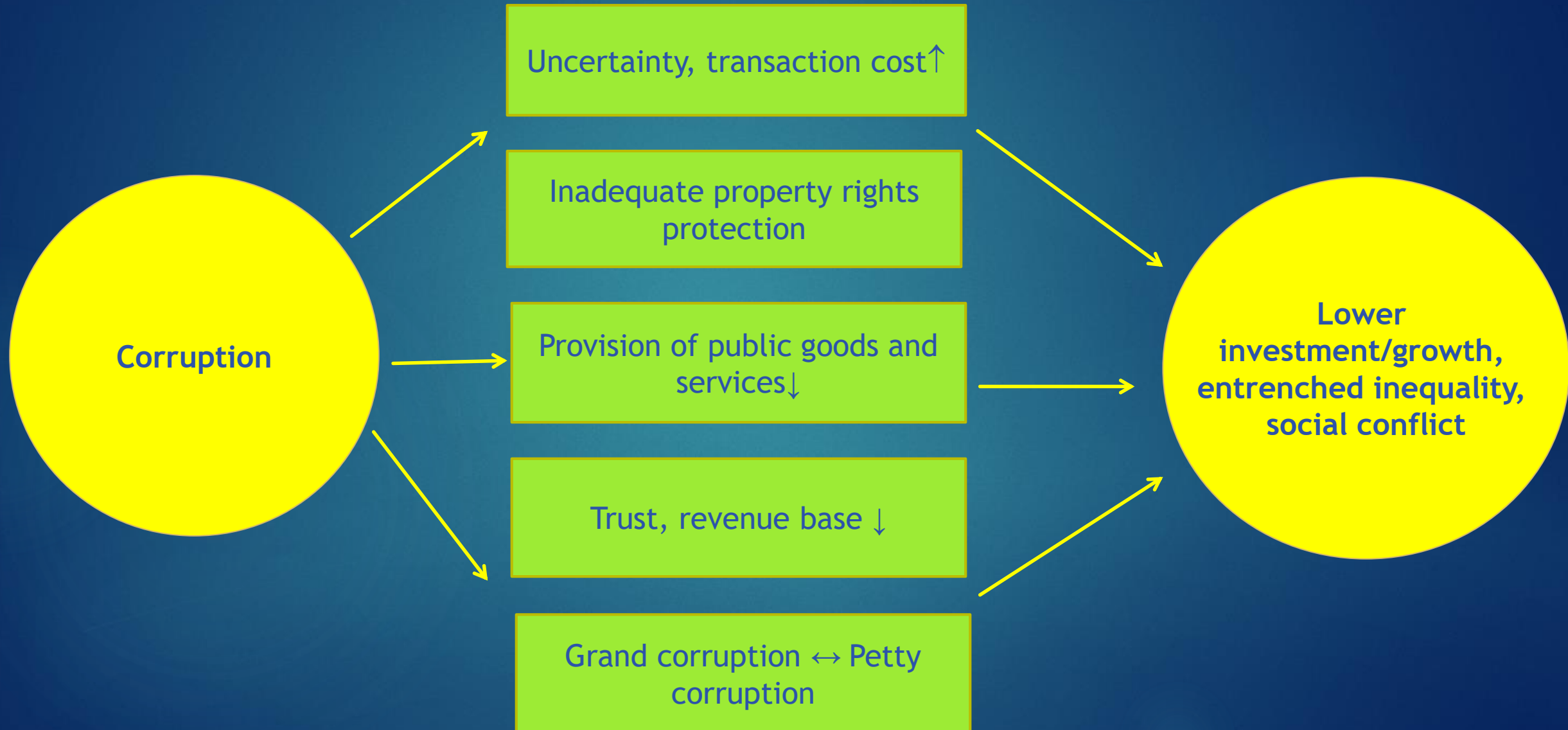
- ▶ Public Sector Corruption — abuse of public office for private gain
- ▶ Afflicts economies at all stages of development
- ▶ Cost of bribery alone – \$1.5 to \$2 trillion annually (about 2 percent of global GDP)
- ▶ Clearly corruption has a macro-economic impact
- ▶ Cross-country studies show that economic and social costs of corruption undermine ability to deliver inclusive and sustainable growth

Objectives

- ▶ The economic and social cost of corruption – Overview
- ▶ How to reduce corruption?
 - ▶ Simple analytical framework – Bridging policies and channels
 - ▶ Role of IMF

The Economic and Social Costs of Corruption

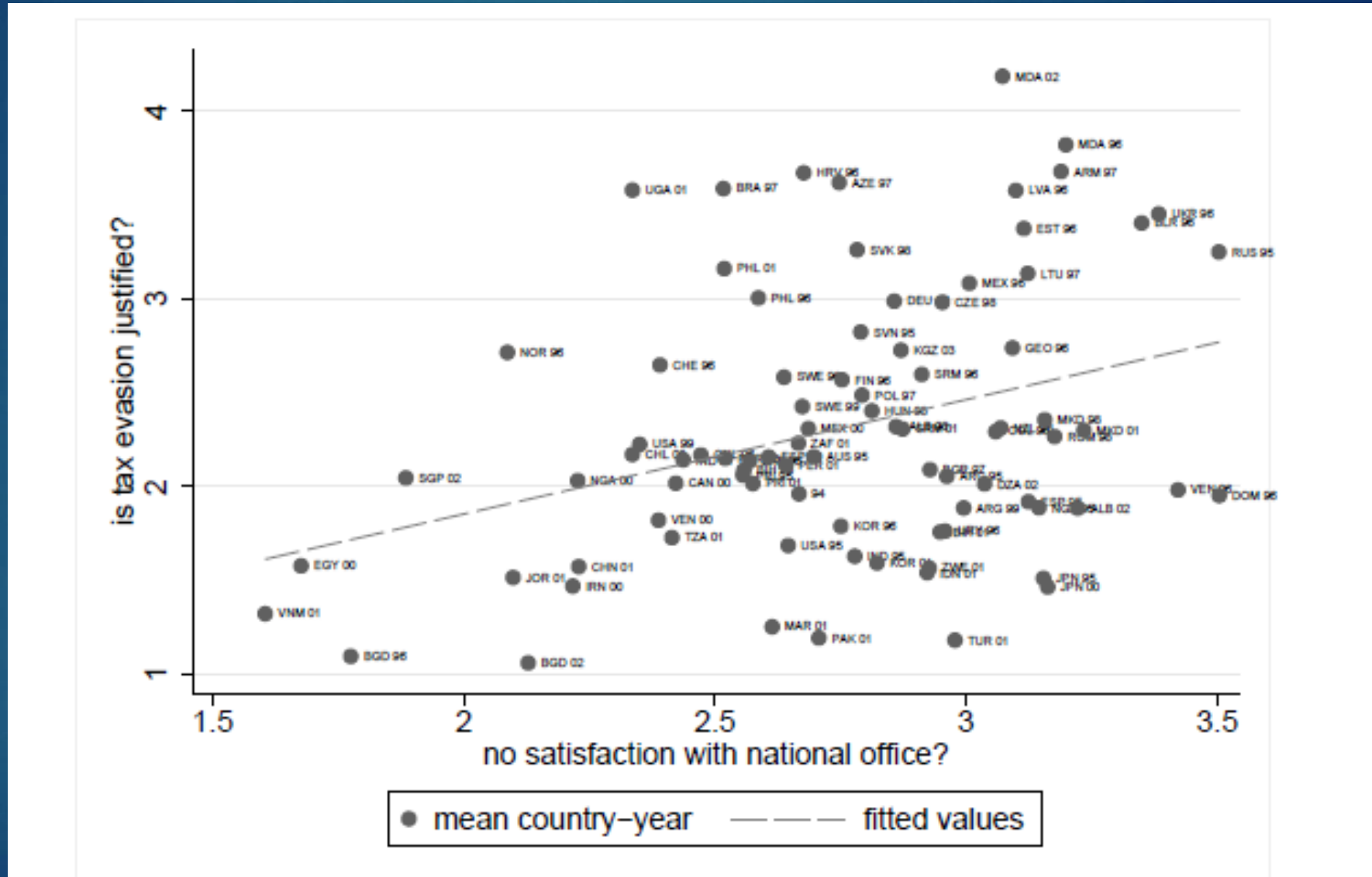
Cost of Corruption: Channels



“Corruption Kills” (Aftermath of Fire in Bucharest’s Nightclub in 2015)



Corruption, Trust, and Revenue Base



Source: World Values Survey

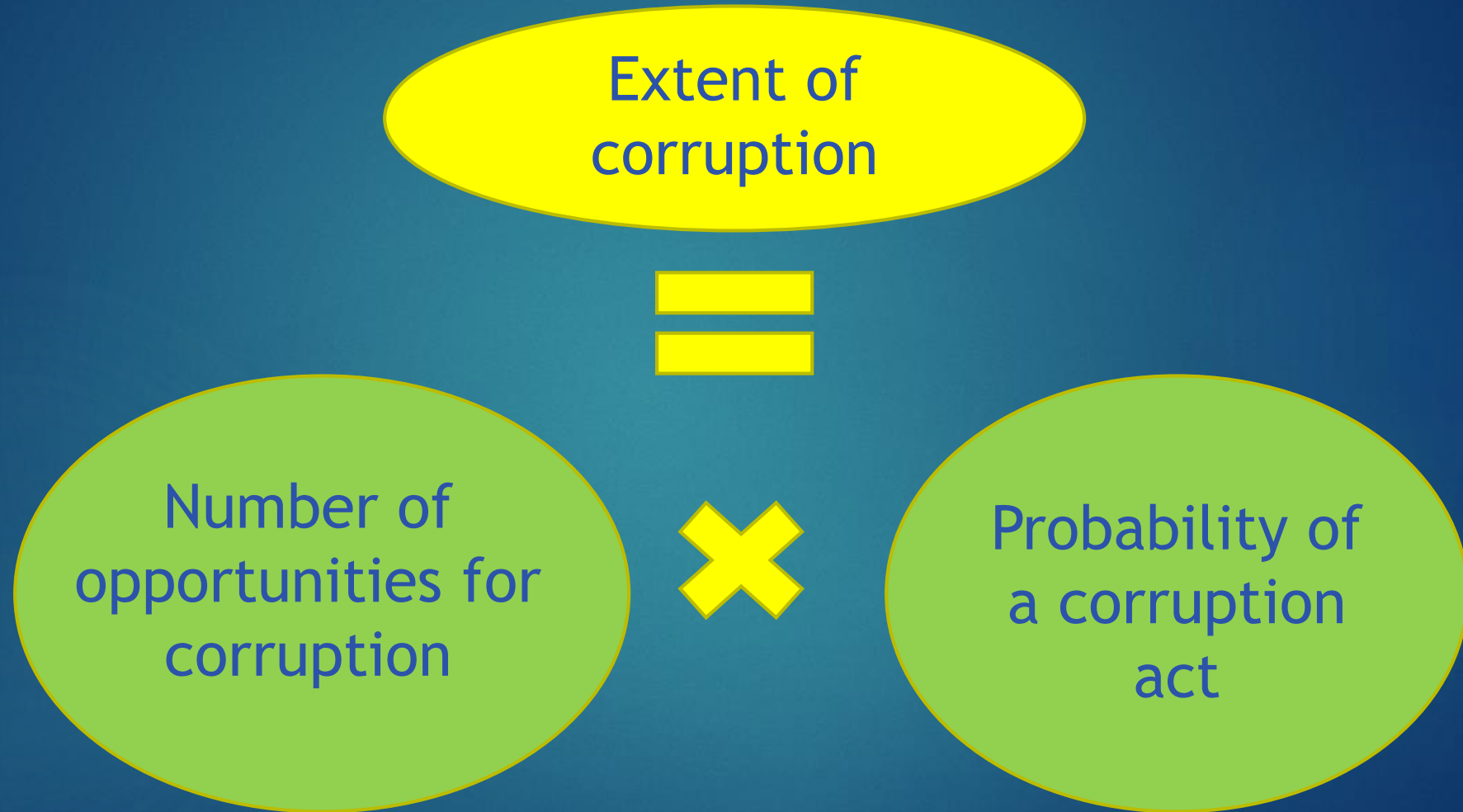
Strategies for Addressing Corruption

Costs and Strategies

Fund experience

- An effective strategy requires a holistic approach
But measures must be sequenced, notably ensuring the institutional framework is adequate.
- It is a long term process (need to manage expectations)
There is a role for short-term measures with more immediate impact.
- Preventive measures are no less important than enforcement
Transparency is a typical example

Corruption: Simple Analytical Framework



How to Reduce Opportunities for Corruption?

- ▶ Structural reform:
 - ▶ # docs, procedures, cost to open business, trade, construct, register property;
 - ▶ Reducing number of controlling services, licenses;
 - ▶ Simplification of tax system, custom tariffs
 - ▶ Privatization
- ▶ Sometimes – pure “red tape”
- ▶ Often – hard choice between reducing corruption and correction of market failures
 - ▶ E.g. Georgia in 2000s: fire and food safety departments closed down
- ▶ Another hard choice: rules vs. discretion

How to Reduce Opportunities for Corruption?

▶ Outsourcing government services:

- ▶ E.g. quality control in less corrupted countries (f.e. medicine licensing)
- ▶ Procurement, customs management

▶ Information technology:

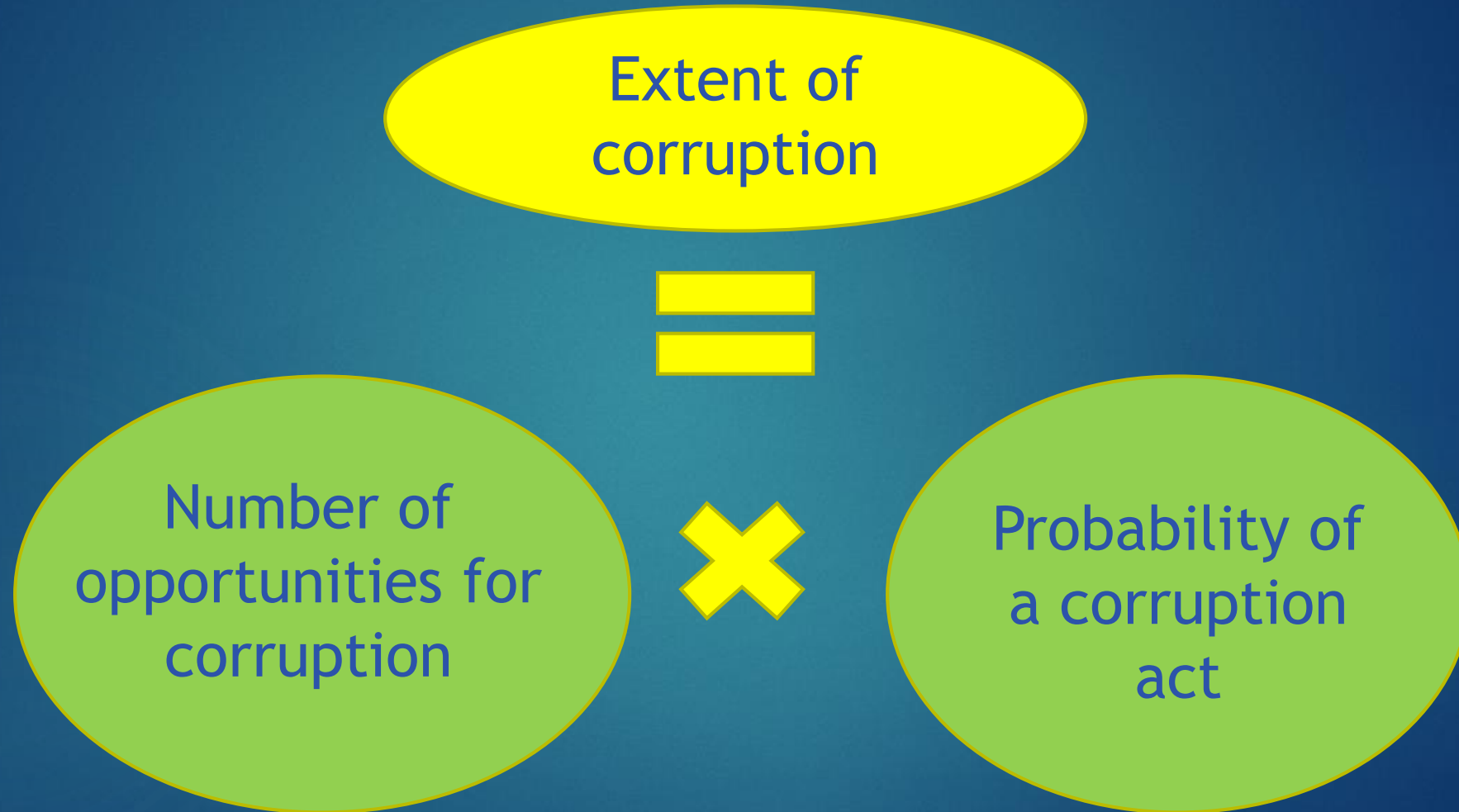
- ▶ Automated procedures: e.g. paying taxes, applying for licenses, detecting traffic rules violations..
- ▶ Digitized, centralized records: one-stop shops for services
- ▶ Software-based choice for audits: at customs, tax administration, bank supervision,
- ▶ Software-based assignment of judges to court cases
- ▶ E-government procurement
- ▶ Automated assignment for social transfers

Opportunity vs. Probability: Sequencing of Anti-Corruption Policies

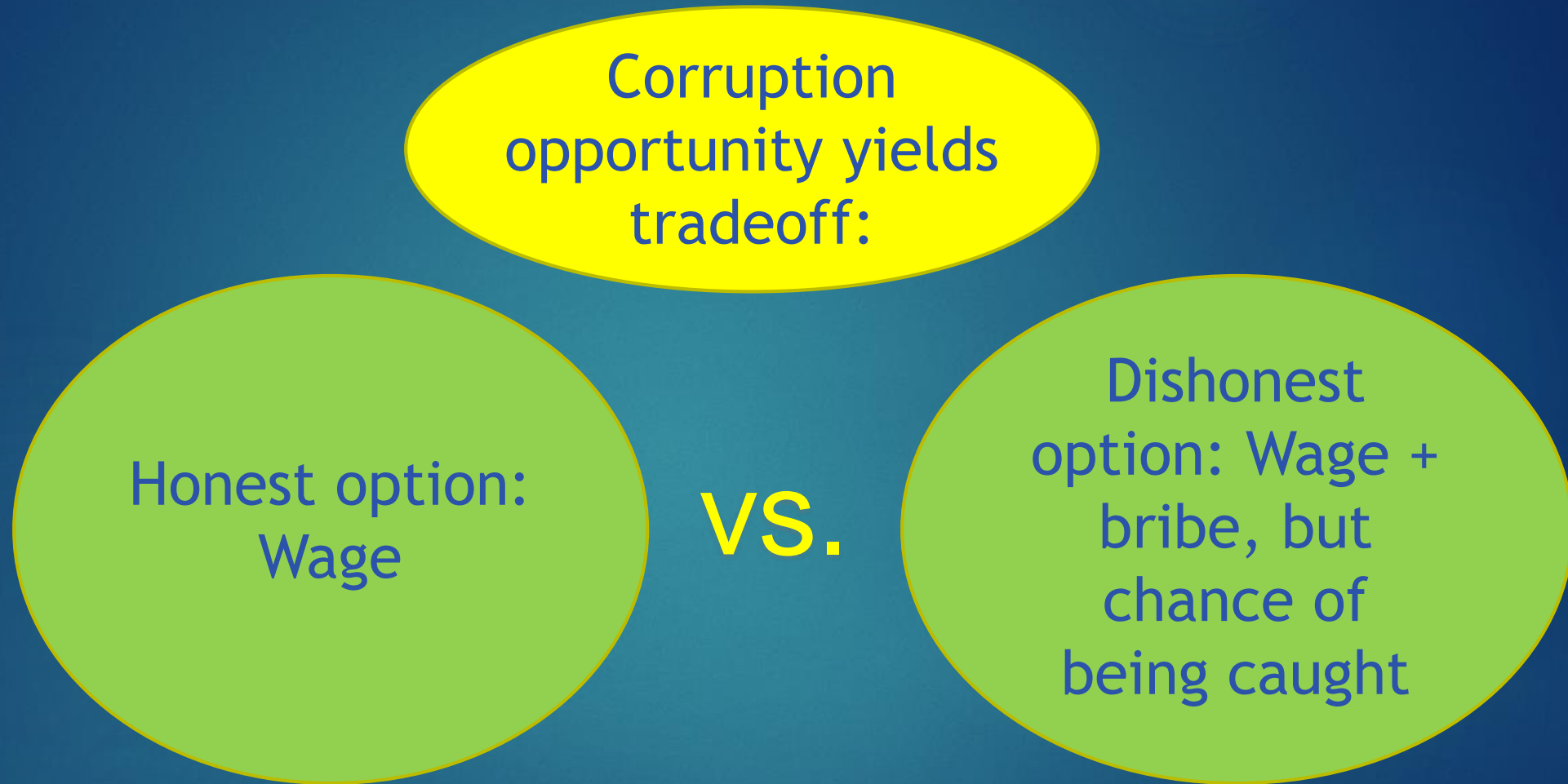


- ▶ Important not to add burden by fighting corruption
 - ▶ Possible if bribery is an escape from excessive “red tape”
- ▶ ⇒ Often reducing opportunities is of higher priority than reducing probability
- ▶ Bribery, extortion exist even if rules are OK
 - ▶ Important to crackdown on them too

Corruption: Simple Analytical Framework



Corruption: Simple Analytical Framework



- ▶ Main components: public sector wages, chance of being caught (and punished),... also non-monetary cost of dishonest action

“Efficiency” Public Sector Wages

- ▶ Wage↑ → chance of corrupted act ↓
 - ▶ Only if punishment and probability of detection are not zero!
- ▶ Effect of efficiency wages is likely stronger is the presence of risk-aversion or aversion to illegal activity
 - ▶ Marginal benefit of illegal income diminishes
- ▶ Effect is also stronger if wage increases are merit-based and transparent
- ▶ Not sufficient but likely necessary measure...
 - ▶ Part of many successful anti-corruption strategies: Georgia, Singapore

Punishment and Intangible Cost of Corruption

- ▶ Punishment (fine, loss of job, etc) $\uparrow \rightarrow$ chance of corrupted act \downarrow
 - ▶ Again, effect depends on probability of detection
- ▶ Cost of illegal act (reputation, social capital, etc.) $\uparrow \rightarrow$ chance of corrupted act \downarrow
 - ▶ Bureaucrats may self-select themselves into public positions based on status or monetary rewards
 - ▶ The cost may also depend on trust, on what others are doing, on culture
 - ▶ As a result, same anti-corruption policies (wage, fines) may lead to low or high corruption in different countries
 - ▶ Also, big one-time crackdown may have a long-lasting effect

“Islands of Excellence”: New Police in Ukraine



Punishment and Intangible Cost of Corruption

- ▶ Making harder to launder proceeds of corruption = effective benefit from corruption is lower
- ▶ Political institutions: harder to “rig” political representation = effective cost of corruption is higher
 - ▶ E.g. political competition, restricted contributions/lobbying/gerrymandering, etc.
- ▶ Enforcement must also target the private sector
 - ▶ Both tangible and intangible costs matter

Intangible cost of breaking rules: Traffic memes in Latin America



Chance of Getting Caught: Official Institutions

- ▶ Probability of detection (audit, etc) \uparrow \rightarrow chance of corrupted act \downarrow
- ▶ ... but subject to caveats:
 - ▶ Audits can be corrupt too, used for victimization and extortion, i.e. exacerbate situation with corruption
 - ▶ Anti-Corruption Bureaus can be rendered ineffective because of institutional flaws or constraints
 - ▶ E.g. “starving” of ACB in Indonesia by delaying wage payments
- ▶ Yet, even though effective legal framework for ACBs may not be sufficient, it is a necessary component
- ▶ Critical role of leadership

Chance of Getting Caught: Transparency and Monitoring

- ▶ Transparency, access to information
 - ▶ Data dissemination rules and standards, property registers, income declarations, procurement process
 - ▶ Governance process: public council hearings, stenographic records of gov't meetings, etc
- ▶ Information technology:
 - ▶ Detecting tax non-compliance, leakages in social spending, illegal financial transactions
 - ▶ Global exchange of information
 - ▶ ... but mind cybersecurity and cyberfraud
- ▶ Encouraging grassroot monitoring
 - ▶ Closeness of government to people (decentralization): increased political competition, yardstick competition
 - ▶ Free press (incl. social networks), human capital, digitalization: supply of and demand for information about gov't abuses
 - ▶ Supply of bribes: whistleblowing encouraged..

Encouraging whistleblowing: “He Would Not Be Silent”



Mitigating Corruption: Role of IMF

Transparency

▶ General initiatives

- ▶ Development of international standards on fiscal and financial transparency
- ▶ Transparency in extractive industries – these are important because of their relative share in many economies
- ▶ Supporting international standards on transparent corporate ownership

▶ Targeted initiatives

- ▶ Targeted interventions in corruption sensitive sectors (wealth declarations; audits fraudulent transactions)

Enhancing the Rule of Law (Punishment)

- ▶ Set up of new specialized institutions
- ▶ An effective anti-money laundering framework to minimize the laundering of proceeds of corruption
- ▶ Enforcement targeting the private sector

Reducing number of opportunities for corruption

De-regulation

Excessive regulation is an important source of corruption

De-regulation and simplification is a cornerstone of anti-corruption strategy

Structural reform, de-regulation are always in Fund's focus

Building Institutions

The key issue is implementation, for which institutions are critical.

Building blocks for effective institutions:

A clear legal framework is required

For example: an independent central bank (mandate, oversight, operational and financial autonomy, appointment criteria, dismissal rules, legal protection of staff)

With adequate technical expertise

Institutions cannot be effective without requisite technical competence

Conclusions

- ▶ Corruption hinders inclusive and sustainable growth
- ▶ How to mitigate corruption?
 - ▶ Reduce number of opportunities: structural reform, de-regulation, technology
 - ▶ Reduce probability of corrupt act: public sector wages, punishment (both monetary and non-monetary cost of corruption), higher chances of being caught (esp. transparency)
- ▶ IMF is active in many directions:
 - ▶ Transparency, enhancing the rule of law (punishment), structural reform and de-regulation, building institutions

Thank You!