

Fighting Corruption: Business as a Partner

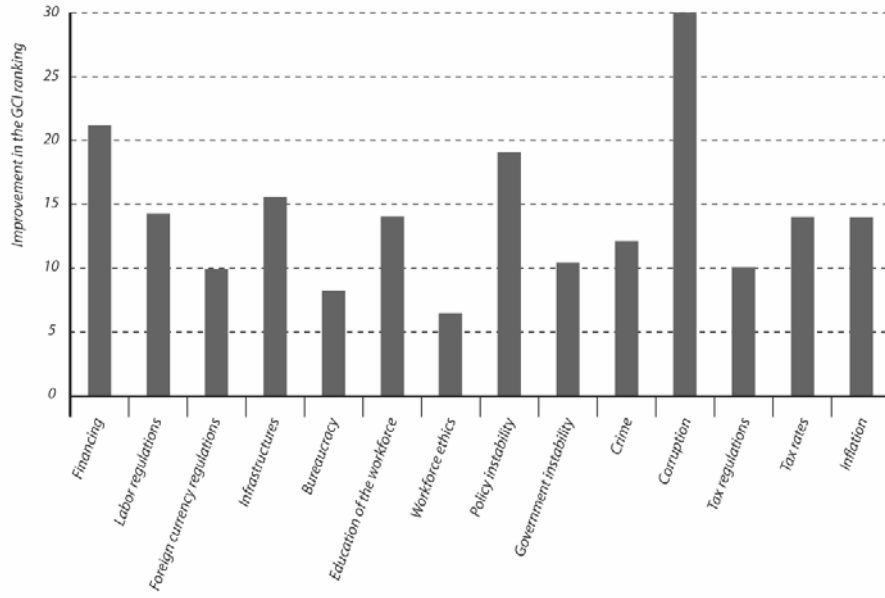
Background Paper for the 24 Hour Consultation Session via Video Conference

New Paradigms for Fighting Corruption

Whether prescriptive or curative, anti-corruption mechanisms have traditionally focused on the demand side of corruption. However, fundamental shifts have occurred over the past decade in regards to how corruption and its respective solutions are considered. The identification of corruption on both demand and supply sides, corrupting influences, and solutions to combat corruption are increasingly being viewed within a multi-stakeholder or collective action framework. This reflects the fact that the pervasive presence of corruption and its permeation of all sectors of society often render unilateral solutions ineffective and unsustainable. For this reason, close attention and steadfast commitment to fighting corruption must come from a range of stakeholders in order to address its root causes and symptoms.

At the same time, the private sector is increasingly recognizing that addressing and eliminating corruption in order to foster a stable business environment is in its own best interest (see figures 1 and 2, and box 1). There are, of course, limitations to such actions and it is often difficult to implement them alike across both international and local businesses. But recent experiences, ranging from Vietnam to South Africa to Columbia¹, suggest that effective and consistent private sector efforts have great potential worldwide, particularly when aligned with non-governmental organizations (NGOs) and government partners. The challenge is to move from individual examples to finding a model that works in different settings.

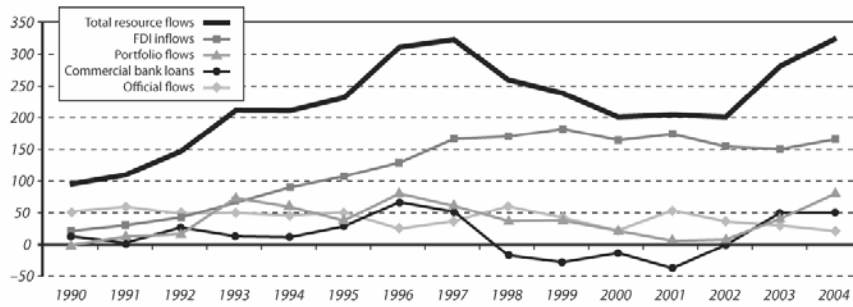
¹ "Partnerships to Combat Corruption: The Role of the Private Sector" e-discussion, World Bank Institute, June 26 – July 12, 2006.



Source: Constraints to Business data based on EOS 2004 (Question: "From the following list, please select the five most problematic factors for doing business in your country, and rank them from 1 to 5."); GCI* based on GCR calculations for 2004/2005; GDP per capita from the World Bank. Gains in competitiveness based on regressive estimates of the impact of the GCI of an improvement in the constraint by one standard deviation. As shown in Daniel Kaufmann, "Click Refresh Button: Investment Climate Reconsidered," *Development Outreach*, World Bank, March 2005.

*GCI: Global Competitiveness Index of the World Economic Forum.

Figure 1. Gains in the competitiveness ranking by tackling the business constraints.



Source: United Nations Conference on Trade and Development, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, United Nations: New York and Geneva, 2005, based on World Bank, *Global Development Finance 2005*, World Bank: Washington, D.C., 2005.
 a. Defined as net liability transactions of original maturity of greater than one year.
 b. The World Bank classification is used here. It differs from UNCTAD's classification in that it includes CEE countries under developing countries.

Figure 2. Unbounding governance – selected components, view of the firm, 102 countries.

Box 1. World Economic Forum Global Corporate Citizenship Initiative

The Global Corporate Citizenship Initiative (GCCI) of the World Economic Forum surveys business leaders. Respondents to the annual GCCI survey were asked to rank what they consider to be the key development changes in the developing countries in which they operate. Corruption and corporate governance are the top two development challenges:

1. **Good Governance**
2. **Tackling Corruption**
3. Poverty Alleviation & Education
4. Sustained Economic Growth
5. Peace & Security
6. Energy
7. HIV/AIDS
8. Water
9. Human Rights
10. International Trade Rules
11. International Financial Architecture

The Costs of Corruption and its Effects on Competitiveness

Measuring the numerous and varied costs of corruption can be quite difficult, as corrupt practices themselves are generally hidden and difficult to trace or quantify. However, several high-quality studies on the impacts that corruption has on the socio-economic development of countries attempt to measure the costs of corruption in terms of disruptions or distortions in investment flows, transaction costs and the provision and quality of public services, among others. For example, more than US\$1 trillion is paid in bribes each year, according to ongoing research at the World Bank Institute (WBI).² The INDEM Foundation estimates in a recent study that bribery in Russia amounts to \$316 billion dollars a year, a significant direct increase in the cost of doing business.³ Corruption also renders government policies less effective, which in turn produces negative impacts on the business environment.

² The US\$1 trillion figure, calculated using 2001-02 economic data compares with an estimated size of the world economy at that time of just over US\$30 trillion, and does not include embezzlement of public funds or theft of public assets. World Bank Institute, "The Costs of Corruption," 2004.
<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20190187%7EmenuPK:34457%7Epa gePK:34370%7EpiPK:34424%7EtheSitePK:4607.00.html>

³ INDEM Foundation, <http://www.indem.ru>

Corruption exists all over the world and can greatly hinder firm-, national-, and regional-level competitiveness, as well as significantly affect investment climates and impact the quality of investments. According to Batra, Kaufmann, and Stone (2004),⁴ the level of corruption is identified as a serious constraint to doing business by over 70 percent of firms in South Asia and almost as many in developing East Asia, the Middle East, and Northern Africa regions. Sixty-four percent of firms in Africa, almost 60 percent of those in Latin America, and about half of those in the Commonwealth of Independent States (CIS) and Central and Eastern Europe regions report corruption to be a serious impediment to private sector development (see table 1 and figure 3 for details). Corruption significantly deters the development of markets, drives away investment, increases costs, reduces competitiveness, increases uncertainty, undermines the rule of law, and is estimated to add 10 percent or more to the costs of doing business in many parts of the world.⁵

A lot is at stake for the private sector in regards to corruption. Continuing to participate in and/or turn a blind eye to corrupt activities can have significant negative consequences for the private sector in terms of competitiveness, the effectiveness of government policies, and the sustainability of development efforts. Ensuring effective risk management, aligning with customer expectations, complying with laws and regulations, meeting the demands of ethical investment funds, and safe-guarding reputation and brand are some of the factors that contribute to the business case for anti-corruption. Rooting out and resisting corruption, for both larger and smaller companies, also creates an environment where businesses are less vulnerable to extortion and their contracts are more likely to be secure.

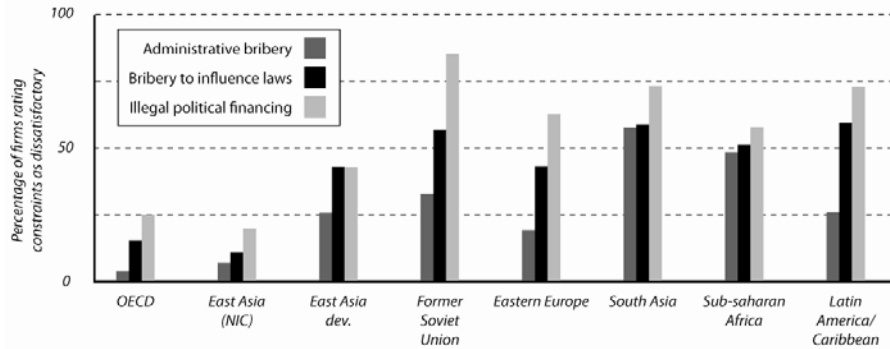
⁴ Batra, Geeta, Daniel Kaufmann, and Andrew H.W. Stone. 2004. "The Firms Speak: What the World Business Environment Survey Tells US about Constraints on the Private Sector Development." Washington, D.C." World Bank.

⁵ Brew, Peter. "The Power of Joining Forces: The case for collective action in fighting corruption", *Development Outreach*. World Bank Institute. Washington, D.C.. Volume 8, Number 2. September 2006.

Table 1. What do active managers view as their main obstacles to operation and growth?

	<i>Leading constraint</i>	<i>Second constraint</i>	<i>Third constraint</i>	<i>Fourth constraint</i>
World	Taxes and regulations	Financing	Policy instability	Inflation
OECD and Newly Industrialized East Asia (including China)	Taxes and regulations	Financing	Policy instability	Inflation
Transition Europe	Taxes and regulations	Financing	Inflation	Policy instability
Developing countries (Africa, MENA, East Asia Developing, South Asia, Latin America)	Corruption	Inflation	Financing	Policy instability/ infrastructure (tie)
Africa	Financing	Corruption	Infrastructure	Inflation
MENA	Policy instability	Corruption	Inflation	Exchange rate
East Asia NIC/ China	Financing	Inflation	Anti-competitive practices	Policy instability
East Asia Developing	Street crime	Corruption	Inflation/ Exchange rate/ Organized crime (tie)	Inflation/ Exchange rate/ Organized crime (tie)
South Asia	Corruption/ Policy instability (tie)	Corruption/ Policy instability (tie)	Inflation	Infrastructure
Latin America	Taxes and regulations	Policy instability	Street crime	Financing
OECD	Taxes and regulations	Financing	Policy instability	Inflation
CIS	Taxes and regulations	Financing	Policy instability	Inflation
CEE	Taxes and regulations/ Inflation (tie)	Taxes and regulations/ Inflation (tie)	Financing	Policy instability

Source: Batra, Kaufmann, and Stone (2004).



Source: EOS 2003, GCR of WEF, author's calculations. Each region has the following number of countries: OECD, 23; East Asia (Developing), 6; East Asia (NIC), 4; Eastern Europe, 14; Former Soviet Union, 2 (Russia and Ukraine); South Asia, 4; Sub-Saharan Africa, 21; and Latin America and Caribbean, 21. As shown in Daniel Kaufmann, "Click Refresh Button: Investment Climate Reconsidered," *Development Outreach*, World Bank, March 2005.

Figure 3. Key constraints to business: OECD vs. emerging economies

The business community is increasingly recognizing fighting corruption to foster sustainable and stable business growth is in its own best interests. Global business leaders are now more publicly supportive of increased regulation to limit corruption and to ensure a level playing field. Yet treaties, conventions, and codes are only as effective as their enforcement. Therefore, a careful assessment of the capacity of government, international agencies, and non-governmental organizations (civil society) to enforce (or private sector bodies to self-regulate) these agreements is needed, in addition to capacity of a range of companies (in size and ownership structure) to implement corruption reduction procedures. Multinational businesses typically have the resources to train and monitor internally, but local firms (down to the level of small and medium enterprises) will often require assistance to develop workable controls.

Conclusion

As there is increased global attention to the issue of corruption, and as more and more organizations seek to find ways to tackle the problem, there is no shortage of questions to address. The sharing of knowledge, not least discussion of what has and has not worked, becomes all the more important to avoid duplication of efforts.