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On the  
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**STRENGTHENING BANK GROUP ENGAGEMENT ON  
GOVERNANCE AND ANTICORRUPTION**

Attached for the September 18, 2006, Development Committee Meeting is a paper entitled "Strengthening Bank Group Engagement on Governance and Anticorruption," prepared by the staff of the World Bank. This item will be considered under Item I of the Provisional Agenda.

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## ABBREVIATIONS AND ACRONYMS

AML	Anti-money laundering
APEC	Asia-Pacific Economic Cooperation Forum
AUSAID	Australia Agency for International Development
BP	Bank Procedure
CAS	Country Assistance Strategy
CDD	Community-driven development
CFAA	Country Financial Accountability Assessment
CFT	Combating financing of terrorism
CPAR	Country Procurement Assessment Report
CPIA	Country Policy and Institutional Assessment
CSO	Civil society organization
DFID	Department for International Development, United Kingdom
DPO	Development policy operation
EITI	Extractive Industries Transparency Initiative
FATF	Financial Action Task Force
FLEG	Forest Law Enforcement and Governance regional Ministerial initiatives
FSAP	Financial Sector Assessment Program
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IFI	International financial institution
IMF	International Monetary Fund
INT	Department of Institutional Integrity
ISN	Interim Strategy Note
MDB	Multilateral development bank
MDG	Millennium Development Goal
MIGA	Multilateral Investment Guarantee Agency
NEPAD	New Partnership for Africa's Development
NGO	Nongovernmental organization
OAS	Organization of American States
OECD	Organisation for Economic Co-operation and Development
OECD-DAC	Organisation of Economic Co-operation and Development Development Assistance Committee
OED	Operations Evaluations Department
PACI	Partnership Against Corruption Initiative
PBA	Performance-based allocation system
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PFM	Public financial management
QAG	Quality Assurance Group
SSIU	Sector Strategy Implementation Update
TA	Technical assistance
UN	United Nations
UNECA	United Nations Economic Commission for Africa
USAID	United States Agency for International Development
VDP	Voluntary Disclosure Program
WBI	World Bank Institute
WDR	World Development Report

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# STRENGTHENING BANK GROUP ENGAGEMENT ON GOVERNANCE AND ANTICORRUPTION

## EXECUTIVE SUMMARY

1. This paper responds to the Development Committee's request for a document articulating the World Bank Group's strategy for heightening its focus on governance and anticorruption as an integral part of its work to reduce poverty and promote growth. It also responds to the increasing demand for governance and anticorruption engagement from stakeholders worldwide.

2. ***Governance and Corruption.*** Governance and corruption are not synonymous. Governance refers to the manner in which public officials and institutions acquire and exercise the authority to shape public policy and provide public goods and services. Corruption is an important aspect of poor governance and can involve the abuse of public office for private gain; it can also take place among private sector parties.

3. ***Purpose of Governance Work.*** The governance agenda, of which anticorruption is one aspect, needs to be understood in the framework of the Bank's core mission of helping countries reduce poverty. On a daily basis, poor people around the world are unable to access health clinics, schools, or other essential services because their public systems are unresponsive or because they themselves cannot or will not pay bribes. Corruption and weak governance often mean that resources that should fuel economic growth and create opportunities for the poor to escape poverty instead enrich corrupt elites. In some cases, extremely poor governance and corruption have contributed to financial and economic collapse, public alienation, and even violence and failed states, with disastrous consequences for the poor. Thus, improving governance and reducing corruption are crucial to helping poor people to escape poverty and countries to achieve the Millennium Development Goals (MDGs).

4. In addition to its developmental mandate to reduce poverty, for which governance and anticorruption is crucial, the Bank also has a fiduciary obligation, enshrined in its Articles of Agreement, to ensure that Bank funds are used for their intended purposes. Aid funds face risks from corruption and weak governance, and both donors and recipients want assurances that this assistance will be protected. In the spirit of the mutual accountability framework of the Monterrey Consensus, countries that improve governance and reduce corruption merit scaled-up assistance to achieve the MDGs. The Bank and the wider development community are far from alone in seeing the dire consequences of poor governance and corruption. A number of developing country leaders are at the forefront of calls for ending corruption. Throughout the world there are increasing demands for more accountable and transparent government.

5. The main aim of the Bank Group's governance work is to help develop capable and accountable states and institutions that can devise and implement sound policies, provide public services, set the rules governing markets, and control corruption, thereby helping to reduce poverty. The behavior of the state, and of other key stakeholders such as the private and financial sectors, shapes the quality of governance and impacts development outcomes. Excessive regulation, for instance, increases the cost of doing business and provides opportunities for corruption. By contrast, reforms that rationalize the role of the state, reduce red tape, and promote competition can result in stronger firms, more jobs, and better services.

Governments around the world are trying to improve governance and tackle corruption, and they are seeking support and learning from international experience to craft and implement complex programs of reform, build supporting coalitions, and monitor their impact. Development institutions have the opportunity and responsibility to help them, and the Bank is responding through the strengthened engagement set out in this paper.

6. ***Lessons of Experience.*** The Bank's strengthened governance and anticorruption strategy builds on more than a decade of global experience working with country, donor, and civil society partners. Key lessons include the following:

- A large body of research shows that in the longer term there is a major development dividend from good governance and controlling corruption: they are associated with robust growth; lower income inequality, child mortality, and illiteracy; improved country competitiveness and investment climate; and greater resilience of the financial sector. Research also indicates that aid projects are more successful in well-governed environments.
- Institutional reforms can succeed, especially when there is committed country leadership and support for local reformers, so Bank programs must work closely with champions of reform in government and in collaboration with a broad range of stakeholders.
- Governance challenges are far from uniform across countries, so strategies must be differentiated and strongly based on local knowledge, innovation on the ground, and extensive collaboration with local constituencies.
- Even when opportunities for governance reform at the national level are limited, there may be entry points at the local level. In some settings, the entry point might be bottom-up participatory reform, such as community-driven development, especially when it also supports the development of local government capacity and accountability.
- While there has been progress in tackling administrative corruption, deep-seated political or systemic corruption—including the link between money and politics and the capture of state institutions by some powerful interests—is harder to address. In these cases, traditional public sector management interventions need to be supplemented with transparency and related reforms as well as wider engagement with multinationals, the domestic private sector, and the financial sector.
- Regulatory red tape and unwieldy public sector enterprises are associated with poor governance and corruption. A thriving, open, and competitive private sector can be a strong source of demand for better governance.
- Strengthening accountability, especially of governments to citizens, is key, and the Bank can help by complementing its work building government capacity with support for institutions outside central government, such as parliament, civil society, nongovernmental organizations (NGOs), the media, and local communities, in

collaboration with other donors. These lessons also point to the need to have Bank staff in the field working closely with governments, sharing best practice and expanding constituencies that have the experience to assist with innovative solutions to governance challenges.

All of these lessons point to the need for significant Bank engagement on the ground, and a long-term perspective that recognizes that governance reform is a continuing endeavor, with large variations from one country to another. What is important—and must be the basis for assessing impact—is that the trends show sustained improvement over time.

7. ***Bank Initiatives.*** In recent years, the Bank Group has engaged in pilot initiatives at the country, sectoral, and project levels in most of the areas discussed, with field-based innovations often leading the way. While many initiatives have been successful, others have not, and generally their application and results on the ground have not been uniform across countries. Moreover, donor efforts have not been consistent, sending mixed signals and weakening effectiveness. Overall, some countries have recently shown improvements in governance and anticorruption, but others have deteriorated, and the world has not made sufficient progress.

8. ***Need for a Strengthened Approach.*** This uneven record in addressing governance and corruption indicates the need for a stronger governance and anticorruption strategy. In learning the lessons of experience and integrating them into a strengthened strategy, the Bank aims to scale-up engagement on governance and anticorruption in a way that ensures more systematic and consistent treatment of governance issues across countries, so as to attain measurable and demonstrable improvements. For the Bank, a stronger approach also means reviewing staffing, skills and the incentives guiding managers and staff, as well as striving to deepen the Bank's engagement on governance and anticorruption activities with partner countries on the ground.

9. ***The Bank Group Strategy.*** Many governments are leading in and taking ownership of the governance and anticorruption agenda; others are giving it less priority. The Bank Group's strategy is to help developing country governments, in light of their distinct national challenges, to identify their own priorities for improving governance and to articulate and implement programs responding to those priorities, in a manner that is effective and sustainable over the long term. The strategy takes a comprehensive approach that involves working at the country, operational, and global levels to enhance and integrate governance and anticorruption measures, deploying the full range of Bank Group activities to assist partner countries in achieving demonstrable results for sustained poverty reduction. As the core of the Bank's support to countries is expected to remain in the sectors, the strategy envisages better integration of governance and anticorruption concerns into the Bank's sectoral programs, including for the private and financial sectors. In addition, the strategy aims to ensure the highest fiduciary standards in Bank operations and to achieve expanded Bank engagement with a wider range of constituencies and institutions outside the executive branch of government, including more emphasis on engagement with the private sector to help reduce bribery.

10. ***Country Level.*** A central focus of the Bank's work is supporting the development of more effective and accountable states, in partnership with other multilateral and bilateral organizations. Reforms to strengthen the accountability and transparency of state institutions are an increasingly important focus of partner countries, and, thus, the Bank needs to provide more

consistent, continuous, and systematic assistance to government programs in governance and anticorruption. To help countries build ownership, the Bank must work broadly across government to design effective interventions, based on best practices identified through sound empirical research. For IDA borrowers, lending allocations will continue to be based on the Bank's performance-based allocation system; for IBRD borrowers, allocations will continue to reflect creditworthiness as well as performance and governance concerns. In all cases, consistent treatment of countries will be a key objective.

11. Specifically, at the country level, the strategy proposes a broader and deeper engagement on governance and corruption:

- A systematic and disciplined approach will be applied to the treatment of governance and corruption issues in CASs, ensuring that the strategy is matched to the risks and challenges that governance and corruption pose for growth and poverty reduction in the country.
- In countries where governance is relatively good and improving, Bank strategies will continue to aim at greater flexibility and customization.
- In high-opportunity countries where country leadership is undertaking major governance and anticorruption reforms, the Bank will match such resolve by rapidly scaling up technical and financial assistance on the ground and providing public recognition of this major positive development.
- In countries where governance and corruption pose major obstacles to reducing poverty and are high in the country's own priorities, the Bank's strategy will feature governance as a central theme and will make use of anticorruption teams, field-based governance advisers, and anticorruption action plans in projects, as appropriate. Where the country's progress depends on advances in governance and anticorruption, strategy formulation and implementation will be supported by in-depth governance diagnostics and monitoring tools, including actionable as well as outcome indicators.
- In countries where there is a high risk of deterioration in governance or where weak governance and widespread corruption block development, government leadership has no commitment to reform, and the Bank and the government cannot agree on priorities, the Bank will engage in areas and sectors where adequate governance arrangements are possible, with a likely focus on building capacity, meeting the basic needs of the poor, and working, within its legal mandate, with institutions outside of central government. In addition, the strategy will include a low-case scenario that may involve highly restricted financing, a shift to nonlending activities, or, very unusually, a suspension in financing support. In these circumstances, IFC and MIGA may still play key roles as partners in pursuing a socially responsible investment policy, as strategic engagement with the private sector remains a potentially important means for change in high-risk settings.
- In all countries where governance is a challenge, there will be a continuing focus on public financial management, procurement, auditing, judiciary, and legal reforms, as

well as a renewed engagement with governments on civil service, institutional, and transparency reforms. In addition, greater systematic attention will be given to addressing governance in key sectors, strengthening local governments and community participation, and building capacity in judiciaries, supreme audit institutions, and other formal oversight institutions.

- The Bank will be flexible in responding to evolving country circumstances, including allowing for midcourse correction in the strategy to respond to governance improvement or deterioration.
- The Bank Group, including IFC and MIGA, will engage more closely with the private sector to address corruption, and will continue to deepen its support for improving the investment climate, supporting regulatory reform and reductions in red tape, and promoting a competitive private sector as well as greater private sector participation across sectors of the economy, including the financial sector.
- The Bank, within its mandate and in collaboration with other multilateral and bilateral organizations, will also support participatory and transparency initiatives, enabling citizens to access information and participate in the development of policies, spending priorities, and service provision; promote community participation to improve local governance; build media capacity; and broaden oversight over public procurement, asset declarations, and other important dimensions of government performance. The Bank will revise its disclosure policy to improve the Bank's own transparency.

12. ***Project Level.*** At the project level, the Bank's strategy aims to improve the integrity and development impact of Bank-funded projects by

- Incorporating concrete good governance and anticorruption objectives in sectoral programs, tailored to each sector's distinctive features and risks;
- Working with governments to identify risky operations and ensure upstream risk mitigation, preparing anticorruption action plans as part of high-risk operations;
- Focusing on fiduciary quality concerns during joint reviews with governments of the Bank's project pipeline and financing portfolio; channeling resources and attention, especially during supervision, toward projects deemed to be of high risk;
- Establishing anticorruption teams, particularly in the field, to review project design, risk rating, and anticorruption action plans and, together with governance advisers, also to serve as a focal point for dialogue on governance and anticorruption issues;
- Improving design and supervision methods, and enhancing oversight and monitoring of Bank-financed projects through the transparent disclosure of project information, in particular anticorruption action plans;

- Strengthening the Bank’s Department of Institutional Integrity (INT) investigation of Bank-funded projects, and when corruption is detected, publicly sanctioning corrupt firms and promoting accountability by government and at the Bank;
- Supporting countries’ efforts to strengthen their investigations and prosecution of corruption, enhancing collaboration between the Bank’s investigative team and the country’s own anticorruption institutions; and
- For IFC and MIGA, working directly with the private sector to strengthen ethical corporate practices across their operations, encouraging clients to join public-private coalitions for reform, and reinforcing that integrity is “good for business.”

13. ***Global Level.*** Finally, at the global level, the strategy aims to strengthen the Bank Group’s bilateral and multilateral partnerships with a view to:

- Promoting coordinated action in higher-risk settings and harmonizing governance and anticorruption initiatives with the IMF, regional development banks, and other donors, including in public financial management, procurement, and the judiciary;
- As part of a process of joint sanctions reform by the multilateral development banks (MDBs), making investigative rules and procedures more consistent, strengthening information sharing, and establishing mechanisms to recognize each other’s sanctions decisions;
- Working closely with the private sector, civil society, youth, and the media to promote change coalitions such as the Global Integrity Alliance as well as sector-specific initiatives such as the Extractive Industry Transparency Initiative and Publish What You Pay, while raising the cost of corrupt behavior through increasingly harmonized MDB sanctions and the Bank Group’s new Voluntary Disclosure Program;
- Supporting implementation of key international conventions such as the OECD Anti-Bribery Convention, the UN Convention against Corruption, and regional initiatives;
- Helping enhance a country’s ability to track, freeze, and confiscate the proceeds of corrupt behavior, including through technical assistance for asset recovery; and
- Working with developed countries, the OECD, and the private sector to provide assistance on anti-money laundering and greater cooperation on asset restitution.

14. ***Role of the Board.*** The Bank’s Board will continue to have an important role in the development of the Bank’s country strategies, to ensure that they are consistent across countries and continue to have broad support in the international community. If country circumstances change in ways that warrant a shift in the Bank’s approach, an appropriate document will be presented to the Board for discussion. In addition, for all CASs that present alternative scenarios, the CAS and the midterm CAS Progress Report will continue to state clearly which scenario applies as well as what conditions would trigger alternative scenarios. New country

developments will continue to be discussed at Steering Committee meetings, and Management views on appropriate financing levels will be presented to the Board in a timely manner. In addition, by interacting with Management—including through approval of Bank-funded operations—the Board will provide guidance and feedback on refining this strategy. The Board will continue to be involved in reviewing individual projects, including any that are delayed because of corruption concerns.

15. ***Going Forward.*** This strategy implies a change in how the Bank Group does business, including providing incentives to managers and staff to engage proactively on the ground on governance issues; addressing staffing, skills, and resource needs to operate effectively in challenging governance settings; and developing a stronger results framework, building on a range of aggregate, actionable, and outcome indicators. The emphasis of the strategy will be on the front lines, tapping local knowledge and engaging closely with partner countries. Operational guidance to staff will need to be developed, reflecting ongoing innovation in the field. Given the complexity of the effort, the Bank Group will also need to proceed pragmatically. In addition, partnerships will need to be strengthened, including with local institutions such as universities and NGOs, to increase the Bank's technical know-how and develop common approaches. Consultations will take place with a wide range of stakeholders (following the initial set of consultations already done) once the Development Committee has provided guidance, and the results will be shared with the Board. Furthermore, given the importance of learning in these fields, the Bank will continue to support research on causes and effects of governance and corruption and their links to growth and development. This agenda demands innovation and experimentation as well as rigorous monitoring and evaluation of results—all in a spirit of openness to learning what works, what does not, and why.



## STRENGTHENING BANK GROUP ENGAGEMENT IN GOVERNANCE AND ANTICORRUPTION

*Today one of the biggest threats to development in many countries is corruption. It weakens fundamental systems, it distorts markets, and it encourages people to apply their skills and energies in nonproductive ways. In the end governments and citizens will pay a price, a price in lower incomes [and] lower investment.*

– President Paul Wolfowitz, Jakarta, April 11, 2006

### I. INTRODUCTION

1. At the 2006 Spring Meetings, the Development Committee “agreed on the need to improve governance in all countries, to help build effective states with strong national systems and to work together on implementing global initiatives to improve governance, increase transparency and build demand for good governance at the country level in a way that strengthens ownership.” It asked the World Bank to set out its strategy on governance and anticorruption, to be discussed at its September 2006 Annual Meetings.<sup>1</sup> This paper responds to the Development Committee’s request. It sets out a comprehensive approach that involves working at the country level, at the level of Bank-financed operations, and at the global level.

2. **Context.** Reformers and citizens all over the world are demanding more accountable and transparent government; and a global movement has emerged to combat corruption in both the public and private sectors. While weak governance and corruption are hardly unique to developing countries, their impact on poverty and growth is particularly devastating. On a daily basis, poor people around the world cannot access health clinics, schools, or other essential services because their public systems are unresponsive, or because they themselves cannot or will not pay bribes. Weak governance and corruption often mean that the resources that should fuel economic growth and create opportunities for the poor to escape poverty instead go to enrich corrupt elites. Aid funds face the same risks, and citizens in both donor and recipient countries want assurances not only that this assistance will be protected, but that it will make a difference in improving governance and combating corruption. In some cases, poor governance and entrenched corruption have contributed to financial and economic collapse, with disastrous consequences for poor people. In extreme cases, the failure of governance can result in widespread alienation, degenerating into violence, and in some instances, leading to failed states. Thus, improving governance and reducing corruption are crucial for helping poor people to escape poverty and countries to achieve the Millennium Development Goals (MDGs).

3. **Governance and Poverty Reduction.** To make progress in reducing poverty, countries need good policies, a workable regulatory framework for markets and private sector development, and reasonably efficient and effective provision of public services—all of which depend greatly on the effectiveness of the state. Research and experience have shown that the quality of governance, including control of corruption, has a significant impact on growth and

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<sup>1</sup> Development Committee Communiqué, World Bank, Washington, D.C., April 23, 2006. Specifically, the Development Committee requested the Bank to “lay out a broad strategy ... for helping member countries strengthen governance and deepen the fight against corruption, working closely with the Fund, other multilateral development banks and the membership, to ensure a coherent, fair and effective approach.”

poverty reduction: on average, countries with better governance grow faster than countries with poor governance, and the effectiveness of Bank-funded projects is significantly impaired in countries with weak governance and high corruption.<sup>2</sup> Unchecked corruption can destroy economies by undermining the legitimacy of state institutions, strangling the private sector, increasing inequality, and damaging civil society. Hence, the main purpose of the World Bank Group's governance work is to help develop capable, transparent, and accountable states and institutions that can reduce poverty, promote growth, and contain corruption.

4. ***Governance and Corruption.*** Governance and corruption are not synonymous. Governance refers to the manner in which public officials and institutions acquire and exercise the authority to shape public policy and provide public goods and services. Corruption is one aspect of poor governance, involving the abuse of public office for private gain. Public office is abused when an official accepts, solicits, or extorts a bribe and when private agents give or offer bribes to circumvent public policies and processes for competitive advantage and profit. It is also abused through patronage and nepotism, the theft of state assets, or the diversion of state revenues. Corruption can also take place among private sector parties, yet interface with and affect public sector performance: for example, bidders may collude in a public procurement with intent to defraud the state. Corruption and governance are also intertwined, as corruption is often a symptom of poor governance, and grand corruption can fundamentally undermine governance.<sup>3</sup>

5. ***The Bank's Mission.*** Poverty reduction is the main mission of the Bank's work. With much evidence demonstrating the link between governance and poverty reduction, and between corruption, governance, and aid effectiveness,<sup>4</sup> strengthening governance and fighting corruption are key to achieving this mission. Pursuing good governance and fighting corruption are also consistent with the Bank's Articles of Agreement (see Box 1). For many years the donor community was virtually silent on these issues, but the last decade has seen a clear shift in emphasis. The Bank Group has been playing its part, through applied research and development of indicators and diagnostics on governance and corruption, policy dialogue, technical assistance, and financing operations. The way the Bank and other donors do business in poorly governed countries has begun to change, even if not systematically across all countries.

6. ***Worldwide Trends.*** The growing attention to these issues has yet to result in discernable improvements worldwide. Some countries have improved, but others have deteriorated, and the world on average has not made sufficient progress on governance and corruption control.<sup>5</sup> While a number of countries and institutions in developing economies are exhibiting real leadership, in other countries rhetoric may be present without concrete reforms or results on governance and corruption. In addition, reformers often have not had the support they need to develop and implement difficult governance reform programs in the face of powerful vested interests.

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<sup>2</sup> There is an extensive body of literature on growth and governance; for example, Jonathan Isham, Daniel Kaufmann, and Lant H. Pritchett, "Civil Liberties, Democracy, and the Performance of Government Projects," *World Bank Economic Review*, Vol. 11, No. 2: 219-422, Washington, D.C., 1997. See Annex F for a selected list of additional references.

<sup>3</sup> Annex G provides definitions of *governance*, *corruption*, and related terms.

<sup>4</sup> See, for example, Victoria Levin and David Dollar, *Sowing and Reaping: Institutional Quality and Project Outcomes in Developing Countries*, World Bank Policy Research Working Paper 3524, Washington, D.C., February 2005.

<sup>5</sup> See, for example, Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi, *Governance Matters IV*, World Bank, Washington, D.C., 2005.

### Box 1. The Bank Group's Legal Framework

Any Bank Group strategy for governance and anticorruption must conform to the purposes set out in the Articles of Agreement of each of the Bank Group's institutions: broadly stated, to promote the economic development of members.<sup>a</sup> In Bank Group work on governance and anticorruption, including interactions with other partners, Bank Group institutions must act within the constraints imposed by the Articles' general limitation on interference in a member's political affairs and on basing decisions on a member's political character or on noneconomic considerations.<sup>b</sup> In addition, IBRD and IDA are specifically required to have arrangements in place to ensure that their funds are used for the purposes intended as expenditures are incurred, with due attention to considerations of economy and efficiency, and without regard to political or other noneconomic influences or considerations.<sup>c</sup>

<sup>a</sup> *IBRD Articles of Agreement*, Article I, *IDA Articles of Agreement*, Article I, *IFC Articles of Agreement*, Article I, *MIGA Convention*, Chapter 1, Article 2.

<sup>b</sup> *IBRD Articles of Agreement*, Article IV, Section 10: "The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I." See also *IDA Articles of Agreement*, Article V, Section 6; *IFC Articles of Agreement*, Article III, Section 9; *MIGA Convention*, Chapter V, Article 34.

<sup>c</sup> *IBRD Articles of Agreement*, Article III, Sections 5(b), (c); *IDA Articles of Agreement*, Article V, Sections 1(g), 1(h).

7. ***Toward a Strengthened Strategy.*** Despite many improvements in the past decade—in global awareness of the issue, in measuring performance, in building domestic and international coalitions for change, and in changing the way the Bank and other donors work—the Bank can do more. In particular, the Bank will apply the lessons from research and experience to a strategy focused on systematic and concrete operational results on the ground. This strategy recognizes that partner governments are increasingly seeking support for policy and institutional reforms that address the roots of weak governance and corruption to spur investment and growth in their countries. It also recognizes that where weak governance and associated corruption systematically weaken the impact of aid, the Bank Group needs to find a strategy of engagement that supports countries' desire for change while directly addressing risks to aid effectiveness.

8. ***Vision.*** This strategy builds on the vision President Wolfowitz outlined in a speech in Jakarta in April 2006, and reflects lessons (detailed in Annex A) from the experience of the Bank and other partners. These lessons underscore that, to advance poverty reduction, the World Bank Group must move toward a more consistent and results-oriented approach to governance and anticorruption across projects, sectors, and country programs. Such an approach has broad implications for the whole Bank Group, including IFC and MIGA, entailing changes in the way it develops Country Assistance Strategies (CASs); prepares, reviews, and implements Bank-funded operations; works collaboratively with development partners; and deploys human resources and operates on the ground.

9. ***Objectives.*** The main aim of the Bank Group's governance work is to help develop capable and accountable states and institutions that can devise and implement sound policies, provide public services, and set the rules governing markets, thereby helping to reduce poverty. In strengthening its strategy on governance and anticorruption, the Bank Group has a number of key objectives: (a) to increase its engagement with countries on governance and anticorruption, with its full range of instruments and operations; (b) to integrate governance and anticorruption innovations into a much wider range of Bank activities across sectors; (c) to promote more systematic and consistent treatment of governance and anticorruption across all countries in coordination with other key donors and partners, in order to obtain measurable results in the

Bank’s country strategies and operations; (d) to ensure the highest fiduciary standards in Bank Group operations; and (e) to expand the Bank’s engagement with a wider range of stakeholders, constituencies, and institutions outside the central executive, strengthening those actors that constitute the demand side for better governance, including parliaments and communities, the private sector, and media and civil society. To support partner countries more effectively, the Bank will deepen and broaden its ongoing work on governance and anticorruption and change the way it operates, as well as advance new priorities and initiatives, as outlined below.

10. **Global Experience.** The Bank’s strengthened governance and anticorruption strategy builds on a decade of global experience and evidence working with country, donor, and civil society partners. In 1996, the then-President of the World Bank Group publicly committed to fight the “cancer of corruption,” and in September 1997, the Board endorsed the World Bank’s first anticorruption strategy.<sup>6</sup> Since then, the state of the art in governance and anticorruption has been evolving and lessons emerging. As Box 2 suggests, the difference between success and failure often turns on whether political and business interests effectively lead the fight against corruption—or whether they collude to obstruct progress. Realities differ from one country to another. There are no “one size fits all” reforms. Modesty is warranted as the Bank Group embarks on a strengthened approach, lending support to encouraging country innovation, experimentation, and adaptation at the local level, with in-country partners.

11. **Learning.** Given the importance of learning in this evolving area, the Bank will continue to support external and internal research on both governance and corruption, and their respective links to growth and development. This research offers the promise to understand better what types of policy interventions and operations are likely to be successful (or not), and in what types of settings. Lessons have been learned thanks to the distillation of experience over the past decade, as indicated below. The need for an expanded research agenda, drawing on worldwide talent and building on country and project-level evidence, stems from the recognition that there is much still unknown or unanswered in this complex and evolving field. (See a list of selected literature on growth and governance in Annex F).

12. **Lessons.** What are some of the key lessons that have emerged over the last decade? Highlights are as follows (Annex A provides a more detailed discussion):

- A large body of research shows that in the longer term there is a major development dividend from good governance and controlling corruption: they are associated with robust growth; lower income inequality, child mortality, and illiteracy; improved country competitiveness and investment climate; and greater resilience of the financial sector.
- Government leadership in governance and anticorruption reforms is very important, and development partners can play an important supportive role. Where leadership is lacking, progress is still possible as key constituencies—civil society, the media, and the business community—strengthen the demand for better governance.

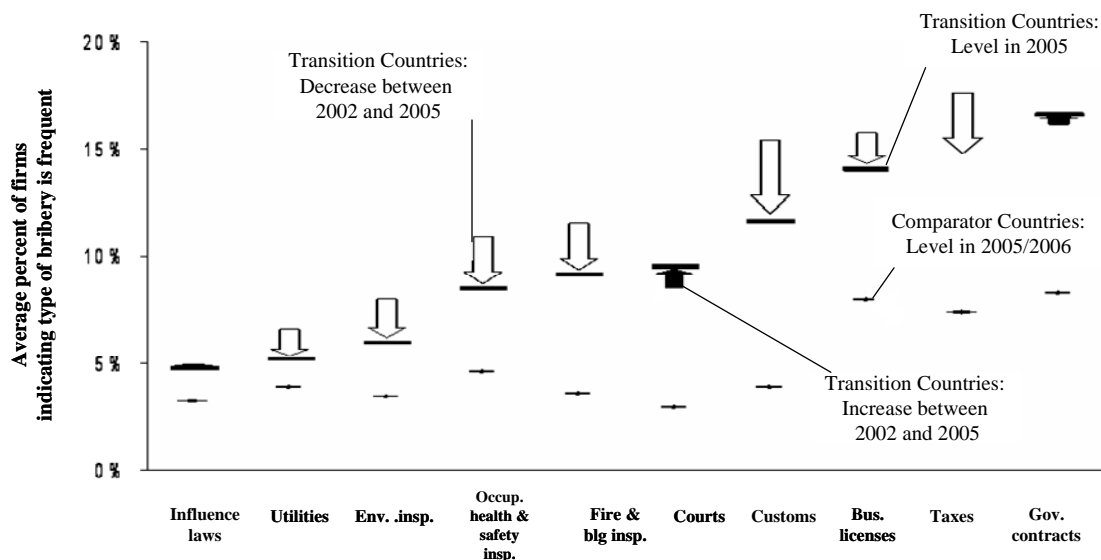
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<sup>6</sup> *Helping Countries Combat Corruption: The Role of the World Bank*, World Bank, Washington, D.C., September 1997. The strategy contains four main components that still have relevance: (a) helping partner countries reduce corruption; (b) mainstreaming anticorruption through the CAS; (c) preventing fraud and corruption in Bank projects; and (d) supporting international efforts to combat corruption.

## Box 2. Lessons from Europe and Central Asia

A recent World Bank report finds significant progress in reducing corruption in several countries in Europe and Central Asia: firms are paying bribes less frequently and in smaller amounts, and they report corruption to be less of a problem than in the past. However, progress is not uniform. The most visible progress has come in areas where reforms, sparked by strong leadership and prospects for European Union accession, have been focused. Transition countries have adopted simplified low- or flat-rate income taxes with broad bases and few exemptions, and firms' perceptions of the tax system have improved, tax evasion is falling, and bribes related to taxes are paid less frequently. Nearly all countries have revised customs legislation, most have invested in new information technology, and many customs administrations in the region are moving to risk-based assessment and more selective auditing—leading to a decline in corruption. The record in other areas is spottier. Judiciaries were neglected in the early years of transition; and bribery to obtain government contracts and corruption in the lawmaking process, or “state capture,” have not declined significantly.

### Some Progress in Reducing Corruption in Europe and Central Asia, 2002-2005



Notes: Transition countries include 26 former socialist countries in Europe and Central Asia; comparator countries are Germany, Ireland, Portugal, Spain and Turkey.

Source: *Anticorruption in Transition III: Who is Succeeding...and Why?*, World Bank, 2006.

- Governance challenges are far from uniform across countries; thus strategies must be differentiated, and strongly based on local knowledge, innovation on the ground, and extensive collaboration with local constituencies.
- Even when opportunities for governance reform at the national level are limited, there may be entry points at the local level. In some settings, the entry point might be bottom-up participatory reform, such as community-driven development, especially when it also supports the development of local government capacity and accountability.
- While there has been some progress in tackling administrative corruption, governance challenges that have deep-seated political or systemic roots—including the link between money and politics, and the capture of state institutions by narrow elites or

powerful conglomerates—are more difficult to address. Traditional public sector management interventions alone cannot succeed in tackling these challenges.

- Improving governance means engaging with institutions outside the central government (parliament, local communities, civil society, and the media) and supporting them to complement ongoing work with central government institutions. In large part, this can be done in the context of development work—by supporting participatory and transparency initiatives, such as those that enable the citizenry to access and use information on policies, spending priorities, and service provision; promote community participation to improve local governance; and foster media and civic oversight over public procurement and asset declarations.
- A thriving, open, and competitive private sector can be a strong source of demand for better governance. Helping governments improve the investment climate, eliminate red tape and nontransparent regulations, reduce monopolistic practices, transparently and competitively privatize state-owned businesses and banks, and facilitate the entry of small and medium-sized enterprises can help level the playing field and stimulate better corporate citizenship.
- While the main responsibility for good governance and corruption control resides with the country’s leadership and the country’s own institutions, external actors—including donor agencies, financial institutions, and multinationals—also play a role. Following the money illicitly obtained from corrupt activities in developing countries often leads back to banks, property, and investments in industrialized countries.
- Donor-financed projects can have an important demonstration effect, as well as direct impact, when strong safeguards against corruption are applied in project design and execution, and when projects support governance reforms and systemic change. At the same time, the recognition of governance and anticorruption challenges across development partners has been uneven and uncoordinated, sending mixed signals to partner countries and to firms participating in bids and project implementation.
- Lessons from World Bank and donor programs point to relative successes in supporting country reforms in some governance areas, such as gains in public financial management, contrasting with a mixed record in other areas, such as supporting civil service reform or anticorruption commissions.
- Within the Bank Group there has been an inconsistent application of governance and anticorruption concerns across country programs, sectors, and member institutions. Innovations have often remained as isolated pilots, not mainstreamed into the Bank’s operational program. Generally, Bank work does not yet have the required staffing, skills, and incentives in governance and anticorruption to effect results-oriented changes at the front lines of Bank Group operations, especially in country offices.

The strategy that follows from these lessons is organized around three levels of activity—the country level, the project level, and the global level. In each of these three levels, the role of institutions outside the executive branch of government—including the private sector and civil society—is integrated into the treatment of that level.

## II. A STRATEGY FOR STRENGTHENED SUPPORT TO COUNTRIES

13. The principal thrust of this new strategy is to expand the Bank Group's support for countries' efforts to address governance and anticorruption and build capable, transparent, and accountable institutions that reduce poverty. While the government remains the key counterpart of the Bank, the strategy envisages supporting a broad range of domestic institutions and actors—both inside and outside of government—who are demanding and working toward governance reform.

### A. Country Assistance Strategies

14. The CAS is the natural starting point for helping countries address governance and anticorruption, because CASs involve extensive discussions with partner countries, donors, and civil society and are a central tool with which Management and the Board review and guide the Bank Group's country program and judge the impact of its work. Coverage of governance and anticorruption issues in CASs and the associated Bank program are often not commensurate with the importance of governance and corruption challenges for the country. A key priority is to institute a systematic and disciplined approach that calibrates the strategy to the challenges that governance and corruption pose for poverty reduction and to the fiduciary and reputational risks to the Bank Group. The treatment of governance issues will be assessed during the corporate review process for strategies, ensuring that higher-risk countries receive focused higher-level Management review.

#### *1. Calibrating Attention to Governance and Corruption*

15. The CAS is the business plan that guides Bank Group activities in a member country. It starts from the country's vision of its development goals, and sets out the Bank's diagnosis of the country's development situation and a selective program of Bank Group support tailored to the country's needs, against the background of the Bank's ongoing portfolio and comparative advantage. The objective of the CAS is to identify the key areas in which Bank Group support can best assist the country to achieve sustainable development and poverty reduction. In the Bank Group's strengthened approach to governance and anticorruption, Bank teams preparing CASs will be required to give explicit consideration, underpinned by improved diagnostic work, to governance shortcomings and corruption in the country, the risks that they pose for development and Bank-funded operations, the government's commitment to reform, and the extent to which this commitment is reinforced by reform leaders and domestic oversight institutions. Within the overarching objective of poverty reduction, Bank teams will use these findings in developing the CAS and its program of Bank activities in the country. These assistance strategies are by their nature programs of engagement—outlining how the full range of Bank instruments can be used most effectively to ensure development results.

16. **Country Patterns.** As noted above, government priorities and performance will continue to shape the CAS's focus. The diversity of country situations and the continuum of risk across countries make it impossible to set out any rigid classification of countries; no lists or rankings of countries is being considered. Nevertheless, experience suggests that the following broad pattern of approaches is likely to emerge from the CAS preparation process:

- In countries where governance is relatively good and improving, and corruption is not a major obstacle to development, Bank strategies will continue to aim at greater flexibility and customization.
- In high-opportunity countries, where the country leadership is undertaking major governance and anticorruption reforms (possibly against a history of poor governance and widespread corruption), the Bank will match such resolve by rapidly scaling up technical and financial assistance on the ground and providing public recognition of this major positive development.
- In countries where governance and corruption pose major obstacles to reducing poverty and are high in the country's own priorities, the Bank's strategy will treat governance more consistently and with greater depth, featuring governance as a central theme, and will make use of anticorruption teams, field-based governance advisers, and anticorruption action plans in projects, as appropriate, to support country efforts to improve governance (see Box 3). Where the country's progress depends on advances in governance and anticorruption, strategy formulation and implementation will be supported by in-depth governance diagnostics and monitoring tools, including actionable and outcome indicators.
- In exceptional-risk countries, where there is a high risk of deterioration in governance or weak governance and widespread corruption block development, government leadership has no commitment to reform, and the Bank and the government cannot agree on priorities, the Bank will prepare an interim strategy for more restricted engagement. In such settings, the Bank will work in areas and sectors where adequate governance arrangements are possible; engagement is likely to focus on building capacity, meeting the basic needs of the poor, and working with institutions outside of central government. The strategy will include an assessment of the factors that weaken government commitment to reform and will strive to expand entry points for engagement on governance issues; it will require anticorruption action plans for all projects facing corruption risk; and it will include a low-case scenario, which may involve highly restricted financing, a shift to nonlending activities, or, very unusually, a suspension in financing support.<sup>7</sup> IFC and MIGA may still play key roles as partners in pursuing a socially responsible investment policy, as strategic engagement with the private sector remains a potentially important means for change in high-risk settings. This approach will not preclude extensive engagement with post-conflict countries where the international community deems it necessary to provide development assistance quickly, against a background of significant governance risks.

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<sup>7</sup> This approach is like that endorsed by the Board in January 2006 for fragile states with deteriorating governance or prolonged crises. See *Fragile States—Good Practice in Country Assistance Strategies* (IDA/R2005-0252), December 21, 2005.

### Box 3. Three Country Assistance Strategies with a Strong Governance Focus

Indonesia (FY03) is an early example of a CAS that featured governance as the dominant principle throughout the strategy; this focus was a necessary and innovative response to the damage done to the Bank Group's reputation in the 1990s by its high levels of financial support to a government that was perceived to be highly corrupt. Two other examples of CASs with a central focus on governance are Bangladesh (FY06) and Albania (FY06). These three CASs all identify governance as a central challenge for poverty reduction and affirm that meeting this challenge requires incorporating governance in all CAS interventions. Each CAS adopts a distinctive approach, underscoring that "no one size fits all" when it comes to governance reform. In all three cases, substantial lending remains a key part of the strategy, underlining the point that government commitment to engagement with the Bank on governance and anticorruption provides considerable lending opportunities.

These CASs propose work on governance across four areas of intervention:

- Sector governance, with a focus on strengthening accountability for the use of public resources, by strengthening sector-level transparency and by making providers more accountable to clients. A sectoral focus is especially strong in the Bangladesh CAS, which highlights governance constraints in power and ports as obstacles to poverty reduction.
- Local governance—with the aim of fostering local citizens' and groups' participation in development decisionmaking, monitoring, and implementation. The Indonesia CAS places a strong emphasis on the interface between local governments and communities as key to improved accountability, and better provision of poverty-reducing services.
- Governance and private sector development, where policy reforms can reduce opportunities for rent-seeking and strengthen the role of private actors committed to competitive markets and an efficient public sector. The Albania CAS highlights the use of business environment surveys as a way of monitoring progress in implementation.
- Core governance—both the supply side of public management (where all three CASs emphasize public financial management and procurement) and the demand side of stronger accountability institutions. The Bangladesh CAS suggests interventions ranging from justice reform to improved freedom of information, and the Indonesia CAS supports a national-level Partnership for Governance Reform that involves civil society, donors, and government.

To mitigate fiduciary and reputational risks, the CASs propose a dual strategy: strengthening the ability of national actors to hold the public sector to account through enhanced transparency and participation, and through improved core governance systems; and deepening the Bank's own fiduciary risk management, including up-front scrutiny of the corruption-proofing features of individual operations, anticorruption action plans in high-risk projects, anticorruption teams, preemptive audits, stronger supervision, vigorous investigation of and follow-up to allegations of corruption in Bank-financed projects, and public disclosure of the results. In addition, the Bangladesh and Indonesia country teams have field-based governance advisers.

Although the Indonesia CAS is well advanced in implementation, the challenge for the other two now lies in translating their governance-intensive CASs into action. Designing operations that address governance in key sectors, as well as using innovative methods to mitigate risk during supervision, requires appropriate staff capacity. Monitoring progress across the ambitious variety of cross-cutting governance initiatives laid out in these CASs is key to their credibility. While each CAS proposes some indicators, the operationalization of governance monitoring needs further work.

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*Note:* See *Indonesia Country Assistance Strategy* (Report No. 27108-IND), *Bangladesh Country Assistance Strategy* (Report No. 21326-BD), and *Albania Country Assistance Strategy* (Report No. 34329-AL) for more details.

17. ***Risks Posed by Weak Governance and Corruption.*** In countries where governance and corruption are central issues, formulating and implementing the CAS will be supported by in-depth governance diagnostics. Key questions are reviewed below and considered further in Annex B. To answer them, staff will rely on technical analysis and professional judgment and be guided by institutionwide principles, which will be set out in new CAS guidelines.

- How detrimental to the country's growth and poverty reduction are governance and corruption challenges in the country? To what extent are weaknesses concentrated in specific sectors or institutions? Bank teams will draw on economic and sector work, including new diagnoses if needed, to answer these questions. If they judge that governance and corruption obstruct progress across the board, the CAS will focus on these issues centrally. If, instead, weaknesses are concentrated in sectors or

institutions that are key for poverty reduction, the CAS will focus attention on improving governance in them.

- How committed is the government to strengthening governance and tackling corruption, and does it have a track record of progress? Strong government commitment to reform warrants consistent support, even where corruption is high or governance weak. If government interest in reform is low, the Bank strategy needs to recognize this disagreement over priorities and assess how the situation can be reversed over time. In such circumstances, it may not be appropriate to provide financing that risks being wasted through corruption or strengthening the position of those who profit from corruption, and the Bank's strategy may instead involve nonfinancing activities aiming to strengthen islands of good governance in specific sectors. It may also be more appropriate in these circumstances to prepare a 12- to 24-month Interim Strategy Note (ISN)<sup>8</sup> that outlines initial steps in how the Bank proposes to address the country's circumstances.
- How effective are domestic oversight institutions, such as the judiciary, legislature, supreme audit institution, media, and civic watchdogs? Are there "champions" of good governance, in or outside of government, whose efforts the Bank can support with analysis, advice, or operations? Where government commitment to reform is uncertain, functioning accountability institutions or influential supporters provide a counterbalance and increase the likelihood that reforms will be started and sustained. These institutions can help improve long-term prospects for development, often play a role in strengthening oversight of Bank-financed operations, and, when active, often justify broader engagement and greater financing.
- Does financial engagement pose a reputational risk to the Bank, and how can that risk be managed or minimized? Are other donors active in the country, and do their activities focus on governance and anticorruption issues? The reputational risk of operating in a country is usually correlated with overall levels of corruption: it is highest in countries where governance is weakest, grand corruption is substantial, and the Bank's financing program is large or high-profile, or Bank assistance is seen to be out in front of other donors and international institutions. Risk mitigation necessarily involves situation-by-situation decisions, sometimes as part of preparation of a CAS or ISN but more often as part of ongoing Management and Board oversight of country programs.
- What is the risk that the governance environment will deteriorate during the CAS period? If there is a substantial risk that it will, then the CAS should include a low-case scenario that involves highly restricted financing or, very unusually, a break in financing support and a shift to nonlending activities with triggers identifying the conditions under which the Bank would move between scenarios. When there is

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<sup>8</sup> An ISN is used whenever a country is not ready for a full CAS, which might be because of a high degree of uncertainty; the lack of a medium-term development/poverty reduction program to frame the Bank's support; or insufficient country knowledge. The choice of an ISN rather than a CAS is not driven by country performance concerns.

substantial uncertainty about how deterioration will affect the government's program, the team may prepare an ISN that takes this uncertainty into account.

- How severe is the risk of fraud and corruption in Bank-financed projects? Significant differences in risk across sectors, institutions, or categories of operations need to be considered in designing the Bank's program and supervising the Bank's portfolio. If the risk to projects is high, and if the Bank's portfolio in the country is substantial, special safeguarding of new operations is warranted, along with careful oversight of ongoing operations (through, for example, mandatory anticorruption action plans for all projects in a sector or in a country, and regular portfolio risk reviews).

## ***2. Designing and Implementing Bank Strategies***

18. All Bank strategies link levels of financial assistance and modes of engagement to progress on key obstacles to development effectiveness, which frequently include weak governance and corruption. For IDA-eligible countries, good governance is rewarded through the performance-based allocation system (PBA), which is based on (a) the Bank's Country Policy and Institutional Assessment (CPIA), where heavy weight is given to governance, and (b) portfolio performance. Based on the financial envelope set by the PBA for IDA-eligible countries or derived from the Bank's creditworthiness analysis for IBRD-eligible borrowers, the Bank develops its country-specific lending program. If the Bank determines governance and anticorruption to be fundamental to a country's further development and the government involved to have little interest in reform, or if there is a high probability of deterioration in the governance environment, the strategy may develop a low-case scenario (see Annex B for additional details).

19. ***Role of the Board in Country Strategies.*** Given the central importance of country strategy documents to strengthening work on governance and anticorruption, the Board's active role in the development of the Bank's assistance and partnership strategies for its member countries places it in the center of implementation of this approach. Board review of CASs, ISNs, and CAS Progress Reports ensures that the Bank Group's strategies are consistent across countries and broadly supported within the international community. If changes in country circumstances warrant a shift in the Bank Group's approach, an appropriate document will be presented to the Board for discussion. In addition, for all CASs that present alternative lending scenarios, the CAS and the midterm CAS Progress Report will continue to state clearly which scenario is assumed to govern the CAS period as well as what conditions would trigger alternative scenarios. The recently introduced arrangement of discussing new country developments at Steering Committee meetings will be continued, and Management views on appropriate financing levels and/or restricting financing will be presented to the Board in a timely manner in order to fully engage the Executive Directors. In addition, by frequently interacting with Management, including through its approval of each Bank-funded operation, the Board will provide continuing guidance and feedback on refinement of this strategy and the status of implementation. The Board will also continue to be involved in reviewing individual projects, including any that are delayed because of corruption concerns.

20. ***Use of Development Policy Operations.*** Bank strategies propose whether development policy operations (DPOs) will be part of the financing program for countries, and this choice

will be affected by the country's governance situation.<sup>9</sup> All DPOs are underpinned by an up-front assessment of the country's overall fiduciary environment and of the country's reform measures to improve public financial management, which over time mitigate fiduciary risks for all budget resources.<sup>10</sup> Fiduciary improvement measures are typically included in the operation, and in exceptional cases, the Bank's policy allows for additional fiduciary arrangements—for example, the use of dedicated accounts for foreign or local currency equivalents of loan proceeds. Although DPOs are predominantly used in stronger governance settings, experience shows that they offer a unique opportunity to support countries emerging from conflict or crisis, including for reestablishing core public governance functions, as in Afghanistan or Timor-Leste, as long as government commitment and ownership are strong.<sup>11</sup>

21. **Joint Nature of the Bank Group Strategy.** A key challenge for the Bank Group is to find ways for its constituent parts to work more effectively together at the country level. Staff need to make every effort to mobilize the full range of Bank Group instruments (including those of IFC and MIGA, as appropriate) to engage as broadly as possible. Multinational corporations often see IFC and MIGA as partners in pursuing a socially responsible investment policy in difficult countries. Engagement with the private sector, even when the Bank is having difficulty structuring lending operations, is potentially an important avenue for change in high-risk settings. Moreover, harmonization with other international financial institutions, particularly the IMF,<sup>12</sup> and with the donor community will be crucial to supporting country strategies, especially for exceptional-risk countries. Joint or collaborative CASs—(such as those recently developed for Bangladesh, Nigeria, and Uganda) could be one effective tool to coordinate across the donor community.

22. **Course Corrections.** During implementation, country teams will need to remain ready to adjust the Bank's strategy to new information, including information from the Bank's Department of Institutional Integrity (INT) about confirmed instances of corruption in Bank-financed projects. New information related to risks from governance weaknesses and corruption may imply distinctly higher overall risks to the country program. The appropriate response may

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<sup>9</sup> Operational Policy (OP)\_8.60, para. 3, explains that the “decision to extend development policy lending is based on the assessment of the country's policy and institutional framework ... The Bank considers the strength of the program and the country's commitment to and ownership of the program against its track record.”

<sup>10</sup> The framework for assessing appropriateness of development policy lending is OP 8.60, para. 3. For fragile states, detailed recommendations are made in *Good Practice Note for Development Policy Lending: Development Policy Operations and Program Conditionality in Fragile States* (SecM2005-0353), June 2005.

<sup>11</sup> The strength of governance is measured by the CPIA's public sector management cluster rating. During FY98-06, 11 percent of Bankwide policy-based lending commitments have been made to countries in the bottom 25 percent of the public sector management CPIA cluster rating, and 20 percent to the bottom half. More narrowly, policy-based lending has also been skewed away from more corrupt countries (as measured by the CPIA question on transparency, accountability, and corruption in the public sector [question 16, formerly question 20]). Bankwide the bottom 33 percent of the CPIA transparency, accountability, and corruption rating received about 20 percent of policy-based lending commitments during FY98-06. See *Development Policy Lending Retrospective* (SecM2006-0319), July 13, 2006.

<sup>12</sup> The key document regarding Bank and IMF staff collaboration at the country level is the *2002 Bank/Fund Collaboration Guidelines* that contain two main elements: (a) early engagement between the staff of the two institutions in program design and country assistance strategies, and (b) transparent and systematic reporting of each institution's views in Board documents. See *Operationalizing Bank/Fund Collaboration in Country Programs and Conditionality: Staff Guidance Note in Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality—Progress Report* (SM/02/271), August 20, 2002.

be to switch scenarios within the existing CAS, propose a revision in the midterm CAS Progress Report, or move to an ISN. It may sometimes be necessary to curtail operations and agree on risk mitigation measures. Likewise, country teams should stand ready to adjust the Bank's strategy (whether a CAS or an ISN) in the event of demonstrated improvements in governance and anticorruption; and the status of the highest-risk countries should be reviewed at least annually. Especially in more volatile country settings, the Bank will be prepared to engage in mid-course corrections responding to changed circumstances, adjusting its program in response to improvements or deterioration during implementation. In particular, the Bank Group will be prepared to scale up its assistance in high-opportunity countries: where, for example, new country leadership is undertaking major governance and anticorruption reforms, the Bank will match such resolve by rapidly scaling up technical and financial assistance and also providing public recognition of this positive development.

## **B. Supporting Country Efforts to Strengthen Governance and Reduce Corruption**

23. Within the principal aim of governance reform—to build capable, transparent and accountable states in support of development—a critical aspect is to align the incentives of state officials with these goals, through an appropriate combination of rules, restraints, and rewards; competitive pressures; and voice and partnership. The incentives of non-state actors also need to be aligned with these goals, especially those of businesses and other nongovernmental entities that often play a pivotal role in governance.

24. ***Broad Interventions.*** Narrow donor interventions (for example, to improve processing or management efficiency in a particular public sector institution) are unlikely to bear fruit where the governance and corruption challenge in a country is highly systemic in nature. Hence, there is often need for a more in-depth and comprehensive diagnostic and reform strategy to improve country governance, aiming to (a) strengthen the capacity, transparency, and accountability of state institutions, including in key sectors and at the local level; (b) raise the demand for better governance by strengthening participation and oversight by civil society and the media; (c) foster a competitive and responsible private sector, including supporting further private sector participation across all the key sectors of the economy; and (d) strengthen political accountability (while acknowledging that this last objective falls outside the Bank's mandate but that work can proceed through the efforts of partner institutions). The design and sequencing of these reforms would need to be tailored to the country's capacity and context. Further, while governments will remain the Bank's main counterparts, the strategy envisages supporting a broad range of domestic institutions and actors—both inside and outside of government—who are demanding and working toward governance reform. Since governance challenges are far from uniform across countries, the resulting strategies must, of course, be differentiated and strongly based on local knowledge, innovation on the ground, and extensive collaboration with local constituencies. The following paragraphs summarize a range of the Bank's interventions. (Annex C details emerging good practice for each entry point).

25. ***Capable and Accountable States.*** The Bank is committed to helping states function effectively, so that the government can deliver public goods, courts can dispense justice, and the legislature can provide leadership and oversight. Capable and accountable states also constitute the strongest defense against corruption. To assist governments, the Bank will (a) continue deepening its work to improve public financial management and strengthen civil service

performance—learning from its successes and failures to better address the complexity of these challenging reforms; (b) significantly scale up work on improving governance and combating corruption in the sectors—for example, in infrastructure, health, extractive industries, and the financial sector; (c) increase attention to working with local governments, as decentralization in many countries has shifted governance and corruption challenges to the local level; and (d) place a special emphasis on capacity building in countries with strong political commitment to governance improvement, but with severe shortfalls in skills and organizational capabilities. Outside the executive branch, the Bank will (a) scale up support for judicial reform; and (b) in partnership with other donors, more systematically help legislatures, supreme audit institutions, and other formal oversight institutions develop the capacity to oversee public expenditures.

26. **Transparency.** A key cross-cutting priority is to help states become more transparent by facilitating greater participation and oversight by civic organizations and the media. Citizens and media that have broad access to information on the operation of state institutions are crucial for holding the state to account. Such access may include publication of budget and procurement data, access to state records and reports, and the state’s active dissemination of information on its operations and performance including through e-government. Moreover, greater transparency can help to establish the credibility of decision-makers through the public disclosure of their income and assets.

27. **Participation and Oversight by Civil Society, Media, and Communities.** A free media, vibrant civil society, engaged local communities, and an independent citizenry are crucial components for good governance: they have a unique place with respect to holding governments accountable for delivering better services, creating jobs, and improving living standards. While government transparency can help to facilitate participation and oversight, more proactive engagement of society is also vital: (a) creating concrete opportunities for participation and oversight, for example, through participatory development of policies and public spending priorities (the poverty reduction strategy process has provided a major impetus in this area in IDA-eligible countries), social accountability in the delivery of services, community-driven development, civil society and media oversight over public procurement, monitoring of income and asset declarations, and other arrangements that empower legitimate social groups; (b) helping civil society organizations to build sufficient capacity effectively to take advantage of these opportunities; and (c) enabling the development of independent and competitive media that can investigate and report on government performance, including corruption. Over the past decade the Bank has engaged increasingly with civil society groups, and Bank capacity and sophistication in this work have expanded dramatically. Experience has underlined the importance of working with groups that are competent and accountable, consistent with the Bank’s legal mandate, and of ensuring that the governments involved are informed about these interactions. Drawing on and informed by this experience, the Bank will systematically scale up governance work in these areas in a manner consistent with its own legal framework, in consultation with governments, and in close collaboration with other development partners, depending on which initiatives offer the best prospects at the country level.

28. **Competitive and Responsible Private Sector.** A thriving, open, and competitive private sector can be a strong source of demand for better governance. At the same time, some private businesses, including some from developed countries, themselves engage in corrupt practices. Facilitating the growth of a competitive, responsible private sector requires multifaceted

engagement at the country level: (a) IBRD, IDA, IFC, and MIGA helping governments improve the investment climate, eliminate red tape and nontransparent regulations, reduce monopolistic practices, transparently and competitively privatize state-owned businesses and banks, and facilitate the entry of small and medium-sized enterprises to help level the playing field, reduce incentives and opportunities for corruption, and stimulate better corporate citizenship; (b) IFC and MIGA working directly with the private sector to strengthen ethical corporate practices, encouraging businesses to join public-private coalitions for reform, such as the Extractive Industries Transparency Initiative and Publish What You Pay, and more broadly advocating that integrity is “good for business;” and (c) the Bank Group using public sanctions to raise the cost to businesses of continuing to engage in corruption. The World Bank Group will continue to monitor the investment climate through its Doing Business reports, and also, in collaboration with outside partners, continue to carry out enterprise surveys providing publicly available indicators that monitor corporate practices by domestic and multinational firms at the country level, including measures of bribery and undue influence by firms.

29. ***Governance in the Financial Sector.*** Developing sound and transparent financial systems that allocate resources well and are a source of discipline on public and private agents is a powerful way to promote good governance and reduce corruption. The World Bank Group will pay increasing attention to the challenges of governance in the financial sector, among other things focusing on continuing support for financial sector reforms; financial systems that reach out to the underserved (and not only to a few insiders); development of transparent financial markets, tools for assessing and improving Bank governance and transparency practices, including financial reporting and disclosure; and the transparent sale of state banks and bankrupt private banks. The Bank Group will also continue to strengthen its efforts on anti-money laundering and take initiatives to build capacity to facilitate asset restitution.

30. ***Supporting Champions and Leaders of Reform.*** While member country governments are the main counterparts and partners of the World Bank Group, the success or failure of a reform program, regardless of its content, depends critically on whether it is led by committed champions or advocates in the country who have the authority to advance the reform agenda as well as the local knowledge to find a way through the inevitable obstacles. Often these champions are in government; this is why “country ownership” is key to the reform process. Even in challenging environments, the Bank Group should, within its legal framework, seek out and support leaders and institutions that are committed to improving governance. Incentives matter, and can usefully go beyond the standard menu of improving pay and strengthening arrangements for accountability to include public recognition of leaders and countries undertaking bold reforms and performing well on governance and anticorruption.

31. ***Tailoring Reforms to Country Realities.*** The scope, sequencing, and speed of governance reforms must be tailored to the country context. Although country evidence indicates that, with leadership and resolve, substantial progress is feasible in the short term, attaining high overall standards of governance is a long-term endeavor, requiring sustained reform efforts, in which the focus is most usefully on performance trends. The trajectory of change will vary from one country to another, depending on both the initial political impetus and the longer-term historical processes that can shape and constrain political and institutional reform. Thus, the Bank needs to work closely with countries and donors to develop workable approaches to governance reform, based on diagnostic analysis with a clear developmental focus.

The *Global Monitoring Report 2006*, as well as other recent research and publications on governance by the World Bank and others offers some guidance on these complex challenges (see selected bibliography in Annex F).

### III. ADDRESSING CORRUPTION IN BANK GROUP OPERATIONS

32. Reducing corruption in Bank-supported projects is essential not only to the Bank's mission to reduce poverty, but also to its credibility in advising and supporting countries' governance and anticorruption efforts. The Bank's fiduciary obligations and its concern for aid effectiveness require a strong anticorruption focus. Bank shareholders, partners, and other stakeholders expect the Bank to do all it can to ensure that its resources, including Bank-administered trust fund grants from other donors, are used for the purposes intended, and thus they expect the highest standards of integrity and accountability. As the accumulating findings from INT's investigations of corruption in projects have made clear, despite substantially strengthened fiduciary arrangements, the Bank needs to do more to ensure the proper use of its funds.

33. *Stand-alone Projects versus Country Systems.* The Bank Group can rely on self-standing "ring-fenced" projects as a straightforward way of addressing fiduciary risks, but the developmental advantages of using country systems—where circumstances are appropriate—are large. The use of country systems can reduce costs for the government and the Bank, enhance capacity, increase country ownership and project sustainability, and facilitate harmonization. In some cases, ring-fenced systems that operate outside of the country's regular rules can weaken the overall project control environment and encourage patronage and corruption. More broadly, while ring-fencing isolates aid projects from other government programs, a country systems approach aims to strengthen the country's own governance system, magnifying the impact of aid (see Annex D). The Bank is increasingly emphasizing capacity development of country systems, which can have a major multiplier effect by leading to broad improvements in the quality of those systems. In recent years, the Bank has begun using country systems in specific fiduciary areas—financial management and national competitive bidding for procurement—where it has appraised those systems and found them to meet mutually agreed and verifiable standards.

#### A. Anticorruption Measures at the Project Level

34. Prevention of corruption, which remains the best protection against fiduciary risk, requires the integration of anticorruption approaches into the early stages of project design. At the identification stage, staff assess the project's susceptibility to corruption by considering country and sector environments as well as the nature of project activities. Projects must be appropriately designed with a focus on enhanced oversight mechanisms, disclosure of project information, timely handling of complaints, and strengthened supervision. Projects should seek to increase the accountability of implementing agencies and service providers through instruments that give voice to beneficiaries (such as beneficiary surveys and citizen scorecards). To allow for subsequent supervision, recordkeeping and documentation by project entities must be improved. In addition, supervision must be cognizant of "red flags" identified by INT work, indicating possible corrupt behavior at various stages of project implementation. (See Annex D for further details).

35. **Communications Strategy.** Because of the importance of an effective dialogue on issues of fraud and corruption (among other matters), it is important to develop an effective communications strategy that covers all phases of the project. The communications plan must provide for consistent messages to be conveyed to all relevant stakeholders: government officials in the implementing agency; contractors, suppliers, and consultants who may be involved in bidding on the project; members of civil society affected by the project; and (as appropriate) the local press. The role of the media may be especially important if the plan includes the use of publicity—both positive and negative stories—as a tool for reducing the level of fraud and corruption in Bank projects. The objective would be to highlight both noteworthy achievements in quality, cost-effectiveness, and sustainability, as well as any incidents of alleged collusion, fraud, or corruption. Further, feedback from each of the groups noted above will enhance the positive impact of these communications.

## **B. Risk Mitigation and Special Tools**

36. Responsibility for risky projects lies squarely with the Regional vice presidents, and so they are best suited to addressing and mitigating risk. Given that the risks of corruption are not the same for all Bank-funded projects, a risk management approach featuring upstream mitigation will focus resources where they are most needed. Projects will be rated early in preparation to identify the subset that are most at risk and provide an efficient way to mitigate corruption and other risks. Review processes will be strengthened, with the review of riskier projects elevated appropriately to more senior levels. It will be particularly important that staff receive clear guidance on due diligence and risk tolerance.

37. **Portfolio Reviews.** The Bank will conduct regular risk reviews of the project pipeline and lending portfolio to identify where attention should be focused, especially during supervision. Projects deemed to be of highest risk will receive enhanced managerial oversight. Clusters of projects that share common features and risks—for example, projects incorporating block grants, cash transfers, compensation payments, or subnational components—will also receive further in-depth review. Finally, projects deemed risky need to receive a consistently higher supervision budget.

38. **INT Investigations.** Prompt investigation by INT into projects in which there are allegations of wrongdoing, together with clear accountability of project teams, form the centerpiece of the Bank's deterrence effort. INT's role is fundamental in reassuring shareholders and others that the Bank's fiduciary obligations are being met and development effectiveness preserved. These investigations, Detailed Implementation Reviews, and findings from the Voluntary Disclosure Program provide lessons for operational staff on where projects are failing and how to address those failures. In order to ensure that the effectiveness of INT work is maximized, Management has agreed to an independent review of INT work to be completed in 2007.

39. **Special Tools for High-Risk Environments.** For countries, sectors, or projects facing especially high risks from corruption and weak governance, some special tools already in use by

some country teams may prove useful. It is expected that they will be widely recommended in governance-oriented CASs.<sup>13</sup>

- ***Anticorruption action plans.*** For high-risk projects, staff will be expected to prepare anticorruption action plans that synthesize the main corruption prevention aspects built into project design. In addition to normal fiduciary controls, these detailed project-specific plans typically cover such areas as transparency of information and processes, participation of project beneficiaries or civil society organizations, receiving and resolving complaints, investigating allegations of wrongdoing, and sanctioning those found guilty. The plans will be jointly developed with the government, included in project documentation, and publicly disclosed. Supervision of these projects will be expected to focus, among other things, on implementation of the action plan. In some cases, these action plans may be at the agency, subsector, or sector level, depending on where they can be the most effective.
- ***Anticorruption teams.*** To oversee the design of projects in risky settings and, in particular, those with anticorruption action plans, and to help manage the portfolio, an anticorruption team may be established at the country level. Especially in high-risk countries, such teams will typically include governance advisers, operations managers, key sector coordinators or project team leaders, and fiduciary staff (procurement, financial management, and legal specialists). Anticorruption teams can review a project's design, risk rating, and anticorruption action plan. They can also serve as a focal point for dialogue on anticorruption issues, both in individual projects and in the country program more broadly, with key local counterparts. A team might also liaise directly with INT during corruption investigations.<sup>14</sup>
- ***Field-based governance advisers.*** These specialists could be used to provide integrated advice on governance in support of the broader country program, leading discussions with the government, local stakeholders, and the donor community; and also to serve as focal points for the country team on governance issues, allowing greater knowledge-sharing across task teams and early warning on high-risk projects.

40. ***IFC and MIGA.*** IFC and MIGA are working actively with clients to ensure strict standards of corporate integrity. IFC actively addresses the need for strong corporate governance as part of its investment decisions, and uses specialized assessment tools, tailored to the type of company, as part of its risk analysis and investment appraisal. IFC is working on an operational strategy for further mitigating corruption risk, focusing on selection of investments, contract

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<sup>13</sup> Experience in fragile states is relevant. Tools that have been useful in countries facing war-to-peace transitions (for example, Afghanistan, Timor-Leste, Sudan, and Liberia) or newly reengaging with the international community (for example, Haiti and the Central African Republic) may well serve in other challenging environments. These tools include early diagnostics and dialogue, a focus on simple, sequenced reforms at the national level and community-based accountability mechanisms at the local level; and, in some cases, use of special transitional arrangements drawing on private sector and civil society capacity for selected executive and oversight functions.

<sup>14</sup> These teams could serve a range of functions; for example, in the South Asia Region they serve as advisers to country and task teams on corruption issues, as a forum for sharing experiences across sectors, and as a vehicle for considering strategies to improve governance.

design and remedies, and supervision and exercise of remedies. Priority actions include preparing additional guidance for staff on due diligence procedures and investments in companies owned by politically exposed persons, as has already been done for anti-money laundering and combating financing of terrorism risk. MIGA has adopted a new and more systematic process for identifying possible integrity issues in projects over the last year; it has designated an Integrity Adviser and arranged access to commercial databases to facilitate due diligence; and it has been making efforts to strengthen the pre-transaction due-diligence process, to assess the level of the client company's commitment to integrity and the quality of its preventive controls to address the risk of corruption in projects.

#### IV. GLOBAL PARTNERSHIPS ON GOVERNANCE AND ANTICORRUPTION

41. Improving governance and reducing corruption requires stronger collective action and partnerships—with donor partners, with the private sector and civil society, and with developed countries. To this end, the World Bank Group will play a strong, proactive role with international donors and other actors on the governance and anticorruption agenda, sharing its own experience in these areas and eliciting input and guidance from partners to inform the Bank's approach. (See Annex E for further details).

42. *Donors and Multilateral Development Banks.* There are serious challenges of coordination among bilateral donors, multilateral development banks (MDBs), and other international financial institutions. If there are divergences in approaches and standards, recipient countries may be inclined to turn to donors that are less stringent on governance and anticorruption issues.<sup>15</sup> Thus, the strategy for enhanced global engagement envisages stronger consultation and coordination among donors to promote a consistent approach to governance and anticorruption. For example, the Bank will continue its coordination with the IMF on a range of areas related to governance and transparency<sup>16</sup>—such as public financial management, tax and customs reform, the poverty reduction strategy process, debt relief, work to assess countries' compliance with the Financial Action Task Force recommendations to combat money laundering and the financing of terrorism, and the Report on Observance of Standards and Codes (ROSC) initiative.<sup>17</sup> The strategy also aims to ensure that, recognizing the limitations of the Bank's legal framework, others can take the lead in areas that are outside the Bank's mandate or expertise (for example, political governance and some aspects of civil society demand for governance), and that development partners can share information and harmonize strategies in countries with weak governance, including through joint assessments, as well as coordinate investigative procedures and sanctions decisions at the level of the institutions (as recommended by the Joint International Financial Institutions Anticorruption Task Force, see Annex E). The Bank is working with bilateral and multilateral donor partners through initiatives such as the Governance Network of

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<sup>15</sup> This paper benefited throughout from comments from partners, especially the IMF and the other MDBs.

<sup>16</sup> Bank-IMF collaboration has been guided since 1989 by a formal Concordat and subsequent guidelines. See *Bank-Fund Collaboration in Assisting Member Countries*, SM/89/54, Rev.1, March 31, 1989.

<sup>17</sup> The IMF launched three international codes of good practice—for fiscal transparency, data dissemination, and monetary and financial policies. Currently, the IMF and the Bank collaborate in assessing the observance of standards and codes in 12 areas critical to the functioning of a market economy, including those relating to transparency, corporate governance, financial sector, market integrity, and anti-money laundering. The results are summarized in Reports on the Observance of Standards and Codes (ROSCs), which are typically published with the consent of the member.

the Organisation for Economic Co-operation and Development's Development Assistance Committee (OECD-DAC) on anticorruption, including joint assessments, coordinated strategies on anticorruption, and support for global initiatives.

43. ***Private Sector, Civil Society, and the Media.*** A principal focus in the next stage will be for the Bank Group to take more proactive steps to engage the private sector, the media, and civil society organizations. While individual firms may benefit from weak governance, the private sector as a whole loses when corruption is pervasive and the rule of law is undermined. The World Bank Group, and particularly IFC and MIGA, will engage with the private sector as a crucial ally for good governance and will promote the idea that avoiding corruption is good for business, consistent with mounting pressure in recent years from investors and regulators for multinational corporations to commit to corporate social responsibility. In addition, the cost of engaging in corruption related to Bank-financed projects has been raised by INT's public sanctions as enhanced by ongoing sanctions reform by the MDBs, and especially by the newly launched Voluntary Disclosure Policy, which is expected to elicit extensive and high-quality evidence on corruption in Bank projects. The World Bank Group will also strengthen partnerships with civil society organizations and the media at the country and global levels as a powerful force for holding governments accountable. This will include stronger partnerships with global civil society organizations such as Transparency International (particularly their country-based chapters) and Global Witness and also with national and local civil society organizations and media on country-level governance initiatives such as monitoring of public procurements or asset declarations of public officials (see Box 4).

#### **Box 4. Views from Consultations**

As part of an ongoing process of consultation on this paper, the Bank solicited feedback through a series of videoconferences and face-to-face discussions, as well as by posting the outline of this paper on the Bank's external website, during a three-week period from mid-July to early August 2006. Subsequently, a draft version of the paper was posted externally for comment during August 18 - 28, 2006. Participants included several hundred stakeholders representing civil society organizations, the private sector, academia, parliaments, and other interested parties from 18 countries in Africa, Asia, the Middle East, Europe, Latin America, and North America.

The majority of contributors welcomed the new strengthened approach, and there was much support for its main initiatives such as further engagement with the private sector. Among the major themes that emerged from this initial consultation period were the following: (a) the Bank should emphasize the importance of transparency, participation, and accountability even more strongly and lead by example; (b) the Bank should endeavor to be more proactive and explicit in its support for fostering stronger institutions of accountability in borrowing countries, particularly by enabling civil society and a free press; (c) the Bank should go even further in the scope of its activities, but while building on the work of others, especially in civil society, and without imposing new conditionality on low-income countries; and (d) the Bank should spell out a stronger and more explicit role in the recovery of funds looted from developing countries. Some contributors from North America and Europe suggested that a wider and more structured consultation process was needed on the overall strategy and its implementation.

44. ***Supporting Global Coalitions for Reform.*** The Bank Group will continue to support initiatives at the global level to promote coalitions among government representatives, civil society, the media, and the private sector for governance reform. The Extractive Industries Transparency Initiative (discussed in Annex E) represents an example of such an effort at the sector level in countries. Through working with such innovative partnerships as the Global Organization of Parliamentarians against Corruption, the Global Integrity Alliance, and associations of young leaders, the Bank Group can identify ways to recognize and support

leaders in developing countries who take a tough stand on corruption, often at high risk to themselves, and can help combat entrenched networks of corruption and promote good governance and integrity.

45. ***International Conventions.*** Corruption is a global problem that requires collective action from developing and developed countries alike. Developed countries have an enormous responsibility to tackle transnational corruption generated by multinational corporations. The World Bank Group will use its global influence to advocate for tougher monitoring and enforcement of the OECD Anti-Bribery Convention,<sup>18</sup> and will support implementation of the UN Convention against Corruption, including helping countries recover stolen assets (see Box 5).

**Box 5. Collective Action against Corruption: The United Nations Convention**

Recognizing the importance of a collective response to corruption, the OECD, the Council of Europe, the African Union, and the Organization of American States have crafted treaties binding members to work collectively to combat corruption. The most comprehensive treaty, in terms both of geographic reach and degree of cooperation required, is the United Nations Convention against Corruption.

Those ratifying the convention must establish a merit system for civil servants, ensure sufficient penalties to deter the commission of corruption-related crimes, increase the transparency of their policymaking process, and assist others to obtain evidence of corruption and return persons wanted for corruption. Special emphasis is put on asset recovery. Nations pledge to honor orders to freeze and seize the proceeds of corrupt activities issued by other parties and to amend bank secrecy laws to ensure that these statutes do not impede asset repatriation.

The World Bank assisted in drafting the convention and is helping to write the technical guide to implementation. It is training its own staff on the convention's provisions, and has provided advice and guidance to Bank clients on ratification. Moreover, it is establishing a trust fund to support the December 2006 meeting of state parties in Amman, Jordan. Unlike other anticorruption conventions, for which the monitoring process is spelled out in the treaty itself, the parties attending this meeting are to decide upon the process for monitoring implementation.

*Note:* The Convention, along with a list of countries that have signed or ratified it, is available at [http://www.unodc.org/pdf/crime/convention\\_corruption/signing/Convention-e.pdf](http://www.unodc.org/pdf/crime/convention_corruption/signing/Convention-e.pdf)

46. ***Restitution of Assets.*** The ability of developing countries to pursue assets stolen by corrupt officials and moved to offshore financial institutions is hindered by a lack of adequate instruments to trace these funds and by legal procedures that make it difficult, costly, and time-consuming to recover such assets once they have been identified. Making it easier for developing countries to recover stolen assets would reduce the incentives for such theft and strengthen the champions of good governance in developing countries. The UN Convention against Corruption has a strong framework for asset recovery that recognizes the return of assets as a “fundamental principle” and urges states to “afford one another the widest measure of cooperation and assistance” (Art. 52). Although the Bank may not have the strongest comparative advantage in this area, it has an important advocacy role to play in this regard and it should use its convening power to place this issue higher on the international agenda. Its anti-money laundering program provides some important support to such efforts, by advising on

<sup>18</sup> The formal name of this convention is the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

capacity to freeze and confiscate corruption proceeds. As the recent experience with asset recovery in Nigeria shows, the Bank can also provide important assurance that the restituted assets will be put to good use in the developing country from which funds were taken.

## V. NEXT STEPS

47. Implementing the strengthened approach to governance and anticorruption set out in this paper will require clear accountabilities and responsibilities, careful development of a realistic but detailed results framework, consideration of budget and staffing implications, the production of guidance to staff on a range of operational areas and topics, and further consultations with stakeholders. Management will be responsible for implementation of the strategy, while the Board will provide overall guidance, through discussion of each country strategy, approval of each operation, and frequent interaction with Management on refinement of the strategy and its implementation, as a way to ensure broad support within the international community. For this accountability to be meaningful, a results framework setting out goals for the Bank's strategy will be necessary, with monitorable indicators including time-bound targets. While it is anticipated that the initial budgetary costs of implementing this strategy can be effectively addressed from reallocations and existing contingencies, sustaining this program over time may imply additional costs. Staffing and skills requirements will need to be carefully developed and addressed, especially on the front line of Bank operations. Perhaps most importantly for the success of implementation, appropriate incentives must be provided for managers and staff to engage proactively on governance and corruption issues with countries, especially in challenging environments. Given the complexity of the effort, the Bank Group will need to proceed with a clear sense of realism as to what can be achieved, and an expectation that midcourse corrections will be necessary.

48. ***Operational Guidance to Staff.*** While some elements of this strategy can become operational immediately, others will require revision of staff operational guidance or the development of new guidance. In particular, staff guidelines on CAS products will need to be revised and expanded to include detailed advice on how to review the nature of risks posed by weak governance and corruption to the country's development and to Bank-funded operations; and to record emerging lessons of good practice on how Bank strategies can effectively address these risks while enhancing development impact. Guidance will also need to be strengthened on identifying high-risk operations as well as on designing and supervising investment projects to be more resistant to corruption (including through enhanced fiduciary approaches). It will be particularly important that staff receive clear guidance on due diligence and risk tolerance. Another important element will be the revision and updating of the Bank's disclosure policy to boost the Bank's own transparency as well as to improve performance of Bank-funded operations.

49. ***Monitoring for Results.*** Monitoring is key to accountability—so it is vital in making a sustained move from principles to action in the Bank Group's work on governance and anticorruption. It will be equally important to ensure that the countries involved in the process can benefit from this monitoring, in particular by ensuring that capacity-building is supported. A governance monitoring framework should provide actionable guidance, directly relevant to the design and implementation of Bank operations. This framework, which would provide information that complements but does not substitute for the PBA system for IDA-eligible countries, could have two parts:

- Characterizing a country's broad patterns of governance along the lines laid out in the *2006 Global Monitoring Report*, which suggested how a variety of existing aggregate governance indicators could be used to broadly characterize a country's strengths and weaknesses across a variety of dimensions of governance.
- Giving greater emphasis to developing and using specific actionable governance indicators (for example, Public Expenditure and Financial Accountability (PEFA) public financial management performance indicators, Doing Business, Investment Climate Surveys, and the Governance and Anticorruption Diagnostic Surveys), as well as performance results indicators to monitor trends in the specific parts of the governance system targeted for improvement during the CAS period.

While improved monitoring across all countries is expected, the Bank will also give greater attention to some countries where the program is innovative and changing substantially as a result of this strategy. The front-line responsibility for monitoring will be with country teams. Central units will have a key role in providing knowledge support, and in monitoring change in Bank practice to assure that the CAS-based approach is being implemented effectively.

50. ***Consultations and Reporting.*** Consultations with MDBs and the IMF, and with stakeholders from civil society, the private sector, academia, and government were carried out during the preparation of the paper, although these have not been as extensive as desirable, given the short timeframe since the Development Committee request. This initial feedback has been incorporated into the paper. Given the emphasis of this strategy on expanding engagement and partnerships with civil society organizations, the private sector, and other donors, additional consultation is essential. The outline for this paper, an interim version, and the final Development Committee paper (as for all Development Committee papers) have been or will be publicly disclosed. Once the Development Committee has provided guidance, Management proposes to carry out follow-up consultations with a wide range of stakeholders, including partners at the country, regional, and global levels, on the strategic directions and the implementation of this approach. The results of these subsequent consultations would be communicated to the Board and publicly disclosed.

51. ***Going Forward.*** Implementation of this new strategy will be challenging and will require ongoing close collaboration with and guidance from the Board. Given the complexity of the effort, the Bank Group will need to proceed with pragmatism. Identifying and sharing lessons from field innovations will be key to making the strategy operational, focusing on how to achieve impact even in difficult environments. An aim is for the Bank to attain significant engagement with countries on the ground, with Bank staff in country offices—both national and international—sharing best practices with governments and also expanding constituencies who have the experience to assist with innovative solutions to governance challenges. As the Bank moves forward, feedback during implementation and continuous adjustments to the strategy will be fundamental to success. In addition, the Bank will need to cultivate and strengthen its partnerships with other donors, but also with local institutions such as universities, research groups, and civil society organizations, to amplify the Bank's technical know-how and to develop common approaches. Both the strategy itself and the ongoing consultations will be guided by the recognition that country differences and the need to learn from experience demand

incentives for innovation and experimentation, as well as rigorous monitoring and evaluation of results—all in the spirit of openness to learning what works, what does not, and why.

## **VI. KEEPING THE MOMENTUM—ISSUES FOR THE DEVELOPMENT COMMITTEE**

52. Throughout this report, the theme has been one of strengthening the Bank’s engagement with countries on governance and anticorruption. This implies engaging more with high-opportunity countries that possess low capacity yet high commitment to address these challenges effectively by undertaking significant reforms. Do Ministers agree with this approach of engagement, particularly in high-opportunity, high-commitment settings?

53. The paper suggests a CAS-based approach for promoting more systematic and consistent treatment of governance and corruption issues across all countries. In very difficult governance settings, where a sharp deterioration in the policy environment is seen as possible, CASs may include low-case scenarios with highly restricted or no financing. Do Ministers agree that the Bank should remain engaged and that in exceptional circumstances financing may be restricted or suspended on the basis of governance concerns?

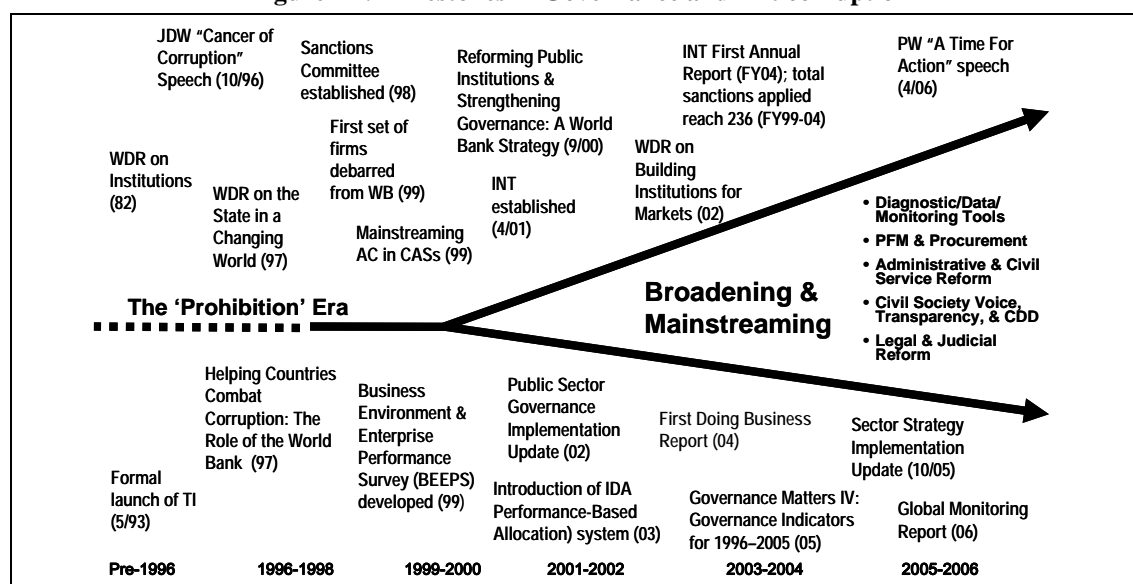
54. While the starting point for the Bank’s strategy is national governments, the paper also highlights the importance of broad-based partnerships within the Bank’s mandate—both within countries and globally, including partnerships with other multilateral institutions, bilateral development agencies, civil society, parliaments, and the financial and private sectors—based on greater coordination, collaboration, and selectivity. Do Ministers agree with the suggested scaled-up approach to partnerships at every level of the strategy?

55. The paper proposes a range of specific initiatives to strengthen the Bank’s work in governance at the project level: anticorruption teams, improved project design to further governance and anticorruption objectives and enhance results to the beneficiaries, and intensified supervision, monitoring, and diagnostics. Do Ministers agree that the proposed package of initiatives to prevent corruption in Bank operations is appropriate?

## LESSONS FROM A DECADE OF SUPPORTING COUNTRY PROGRAMS ON GOVERNANCE AND ANTICORRUPTION

1. For much of the history of the World Bank Group, corruption was considered nearly a taboo subject—something that many were aware of but did not speak of or address. President Wolfensohn changed that attitude in 1996, when he publicly committed the institution to fighting the “cancer of corruption.” In September 1997, the Board endorsed the World Bank’s first anticorruption strategy,<sup>1</sup> and in parallel, the 1997 World Development Report (WDR) deepened global understanding that an effective state is crucial for development. In 2000 the Board endorsed a Public Sector Governance Strategy that recognized corruption as an outcome of a poorly functioning governance system.<sup>2</sup> Subsequent WDRs elaborated potential pathways of reform, focusing on cross-cutting public sector institutions (2002), service delivery (2004), and the investment climate (2005). Over the same period, the Bank has also been increasingly engaged in research and data analysis on governance and corruption, distilling lessons for policy. Most recently, the 2006 Global Monitoring Report proposed a framework for monitoring developments in a range of areas, including corruption, complementing the existing research on governance indicators inside and outside the Bank.<sup>3</sup> President Wolfowitz has made it clear since his arrival at the Bank that attention to governance and anticorruption will be a key theme of his presidency. (Figure A1 provides a graphic presentation of this history).

Figure A1. Milestones in Governance and Anticorruption



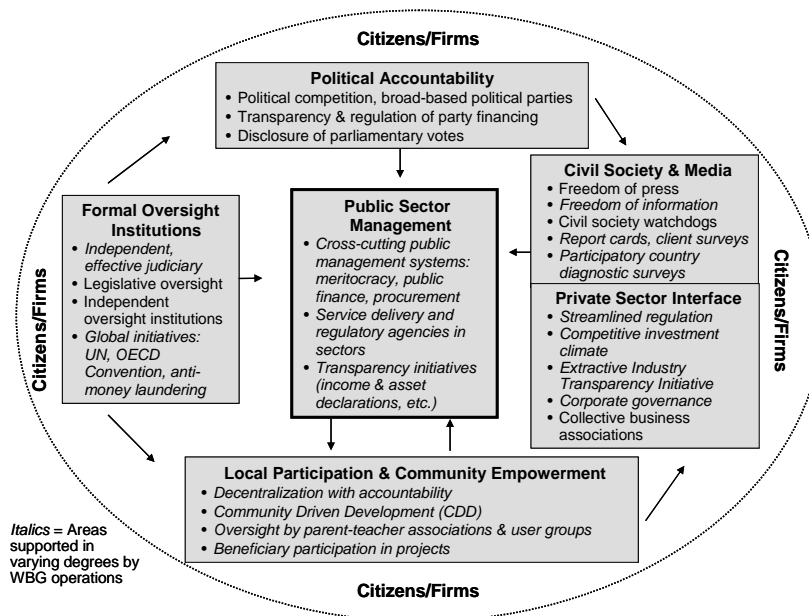
<sup>1</sup> *Helping Countries Combat Corruption: The Role of the World Bank*, PREM, World Bank, Washington, D.C., September 1997. The strategy contains four main components that remain relevant today: (a) helping partner countries reduce corruption, (b) mainstreaming anticorruption through the CAS, (c) preventing fraud and corruption in Bank-financed projects, and (d) supporting international efforts to combat corruption.

<sup>2</sup> *Reforming Public Institutions and Strengthening Governance: A World Bank Strategy* (R2000-91), November 2000. The strategy identifies four key priorities: (a) supporting public sector reform through a combination of voice and participation, competition, and internal rules and restraints; (b) tailoring reform interventions to institutional and political realities through systematic institutional and political assessments; (c) focusing Bank lending activities on long-term institution building, including greater strategic use of programmatic lending; and (d) strengthening internal capacity through improvements in staff skills, incentives, and partnerships.

<sup>3</sup> See *Selected Literature on Growth and Governance* in Annex F.

2. **Governance Systems** Figure A2 groups the actors that comprise a public sector governance system into five broad categories: (a) the *central government executive*, including cross-cutting control agencies responsible for public finance and human resource management, and front-line regulatory and service provision agencies; (b) *formal oversight institutions outside the executive*, including the judiciary, parliament and other independent oversight institutions; (c) *subnational governments and local communities*, with their own service provision responsibilities, and often their own local arrangements for control and accountability; (d) *civil society and the private sector*, both in their role as watchdogs (including the independent media) and as the recipients of services and regulations, and hence a potential source of pressure for better performance; and (e) *political actors and institutions* at the apex, setting the broad goals and direction of the system as a whole.

Figure A2. Entry Points for Governance Reform



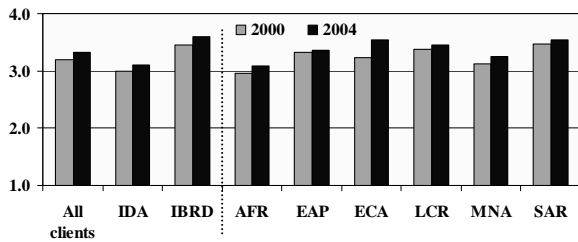
3. **Accountability Relationships.** In a well-functioning governance system, accountability relationships between these actors help ensure that public policy supports development, that public services are delivered efficiently and effectively, and that corruption is held in check. But with weak governance, policy can be captured, service provision and regulation can be distorted to support favored elites, and corruption can run rampant. Improving governance requires interventions to strengthen *capacity* (boxes) and *accountability* (arrows) and to match the *role of the state* to its ability to effectively provide public goods. *Transparency* is a system-wide feature that helps to make accountability relationships work.

4. **Global Trends.** Global trends in governance and corruption (Figure A3) indicate that, while some progress may have been made in strengthening state capacity and accountability worldwide, there is little evidence that this has had a significant aggregate impact on reducing corruption overall. Where reforms have been sustained, economic liberalization, increased competition, and improvements in state capacity and accountability have contributed to improved service delivery, more efficient regulation, and lower rates of corruption. When implemented, reforms have been particularly effective in combating certain types of

administrative corruption, such as petty bribes to utility officials, tax collectors, licensing officials, and inspectors. In many states, however, forms of corruption with deep political roots—such as state capture and procurement corruption—have been more difficult to address. Political and business interests, including multinational corporations from developed countries, often collude to obstruct progress in combating corruption; unraveling these networks is extremely difficult. Thus, it is clear that effective leadership from both arenas is essential to tackling the problem.

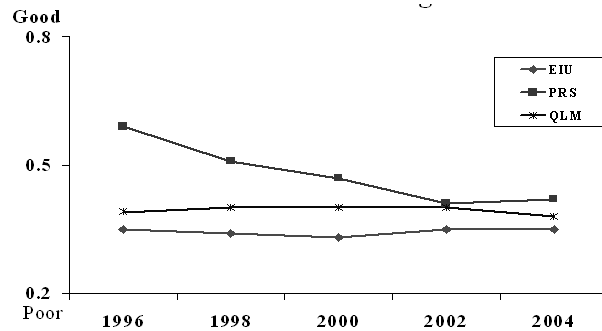
Figure A3. Trends in Governance and Corruption

CPIA, Core Public Sector Management Practices, FY00-FY04



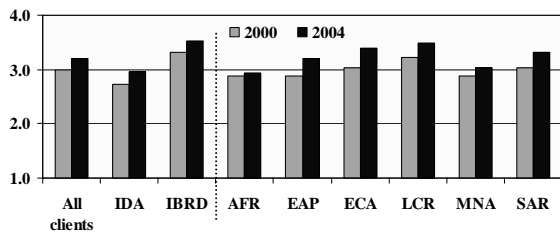
Note: CPIA average for quality of budget and public administration. Source: World Bank, CPIA.

Control of Corruption: Worldwide Averages



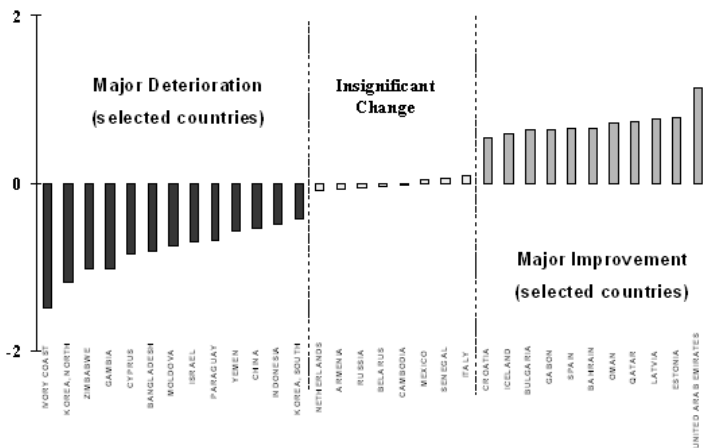
Note: Country coverage of PRS (Political Risk Services): 1996, 129; all other periods, 140. QLM (Qualitative Risk Measure) and EIU (Economist Intelligence Unit): 115 for all periods. Source: Analysis in *Governance Matters IV*.

CPIA, Broader Governance Practices, FY00-FY04



Note: CPIA average for property rights and transparency and accountability. Source: World Bank, CPIA.

Changes in Control of Corruption, 1996-2004



Note: Changes were calculated on the basis of the differences in country estimates from 1996-2004. Classification for major deteriorations and improvements were based on a 75% confidence interval.

Source: <http://www.worldbank.org/wbi/governance/govdata/>

5. **Country Experiences with Reform.** Across the globe, countries with committed governments have made significant progress in improving governance and reducing corruption. In some countries the governance reforms with the most impact on development efforts have improved public policy and management; in other countries the gains have come more from

strengthening formal oversight institutions or increasing opportunities for civic participation and oversight (see Box A1). Regulatory reform has been a successful instrument for reducing opportunities for corruption—for example in tax, customs, permits and licensing, and inspections—particularly when combined with reform of administrative practices. In addition to reducing corruption, these reforms have contributed to the development of a class of independent small and medium-sized businesses with a stake in supporting governance reform. Many countries have tried to address corruption by creating an anticorruption agency. While in a few cases such a structure appears to be working reasonably well, recent research shows the Hong Kong or Singapore models are not suitable for many other countries. In many countries, these agencies are captured by political elites and are unable to successfully tackle political corruption.

### **Box A1. Country Progress in Improving Governance**

#### ***Public Sector Policy and Management***

- Efforts to monitor trends in the performance of public financial management systems as part of the Heavily Indebted Poor Country (HIPC) debt reduction process have been a powerful spur to improving these systems in at least some countries. Between 2001 and 2004, Ghana, for example, made visible improvements in seven of the 15 areas monitored; and substantial gains also were achieved by Senegal, Niger, Mali and Cameroon.
- Procurement reforms, including the use of Integrity Pacts (for example, Argentina) and e-procurement (for example, Chile, Guatemala, India, the Republic of Korea, and Mexico) have significantly reduced the time and cost of public procurement, saving billions of dollars in public sector expenditures.
- Public administrative systems showed improvement in countries, such as Tanzania and Latvia, where there was some political commitment and the reform program was skillfully designed.
- In many countries in Eastern Europe, more streamlined policies and administrative practices have contributed to improved regulatory compliance and lower rates of corruption in tax and customs, permits and licensing, and business regulations.
- Efforts to deepen downward accountability by shifting resources and accountability downwards to local governments and their constituents have been a central feature of governance reform across Latin America, East Asia, many countries in Europe and Central Asia.

#### ***Formal Oversight Institutions***

- Kenya's parliament emerged in the 1990s as an important counterweight to a government that seemingly had acted without the restraint of formal accountability—and systematically called government to account on policies, on how resources were used, and on the openness of government to civil society more broadly.
- Supreme audit institutions, operating independently and reporting directly to parliament, became a focus of capacity development across a number of African countries, including Cameroon, Ghana, Rwanda and Zambia.
- Since 2002, the High Court in Malawi has provided an important check on the executive and legislative branches. For example, when the ruling party sought to expel six members of the legislature, and thus give it the two-thirds majority required to amend the constitution so as to enable the ruler to seek a third term, the court held that the expulsions were unlawful.

#### ***Transparency, Participation, and Oversight***

- Close to a dozen countries showed measurable, statistically significant gains in voice and accountability between 1996 and 2004, including Bosnia, Croatia, Serbia and the Slovak Republic in Eastern and South-Eastern Europe; the Gambia, Ghana, Nigeria and Sierra Leone in Africa; plus Indonesia and, in Latin America, Mexico and Peru.
- A growing number of countries have adopted a Freedom of Information Law—over 50 as of the end of 2004, with efforts under way in an additional 30. In Asia, for example, nearly a dozen countries have either adopted laws or are very close to doing so. The Mexican office of Human Rights Watch says that such a law “dealt a major blow to [the] culture of secrecy” and describes it as “the single most unambiguous achievement in the area of human rights during the Fox presidency.”
- Governments around the world are requiring senior public officials to disclose their income and assets. In the first six months of 2006 alone, Cameroon, Liberia, Mongolia, Serbia, and the Kyrgyz Republic all instituted disclosure requirements, bringing to 103 the number of World Bank clients with such requirements. Of these 103, almost one-third also require the statements be disclosed to the public as well.

6. **Country Assistance Strategies.** As reported in the latest Sector Strategy Implementation Update (SSIU),<sup>4</sup> governance issues are being addressed in CASs, with instances of notable initiatives in higher risk environments to develop integrated governance strategies to help strengthen state capacity and accountability and reduce fiduciary and reputational risks. Four-fifths of CASs incorporated some diagnosis of the causes of corruption, and an even higher proportion integrated some governance and anticorruption elements in their lending and analytic work. A review of FY05 CASs indicates that, while all CASs comply with the mandate to treat governance, the majority of CASs deal with governance in a perfunctory manner and still do not adequately assess the developmental or fiduciary risks of corruption. Indeed, the majority of FY05 CASs reviewed incorporated governance into their operational programs in a narrow way, focusing primarily on traditional areas of core public management. According to the FY05 SSIU, three reasons for this are weak commitment of governments to governance reform, disincentives for Bank country teams to analyze more fundamental institutional and political drivers of corruption and poor governance, and the tendency to compartmentalize and treat governance as a sector rather than as a cross-cutting theme.

7. **Public Sector Governance Operations.** Public sector governance operations have been launched in many countries (see Box A2), with a strong focus on core public management reforms. In FY06, over 20 percent of new Bank-supported operations and almost 20 percent of new financing commitments tackled public sector governance issues broadly defined, and nearly half of the prior actions for development policy operations were related to governance. Compared to all Bank operations, public sector governance operations have about the same quality at entry, perform less well in supervision, and are about average in terms of institutional development impact and likely sustainability. The overall performance of the public sector governance portfolio is very sensitive to the larger governance environment.<sup>5</sup> One of the most important lessons that the Bank has learned is that diagnostic and operational instruments are most effective when there is a committed leadership, a coalition of reform, and basic bureaucratic capacity in a country. To more effectively learn which approaches have been most effective, greater attention needs to be paid to integrating research into Bank operations.

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<sup>4</sup> *Sector Strategy Implementation Update, FY05 (SecM2006-0125)*, March 21, 2006.

<sup>5</sup> Compared to all Bank-financed operations, governance operations have about the same quality at entry, tend not to perform as well during implementation, and are about average in terms of institutional development impact and likely sustainability. Quality Assurance Group (QAG) assessments of the public sector governance portfolio have showed that it has been riskier than the overall Bank portfolio, although at the end of FY06 it outperformed the overall Bank portfolio: the percentage of both projects and commitments at risk in governance portfolio was lower than that for the Bank overall. The average Country Policy and Institutional Assessment (CPIA) ratings for transparency, accountability, and corruption for satisfactory projects in FY04-05 was 3.4, while for unsatisfactory projects it was 2.5.

**Box A2. Examples of Innovative Governance Programs Supported by the Bank*****Improving Public Sector Policy and Management***

- With support from policy and technical assistance lending from the Bank, between 1999 and 2004, Albania has introduced merit-based competitive recruitment of civil servants. This has resulted in a decrease in turnover compared to political appointees (2.7 percent versus 11.7 percent), an increase in the number of qualified applicants per advertised positions (from 5.9 in 2003 to 9.3 in 2004), and the creation of a reasonably independent appeals body.
- The Guatemala Judicial Reform Project has brought justice closer to the people (6,000 poor in peri-urban neighborhoods and indigenous communities in its first year) through mobile courts providing free mediation services and a forum for resolving small claims and civil, family, and labor disputes.
- Through Peru's Urban Property Rights Project, over 1.1 million property titles were recorded, which benefited more than 5.7 million Peruvians in marginal communities; property values increased by over \$1 billion; and \$400 million of formal credit was mobilized.
- Sierra Leone's Institutional Reform and Capacity Building Project has improved local public resource management through a decentralization and empowerment program that has established an inter-governmental transfer system, including block grants to finance local government development projects. Using a Rapid Results Approach, local councils have developed project management, procurement, and accounting capacity, accelerated service delivery, and improved inclusiveness, transparency and accountability.
- The multidonor Planning and Capacity Building Program in Timor-Leste includes an innovative approach to capacity building, which integrates skills and knowledge, systems and processes people work within, and a staff performance framework built around transparency, accountability, leadership, ethics, teamwork, and communications components, and assistance from expatriate advisers.

***Strengthening the Demand for Better Governance***

- The Global Development Learning Network Municipal Anticorruption Digital Program, part of the Africa Digital Radio Project, uses innovative digital radio technology to reach remote and rural areas and disseminate instruments and practices in anticorruption and good governance. It provides a structured platform for local officials and citizens to learn specific anticorruption strategies.
- Governance and Anticorruption Surveys provide in-depth diagnostic analysis of governance dynamics at the micro level and generate specific input for country-specific action programs. The Bank has supported the design and implementation of such tools in client countries, in partnership with bilateral agencies and local nongovernmental organizations (NGOs) (for example, in Albania, Benin, Georgia, Guatemala, Guinea, Haiti, Madagascar, Mozambique, and Paraguay).
- The Government of Karnataka, India is undertaking innovative improvements in service delivery, including compacts with service-providing agencies. Bangalore has dramatically improved the quality of services provided by city agencies; survey-based report cards show user satisfaction increasing from 6 to 94 percent for electricity, 4 to 73 percent for water, and 25 to 73 percent for public hospitals.
- In FY06, the World Bank Institute's Media, Information and Governance Program launched a multi-year program to support the media's role in increased transparency and accountability in the governance environment in Nigeria. The program employs a comprehensive approach to media and information issues, highlighting media institutions, journalism capacity, access to information and public information capacity.
- The Development Grant Facility grant-supported Partnership for Transparency Fund, an international NGO dedicated to helping civil society play an effective role in the design, implementation and monitoring of anticorruption programs, provides financing of up to \$25,000 for specific, discrete and time-bound activities or projects aimed at fighting corruption.

8. **Assessment.** Important gains have been made in the area of public finance management, the dominant part of the governance portfolio. Through HIPC expenditure tracking and now Public Expenditure and Financial Accountability (PEFA), a set of actionable indicators have been developed to track progress in public finance management; these indicators are in the

process of being implemented in 70 countries worldwide. Public financial management (PFM) operations increasingly incorporate measures to strengthen transparency to citizens and other stakeholders regarding how public resources are used. Unlike other types of governance operations, PFM operations tend to perform well, regardless of country context, possibly reflecting the Bank's long track record of working with governments to improve public financial management. Public administration reform operations, many of which aim to reform systems that are heavily based on patronage, appear to be much more sensitive to country context. Many of the less successful operations are overly ambitious relative to the setting, and are thus not sufficiently tailored to the political and institutional realities on the ground.

9. *At the Sector Level.* The sector level provides a potentially important entry point for governance reform.<sup>6</sup> During the past decade, the focus on governance in key sectors has primarily been on experimenting with more efficient means of delivering services, including through restructuring, contracting out to private sector firms, and privatization. More recently, attention has also been given to addressing vulnerabilities of sectors to illegal practices, including corruption and fraud, with some evidence of success (see Box A3). Some sectors, such as forestry, roads, extractive industries, fisheries, water, and agriculture, have begun to develop risk assessment tools, specialized databases, and monitoring systems. In many sectors, transnational corruption and fraud have become especially problematic, with multinational corporations and networks playing a critical role. Weaknesses in public sector institutions, including public expenditure planning and execution, public procurement, civil service incentives and turnover, and continuity in commitment to reform, have had a considerable impact on sector performance. However, in many countries, the Bank has had difficulty in marrying reforms that support the development of these cross-cutting systems with reforms within specific sectors. As the spotlight is increasingly focused on governance and corruption in key sectors where lending is expected to scale up, attempts are being made to identify the points at which the sector is most vulnerable. While there have typically been some low-cost quick wins, in some cases focusing on only one or two points shifted corruption to other points in the system.

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<sup>6</sup> *Mainstreaming Anticorruption Activities in World Bank Assistance—A Review of Progress Since 1997*, OED report no. 29620, The World Bank, Washington, D.C., July 14, 2004.

### Box A3. Strengthening Governance and Reducing Corruption in Sectors

#### Pharmaceuticals

**International cooperation:** In 2003, an alliance between the United States, the World Health Organization, and local authorities began a drug monitoring program in the Mekong Region which revealed fake anti-malaria medicine in circulation. The effort increased communication between regional monitoring authorities and the speed of notification of sale of fake drugs.

**Modernization:** The Azeri Central Drug Control Laboratory began a program of labeling quality tested drugs with hard-to-copy hologram labels to prove that the drugs had passed quality control. As a result, trade of counterfeit drugs dropped dramatically and confiscation of unregistered drugs rose.

#### Electricity

**Modernization and enforcement:** In Andhra Pradesh, India, revenue losses of 38 percent due to theft and inefficiency prompted authorities to establish special courts to punish electricity theft and to install millions of new meters for customers. As a result, 2.25 million unauthorized users were brought into the billing records, collection dues reached 98 percent, and a large number of electricity thieves were successfully prosecuted.

#### Forestry

**Independent monitoring and reporting units:** In 1999, Global Witness became an independent monitor for forest crimes and for the performance of two state-run forest regulatory agencies in Cambodia. This led to the suspension of corrupt forest officials and to increased investigation of illegal logging.

**Involving local stakeholders:** In the Philippines, the Bank supported local stakeholder alliances, provided effective reporting services, mobilized public opinion against violators, and took action against illegal loggers. The number of alliances grew from 16 in 1994 to over 400 nationwide by 1999.

#### Banking and Money Laundering

**Regulatory enforcement:** The Swiss Federal Banking Agency forced the resignation of the general manager of Bank Leumi le-Israel (Switzerland) Ltd., after the bank was found responsible for laundering money for corrupt former Peruvian security chief Vladimiro Montesinos.

**Forensic investigation:** Forensic investigations in Lesotho revealed a money trail, exposing bribery in the 1990s Highlands Water Project. Finding the Chief Executive Officer of the project guilty of accepting bribes, Lesotho courts sentenced him to 15 years in prison for receiving \$1 million through a money laundering intermediary.

10. **The Role of the Private Sector.** While the public sector takes a lead role in shaping the investment climate faced by domestic firms and foreign investors in a country, private sector firms are not always the passive “takers” or recipients of such investment climate. Politically-connected companies can also play an important role in shaping public policies and regulations that constitute the “rules of the game” and the business environment within which they operate, hampering competition. Further, unsolicited bids for public investment projects, often accompanied with promises of kickbacks, can seriously distort public investment. Over the medium- to long-term, a key defense against such activity is to enable entry of firms, providing incentives to build a vibrant private sector and an entrepreneurial citizenry, promoting better governance and a level playing field.

11. **Transnational Issues.** The private-public sector governance challenge is not confined to domestic businesses. In spite of the OECD Anti-Bribery Convention having come into force over five years ago, many multinational corporations are still involved in less-than transparent behavior abroad, at times undermining public governance in emerging economies. While one ought not to foreclose the possibility that some progress may be taking place thanks to the OECD

convention, in most signatory countries there appears to have been little progress in actually bringing serious cases of bribery to court. The existence of a significant gap between practices of multinationals within the OECD and outside it in terms of bribery highlights the need for tougher monitoring and enforcement of the convention across the OECD, and of considering deeper complementary measures. The UN Convention against Corruption also addresses transnational corruption, but has only recently come into force.

12. ***Tailoring Reforms to Country Realities.*** The scope, sequencing, and speed of governance reforms must be tailored to country context. Although country evidence indicates that with leadership and resolve, substantial progress is feasible in the short-term, attaining high overall standards of governance is a long-term endeavor, requiring sustained reform efforts in which the focus is most usefully on performance trends. The trajectory of change will vary from one country to another, depending on both the initial political impetus and the longer-term historical processes that can shape and constrain political and institutional reform. It is also important to tailor reforms to the particular country context. Thus, the Bank needs to work closely with countries and donors to develop workable approaches to governance reform, based on diagnostic analysis, with a clear developmental focus. The *Global Monitoring Report 2006*, as well as other recent research and publications on governance by the World Bank and others, offers some guidance on these complex challenges. (See the selected bibliography in Annex F).



## INCORPORATING GOVERNANCE AND ANTICORRUPTION INTO THE WORLD BANK GROUP'S OPERATIONAL STRATEGIES

1. This Annex supplements the text discussion of CASs by providing additional detail as to (a) how the six questions highlighted in the text might usefully be addressed in CASs; and (b) the link between governance performance and levels of assistance.

### A. Diagnosing Governance in CASs

2. In preparing CASs, country teams are expected to diagnose governance and consider corruption issues.<sup>1</sup> However, they do not always assess risks to Bank-financed projects, make explicit the causes of corruption, or calibrate the depth of coverage to the importance of the issue for the specific country. Going forward, the Bank's CASs will systematically consider the implications of corruption and weak governance on the overall objective of poverty reduction and on the nature of risk posed to the Bank. Management proposes to give priority to addressing corruption and governance issues where they are a major constraint to development or where reputational risks are high. (Box 2 describes how governance has been emphasized in three recent CASs). These elements will be assessed during the corporate review process for strategies, ensuring that higher-risk countries will get focused higher-level management review.

3. **Key Questions.** In preparing a CAS, teams will be expected to review the nature of risks posed by corruption and weak governance in the country, and then use their findings to design the country strategy and assess how governance should feature in it. Answering the following questions will rely on staff's professional judgment guided by analytical work and institution-wide principles:

- How detrimental to the country's growth and poverty reduction are governance and corruption challenges in the country? To what extent are weaknesses concentrated in certain sectors or institutions?
- How committed is the government to strengthening governance and tackling corruption, and does it have a track record of progress?
- How effective are domestic oversight institutions, such as the judiciary, the legislature, the supreme audit institution, media, and civic watchdogs? Are there individual or institutional "champions" of good governance—within government or outside—whose efforts can be supported by Bank analysis, advice, or operations?

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<sup>1</sup> BP 2.11, *Country Assistance Strategies* (June 2005), does not provide detailed guidance on content. "Guidelines to Staff for CAS Products" notes that governance is one of the seven topics to be covered in CAS diagnosis: "A careful diagnosis of governance conditions, including corruption and public financial accountability issues, their impact on the country strategy, and the risks they pose to Bank Group activities." It also notes that corruption should be considered as part of CAS programming: "In determining the choice of lending and nonlending instruments, the country team takes into account country needs, policies, institutions, capacity, fiduciary arrangements, corruption, partner programs, debt sustainability, and the Bank's mandate and comparative advantage."

- Does financial engagement pose a reputational risk to the Bank, and how can that risk be managed or minimized? Are other donors active in the country, and do their activities focus on governance and anticorruption issues?
- What is the risk that the governance environment will deteriorate during the CAS period?
- How severe is the risk of fraud and corruption in Bank-financed projects?

4. ***Obstacles to Development.*** In determining the extent to which weak governance and corruption are obstacles to a country's development and poverty reduction, Bank teams should draw on economic and sector work (see Box B1). If the risk to development is substantial, then governance must receive a thorough treatment in the CAS, including a high-quality diagnosis and support of governance improvements as part of the Bank's program, and implementation should be supported by monitoring tools, including actionable and outcome indicators, where relevant benefiting from the results of diagnostic surveys. The centrality of governance must be calibrated to the degree to which governance challenges and corruption obstruct progress. While it will be considered in all settings, as noted above, in some countries governance will be an overarching theme for Bank interventions. If, instead, weaknesses are concentrated in certain sectors or institutions, the CAS will need to focus attention on improving governance in those sectors, although in some cases, the Bank may instead decide to engage elsewhere in support of that country development. Strategic engagement with the private sector, including by IFC and MIGA, remains a potentially important means for change in high risk settings.

#### **Box B1. Governance Diagnostics**

To understand how and to what degree weak governance and corruption obstruct development, Bank teams can draw on a number of sources. For example, the annual Country Policy and Institutional Assessment (CPIA) and the World Bank Institute (WBI) aggregate governance indicators can be used to situate the country in a comparative context. At the country level, Development Policy Reviews and Investment Climate Assessments can help identify some of the more binding constraints to development. Institutional and Governance Reviews can help uncover some of the political and institutional drivers of these obstacles, while Governance and Anticorruption Diagnostic Surveys (for within country, rather than cross-country, analysis), as well as Doing Business Reports, and Anticorruption in Transition reports can help to document and benchmark specific forms of weak governance and corruption and serve as an input to concrete action plans. Public financial management (PFM) analytic work such as a PFM Performance Report using the Public Expenditure Financial Accountability (PEFA) program framework (and where appropriate, the institutional aspects of Public Expenditure Reviews [PERs], Country Financial Accountability Assessments [CFAAs], Country Procurement Assessment Reports [CPARs], and the IMF's Reports on Standards and Codes [ROSCs]) can help assess and identify strengths and weaknesses of the country's public financial management system. The Department of Institutional Integrity's (INT) investigative findings and Detailed Implementation Reviews can help identify specific country or sectoral fiduciary risks. Sector-specific diagnostics are currently under development.

Other sources of information may be available at the country level, produced by local or other international organizations, such as the UK's Department for International Development (DFID) Drivers of Change Report, Transparency International's National Integrity System Country Studies, or the World Resources Institute Electricity Governance Toolkit. To address gaps and to provide a more structured diagnosis for the CAS, some country teams may choose to prepare an integrated report (a Country Governance and Corruption Assessment). All these instruments can be used to help gauge the importance of weak governance and corruption in a country and identify potential entry points and options for reform. Many of these reports can be prepared in collaboration with other development partners and made public. The Organisation of Economic Co-operation and Development-Development Assistance Committee (OECD-DAC) Governance Network is planning to undertake joint assessments on governance and corruption in selected countries, beginning with Cameroon.

5. **Government Commitment.** Strong government commitment to reform warrants consistent Bank support, even where corruption is high or governance weak (although the mode of engagement and the design of interventions will differ from those in countries not subject to such risk). However, if corruption and weak governance pose a substantial risk to development but government interest in reform is low, the Bank strategy needs to recognize this disagreement over priorities and assess how the situation can be effectively reversed over time. Indeed, the appropriate Bank response (set out in guidance to staff) may often be preparation of a 12- to 24-month Interim Strategy Note (ISN), rather than a full four-year CAS.<sup>2</sup> Whether the ISN focuses centrally on governance and anticorruption depends on whether highlighting the issue is expected to advance or undermine country relations and the prospects for future reform, but its program needs to outline initial steps in how the Bank proposes to address the country's specific circumstances. If the Bank and the government are unable to agree on a program ensuring a governance environment that provides an adequate basis for an active financing program, then the ISN will likely propose curtailed financing. In these circumstances, the Bank may choose to work in areas and sectors where adequate governance arrangements are possible, and engagement is likely to focus on building capacity, meeting basic needs, and working with institutions outside of central government. IFC and MIGA may still play key roles as partners in pursuing a socially responsible investment policy.

6. **Domestic Oversight Institutions and Reform Champions.** Accountability is fundamental to better governance. Government transparency, civic participation, and effective oversight by state actors (including judiciaries, legislatures, and supreme audit institutions) and nonstate actors (such as the media and civil society watchdogs) are important sources of pressure for better governance. Likewise, champions of reform, both inside or outside of government, are critical for providing the leadership necessary to execute effective reforms. Where government commitment to reform is uncertain, the existence of functioning accountability institutions or influential supporters provides a counterbalance and increases the likelihood that reforms will be undertaken and sustained. These institutions can help improve long-term prospects for development and can often play a role in strengthening oversight of Bank-financed operations. Where institutions of accountability are active, the Bank often can justify broader engagement and greater financing.

7. **Reputational Risk.** For the Bank, the reputational risk of operating in a country is usually correlated with overall levels of corruption in the country: it is highest in countries where governance is weakest, grand corruption is substantial, and the Bank's lending program is large or high-profile or Bank assistance is seen to be out in front of other donors and international institutions. Reputational risk may, in some cases, exceed the risk corruption poses to development, since development risk focuses more heavily on the economic realm; and it may also be more volatile, since it can be driven by singular political or social events. Reputational risk tends to be lower (even in very high-risk countries) where Bank assistance is part of a multidonor effort (as, for example, in Afghanistan). Financing operations in high-risk countries

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<sup>2</sup> ISNs are used in a variety of circumstances, and the choice of an ISN rather than a CAS is not driven by country performance concerns. *Guidelines to Staff for CAS Products* advises use of an ISN when a country is not ready for a full CAS. An ISN rather than a full CAS may be considered to be the more appropriate instrument for countries where (a) a high degree of uncertainty prevents longer-term engagement; (b) a medium-term development/poverty reduction program to frame the Bank's support is missing; and/or (c) the Bank has insufficient country knowledge.

are particularly subject to criticism and international public scrutiny because they involve money that is generally channeled through government processes, systems, and structures that are likely to be inadequate and to present opportunities for corruption. Mitigation of this risk necessarily involves situation-by-situation decisions, sometimes as part of preparation of a CAS or ISN but more often as part of ongoing Management and Board oversight of country programs.

8. ***Risk of Deterioration.*** CASs typically deal with the risk that the governance environment will deteriorate during the strategy implementation period by including high- and low-case scenarios that try to capture both the main features of potential deterioration and the Bank's proposed response. If there is a substantial risk that governance will deteriorate, then the CAS should include a low-case scenario that involves highly restricted financing or, very unusually, a break in financing support and a shift to non-lending activities with triggers identifying the conditions under which the Bank would move between scenarios; and when there is substantial uncertainty about how deterioration will affect the government's program, the team may prepare an ISN that takes this uncertainty into account.

9. ***Risk of Corruption in Projects.*** While the risk of fraud and corruption in Bank-financed projects is generally correlated with the overall risk corruption poses to development, there may be significant differences across sectors, institutions, or categories of operations that need to be considered in designing the Bank's program and supervising its portfolio. Specific evidence may be available where INT has conducted investigations or undertaken a Detailed Implementation Review (a review of Bank-financed projects focusing on indicators of fraud, collusion, and corruption) or where the Region has conducted a fiduciary review of the Bank-funded country portfolio. Information from supervision of Bank-financed projects (especially misprocurement or other findings), sector-specific PFM analytic work, and staff insights frequently can also guide these determinations. If the risk to projects is high, and if the Bank's portfolio in the country is substantial, special safeguarding of new operations is warranted as well as careful oversight of ongoing operations (through, for example, mandatory anticorruption action plans for all projects in a sector or in a country, and regular portfolio risk reviews). Drawing on information on country PFM performance and the broader country governance environment as well as past portfolio fiduciary performance, CASs will set out an analysis of fiduciary issues and risks in the Bank-financed portfolio and associated fiduciary risk-management strategy.

## **B. Levels of Assistance: Additional Considerations**

10. Bank strategies reflect governance concerns in overall assistance levels and in instrument choice. Collaboration with other development partners will be crucial to enhance the Bank's impact and ensure a clear message. In the uncertain environment of higher-risk countries, the Bank's ability to modify a strategy during implementation may be especially important. The material which follows provides additional detail to the discussion in the main text.

11. ***Linking Levels of Assistance to Governance Performance.*** In all countries, CASs link levels of overall financial assistance and modes of engagement to progress on key obstacles to development effectiveness; and in most countries, these obstacles include weak governance. In IDA-eligible countries, this linkage is achieved partly by the way IDA resources are allocated across countries, with a strong emphasis on governance. For IBRD-eligible borrowers, the CAS sets out IBRD lending envelopes that derive from the Bank's creditworthiness analysis, which explicitly considers governance as it impinges on political stability or economic policies and

outcomes. CASs have traditionally set out financing scenarios that specify how the Bank will respond to changing country circumstances and policy performance during the implementation of the program. These scenarios provide the indicative size of the financial envelope and spell out performance benchmarks or triggers for moving between scenarios.<sup>3</sup> Triggers have generally covered three areas of policy relevant to setting financing envelopes: economic management, policy environment, and portfolio performance. Scenarios can also be used to determine the instrument mix and, if appropriate, can indicate conditions under which the Bank will engage in a particular sector or issue. CAS financing scenarios have typically included aspects of governance among other key obstacles to effective use of development aid.

12. ***IDA's Allocation Mechanism.*** IDA's Performance Based Allocation system (PBA) ensures that the Bank's resources are directed toward better governed countries. Since IDA12, when donors deemed it crucial to IDA's effectiveness, governance has been incorporated as a key pillar of the PBA. The high weight assigned to CPIA- and portfolio performance-based governance factors (averaging about two-thirds) in the PBA ensures that better governed countries are allocated a higher per capita share of IDA resources. More specifically, a country whose governance performance is half a standard deviation less than the median governance performance will be allocated 50 percent less IDA per capita than one whose performance is half a standard deviation greater than the median.

13. ***Restricted Financing or "Low Cases."*** Starting from the financial envelope set by the PBA for IDA-eligible countries or derived from the Bank's creditworthiness analysis for IBRD-eligible borrowers, the Bank considers a lending program. If the Bank finds significant governance or corruption issues and low government interest in reform or high downside risk with respect to the governance environment during the CAS period, it could develop a "low-case" scenario that may involve highly restricted financing, a shift to nonlending activities, or, very unusually, a break in financing support. A restricted-financing scenario might be the most likely scenario if the Bank determines that governance or corruption issues are likely to preclude the full envelope of IDA or IBRD resources from being used effectively. If the Bank perceives a very high probability of deterioration in the governance environment, a restricted- or no-financing base case may be the best way to capture the Bank's concern about imminent policy deterioration, providing the country an incentive to build a positive track record before engaging more broadly. Triggers defining the conditions under which the Bank would move to a more restricted scenario and under which it would move to a less restrictive scenario would be included in the CAS or ISN.

14. ***Joint Nature of the Bank Group Strategy.*** A key challenge for the World Bank Group is to find ways for its constituent parts to work more effectively together at the country level. Staff need to make every effort to mobilize the full range of Bank Group instruments (including those of the IFC and MIGA, as appropriate) to engage as broadly as possible. Multinational corporations often look upon IFC and MIGA as partners in pursuing a socially responsible investment policy in difficult countries. Strategic engagement with the private sector, even when the Bank is having difficulty structuring lending operations, is potentially an important instrument for change in high-risk settings.

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<sup>3</sup> In recent years, the CAS framework has evolved, especially for better performing countries, toward setting out a range of interventions depending on country performance and circumstances, rather than distinct lending scenarios.



## COUNTRY EFFORTS: ENTRY POINTS FOR GOVERNANCE AND ANTICORRUPTION REFORM

1. The principal aim of governance reform is to build capable and accountable states that can devise and implement sound policies, provide public services, set the rules governing markets, provide oversight of how public resources are used, and so support development. Within this, a critical aspect is to align the incentives of state officials with these goals, through an appropriate combination of rules, restraints, and rewards; competitive pressures; and voice and partnership.<sup>1</sup> The incentives of nonstate actors, too, need to be aligned with these goals, especially those of businesses and other nongovernmental entities that often play a pivotal role in undermining governance.

2. **Entry Points.** Potential entry points for strengthening incentives and improving governance fall into five broad categories.<sup>2</sup> The first comprises reforms to improve the capacity, transparency, and accountability of state institutions. Government reforms have historically been the strongest area of Bank engagement in countries, although less attention has been paid to institutions outside of the executive branch of government. A second category comprises reforms that help to increase opportunities for participation and oversight by civil society, the media, and communities. The Bank has been engaged in this work during the past decade, but in a limited and uneven way. A third category is reforms to create a competitive and responsible private sector. The Bank Group (IBRD/IDA, IFC, and MIGA) will jointly take a more proactive role in engaging with the private sector on governance and anticorruption. A fourth category comprises leadership—specifically the key role of country-level champions in moving forward the governance reform agenda. Finally, a fifth category is reforms to strengthen political accountability, for instance, through political competition, and transparency and regulation of political parties. However, this area is outside the Bank Group’s mandate and legal framework, and work where needed will be supported by other development partners.

3. **Differentiated Tactics.** The Bank has learned that governance challenges are far from uniform across countries—implying that relative emphasis across the categories must be differentiated, and strongly based on local knowledge, innovation on the ground, and extensive collaboration among local constituencies.

### A. Capable, Transparent, and Accountable States

4. The Bank is committed to helping states function effectively, so that the executive branch of government can deliver public goods, courts can dispense justice, and the legislature can provide leadership and oversight.

5. **Improving Public Financial Management.** Better public financial management remains central to getting results on the ground and assuring donors that aid resources are being used prudently. Key dimensions include: policy-based budgeting; comprehensiveness of budget

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<sup>1</sup> *World Development Report 1997: The State in a Changing World.* (New York: Oxford University Press, 1997).

<sup>2</sup> For a list of entry points and description of the governance strategy in the Middle East and North Africa Region, see the *Better Governance for Development in the Middle East and North Africa: Enhancing Inclusiveness and Accountability*, World Bank, Washington, D. C., 2003.

coverage; transparency of fiscal and budget information; budget credibility—that the budget is realistic and implemented as planned; predictability, control, and stewardship in the use of public funds (for example, internal audit, payroll and procurement systems); accounting, recordkeeping and reporting to provide information for proper management and accountability; and external audit and other mechanisms to ensure external scrutiny of the operations of the executive branch (for example, by the legislature). Improvements to these facets of PFM need to be carried out in a feasible sequence, matching the reform to current country performance and capacity – in a way which assures country ownership and leadership for PFM reforms, a coordinated program of support by development partners, and integrated harmonized approaches to measuring country PFM performance over time. The multi-donor Public Expenditure and Financial Accountability (PEFA) performance measurement program provides a useful, harmonized system for assessing and monitoring the quality of PFM systems, and is being implemented in about 70 countries worldwide. In addition, the Bank collaborates with the IMF in PFM through the integration of IMF ROSCs, technical assistance in public sector financial management, and other work in improving transparency and good governance.<sup>3</sup>

6. ***Improving Administrative Capability.*** Experience has shown that an effective public administration involves well-functioning mechanisms for policy coordination; well-designed administrative structures for individual line ministries and semiautonomous executive agencies, with little duplication of responsibility, clear lines of authority, streamlined business processes, and a focus on results; meritocratic human resource management; adequate pay and benefits; and sufficient controls to ensure that the public sector wage bill is sustainable under the country's fiscal constraints. In countries where public administration reform is confronting heavily patronage-based systems, the experience of reform has been mixed. The Bank is learning from these experiences and designing new approaches that are more tailored to these environments. (Box C1 discusses the lessons of experience in civil service reform).

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<sup>3</sup> For example, the Bank and Fund continue to have active collaboration in public financial management work anchored in the principles of: (a) government articulation of a public expenditure reform strategy in the Poverty Reduction Strategy Process or other country-owned work; (b) an integrated and well-sequenced program of diagnostic work by development partners; (c) well-coordinated technical and financial support from development partners for implementation of the country's public expenditure reform strategy; and (d) periodic reporting by countries of performance in public expenditure policy, financial management and procurement. See *Bank/Fund Collaboration on Public Expenditure Issues*, (SecM2003-0077), February 27, 2003.

### Box C1. Civil Service Reform: Some Emerging Lessons

After two decades of supporting civil service reform, the World Bank has learned that a narrowly technocratic approach—which seeks to apply a similar blueprint across very disparate settings—is less effective than a more learning-oriented approach. Three lessons stand out:

***Comprehensive civil reform IS feasible***—but the process is slow, and can succeed only in settings with strong and sustained political commitment. Between 2000 and 2003, Latvia promulgated an ambitious agenda of administrative reform, including a civil service law that guaranteed meritocracy; though implementation certainly has not been perfect, the effort transformed the environment for civil service recruitment. Over a 15-year period, Tanzania brought civil service employment and the wage bill under control, clarified roles, and right-sized across a wide range of government ministries, departments, and agencies; today, its performance improvement program gives agencies incentives to clarify their results targets, make public commitments to service standards, and address capacity shortfalls.

***The Bank’s standard approach to civil service reform tends to be less successful in weaker governance settings.*** The Independent Evaluation Group rated 23 operations whose primary theme was administrative and civil service reform that closed between 2001 and 2005—12 in countries whose score on the CPIA measure of “transparency, accountability and corruption” was 3.0 or higher; and 11 in countries where this CPIA score was below 3.0. Ten of the first group (83 percent) were rated satisfactory or higher, a rate that is similar to the Bank portfolio as a whole. By contrast, four of the second group (36 percent) were rated satisfactory.

***However, in weaker governance settings, carefully designed incremental approaches can achieve significant results.*** Albania’s administrative reform focused narrowly on introducing meritocracy and market-competitive pay for the country’s top 1,300 civil servants. Such a narrow target is not enough for system-wide improvements, but it can yield important gains in the quality of policymaking and the management of public resources, establish a precedent of new ways of doing business, and open the way to broaden the scope of application over time. The reforms were widely publicized and enjoyed both the support of donors and broad approval among Albania’s citizens; therefore, in 2002 when the reformist prime minister was replaced, the senior civil servants constituted a powerful constituency for continuing the reforms, and the meritocracy arrangements have largely been sustained.

7. ***Public Salaries.*** Low pay can contribute to corruption within a public administration, particularly when total remuneration fails to pay a living wage, as is often the case in many African countries. In many countries, however, careful analysis suggests that public sector salary structures are the real problem, rather than average levels of public sector remuneration. First, public administrations typically pay progressively less competitive total remuneration the higher are the skill requirements and levels of responsibility. Second, when the extent of bribe-taking or other measures of bureaucrat-level administrative corruption has been subjected to careful, multivariate statistical analysis, average salaries are often not statistically significant determinants of such corruption. When similar analysis is undertaken, but is able to include position-specific measures of the competitiveness of remuneration, low competitiveness does bear a significant relationship with such bribe-taking. This research strongly suggests that key human resource management determinants of lower bureaucratic corruption are meritocratic human resource management practices and the competitiveness of remuneration ensured by the structure of remuneration. In short, simple linkage between pay and corruption can be misleading. Changes in compensation levels can only work if they are part of a package to reform public servants’ behavior. Other elements are essential to reducing corrupt practices.

8. ***Sectoral Approach.*** Because reforms of bureaucracies generally take a long time to help improve governments’ front-line performance, it is natural to complement them with approaches that work more directly at the interface between governments and citizens and firms: the provision of such services as education, health, utilities, and transport infrastructure, and credible

regulation of markets to protect public welfare without unduly raising the costs of doing business. A central priority is to combat corruption in these sectors where it poses major challenges for service delivery, investment climate, and accountability in the use of public resources. A sector-specific approach to governance and anticorruption also requires paying particular attention to the particular challenges of the financial sector, which have economy-wide repercussions (see Box C2).

### **Box C2. Governance and the Financial Sector**

Well-functioning and transparent financial markets and institutions are a powerful force for improving governance and combating corruption by imposing discipline on public and private agents. When financial systems do not function well, they become vulnerable to abuse. And the costs of sub par governance in the financial sector can be dire. In the case of Indonesia, which was hit hard during the Asian financial crisis, the fiscal costs to the government to make good on the obligations of the privately held banks exceeded 100 percent of the country's GDP. Empirical studies show a strong link between good governance and the soundness of financial systems.

Banks are the principal financial intermediary in emerging markets. Despite a wave of privatization around the world in the past two decades, 40 percent of the world's population still resides in countries where most bank assets are controlled by state-owned institutions. State-owned banks pose particular challenges, since they can undermine competition, and thwart supervision, increase the opacity of banks' operations, and often lead to excessive and misused government spending. Even in countries with fully privatized banks, the effectiveness of financial sector regulators to intervene is often constrained. Recent research suggests that direct official supervision of banks and disciplinary powers does not promote bank development or efficiency, nor does it reduce corruption in lending or banking fragility. By contrast, policies that promote good corporate governance of banks and banking regulatory policies facilitating private sector monitoring of banks, and including disclosure of reliable and timely information, do make a contribution to improving bank efficiency and controlling corruption in lending.

Generally, independence of financial regulators is key, as are laws that strengthen the rights of private investors to enhance the corporate governance of banks, as opposed to policies that weaken market monitoring of banks, such as deposit insurance, which tend to introduce moral hazard effects. A public policy role for the government is, however, important, particularly in the development of an effective legal system and in government regulations regarding transparency and disclosure requirements.

Corruption in the financial sector takes several forms, such as borrowers bribing loan officers, particularly in state banks that offer subsidized loans; well-connected borrowers; political insiders benefiting from loans on favorable terms that are not collected; corruption in public oversight of banks; foreign exchange and financial assets sold at favorable rates; and money laundering.

The Bank Group addresses these financial sector governance challenges in a number of ways, including:

- Strong support through Bank policy-based operations, technical assistance, and IFC investments in bank restructuring and privatization—the Bank Group promotes the transparent sale of state banks and insolvent private banks to new, well-run banks, thereby ensuring good practice and transparency in the sale process. These new banks reduce the power of insiders, increase competition, and improve lending and collection practices;
- Better corporate governance in banks through policy dialogue, financial support and technical assistance, financial sector reform (as component of development policy operations), and methodologies for assessing and improving bank governance and transparency practices, such as the Corporate and Bank Governance ROSCs undertaken jointly by the Bank and IFC;
- Development of financial markets and non-bank financial institutions to stimulate competition and alternative sources of finance;
- Supporting the development of improved regulation, supervision and financial reporting (for example, through the Bank-IMF Financial Sector Assessment Program (FSAP) program, support from Bank technical assistance (TA) loans, including over 160 Bank restructuring and privatization loans in the last 10 years), as well as better transparency on customer information through the supervisory framework for anti-money laundering (AML), followed up by Bank TA where needed (see detailed treatment of AML in Annex E on Global Partnerships and of asset restitution in para. 46 of the main text); and,
- Ensuring that in its projects, the Bank works with financial intermediaries that are sound and associated with good governance practices.

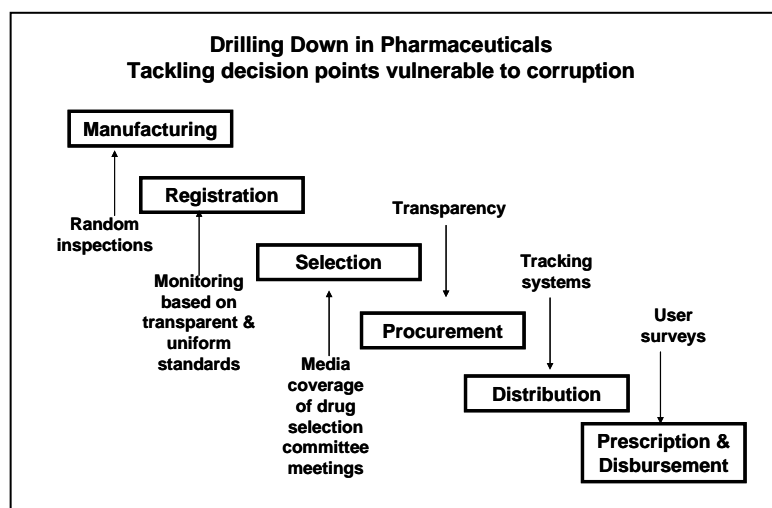
9. Building on lessons from the last decade, a common operational approach is emerging to identify and address governance vulnerabilities at the sector level—for example, in pharmaceuticals, forestry, roads, education, and customs (see Box C3). One lesson of work at

the sector level is the importance of involving stakeholders who care about the outcome—engaging not only users of social services and communities, but also the private sector, civil society organizations, politicians, and bureaucrats in a sustained process of reform. Another lesson is the importance of transparency, competition, and oversight: in the financial sector for instance, the Bank has supported the open, transparent sale of state banks and bankrupt private banks; better regulation, supervision, and financial reporting; and strengthened corporate governance in banks. Finally, experience also suggests that even in countries with more pervasive governance challenges, some sectors can function well.

### Box C3. Tackling Vulnerabilities at the Sector Level

A forthcoming World Bank Group publication sets out an approach to combating corruption that is being piloted in many sectors in the Bank: preparing a detailed “road map” at the beginning of a program with indicators along the way to signal possible corruption risks that might arise at various points in the program cycle. Two examples:

- In public procurement, corruption risks could arise during procurement planning, product design, advertising/invitation to bid, prequalification, bid evaluation (technical and financial evaluation), post-qualification, contract award, and contract implementation.
- In the delivery of essential drugs in the primary health sector, corruption risks could arise in the manufacturing of the drugs, drug registration, drug selection, procurement, distribution, and dispensation/prescription (see figure).



A road map approach provides a structured and detailed picture of a problem area and can help identify remedial measures. In the transport/roads sector, for example, the capture of resource allocations by vested interests during budget formulation can underpin bid rigging during the procurement stage (when the budget is executed), which in turn can trigger so-called “change orders” during contract implementation. Similarly, in the forestry sector, high rents are reaped (and large-scale corruption takes place) during the stage when illegal lumber is laundered into legal products such as furniture; and any serious attempt to address corruption in the sector would have to focus on this particular link in the chain. The road map also offers a tool for developing measurable indicators for tracking the incidence of corruption. In procurement, for example, if bidders systematically drop out from the initial expression of intent through the financial evaluation of bids, it may signal some form of collusion among participating firms.

*Source:* J. Edgardo Campos and Sanjay Pradhan, eds., “The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level,” World Bank, forthcoming.

10. ***Strengthening Governance at the Local Level.*** Even when opportunities for governance reform at the national level are limited, there may be entry points at the local level. Local politics vary considerably, so that there are sometimes very striking differences in local governments’ interest and willingness to engage in governance reform. In some settings, top-down reforms can recognize, support, and reward progress at the local level. In other settings,

the entry point might be bottom-up participatory reform, such as community-driven development (CDD), especially when it also supports the development of local government capacity and accountability. In a small number of countries where prospects for government reform are limited, CDD operations may be the only feasible entry point for reform.

11. ***State Oversight Institutions.*** Formal oversight institutions can provide important pressures for improving government performance. Where judiciaries are independent, competent and accountable and where public accounts committees, supreme audit institutions, and ombudsmen have sufficient capacity, they often can hold the executive to account. Equally important is attention to the legal framework by which the judiciary operates and which it applies. Poorly conceived and drafted laws can contribute to creating an environment in which corruption flourishes. While the Bank has a fairly active engagement in judicial reform in Latin America and Europe and Central Asia, it has taken a more limited role elsewhere. The Bank has also been increasingly engaging with and supporting supreme audit institutions and the work of public accounts committees, state audit institutions, and ombudsmen through policy dialogue, capacity building, and operations; however, these areas have not historically been a strong central focus of the World Bank Group. The Bank will work more systematically, consistent with its legal framework and in partnership with other donors, to help countries strengthen their formal oversight institutions.

12. ***Strengthening Transparency in Government.*** Assuring that the executive operates in a transparent way by making information broadly available to citizens on the operation of the public sector can help strengthen accountability, and so improve public sector performance. Citizens and media that have broad access to information on the operation of state institutions are crucial for holding the state to account. Such access may include attendance at key meetings where important state decisions are made, publication of information on budget and procurement data, access to state records and reports, and the state's active dissemination of information on its operations and performance including through e-government. Moreover, greater transparency can help to establish the credibility of decision-makers through the public disclosure of their income and assets. Box C4 provides some examples of how some of the Bank's development policy operations (DPOs) have helped strengthen transparency and foster opportunities for greater civic engagement. Working with partners, the Bank will push for a significantly greater focus on assuring greater access by citizens to information on how government operates, including expanded production of information that can allow citizens to assess the services they are getting from government.

## **B. Participation and Oversight by Civil Society, Media, and Communities**

13. A free media, vibrant civil society, engaged local communities, and an independent citizenry are crucial components for good governance: they have a unique place with respect to holding governments accountable for delivering better services, creating jobs, and improving living standards. Therefore, it is important to expand work beyond the state to increase opportunities for participation and oversight by these groups. The Bank Group will scale up governance work in these areas, in a manner consistent with its own legal framework,<sup>4</sup> in

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<sup>4</sup> In particular, in addressing the demand for governance, the Bank will not: (a) involve itself in the political affairs of a country; (b) be influenced by the political character or form of government of the country; or (c) make its decisions on the basis of political or other noneconomic factors. See *IBRD Articles of Agreement*, Article IV, Section 10, and Article III, Section 2.

consultation with government and in close collaboration with its development partners, on the basis of country-focused assessment and dialogue as to which entry points offer the best prospects for building and sustaining momentum for improved governance.

14. **Participation and Oversight.** While government transparency can help to facilitate participation and oversight, more proactive engagement of society is also vital. Opportunities for participation and oversight can be increased, for example, through participatory development of policies and public spending priorities (where the poverty reduction strategy process has provided a major impetus in IDA-eligible countries), social accountability in the delivery of services, community-driven development, civil society and media oversight over public procurement, monitoring of income and asset declarations, and other arrangements empowering legitimate social groups. In many settings, capacity in civil society organizations (CSOs) will need to be strengthened to effectively take advantage of these opportunities. Also vital is the development of independent and competitive media that can investigate and report on government performance, including corruption. As some of the examples in Box C4 illustrate, the Bank increasingly has recognized that an engaged citizenry, buttressed by transparency in government, is a powerful force for strengthening the demand for governance—and has used multiple mechanisms to help promote this. The Bank will more systematically use a range of instruments—policy dialogue, analytic work, capacity-building, policy-based lending, and community driven development—to increase opportunities for participation and oversight.

#### **Box C4. Bank-Supported Operations Strengthening Transparency, Participation, and Oversight**

A recent review of DPOs approved by the Bank during 2004 to 2006 highlights that the Bank's policy-based lending promotes transparency and civic participation. Complementary investment loans, credits, and grants have provided the focused capacity-building resources needed to support effective implementation by public officials and civil society actors.

**Access to Information.** DPOs in Bangladesh, Ghana, Peru, Rwanda, and Uganda all helped to improve citizens' access to public information.

**Asset Declaration.** Uganda's poverty reduction support credit supported government efforts to require public officials to declare their assets and publish the information, and to establish sanctions for noncompliance.

**Participation in Budget Prioritization, Oversight, and Local Governance.** DPOs in Ecuador supported a dialogue between civil society and the government on the national budget facilitated by a national nongovernmental organization; in Bolivia they supported the inclusion of civil society representatives on the government's main credit agency responsible for the allocation of transfers to municipalities and supported the approval of a law reinforcing the role of local social control committees to monitor municipal administrative management and expenditures; in Uganda and Tanzania DPOs supported publicly released information on resource transfers to subnational governments, by including benchmarks on the publication of transfers to local governments; in Peru DPOs supported the approval and implementation of a law making participatory budgeting mandatory for a portion of all regional and municipal governments' annual budgets, and included committees to monitor the execution of the municipal budget subject to participatory budgeting; in Sierra Leone, DPOs helped support the development of Community Budget Oversight Committees in all regions to participate in the annual discussion of the budget with ministries and departments and to monitor regional budget execution; and in Uganda and Timor-Leste they supported the production and publication of a citizens' guide to the budget.

**Transparency and Participation in Service Delivery.** DPOs in Burkina Faso, Chad, Sierra Leone, and Uganda supported the publication of information on resource transfers at delivery points such as schools and health clinics. DPOs supported the use of citizen report cards to strengthen the voice of users in service delivery in education, health, and social protection services in Brazil, Ecuador, Georgia, Ghana, Laos, Peru, and Rwanda. A Tanzania DPO included a benchmark on the conversion of results of service delivery surveys into a user-friendly format and their publication; a Bolivia DPO supported the publication of a pregnant women's rights charter in indigenous languages; a Brazil DPO supported the establishment of a consumer grievance system in the health sector; and DPOs in Peru and Uruguay introduced user feedback on services and participatory monitoring as components of monitoring and evaluation systems for social programs established through the DPOs.

*Source:* "Development Policy Loan Stocktaking: Participation and Poverty and Social Impacts," Social Development Department, World Bank, Washington, D.C., draft report, May 16, 2006.

15. **Financing.** At the country level, the Bank will continue to pursue this agenda in partnership with other donors that have traditionally engaged actively with civil society and media, and will work to strengthen these partnerships. Because the Bank's traditional financing instruments are geared to work with the executive, nontraditional funding mechanisms have a special salience in this area. A number of grant facilities already have proven useful. Examples include the Japan Social Development Fund, which (with the concurrence of government) provides grant support directly to CSOs working with communities; trust funds which provide financing for innovative accountability mechanisms and capacity-building of both government and civil society, like the Bank Netherlands Partnership Program priority support for social accountability, the Norwegian Governance Trust Fund, and the Trust Fund for Environmentally and Socially Sustainable Development; and the financing provided through the Development Grant Facility to the Partnership for Transparency, a highly effective organization that gives small grants to civic watchdogs, and encourage other donors to increase financial support for such organizations as well.

### C. Competitive and Responsible Private Sector

16. While the public sector takes the lead role in shaping the investment climate for domestic firms and foreign investors in a country, private sector firms are not always the passive "takers" of that investment climate. Politically connected companies can also play an important role in shaping key public policy, legislation, and regulations that constitute the "rules of the game" and the business environment within which these companies operate, hampering competition. It is also important to bear in mind that the private-public sector governance challenge is not confined to domestic businesses: in spite of the Organisation for Economic Co-operation and Development (OECD) Anti-Bribery Convention that came into force over five years ago, multinational corporations' involvement in corrupt behavior abroad can undermine public governance in emerging economies. There has been little progress in bringing serious cases of bribery to court; and the gap revealed in enterprise surveys between multinationals' bribery behavior when operating in another OECD country as compared with operating outside of it highlights the need for rigorous monitoring and enforcement of the OECD convention. In recent years, some large multinational corporations have adopted anticorruption policies, in part as a function of tighter regulations in key markets (represented, for example, by the Sarbanes-Oxley Act in the United States) that increased the compliance requirements for listed companies and raised penalties for failures in corporate governance.

17. **A Sound Investment Climate and Competitive Private Sector.** Facilitating the growth of a competitive, responsible private sector requires multi-faceted engagement at the country level, which can be taken up by different members of the World Bank Group. First, IBRD, IDA, IFC, and MIGA all have roles to play in helping governments improve the investment climate,<sup>5</sup> eliminate red tape and nontransparent regulations, reform procurement and concession arrangements in sectors characterized by natural monopolies or substantial resource rents, transparently and competitively privatize state-owned businesses and banks, introduce anti-money laundering, and facilitate the entry of small and medium-sized enterprises. Reforms such as these can help level the playing field, reduce incentives and opportunities for corruption,

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<sup>5</sup> In addition, IFC's strategic sectors include domestic finance and infrastructure, which are important for improving the investment climate

stimulate better corporate citizenship, and help nurture demand for better governance. Bank support for developing countries' efforts to address barriers to doing business yields a double benefit on the anticorruption front: many of the obstacles to business identified in the Doing Business Reports and Investment Climate Assessments are also “collection points” for various forms of illegal levies, and serve as invitations for corrupt behavior by both government officials and private sector individuals. A successful private sector that widens opportunities to make money honestly commensurately reduces the pressure on individuals to seek corrupt avenues.

18. ***A Responsible Private Sector.*** Direct engagement by IFC and MIGA with the private sector to strengthen ethical corporate practices and to encourage them to join public-private coalitions for reform, such as the Extractive Industries Transparency Initiative (EITI), Publish What You Pay, and the regional Forest Law Enforcement and Governance regional Ministerial initiatives (FLEG), can help create pressures on government to reform. IFC, in particular, has an important role to play: it can use its investments and advocacy to engage the private sector as a proactive ally in the fight against corruption. IFC will work to introduce partnerships that create and reinforce incentives for private firms to avoid corruption, helping create visibility around the idea that avoiding corruption is good for businesses. This will be consistent with IFC's existing approach to building the “business case” for private sector engagement on environmental and social issues.

19. ***Raising the Cost of Corruption.*** Finally, public sanctions by the Department of Institutional Integrity (INT) can help to raise the cost to businesses for continuing to engage in corruption, while voluntary disclosure by contractors that have engaged in corruption can help to unravel embedded corruption networks. Joint sanctions reform by the MDBs has begun the important process of standardizing definitions of corruption; improving the consistency of investigative rules and procedures; strengthening information sharing; and assuring compliance and enforcement actions taken by one institution are supported by all others. For the Bank, the recently launched Voluntary Disclosure Program (VDP) promises to be an efficient and very cost-effective method of eliciting high-quality evidence of the nature, forms, and patterns of corruption in Bank projects, as well as the identities of corrupt actors. With both the UN Convention against Corruption and the OECD Anti-Bribery Convention now in force, firms with corrupt practices face greater law enforcement risks, which are amplified by the new possibility of being identified by a VDP participant. As a result, entering the VDP is likely to make good business sense for many firms, especially since they will then have an opportunity to come clean while continuing to do business with the Bank.

20. ***Working Together.*** The World Bank Group will more fully engage in countries to create a competitive and responsible private sector, working with both governments and firms in a more coordinated way, through joint IBRD/IDA, IFC, and MIGA CASs. The Bank Group will more effectively work together to create public-private partnerships in countries, exploring how to extend existing approaches to new areas.

#### **D. Supporting Champions of Reform**

21. Irrespective of the entry point—strengthening the executive, supporting the demand side, or facilitating more private sector involvement—the success or failure of World Bank Group efforts to help countries strengthen governance and reduce corruption ultimately depends

on the extent to which the reform program is driven by country-level champions with the commitment and authority to move forward the reform agenda and the local knowledge to find a way through the inevitable morass of obstacles. This is why country ownership is key to the reform process. Often tremendous obstacles to governance reforms are thrown up by vested interests, including entrenched corruption networks in several countries and sectors. Successful reform may then require effective coalitions of reform leaders—as in the Philippines where a coalition of government, civil society organizations, private sector associations, church groups, and the media provided crucial support to champions of procurement reform design and implementation.<sup>6</sup> International organizations can play an important role in supporting reform champions and coalitions of reform leaders from the public sector, private sector, and civil society—the World Bank Group can work with government counterparts to support leaders and agents of change across society. As a recent multi-stakeholder conference at Oxford University (cosponsored by the World Bank) concluded, a key challenge for governance reform is thus to “catalyze, support, empower, recognize and connect committed leaders and reform champions, and promote integrity alliances at the global, country and sector levels.”<sup>7</sup> Finding, backing and honoring champions of change is the all-too-hidden secret of development effectiveness. It warrants greater attention in the toolkit of governance reform.

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<sup>6</sup> J. Edgardo Campos and Jose Syquia, “Managing the Politics of Reform: Overhauling the Legal Infrastructure of Public Procurement in the Philippines,” World Bank Working Paper No. 70, World Bank, 2006.

<sup>7</sup> Oxford Conference, “Leadership, Ethics and Integrity in Public Life,” April 2006, co-sponsored by the World Bank, USAID, AUSAID, and DFID, was attended by over 250 leaders from 70 countries and major civil society organizations, such as Transparency International. The Conference led to proposals to form and support a Global Integrity Alliance .

## ADDRESSING CORRUPTION IN BANK GROUP PROJECTS

1. The Bank’s record in reducing corruption in projects that it supports is essential for achieving its mission to reduce poverty in its client countries, as well as for its credibility in advising and supporting governance and anticorruption efforts. Bank shareholders expect the Bank to do all it can to ensure that the resources it provides will not be wasted, especially at a time when so much attention is being given to the issue of aid effectiveness. At the same time, the institution has become more sensitive to reputational risk and concerns about the effective use of aid. Given the small share of overall spending represented by Bank-financed projects in most countries, merely protecting Bank-financed projects from the misuse of funds will not affect overall corruption levels; but the Bank can demonstrate good practice in the projects it supports.
  
2. ***Fiduciary Controls.*** The Bank has always been concerned to ensure that the funds it provides are used for the intended purposes, and it has generally relied on safeguards on lending for this purpose. Fiduciary controls—the Bank’s financial management, procurement, and disbursement procedures—have advanced since 1977: in most countries the Bank routinely assesses not just the arrangements for Bank-supported operations but the country’s overall fiduciary environment. This diagnosis informs the Bank’s operational strategy; and Bank-financed operations (including policy-based loans) in turn support governance reform to strengthen public financial management. More recently, some Bank-financed operations have begun to include accountability mechanisms aimed at giving “voice” to civil society as a means of reducing the risks of corruption. These mechanisms might include social assessments, institutional and implementation assessments, and strategic communications. Importantly, operational experience has demonstrated that protecting Bank funds can also advance local capacity. (See Box D1).

### **Box D1. Developing Local Capacity is Key to Protecting Bank Funds in Latin America**

Experience in Latin America indicates that good procurement and financial management help improve public expenditure, achieve development results, and protect the use of country, Bank, and donor funds for intended purposes. For example, in *Mexico* the introduction of a state-of-the-art e-procurement system resulted in 20 percent cost savings in public procurement, as well as increased foreign competition. In *Guatemala* the development of an integrated financial management system, also linked to the e-procurement system, has led to a significant improvement in the perception of transparency at both the central and municipal government levels. In both countries the prospect of using such systems under Bank-financed projects motivated some of the reforms.

In countries where fiduciary risks are very high and the government’s engagement on public expenditure and fiduciary reforms is limited or institutional capacity is very low, ring-fencing Bank-financed projects may be the only feasible option. For example, Bank-supported projects in *Haiti* use simple project designs and rely both on permanent organizational structures such as the Ministry of Finance and on special-purpose project implementation units. The Bank reduces opportunities for corruption through procurement prior review of contracts; ring-fencing of funds, including through special accounts in the Central Bank and disbursement of funds on the basis of statements of expenses; and careful prior evaluation of control systems and implementation of action plans to improve them.

Latin American experience indicates that development of local capacity (with a view toward progressive reliance on domestic systems) and ring-fencing can be complementary, not mutually exclusive, approaches. They can both be part of an overall development strategy tailored to fit specific country, sector, or program circumstances. As a critical tool for strengthening fiscal and program management, combating corruption, and improving governance, project-level procurement and financial management work is becoming progressively integrated with analytic work, institutional development, and capacity building in borrowing countries.

3. **Department of Institutional Integrity.** Concern about fraud and corruption in Bank-financed operations has risen sharply in recent years because of the accumulating findings of the Bank's Department of Institutional Integrity's (INT) investigations of investment projects. The establishment of INT and the Sanctions Committee/Board in 2001 has created capacity to investigate allegations of fraud, corruption, coercion and collusion related to Bank Group-financed projects and to sanction firms and individuals found to have breached the fraud and corruption provisions of the Bank's Procurement Guidelines or the Consultants Guidelines. More than 2,000 external cases of alleged fraud, corruption, or other misconduct have been handled since 1999 and more than 330 companies and individuals have been publicly sanctioned, providing significant examples of issues in projects financed or managed by the Bank across countries. Lessons are also emerging from INT's proactive Detailed Implementation Reviews (in which several projects in multiple sectors in a relatively high risk country are reviewed by INT for indicators of fraud and/or corruption), with four reviews completed and two under way. Problems identified include kickback brokers (a local agent arranging kickback payments to the officials responsible for awarding a contract), bid rigging (in which government officials agree on who will win the bid), use of front companies (generally used with other schemes, to disguise ownership), and use of official-owned companies (generating conflict of interest).<sup>1</sup>

4. **Lessons.** Both INT investigations and Bank supervision have revealed frequent shortcomings in project documentation and recordkeeping by project agencies. INT findings further point to the need for each project to identify the risks it faces clearly and meaningfully and the need for supervision to be carried out differently, with a team that includes fiduciary and technical skills undertaking a unified review. About half of INT investigations that led to specific corrective actions were linked to infrastructure projects, suggesting the heightened vulnerability of this sector. Among the lessons of recent experience: country-specific, risk-based assessments of fiduciary management are important; internal Bank incentives need to be aligned with the goal of identifying country institutional weaknesses; operations staff need to be appropriately trained; and results-focused and participatory approaches are essential to good project preparation and implementation.<sup>2</sup>

5. **Prevention.** Prevention of corruption in investment operations will emanate from a more explicit focus on anticorruption during project identification as well as during implementation and supervision. At the identification stage, the project's susceptibility to corruption will be assessed by considering the country and sector environments as well as the nature of project activities. A key source of information is any INT investigative findings or relevant Detailed Implementation Reviews. Appropriate corruption mitigation measures will then be included in the project's design with, in a growing number of countries, the assistance of INT advice on effective anticorruption safeguards and due diligence. Project design should increasingly include enhanced oversight mechanisms, disclosure of project information, complaints handling, and strengthened supervision. Moreover, project agencies or units need processes in place to ensure adequate recordkeeping and documentation, which is vital for subsequent detection of problems. Most importantly, the measures must aim to increase the accountability of project implementing

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<sup>1</sup> See Glenn Ware, J. Edgardo Campos, J. Oliver Moss, and Gregory Noone, "Corruption in Public Procurement: A Perennial Challenge," in J. Edgardo Campos and Sanjay Pradhan, eds., *The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level*, World Bank, forthcoming.

<sup>2</sup> For more detail, see *Infrastructure: Lessons from the Last Two Decades of World Bank Engagement*, World Bank, Washington, D.C., January 30, 2006.

agencies and service providers through instruments that give “voice” to beneficiaries (such as beneficiary surveys and citizen scorecards). Strengthened anticorruption measures will also include an enhanced focus on internal controls, audits, and readiness of fiduciary arrangements for project implementation. Other measures might include technical assistance components, especially in fiduciary areas; enhanced transparency and disclosure on project procurement and financial management issues; and stronger monitoring mechanisms (including physical and value-for-money audits). Since an effective dialogue on issues of fraud and corruption (amongst other matters) is critical to project success, a communications strategy that covers all phases of the project should be developed. (See Box D2 for a recent project example).

**Box D2. Integrating Anticorruption Elements into Project Design: Paraguay Road Maintenance**

The \$74 million Paraguay Road Maintenance Project currently under preparation, which finances the enhancement, management, and maintenance of the country’s roads infrastructure, directly integrates anticorruption components. The design of the project sets three guiding themes in all components: (a) *performance*, through monitoring targets whose attainment will be the indication of success; (b) *accountability*, through planning and programming all interventions on the basis of objective and quantifiable criteria; and (c) *participation and transparency*, through mechanisms that allow stakeholders to influence and share control over the decisionmaking. Preparation of the proposed project, while two years in the making, has influenced the implementing ministry to prepare a road sector strategy that aims to generalize the approach.

The project’s design includes clear roles for the borrower, the Bank’s task team, and—an innovation—INT during project implementation, including a set of monitorable indicators triggering specific responses tailored to the level of the corruption risk identified. The project’s anticorruption action plan proposes enhanced supervision to be triggered by biannual Borrower reports on indicators of potential inefficiencies or “alerts” (such as the number of firms participating in bids dropping below three). If the Bank discovers indicators of potential fraud or “red flags” (such as improper communication with contractors) during enhanced supervision, then the team reports its findings to INT. If the gravity of the flags is deemed high, INT will investigate.

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*Note: See Paraguay - Road Maintenance Project - Project Appraisal Document (R2006-0162/1), August 7, 2006.*

6. **Detection and Deterrence.** The focus on prevention during project design will be pointless unless the borrower and the Bank follow up during project implementation and supervision. The starting point in detecting corruption must be a change in mindset that assumes little or no corruption, to a realization that with weak accountability mechanisms, the likelihood of corruption is high. Within the Bank, this change will be facilitated through better dissemination of INT findings and emerging good practice, and more explicit training and sensitization of task teams. Supervision will also rely more heavily on “red flags,” that is, indicators of corruption that task teams can use during supervision (see Box D3). Strengthened anticorruption measures include an enhanced focus on controls, audits, and reviews, and greater attention to fiduciary arrangements and to the readiness of the implementing agency or unit for project implementation. Other elements of a more effective approach to supervision might include integrating procurement, financial management, and implementation reviews; integrated procurement and financial management monitoring of controls in the contract cycle; carrying out detailed reviews of selected contracts and corresponding site visits; creating twinning arrangements with government auditors and inspectors general for training purposes; suspending disbursements if government response is inadequate; and publicizing both quality work and

suspensions, misprocurement, and cancellations. More intensive supervision will be more costly, disbursements may slow to some extent as a result of this more careful supervision, and cancellations due to misprocurement may rise. Revised staff guidelines on supervision in general and supervision of high-risk operations in particular will be prepared.

**Box D3. Red Flags from INT: Indicators of Corruption in Procurement**

Corruption in a development project may involve bribes and kickbacks, bid collusion or manipulation, and fraud

***Bribes or kickbacks are paid to secure contracts.*** If they are required to secure the payment of subsequent invoices, they may be in the nature of facilitation payments.

***Bid collusion*** may take place either among all bidders or, more often, among project officials on the one hand and the bidders on the other hand. It relies on designated losers being paid for their willingness to support collusion. Since the designated winning bidder may have to pay off the losers—in addition to project officials—to secure the contract, the winning contractor/supplier inflates prices, overbills for materials and labor, and/or underdelivers on quantity and quality in comparison with what the bid and the contract specify. Indicators of bid collusion may be in the form of rotating awards in any given series of consecutive or concurrent biddings; often the bids show unusual similarities (for example, the same typographical errors, or the same breakdown of unit prices). More broadly, indicators of bid manipulation by project officials may include bid specifications too narrow or too vague; unreasonable prequalification requirements; an unreasonably short time to submit bids; selection of other than the lowest evaluated bidder; selection of a bidder followed by change orders increasing price or scope; questionable disqualification of winning bidder and rebidding; persistent high bid prices; the same (few) bidders bidding; or apparent connections between bidders.

***Fraud*** indicators include the appearance of local agents or consultants that provide ill-defined, generic, or unneeded services—especially in a country with a reputation for corruption; unjustified or repeat sole-source awards; repeated selection of unqualified or high-priced contractors; a project official insisting on the use of certain local subcontractors or suppliers; long or unexplained delays in contract execution after bid award; and a project official living beyond his means. It may also include the surfacing of new and unknown bidders or subcontractors, or a sudden and significant change in an implementing agency’s approach to procurement—either rigid adherence to normally flexible procurement rules, or the reverse. Indicators of fraud during contract implementation include poor-quality work, repeated failed tests or inspections, delays or refusals to allow tests or inspections, and complaints from users.

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*Source: Annual Report on Investigations and Sanctions of Staff Misconduct and Fraud and Corruption in Bank-Financed Projects: Fiscal Year 2004, Department of Institutional Integrity, February 2005.*

## GLOBAL PARTNERSHIPS ON GOVERNANCE AND ANTICORRUPTION

1. To strengthen the impact of work on governance and anticorruption and more effectively support individual countries in their effort, the World Bank Group is engaged broadly with other development institutions and international partners on the global anticorruption agenda. Global partnerships promote coordinated action, resource pooling, sharing of innovations and expertise, and a more effective division of labor consistent with each organization's resources and mandate. The Bank's strategy for enhanced global engagement consists of stronger coordination with multilateral and bilateral donors; strengthened global partnerships with civil society, the private sector, and the media; strengthened global coalitions among leaders of the state, civil society, the media, the private sector, and international organizations to promote change at sector, country, and global levels; and support for implementation of international initiatives and conventions.

2. ***Enhancing Public Goods.*** In the area of governance and anticorruption, global partnerships on anticorruption have been used to enhance global public goods, including by: (a) sharing experience and information;<sup>1</sup> (b) developing approaches to tackle transnational aspects of corruption;<sup>2</sup> (c) supporting the demand for better governance;<sup>3</sup> and (d) fostering coordination among donors.<sup>4</sup> In many of these partnerships, the Bank has played a central, proactive role.<sup>5</sup>

3. ***Areas for Strengthening.*** Deeper and more effective partnerships are needed in (a) understanding the political determinants of poor governance, and strengthening capacity in media, civic associations, legislatures, and other institutions of accountability; (b) addressing the role of multinational firms in the governance and anticorruption agenda; and (c) harmonizing donor approaches, especially in higher-risk settings where mixed signals from donors can undercut progress on governance.

4. ***Harmonization and Coordination with Donor Partners.*** There are serious challenges of coordination among bilateral donors, multilateral development banks (MDBs), and other international financial institutions (IFIs). For example, if there are divergences in approaches and standards, recipient countries may be inclined to turn to donors who are less stringent standards on governance and anticorruption issues. More broadly, improved coordination among donors in governance work generally and anticorruption work specifically is central to ensuring development impact. By working jointly on analytic work, donors can ensure better quality work, develop consistent messages on key issues, and encourage the identification of agreed follow-up programs that have broad support. With respect to project funding and subsequent implementation, consolidating a myriad of donor activities into one agreed program reduces transaction costs, facilitates priority setting, allows for common reporting, and generally reduces

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<sup>1</sup> Transparency International, Internal Tax Dialogue, Global Organization for Parliamentarians Against Corruption, International Anti-Corruption Conference, and the Ethics Resource Center.

<sup>2</sup> The Organisation for Economic Co-operation and Development (OECD) Anti-Bribery Convention, the United Nations Convention against Corruption, the Global Program on Fisheries, the Extractive Industries Transparency Initiative, and the Forestry Law Enforcement and Governance Ministerial initiatives.

<sup>3</sup> The Partnership for Transparency Fund, the Global Integrity Alliance, the Partnership Against Corruption Initiative (PACI), and the Business Competitiveness and Development Program for corporate governance.

<sup>4</sup> The OECD-DAC Governance Network (GovNet), the Public Expenditure and Financial Accountability (PEFA) program, and the MDB Governance and Capacity Building Working Group.

<sup>5</sup> For example, the Forest Law Enforcement and Governance Ministerial processes (FLEG) in East Asia, Africa and Europe and North Asia have been facilitated by the Bank since the first Ministerial Conference in Bali, Indonesia in 2001.

the burden of donor requirements on governments. The main messages of the Paris Declaration<sup>6</sup> have particular relevance in many areas of governance—it makes little sense for donors to pursue separate approaches to civil service reform, work on budget and financial management systems, and support for key anticorruption and judiciary institutions. New and emerging strategies on governance and anticorruption by several donor organizations, including the African Development Bank, the Asian Development Bank, Australia’s Australia Agency for International Development (AusAID), the Canadian International Development Agency, the UK’s Department for International Development (DFID), the US Agency for International Development, and others provide important opportunities to advance coordination.

5. **Bank Efforts.** A substantial body of country-level good practice on harmonization is emerging, and the lessons of this work need to be more broadly applied. At the global level, coordinated and harmonized donor approaches can better support partner countries in building more capable and accountable institutions, and can tackle more effectively the challenges of poor governance and corruption in high-risk settings. The Bank’s efforts in global areas include the following:

- Enhanced focus on undertaking joint assessments of governance and corruption and fostering greater specialization among international organizations and donors. The Bank is working closely with bilateral and multilateral donors through the Governance Network (GovNet) of the OECD-Development Assistance Committee (DAC) in preparing a policy paper for the DAC that outlines an agenda for collective donor action on anticorruption. The GovNet is piloting a collective donor approach in Cameroon.
- Continued coordination with other institutions—for example, the recent work of an IFI task force on sanctions reform to improve consistency in investigative rules and procedures, strengthen information sharing, and implement mechanisms to recognize each other’s sanctions decisions.<sup>7</sup> Another priority is to coordinate donor strategies in exceptional-risk countries to avoid mixed signals—that is, a determined stance by one donor may be negated by different standards or opportunistic behavior of other donors. To this end, it is important that efforts are made to integrate new and emerging donors. There are some examples of collaborative CASs (for instance, Uganda), which could serve as an important instrument to facilitate coordination.

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<sup>6</sup> *Paris Declaration on Aid Effectiveness: Ownership, Harmonization, Alignment, Results and Mutual Accountability*, March 7, 2005 (R2005-0058).

<sup>7</sup> In November 2005, the integrity units of all the MDBs met for the first time to discuss common issues, challenges, and their experiences. At a meeting in February 2006, the heads of MDBs agreed to launch the Joint International Financial Institutions Anticorruption Task Force with a mandate to: standardize definitions of corruption; improve consistency of investigative rules and procedures; strengthen information sharing; and assure compliance and enforcement actions taken by one institution are supported by all others. The task force has agreed in principle on definitions (see Annex G) (and the Bank approved those definitions on August 1, 2006); on investigative guidelines; and on information sharing. For further details, see *Sanctions Reform: Expansion of Sanctions Regime Beyond Procurement and Sanctioning of Obstructive Practices - Revised* (R2006-0149/4, IDA/R2006-0158/4, IFC/R2006-0209/4, MIGA/R2006-0045/4), July 28, 2006.

- Continued coordination with the IMF on a range of areas related to governance and transparency<sup>8</sup>—for example, in public financial management, tax and customs reform, support for Poverty Reduction Strategy Papers, coordinated strategies on debt relief, through the IMF’s publications policy, work with the Financial Action Task Force (FATF) to assess countries’ compliance with the FATF’s recommendations to combat money laundering and the financing of terrorism, and on the Report on Observance of Standards and Codes (ROSC) initiative.<sup>9</sup> (See Box E1). The Fund’s involvement in governance requires a macroeconomic rationale and is concentrated in their areas of expertise, notably fiscal and financial sector policies and practices—two key areas where governance issues arise. When warranted, anticorruption and governance measures are incorporated in conditionality and are addressed in many Article IV consultations and programs, and the Fund’s governance-related conditionality focuses on questions of good economic governance and measures that are directed toward achievement of the objectives of members’ programs, for example under the Poverty Reduction and Growth Facility (PRGF), or under the enhanced Heavily Indebted Poor Country (HIPC) initiative.

#### **Box E1. The IMF’s Approach to Promoting Good Governance and Combating Corruption**

In response to the IMF’s Board of Governors’ request, in 1997 the IMF’s Executive Board adopted a guidance note, *Good Governance: The IMF’s Role*, which describes how the IMF, given its mandate and expertise, can contribute to good governance (including the avoidance of corrupt practices) through its policy advice and technical assistance, focusing mainly on two spheres: i) improving the management of public resources through reforms covering public sector institutions, including administrative procedures; and ii) supporting the development and maintenance of a transparent and stable macroeconomic and regulatory environment conducive to efficient private sector activities. The note also indicates that the IMF should get involved in governance issues only when they have a significant current or potential impact on macroeconomic performance, focusing only on the economic aspects of those issues that fall within its mandate. IMF staff are encouraged to collaborate closely with other multilateral institutions, in particular the Bank.

Since 1997, the IMF’s role in promoting good governance has been to encourage transparency and accountability in economic policies through the development and promotion of internationally recognized standards and codes of good practice, and, together with the Bank, address the adequacy of systems for tracking public expenditures on poverty reduction. The IMF assists countries’ compliance with internationally recognized standards and codes through the joint IMF-World Bank ROSC initiative. This includes implementing policy transparency codes on fiscal policy, monetary and financial policies, and data, as well as on other financial sector institutions and regulations. It also includes the intensifying of Bank and Fund involvement in international AML/CFT activities. Minimum standards for control, accounting, reporting and auditing systems of central banks were also introduced to safeguard the use of Fund resources, and a *Guide on Resource Revenue Transparency* was developed in 2005 to supplement the general manual on fiscal policy transparency with good practice examples of specific relevance to countries with large extractive industries.

Increasingly, countries request IMF technical assistance in building capacity—such as strengthening tax and customs administrations, and improving budgeting and public expenditure management—that has a direct bearing on good governance.

Source: IMF staff and website.

<sup>8</sup> Bank-IMF collaboration has been guided since 1989 by a formal Concordat and subsequent guidelines. See *Bank-Fund Collaboration in Assisting Member Countries*, SM/89/54, Rev.1, March 31, 1989.

<sup>9</sup> The IMF launched three international codes of good practice—for fiscal transparency, data dissemination, and monetary and financial policies. Currently, the IMF and the Bank collaborate in assessing the observance of standards and codes in 12 areas critical to the functioning of a market economy, including those relating to transparency, corporate governance, financial sector, market integrity, and anti-money laundering. The results are summarized in Reports on the Observance of Standards and Codes (ROSCs), which are typically published with the consent of the member.

6. ***Strengthened Partnerships with Civil Society and the Private Sector.*** The World Bank Group will take a strong, proactive role in working with civil society and the private sector as vital partners in promoting the demand for good governance and anticorruption. At the global level, the Bank partners with civil society organizations along a range of economic reform and governance dimensions,<sup>10</sup> and it will work to strengthen these partnerships. The Bank Group, and especially IFC, has also been working with business associations and private firms in the area of corporate responsibility and transparency, as also with global professional and standard-setting bodies. These partnerships have been especially useful to establish a dialogue with the private sector and other stakeholders, examine the challenges facing businesses at the local level, and identify possible policy solutions to improve the business environment, and shape the standards and codes and thus have an impact on regulatory approaches in developed and developing countries. More broadly, while IFC/MIGA focus on ensuring adherence to corporate integrity at a transactional level, the World Bank Group will marshal its collective efforts to engage proactively with the private sector at the country and global levels, as in Partnership Against Corruption Initiative (PACI). The World Bank Group, and particularly IFC and MIGA, will engage with the private sector as a crucial ally for good governance and will promote the idea that avoiding corruption is good for business, consistent with mounting pressure in recent years from investors and regulators for multinational corporations to commit to corporate social responsibility. The World Bank Group will also strengthen partnerships with civil society organizations and the media at the country and global levels as a powerful force for holding governments accountable. This will include stronger partnerships with global civil society organizations such as Transparency International, and also with national and local civil society organizations and media on country-level governance initiatives such as monitoring of public procurements or asset declarations of public officials.

7. ***Supporting Global Coalitions for Reform.*** The Bank Group will continue to support a series of initiatives at the global level to promote coalitions among government representatives, civil society, the media, and the private sector for governance reform. The Extractive Industries Transparency Initiative (see Box E2) represents an example of such an effort at the sector level in countries. Another important sectoral initiative is the Forest Law Enforcement and Governance regional Ministerial processes (FLEG), which help to combat illegal logging and other forest crime through a shared responsibility of producer and consumer countries of forest products, and in which governments, civil society, and the private sector all have distinct roles to play. Through such innovative global partnership as the Global Integrity Alliance and the Global Organization of Parliamentarians Against Corruption, and through working more with youth groups and leaders, as well as with reformist networks within countries, the Bank Group can identify ways to recognize and support leaders in developing countries who take a tough stand on corruption, often at high risk to themselves, and can help combat entrenched networks of corruption.

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<sup>10</sup> The Bank collaborates with Transparency International on a variety of initiatives, including the International Anticorruption Conferences and periodic consultations. A joint workshop in 2003 with Transparency International took stock of the Bank's progress on anticorruption.

**Box E2. The Extractive Industries Transparency Initiative (EITI)**

The Extractive Industries Transparency Initiative (EITI), a global initiative aimed at increasing transparency and accountability in countries dependent on extractive industries (oil, gas and mining), was developed in response to the so-called “resource curse”—increasing evidence that resource endowments only contribute to sustained growth when there are high levels of transparency and accountability. EITI was launched in 2002 as donors, companies, and civil society groups (for example, the *Publish What You Pay Coalition*) looked for a mechanism to address extractive industries’ issues. The multi-stakeholder initiative promotes auditing, reconciliation, and publication of information on what companies have paid to governments, and what governments have received from those companies. A Secretariat based in the UK’s DFID coordinates and leads the Initiative. Some 21 countries across Africa, Asia, Latin America, and the former Soviet Union have endorsed or are implementing EITI. Of these, 14 have active ongoing EITI programs, and 4 have produced EITI reports. Examples of EITI implementation include Nigeria, one of the most advanced country in terms of implementing the EITI, where financial, physical, and process audits have been carried out which have identified a number of problem areas where sector management is not transparent and where reforms are required to deter corruption and mismanagement; and Azerbaijan, where recent EITI reports have identified discrepancies between the figures reported by companies and the Government, enabling Azeri civil society to scrutinize the oil and gas sector and to be more closely involved in discussions with the Government and the oil companies. Looking forward, EITI is recognized as an important first step, but that countries need to see it as a part of an overall sector governance program which looks at broader issues of effective regulation, sector management, and revenue distribution. An international validation system is being developed which will assess the level of implementation of the Initiative.

*Note:* For further information see [www.eitransparency.org](http://www.eitransparency.org)

8. ***Supporting Implementation of International Initiatives and Conventions on Governance and Anticorruption.*** Certain international legal conventions and initiatives strengthen the anticorruption framework in industrial countries in ways that hold individuals and companies responsible for acts committed in other countries. This extraterritorial reach is potentially a great support for developing countries, whose judiciaries are not always up to the task of prosecuting complicated corruption cases with international dimensions, especially when they involve large international companies or politically influential nationals. The most important such anticorruption initiatives are the OECD Anti-Bribery Convention, the anti-money laundering recommendations of the Financial Action Task Force (FATF), and the United Nations Convention against Corruption.

- Inspired by legislation in effect in the United States since 1977, the OECD Anti-Bribery Convention actions came into effect in 1997 as the first global instrument to target the supply side of corruption. Until then, most OECD countries considered bribes paid to foreign officials as legitimate tax-deductible business expenses. The implementation of the Convention is supported by a strong monitoring mechanism.<sup>11</sup> Ways will need to be found to engage more with countries, especially emerging market economies whose importance in trade and investment in developing countries

<sup>11</sup> The OECD will soon publish a review of two dozen reports from the peer review monitoring process, involving on-site visits to assess enforcement. Transparency International has published a report that shows a positive start to enforcement, with foreign bribery cases or investigations in 15 of 24 countries surveyed, but it notes with concern the nine countries that have neither cases nor investigations. Transparency International’s *2006 Progress Report on the Enforcement of the OECD Convention* notes both strengths and potentially serious weaknesses, and recommends strengthening government enforcement organizations to deal with foreign bribery cases.

is growing rapidly. The Bank will continue its partnership clients and the OECD for tougher monitoring, disclosure, and enforcement of the OECD Anti-Bribery Convention.

- The multinational FATF issued its Forty Recommendations on Money Laundering, now an international standard, in 1990 and added nine special recommendations for measures to aid in combating financing of terrorism (CFT) in 2003 and 2004. At the heart of the anti-money laundering (AML) recommendations is the identification of the crimes—including corruption and bribery—that give rise to money laundering. The Bank and Fund have been providing assistance and training to partner countries to build AML/CFT systems and implement measures to complement other instruments to combat corruption, including assistance on asset freezing and forfeiture.<sup>12</sup> In the Bank, assistance is provided as stand-alone AML/CFT programs, or as part of Bank lending and nonlending financial sector programs. Further, in financial sector lending programs, putting in place AML/CFT laws has been supported by development policy operations, such as in Vietnam and Cambodia.
- A very important global anticorruption convention is the United Nations Convention against Corruption, which became effective in December 2005, after 30 countries had ratified it. The Convention covers both public and private corruption and emphasizes prevention, detection, prosecution, confiscation of proceeds, and international cooperation. The World Bank is working closely with UN Office of Drugs and Crime in supporting the implementation and monitoring of the Convention (see Box 5).
- The regional dimension of the multi-partner, multi-country collaboration strategy is also of high importance, such as working closely with New Partnership for Africa's Development (NEPAD), the African Union, the UN Economic Commission for Africa (UNECA), regional bodies under the FATF, the Asia-Pacific Economic Cooperation Forum (APEC), and the Organization of American States (OAS), (in particular, in their regional peer review and related anticorruption and good governance mechanisms and initiatives).

9. ***Restitution of Assets.*** The ability of developing countries to pursue assets stolen by corrupt officials and moved to offshore financial institutions is hindered by a lack of adequate instruments to trace these funds and by legal procedures that make it difficult, costly, and time-consuming to recover such assets once they have been identified. Making it easier for developing countries to recover stolen assets would reduce the incentives for such theft and strengthen the champions of good governance in developing countries. The UN Convention against Corruption has a strong framework for asset recovery that recognizes the return of assets as a “fundamental principle” and urges states to “afford one another the widest measure of cooperation and assistance” (Art. 52). Although the Bank may not have the strongest comparative advantage in this area, it has an important advocacy role to play in this regard and it

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<sup>12</sup> A stronger AML/CFT system can be crucial in detecting large-scale corruption, reducing incentives, and facilitating prosecution for corruption. See, for example, the *Joint Fund/Bank Report on the AML/CFT Work Program*, SM/05/338, September 1, 2005.

should use its convening power to place this issue higher on the international agenda. Its AML program provides some important support to such efforts, by advising on capacity to freeze and confiscate corruption proceeds. As the recent experience with asset recovery in Nigeria shows, the Bank can also provide important assurance that the restituted assets will be put to good use in the developing country from which funds were taken. On asset restitution, the Bank will continue these efforts and engagement through strengthening its technical assistance programs and working with the OECD and other interested private sector groups to enhance cooperation to facilitate asset recoveries.



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## DEFINITIONS

**Governance:** Governance refers to the manner in which public officials and public institutions acquire and exercise the authority to provide public goods and services, including the delivery of basic services, infrastructure, and a sound investment climate. Corruption is one aspect of weak governance.

**Corruption:** the abuse of public office for private gain;<sup>1</sup> public office is abused when an official accepts, solicits, or extorts a bribe. It is also abused when private agents give or offer bribes to circumvent public policies and processes for competitive advantage and profit. Public office can also be abused for personal benefit even if no bribery occurs, through patronage and nepotism, the theft of state assets, or the diversion of state revenues. Corruption can also take place among private sector parties, yet interface with and affect public sector performance: for example, collusion among bidders to a public procurement with the intent to defraud the state can seriously distort procurement outcomes.<sup>2</sup>

*In exercising its fiduciary duties regarding projects it funds, the Bank applies specific legal definitions, contained in the Procurement and Consultant Guidelines. The following new definitions have been proposed to strengthen the Bank's approach on governance and corruption.*<sup>3</sup>

**Corrupt practice:** offering, giving, receiving, or soliciting, directly or indirectly, anything of value to influence improperly the action of another party.

**Fraudulent practice:** any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation.

**Coercive practice:** impairing or harming, or threatening to impair or harm, directly or indirectly, any party or property of the party to influence improperly the actions of a party.

**Collusive practice:** an arrangement between two or more parties designed to achieve an improper purpose, including to influence improperly the actions of another party.

**Obstructive practice:** (a) deliberately destroying, falsifying, altering, or concealing evidence material to the investigation, or making false statements to investigators in order to materially impede a Bank investigation into allegations of a corrupt, fraudulent, coercive, or collusive practice; and threatening, harassing, or intimidating any party to prevent it from disclosing its knowledge of matters relevant to the investigation or from pursuing the investigation, or (b) acts intended to materially impede the exercise of the Bank's contractual rights of audit or access to information.

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<sup>1</sup> *Helping Countries Combat Corruption: The Role of the World Bank*, PREM, World Bank, Washington, D.C., September 1997.

<sup>2</sup> In other circumstances, private sector corruption may not directly affect public sector performance, yet have a significant development impact. When corporate governance is weak, employees in one firm may purchase higher priced or lower quality goods from another in exchange for kickbacks, raising the cost of doing business.

<sup>3</sup> See *Sanctions Reform: Expansion of Sanctions Regime Beyond Procurement and Sanctioning of Obstructive Practices, Revised* (R2006-0149/4, IDA/R2006-0158/4, IFC/R2006-0209/4, MIGA/R2006-0045/4), July 28, 2006.