

Service Delivery, Poverty and Corruption – Common Threads from Diagnostic Surveys

Background Paper for the 2004 WDR “Making Services Work for Poor People”

James Anderson, ECSPE
Daniel Kaufmann, WBI
Francesca Recanatini, WBI

DRAFT—DRAFT— DRAFT—DRAFT— DRAFT—DRAFT— DRAFT

WDR Corr and Serv Del draft 6 jan14.doc
June 27, 2003

Acknowledgements

This Note is based on a large number of reports that are based on a large number of detailed in-country surveys. It is, unfortunately, not practical to attempt to acknowledge all of the people involved in all of those studies. Nevertheless, we would like to offer a blanket note of appreciation to the many researchers, NGOs, Bank staff, and other people who have helped bring the diagnostics to life and helped them evolve from modest roots. The reader is invited to peruse the acknowledgements sections of the underlying reports for specific names. Although we can not cite here all of these people by name, we would like to acknowledge those who were direct authors and contributors to the reports. In addition to the authors of the present Note, contributors to the underlying diagnostics include: Omar Azfar, Sergiy Biletsky, Bogdan Cosmaciuc, Phyllis Dininio, Michal Dybula, Maria Gonzales de Asis, Turgul Gurgur, Sahr Kpundeh, Young Lee, Marta Menendez, Luis Moreno Ocampo, Amitabha Mukherjee, Randi Ryterman, Felipe Saez, Maria Shkaratan, Bert Spector, Helen Sutch, Jacek Wojciechowicz, and Pablo Zoido-Lobaton.

This needs to be checked once more.

Table of Contents

1. BACKGROUND	5
2. INDIRECT EFFECT OF CORRUPTION ON SERVICE DELIVERY	9
WEAKENING OF THE RESOURCE BASE	9
<i>Corruption in revenue collection diverts resources from the state budget.....</i>	9
<i>Corruption fosters underground economic activity.....</i>	10
WASTING AVAILABLE RESOURCES	10
<i>Embezzlement.....</i>	11
<i>Weak and Non-Transparent Procurement.....</i>	11
<i>Subsidies</i>	13
<i>Misallocation of talent and resources.....</i>	13
SLOWING GROWTH AND INVESTMENT	14
<i>Hampering the new and small enterprises.....</i>	14
<i>Hindrance on trade.....</i>	16
<i>Non-transparencies in regulation.....</i>	17
THE NET EFFECT ON FIRMS	17
3. DIRECT EFFECT ON SERVICE DELIVERY AND ON POOR PEOPLE.....	19
REGRESSIVE NATURE OF UNOFFICIAL PAYMENTS	19
REDUCING ACCESS TO SERVICES	20
<i>Health Care.....</i>	21
<i>Education</i>	23
<i>Utilities.....</i>	23
<i>Justice</i>	24
4. PUBLIC SECTOR INSTITUTIONS AND SERVICE DELIVERY	25
EXTERNAL PRESSURE ON STATE BODIES.....	25
INTERNAL INSTITUTIONS OF PUBLIC ADMINISTRATION.....	27
EVALUATING EXTERNAL AND INTERNAL INFLUENCES	28

List of Figures

Figure 1. Misuse of Public Resources in Latin America	11
Figure 2. Municipal Corruption in Peru.....	12
Figure 3. Misallocation of Talent and Budget in Latin America.....	14
Figure 4. Bureaucracy and Corruption in Honduras.....	15
Figure 5. Bribery During Enterprise Registration in the Kyrgyz Republic	16
Figure 6. Methods of Getting Export Licenses in Slovakia.....	17
Figure 7. Discouraged Investment in Ecuador.....	18
Figure 8. Services in Kazakhstan: The Rich Bribe For Speed, The Poor Bribe For Access.....	20
Figure 9. Discouraged Use of Public Services in Latin America	21
Figure 10. Regressive Payments and Effect on Access to Health Care in Romania	22
Figure 11. Reasons for Not Using Courts in the Kyrgyz Republic	25
Figure 12. Problems with Complaint Systems in Latin America	26
Figure 13. Informality in Public Administration	28

1. Background

In 1996 the World Bank began to discuss openly the issue of corruption and soon thereafter began to explicitly offer assistance to countries in combating corruption. Around the same time and in parallel with these efforts, there have been several new empirical studies on the link between the quality of government and development outcomes. This growing body of cross-country research has emphasized the key role of poor governance and corruption in lowering the standards of living and worsening the distribution of income among citizens. There are several mechanisms through which corruption exacerbates poverty and inequality¹.

- Higher corruption leads to lower investors' confidence, and in turn to lower domestic and foreign investment. Since sustained growth generally provides rising incomes for the poor, the retardation of growth due to corruption limits opportunities for countries to eliminate poverty.
- Politicization and the purchasing of public positions translates into misallocation of talent, including underutilization of key segments of society.
- Widespread corruption within government agencies interacting with the private sector clouds the business environment, hampering enterprise growth.
- Corruption has been linked to the unofficial economy², resulting in lower tax revenues which the state might otherwise use for stimulating economic development or direct poverty reduction measures.
- The rent-seeking associated with corruption leads to distortions in budget allocations, for example away from pro-poor investments in primary education and in favor of large-scale, and arguably more corruptible, public works projects.³ This misallocation of public funding and public investment

Empirical studies
draw the link
between corruption
and poverty and
inequality

¹ See *The Quality of Growth*, Chapter 6 (2000, The World Bank).

² For the relationship between corruption and the unofficial economy, see Simon Johnson, Daniel Kaufmann and Andrei Shleifer, 1997, *The Unofficial Economy in Transition*. Brookings Papers on Economic Activity, 2, pp. 159-239; Simon Johnson, Daniel Kaufmann, and Pablo Zoido-Lobaton, 1998, *Corruption, Public Finances and the Unofficial Economy*, Mimeo; Simon Johnson, Daniel Kaufmann, John McMillan, and Christopher Woodruff, 2000, *Why Do Firms Hide? Bribes and Unofficial Activity after Communism*. Journal of Public Economics, 76, pp. 495-520; and Eric Friedman, Simon Johnson, Daniel Kaufmann, and Pablo Zoido-Lobaton, 2000, *Dodging the Grabbing Hand: The Determinants of Unofficial Activity in 69 Countries*, Journal of Public Economics, 76, pp. 459-493.

³ See Paolo Mauro, 1998, *Corruption and the Composition of Government Expenditure*, Journal of Public Economics, 69, pp. 263-279.

The rationale for a quantitative approach was to depoliticize the issue by forcing on problems, rather than personalities

leads in turn to the deterioration of the existing physical infrastructure.

- Corruption reduces public revenues and weakens rule of law.
- State capture by the corporate elite biases the laws and policies of a country, allowing few to obtain selective benefits at the expense of the rest of the society, undermining the growth of output and investment of the enterprise sector and exacerbating inequality.
- Mis-governance and corruption act as regressive taxes on households and firms;
- Corruption is associated with lower quality of public service provision.
- Poor governance accounts for a large proportion of the difference not only in income levels among countries but also in voter turnout and civil participation,⁴ with the latter undermining the very foundations of civil society.

The increasing interest in the topic and the preliminary evidence on the link between poverty and corruption have led to a proliferation of new tools to measure corruption and governance. Practitioners within the World Bank have begun developing empirical tools to assess governance that would help encourage local capacity and action programming while generating new information. A quantitative survey approach was introduced for this purpose. Part of the rationale of a quantitative approach was to let the numbers speak for themselves, and to depoliticize the public discussion by focusing on problems rather than personalities.⁵ In the years since the first surveys were undertaken, the scope of the surveys expanded to consider the whole realm of governance and service delivery, and less parochially on corruption issues.

The objective of this note is to bring together the findings based on this set of survey databases. The overview we present cannot be qualified as “cross-country” since the country-specific characteristics of the surveys do not make the databases fully comparable. Common threads and country- or region-specific issues related to service delivery and poverty have, however, emerged quite strongly from this world-wide efforts. Our contribution is to provide a systematic overview of the findings available based on the information from these diagnostic surveys.

From the beginning, the survey approach, hereafter referred to as the “diagnostics,” included three separate survey instruments, one for

⁴ ‘Development Beyond Economics’, Interamerican Development Bank (IaDB), 2000. Furthermore, the IaDB report identifies the following political failures as factor that may influence development outcomes: problems of bias in representation; agency problem; problems of aggregation (i.e. political representatives unable to reconcile diverse interests they claim to represent).

⁵ See Kaufmann, Pradhan, and Ryterman (1999) for a summary of the early diagnostic approach.

households, one for enterprises, and one for public officials. The combination of viewpoints and experiences from each of these perspectives provided powerful evidence of the extent of the problems, the consequences, and the underlying weaknesses that weaken service delivery and foster corruption. The design, implementation, analysis and the linking between main findings emerging from these surveys is carried out through a fully participatory process, with involvement of key stakeholders from the executive, legislative, civil society and private sector.

Key features of the diagnostics, inter alia, comprise the following:

- i) multi-pronged, separate surveys of users of public services/households, firms and public officials, which permits triangulation of the results;
- ii) use of experience-based (vs. ‘opinions’/generic) type of questions;
- iii) a broad governance and service delivery conceptual framework;
- iv) rigorous technical specifications at the implementation stage.

The surveys have now been undertaken on four continents, spanning 20 countries and one municipality, all listed in Table 1.

Table 1. Diagnostics on Anticorruption, Governance and Service Delivery

Country	Year of Surveys	Report
Albania	1998	Combating Corruption in Albania – A Comprehensive Reform Program, 1998
Bolivia	1999	Voice of the Poor and the Taming of the Shrew
Bosnia and Herzegovina	2000	Bosnia and Herzegovina – Diagnostic Surveys of Corruption
City of San Paulo	2002	In progress
Colombia	2001	Corrupción, desempeño institucional y gobernabilidad: desarrollando una estrategia anti-corrupcion para Colombia
Ecuador	1999/2000	Anti-Corruption and Governance Diagnostic Report
Georgia	1998	Corruption in Latvia – Survey Evidence, 2000
Ghana	2000	The Ghana Governance and Anti-Corruption Report
Honduras	2001	Governance and Anti-Corruption in Honduras
Indonesia	2001	Partnership for Governance Report in Indonesia
Kazakhstan	2001	Governance and Service Delivery in Kazakhstan – Results of Diagnostic Surveys, 2002
Kyrgyz Republic	2001	Governance and Service Delivery in the Kyrgyz Republic – Results of Diagnostic Surveys, 2002

Surveys collect information on actual experiences with service delivery, not just perceptions

Latvia	1998	Corruption in Latvia – Survey Evidence, 1998
Nigeria	2002	In Progress
Paraguay	1999	Diagnostico Sobre Los Patrones De Comportamiento Institucional, Gobernabilidad, Corrupcion Y Desempeño Institucional
Peru	2001	Voice of the Misgoverned and Misruled
Poland	1999	
Romania	2000	Diagnostic Surveys of Corruption in Romania, 2001
Russia	2000	Indem ???
Sierra Leone	2002	In Progress
Slovak Republic	1999	Corruption in Slovakia – Results of Diagnostic Surveys, 2000
Thailand	2001	Thailand Governance and Anti-Corruption Report

This Note

summarizes

empirical findings

on the relationship

between corruption

and service delivery

from 20 diagnostic

studies

Despite the large and growing number of countries that have participated in the diagnostics, the findings will generally not be presented here in a unified cross-country framework. There are a number of reasons for this. In each country a special effort was made to revise and update the questionnaires, both to reflect lessons learned and to ensure that the questionnaires captured adequately the local conditions and institutions. Although sample selection was generally similar from one country to the next, the differences in sampling, particularly for the public officials and enterprise surveys, are sufficient to suggest caution when making direct comparisons.

Although the presentation will not be cross-country, certain common threads are evident, threads that taken as a whole present a compelling story about the relationship between corruption, service delivery and poverty. The purpose of this paper is to bring together in a single source many of the empirical findings on the relationship between corruption and service delivery as found in diagnostic surveys of corruption. Section 2 examines the evidence the diagnostics provide on the indirect effects of corruption on service delivery. Section 3 describes the concrete direct impact that corruption on service delivery for the poor. Section 4 examines the role of public sector institutions in fostering better public sector performance.

2. Indirect effect of corruption on service delivery

Corruption is a complex and nefarious problem and its consequences are nearly as difficult to parse as corruption itself. A widely accepted definition of corruption is the (mis-)use of public office for private gain. This definition includes all (and only) activities in which “public officials, bureaucrats, legislators and politicians use powers delegated to them by the public to further their own economic interests at the expense of the public good”, (Jain, 2002). Moreover, this broad definition embraces many different forms of corruption from ‘petty’ corruption to “state capture” – when powerful groups buy influence and shape the laws to their benefit. For the purpose of this overview, we concentrate on the types of corruption that (either directly or indirectly) affect service delivery and accessibility.

A key contribution the diagnostics have made is to unbundle the complex into digestible chunks, making the problem manageable. Similarly, by analyzing the mutually reinforcing ways in which corruption hurts the poor, the full scope of the problem becomes apparent.⁶ In this section, we describe the evidence the diagnostics provide on ways in which corruption weakens service delivery indirectly, through the deleterious effect on the state budget, and through the impact it has on growth and investment, and hence on income and employment generation.

Weakening of the resource base

Making services work for the poor requires adequate resources, provided transparently and predictably. Corruption diminishes the state’s ability to provide high quality services in many ways. Since fiscal resources depend on economic activity, the negative effect on growth has a fiscal impact, reducing resources which might be used to improve services for poor people. However, we take up this issue in the subsequent section on growth and investment and focus here on direct evidence on the impact of corruption on the revenue side of the state budget.

Corruption in revenue collection diverts resources from the state budget

⁶ For the mechanisms by which corruption exacerbates poverty and inequality, see also The World Bank, 2000, *The Quality of Growth*, Chapter 6.

By analyzing the mutually reinforcing ways in which corruption hurts the poor, the full scope of the problem becomes apparent

In nearly every country in which the diagnostics have been undertaken, the customs and tax administrations consistently are cited both for the experience of frequent and large unofficial payments, and for the broader perception that corruption is rife in such bodies. Corruption in these bodies diverts resources from the state's coffers into private pockets. In a similar way, bribes to inspectors and regulators to avoid fines have the same effect. Two common threads of the diagnostics are (i) that some measure of unofficial payments are present in virtually every state body, and (ii) that revenue generation bodies are often among the worst.

[xxx. note: we can put in some numbers here, but I am not sure it is needed.]

Corruption weakens
the revenue side of
the state budget,
leaving fewer
resources available
for improving
service delivery

Corruption fosters underground economic activity

Corruption and the unofficial economy go hand-in-hand.⁷ When a firm evades taxes or regulations, they usually could not do so without the complicity of an official willing to look the other way. Expansion of the unofficial economy is a fact of life in many of our countries, and there are a number of pernicious consequences. In addition to the immediate deprivation of needed resources associated with tax evasion, the effect that it has on competition is equally worrisome. In Latvia, firms estimate that competitors earn a 60 percent increase in profits by not paying taxes, not getting appropriate licenses, etc. Moreover, among complaints about the tax system, more firms cited the unfair advantage gained by unofficial competitors than they did the bureaucratic hassle.

Wasting available resources

The impact that corruption has on the state's coffers is not limited to the revenue side of the budget. Indeed, the impact on the expenditure side is even more direct and clear. The diagnostics provide detailed illustrations of how corruption and weak governance waste government resources that could otherwise be devoted to making services work for the poor.⁸

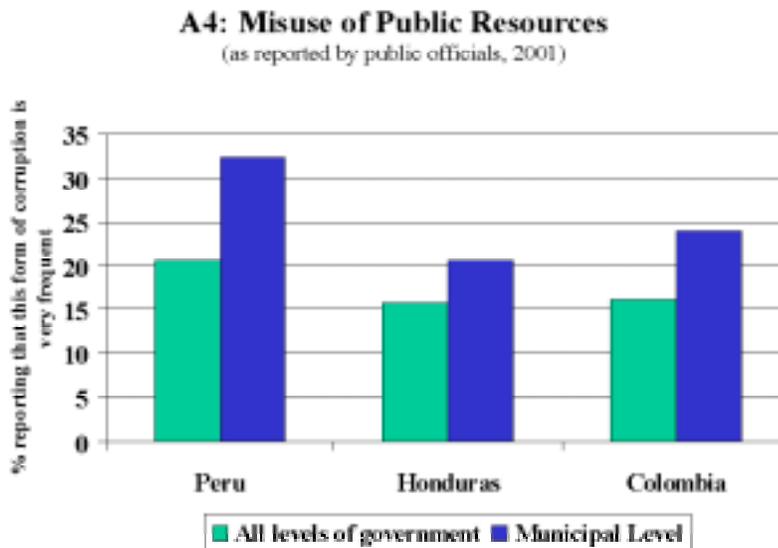
⁷ For the relationship between corruption and the unofficial economy, see Simon Johnson, Daniel Kaufmann and Andrei Shleifer, 1997, "The Unofficial Economy in Transition." *Brookings Papers on Economic Activity*, 2, pp. 159-239; Simon Johnson, Daniel Kaufmann, and Pablo Zoido-Lobaton, 1998, "Corruption, Public Finances and the Unofficial Economy", Mimeo; Simon Johnson, Daniel Kaufmann, John McMillan, and Christopher Woodruff, 2000, "Why Do Firms Hide? Bribes and Unofficial Activity after Communism." *Journal of Public Economics*, 76, pp. 495-520; and Eric Friedman, Simon Johnson, Daniel Kaufmann, and Pablo Zoido-Lobaton, 2000, "Dodging the Grabbing Hand: The Determinants of Unofficial Activity in 69 Countries", *Journal of Public Economics*, 76, pp. 459-493.

⁸ It has also been suggested that rent seeking diverts budget allocations away from pro-poor investments such as primary education and healthcare and in favor of large-scale,

Embezzlement

Although corruption take many forms, none is less ambiguous than that of embezzlement, the direct theft or misappropriation of state resources. In Kazakhstan, 27 percent of surveyed public officials said that embezzlement sometimes occurs where they work, and in the Kyrgyz Republic over half of the officials said the same. In Latin America, misuse of public resources is most severe at the municipal level. (See Figure 1.)

Figure 1. Misuse of Public Resources in Latin America



Through weak procurement, and misallocation of resources, corruption weakens the expenditure side of the state budget

Weak and Non-Transparent Procurement

Government purchases of goods and services makes up a sizable chunk of overall GDP in most countries. In 1999, for example, government purchases of goods and services made up 6.2 percent of GDP.⁹ Government contracts are potentially very lucrative for the winning firms, and it should come as no surprise that such contracts often involve large rents. When goods are purchased in an inefficient way, i.e., through non-competitive or non-transparent procurement, the state

and arguably more corruptible, public works projects. Paolo Mauro, 1998, "Corruption and the Composition of Government Expenditure", *Journal of Public Economics*, 69, pp. 263-279.

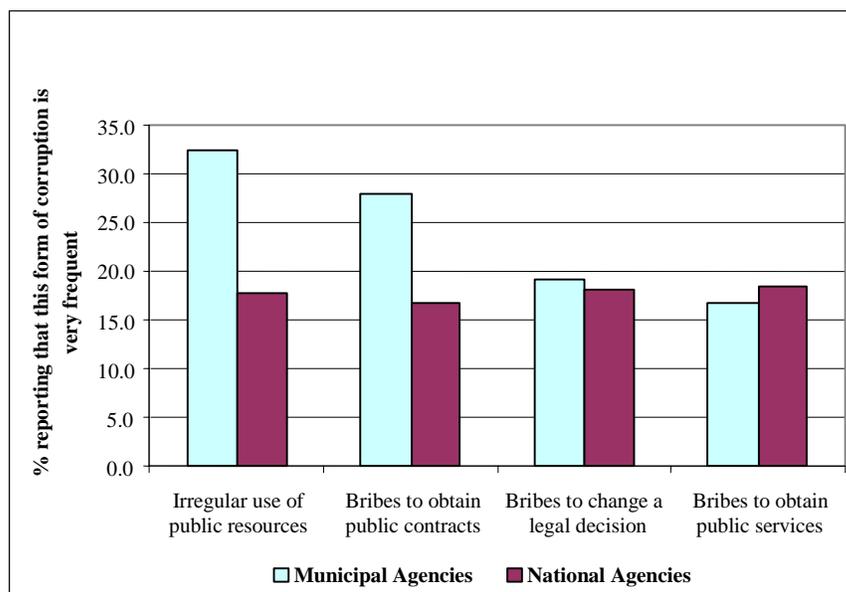
⁹ World Bank, World Development Indicators 2002.

wastes scarce resources that might otherwise be used to improve service delivery.¹⁰

Since the diagnostics collect experiences from enterprises and public officials, they bring a potent mix of evidence to bear on the degree of corruption in procurement. While the severity of the problem varies from country to country, the existence of the problem is universal. At the local level, corruption in procurement can be particularly severe. In Peru, for example, public officials state that the incidence of bribes to obtain public contracts is almost twice as high within municipal agencies than national ones. (See Figure 2.) At the same time, around one third of local public officials report that during the past two years the misuse of public funds and resources has been very common, versus only about 18% of national public officials.

Municipal bodies,
often those directly
responsible for
service delivery,
frequently have
severe problems
with corruption

Figure 2. Municipal Corruption in Peru



Besides the immediate effects of corruption, spending too much for potentially substandard products, there is also the reputational effect whereby honest firms avoid state procurements altogether. In Slovakia, for example, 34 percent of firms that said they had not participated in a state tender in which they had otherwise planned to submit a proposal said the reason was the high level of unofficial payments. Similarly, over half of the enterprises surveyed in Georgia said that the necessity of

¹⁰ In addition, quality might suffer when substandard goods are purchased, a subject that is taken up in Section XXX, below.

unofficial payments was a very important reason for not participating in procurement.

Even where advanced procurement methods are available, as in Poland, they may be circumvented. The diagnostics in that country found that significant abuses occur before the tender is issued, including bribery to ensure early access to information on the technical requirements, and after the award is made, such as by large additional contracts to the contract of the winning bidder after an initial small contract has been signed or by allowing winning firms to negotiate the tender price upwards after the contract has been awarded.

Subsidies

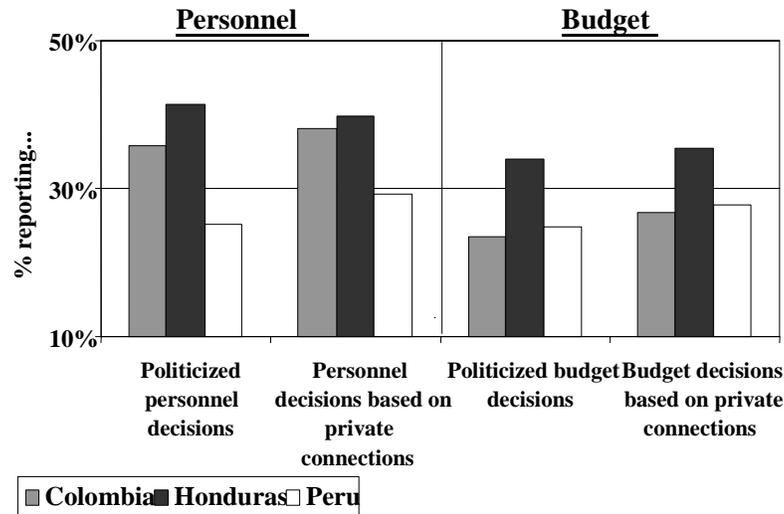
A third way that corruption wastes scarce public resources is through the non-transparent allocation of state subsidies. In the Slovak Republic, one out of five enterprises reported receiving some form of subsidies from the state and, of those, 12 percent reported paying a bribes to get the subsidy, always in combination with either political influence or connections with friends or relatives.

Misallocation of talent and resources

Corruption in public administration leads to a misallocation of talent and resources, weakening the state's ability to provide quality services. The diagnostics from three countries of Latin America, for example, show how the decision making processes in public agencies can be plagued with signs of corruption. (See Figure 3) Significant proportions of officials in all three countries (20%-40%) report that personnel and budget decisions are politicized and based on private connections leading, therefore, to inefficient outcomes in public administration. The diagnostics in other countries often point to similar conclusions.

Corruption hinders
economic activity
slowing growth and
investment,
weakening the
ability of the poor
to help themselves

Figure 3. Misallocation of Talent and Budget in Latin America



New small enterprises, the engines of growth

and poverty

alleviation, are most

affected by

corruption

Slowing Growth and Investment

The importance of economic growth for poverty reduction is well-known. Unfortunately, corruption serves as a disincentive for firms to investment and, with investment kept below potential, economic growth is also kept under potential.

We should have a section on State Capture, grand corruption and subversion of investment

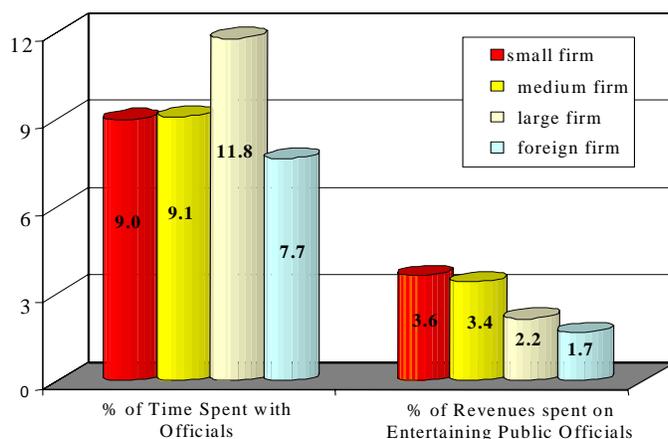
Hampering the new and small enterprises

In most of the countries in which the diagnostic is undertaken, new and small firms are more likely to pay bribes than established or larger firms. In many countries, such as Peru, Colombia, Ecuador, Georgia and Honduras, for example, small and micro enterprises report more often the request for a bribe to obtain a service than larger firms. The cost to enterprises of the regulatory burden is also greater for smaller firms. In Peru, more than a third of managers believe that the burden of regulation is a very serious obstacle to do business, with small size firms being penalized the most. Moreover, small firms spend more time dealing with public officials and more revenues in bribes (in percentage) than large and foreign firms, as in Bosnia and Herzegovina and Honduras. According to firms in the latter country, for example, managers spend

almost 10 percent of their time dealing with officials and over 3 percent of their revenue in entertaining them. As Figure 4 shows, time spent with officials is significantly higher for large firms and significantly lower for foreign firms. In addition, smaller firms allocate a higher share of their revenue to organize meetings with officials.

Though smaller businesses pay more than larger ones as share of their revenues, medium size enterprises sometime appears to pay the largest share of all to obtain services (as in the case of Honduras and Colombia, for example).

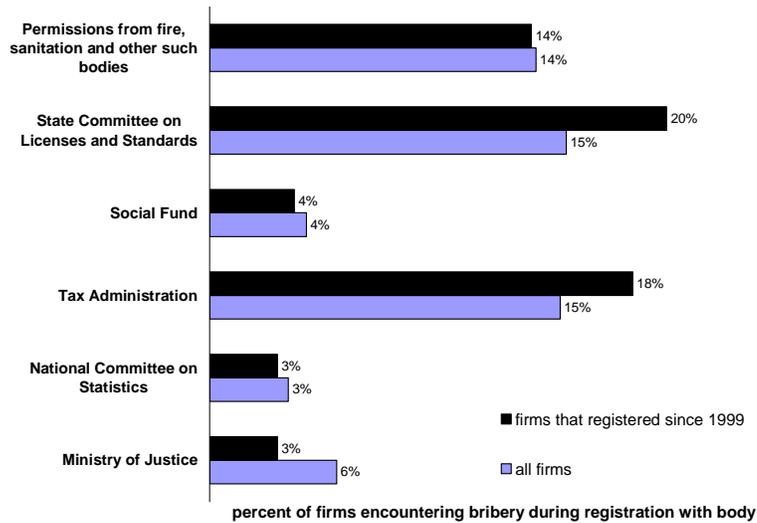
Figure 4. Bureaucracy and Corruption in Honduras



The time tax on firm managers, in their dealings with state officials, can be significant

The regressive nature of bribery is hardly surprising, since new firms have many more interactions with state officials as they make utility connections and collect the necessary licenses and registrations needed to conduct business. In the enterprise registration process, for example, there are often many individual steps, each raising the possibility of a bribe. (See Figure 5 for the Kyrgyz Republic.)

Figure 5. Bribery During Enterprise Registration in the Kyrgyz Republic



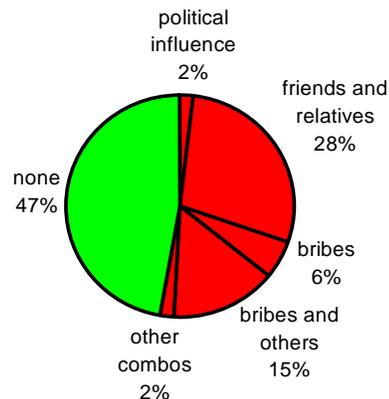
Corruption in
 customs, border
 crossing, and trade
 licenses hinders
 international trade

Microenterprise, a vehicle allowing the poor to help themselves to escape poverty, is also hindered by corruption. In Slovakia and Latvia, as in many other countries, households involved in small-scale business activities were more likely to make unofficial payments.

Hindrance on trade

International trade offers the prospect for countries, especially small ones, to benefit from specialization, from competition, and from low priced imports. These benefits can not be fully realized, however, when public officials involved in trade use their positions to their advantage. In virtually every country in which the diagnostics have been undertaken, the customs administration ranks among the organizations to which firms pay bribes most frequently, thus punisher firms engaged in trade. In Latvia, exporters were more likely to have paid bribes than non-exporters, and in the Slovak Republic, many firms reported using bribery to get export licenses.

Figure 6. Methods of Getting Export Licenses in Slovakia



Non-transparencies in regulation.

In order for an economy to grow and prosper, firms must be able to work in an environment conducive to their operations. The diagnostics present considerable evidence that the large numbers of inspectors, regulators, and licensers that they must deal with each represents the potential for bribery. For example, in Slovakia, 30 percent of firms that had sought construction permits encountered bribery. Significant bribes are often reported for fire supervision, hygiene supervision, offices of environmental protection, certification authorities, and others.

The Net Effect on Firms

Often, the most deleterious effects on firms are not the direct effect of corruption, but the indirect effects of a weakened environment. In Romania, for example, many of the most important obstacles that firms face are closely associated with specific forms of state capture. Firms that reported being affected by central bank mistakes were likely to report shortage of credit and currency depreciation as serious obstacles to their development. Firms that reported being affected by parliamentary capture were most likely to say that instability of laws, rules, and regulations posed problems. Firms that reported being affected by capture involving court decisions were the most likely to report slow courts and low executability of justice to be obstacles to business development.

In Latvia and Slovakia, the investors and faster growers are the ones more likely to encounter bribery. But the reason is clearly that new and growing firms have more interactions with state officials, collecting more licenses, etc., than stagnant firms. In Slovakia, once controlling for the overall number of interactions with state officials, the higher

The diagnostics show consistently that firms view corruption not as “grease” but as a serious problem for their firm’s growth

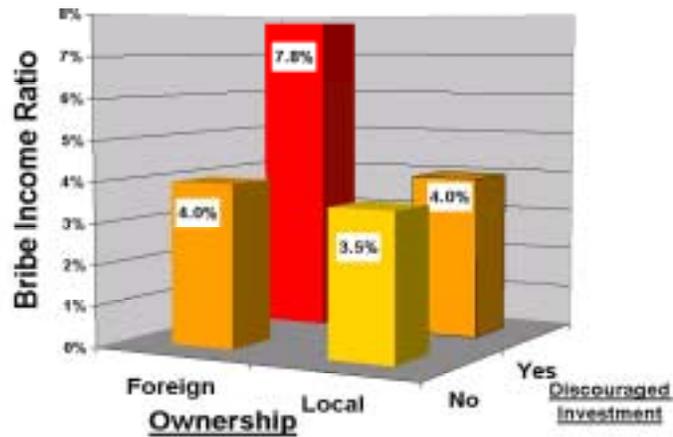
incidence of bribery among growing firms becomes insignificant. Similarly, in Kazakhstan, growing firms had more than twice as many interactions with state officials than non-growing firms. It is also plausible, as is argued in several of the diagnostic reports, that the more successful firms are explicitly targeted for bribes by public officials. Lastly, some growing firms may attempt to use the system to their advantage. As a whole, however, this last explanation finds little support. Many of the diagnostics find that firms that had encountered bribery were more likely to describe it as a hindrance than a help.

The diagnostics in Latin America provide a similar story. Enterprises in Ecuador, for example, were asked whether or not they had decided against carrying out an investment that they had previously planned to undertake. The evidence is that those enterprises most burdened by bribes are also those whose investment was discouraged, a pattern that is particularly strong among foreign-owned firms. (See Figure 7.)

Corruption
discourages
investment

Figure 7. Discouraged Investment in Ecuador

A6: Discouraged Investment in Ecuador
(as reported by managers, 2001)



In Honduras, firms interviewed reported that investment would raise by 11 percent if corruption in the public sector were eliminated. Small firms, in particular, are less willing to go ahead with new investments. More than 16 percent of small firms report that they decided not to invest because of corruption, as compared to 3 percent of large firms.

In country after country firms reported a willingness to pay additional taxes for the reduction of corruption, an indicator that corruption represents a net cost, and not a net benefit, to firms. In Albania and

Kazakhstan, the willingness to pay to eliminate corruption was even greater than the willingness to pay to eliminate crime.

In Ecuador and Peru the data indicates that enterprises spend more on bribes and gifts to public officials than on security. On average, Peruvian managers report that they spend about 5.2 percent of their profits in tokens for public officials compared to about 4.7 percent spent on security. In Ecuador, we observe a similar pattern, with enterprises reporting that unofficial payments to public officials are 8 percent of their gross revenues, versus “only” 5 percent dealing with red tape, and 4 percent on security.

In Honduras, the situation is even more dramatic with enterprises reporting on average that about 10 percent of their monthly revenues would be available if corruption were eliminated in the public sector. The loss of revenues is more significant among domestic firms, which lose as much as 12 percent of their revenues, compared to 8.8 percent of foreign firms.

3. Direct effect on service delivery and on poor people

The previous section described the evidence brought to bear by the diagnostics on the indirect effect that corruption has on service delivery and on the poor, by weakening the resources available to improve services and by stymieing growth and investment. In this section we look at the direct effect of corruption on the poor, focusing on the regressive nature of unofficial payments and the shunting of access to key services.

We should have a section on (i) services from the perspective of firms and (ii) the link between corruption and quality (not simply corruption and access)

Regressive Nature of Unofficial Payments

A consistent finding from diagnostics on four continents is that although the rich are more likely to pay bribes, the poor pay more as a share of income. The reasons are not difficult to fathom. Many unofficial payments serve as unofficial copayments acting like a flat tax. Indeed, the overall regressive pattern is mirrored when examining specific services, such as health care and justice, both of which are discussed below. In study after study, from Latin America to Europe to Central Asia, corruption penalizes the poor more than the rich.

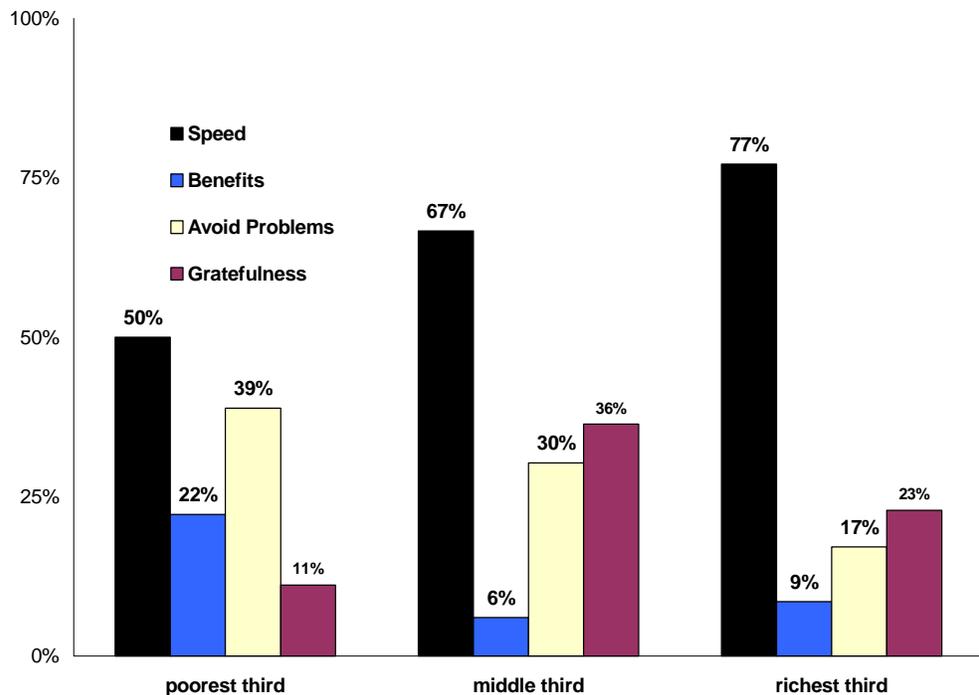
Unofficial payments
are found to be
regressive –
although the rich
are more likely to
pay bribes, the poor
pay more dearly

Reducing Access to Services

Corruption has a direct effect on the access of the poor to key services. In this section we present some of the evidence from the diagnostics on this link. Rather than attempt to present information on every sector, we will focus on select sectors – health, education, and justice – and also explain how access restrictions affect the poor the most.

The Kazakhstan household survey indicates how access and corruption are closely related, and how the motivation for unofficial payments varies by income. Respondents said that the most important reason for making unofficial payments was to obtain speedier service. However, the poor were much more likely than the rich to say that they were paying bribes in order to receive the benefits that they are entitled to and to avoid problems; the rich were more likely than the poor to bribe for speed of service. (See Figure 8.)

Figure 8. Services in Kazakhstan: The Rich Bribe For Speed, The Poor Bribe For Access



Notes: This chart is restricted to those respondents who made unofficial payments that they felt were necessary in order to receive proper service. Thus the designation "gratefulness" not not imply an innocuous token of appreciation or tradition.

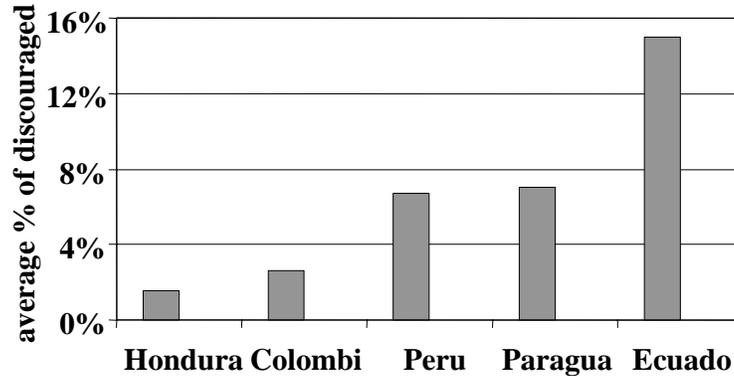
Similarly, in Latin America, households were asked directly why they might have declined to use public services, and many noted specifically the need to pay a bribe. (See Figure 9.)

When paying unofficially for services, the rich bribe for speed, and the poor bribe for access

Figure 9. Discouraged Use of Public Services in Latin America

Costs of Corruption: Discouraged Public Service Users due to Bribes

(As reported by



Source: WBI diagnostics and survey data; various countries; 19992001. *Note: The data shown are computed as average percentage (across a list of services specific for each country) of users who did not apply for a service because they could not afford a bribe (comparing to those who did not apply because other reasons).

Unofficial payments

for service delivery

often act as flat

taxes, hurting the

poor the most

Although poorer households generally pay more in bribes as a share of income, the diagnostics suggest that rich households are more likely to pay bribes in the first place. This is partially because rich households are more likely to own automobiles, travel frequently, and generally have more interactions with state offices. But there appears to be more to this story. In the Slovak Republic, richer households were more likely to have made unofficial payments even after controlling for the fact that they have more interactions with public officials. One interpretation is that richer households can buy their way out of situations that poorer households can not.

Health Care

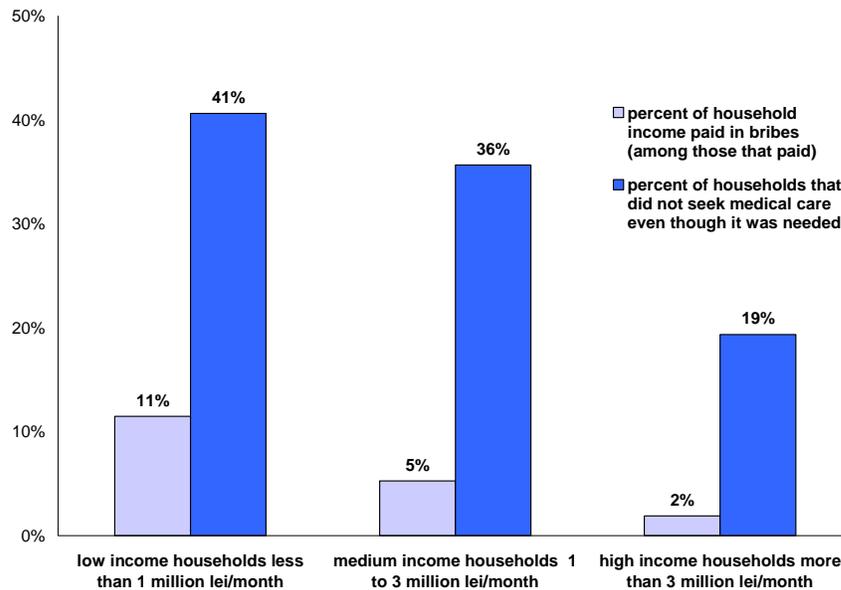
Health care is a sector that touches nearly everyone and is also a sector crucial for economic development. The widespread use of unofficial payments for health services has been documented not only in the diagnostics, but in detailed sector studies, as well. (See, for example, Maureen Lewis, *Who is Paying for Health Care in Eastern Europe and Central Asia?*, World Bank, 2000.)

The diagnostics show that the regressive nature of unofficial payments holds for health services. In the Slovak Republic, for example, the size of unofficial payments made for health care is uncorrelated with income, suggesting that many are flat payments. Thus, while the median visit to a general practitioner represented 1 percent of household income, the poorest third of the population paid an average of 3.6 percent of an already small monthly income for a visit to the doctor.

In Romania, hospital stays topped the list of household-state interactions involving unofficial payments, with nearly two thirds of households reporting that they paid unofficially. Yet the most pernicious effect of unofficial payments in health care may not be the payments themselves, but the deterrent effect they impose on poor people. The Romania household survey asked respondents that had not been to a medical facility in the twelve months prior to the survey, if they had been ill to the point of needing medical attention, but did not see a physician. (A similar patterns was found for Peru.) Poor households were more than twice as likely to say they had not sought medical attention, even though it was needed. Responses were highly correlated with respondents' perceptions of the level of corruption in health care.

The report in Poland argues that health services and markets are a fertile ground for corruption and that patients, particularly the poor, are in a uniquely weak position to counter difficulties. Moreover, reforms within the health sector were perceived to be at risk by many respondents.

Figure 10. Regressive Payments and Effect on Access to Health Care in Romania



Note: The left bar includes only those households which reported paying bribes and reported the amounts of those bribes and overall household income. Sample sizes were 19, 68, and 54 households. The right bar shows the percentage of households that did not seek medical care even though it was required. Sample sizes were 96, 143, and 62.

In Kazakhstan, the household survey asked respondents to assess whether various situations are corruption or not. Interestingly, many situations that are often described as just a tradition, such as presenting a doctor with a box of chocolates, was described by many respondents as “definitely corruption”, especially if the gift was made prior to service.

Unofficial payments for services are not merely co-payments; they actively deter the poor from seeking needed services

(See Table 2.) Moreover, assessment of what constitutes corruption varied by income of the respondent. Low income household more likely to view any given situation as “corruption” than high income household.

Table 2. What is Corruption? (Kazakhstan)

After a visit to a doctor, the doctor is given a box of chocolates.	Definitely corruption	8%
	Some ways yes, some ways no	28%
	Definitely not corruption	64%
After a visit to a doctor, the doctor is given money (in addition to the official payments).	Definitely corruption	31%
	Some ways yes, some ways no	46%
	Definitely not corruption	23%
At the beginning of a visit to the doctor, the doctor is given a box of chocolates.	Definitely corruption	24%
	Some ways yes, some ways no	38%
	Definitely not corruption	39%
At the beginning of a visit to the doctor, the doctor is given money (in addition to the official payments).	Definitely corruption	47%
	Some ways yes, some ways no	41%
	Definitely not corruption	12%
During a visit at the hospital, money (in addition to the official payments) is offered to doctors and nurses to ensure proper care.	Definitely corruption	35%
	Some ways yes, some ways no	47%
	Definitely not corruption	19%
During a visit at the hospital, money (in addition to the official payments) is requested by doctors and nurses to ensure proper care.	Definitely corruption	66%
	Some ways yes, some ways no	25%
	Definitely not corruption	9%

The costs of corruption for service delivery in health is not limited to unofficial payments. The quality of care may be weakened through procurement of inferior equipment, for example. The diagnostic in Poland found that many cases in procurement violations are reported, and that some of the equipment purchased is apparently so remote from patients’ needs that it will “never depreciate”.

Education

Informal payments are increasingly being made for education services. In Kazakhstan, for example, informal payments were prevalent at each level, and they are paid at higher rates for elementary and secondary schools than for many other state bodies. When asked why people give gifts and unofficial money to schools (excluding universities), the top two answers were to get a place for the children in school (26 percent), and to get the teacher to give more attention to the children (26 percent). Such a regime opens the scope for differential quality of education for rich and poor.

Utilities

According to the Georgia survey, each household had only 5 hours of electricity supply per day, on average, and as a response to this

Informal payments
for education
services lead to
differential quality
for the poor

inadequate supply, around half of households have some kind of independent source of electricity such as a privately owned generators. Households and enterprises both reported their perception that the main reason for the inadequate supply of electricity is that there is a conspiracy among corrupt government officials to induce households and firms to purchase other types of energy products.

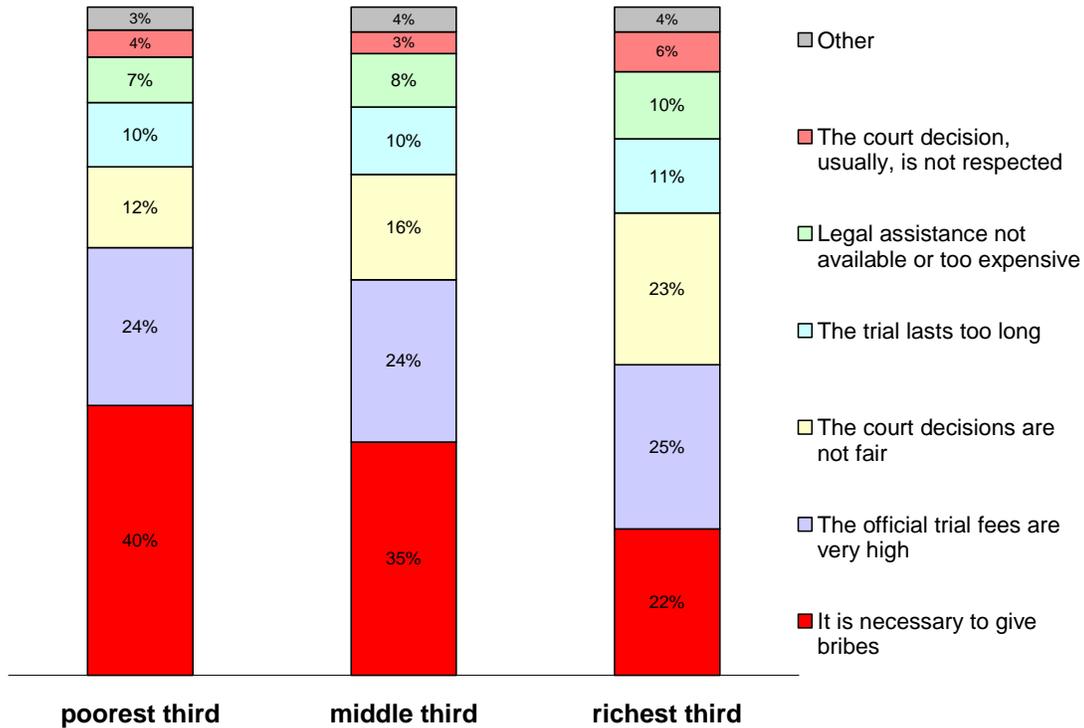
Justice

Weaknesses in the justice system can have wide ranging implications, the most deleterious effects of corruption being the indirect effects of a weakened environment. Consider, for example the case of Honduras where, as in many countries, the perceptions of users and firms of the judicial system is not positive. The overwhelming majority of respondents agree that the judiciary is influenced by economic and political pressures and 63 percent of firms have serious mistrusts about using the official judicial system to solve business conflicts. Facing a poorly functioning judicial system, enterprises and users may decide to use alternative mechanisms without going to trials. In Honduras, 14 percent of the users and 9 percent of the enterprises had decided not to go to the courts in the last 2 years when they needed to use the judicial system, and a subset of these reports that they have used alternative dispute resolution mechanisms during the last two years. Survey data from Peru and Ecuador reveal similar findings.

The diagnostic in the Kyrgyz Republic sheds more light on how corruption weakens services for poor people. Respondents who said they had reasons for going to court but decided not to were asked for the reason. Splitting the responses by income level is instructive. The poor were much more likely to say that the need to pay bribes was the key reason for not using the courts. (See Figure 11.)

Even access to
justice becomes a
luxury good when
the courts are
viewed as corrupt.

Figure 11. Reasons for Not Using Courts in the Kyrgyz Republic



4. Public Sector Institutions and Service Delivery

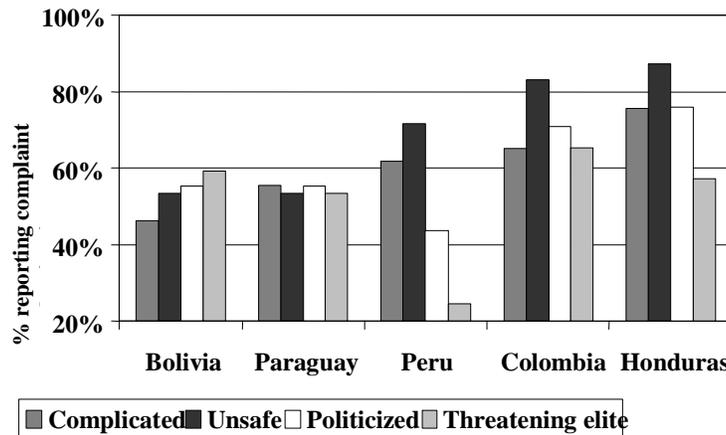
The diagnostics provide valuable evidence on internal institutions of public administration that strengthen service delivery. In particular, the public officials surveys provide detailed descriptions of the strengths or weaknesses of various systems and also assessments of performance in service delivery. This section describes information the diagnostics provide on the effectiveness of both external and internal influences on service delivery bodies, as well as two important studies assessing the relative importance of these institutions.

External pressure on state bodies

One of the factors that increase corruption in state agencies is deficiency of monitoring mechanisms. Public officials often reveal that procedure to report corruption are flawed across several dimensions. In the countries shown in Figure 12, on average more than half of public officials say that reporting corruption is complicated, unsafe, and that the mechanisms to report are politicized. On the other hand, approximately only the same proportion of the respondents believe that complaints actually threaten ruling elite.

The diagnostics help identify the institutional characteristics of state bodies that help most to improve service delivery

Figure 12. Problems with Complaint Systems in Latin America



Complaint systems can be effective for giving users voice about the quality of service delivery, but the mechanism must include follow up actions and make it easy for citizens to complain

Complaints voice the concerns of users about the quality of the public services that they receive. These complaint mechanisms provide the means to hold accountable those in charge of delivering public services. Thus, those institutions that are more responsive to complaints from its clients are also those with higher integrity ratings and lower corruption. This relationship is supported by the evidence in many of the countries surveyed. A more rigorous analysis confirms this preliminary conclusion for agencies dealing with private citizens in countries such as Peru, Honduras and Bolivia: an effective complaint mechanism is associated to lower levels of corruption. This finding suggests that making complaint mechanisms more transparent, accessible, and responsive helps reduce corruption in public services. Moreover, a systematic analysis of the relation between the frequency of corruption and the quality and extent of voice and accountability by each agency in Peru indicates that government agencies with better feedback mechanisms display lower levels of corruption. In the Kyrgyz Republic, by contrast, although most public officials report that they have a specific department or designated person to whom a citizen or businessman can complain if they encounter a problem, the public rarely avails itself of such channels. Despite the relatively low levels of satisfaction with publicly provided services, and the frequent need for unofficial payments, less than three percent of the households surveyed had ever filed an official complaint regarding poor services or requests for bribes. Part of the reason for this disconnect may be that the complaint system relies on the users to find out how they should make a complain, rather than making such mechanisms easily accessible.

The active provision of information by public bodies can also be important. However, when it is entirely up to the state, the usefulness of the information as a mechanism for accountability is limited. In the

Kyrgyz Republic, for example, many public officials indicated that they inform the public of their activities in a number of ways. However, the public at large does not seem to have responded to this provision of information. The public provision of information is less correlated with performance than is found in other countries. A demand-driven information system, such as embodied in a freedom of information law, would serve as a more effective check on the public sector.

Internal institutions of public administration

The diagnostics provide insight into the internal institutions of public administration and how these are correlated with levels of corruption and with quality of service deliver. A key theme arising from many of the diagnostic studies is the importance of human resources systems.

It is often argued that the key to reducing corruption is improving salaries of state employees. While it is undeniable that a low salary serves as a disincentive for honest high quality work, the diagnostics suggest that improving salaries alone will not yield results. The Latvia report, for example, argues that the tremendous variation in levels of corruption across bodies makes it clear that salaries alone are not the answer. Similarly, in Romania and Kazakhstan, salaries in government bodies not correlated with levels of corruption.

In virtually every country the importance of building a meritocratic system of personnel management is confirmed. If Romania, for example, meritocracy, the quality of the budget process, the quality of administrative rules, and enforcement are all associated with lower levels of corruption, but among these, the most robust are meritocracy and enforcement.¹¹ A stable depoliticized workforce is also important. In Albania, even career officials were more likely to say they got their job through political changes or connections than through a formal job posting or meritocracy.

One cross-cutting theme identified in the diagnostics is the importance of formality in systems of public administration. Figure 13 shows percentages of public officials in five Latin American countries who agree with the statement that public service in their institution is provided according to informal and non-written rules. In all countries more than 20% (and up to about 40%) of public officials agree with this point of view. A similar story is told by enterprise managers. In Latvia,

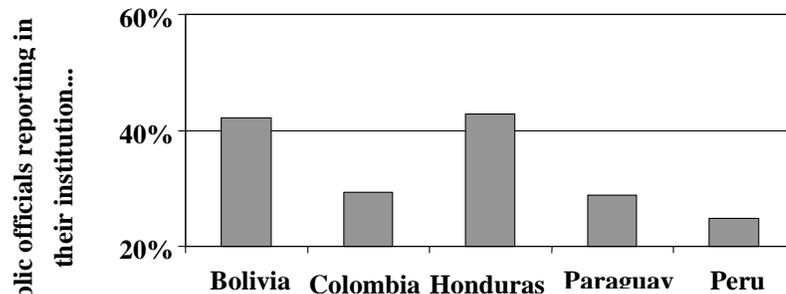
Meritocracy in the
civil service is
associated with
lower levels of
corruption

¹¹ The importance of meritocracy is consistent with the cross-country studies of Rauch and Evans, 2000, who examine how competitive salaries, internal promotion and career stability and meritocratic recruitment affect bureaucratic performance in 35 less developed countries. They found that meritocratic recruitment is the most consistently significant determinant of performance.

firms report that discretion in interpretation of complex laws is the most important cause of corruption.

Figure 13. Informality in Public Administration

**Public Services are Provided
According to Informal and Non -Written rules**
(As reported by Public Officials)



Source: WBI diagnostics and survey data; various countries; 1999-2001. Note: The original responses ranged from 1("completely disagree ") to 7("completely agree ") and the percentage of those who agree includes categories 5-7

Transparency in procedures and decisions is associated with lower levels of corruption

A related characteristic of healthy public administration is the degree of transparency of a government agency, a potential predictor of the level of corruption within that institution. In the case of Peru, the relationship between corruption and the degree of transparency within an agency is significant: agencies whose procedures and decisions are more transparent are less likely to display high level of corruption.

Evaluating External and Internal Influences

The diagnostics have formed the basis for several interesting attempts to isolate the characteristics of public administration that are most associated with performance. On the one hand, this line of research is a little bit like asking what is more important for a sailing ship, the hull or the sail. One propels the sailboat forward, while the other keeps it from sinking, so both are essential. On the other hand, a boat designer is perfectly justified in wondering whether marginal improvements to the sail of the hull will have the greatest effect on the boat's speed. It is in this spirit that we attempt to understand the institutions of public administration that are most associated with performance.

Understanding public sector performance and the factors that bring it about poses an empirical challenge. As a brand new field of research, the methodologies and approaches are nascent and the conclusions tentative. However, they are also extremely interesting and important.

The approach to this question has become more sophisticated over time. Early diagnostics relied on simple correlations and regressions of levels of corruption on characteristics of the institutional environment. The Romania diagnostic maintained the use of multiple regression, but represented a step forward by using a mix of respondent-level and organization-level, as well as external assessments of corruption. These approaches provided a strong check on the robustness of the findings from simple regressions. As intimated earlier, the results for Romania suggested a strong role for meritocracy in reducing corruption.

In Kazakhstan a similar approach was used, but the concept of performance was expanded, with separate analyses for quality, accessibility, and corruption. Although most of the characteristics of public administration, including meritocracy and quality of administrative procedures, were associated with better access to services, access was most robustly influenced by organizational culture and internal communications, and by proactive publicizing information.

In the Kyrgyz Republic, a somewhat more sophisticated approach was employed, allowing for some mutual endogeneity. Accessibility, quality and corruption were all used as indicators of performances, and regressed on variables representing meritocracy, salaries, punishment of corrupt behavior, organizational culture, quality of administrative procedures, quality of information channels within the institution, quality of budget preparation processes, procurement practices, and efforts to provide information to the public.

A variant of the model used in the Kyrgyz Republic is now being tested on the data for Romania and the Slovak Republic in a study entitled *Understanding Public Sector Performance In Transition Countries – An Empirical Contribution*.¹² A key innovation of this approach is the idea of a production function of performance, with mutually endogenous intermediate inputs. In the construct for this model, corruption and meritocracy are both influenced by rents, which are omitted from simple regressions. The results suggest that for each of the three countries under study, the Kyrgyz Republic, Romania, and the Slovak Republic, a merit-oriented system of personnel management is strongly and robustly correlated with performance.

Another approach, employed in Latin America, treats corruption and aspects of public administration as directly endogenous. This study is entitled *Voice or Public Sector Management? An Empirical Investigation of Determinants of Public Sector Performance based on a*

¹² *Understanding Public Sector Performance In Transition Countries – An Empirical Contribution* is being prepared in ECSPE by James Anderson, Gary Reid, and Randi Ryterman.

In Europe and
Central Asia,
meritocracy has
been found to be the
most robustly
significant
determinant of
public sector
performance

*Survey of Public Officials.*¹³ Using a large sample public officials survey in Bolivia, they argue that undue emphasis may have been given in previous work to a number of conventional public sector management variables (such as civil servant wages, internal enforcement of rules, autonomy of agency by fiat, etc.), while undermining the priority due to more ‘external’ (to public sector management) variables, such as external voice, transparency, and politicization. In their analysis, the latter set of ‘voice’-related variables has larger affect on the quality of service and corruption than the more traditional public sector management type of variables.

In Latin America,
mechanisms for

voice were found to

We should include a section on transparency, social auditing

be more important

than traditional

public

administration

solutions to

corruption

¹³ *Voice or Public Sector Management? An Empirical Investigation of Determinants of Public Sector Performance* was written by Daniel Kaufmann (World Bank), Gil Mehrez (IMF) and Tugrul Gurgur (World Bank).