STRENGTHENING BANK GROUP WORK IN GOVERNANCE AND ANTICORRUPTION

REVISED DRAFT

JULY 20, 2006
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>Analytic and advisory activities</td>
</tr>
<tr>
<td>ACS</td>
<td>Activity Completion Summary</td>
</tr>
<tr>
<td>AML</td>
<td>Anti-money laundering</td>
</tr>
<tr>
<td>BP</td>
<td>Bank Procedure</td>
</tr>
<tr>
<td>CAS</td>
<td>Country Assistance Strategy</td>
</tr>
<tr>
<td>CDD</td>
<td>Community-driven development</td>
</tr>
<tr>
<td>CFAA</td>
<td>Country Financial Accountability Assessment</td>
</tr>
<tr>
<td>CFT</td>
<td>Combating financing of terrorism</td>
</tr>
<tr>
<td>CGIAR</td>
<td>Consultative Group on International Agricultural Research</td>
</tr>
<tr>
<td>CPAR</td>
<td>Country Procurement Assessment Report</td>
</tr>
<tr>
<td>CPIA</td>
<td>Country Policy and Institutional Assessment</td>
</tr>
<tr>
<td>DPL</td>
<td>Development policy operation</td>
</tr>
<tr>
<td>EITI</td>
<td>Extractive Industry Transparency Initiative</td>
</tr>
<tr>
<td>FATF</td>
<td>Financial Action Task Force</td>
</tr>
<tr>
<td>FLEG</td>
<td>Forest Law Enforcement and Governance</td>
</tr>
<tr>
<td>FSAP</td>
<td>Financial Services Action Plan</td>
</tr>
<tr>
<td>HIPC</td>
<td>Heavily Indebted Poor Countries</td>
</tr>
<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>IDA</td>
<td>International Development Association</td>
</tr>
<tr>
<td>IEG</td>
<td>Independent Evaluation Group</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>INT</td>
<td>Department of Institutional Integrity</td>
</tr>
<tr>
<td>ISN</td>
<td>Interim Strategy Note</td>
</tr>
<tr>
<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
</tr>
<tr>
<td>NGO</td>
<td>Nongovernmental organization</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>OP</td>
<td>Operational Policy</td>
</tr>
<tr>
<td>OPS</td>
<td>Operations Policy and Country Services</td>
</tr>
<tr>
<td>PACI</td>
<td>Partnership Against Corruption Initiative</td>
</tr>
<tr>
<td>PEFIA</td>
<td>Public Expenditure and Financial Accountability</td>
</tr>
<tr>
<td>PER</td>
<td>Public Expenditure Review</td>
</tr>
<tr>
<td>PFM</td>
<td>Public financial management</td>
</tr>
<tr>
<td>SSIM</td>
<td>Sector Strategy Implementation Update</td>
</tr>
<tr>
<td>TA</td>
<td>Technical assistance</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>WBI</td>
<td>World Bank Institute</td>
</tr>
<tr>
<td>WDR</td>
<td>World Development Report</td>
</tr>
</tbody>
</table>
STRENGTHENING BANK GROUP WORK IN GOVERNANCE AND ANTICORRUPTION

CONTENTS

Executive Summary ........................................................................................................... v

I. Introduction .................................................................................................................. 1

II. Lessons from World Bank Group Engagement ..................................................... 2
    A. Support to Country Programs ........................................................................... 3
    B. Protecting Bank-Supported Operations ......................................................... 5
    C. Global Partnerships ......................................................................................... 6

III. A Strategy for Strengthened Support to Countries ............................................. 7
    A. Country Assistance Strategies ....................................................................... 7
    B. Supporting Country Efforts to Strengthen Governance and Reduce
       Corruption .................................................................................................. 14

IV. Addressing Corruption in Bank Group Operations ............................................. 21
    A. Anticorruption Measures ............................................................................. 22
    B. Risk Mitigation and Special Tools ................................................................ 25

V. Global Partnerships on Governance and Anticorruption .................................... 27

VI. Implications and Next Steps .................................................................................. 31
    Kaufmann, Daniel, Aart Kraay and Massimo Mastruzzi (2005). Governance
    matters IV ....................................................................................................... 35

Annexes

Annex A. Selected Literature on Growth and Governance .................................... 35
Annex B. Definitions .................................................................................................. 37

Boxes

Box 1. Lessons from ECA .......................................................................................... 5
Box 2. Three Country Assistance Strategies with a Strong Governance Focus .... 8
Box 3. Governance Diagnostics ............................................................................. 9
Box 4. Fiduciary Review of Cambodia: Remaining Engaged Despite Portfolio
       Challenges .................................................................................................. 13
Box 5. Civil Service Reform: Some Emerging Lessons .......................................... 16
Box 6. Tackling Vulnerabilities at the Sector Level ................................................. 17
Box 7. Bank-Supported Operations Strengthening the Demand for Better Governance ................................................................................................................................. 19
Box 8. Strategy on Strengthening Governance and Anticorruption in the Financial Sector .................................................................................................................. 21
Box 9. Developing Local Capacity is Key to Protecting Bank Funds in Latin America ................................................................................................................................. 22
Box 10. Integrating Anticorruption Elements into Project Design: Paraguay Roads Maintenance Project ........................................................................................................ 23
Box 11. Red Flags from INT: Indicators of Corruption in Procurement ................................................................................................................................. 24
Box 12. Anticorruption Action Plans in Indonesia ......................................................................................................................................................................................... 26
Box 13. The Extractive Industries Transparency Initiative (EITI) ........................................................................................................................................................................ 29

Figures

Figure 1. Milestones in Governance and Anticorruption ........................................ 3
Figure 2. Entry Points for Governance Reform ..................................................... 15
STRENGTHENING BANK GROUP WORK IN GOVERNANCE AND ANTICORRUPTION

EXECUTIVE SUMMARY

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....

Paul Wolfowitz, April 11, 2006

1. Over the past decade there has been increasing global recognition of the highly detrimental effect of weak governance and corruption on growth and poverty reduction. Reformers and citizens all over the world are demanding more accountable and transparent governments. Extensive research has shown that on average, countries with better governance grow faster than those with poor governance. Although some countries have achieved growth in the short term despite entrenched corruption and poor governance, such growth can be fragile. Unchecked corruption can destroy economies by undermining the legitimacy of state institutions, strangling the private sector, and damaging civil society.

2. Purpose of Governance Work. The principal purpose of the World Bank Group's governance work is thus to help build capable and accountable states that can make policies, provide public services, set the rules governing markets, and provide oversight of how public resources are used—and thereby support the development objective of reducing poverty and at the same time combat corruption. The role of the state is an integral aspect of governance systems, and can have important consequences for governance outcomes. Excessive regulations, for instance, increase the cost of doing business and provide opportunities for corruption. Reforms that rationalize the role of the state, reduce red tape, and promote competition can help improve governance and reduce corruption.

3. Need for Greater Results. The World Bank Group has been a key player in the broader effort to improve governance, and the way the Bank and donors do business in some highly corrupt and poorly governed countries has begun to change. However, while some countries have made progress, the growing attention to these issues has yet to result in improved outcomes across the globe. The governance agenda needs to be translated more effectively into concrete results.

4. Purpose of Paper. This paper proposes a comprehensive strategy for the World Bank Group to enhance and integrate governance and anticorruption measures across the entire range of its activities and operations, in order to assist partner countries in achieving demonstrable results on governance reform for sustainable poverty reduction. The paper builds on the strong vision and strategic thrust President Wolfowitz outlined in his Jakarta speech on governance, and reflects lessons from the past decade of experience of the Bank and other partners in this area. In this executive summary the concluding section includes a list of the main features of the new strategy.
A. Lessons of Experience

5. In 1996, the President of the World Bank publicly committed to fight the “cancer of corruption,” and in September 1997, the Board endorsed the World Bank’s first anticorruption strategy.1 Since then, the governance and anticorruption effort has been evolving, although there is much that is still unknown or subject to debate in this complex field. This recognition, coupled with the mixed record of progress and the differing conditions across countries, supports a rationale for encouraging experimentation.

6. Key Lessons. Some of the key lessons learned over the past decade include the importance of political leadership for reforms; the central role of governance reforms in preventing opportunities for corruption, not only at the central level but also at local levels and in key sectors; and the crucial role of citizens, the media, and the business community in demanding better governance, especially where government leadership is lacking. Within the Bank, attention to upstream review processes increased but has not translated into consistent treatment of this agenda across country programs and sectors, in part because these issues did not receive adequate attention in implementation. Innovations in anticorruption have often remained as “pilots,” not mainstreamed into the Bank’s operational program. Donor approaches have also been inconsistent and insufficiently coordinated, resulting in mixed signals to governments and creating conditions that allow some multinational corporations to propagate corruption. Extractive industries and infrastructure projects appear particularly vulnerable to corruption, although recent innovations in transparency and in project design and supervision hold promise.

7. Raising the Bar. These lessons suggest that the World Bank Group needs to build on the experience of the past decade to move toward a more consistent and results-oriented approach to governance and anticorruption across projects, sectors, and country programs, and in close coordination with donors and development partners. This has broad implications for the Bank Group, entailing changes in the way it develops Country Assistance Strategies; the way it prepares, reviews, and implements Bank-funded operations; and the way it monitors and assesses outcomes. It will also require attention to ensuring appropriate skills, staffing, and incentives to deliver on this new approach, especially on the front line of Bank operations.

8. Objectives. This strategy has five main objectives: (a) to increase the Bank Group’s engagement with countries on governance and anticorruption, utilizing its full range of instruments; (b) to promote greater consistency in the treatment of governance and corruption across all countries, in the Bank’s strategy and the operations it finances, and among other key donors and partners; (c) to integrate governance and anticorruption innovations into a much wider range of Bank activities across sectors; (d) to expand the Bank’s engagement with a wider range of stakeholders to strengthen the demand for better governance; and (e) to ensure the highest fiduciary standards in Bank Group operations. To attain these objectives, this strategy paper is organized around three levels of activity—the country level, the project level, and the global level.

---

1 [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: (a) help 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.]
B. Strengthened Support to Countries

9. The principal thrust of this new strategy is to expand the Bank’s support for countries’ efforts to address governance and anticorruption and build capable, transparent, and accountable institutions that reduce poverty. The strategy envisions supporting a broad range of institutions and actors—both inside and outside of government—who are demanding and working toward governance reform.

1. Country Assistance Strategy

10. The Country Assistance Strategy (CAS) is the natural starting point for helping countries address governance and anticorruption. The depth of coverage and the program of Bank activity in CASs are now often unrelated to the importance of the governance and corruption challenges for the country. Therefore, a key priority is to institute a systematic and disciplined approach that calibrates the assistance strategy to the challenges that governance and corruption pose for poverty reduction, and to the fiduciary and reputational risks to the World Bank Group. Successful implementation of the CAS will require adequate skills, resources, and incentives.

11. CAS Design and Development. In preparing CASs, Bank teams will be required to give explicit consideration, underpinned by diagnostic work, to the level of corruption and the shortcomings of governance in the country, the risks that their situation poses for development and for Bank-funded operations, the government’s commitment to reform, and the extent to which this commitment is reinforced by non-executive institutions. They will then use these findings in developing the CAS and its program of Bank activity in the country. Although the diversity of country situations and the continuum of risk across countries makes it impossible to set out a rigid classification of countries, three broad sets of country patterns are likely to emerge. For the group of countries in which governance is relatively strong and corruption is not a major hindrance to development, Bank efforts on governance will be largely responsive to the interests and direction of the government (and Bank strategies for well-performing middle-income borrowers will remain flexible and customized.) For the large middle group of countries where governance and corruption pose a challenge, governance will be treated more consistently and with greater depth in CASs. For some of these countries, the Bank’s strategy will feature governance as the central theme and make use of tools such as anticorruption action plans in projects, field-based governance advisers, and anticorruption teams. For the small group of exceptional-risk countries where corruption and weak governance are blocking progress and the government and Bank cannot agree on priorities, a more restricted interim strategy will be prepared, which will include the possibility of curtailed financing with specific triggers and may focus mostly or entirely on nonlending forms of engagement.

2. Supporting Country Efforts

12. Potential entry points for governance reform fall into two broad categories: supply-side reforms to improve governance capacity, focused on public sector management within the executive; and reforms that help strengthen the demand for better governance, including reforms in institutions of accountability outside the executive.

Confidential: Draft—Not for Distribution
13. **Supply Side.** The Bank is committed to helping governments function effectively, by strengthening transparency and accountability in government. The Bank will draw from its lessons of success and failure to continue deepening its work to improve public financial management and strengthen civil service performance—complex and challenging reforms. A central priority is to improve governance and combat corruption in the real sectors—such as infrastructure, health, extractive industries—as well as in the financial sector. As decentralization in many countries has shifted governance and corruption challenges to the local level, the Bank will also give increased attention to working with local governments and countries on a governance agenda.

14. **Demand Side.** An independent judiciary, free media, vibrant civil society, flourishing and competitive private sector, and independent middle class are crucial components for good governance: they balance the power of governments and hold them accountable for delivering better services, creating jobs, and improving living standards. Therefore, it is important to expand the scope of governance work well beyond supply-side interventions, to strengthen institutions of accountability outside the executive branch of government. The Bank Group will scale up governance work in these areas, within its mandate and in close collaboration with partners, depending on which initiatives offer the best prospects at the country level. This will entail a change in how the Bank Group does business and in its staffing, since its systems and skill mix have been designed to support traditional lending to government rather than supporting a broader range of stakeholders.

15. **Private Sector.** Poor governance can have a detrimental effect on private sector growth and development, and thus entrepreneurs, managers, and business associations should be appropriate partners in the fight against corruption. Conversely, some private businesses and nongovernmental organizations (NGOs) are themselves corrupt, and can have a negative impact on a country’s governance. This dual role of the private sector—as potential partner to promote demand for better governance, but with a segment potentially undermining governance—implies the need for a differentiated engagement. Helping governments improve the investment climate, eliminate excessive 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 enterprises can help level the playing field and stimulate better corporate citizenship. The World Bank Group (including IFC/MIGA) will proactively engage the private sector in countries as an ally in the fight against corruption through a range of instruments (e.g., Bank-financed operations that develop the commercial and financial sectors, IFC investments, and global partnerships with multinational groups). Moreover, engagement with the private sector will be better integrated into the CAS when IBRD/IDA, IFC, and MIGA work jointly on it.

**C. Addressing Corruption in Bank Group-Supported Operations**

16. The Bank’s record in reducing corruption in projects that it supports is essential for its credibility in advising and supporting governance and anticorruption efforts in partner countries. Bank shareholders and country stakeholders expect the Bank to do all it can to ensure that loan, credit, and grant resources will be used for the purposes intended, and thus they expect the highest standards of integrity and accountability. Moreover, Bank-financed projects have demonstration effects on best practice on governance in all borrowing countries. Therefore, as
the accumulating findings from investigations of corruption in projects by the Bank’s Department of Institutional Integrity (INT) have made clear, despite substantially strengthened internal controls, more needs to be done to protect Bank funds.

17. **Anticorruption Measures at the Project Level.** Prevention of corruption, which remains the best protection, requires the integration of anticorruption approaches into the early stages of project design. 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. Projects must be approximately designed with a focus on enhanced oversight mechanisms, disclosure of project information, complaints handling, and strengthened supervision. Fiduciary was requires an enhanced anticorruption focus. To allow for subsequent supervision, recordkeeping by project entities must be improved. Supervision must be cognizant of “red flags” indicating possible corrupt behavior at various stages of project implementation. Because of the importance of an effective dialogue on issues of fraud and corruption, it is important to develop an effective communications strategy that covers all phases of the project, to manage client relations and to avoid surprises later on.

18. **Risk Mitigation.** To identify high risks, the Bank is implementing a risk management approach to rating projects at the concept stage and in the portfolio. Project documentation will include an explicit treatment of the risks to development objectives posed by poor governance and corruption, and project-specific risk-mitigation plans will be developed. Regions will conduct regular risk reviews of their project pipeline and portfolio to ensure that the highest-risk projects receive adequate supervision resources and Management attention. In high-risk countries and sectors, publicly disclosed anticorruption action plans for each project will be prepared, anticorruption teams may be set up to supply expertise and oversight of projects, and field-based governance advisers to provide integrated advice may be put in place. Finally, the centerpiece of the Bank’s deterrence effort is continued aggressive investigation by INT into projects where there are allegations of wrongdoing. Most of these elements will impose some additional costs on projects.

D. **Strengthening Partnerships**

19. Improving governance and reducing corruption requires stronger collective action and partnerships—with donor partners, with private sector and civil society, and with developed countries. The World Bank Group will take leadership among international donors on governance and anticorruption.

20. **Donors and Multilateral Development Banks.** There are serious challenges of coordination among disparate donors and multilateral development banks: if some diverge in their standards on governance, recipient countries may be inclined to shop around for funds from those donors that offer weak governance and anticorruption preconditions. Thus, the strategy for enhanced global engagement envisages stronger coordination with multilateral and bilateral donors to promote a consistent approach to governance and anticorruption in aid. It also aims to ensure that others can take the lead in areas that are outside the Bank’s mandate or expertise (e.g., political governance and some aspects of demand for governance), and that development partners can share information and harmonize strategies in countries with weak governance, as well as coordinate investigative procedures and sanctions decisions.

Confidential: Draft—Not for Distribution
21. **Private Sector and Civil Society.** A principal focus in the next stage will be World Bank leadership in engaging the private sector and civil society. While individual firms may benefit from weak governance, the private sector as a whole loses when corruption is pervasive and rule of law is undermined. The World Bank Group, and particularly IFC and MIGA, will exercise leadership in engaging with the private sector as a crucial ally for good governance, and will create visibility around the idea that avoiding corruption is good for business—consistent with IFC’s “business case” for environmental and social issues. Similarly the World Bank Group will strengthen partnerships with civil society at the country and global levels as a powerful force for holding governments accountable.

22. **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 from multinational corporations. The World Bank Group will use its global position to advocate tougher monitoring and enforcement of the OECD Convention, and will support credible implementation of the UN Convention Against Corruption, including helping countries recover stolen assets.

**E. Implications and Next Steps**

23. The following points summarize the main features of the Bank’s comprehensive strategy on governance and anticorruption:

**The country level**

- A systematic and disciplined approach to the treatment of governance and corruption issues in CASs, underpinned by improved diagnosis and a concrete strategy to improve governance, calibrating assistance programs to the challenges governance and corruption pose for poverty reduction and for the management of fiduciary and reputational risks to the World Bank Group.

- Scaled up engagement across a broad range of countries to support country efforts to improve governance and reduce corruption.

- In countries with severe governance concerns, weak government commitment to reform, and/or a high risk of deterioration, use of shorter-term Interim Strategy Notes with mandatory anticorruption action plans for projects; no use of development policy operations; and a required highly restricted or no-lending scenario.

- Use of anticorruption action plans, anticorruption teams, and field-based governance advisors in high-risk country settings.

- Continued strengthening of the executive, with greater focus on improving governance and combating corruption in sectors and at the local levels.

- Systematic support for improving government transparency and the demand for better governance, expanding Bank support, within the Bank’s mandate and in partnership
with other donors, to non-executive institutions including legislatures, the media, and civil society.

- More effective engagement of the private sector as an ally in the fight against corruption through IFC and MIGA, while the Bank works with governments to improve the investment climate, increase competition, and limit opportunities for corruption.

**Addressing corruption in Bank-supported operations**

- A risk-based approach, featuring upstream mitigation.

- An enhanced anticorruption focus within fiduciary approaches.

- Agreed and disclosed anticorruption action plans in higher-risk projects.

- Enhanced attention to adequate recordkeeping and documentation by project agencies.

- Aggressive investigation by INT into projects as warranted, with the aim of both fulfilling the Bank’s fiduciary obligations and sharing lessons learned with operational staff.

**Global partnerships**

- Leadership by the World Bank Group on governance and anticorruption among international donors.

- Improved consistency among development institutions in investigative rules and procedures, strengthened information sharing, and mechanisms to recognize each other’s sanctions decisions.

- Coordinated donor strategies in exceptional-risk countries to ensure that tough action by one donor is not undermined by another’s different standards.

- Stronger collective action among donors and multilateral development banks, based on comparative advantage and expertise, to support country efforts to improve governance and combat corruption.

- A leadership role for the World Bank Group in engaging with the private sector and civil society as powerful forces for good governance.

- Forceful advocacy on credible implementation of key international conventions to combat transnational corruption, and exploration of ways to support restitution of assets to countries plundered by corrupt leaders.
24. **Staffing.** Implementing this strategy will require additional expertise in governance and anticorruption across the Bank—in country teams, in sectors, and at the center. It could mean major changes in the type of staff needed in the front line to implement these new directions, possibly necessitating a different combination of staff, skills, and managers. The most important need may be to ensure that country directors and Regional and sectoral managers are committed to, and have capacity in, governance and anticorruption. In addition, a major increase in capacity will be needed in country teams—especially in high-risk country and project situations—to develop and implement governance reform programs with partner countries. In countries where governance and corruption are a central priority for the CAS, greater use of field-based governance advisers and anticorruption teams is envisaged. Expertise will need to be strengthened in such key sectors as infrastructure, financial sector, human development, and private sector. Central capacity will be needed to support country teams with operational support, training, peer learning programs, and specialist advice, and to provide central oversight and monitoring. The strengthened strategy implies a major change in the way the Bank operates—for selecting and promoting managers; putting together country teams and expertise in the field; reviewing and approving CASs; preparing, reviewing, implementing, and monitoring projects; and monitoring and assessing Bank performance. Overall, this strategy implies much more focus on the World Bank Group's operational front lines, with a recognition that increased levels of document reviews and internal processes will not suffice.

25. **Budget.** Detailed budgetary implications will be worked out for different parts of the Bank at the country team, sectoral, and central levels. Incremental budget will be needed to more firmly incorporate governance and anticorruption in the design, implementation, and monitoring of CASs and Bank-financed operations, and most of it will be channeled to front-line operational work. The total cost of this policy is initially estimated to be $20 million, of which about half would be expected to come from reallocating existing resources.

26. **Consultations and Reporting.** Consultations with multilateral development banks, civil society, and other interested groups—necessarily limited in scope, given the short timeframe—have been carried out during the preparation of the paper. Once the Development Committee discusses the final paper, Management proposes to launch a broad set of follow-up consultations on the operationalization of this approach. Management will report to the Development Committee in one year.

Confidential: Draft—Not for Distribution
STRENGTHENING BANK GROUP WORK IN GOVERNANCE AND ANTICORRUPTION

I. INTRODUCTION

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.1 It sets out a comprehensive approach that involves working at the country level (in the CAS, country dialogue, diagnostic work, and Bank-financed operations), at the level of Bank operations, and at the global level.

2. Governance and Poverty Reduction. If countries are to make progress in reducing poverty, they need good policies, a workable regulatory framework for markets and private sector development, and a reasonably efficient and effective provision of public services—all of which are greatly dependent on the effectiveness of the state. Research and operational experience have shown that the quality of governance, including control of corruption, has a significant impact on economic growth and poverty reduction.2 On average, countries with better governance grow faster than those with poor governance, and the effectiveness of Bank-funded investment projects is significantly impaired in countries with weak governance and high corruption.3 Unchecked corruption can destroy economies by undermining the legitimacy of state institutions, stranding the private sector, and damaging civil society. Therefore, the principal purpose of the World Bank Group’s governance work is to help build capable and accountable states that can make policies, provide public services, set the rules governing markets, and oversee the use of public resources—and thus reduce poverty, promote growth, and contain corruption.

3. Fiduciary and Reputational Risks. The Bank Group has other concerns in fighting corruption: to address the fiduciary and reputational risks associated with the aid endeavor, and assure itself and its stakeholders that aid funds are used for the intended purposes.4 In addition, as the Bank Group focuses more strongly than ever on governance and anticorruption, it understands the importance of working closely with other development institutions and donor countries on a coherent and coordinated approach.

---

1 In April 2006, 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 IMF, other multilateral development banks and the membership, to ensure a coherent, fair and effective approach.” Development Committee Communiqué, World Bank, Washington, D.C., April 23, 2006.

2 There is an extensive body of literature on growth and governance; Annex A provides a partial list.


4 The Bank’s Articles of Agreement impose fiduciary obligations on its actions. In particular, Article III Section 1 b(5) reads: “The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency, and without regard to political or other non-economic influences or considerations.” Search for IBRD Articles of Agreement at www.worldbank.org.
4. **Good Governance and Development: A Time for Action.** Governance and anticorruption have been prominent themes in the work of the World Bank Group for nearly a decade, and Bank teams have been integrating these concerns into sectoral operations and country programs. In a speech in Jakarta on April 11, 2006, President Wolfowitz called for stepped-up engagement on governance and anticorruption and outlined the key pillars of this heightened focus: strengthening country programs, reducing the risk of corruption in Bank-funded operations, and strengthening global partnerships. This paper elaborates this strategy.

5. **Governance and Corruption.** 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 poor governance, involving the abuse of public office for private gain. 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 solely within the private sector, yet 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.5

6. **Structure of the Paper.** Part II of this paper summarizes the lessons from the Bank’s engagement in governance and anticorruption. The next three sections outline the Bank’s strategy for a strengthened focus in each of the three pillars—Part III in support to countries, Part IV in the Bank’s operations, and Part V in global partnerships. Part VI discusses monitoring and evaluating the results of this work, implications for staffing and resources, and next steps.

## II. LESSONS FROM WORLD BANK GROUP ENGAGEMENT

7. Recent years have seen a range of efforts in countries around the globe to strengthen state capacity and accountability. While some countries have made progress, there is little evidence that there has been a significant impact on reducing corruption overall; and governance remains a binding constraint to growth and poverty reduction in many countries. This section summarizes the history of the Bank’s engagement in governance and anticorruption.

8. **History.** For much of the history of the World Bank Group, corruption was considered nearly a taboo subject—something that many were aware of but could 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,6 and in parallel, the 1997 World Development Report (WDR) deepened global understanding that an effective state is crucial for development. In 2000 the

---

5. Annex B defines terms used in this paper
6. *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.

Confidential: Draft—Not for Distribution
Board endorsed a Public Sector Governance Strategy that recognized corruption as an outcome of a poorly functioning governance system. Subsequent WDRs elaborated potential pathways of reform, focusing on cross-cutting public sector institutions (2002), service delivery (2004), and investment climate (2005). Most recently, the 2006 Global Monitoring Report proposed a framework for monitoring developments in a range of areas, including corruption. President Wolfowitz has made it clear since his arrival that attention to governance and anticorruption will be a key theme of his presidency. (Figure 1 provides a graphic presentation of this history.)

A. Support to Country Programs

The latest Sector Strategy Implementation Update (SSIU) reports that Country Assistance Strategies (CASs) are addressing governance issues. While there are notable initiatives in a few higher-risk environments to develop integrated governance strategies to help strengthen state capacity and accountability and reduce fiduciary and reputational risks, most CASs still deal with governance in a perfunctory way—focusing primarily on the traditional areas of core public management—and do not adequately assess the developmental or fiduciary risks of corruption. 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, insufficient staff expertise, and the tendency to compartmentalize and treat governance as a sector rather than as a cross-cutting theme.

---

7 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.

8 Sector Strategy Implementation Update, FY05 (SecM2006-0125), March 21, 2006.
10. **Lending.** Bank-financed public sector governance lending\(^9\) operations have been launched in many countries, with a strong focus on core public management reforms. In FY06, over 20 percent of new Bank-financed operations and almost 20 percent of new financing commitments tackle public sector governance issues broadly defined, and nearly half of the prior actions for development policy operations are related to governance. The overall performance of the public sector governance portfolio is very sensitive to the larger governance environment.\(^10\)

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.

11. **Reforms.** Global trends in governance and corruption indicate that, while some possible progress has been made in strengthening state capacity and accountability worldwide, there is little evidence that this has yet 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. 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 rich countries, often collude to obstruct progress in combating corruption. Thus it is clear that effective leadership from both arenas is essential to tackling the problem. (Box 1 illustrates this pattern in corruption trends in Eastern Europe and Central Asia).

12. **Challenges Remain.** Ultimately, sustainable improvements in governance will be critically dependent on the strength of accountability institutions, inside and outside the state. While Bank programs support judicial reform and have helped increase transparency and civic participation, this support has been uneven across countries. Thus, while an important start has been made on the governance and anticorruption agenda, formidable challenges remain.\(^11\)

---

\(^9\) Lending in this paper refers to the extending of loans, credits, and grants.

\(^10\) 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. 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 CPIA for transparency, accountability, and corruption for satisfactory projects in FY04-05 was 3.4, while for unsatisfactory projects it was 2.5.

\(^11\) "Our Difficult Climb: Initial Progress and the Ascent Ahead." Transparency International—World Bank Combating Corruption Workshop, March 2003. See also *Sector Strategy Implementation Update FY05*, (SecM2006-0125), March 21, 2006, which recommends addressing these challenges by (a) better managing the governance risks in Bank-financed operations, including through more in-depth analysis of governance bottlenecks, new approaches for engaging countries with higher risks of corruption, and a greater focus on monitoring results; (b) supporting checks and balance institutions to complement the Bank's traditional focus on core public management, partly through effective collaboration with other donors; (c) placing stronger emphasis on governance across all key sectors in the design and implementation of operations, especially where lending is expected to increase; and (d) building deeper capacity within the Bank in public sector governance—all areas that are addressed in the strategy set out in this paper.
Box 1. Lessons from ECA

A recent World Bank report finds significant progress in many ECA countries: firms are paying bribes less frequently and in smaller amounts, and they report corruption to be less of a problem than in the past. Progress, however, is not uniform. The most visible progress has come in areas where reforms, sparked by strong leadership and prospects for EU 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 for the region as a whole.

Progress in Reducing Corruption in Europe and Central Asia 2002-2005

Notes: Transition countries include 29 former socialist countries in ECA; comparator countries are Germany, Greece, Ireland, Portugal, Spain, and Turkey.


B. Protecting Bank-Supported Operations

13. 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 strategy; and then Bank-financed operations (especially 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. Nevertheless, concern about corruption in Bank-financed operations has risen sharply in recent years because of the
accumulating findings of INT's investigations of investment projects, the pilots of the Voluntary Disclosure Program, and Detailed Implementation Reviews (with three completed and two under way), which have revealed patterns of corruption in Bank-financed investment projects that follow similar patterns across countries.\(^\text{12}\)

14. **Lessons.** Both INT investigations and Bank supervision has revealed frequent shortcomings in project documentation and recordkeeping by project agencies, rendering both proper supervision and investigation of allegations extremely difficult. INT findings further point to the need for each project to clearly identify the risks it faces and do so in a meaningful way and the need for supervision to be carried out differently, using a team including fiduciary and technical skills that undertakes a unified review. About half of INT investigations that led to specific corrective actions were linked to infrastructure projects, seemingly indicating special vulnerability of this sector. Among the lessons of recent experience: country-specific, risk-based assessments of fiduciary management are important, but uniform restrictive approaches that fail to take strong country governance into account alienate partner countries and reduce the Bank's ability to engage; internal Bank incentives need to be aligned with the goal of identifying country institutional weaknesses, and operations staff need to be appropriately trained; and results-focused and participatory approaches are essential to good project preparation and implementation.\(^\text{15}\)

C. Global Partnerships

15. Global partnerships have been used for global public goods: (a) sharing experience and information;\(^\text{14}\) (b) developing approaches to tackle transnational aspects of corruption;\(^\text{15}\) (c) supporting the demand for better governance;\(^\text{16}\) and (d) fostering coordination among donors.\(^\text{17}\) In many of these partnerships, the Bank has played a leadership role. Deeper and more effective partnerships are needed in (a) understanding the political drivers 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

\(^{12}\) In addition, the establishment of the Department of Institutional Integrity (INT) and the Sanctions Committee/Board in 2001 has created capacity to investigate allegations of fraud and corruption in Bank Group operations and sanction firms and individuals found to have breached the Bank's procurement rules. The more than 1,700 cases of alleged fraud, corruption, or other misconduct handled by INT since 2001 and the more than 330 companies and individuals sanctioned as a result point to standard schemes: kickback brokers (a local agent arranges 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). See Glenn Ware, J. Edgardo Campos, J. Oliver Moss, and Gregory Noone, "Corruption in Public Procurement: A Perennial Challenge," in J. Edgardo Campos and Vinay Bhargava, eds., *Tackling A Social Pandemic*, World Bank, forthcoming.


\(^{16}\) OECD Anti-Bribery Convention, UN Convention Against Corruption, Global Program on Fisheries, Extractive Industries Transparency Initiative, Forestry Law Enforcement and Governance.

\(^{17}\) Partnership for Transparency Fund, Global Integrity Alliance, Partnership Against Corruption Initiative (PACI) and Business Competitiveness and Development Program for corporate governance.

OECD Governance Network (GovNet), PEFA, MDB Governance and Capacity Building Working Group.
anticorruption agenda; and (c) harmonizing donor approaches, especially in higher-risk settings where mixed signals from donors can undercut progress on governance.

III. A STRATEGY FOR STRENGTHENED SUPPORT TO COUNTRIES

16. This section sets out the country pillar of the Bank’s strategy on governance and anticorruption. It first describes how Country Assistance Strategies can be more effectively geared to address governance issues and fiduciary and reputational risks and then provides a framework for Bank support in strengthening country governance.

A. Country Assistance Strategies

17. In preparing CASs, country teams are expected to diagnose governance and consider corruption issues. 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 strategy in any country must 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 put a priority focus on addressing corruption and governance issues where they are a major constraint or where reputational risks are high, and on safeguarding the use of resources under Bank-financed projects. These elements will be assessed during the lengthy corporate review process for strategies, which takes a risk-based approach, selecting higher-risk strategies for higher level management review. Although the diversity of country situations and the continuum of risk across countries makes it impossible to set out a rigid classification of countries, three broad sets of country patterns are likely to emerge:

- For the group of countries in which governance is relatively strong and corruption is not a major hindrance to development, Bank efforts on governance will be largely responsive to the interests and direction of the government. In particular, for well-performing MIC borrowers, Bank strategies will continue to aim at greater flexibility and customization and less conditionality.

- For the large middle group of countries where governance and corruption still pose a challenge, governance will be treated more consistently and with greater depth in CASs. For some of these countries, the Bank’s strategy will feature governance as the central theme and make use of tools such as anticorruption action plans in projects, field-based governance advisers, and anticorruption teams. (Box 2 describes how governance has been emphasized in three recent CASs.)

---

18 BP 2.11, Country Assistance Strategies (June 2005), does not provide 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,” and 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.”
• For the small group of exceptional-risk countries where corruption and weak governance are blocking progress and the government and Bank cannot agree on priorities, only a more restricted interim strategy will be prepared. It will require anticorruption action plans for all projects, include the possibility of curtailed financing, and, in some cases, may focus mostly or entirely on a nonlending engagement.

Box 2. Three Country Assistance Strategies with a Strong Governance Focus

| The Indonesia (FY03), Bangladesh (FY06), and Albania (FY06) CASs all identify governance as a central challenge and affirm that meeting this challenge requires incorporating governance in all CAS interventions. 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.

All three 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.

• Local governance—both local governments and communities—with the aim of fostering local citizens’ and groups’ participation in development decision-making, monitoring, and implementation.

• 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.

• Core governance—both the supply side of public management (where all three CASs emphasized public financial management and procurement), and the demand side of stronger accountability institutions: the Bangladesh CAS suggested interventions ranging from justice reform to improved freedom of information, and the Indonesia CAS supported a national-level Partnership for Governance Reform of civil society, donors, and government.

To mitigate fiduciary and reputational risks, all three documents propose a dual strategy: strengthening the ability of national actors to hold the public sector to account through enhanced transparency and participation, and 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, Bangladesh and Indonesia have field-based governance advisers.

For these three countries, the challenge now lies in implementing their governance-intensive CASs. 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.

1. Calibrating Attention to Governance and Corruption

18. In preparing a CAS, CAS teams will be expected to explicitly consider and discuss a few key questions on the nature of risks posed by corruption and weak governance in the country, and then use their findings to design the broad shape of the country strategy and assess how centrally governance should feature in it. Answering these questions will rely on staff’s professional judgment guided by institutionwide principles:

• How detrimental to the country’s growth and poverty reduction arc weak governance and corruption? 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 nonexecutive institutions of accountability, such as the judiciary, the legislature, the supreme audit institution, media, and civic watchdogs?

• Does engagement pose a reputational risk to the Bank, and how can that risk be managed or minimized?

• 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?

19. **Obstacles to Development.** In deciding to what extent weak governance and corruption are obstacles to a country’s development and poverty reduction, Bank teams need to draw on economic and sector work (see Box 3). If the risk critical to development is concentrated in particular sectors, the CAS will need to focus attention on improving governance in those sectors. If risk 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. The centrality of governance must be calibrated to the degree to which governance and corruption obstruct progress—in some countries, governance needs to be the central element of the CAS, likely as an overarching theme for Bank interventions. If weaknesses are concentrated in certain sectors or institutions, must they be addressed head-on, or can the Bank engage elsewhere in support of country development?

**Box 3. 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 CPIA and WBI aggregate 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 the Governance and Anticorruption Diagnostic Surveys, Doing Business Report, and Anticorruption in Transition reports can help to document and benchmark specific forms of weak governance and corruption and serve as an input in concrete action plans. The Public Financial Management Performance Report, integrating the institutional aspects of PFRs, CFAAs, and CPARs into one report using the PEFA framework, can help measure risks to effective budget management. INT’s 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. To address gaps and to provide a more structured diagnosis for the CAS, some country teams may choose to prepare an integrated report. 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.

20. **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, and engagement may be modulated over the CAS period to match the government’s reform performance). However, if corruption and weak governance pose a substantial risk to development but government interest in reform is very 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) is preparation of a 12- to 24-month Interim Strategy Note (ISN), rather than a full 4-year CAS. 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. Especially if governance is not strongly featured, the ISN will likely propose curtailed financing because the Bank and the government have been unable to agree on a program that will ensure a governance environment that provides an adequate basis for an active financing program.

21. **Institutions of Accountability.** Institutions such as judiciaries, legislatures, supreme audit institutions, media, and civic watchdogs are important sources of pressure for better governance. Where government commitment to reform is somewhat uncertain, the existence of functioning accountability institutions 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. (See Part III.B.2 for a discussion of how the Bank can support these institutions.) Where institutions of accountability are active, the Bank can justify deeper engagements and additional financing than it otherwise would.

22. **Reputational Risk.** Reputational risk goes to a critical core competency of the World Bank Group—its ability to manage public resources responsibly and effectively. For the Bank, the reputational risk of operating in a country is usually, but not always, correlated with overall levels of corruption in a 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 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. Thus, CPIA scores may not capture it well in all instances. Reputational risk tends to be lower even in very high-risk countries where Bank assistance is part of a multdonor peace-building effort (as, for example, in Afghanistan, where the international community largely understands the risks of corruption but has judged them to be worth taking in the interests of larger peace-building objectives). Lending operations in high-risk countries 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 but more often as part of ongoing Management and Board oversight of country programs.

---

19 *Guidelines to Staff for CAS Products* advises use of an ISN if the country has no medium-term program to frame the Bank’s support.
23. **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 deterioration and the Bank’s proposed response. (In most cases, however, substantial uncertainty remains, which itself constitutes one of the risks of the strategy.) If there is a substantial risk that governance will deteriorate, then the CAS should include a restricted financing scenario (which in extreme cases may be a suspension of lending), with specific triggers identifying the conditions under which the Bank would move to those scenarios; and if there is substantial uncertainty about how deterioration will affect the government’s program, the team should prepare an ISN.\(^{20}\)

24. **Risk of Corruption in Projects.** While the risk of fraud and corruption in Bank-financed projects is also 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 the Bank’s portfolio. Specific evidence may be available where INT has conducted investigations or undertaken a Detailed Implementation Review (or Fiduciary Review). Information from supervision of Bank-financed projects (and especially any misprocurement or other findings) 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, discussed in Chapter IV).

25. **Exceptional-Risk Countries.** The greatest challenge for this more rigorous CAS-based approach to addressing governance and anticorruption will be for the limited set of countries where corruption and weak government have an especially high impact on development or the Bank’s reputation more broadly; where the risk of deterioration is substantial; where the weakness of the government’s commitment is not countered by strong institutions of accountability; and where Bank-financed operations face substantial corruption risk. As laid out above, the strategies for these countries will be ISNs which, while they may not always feature governance as the central theme, will be based on an assessment of the factors that weaken government commitment to reform and will strive to expand entry points for engagement on governance issues. Anticorruption action plans will be mandatory for all projects in these countries, and development policy operations will not be proposed for these countries. If the government and the Bank cannot agree on priorities, the ISN may include a curtailed or strictly nonlending engagement, as elaborated below.\(^{21}\)

---

\(^{20}\) The Bank’s *Fragile States—Good Practice in Country Assistance Strategies* (IDA/R2005-0252), December 21, 2005, endorsed by the Board in January 2006, provides advice on addressing the risks of deteriorating governance in an ISN.

\(^{21}\) This approach is akin to that endorsed by the Board in January 2006 for fragile states. See *Fragile States—Good Practice in Country Assistance Strategies* (IDA/R2005-0252), December 21, 2005.

**Confidential: Draft—Not for Distribution**
2. Designing and Implementing Bank Strategies

26. Bank strategies will reflect a governance approach at the country, sector, and project level, as appropriate, and will reflect governance concerns in assistance levels and instrument choice. Collaboration with other development actors 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.

27. 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 countries, this linkage is achieved partly by the way IDA resources are allocated across countries, with a strong emphasis on governance. For IBRD borrowers, the CAS sets out IBRD lending envelopes that derive from the Bank’s creditworthiness analysis and explicitly consider governance only as it impinges on political stability or economic policies and outcomes. CASs have typically 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. 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 inclusion of policy-based operations, in particular) 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.

28. IDA’s Allocation Mechanism. IDA’s Performance Based Allocation (PBA) system ensures that the Bank’s resources are directed towards 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 system. The heavy weight assigned to CPIA- and portfolio performance-based governance factors (67 percent) in the PBA system ensures that better governed countries are allocated a higher share of IDA resources. In fact, IDA goes farther than any other donor agency in rewarding good governance when allocating scarce aid resources. While some donors have expressed an interest in rebalancing the PBA system in ways that give more weight to “needs” relative to “performance,” there is generally broad-based support for preserving the governance-oriented aspects of IDA.

29. Restricted Lending or “Low Cases.” 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 lending, a shift to nonlending activities, or, very unusually, a break in lending support. In fact, a restricted-financing scenario might be the appropriate “base-case” or most likely scenario if the Bank determines that governance or corruption issues are likely to prevent the full envelope of IDA or IBRD from being used effectively. This situation might arise in IDA countries where recent developments are not yet captured in the CPIA; or, for any borrower, if the Bank fails to reach agreement with the government on the overall development program, on specific priorities, or on the content and structure of Bank-financed operations. 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. (Box 4 describes how the Bank remains engaged in one high-risk country.)

Box 4. Fiduciary Review of Cambodia: Remaining Engaged Despite Portfolio Challenges

In June 2004 the Bank initiated a Detailed Implementation Review (or Fiduciary Review)—the third in the Bank’s history—in partnership with the Cambodian Government. The subsequent INT investigations (completed June 2006) into seven Bank-financed projects discovered corrupt practices including bribery, rigging of bids, manipulation of procurement, fraudulent bid securities, price fixing, and collusion. In June, the Bank declared misprocurement on 43 contracts on five projects and cancelled US$11.9 million from the projects. It also suspended parts of the three ongoing projects pending the Government’s implementation of agreed action plans.

Staff are reviewing how to further strengthen fiduciary measures for new and ongoing projects across the portfolio. The fiduciary action plan that was agreed with the Government in 2005 is being updated to take INT findings into account. The Cambodia Anti-Corruption Committee of Bank staff will be reviewing the design of all new projects from an anticorruption perspective.

Early lessons: The proactive approach has raised governance higher on the agenda of both Government and civil society; and undertaking the Review transparently and jointly with Government has meant that subsequent reform action is more likely, and more likely to be effective. Nevertheless, future anticorruption processes should ensure a clear protocol for managing the dissemination of review and INT findings.

30. Use of Development Policy Operations. Bank strategies propose whether budget support—development policy operations—will be part of the financing program for the country, and this choice, too, is affected by the country’s governance situation. Development policy operations have been a key instrument for supporting governance reforms; more than 45 percent of total conditionality (actions against which Bank financing is disbursed) during FY98-06 was related to governance issues. Corruption risk in the operations themselves is, in general, mitigated by an up-front assessment of the overall fiduciary environment and inclusion in the operation of measures to mitigate fiduciary risks for all budget resources. In cases with high residual fiduciary risks or lack of an appropriate action plan to address them, 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 development policy operations are generally used in stronger settings, experience shows that they offer a unique opportunity to support pro-governance and anticorruption reforms even in very weak settings such as Haiti or Cambodia.22

---

22 The strength of governance is measured by the public sector management cluster rating of the CPIA (the last cluster of five CPIA questions). 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 transparency, accountability, and corruption in the public sector CPIA question (question 16, formerly question 20)). Bankwide the bottom 33 percent of the CPIA corruption ratings received about 20 percent of policy-based lending commitments during FY98-06. See Development Policy Lending Retrospective (SecM2006-0319), July 13, 2006.
31. **Collaboration.** 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. Regardless of the level of financial support, staff will 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. 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. Moreover, harmonization with other donors will be crucial to supporting country strategies, especially for exceptional-risk countries. Joint or collaborative CASs can be a very effective tool to coordinate across the donor community (for example, recent CASs for Bangladesh, Nigeria, and Uganda), especially on fundamental and cross-cutting issues such as governance issues, and particularly in the most challenging environments (see Section V).

32. **Responding to New Information.** During implementation, country teams will need to remain ready to adjust the Bank’s strategy to new information, including information from INT about confirmed instances of corruption in Bank-financed projects. New information about risks from governance weaknesses and corruption may shift the balance of reputational risk for the Bank or may imply distinctly higher risks to development effectiveness or to the project. The appropriate response may be to switch scenarios within the existing CAS, propose a revision in a 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 in the event of demonstrated improvements in governance and anticorruption. The status of the highest-risk countries should be reviewed at least annually.

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

33. Potential entry points for governance reform (see Figure 2) fall into two broad categories: supply-side reforms to improve governance capacity, focused on public sector management within the executive; and reforms that help to strengthen the demand for better governance, including reforms to strengthen institutions of accountability outside the executive. The World Bank Group has historically engaged quite intensively in the first category; and although it has been engaging more in the second category over the past decade, its engagement is uneven. Progress on both the supply and demand sides is typically necessary to effect change in the long term, and greater efforts to link work on these two fronts is needed. One topic—transparency—is a cross-cutting imperative that helps bridge both supply of and demand for governance.
1. Supply Side of Governance: Public Sector Management

34. The Bank Group will continue to engage on the public management, or supply side, of governance, giving increased attention to initiatives to strengthen the transparency with which the public bureaucracy operates.

35. Improving Public Financial Management. Better PFM remains key to getting results on the ground and assuring donors that aid resources are being used prudently. The centerpiece of the Bank's engagement in this area is the monitoring framework for assessing the quality of public finance systems, developed by the Public Expenditure and Financial Accountability (PEFA) partnership program and now being implemented in over 70 countries worldwide. The PEFA framework covers four facets of the budget cycle: policy-based budgeting; arrangements for predictability, control, and stewardship in the use of public funds (for example, payroll and procurement systems); systems of accounting and recordkeeping to provide information for proper management and accountability; and external audit and other mechanisms that ensure external scrutiny of the operations of the executive (for example, by parliament). The framework also examines the comprehensiveness of budget coverage and transparency of fiscal and budget information; credibility—that the budget is realistic and implemented as intended—as a key intermediate outcome; and the sequencing of implementation. The Bank will continue collaborating with other donors to implement the PEFA approach.
36. **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 5 discusses the lessons of experience in civil service reform.)

**Box 5. 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 (IEG) 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%) were rated satisfactory or higher, a rate that is similar to the Bank portfolio as a whole. By contrast, seven of the second group (64%) were rated unsatisfactory.

- **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 systemwide 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.

37. **Sectoral Approach.** Because top-down 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. The Bank has been gathering key lessons from different sectors and developing a common framework (Box 6) to identify governance vulnerabilities at the sector level (e.g., in pharmaceuticals, forestry, roads, education, and customs). 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.

Box 6. Tackling Vulnerabilities at the Sector Level

The Many Faces of Corruption: Tracking 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).

**Drilling down in pharmaceuticals**

**Tackling decision points vulnerable to corruption**

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.

38. **Strengthening Governance at the Local Level.** Even when opportunities for governance reform at the national reform 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 may be the only feasible entry point for reform.

2. The Demand Side of Governance: Institutions of Accountability

39. An independent judiciary, free press, vibrant civil society, flourishing and competitive private sector, and independent middle class are crucial components for good governance: they balance the power of governments and hold them accountable for delivering better services, creating jobs, and improving living standards. Therefore, it is important to expand work beyond core public sector management to strengthen nonexecutive institutions of accountability and improve the state's interface with citizens and businesses. The Bank Group will scale up governance work in these areas, within its mandate and in close collaboration with 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.

40. **Strengthening Transparency, Participation, and Oversight.** 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;\(^\text{23}\) access to state records and reports; and the state's active dissemination of information on its operations and performance.\(^\text{24}\) Transparency reforms can also help to create opportunities for greater civic engagement. For example, the state can routinely invite public comment in budgeting and policymaking, establish consultative groups for agencies dealing with the public or business community, and hold elections. Moreover, greater transparency can help to establish the credibility of decisionmakers, including political leaders and political parties—for example, through the public disclosure of their income and assets, for verification by the media and civic groups. Recognizing that transparency in public sector management can be a powerful tool for strengthening the demand for good governance, the Bank has helped some governments increase transparency and participation (Box 7); but much remains to be done. The Bank will systematically use a range of instruments—policy dialogue, policy-based lending, capacity building, and analytic work—to strengthen transparency and opportunities for participation and oversight by civic groups and media. 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. The Bank also expects to continue providing small amounts of grant financing 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.

---

\(^{23}\) Examples are legislative debates, regulatory commission hearings, public procurements, and trials.

\(^{24}\) Examples of dissemination are through e-procurement, annual reports, or disclosure of audit findings.

Confidential: Draft—Not for Distribution
Box 7. Bank-Supported Operations Strengthening the Demand for Better Governance

A recent review of 224 development policy operations (DPOs) approved by the Bank between 2000 and 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 NGO; in Bolivia supported the inclusion of CSO 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 publicly released information on resource transfers to subnational governments, by including benchmarks on the publication of transfers to local governments; in Peru included 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, created 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 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.

41. **State Institutions of Accountability.** Formal oversight institutions can provide important pressures for improving government performance. Where judiciaries are politically and economically independent, they can be an important check on executive power; and where public accounts committees, supreme audit institutions, and ombudsmen have sufficient capacity, they often can hold the executive to account. While the Bank has a fairly active engagement in judicial reform in Latin America and Eastern Europe, it has taken a more limited role elsewhere. The Bank has also supported 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, within its mandate and in partnership with other donors, to help countries strengthen their formal oversight institutions.25

---

25 When such work is beyond the Bank's mandate, it should proceed through other donors.
3. Private Sector

42. Contrary to conventional wisdom, the public sector is not the sole “shaper” of the investment climate for domestic firms and foreign investors in a country, nor is the private sector the passive “taker” of that investment climate. In reality, there is a complex interplay between corporate and public sector governance and policymaking, so that powerful segments of the private sector play a very important role in shaping key public policy, legislation, and regulations that constitute the “rules of the game” and the business environment within which corporate organizations operate. 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 OECD convention against cross-border bribery that came into force over five years ago, multinational corporations’ involvement in corrupt behavior abroad can undermine public governance in emerging economies. There appears to have been little progress in bringing serious cases of bribery to court; and the significant gap between multinationals’ bribery behavior within the OECD and outside it highlights the need for tougher monitoring and enforcement of the convention across the OECD.

43. Bank Group Role. The strategic role of the World Bank Group is to improve the investment climate and increase domestic competition by (a) helping countries build a transparent and competitive investment climate—from reform of the regulatory environment for doing business, to corporate governance reform, to privatizing economic and financial entities, to reform of procurement and concession arrangements in sectors characterized by natural monopoly or substantial resource rents; and (b) engaging the private sector as a proactive ally in the fight against corruption. Reforms such as these can help nurture the development of an independent middle class with a vested interest in demanding 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 to support themselves and their families.

44. Bank Group Engagement. The Bank Group has several different modes of engagement with private sector counterparts. Bank operations can work with governments to improve the investment climate, develop the commercial and financial sectors, and build capacity in anti-money laundering, and IFC and MIGA can engage directly with the private sector. IFC in particular has an important role to play: its strategic sectors include domestic finance and infrastructure, which are important for improving the investment climate; and 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 create 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

---

26 In many societies, politicians and bureaucrats are compensated for sitting on corporate boards – a potential conflict of interest to be addressed.

27 Two critical challenges in privatization, especially in poorly governed countries: (a) to conduct it using a transparent and competitive process and (b) ensuring that it leads to greater productivity and competition.
“business case” for private sector engagement on environmental and social issues. The Bank Group will deepen its involvement in such global partnerships as the Partnership Against Corruption Initiative (PACI), the Extractive Industry Transparency Initiative (EITI), and the Forest Law Enforcement and Governance (FLEG) Ministerial Processes, possibly extending these approaches to new areas and collaborations with groups of multinationals that have organized to promote anticorruption principles and codes of conduct. (See Box 8 on partnerships in the financial sector.)

Box 8. Strategy on Strengthening Governance and Anticorruption in the Financial Sector

Corruption in the financial sector takes many forms: smaller borrowers may make payments to loan officers, particularly in state banks that offer subsidized loans or where competition is limited; well-connected borrowers, political favorites, and private bank insiders may benefit from loans on favorable terms that are not collected; or foreign exchange and financial assets are sold at favorable rates and money laundering may occur through the banks. The Bank has a three-pronged strategy to address these sector-specific governance challenges:

- Support from more than 60 adjustment and technical assistance loans for privatization has encouraged the open, transparent sale of state banks and bankrupt private banks to new banks, particularly well-known foreign banks, and has helped reduce corruption in the sale. Such new banks can reduce the power of insiders, increase competition, and improve collection efforts. The Bank has also encouraged development of financial markets and non-bank financial institutions to stimulate competition and alternative sources of finance.

- The Bank has supported better regulation and supervision and better financial reporting (through the Bank-IMF FSAP and support from many of the Bank’s 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 and combating the financing of terrorism, followed up by Bank technical assistance where needed.

- The Bank and IFC are supporting better corporate governance arrangements in banks through policy dialogue, financial support and technical assistance, financial sector reform parts of DPOs, and new methodologies for assessing and improving bank governance. In particular, the Bank has developed a methodology on bank governance review as part of its effort to help countries adopt better governance and transparency practices in the banking sector.

IV. ADDRESSING CORRUPTION IN BANK GROUP OPERATIONS

45. This section sets out the project pillar of the Bank’s strategy on governance and anticorruption, describing how to address the challenges corruption poses to Bank-financed projects.

46. Rationale. The Bank’s record in reducing corruption in projects that it supports is essential for its credibility in advising and supporting governance and anticorruption efforts in countries. 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 theft of funds will not affect overall corruption levels; but the Bank can demonstrate good practice in the projects it supports.

47. Stand-alone Projects vs. 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 Bank, enhance capacity, increase country ownership and project sustainability, and facilitate harmonization. More broadly, while ring-fencing isolates aid projects from other government programs, a country systems approach strengthens the country’s own governance system, magnifying the impact of aid. As part of a move to greater use of country systems, the Bank is increasingly emphasizing capacity development and human resource development, which can have a major multiplier effect by leading to broad improvements in the quality of government systems (see Box 9). In recent years, the World Bank has begun using country systems in specific fiduciary areas—financial management and national competitive bidding for procurement—for projects in an increasing number of countries where it has appraised such country systems to be adequate, or when specific unacceptable practices are identified and clearly precluded in the Loan Agreement. This agenda is of particular importance for middle-income borrowers, where the Bank intends to support countries in building capacity to meet the agreed standards while pursuing operational objectives.

Box 9. 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.

A. Anticorruption Measures

48. The elements of a strengthened approach to fight corruption in operations include prevention—which should be the highest priority—as well as detection and deterrence.

28 In the Africa region, a Capacity Development Management Action Plan (CDMAP) has been developed as part of the Africa Action Plan (AAP). Action 1 of the CDMAP is strengthening public financial management and accountability, including public procurement. Under this action, the Bank will assist in the training of over 5,000 accountants and auditors in 14 countries and about 4,000 procurement personnel in 18 countries.
49. **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. Projects must be simply designed with a focus on enhanced oversight mechanisms, disclosure of project information, complaints handling, and strengthened supervision. Project agencies or units should be made ready for implementation, with processes in place for adequate recordkeeping and documentation, which is vital for subsequent detection of problems. Most importantly, the measures must seek to increase the accountability of project implementing agencies and service providers through instruments (such as beneficiary surveys and citizen scorecards) that give “voice” to beneficiaries. Other measures might include technical assistance components, especially in fiduciary areas; enhanced transparency and disclosure on project procurement and financial management issues; stronger monitoring mechanisms (including physical and value-for-money audits) and, on the part of the Bank, more comprehensive and intensive supervision plans designed early and fully staffed and funded. (See Box 10 for a recent project example.)

Box 10. Integrating Anticorruption Elements into Project Design: Paraguay Roads Maintenance Project

The $74m Paraguay Roads Maintenance Project, which finances the enhancement, management, and maintenance of the country’s roads infrastructure, directly integrates anticorruption components. The project’s design includes clear roles for the borrower, the Bank’s task team, and INT during project implementation, including a set of monitorable indicators triggering specific responses tailored to the level of the corruption risk identified. 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. The project has influenced the implementing ministry to prepare a road sector strategy generalizes the approach.

50. **Communications Strategy.** Because of the importance of an effective dialogue on issues of fraud and corruption, not just at the start of project identification and design but throughout the life of the project, it is important to develop an effective communications strategy that covers all phases of the project, to manage client relations and to avoid surprises later on. The communications plan must provide for consistent messages to be conveyed to all of the relevant stakeholders: government officials in the implementing agency, and if there is a project implementing unit, to those staff; 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.

51. **Detection and Deterrence.** Ultimately, 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 11). Strengthened anticorruption measures include an enhanced focus on controls, audits, and reviews and greater attention to fiduciary arrangements and 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; 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 needed.

Box 11. Red Flags from INT: Indicators of Corruption in Procurement

<table>
<thead>
<tr>
<th>Bribery 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.</th>
</tr>
</thead>
<tbody>
<tr>
<td>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 (same typographical errors, same breakdown of unit prices, etc.). 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.</td>
</tr>
<tr>
<td>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.</td>
</tr>
</tbody>
</table>

B. Risk Mitigation and Special Tools

52. Because responsibility for risky projects lies squarely with the Regions, 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 at the concept stage (and reviewed once in the portfolio) to identify the subset of projects that are most at risk and provide an efficient way to mitigate corruption and other risks. The Bank will develop criteria and diagnostic tools to assess new projects according to their corruption risk, and will then require that the concept reviews of all projects include explicit discussion of the risks to development objectives posed by governance weaknesses and corruption, and that a risk mitigation plan be developed as appropriate. Regions will refer moderate-risk projects for review by the Bankwide Regional Operations Committee and will elevate highly risky projects to the Operations Committee or other Senior Management review for the appraisal decision meeting. However, it will be important that staff receive clear guidance on due diligence and risk tolerance.

53. **Portfolio Reviews.** Regions will be expected to conduct a regular risk review of their project pipeline and lending portfolio to identify where resources should best be focused, especially during supervision. Projects deemed to be of highest risk should receive both consistent Regional oversight in risk review processes and subsequent managerial attention during implementation. For countries with systemic corruption, senior Regional management will chair periodic reviews of the entire country pipeline. Clusters of projects that share common features and risks—for example, projects incorporating conditional cash transfer, land, or subnational components—will also receive further in-depth Regional review. Finally, projects on the Regional vice president’s list need to consistently receive a premium over the standard supervision budget (which may or may not be able to be funded from supervision savings on less risky projects).

54. **INT Investigations.** Aggressive investigation by INT into projects where there are allegations of wrongdoing is 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, and Detailed Implementation Reviews, where conducted, as well as findings from the Voluntary Disclosure Program once it is mainstreamed, provide lessons for operational staff on where projects are failing and how to rectify those problems.

55. **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 and will be expected to be widely recommended in governance-oriented CASs. However, these are not costless: both the Bank and partner countries will need additional resources to design and implement anticorruption action plans, and anticorruption teams and governance advisers will represent additional staffing costs for the Bank. Project preparation will be somewhat lengthier, and some projects may be dropped.

- **Anticorruption action plans.** For high-risk projects, staff will be expected to prepare anticorruption action plans that identify the main corruption prevention aspects of the project. These detailed project-specific plans will be centered on the following
principles: transparency of information and processes, participation of project beneficiaries or civil society organizations, and accountability, including receiving and resolving complaints, investigating allegations of wrongdoing, and sanctioning those found guilty (see Box 12). 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 on implementation of the action plan. Such plans will be mandatory for all projects in exceptional risk countries.

**Box 12. Anticorruption Action Plans in Indonesia**

Anticorruption action plans were first created by the Indonesia country team, which has designed more than a dozen plans to date. Their advice to preparation teams is that each plan should build on knowledge generated by previous plans, be tailored to suit the individual project, and include six key elements:

- Enhanced disclosure provisions
- Civil society oversight
- Mechanism to handle complaints
- Policies to mitigate chances of collusion
- Mitigation of fraud and forgery risks
- Sanctions and remedies

- **Anticorruption teams.** To oversee the design of projects in risky settings and, in particular, with anticorruption action plans, and to help manage the portfolio, an anticorruption team (or operations risk management team) may be established at the country level. Especially in high-risk countries, such teams will consist of fiduciary staff (procurement, financial management, and legal specialists) situated in the country office, supplemented as appropriate by a governance adviser, an operations manager, and key sector coordinators or project team leaders. Anticorruption teams would formally review project design, the project’s risk rating, and its anticorruption action plan. They would 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 any corruption investigations and follow up on corruption allegations not directly investigated by INT.

- **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 could serve as a focal point for the country team on governance issues, allowing greater knowledge sharing across task teams and early warning on high-risk projects.

56. **IFC and MIGA.** IFC and MIGA are working actively with clients to ensure strict standards of corporate integrity.

- IFC addresses the need for stronger corporate governance and explicitly integrates avoidance of corrupt acts into corporate governance standards as part of its investment decisions, and it uses specialized assessment tools, tailored to the type of company, as part of its risk analysis and investment appraisal. To mitigate the risk of corruption, IFC is working on an operational strategy that focuses on selection of
investments, contract design and remedies, and supervision and exercise of remedies. Priority actions include preparing guidance on due diligence procedures and investments in companies owned by politically exposed persons. At the country level, IFC can take an active role in mitigating corruption by the way in which it selects investment operations and technical assistance engagements.

- Over the past year MIGA has adopted a new and more systematic process for identifying possible integrity issues in projects: it has designated an Integrity Advisor and arranged access to commercial databases to facilitate due diligence. Unlike lenders or investors, MIGA benefits from the inherent nature of a guarantee contract: although MIGA undertakes its own due diligence, the nature of the guarantee relationship provides a strong incentive for fully reputable behavior on the part of the investor. As an insurer, MIGA can cancel a contract or deny a claim if there is any evidence of corruption. In addition, MIGA's support to a project raises its public profile, making it more difficult for the projects to be a source of, or a victim of, corrupt behavior.

V. GLOBAL PARTNERSHIPS ON GOVERNANCE AND ANTICORRUPTION

57. To strengthen the impact of work on governance and anticorruption and more effectively support individual countries in their effort, the World Bank Group has 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, private sector, and the media; strengthened global coalitions among leaders of the state, civil society, the media, private sector, and international organizations to promote change at sector, country, and global levels; and support for implementation of international initiatives and conventions.

58. Harmonization and Coordination with Donor Partners. 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. In respect to project funding and subsequent implementation, consolidating a myriad of donor activities into one agreed program reduces transaction costs, facilitates improved priority setting, allows for common reporting, and generally reduces the burden of donor requirements on governments. The main messages of the Paris consensus 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. A substantial body of country-level good practices 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 more effectively tackle the challenges of poor governance and corruption in high-risk settings. The Bank’s efforts in global areas include the following:

- In global partnerships, the Bank will focus on undertaking joint assessments of governance and corruption and fostering greater specialization among international organizations and donors. A particular priority will be to encourage other multilateral and bilateral donors to focus on issues pertaining to political drivers of governance problems that are outside the Bank’s mandate (for example, supporting demand for governance by building capacity of institutions of accountability that are outside the executive branch).  

- The Bank will continue its work in coordination with other institutions—for example, the recent work of an MDB Task Force to improve consistency in investigative rules and procedures, strengthen information sharing, and implement mechanisms to recognize each other’s sanctions decisions. Another priority is to coordinate donor strategies in exceptional-risk countries to avoid mixed signals—that is, a tough stance by one donor or the World Bank may be negated by different standards or opportunistic behavior of other donors. To this end it is important not only that all MDBs are part of a harmonized strategy, and also that efforts are made to integrate new and emerging donors. There are some examples of joint CASs (e.g., Uganda), which could be an important instrument to facilitate coordination.

- The Bank will continue its coordination with the IMF on a range of areas related to governance and transparency—public expenditure management, tax and customs reform, support for Poverty Reduction Strategy Papers, coordinated strategies on debt relief, and 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.

59. **Strengthened Partnerships with Civil Society and Private Sector.** The World Bank Group will take a leadership role in working with civil society and the private sector as vital

---

29 This focus is also identified in the upcoming OECD-DAC Governance Network Paper on Anticorruption. An example of such collaboration is the recent joint CAS for Bangladesh, which provides for bilateral donors to focus on issues related to political corruption, such as electoral and party financing.

30 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 on moving together in standardizing the definitions used by the institutions in sanctioning firms involved in corrupt activities, improving the consistency of investigative rules and procedures, strengthening information sharing, and ensuring that compliance and enforcement activities taken by each institution are supported by others. The IFI anticorruption task force created to work on this agenda has drafted harmonized definitions of fraudulent and corrupt practices and has submitted them to their respective institutions for review. The task force’s most recent meeting in June 2006 reviewed principles and guidelines for investigations with a view toward harmonization and developing a mechanism to recognize each other’s sanctions decisions. For further details, see *Sanctions Reform: Expansion of Sanctions Regime Beyond Procurement and Sanctioning of Obstructive Practices* (R2006-0149, IDA/R2006-0158, IFC/R2006-0209, MIGA/R2006-0045), July 17, 2006.

31 IMF launched three international codes of good practice—for fiscal transparency, data dissemination, and monetary and financial policies. Currently IMF and the Bank collaborate in assessing the observance of standards and codes in 12 areas critical to the functioning of a market economy. The results are summarized in Reports on the Observance of Standards and Codes (ROSCs), which are typically published with the consent of the member.
partners in promoting the demand for good governance and anticorruption. At the global level, the Bank partners with civil society organizations in a range of economic reform and governance dimensions, and it will work to strengthen this partnership. The Bank Group, and especially IFC, has also been working with business associations and private firms in the area of corporate responsibility and transparency. 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. 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 PACI.

60. **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, media, and the private sector for governance reform. The Extractive Industries Transparency Initiative (Box 13) represents an example of such an effort at the sector level in countries. Through such innovative global partnership as the Global Integrity Alliance and the Global Organization of Parliamentarians Against Corruption, 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.

**Box 13. The Extractive Industries Transparency Initiative (EITI)**

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 increasing evidence that resource endowments contribute to sustained growth only where transparency and governance are good (for example, in Botswana and Chile). Where governance is poor, countries dependent on extractives are susceptible to poor economic performance, corruption, and conflict.

Launched in 2002, the Initiative has developed into an international coalition of developing countries, donors, extractive industry companies, civil society groups, investors, and multilateral organizations. It promotes auditing, reconciliation, and publication of information on what companies have paid in taxes and production share to governments, and what governments have received from those companies. At present some 20 countries across Africa, Latin America, the former Soviet Union, and Asia are implementing EITI programs. A Secretariat based in the UK’s Department for International Development coordinates and leads the Initiative.

EITI has developed into a strong international initiative on the basis of three key strengths:

- It is a multi-stakeholder process that works with governments and with international, state-owned, and local companies, and aims to improve transparency in all of them.
- The accounting is matched with accountability. EITI promotes greater transparency of payments and revenue data, but it also complements that by working with international and local civil society groups to include them in the process and improve their ability to hold governments and companies accountable.
- Clear and narrow focus. EITI has succeeded because it has focused on one major sector, and one set of transactions between that sector and governments.

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

---

22 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.
61. **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 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 anti-foreign bribery convention of the Organisation for Economic Co-operation and Development (OECD), 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 Convention on Bribery of Foreign Public Officials in International Business Transactions 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.\(^{33}\) Ways will need to be found to engage more with countries, especially emerging market economies whose importance in trade and investment in developing countries is growing rapidly. The Bank will need to use its global position and partnership with OECD for tougher monitoring, disclosure, and enforcement of the OECD 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 AML recommendations is the identification of the crimes—including corruption and bribery—that give rise to money laundering. The Bank has been providing assistance and training to partner countries to build AML/CFT frameworks with important implications for anticorruption. In some country programs, having AML/CFT laws has been used as a trigger for the Bank’s programs.

- The most 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 (Box 14).

\(^{33}\) 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 13 of 24 countries surveyed, but it notes with concern the 9 countries that have neither cases nor investigations. Transparency International’s 2006 *Progress Report on the Enforcement of the OECD Convention* notes both strengths, but also potentially serious weaknesses, and recommends strengthening government enforcement organizations to deal with foreign bribery cases.

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 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.

62. **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. As the recent experience with asset recovery in Nigeria showed, 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 plundered.

VI. IMPLICATIONS AND NEXT STEPS

63. This paper sets out a broad and many-faceted strategy for increasing the Bank’s focus on governance and anticorruption. Operationalizing this strengthened approach will necessarily involve consideration of timing and sequencing, budget and staffing implications, monitoring for results, conducting consultations, and producing guidance to staff on a range of operational areas and topics.

64. **Staffing.** Implementing this strategy will have significant implications for staff capacity in governance and anticorruption across the Bank—in country teams, in sectors, and at the center. It could mean major changes in the type of staff needed in the front line to implement these new directions, and possibly a different combination of staff, skills, and managers.

- Most of the capacity will be needed at the level of country teams (especially in high risk project and country situations), to undertake risk and vulnerability assessments,
and to develop and implement governance reform programs to help partner countries. In some countries Bank teams have already been relying on field-based governance advisers (e.g., currently in Brazil, Cambodia, India, Indonesia, Madagascar, and Tanzania, and planned in Bangladesh, Ethiopia, Philippines, West Bank and Gaza, and Yemen) to provide the integrated advice on governance the country program needs, and other Bank offices have established anticorruption teams to oversee project design and advise on portfolio management—both useful ideas that other units may wish to adopt or adapt to their circumstances.

- Governance and anticorruption expertise will also need to be strengthened in such key sectors as infrastructure, financial sector, human development, and private sector.

- Central capacity will be needed to support country teams with operational support, training, peer learning programs, and specialist advice, and to provide central oversight and monitoring.

- Focal points across the Bank—in the Regions, in country teams, in the Networks, in Operations Policy and Country Services, and in the World Bank Institute—could be useful to coordinate this new area of emphasis (for country strategies and for operations).

- Key knowledge gaps remain—among staff with governance expertise and, especially, among staff who currently lack that expertise but who will be expected to take the strengthened approach forward. Country teams slated to give intensified scrutiny to governance and anticorruption in CAS design and implementation will seek support as they proceed. So, too, will sectors seeking to incorporate these elements into their toolkits of sectoral knowledge and operational design and implementation.

65. Implementation. Management expects to operationalize this new strategy over a period of one year. Systems are already in place for much of the work—for example, harmonization with other institutions and taking a risk management approach to project supervision—and in these areas staff can begin at once intensifying their focus on governance and corruption. Similarly, for the CAS treatment of governance and corruption, the discussion of the risks governance issues pose to development in any country could be immediately ramped up at the level of the upstream review. Management will begin revising existing guidance, or preparing new guidance as necessary, to assist staff in understanding and implementing the new approach. In the meantime, Management proposes to select about eight countries for intensive attention to governance and corruption issues, to learn lessons from the experience that could be applied to other situations and could inform broader guidelines.

66. Communications and Consultation. The proposed framework for strengthening the Bank Group’s approach to the critical issues of governance and anticorruption potentially has significant implications for many stakeholders, member countries, and development partners. Thus the Bank Group needs to engage in an active process of consultation and engagement with these key groups, and to communicate with internal and external audiences about it. External Affairs will work with interested internal and external audiences to support the necessary consultations and to communicate the details and the evolution of the strategy. Management

Confidential: Draft—Not for Distribution
proposes to build on the limited consultations of the past few weeks with a second, broader phase of consultation and dialogue with a wider set of actors (particularly in countries where governance issues are paramount) once the Development Committee paper is made public. The goal of the second phase will be to elicit feedback on the strategic framework laid out in the paper and on specific implementation issues. Specifically, Management would propose a series of engagements with key stakeholders and partners, including private sector representatives, parliamentarians, civil society organizations, trade union leaders, and representatives of think tanks and academia, undertaken by Bank Group teams at the regional, country and headquarters levels. The feedback would be collected, summarized, and made public, and would feed into a progress report for consideration by the Development Committee at the 2007 Annual Meetings. In addition, External Affairs will seek to ensure a transparent process over the coming months by regularly briefing the media on the progress of the paper and explaining the scope of the strengthened approach, likely next steps, and implications for the work of the Bank Group and its partners.

67. **Reporting.** Management proposes to report to the Development Committee on the implementation of the strategy at the Annual Meetings in 2007 and periodically thereafter.

68. **Budget.** Strengthening governance and anticorruption work will require additional investments at:

- The country and regional level: for exceptional risk countries, diagnostic work, and program design, governance specialists, regional focal points, enhanced supervision in Bank projects;

- The central level: for corporate oversight, country support work and capacity in frontier areas such as political economy, media, parliaments, monitoring, and global partnerships; and

- The sector level: governance and anticorruption expertise and work in sectors such as the private and financial sectors, infrastructure, and human development.

Detailed budgetary implications will be worked out for different parts of the Bank at the country team, sectoral, and central levels. The total cost of this strategy is initially estimated to be $20 million, of which about would come from reallocation of existing resources.

69. **Monitoring for Results.** Monitoring is key to accountability—so it is vital in making a sustained move from principles to action in the WBG’s work on governance and anticorruption. This paper has proposed the CAS as the entry point for implementation of the strengthened approach to governance and anticorruption work. CASs are thus the natural point of departure for the task of monitoring World Bank Group implementation of the strengthened approach to governance and anticorruption. Two sets of CAS-related monitoring challenges are key. First, there is a need for clarity as to what should be the governance monitoring framework to be included in CASs. Second, there is a need for clarity as to how the monitoring framework is to be implemented—what will be the arrangements for filling key gaps in knowledge about the design of such a framework, and what will be the mechanisms for reporting consistently as to the quality of governance monitoring frameworks in CASs, and in their implementation.
70. **Framework.** To begin with the challenge of what should be the content of CAS-based governance monitoring, a framework could have three parts. The intensity of attention to these three parts would be expected to vary across CASs, depending on the extent of perceived governance-related development, fiduciary, and reputational risks.

- 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 (e.g., CPIA; Kaufmann-Kraay) could be used to characterize broadly a country’s strengths and weaknesses across a variety of dimensions of governance.

- Using specific governance indicators (e.g., PEFA, Doing Business, Investment Climate Surveys, WBI Governance and Anticorruption Diagnostic Surveys) to monitor trends in the specific parts of the governance system targeted for improvement during the CAS period.

- Monitoring sector-specific trends in governance and anticorruption within those sectors highlighted in the CAS as priority areas for achieving poverty reduction goals.

As for how an enhanced governance monitoring framework is to be implemented, while the front-line responsibilities will be with country teams, central units will have a key role in providing knowledge support, and in monitoring change in Bank practice so as to assure that the CAS-based approach is being implemented effectively.

71. **Building Capacity to Monitor.** It will be equally important to ensure that the countries involved in the process can benefit from this monitoring. For this reason, this monitoring framework will include a capacity-building component, to (a) ensure that the countries involved in this process can to benefit from this information, (b) ensure that countries have ownership of the reform process, and (c) ensure sustainability of the governance reforms beyond the length of the engagement with the Bank.

72. **Operationalizing the Approach—Guidance to Staff.** OPCS has a work program of ongoing and planned revisions of policies, procedures, and guidelines on CASs and ISNs, investment operations, and development policy operations. OPCS will strengthen these documents to deal explicitly with corruption concerns, including such areas as CASs for which governance is the central element of the strategy, approaches to identifying high risk operations, and designing projects to be more resistant to corruption. Sector guidance on sector-specific aspects of corruption and how to address it in operations will be issued to supplement Bankwide guidance. If any policy issues arise in implementing the strengthened approach, Management will bring them to the Board for consultation and approval.
ANNEX A. SELECTED LITERATURE ON GROWTH AND GOVERNANCE


Confidential: Draft—Not for Distribution


ANNEX B. 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;¹ 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 solely within the private sector, yet 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.²

*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.*³

**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 that 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) a deliberate act intended to materially impede a Bank investigation into allegations of a corrupt, fraudulent, coercive, or collusive practice, including the destroying, falsifying, altering, or concealing of evidence material to the investigation and the making of false statements to investigators; 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 prevent the Bank from exercising its inspection and audit rights.

---


² 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.
