

OUTLINE

STRENGTHENING BANK GROUP WORK IN GOVERNANCE AND ANTICORRUPTION

1. This outline sets out the main elements of a paper under preparation that responds to stakeholder concerns, in particular those expressed by the Development Committee.¹ The paper will describe the policy framework and address the operational implications of the World Bank Group's heightened focus on governance and anticorruption and its envisioned scaled up support for country efforts to strengthen governance and reduce corruption. This outline is intended as a vehicle to solicit comments from shareholders and other interested parties as input to the final paper. Bank shareholders have significant experience in assuring sound governance policies and practices that provide a strong foundation for development and growth, and their views and experiences are expected to provide valuable input and guidance for the paper.

2. *Elements of Approach.* The enhanced approach proposed in this outline builds on existing strategies in governance and anticorruption, on the experience of Bank support for country efforts on this agenda, on the imperative of assuring aid effectiveness, and on the experience of Bank efforts to mitigate development, fiduciary, and reputational risks in operations and programs that it supports, and it aims to capture lessons of experience. The reputational risk involved goes to a critical core competency of the World Bank Group – its ability to manage public resources responsibly and effectively.² The application of the approach to a partner country is intended to be based on the degree to which weak governance and corruption, as assessed by staff professional judgment guided by institution-wide principles, constrain the Bank's overarching goal of reducing poverty and fostering economic growth. New or strengthened elements of the Bank's approach under consideration include the following: (a) a risk-based approach, featuring upstream mitigation, enhanced due diligence, and strengthened diagnostics, possibly including the development of a new Country Governance and Anticorruption Assessment; (b) a heightened focus on governance in Country Assistance Strategies (CASs), with mandatory components in highly vulnerable countries; (c) a greater focus on strengthening governance and combating corruption at the sector level; (d) greater engagement with the private sector; (e) increased attention in partnership with other donors to strengthening institutions of accountability outside of the executive branch of government (the demand side of governance); and (f) deeper investigations into projects as warranted, with the

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 the Fund, 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 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." The organization's policies and procedures for financial management, procurement, and disbursement of loaned funds are core elements of the arrangements to meet this requirement. In addition, the Bank has a well-founded concern for its reputation, which is a foundation stone of its ability to raise financing to support developing country efforts to foster growth and reduce poverty (an ability that potentially could be hindered if its reputation were to be tarnished by lending large sums in highly corrupt environments). Both of these concerns have added urgency to efforts to tackle corruption more aggressively and systematically.

aim both of fulfilling the Bank's fiduciary obligation and of extracting "lessons learned" to be fed into the design of new projects.

I. INTRODUCTION

3. This section will provide context for the proposed approach and highlight its fundamental aim: to deepen the engagement with partner countries on governance and corruption in order to improve developmental outcomes while at the same time more effectively mitigating fiduciary and reputational risks in Bank operations and programs.

4. **Governance and Corruption.** Public sector governance refers to the manner in which public officials and public institutions acquire and exercise the authority to provide and manage public goods and services, including the delivery of basic services, infrastructure, and a sound investment climate.³ Corruption is only one aspect of weak governance

5. **Development Effectiveness.** For both partner countries and the World Bank Group, improving governance and reducing corruption are central for strengthening development effectiveness. Extensive research over the last two decades convincingly shows that the quality of governance, including corruption control, has a significant impact on economic growth and poverty reduction.⁴ 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 when institutions and norms of accountability are systematically weakened, hampering sustained development and growth.⁵ In several cases, when unchecked, corruption has destroyed economies by undermining the legitimacy of state institutions, strangling the private sector, and damaging civil society. Thus, for many of the Bank's partner countries, improving governance is critical to fostering and sustaining development.

³ *Sector Strategy Implementation Update, FY05 (SecM2006-0125)*, March 21, 2006, p. 65.

⁴ Pertinent research includes World Bank/PREM, "Improving Public Sector Governance: The Grand Challenge?" in *Economic Growth in the 1990s: Learning from a Decade of Reform*, Washington, D.C.: World Bank, 2005; Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi, "Governance Matters IV: Governance Indicators for 1996-2004," World Bank Policy Research Working Paper 3630, Washington, D.C., May 2005; "Mainstreaming Anti-Corruption Activities in World Bank Assistance: A Review of Progress since 1997," Operations Evaluation Department, World Bank, Washington, D.C. July 2004; Susan Rose-Ackerman, *Corruption and Government*, Cambridge University Press, 1999; and Vinod Thomas, Mansoor Dailami, Ashok Dhareshwar, Daniel Kaufmann, Nalin Kishor, Ramón López, and Yan Wang, *The Quality of Growth*, New York: Oxford University Press for the World Bank, 2000; Daniel Kaufmann, Aart Kraay, and Pablo Zoido-Lobaton, "Aggregating Governance Indicators," World Bank Policy Research Working Paper No. 2195, Washington, D.C., October 1999; Daniel Kaufmann, Aart Kraay, and Pablo Zoido-Lobaton, "Governance Matters," World Bank Policy Research Working Paper No. 2196, World Bank, Washington, D.C., 1999.

⁵ Beyond country aggregates, there is also evidence at the more micro or project level: in countries with weak governance and high corruption, the effectiveness of investment projects carried out by the government (and funded by the World Bank) is significantly impaired. By contrast, the effectiveness of projects is much higher where governance is not very weak. See Jonathan Isham, Daniel Kaufmann, and Lant H. Pritchett, "Civil Liberties, Democracy, and the Performance of Government Projects," *World Bank Economic Review*, Vol. 11, No. 2: 219-422, 1997; and Victoria Levin, and David Dollar, "Sowing and Reaping: Institutional Quality and Project Outcomes in Developing Countries," *World Bank Policy Research Working Paper 3524*, February 2005.

6. **Aid Effectiveness.** Because aid delivered to settings with improving governance generally has a larger development impact than that delivered to governments with very weak governance and high corruption, and because there are always opportunity costs associated with channeling funds to one setting as opposed to another given limited aid budgets, it is important for the development community to be able to demonstrate that assistance is being delivered effectively and that it is going to governments and institutions that have a record of improving governance. This is particularly the case as donors scale up their assistance, including the promised additional resources to IDA to support the Multilateral Debt Relief Initiative.

II. HISTORY OF BANK ENGAGEMENT AND LESSONS LEARNED

7. This section summarizes the history of the Bank's engagement in governance and anticorruption, and draw lessons from country experiences that will inform the Bank's heightened emphasis on these issues.

A. History

8. The World Bank has come a long way on governance and anticorruption in a brief period. In 1996, the President of the World Bank publicly committed to fight the "cancer of corruption;" and in September 1997, the Board endorsed the first anticorruption strategy of the World Bank.⁶ In the ensuing years, the Bank has significantly expanded its work on governance and anticorruption and has registered progress on more than one front.⁷ The Bank's engagement in the area of governance has resulted in increased awareness, a large body of empirical research, and the development of diagnostics and indicators to monitor progress.⁸ Today, almost 20 percent of Bank operations and 13 percent of new lending tackle governance issues broadly defined, and nearly half of the prior actions for development policy operations are related to

⁶ *Helping Countries Combat Corruption: The Role of the World Bank*, PREM, World Bank, Washington, D.C., September 1997. The strategy contained 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 projects; and (d) supporting international efforts to combat corruption.

⁷ Progress has been guided by a series of reports and of strategy papers endorsed by the Board. For example, governance work received a major impetus from the *World Development Report 1997*, which emphasized that an effective state is crucial for development. The 2000 Public Sector Strategy focused on ways to help countries strengthen institutions of governance to improve development outcomes, including by combating corruption. (The strategy identified 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. See *Reforming Public Institutions and Strengthening Governance: A World Bank Strategy* (R2000-91), November 2000). In 2000, an update on implementing the anticorruption strategy was presented to the Board. See *Helping Countries Combat Corruption: Progress at the World Bank since 1997*, Operations Core Services and PREM, World Bank, Washington, D.C., June 2000. Progress in implementing the public sector strategy has been reported to the Board in Sector Strategy Implementation Updates (SSIUs) in 2002 and 2005. In addition, a series of *World Development Reports* (2002, 2004, and 2005) have continued to provide rich lessons on different aspects of the governance agenda, and the *Global Monitoring Report 2006* featured governance and proposed a framework for monitoring developments, including on corruption.

⁸ The Bank Group has developed a large set of tools to evaluate and monitor governance, from Institutional Governance Reviews, to Public Expenditure Tracking Surveys, Governance and Anti-corruption Diagnostic Surveys, and Doing Business and Investment Climate Assessments.

governance (principally in the field of public financial management).⁹ In addition, the Department of Institutional Integrity (INT) was established in 2001 to safeguard Bank-financed projects (building on several predecessor units). Its findings have underscored the value of a heightened focus on anticorruption work. In sum, the Bank Group's engagement across all Regions and most countries in support of country efforts on governance and anticorruption reveals that a significant and credible start has been made, but that much more remains to be done.

B. Lessons of the Past Decade

9. Drawing on engagement since the adoption of the 1997 strategy on anticorruption, this section will discuss (a) aggregate global and country-level trends, (b) country efforts, (c) the Bank's country-level experience, (d) sector-level experience, (e) project-level experience, (f) the role of the private sector, and (g) global partnerships, to identify approaches and activities that have produced significant results and interventions that have not yielded anticipated gains, and to help shape an enhanced strategy.

10. *Aggregate Global and Country-Level Trends.* At the global level, it is unlikely that the level of corruption has declined, although aggregate averages mask substantial variation across countries and changes over time.¹⁰ In some countries, corruption has fallen following the introduction of specific reforms. In many states, however, progress has been limited and the suggested reforms have not translated into better governance. As other obstacles to growth and poverty alleviation, such as macroeconomic instability, have become more manageable in many countries, it may be the case that governance has become a more binding constraint.

11. *Country Efforts.* Across the globe, some countries have made significant progress in improving governance and reducing corruption in a brief period of time, while others still lag behind. Strengthened public sector management practices have contributed to improved service delivery and lower rates of corruption in a number of countries where reforms have been sustained. For example, in some countries, significant reforms have been implemented and some forms of administrative corruption—such as petty bribes to utility officials—have decreased. In other countries, reforms have been more focused and progress has been achieved within specific sectors. However, in many states, key forms of corruption that have deep political roots—such as state capture and procurement corruption—have not been adequately addressed. Lack of transparency, unequal rights of women and other groups, constrained media, weak governance at

⁹ For operations, the theme of Public Sector Governance/Rule of Law includes thematic codes: 25-Administrative and Civil Service Reform, 26-Decentralization, 27-Public Expenditure, Financial Management and procurement, 28-Tax Policy and administration, 29-Other accountability/anti-corruption, 30-Other Public Sector Governance, 31-Access to Justice, 32-Judicial and other dispute resolution mechanisms, 33-Law reform, 34-Legal institutions for a market economy, 35-Legal services, 36-Personal and property rights, and 37-Other rule of the Law. The sectors/themes of conditions in development policy lending are recorded in the Bank's Adjustment Lending Conditionality Implementation Database.

¹⁰ For example, as monitored since 1996 through aggregate worldwide governance indicators in Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, "Governance Matters IV: Governance Indicators for 1996-2004," World Bank Policy Research Working Paper 3630, Washington, D.C., May 2005; Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi, "Governance Matters V," World Bank, Washington, 2006; and the "Governance Matters" series, www.worldbank.org/wbi/governance; and *Anticorruption in Transition Series* (2000, 2004, and 2006), www.worldbank.org.

the subnational level, and political corruption and undue influence continue to be deep-seated challenges in many partner countries. The underlying sources of poor governance remain untouched, and in many instances include weak commitment in states afflicted by various forms of grand corruption, powerful vested interests against reform and undue influence by powerful corporations and state capture, weak demand-side pressures, and strong political drivers of corruption. It is clear that these are long-term concerns and that progress depends on continuous improvement, often from low initial conditions.

12. **Country-Level Bank Experiences.** At the country level, governance and anticorruption have become key to our development dialogue with many partner countries, attaining a more central status in the Bank's CASs and in the operational portfolio, although the quality of diagnosis and attention to sectoral and demand-side issues need be deepened. As reported in the latest Sector Strategy Implementation Update (SSIU), governance issues are being addressed in CASs, with instances of notable initiatives to develop integrated governance strategies in high-risk environments.¹¹ However, the quality of the diagnosis in CASs and of the links to risks in Bank projects have been uneven overall. Public sector governance operations have been launched in many countries, with a strong focus on core public management reforms. Compared to all Bank operations, these operations have high quality at entry, perform less well in supervision, and are about average in terms of impact and sustainability. Other areas critical to the governance challenge—such as formal oversight institutions, political accountability, and the interface with civil society, media, and the private sector—have received much less attention. Overall, Bank experience points clearly to government commitment as key to improving governance and reducing corruption levels, and Bank experience suggests that diagnostic and operational instruments are most effective when there is strong leadership, a coalition for reform, and basic bureaucratic capacity.

13. **Sector-Level Experiences.** Working closely with partner countries, the Bank has been pursuing a strong agenda of institutional development in the sectors for the last two decades, but initiatives aiming explicitly to combat corruption are relatively new. Long-standing institutional development efforts have sought to improve some key aspects of sector governance. For instance, in the infrastructure sector, lessons learned in areas such as sector restructuring and unbundling, privatization, regulation, pricing reform, and access initiatives all have significant bearing on the anticorruption agenda. More recently, some sectors, such as forestry, roads, extractive industries, fisheries, water, and agriculture, have begun to focus on their specific vulnerabilities and have developed risk assessment tools, specialized databases, or monitoring systems. Other sectors have focused on improving governance by strengthening community participation and building coalitions for reform.

14. **Project-Level Experiences.** The Bank's record in supporting borrowing governments in reducing corruption in projects will be essential for its credibility in offering advice and supporting wider governance and anticorruption efforts in partner countries. To this end, over the past 10 years, issues of fraud and corruption have increasingly and explicitly been taken into account in project design and implementation. The Bank has added explicit anticorruption provisions to its Procurement Guidelines, placed procurement and financial management specialists on every project team, and increased the use of special audits, among other measures.

¹¹ *Sector Strategy Implementation Update, FY05 (SecM2006-0125)*, March 21, 2006.

Project team awareness has increased markedly over the past decade and resources devoted to financial management have increased dramatically. Among the lessons that have emerged are the importance of country-specific, risk-based assessments of fiduciary management (and that uniform restrictive approaches that fail to take into account strong country governance alienate partner countries and reduce the Bank's ability to engage); the need to align internal Bank incentives with the goal of identifying country institutional weaknesses, and to appropriately train operations staff; and the importance of results-focused and participatory approaches to project preparation and implementation.¹² It is essential to stress that at the project level, as elsewhere, the Bank is still actively drawing lessons to inform a strengthened approach to supporting country efforts on the governance and anticorruption agenda.

15. **INT Findings.** However, concern about corruption in Bank operations has risen because of the accumulating findings of INT investigations of investment projects. The results of investigations and of Detailed Implementation Reviews—in which INT works with country teams to conduct a substantive review of documents, processes, and contract implementation to identify indications of fraud, corruption, collusion, or coercion throughout the entire project cycle for a single project, selected projects, or an entire country portfolio—have revealed serious and challenging weaknesses in implementation performance.

16. **Role of the Private Sector.** Within the private sector, some powerful firms can capture the state through corrupt practices, or may improperly or unlawfully seek to induce or coerce actions by individuals within the public service; however, the private sector also can be an important ally in demanding better governance—both where large corporations model good behavior and where a thriving private sector creates a growing middle-class with an interest in governance reform. Accordingly, the Bank Group needs to combine steps to reduce the scope and incentives for private misbehavior in collusion with public officials with steps to foster the kind of growing, competitive private sector that will be a source of demand for better governance.

17. **Global Partnerships.** Successful global partnerships for governance and anticorruption have been confined to a few areas, such as public expenditure and financial accountability (PEFA) arrangements and the Global Organization for Parliamentarians Against Corruption (GOPAC). Strengthened global partnerships in two areas are crucial for advancing the governance and anticorruption agenda: (a) work on political and institutional drivers of poor governance, and on explicit initiatives that support demand for governance from institutions of accountability that lie outside the executive branch of government, and (b) progress in addressing the role of multinational firms in the governance and anticorruption agenda. More broadly, all such efforts demand reinforced commitment to harmonized donor approaches, especially in countries where the challenges are greatest, and intensified work with both bilateral donors and MDBs will be proposed.

18. **Coalitions for Change.** Among the critical lessons from a decade of governance reform is the importance of broad-based coalitions for change. Unfortunately, the forces opposed to change (e.g., embedded global and country-based corruption networks) are powerful and well

¹² See *Infrastructure: Lessons from the Last Two Decades of World Bank Engagement*, World Bank, Washington, D.C., January 30, 2006, www.worldbank.org.

financed. Public interest coalitions can act as countervailing forces, especially when they can link reformers in different sectors of society and across the globe. One issue going forward is how the Bank can more effectively participate in and support broad-based partnerships and coalitions for reform and how its shareholders can support these efforts by actions on the supply side of corruption.

III. A STRATEGY FOR STRENGTHENED SUPPORT TO COUNTRIES

19. This section will outline a strategy for partnering with governments to help achieve greater development impact at the country level. It will emphasize the importance of an enhanced CAS focus on governance, particularly in countries deemed at higher risk, as well as strengthened Bank interventions to scale up support for country efforts to improve governance, and new initiatives in the sectors, with the private sector, and on the demand side in partnership with other donors. The intent is to facilitate a more consistent engagement with countries, intensified Bank efforts in some countries, and a more effective use of Bank resources. The expectation is that in the vast bulk of countries, where governance is a major constraint on poverty reduction, the Bank's engagement will deepen. The section will also describe ongoing efforts to further strengthen anticorruption efforts in Bank Group-supported projects.

20. *Country Assistance Strategies.* CASs, and, more broadly, working with partner countries to formulate and implement programs and projects should consider more carefully the implications of corruption and weak governance on the overall objective of poverty reduction. The approach under development aims to: (a) better address corruption and governance issues where they are a major constraint to development or where reputational risk to the Bank is high; (b) ensure that the Bank's modes of engagement with countries align properly with corruption and governance concerns; and (c) ensure that agreement is reached with partner countries on how Bank projects can be appropriately and effectively safeguarded.¹³

21. *Impact on Strategy Design.* It would appear that several intertwined aspects of country circumstances related to corruption and governance are likely to be relevant to the design of a better country strategy. How detrimental to a country's growth and poverty reduction is weak governance and corruption? How committed is the government to strengthening governance and tackling corruption, and does it have a track record of progress? Is there reputational risk to the Bank posed by engagement, and how can that risk be managed or minimized? Can this risk be managed by working with some sectors and not others? Can the risk be managed by innovative methods of project delivery? Can civil society be used as an instrument for ensuring accountability and minimizing risk in Bank projects in high-risk situations? Are there individual or institutional "champions" of good governance – whether within government or among local civil society – whose efforts can be supported by Bank analysis, advice or operations? especially through lending? What is the risk of deterioration of the governance environment during the CAS period? How severe is the risk of fraud and corruption in Bank projects?

22. *Impact on Donors.* As donors scale up their assistance, including the promised additional resources to IDA to support the MDRI, it will be increasingly important for the

¹³ While the remainder of this section focuses on the CAS, issues about governance and corruption throughout the ongoing portfolio as well in new operations and analytic and advisory activities (AAA) will also need to be addressed in the proposed strengthened approach.

development community in general, and the Bank in particular, to be able to demonstrate that the assistance is being delivered effectively and that it is going to governments and institutions that have a record of improving governance.

23. **Possible Diagnostic Tool.** To help strengthen the treatment of governance and corruption in CASs, the Bank will provide greater guidance regarding the types of information that are needed. Specifically, CASs will need to identify the risks to development effectiveness, the Bank's reputation, and integrity of Bank projects posed by weak governance and corruption; propose specific analytic and advisory activities (AAA) and lending products and processes to address these risks; and provide indicators that can be used to monitor the effectiveness of the approach. To this end, building on existing anticorruption diagnostic tools at the Bank, consideration will be given to the development of a new diagnostic tool, the Country Governance and Corruption Assessment. The instrument would examine the risks posed by corruption at both the country level and in key sectors deemed critical for development. It would likely involve data gathering and analysis as well as consultations with the government, local stakeholders (including civil society, media, and the private sector), and other donors. It is primarily envisioned to be an internal document used to inform CAS preparation, with key elements published as part of the CAS.¹⁴

24. **Consistent Approach, Differentiated Application.** What is anticipated is a more systematic and disciplined approach across countries that calibrates the level of attention to governance and corruption to the assessed level of risk these issues present to effective poverty reduction. Specifically, the approach contemplates a continuum of countries, from those where high capacity and strong government ownership of governance programs would imply low risks, to the other extreme where limited capacity and low government engagement and interest present significant risks to development. In low-risk countries, Bank efforts would be largely responsive to the interests and direction of the government concerned. In the vast majority of countries, where there is some commitment to reform and a modicum of capacity, such an approach would anticipate a detailed analysis of governance and corruption and more comprehensive country-specific strategies to address governance and corruption issues as obstacles to poverty reduction. Indeed, in most of the countries in this group, the more aggressive and consistent treatment of these issues would be expected to provide the basis for a scaling up of Bank programs over time, for even greater development impact.

25. **Exceptional Risk Countries.** Finally, there would remain a small number of partner countries where low capacity and limited government interest and commitment would imply significant risks for the Bank's operational program. In these countries, the paper is likely to propose that the governance agenda be a mandated pillar of the CAS. Specifically, it would be anticipated that in these cases there would be an in-depth analysis of governance and corruption challenges, a full assessment of the factors that weaken government commitment to reform, and a discussion on how the proposed program of engagement (both lending and nonlending work)

¹⁴ This assessment will differ from the existing Governance and Anticorruption Diagnostics carried out by WBI, which are led by a country coalition of stakeholders (requested by the government and with assistance from the Bank) and intended as an external participatory tool to promote capacity building and collective action.

would address identified weaknesses.¹⁵ In a limited number of cases where government commitment is particularly weak or where the risk of deterioration in performance is high, the strategy could include a restricted or no-lending scenario, with specific triggers identifying the conditions under which the Bank would move to those scenarios. Clearly, decisions on adopting more restricted scenarios would require case-specific judgments, but existing sources of knowledge would be tapped to support these judgments (including findings from AAA work on governance and corruption; the wide range of available governance indicators; and INT work).¹⁶ Anticorruption plans would likely be required for projects that do proceed, and close monitoring of the strategy's implementation would be standard. Even when financial support is limited, every effort would be made to mobilize the full range of Bank Group instruments (including those of IFC and MIGA as appropriate) to engage more effectively with these countries; some countries may provide an environment where innovation and new approaches could be encouraged.

26. *Adjusting to Circumstances.* Country teams will need to stand ready to adjust the Bank's strategy to new information, including from INT about confirmed instances of corruption in Bank projects. The revelation of new information about risks created by governance weaknesses and corruption may shift the balance of reputational risk for the Bank or may imply distinctly higher development effectiveness or project risks. The appropriate response may be to switch scenarios within the existing CAS or to propose a revision in a CAS Progress Report.

27. *Supporting Country Efforts to Strengthen Governance and Reduce Corruption.* The Bank has a well-established framework that will guide a strengthened effort to work more effectively with country partners in identifying key elements for governance reform and supporting key entry points, tailored to the country context.¹⁷ Improving governance requires interventions to strengthen both the supply of and demand for better governance. Transparency is a cross-cutting aspect of an effective governance system, contributing to both strengthened capacity and accountability.

28. *Entry Points for Intervention.* To improve development outcomes and more effectively support country efforts to strengthen governance and reduce corruption, the Bank will more actively support reforms across the range of entry points suited to country-specific contexts. These include issues on which the Bank can provide support directly, such as *bureaucratic capability* (especially public finance management, and administrative and civil service reforms); *sector-specific reforms* (particularly if problems are concentrated in a few sectors); *local government capacity*; and *transparency initiatives* (such as freedom of information laws, e-procurement, public disclosure of incomes and assets of senior government officials, and public listing of board members of state-owned enterprises). There are also important areas where the Bank may work primarily in and/or through partnerships with other donors such as *check-and-*

¹⁵ Development policy lending would remain an option in these countries, subject to the usual assessment of the fiduciary environment. In practice, considerable caution would be expected, as has been exercised to date (with little development policy lending going to countries with very weak public sector governance).

¹⁶ In cases where a CAS is not feasible, an Interim Strategy Note (ISN) would be used to outline a revised strategy, suggesting entry points for more effective engagement on the governance agenda.

¹⁷ The framework has been defined and refined over successive World Bank reports and publications, including *World Development Report 1997*, *Public Sector Strategy 2000*, *Governance Matters series*, *Global Monitoring Report 2006*, www.worldbank.org.

balance institutions inside the state (such as the judiciary and the legislature), and *demand for better governance outside government* (media access; civil society and private sector participation and oversight). Where government commitment is strong, the Bank will actively support the government-led program; where prospects are more limited, the Bank will work closely with governments to identify suitable entry points and, in partnership with other donors, help strengthen demand for better governance.

29. ***Strengthening Governance and Combating Corruption at the Sector Level.*** A sector-level focus on governance and anticorruption reform may frequently be the most effective intervention. If a sector is particularly rife with corruption but recognized by the government and the Bank as central to overall developmental progress, the sector may present an appropriate entry point for engagement on governance; in other instances, the Bank may choose to avoid high-corruption sectors altogether. Work here will draw on the Bank's existing framework of sectoral diagnosis and will be explicitly discussed in the CAS. Country Governance and Corruption Assessments can be used to help identify circumstances where treatment of sector-specific governance issues is essential for unblocking reform, while sector-specific diagnostic instruments will be used for more in-depth investigation. The Bank has been constructing a common framework specifically for diagnosing corruption at the sector level (e.g., pharmaceuticals, forestry, roads, education, and customs). The framework will assist government efforts to identify decision points most vulnerable to corruption in each sector, possible interventions, and indicators for tracking progress.

30. ***Private Sector Role.*** More effective engagement of the private sector is critical to increasing development effectiveness. The Bank Group has already a number of different modes of engagement with private sector counterparts—Bank operations focusing on developing the commercial and financial sectors and on anti-money laundering, IFC investments, a MIGA product insuring against corruption, and global partnerships with multinational groups such as PACI (Partnership Against Corruption Initiative). IFC and MIGA clients are already working actively to ensure strict standards of corporate integrity. Moreover, IFC has already begun to address the need for stronger corporate governance (and explicitly integrates avoidance of corrupt acts into corporate governance standards) as part of its investment decisions, and employs specialized assessment tools tailored by type of company as part of its risk analysis and investment appraisal. Global partnerships will continue to build on existing initiatives in sectors, such as the Extractive Industry Transparency Initiative (EITI) and Forest Law Enforcement and Governance (FLEG) Ministerial Processes, possibly extending these sectoral approaches to new areas and collaborations with groups of multinationals that have organized to promote anticorruption principles and codes of conduct.

31. ***Promoting a Better Climate for Doing Business.*** The role of the private sector, both in fostering growth and in promoting good governance and reducing corruption, can be enhanced by further Bank support for efforts to curtail barriers to doing business in developing countries. Such work yields a double benefit on the anticorruption front because 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 thus serve as invitations for corrupt behavior by both government officials and private sector individuals; and 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.

32. ***Addressing Corruption in Bank Group Operations.*** In considering the elements of a strengthened approach to fighting corruption in operations, efforts can be usefully separated conceptually into prevention, detection and deterrence, and investigation—of which prevention should be the highest priority. The strengthened approach proposes improvements to the preparation and supervision of operations financed by the Bank to heighten the protection of the use of Bank funds. A risk management approach, with an emphasis on upstream mitigation of risk, would be a more efficient method of protecting projects.

33. ***Prevention.*** Minimization of corruption in investment lending will emanate from better project identification and design. Two areas of project preparation in need of greater emphasis are (a) properly preparing the Project Implementation Unit (PIU) or implementing agency to carry out its responsibilities, and (b) communicating expectations about what the government should focus on as the project is further developed and then implemented, including a new emphasis on anticorruption. A more explicit anticorruption focus in fiduciary approaches is to be adopted. For development policy lending and some investment operations (that finance recurrent costs such as salaries), prevention must be even more prominent, since detection is made more difficult by the merging of operation funds into the country's budget resources.

34. ***Detection and Deterrence.*** The supervision of projects should include detection and a search for "red flags" that may indicate possible corrupt behavior, and deterrence, through predictable consequences of violation of rules. One key indicator is adequacy of documentation by PIUs (a major failing in many projects reviewed by INT), the absence of which prevents assessment of whether the Bank's fiduciary guidelines have been followed.

35. ***Investigating Corruption in Bank Projects.*** INT is realigning its activities to better support operational decisionmaking, with greater emphasis on preventive action as well as on better balance between reactive and proactive approaches. INT has been strengthening its support of the Bank's operational work, by providing advice to operations staff in INT's investigative reporting, discussing investigative findings with operations staff and sharing lessons learned, and assisting operations staff by providing advice on anticorruption safeguards and due diligence during the project design phase. In addition, INT has developed new instruments such as Detailed Implementation Reviews and the Voluntary Disclosure Program to gain better information on corruption affecting Bank projects.

36. ***Mitigation of Risk in Bank Projects.*** A risk management approach to rating projects at the concept stage may be an efficient way to mitigate corruption risk. Additional time, attention, and resources will need to be devoted to individual projects to reduce the risk of corruption. Given the obvious constraints on all of those factors, and the fact that the risks of corruption are not the same for all Bank-funded projects, it might make sense to adopt a risk-management approach to identifying the subset of projects that are most at risk. It might also make sense to focus on the design stage and prevention of corruption and on the upstream mitigation of risks.

37. ***Anticorruption Action Plans.*** For high-risk projects, governments should be supported in developing anticorruption action plans. These detailed project-specific plans would be included in the loan/credit/grant agreement and publicly disclosed. They could include efforts on transparency (of both information and processes); participation (of project beneficiaries and/or civil society organizations as independent third-party monitors); and accountability (including

control measures such as procurement and financial management rules, and accounting and auditing, but also mechanisms for receiving and resolving complaints, investigation of allegations of wrongdoing, and sanctioning for those found guilty).

38. *Addressing Corruption in IFC Operations.* At the transaction level, working with a party that misbehaves would lead to credit risk, with implications for investment performance, reputation and ability to work with new clients. Thus, operations with the private sector through IFC are governed through a range of provisions aimed at mitigating the risk of corruption as a protection against credit and reputational risk. IFC carries out extensive research on sponsors and other investors before starting work on any investment project and supervises these issues closely throughout the life of the investment. IFC's primary defense against corruption in the projects in which it invests is its experience and familiarity with industry practices, technologies, and capital costs. IFC will also take an active role in mitigating corruption by the way in which it selects investment operations and technical assistance engagements.

39. *Broadening the Global Agenda/Building on Existing Initiatives.* Governance is a complex problem that involves both domestic and international actors and relationships. Global partnerships can allow the Bank Group to pool resources, share innovations and expertise, and foster a more effective division of labor. The strategy for such broader engagement will be built on the following principles—closer coordination among multilateral and bilateral donors to harmonize strategy in countries with especially weak governance as well as in investigative procedures; emphasis on helping to build coalitions for change among leaders in the state, civil society, private sector, and the media; and support for implementation of international conventions and specific governance action plans. Through a number of initiatives, the Bank is working with other donors at both the country and regional level to better coordinate activities in countries with weak governance. In addition, in recent years, partnerships to build coalitions in support of better governance have grown significantly at the sector level.¹⁸ Also, donor countries have an obligation to prevent efforts by their own nationals and corporations to enable corruption in developing countries.

40. *Transnational Perspective.* Corruption in countries with weak governance is often fed by the actions of individuals and companies from countries with stronger governance. The Bank Group must thus work with developed countries to deter and prevent corrupt activities by their

¹⁸ For example, through the OECD-DAC Governance Network (GovNet), the Bank has been supporting the preparation of an Anticorruption Policy Paper for the DAC and the creation of a Global Integrity Alliance (GIA), involving multiple stakeholders and integrity leaders across countries. The Bank is also working with other MDBs to harmonize procedures for investigation and disbarment. A task force has already been established to develop a uniform Framework for Preventing and Combating Fraud and Corruption, with the goal of concluding an agreement by the September Annual Meetings. Further, a new alliance is also being forged between the private sector (including multinationals) and the public sector to address private-public sector corruption issues. The Bank will also be more active in coordinating with the Partnership Against Corruption Initiative. At the sector level, the Bank has been active and should strengthen its work with the Extractive Industry Transparency Initiative, Forest Law Enforcement and Governance Ministerial Processes, and Publish What You Pay. New sector initiatives, including the Alliance for Responsible Fisheries (ALLFISH) and the DFID-led partnership on Construction Sector Transparency Initiative (CoST) and innovative partnerships with business associations and chambers of commerce are in early stages of development. At the thematic level, the Bank has been involved with PEFA, International Tax Dialogue, and the Global Organization of Parliamentarians against Corruption.

entities in developing countries. Strengthened global partnerships are a key tool to address transnational corruption and to implement international conventions against corruption credibly. Looking forward, a key issue for the Bank's governance and anticorruption strategy is how to strengthen global partnerships, including with the private sector. The Bank Group will therefore continue to support international conventions on anticorruption¹⁹ while improving its staff knowledge of these conventions and exploring innovative ways to link its technical assistance to countries to implementation of key elements of relevant conventions. The Bank Group will also explore ways to support the restitution of assets to countries plundered by corrupt leaders. The ability of developing countries to pursue assets stolen by corrupt officials and moved to off-shore financial institutions is currently 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. If it became easier for developing countries to recover stolen assets, the incentives for such theft would be reduced and the champions of good governance in developing countries would be strengthened. 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.

41. ***Managing for Results.*** The Bank will monitor the implementation of this strategy using the approach outlined in the Global Monitoring Report 2006 and the relevant results identified in CASs, with the understanding that sustained improvements in governance are a medium-term objective.²⁰ The Bank's CASs will outline a set of specific and monitorable results agreed for each country. These results form the centerpiece of the Bank's commitment to development results and should also be the primary way of assessing progress in the Bank's impact on governance and anticorruption. This monitoring framework will include a capacity-building component, to (a) ensure that the countries involved in this process can and are able 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.

IV. IMPLICATIONS AND NEXT STEPS

42. Implementing a strengthened approach to governance and anticorruption will have implications for resources and staffing, the significance and details of which will be a function of the series of choices to be made on ways to deepen Bank engagement on the governance and anticorruption agenda. As discussed in the latest SSIU, the Bank would benefit from strengthened capacity in governance, at the level of the country team, the Networks, and the World Bank Institute (WBI). Focal points across the Bank—in the Regions, in country teams, in the Networks, in Operations Policy and Country Services, and in WBI—to coordinate this new area of emphasis (for country strategies and for operations) could be useful. In countries with

¹⁹ Among these conventions are the UN Convention Against Corruption (which includes covenants on transparency of procurement systems and restitution of proceeds of corrupt acts), the OECD Anti-Bribery Convention, the Financial Action Task Force, which focuses on fighting international money laundering, and regional treaties.

²⁰ This approach uses aggregate indicators (e.g., CPIA, Kaufmann-Kraay) to monitor progress in implementing broad elements of a governance framework at the country level, and more disaggregated actionable indicators (e.g., Doing Business, WBI Governance Diagnostic Surveys, and Investment Climate Surveys) to monitor implementation of specific policies to strengthen governance.

weak governance environments, a Governance Advisor may be appointed to ensure coordination, to take the lead in discussions with Government on the relevant issues, and to provide country-specific guidance to sector staff working in the country.

43. ***Trade-offs for Developmental Impact.*** Moving to operationalize a strategy to minimize corruption risks in Bank projects will most likely involve trade-offs and additional costs. A stronger commitment of partner countries will be required. The enhanced approach will need to be part of the CAS dialogue supplemented by Senior Management guidance as to risk tolerances. A number of questions may well be asked by shareholders. Is the Bank prepared to accept a possible slowdown in the pace of lending, at least temporarily, as both the Bank and partner countries engage on the issue of corruption risks and anticorruption action plans at the project level? How probable is it that there will be delays in project identification and preparation, and that some projects may be dropped? Is the Bank prepared to accept a lower rate of disbursements and higher level of cancellations due to misprocurement as supervision missions simultaneously look more carefully for corruption indicators and take a harder line on suspension of disbursements or declarations of misprocurement? How would the Bank reallocate funding to support the investment that will be required to minimize corruption in risky projects and supervise projects more intensively, as well as support the ongoing work on training, knowledge management, and improvement of procedural guidance?

44. ***Implications for Other Priorities.*** Strong implementation of the anticorruption agenda will have implications for other Bank priorities, such as harmonization, results, and achievement of the Millennium Development Goals. Although all these efforts of the Bank are ultimately aimed at poverty reduction, in the near-term as specific operational choices are made, trade-offs are likely to arise. For example, delaying the use of country systems, tight ring-fencing of Bank-financed projects, and dominance in some country strategies of the governance agenda might slow progress on these other Bankwide priorities. It will also be important to harmonize governance approaches with our MDB partners and with the private financial markets, to avoid the downside risk of simultaneously losing opportunities for business and for strengthening governance.

45. ***Time-Line.*** This paper is (tentatively) scheduled for a Committee of the Whole discussion on August 30, 2006.