

Changing perspectives: how donors can work with the private sector to reduce corruption

Corrupt dealings by companies are often only a way to avoid inefficiency caused by weak regulations and institutions. While the private sector is commonly perceived to be a *source* of corruption, it is also a *victim* – with considerable interest in contributing to solutions. Donors can help by engaging private sector representative organizations in discussions, develop local capacity to instigate and run anti-corruption programs, and support financial media in fulfilling a watchdog role that goes beyond simply reporting on corrupt individuals.



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Despite increased attention, booming research, and a wealth of reform experiences, corruption continues to be one of the key challenges facing governments, industries, individual companies, and citizens in developing countries. With regard to the private sector, the issue of corruption is particularly interesting from the perceptions standpoint. In the view of the public, the private sector is often a source of corruption. Although this is true in some cases – individual companies can, and do, benefit from bribery – the private sector must also be regarded as a victim of corruption. Corruption actually increases the cost of doing business in a number of ways: for example, by increasing the costs of capital, suppressing access to investment, increasing uncertainty, and undermining long-term sustainability. More importantly, the private sector can be a solution to the corruption problem.

While it may seem that corruption, especially in emerging markets, is difficult if not impossible to tackle, there are many examples of successful initiatives. Such efforts provide important lessons for reformers, government officials, and business and civic leaders. We recognize that corruption cannot be

fully eliminated, yet, it is plausible to suggest that its effect on citizens, companies, and government can be minimized. At the end of the day, we can confidently say that an average small entrepreneur in a country at the top of Transparency International's anti-corruption rankings will have a much easier time competing within a predictable business climate based on the rule of law, than a counterpart in a country at the bottom of the list. From the private sector perspective, the challenge lies in reforming the institutional environment of countries as well as internal structures of companies to ensure that opportunities for fair competition among firms exist.

New attitudes and new challenges

Perhaps one of the more significant changes in attitudes towards corruption that we at the Center for International Private Enterprise have seen over the past two decades has to do with the private sector. No longer is the topic taboo as it was in the 1980s and the early part of the 1990s, and companies to a lesser extent blame corruption on governments, or view it exclusively as a public sector problem. While the change in attitudes started with large companies in developed

markets (partly driven by a host of anti-corruption regulations and conventions), businesses large and small in the most remote regions of the world are beginning to view corruption as their own problem. Russia is a good example. In the 1990s, corruption was a way to avoid inefficient and weak regulations – and for many Russian firms bribery was simply a way to get things done. But as corruption became institutionalized, and its costs became more evident and grew exponentially,

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it began to be recognized as a real barrier to doing business. Now, small businesses in Russia are trying to figure out how to reduce corruption and create a more competitive market place.

It is certainly the case that in many countries the private sector is part of the problem. But it also can be, and in many cases is, an integral part of the solution. However, to change the mindset and convince many of the development agencies to factor in the private sector as part of their anti-corruption programs, it is important to stop thinking of the private sector as a monolith and recognize its different constituents. The private sector has many different faces, including, but not limited to, state-owned enterprises, large national firms, small- and medium-sized enterprises, informal sector entrepreneurs, and leading-edge firms (the first to innovate, explore new technology, and seek greater access to global markets and capital). These all have different interests, wield different levels of political influence, and have different attitudes towards corruption.

Certainly, more needs to be done to solve the collective action problem and engage business in being proactive to reduce corruption rather than just complaining about it. Firms around the world increasingly refuse to accept bribery as a cost of doing business and are searching for ways to combat it. Chambers of commerce, business associations, and other voluntary private sector representative organizations play a key role in this regard – they are uniquely positioned to voice broad-based business concerns and push for greater transparency in both the public and private sectors. They are especially effective in helping small business to stand up to corruption – it may be quite difficult for an individual firm to challenge the culture of bribery and extortion on its own, but the backing of a large number of colleagues undoubtedly makes things easier.

The shift in private sector attitudes does bode well for the future. However, challenges remain in convincing the public and the development community that the private sector is often a victim of corruption and can be a solution to this problem.

Causes and realities

We often find that corruption is not a problem in and of itself. It is a symptom of deeper, structural problems of the economic and political environments in which companies operate. Why does an entrepreneur feel compelled to pay a bribe when registering a firm in Nairobi, while there is little need to do so in New York? Why would an entrepreneur in Jakarta pay off countless inspectors to continue operating, while there are few incentives to do so in London? One of the key root sources of corruption emerges in answering these questions – from the private sector perspective, corruption has much to do with weak rule of law and bad laws and regulations (including government officials' discretion in interpreting and applying laws and regulations).

The reality of doing business in developing countries is that opportunities for corruption often arise when companies explore ways to avoid inefficiency. In other words, corruption thrives in systems plagued

by inadequate, unclear, excessive, unpublicized, and frequently changing laws and regulations. The informal sector is perhaps one of the best examples of this dilemma. Faced with the prospect of dealing with complex regulations in registering a business, paying taxes, obtaining licenses, or enforcing contracts – and paying bribes in the process – entrepreneurs may choose to remain outside of legal structures – in the informal sector – where, without access to the legal system or public services, they often face limited opportunities for growth and job creation. Being in the informal sector, however, they don't escape bribery – they can still be a subject to harassment by government officials, police, or even criminal groups.

This is not a minor problem: in some countries, the informal sector contributes well above 50 percent of GDP. In its Doing Business database, the World Bank links overregulation and poor implementation of laws and regulations to instances of corruption in more than 100 countries.

Certainly, there are other sources of corruption, a detailed analysis of which is beyond the scope of this brief. In addition to weak legal and regulatory systems they include:

- Lack of transparency and accountability both in the public and private sector
- Poor regulation of political contributions
- Low public sector wages
- Weak enforcement of laws and regulations
- Lack of free and independent media
- Excessive discretionary authority of public officials

Private sector approaches to combating corruption

How should the private sector approach corruption? There are two approaches that are not necessarily mutually exclusive: *transaction*-based and *institutions*-based. Both approaches are important in their own right, but require different strategies, use different tools, and operate within different timelines.

When companies implement transaction-based anti-corruption efforts, they seek to ensure that individual transactions are based on free and competitive exchange rather than bribery. Here, the emphasis is on ensuring the integrity of transactions in a weak rule of law environment. For example, if a company considers a particular business deal that has a high potential for bribery or unfair competition, such as a public procurement contract, it may implement certain measures to ensure that the bidding process is transparent. Integrity pacts are a useful tool in this regard – they help ensure that public officials and companies participating in a particular transaction do so transparently and fairly.

The institutional approach examines the environment that enables corruption and seeks to reform a country's political and economic institutions. The idea is that if opportunities for corruption are reduced, public and private governance improved, and a functional civil society developed, corruption can be limited in a country as a whole, not just within a particular

transaction. Consider the public procurement example referenced above – in addition to making each individual transaction transparent, the private sector can also seek to improve public procurement laws and regulations and reduce the discretionary power of public officials in charge of the process.

The two approaches are not mutually exclusive. They can be implemented simultaneously to address both short-term and long-term needs. Consider corporate governance. Good corporate governance helps companies set up internal structures that make bribery unsustainable. At the same time, corporate governance benefits spread far beyond the individual companies that put them in place – corporate governance can create a broader reform momentum to improve property rights, transparency and accountability institutions, checks and balances, and legal enforcement mechanisms throughout the economy.

Around the world, we see two types of trends that drive corporate governance reforms. On one side, it is the scandals and financial crises that frequently push regulators to take measures to create more transparent corporate climates. On the other side, it's the benefits of good corporate governance companies are realizing – in addition to anti-bribery tools, stronger corporate standards offer better access to capital, improve succession planning in family firms, increase companies' standing in society, and improve sustainability. Although negative drivers (such as corporate scandals) may receive more attention, positive drivers tied to the benefits of good governance should also be recognized.

Recommendations for donors

There are several issues donors must keep in mind when supporting private sector-led anti-corruption programs in developing countries:¹

Recognize corruption as a political, social, and economic problem

The complexity of corruption as a phenomenon mandates that it is viewed from political, economic, and social angles. Too often there is a donor tendency to operate within a single area of expertise and mount economic or political initiatives independently from other donors. This is the point increasingly made in many of the declarations by international organizations, including the OECD. It applies to initiatives within the same area (economic, political, or social) as well as to initiatives between different areas of focus.

The reality is, however, that economic, political, and social institutions are interlinked; therefore, anti-corruption programs must be as well. For example, in one of our own programs we found that one of the sources of corruption in Ecuador was the legal system – with thousands of conflicting and outdated laws and regulations. The solution to this economic problem, however, was political in nature – it required a lot of effort from the National Association of Entrepreneurs (ANDE) to launch an advocacy campaign to review the legal system and repeal more than 1,000 conflicting

laws regarding commercial transactions. This does not mean that individual donor organizations should expand into all possible anti-corruption programs. We simply suggest that different donors operating in the same country must do a better job of coordinating with each other to complement the others' work, build on their own core competencies, avoid duplication of efforts, and incorporate lessons learned.

Engage a wide variety of groups in anti-corruption work, including the private sector

Often, there is a tendency to work with public sector institutions in designing and implementing anti-corruption programs. While reforming the public sector is certainly an important part of reducing corruption, it must be recognized that corruption has both bribe-takers and bribe-givers. Therefore, for efforts to be truly successful, donors must break down barriers between the different sides of the corruption equation and assist governments, the business community, and civil society to communicate openly about problems, strategies, and approaches. In Bulgaria, for example, we worked with the Center for the Study of Democracy (CSD), a civil society group, to bring together both public and private sector leaders to discuss ways to combat corruption. Acting as an independent third party and bringing national attention to the issue, CSD helped slash administrative corruption in half.

Work with private sector representative organizations rather than individual companies

Typically, when the idea of working with the private sector to address corruption comes up, donors immediately think of the challenges that arise in working with individual companies. It is difficult for individual companies to commit to transparent transactions in an environment of weak rule of law, especially when their competitors continue corrupt practices. Private sector representative organizations, such as chambers of commerce or business associations, are perfectly positioned to solve the collective action problem and get broad-based private sector support behind an anti-corruption campaign. Obviously, not all organizations are alike, and some associations and chambers can be part of the corruption problem. Careful consideration must be given to organizations' credibility, strength, commitment, and experience in leading broad-based business-friendly reform efforts.

Carefully study the country environment and put aside assumptions before developing an anti-corruption strategy

While international indices and macro-level statistics provide important insight into a country environment, donors should not form conclusions on how corruption can and should be approached in a specific country, based on this information alone. Although macro-level statistics may indicate an area that requires attention, such numbers rarely provide enough information on a country's specific anti-corruption challenges and how these challenges can be addressed. Effective anti-corruption programs require careful micro-level research on root causes, opportunities and strategies for reform, and social and political barriers. To get the full picture of the corruption climate, it is useful to engage in dialogue with a variety of research, watchdog, and advocacy organizations in a country. Such work may

¹ These recommendations are based on CIPE's work in more than 100 countries engaging the private sector in institutional reform to build democratic governance and free market economies.

be time-consuming, but gathering a wide range of opinions can help identify the areas that can be most effectively addressed.

Allow local partners to have ownership of the process – do not design or implement anti-corruption programs for them

This issue is most common in countries with a weak institutional environment. Donors should achieve the right balance between providing technical and financial assistance to local organizations while not driving the agenda, developing strategies and action plans, or actually implementing programs. CIPE's anti-corruption work in dozens of countries over the past 20 years indicates that efforts are successful over the long term only when local organizations assume ownership of the process. Ultimately, the goal for donors should be to develop *local capacity* to reduce corruption, not to go into a country and reduce corruption on their own.

Have reasonable expectations and set achievable goals

The institutional nature of corruption means that it can't be reduced overnight. Many anti-corruption programs, however, operate within strict timelines (for example, one to three year limits for specific projects), which means that donors and local organizations must have reasonable expectations when designing programs and evaluating impact. Sometimes, even changing a single piece of key legislation may take a long time, and while the legislation itself may be a small part of the overall anti-corruption strategy for the country, building public and private consensus in the process should also be recognized as a success in instances where it provides a sound foundation for future anti-corruption efforts.

Know how to diagnose corruption

Corruption is difficult to measure since it is often based on perceptions and is not easily observed. Rather than trying to determine the magnitude and pervasiveness of corruption, an alternative approach is to look at institutions that help prevent corruption. Global Integrity (www.globalintegrity.org), for example, provides detailed studies of countries, pointing out key institutional gaps that may create opportunities for corruption. Are there laws that specify the public's right to access information? Are those laws actually enforced? Is conflict of interest addressed in privatization regulations? By comparing the institutional framework of a country to internationally-recognized benchmarks for controlling corruption, reformers can identify gaps that must be addressed. While these gaps do not necessarily constitute an action plan for moving forward, the analysis can be useful in identifying priorities for effective anti-corruption programs.

Support financial media

Financial media plays an important part in exposing corrupt dealings, forming public opinion, and pushing for action. Journalists often receive training on various aspects of professional journalism, which is of course important in its own right. In addition to developing reporting skills, donors should pay greater attention to journalist training specifically in the area of anti-corruption. Some areas to consider include: recognizing and exposing corruption structures and processes rather than simply reporting on corrupt individuals, understanding the financial environment, and providing analyses of complex transactions in simple language. Media that can expose corrupt transactions, develop an understanding of the institutional nature of corruption, and highlight the costs that corruption puts on the economy, can help build public awareness and generate pressure for reform.

Publicize success

The public often remains skeptical about tackling corruption. This skepticism may be linked to culture, the nature of political institutions, or the structure of the economies that permit bribery. Where there is a growing recognition that corruption has a negative effect on countries' development, would-be reformers may remain unconvinced that institutions can be changed. But there are many instances where corruption has, in fact, been successfully limited.

In Colombia, for example, working with the Colombian Confederation of Chambers of Commerce (Confecamaras) we were able to ensure the country's new Procurement Law incorporated private sector recommendations that enhanced competitiveness and transparency. Recently in Argentina, leading water sector companies, which manage 80 percent of water distribution in the country, signed an anti-bribery sector agreement based on the Business Principles for Countering Bribery. In Serbia, following their study of corruption in Customs, the Center for Liberal Democratic Studies (CLDS) embarked on an advocacy campaign to reduce corruption in this government institution. Many of CLDS's recommendations were incorporated into a new customs law, including greater use of IT in customs procedures, risk control methods, and stricter punishment for officials found guilty of engaging in corruption.

Overall, we should keep in mind that it is important to publicize successes to inspire action and show that corruption is a problem that can be successfully tackled – even in countries at the bottom of the development ladder. ■