



# Building Public Integrity through Positive Incentives: MCC's Role in the Fight against Corruption

## **Executive Summary:**

The Millennium Challenge Corporation (MCC) was founded on the principle that aid alone will never rescue the developing world from the scourge of grinding poverty. Research and practical experience suggest that aid is most transformational when countries promote good governance, invest in health and education, and expand opportunities for entrepreneurship and private sector growth. In this regard, a country's commitment to fighting corruption is particularly important. Corruption retards economic growth by increasing costs, lowering productivity, discouraging investment, reducing confidence in public institutions, limiting the development of small and medium-sized enterprises, weakening systems of public financial management, and undermining investments in health and education. Corruption also increases poverty by slowing economic growth, skewing government expenditure in favor of the rich and well-connected, concentrating public investment in unproductive projects, promoting a more regressive tax system, siphoning funds away from essential public services, adding a higher level of risk to the investment decisions of low-income individuals, and reinforcing patterns of unequal asset ownership and thereby limiting the ability of the poor to borrow and increase their income. As such, fighting corruption is one of MCC's highest priorities.

One way that MCC is working to build public integrity is through the use of an objective, transparent, and competitive partner selection process. MCC offers hundreds of millions of dollars in Millennium Challenge Account (MCA) grant assistance to developing countries that are willing to implement tough anticorruption reforms. As a result, countries are passing stronger anticorruption laws, strengthening oversight institutions, opening up the public policy-making process to greater public scrutiny, and stepping up corruption-related investigations and prosecutions. The "MCC Effect" has been widely recognized and documented by academics, journalists, NGOs, and donor agencies. To date, 14 countries have established inter-ministerial committees and presidential commissions to devise, implement, and track reform strategies that address the MCA selection criteria, and this list continues to grow. Interestingly, these reforms do not appear to be limited to countries aspiring to MCA eligibility. Many countries already compact-eligible or receiving compact assistance have also enacted important policy changes to remain competitive in future rounds of the selection process. Others cite

their MCA-eligible status as a “badge of honor” that sends an important policy signal to the donor community and private investors.

MCC is also helping countries root out corruption through its threshold programs. These programs are for countries that do not yet qualify for MCC funding, but demonstrate their commitment to improving policy performance on the MCA selection criteria. They are designed to accelerate *ongoing* reform efforts and increase a country’s prospects of fully qualifying for MCA compact assistance. Over the last three years, MCC’s board of directors has approved anticorruption assistance programs totaling more than \$200 million with countries such as Albania, Indonesia, Malawi, Moldova, Paraguay, the Philippines, Tanzania, Ukraine, and Zambia. These programs focus on a range of activities, including tax administration, customs administration, public financial management, and business licensing reforms; training of investigative journalists, investigators, public prosecutors, and magistrates; assistance in drafting and implementing anticorruption legislation; strengthening of civil society watchdog units and government auditing agencies; and the establishment of mechanisms for income and asset disclosure.

Finally, MCC is advancing the global anticorruption agenda by setting a new standard for performance-based aid allocation. While many donors take corruption into account in making resource allocation decisions, MCC is currently the only donor that ties eligibility for assistance directly to performance on a publicly-available indicator of anti-corruption commitment produced by a third party. To receive MCC compact funding, countries *must* perform above the median within their peer group on the World Bank Institute’s Control of Corruption index. Donors have taken note of this approach. MCC is seeing a growing interest to consider rating systems – similar to MCA country scorecards – to determine which countries might receive assistance. In this regard, MCC is helping institutionalize the idea that foreign aid should be a two-way street. If donors are going to provide more assistance, recipient countries need to provide greater accountability and deliver results.

This paper reviews five key “lessons learned” from the past twenty years of anticorruption reform and explains how these insights inform MCC’s policy dialogue with candidate countries and the development of MCC’s threshold programs.

## I. Introduction

In 2002, President Bush announced a ground-breaking initiative called the Millennium Challenge Account (MCA). The MCA rewards developing countries that have a sound policy framework in place that promotes economic growth and poverty reduction. In 2004, the Millennium Challenge Corporation (MCC) was established to administer the MCA. Every year, MCC selects partner countries based on their commitment to good governance, economic freedom, and investments in health and education. MCC uses sixteen quantitative indicators – developed by independent third parties – that measure government policies in these three categories: Ruling Justly, Investing in People, and Economic Freedom.<sup>1</sup> Countries are measured against peers in a similar income bracket, and must perform above the median on at least half of the indicators in all three categories to become eligible for MCA assistance. To be considered for hundreds of millions of dollars in growth-enhancing and poverty-reducing funds, countries must also perform above the median on the World Bank Institute’s Control of Corruption index.<sup>2</sup> Indeed, the “hard hurdle” of Control of Corruption is a key distinguishing characteristic of the MCA.

MCC tackles the difficult issue of corruption because of its central role in shaping development outcomes. Corruption, or the abuse of public power for private gain, manifests itself in very different ways: bribery, graft, embezzlement, fraud, extortion, patronage, nepotism, cronyism, and kickbacks. In all of these forms, its impact on social and economic development is profoundly negative. Corruption increases costs, lowers productivity, discourages investment, reduces confidence in public institutions, limits the development of small and medium-sized enterprises, weakens systems of public financial management, and undermines investments in health and education.<sup>3</sup>

Corruption also increases poverty by reducing economic growth, skewing government expenditure in favor of the rich and well-connected, concentrating public investment in unproductive projects, promoting a more regressive tax system, siphoning funds away from essential public services, adding a higher level of risk to the investment decisions of low-income individuals, and reinforcing patterns of unequal asset ownership and thereby limiting the ability of the poor to borrow and increase their income.<sup>4</sup> The World Bank refers to corruption as “the single greatest obstacle to economic and social development” and estimates that bribery alone is responsible for global economic losses totaling \$US 1 trillion a year.<sup>5</sup> That’s roughly equivalent to ten times the total amount of Official Development Assistance (ODA) given every year, or 3% of global GDP.<sup>6</sup>

Corruption is also a key impediment to the effective use of foreign assistance. The developing world is littered with projects that have failed to realize their stated objectives because of outright theft and embezzlement. Bribes and kickbacks in public procurement reduce the value of the goods and services purchased by donors. Political targeting artificially inflates the needs of relatively wealthy and

well-connected groups and diverts funds away from those with the greatest needs.<sup>7</sup> Indeed, statistical research shows that countries with weak public institutions are significantly less effective at putting foreign assistance to productive use.<sup>8</sup>

## II. How Is MCC Addressing Corruption?

MCC is addressing corruption in three ways. First, MCC's competitive selection process is a powerful incentive for countries to adopt tough anticorruption reforms. Countries are taking it upon themselves to reevaluate their policies, regulations, and legislation and are beginning to see tangible effects of these reforms on governance, growth, and poverty reduction. Second, MCC is using its threshold program to scale up and accelerate the anticorruption programs of reform-minded governments. Finally, MCC is advancing the global anticorruption agenda by helping to institutionalize the idea that foreign aid should be a two-way street. If donors are going to provide more assistance, recipient countries need to provide greater accountability and deliver results.

### Selectivity and the MCC Effect

The most important way in which MCC is addressing corruption is by altering the calculus of reform in developing countries. By tying its assistance to performance on the World Bank Institute's Control of Corruption indicator, MCC is a powerful incentive for governments to adopt tough anticorruption policies and strengthen the public institutions that control corruption. In effect, the expected return on anticorruption reform increases, and the cost of *not* reforming also increases.

Outside observers, such as Steve Radelet of the Center for Global Development, rightly emphasize the significance of this departure from the status quo.<sup>9</sup> For decades, recipient governments received aid regardless of their commitment to good governance, and a growing body of evidence suggests that much of this aid was not been put to productive use.<sup>10</sup> When donors considered a government's commitment to sound development policies, they have primarily done so through conditionality: by first agreeing to an aid package, and then linking future disbursements to specific policy reforms. However, this approach of punishing back-sliders through *negative* incentives has had very limited success.<sup>11</sup> A key lesson learned over the last two decades is that reform requires "ownership," and ownership is something that aid cannot buy.<sup>12</sup>

By comparison, the MCC approach of providing *positive* incentives for reform shows tremendous potential. Indeed, the so-called "MCC effect" created by MCC's objective, transparent, and predictable selection process has been widely recognized and documented by academics, journalists, NGOs, and donor agencies.<sup>13</sup> MCC has also witnessed this effect first-hand. Countries have hired outside experts to help them assess their indicator performance, entered into policy dialogues with the independent

third parties who provide the data, and submitted detailed reform agendas to MCC. Presidents and ministers also regularly visit MCC, write to MCC, and ask U.S. ambassadors in the field, “What reforms do we need to make to become eligible for MCC funding?” To date, at least 14 countries have established inter-ministerial committees and presidential commissions to devise, implement, and track reform strategies that address the MCA selection criteria: Cameroon, Djibouti, the Dominican Republic, El Salvador, Fiji, Guatemala, Indonesia, Jordan, Kyrgyz Republic, Moldova, the Philippines, Rwanda, Ukraine, and Yemen. The list continues to grow.

In the Dominican Republic, for example, the government set up three working groups to address performance weaknesses in each of the MCA categories: Ruling Justly, Investing in People, and Economic Freedom. Recent reforms motivated in part by MCC include the development of a national anticorruption plan, a draft public information law, a draft law on government efficiency, simplification and automation of customs procedures, and significant reductions in the time and cost of starting a business. Presidential Technical Secretary Temistocles Montás said the following about the MCA selection criteria: “We are embracing these goals because they are the right thing to do. They will constitute part of this administration’s legacy to the Dominican people.”<sup>14</sup> In Cameroon, a similar pattern is evident. The government indicated a strong interest in becoming eligible for MCC funding and stepped up its fight against corruption by eliminating 3000 “ghost workers”, imposing administrative sanctions on hundreds of corrupt civil servants, and committing itself to the Extractive Industries Transparency Initiative. The government also established an MCA Action Plan to come into compliance with MCA eligibility standards.

Yemen is another powerful example of the MCC effect. After being suspended from MCC’s threshold program in late 2005 due to policy slippage on a number of MCC’s selection indicators, the government built its National Reform Agenda around a series of reforms that it expected would enhance its chances of being reinstated into the threshold program. In 2006, the government developed an impressive track record of implementation. Under the direction of Yemen’s Ministry of Planning and International Cooperation, the government passed important anticorruption and financial disclosure legislation, launched a large national anticorruption awareness campaign, removed the president from the Supreme Judicial Council, retired, sanctioned, suspended, and prosecuted more than 30 judges, approved a national procurement manual and standard bidding documents, prepared a new procurement law for parliamentary approval, initiated online disclosure procurement-related information, and eliminated thousands of “ghost workers” through the issuance of biometric identity cards and the creation of a the civil servant identification system. According to Yemen’s Ministry of Planning and International Cooperation, MCC “helped pave the way for the current reform momentum.”<sup>15</sup>

Indonesian Finance Minister Sri Mulyani Indrawati, who is currently playing a key role in her government's anticorruption campaign, argues that the real draw of the MCA is its "good housekeeping seal of approval," which sends a powerful signal to private investors. For her, "It's not about the money. It's about the recognition that we're doing the right thing."<sup>16</sup> The MCC effect can also be seen in the Philippines, where the announcement of an MCA threshold program appears to have given the government renewed vigor in fighting corruption. Last year, in an unprecedented move, President Gloria Macapagal-Arroyo matched MCC's \$21 million threshold program with \$19 million in anti-corruption counterpart funds.

Interestingly, these reforms do not appear to be limited to countries that are aspiring to MCA eligibility. Many countries already compact-eligible or receiving compact assistance enacted important policy changes to remain competitive in future rounds of the selection process. Others cited their MCA status as a "badge of honor" that sends an important policy signal to the donor community and private investors. One particularly interesting example is Georgia, which since being selected as MCA-eligible adopted dramatic anticorruption reforms that brought about significant improvements on the MCA selection criteria. Georgia climbed from the 36<sup>th</sup> percentile (among low income countries) in 2004 to the 78<sup>th</sup> percentile (among low income countries) in 2005 on the World Bank Institute's Control of Corruption index. During this period, the government arrested scores of corrupt public officials, made important legislative changes that facilitate the prosecution of corruption cases, fired 15,000 members of the notoriously corrupt police force, dramatically increased the salaries of 10,000 public servants to counter the lure of petty corruption, and improved public financial management through adoption of a medium-term expenditure framework and a single treasury account for the central government.<sup>17</sup>

The government of Georgia also dramatically reduced opportunities for corruption through sweeping economic reform. According to the IFC, "[a] new licensing law cut from 909 to 159 the number of licensed activities. A one-stop shop was created for license applications, so that now businesses can submit all documents there, with no verification by other agencies required. A simplified tax code eliminated 12 of 21 taxes. And the time to register property fell by 75 percent and the cost by 70 percent."<sup>18</sup> As a result, the frequency of reported corruption in business licensing and tax collection fell significantly and the professionalism of government agencies involved in property registration increased.<sup>19</sup> The IFC traced a number of these policy changes back to the positive incentive created by the MCA.

In the run-up to the fiscal year 2006 MCA selection process, the government of El Salvador also provided MCC with an extensive list of adopted and planned reforms. President Antonio Saca approved an executive decree that established a code of ethics for public employees and created a Public Service

Ethics Commission to develop and carry out policies that foster integrity, impartiality, and honesty on the part of public officials. Due in part to the MCA incentive, the government also reduced opportunities for corruption by slashing the number of days it takes to start a business from 115 days to 26 days. This particular reform yielded impressive benefits: a 500% increase in business registration and a sharp spike in customer satisfaction among business registrants (from 32% to 87%). A series of related reforms continued after El Salvador was declared an MCA-eligible country.<sup>20</sup>

### MCC's Threshold Programs

MCC is also rooting out corruption through its “threshold programs.” These programs are for countries that do not yet qualify for MCA funding, but demonstrate their commitment to improving policy performance on the MCA selection criteria. The program lasts for two years and is designed to accelerate a country’s *ongoing* reform efforts and increase the country’s prospects of fully qualifying for MCA compact assistance. Over the last three years, MCC’s board of directors has approved anticorruption assistance programs totaling more than \$200 million with Albania, Indonesia, Malawi, Moldova, Paraguay, the Philippines, Tanzania, Ukraine, and Zambia. These programs focus on a range of activities, including tax administration, customs administration, public financial management, and business licensing reforms; training of investigative journalists, investigators, public prosecutors, and magistrates; assistance in drafting and implementing anticorruption legislation; strengthening of civil society watchdog units and government auditing agencies; and establishing mechanisms for income and asset disclosure.

All of MCC’s threshold programs are anchored in three key principles. The first principle is that aid alone will never strengthen systems of governance: strong country ownership and political will are essential. MCC’s threshold programs are therefore *not* designed to be stand-alone anticorruption programs. Rather, they are meant to fit into a larger reform agenda that, with the right resources, will be able to help a country achieve a passing score on the Control of Corruption indicator. The second principle is that successful anticorruption programs must be tailored to local institutions, knowledge, culture, social structures, and technologies.<sup>21</sup> MCC begins its policy dialogue with all threshold countries by providing a detailed diagnostic of their performance on the WBI Control of Corruption index. In some cases, these diagnostics reveal that the judiciary is the key obstacle to lasting anticorruption reform; in other cases, illicit behavior appears to be concentrated in customs administration, public procurement, or business licensing. Every country’s history of governance is different and each policy intervention needs to be tailored to these context-specificities. A third foundational principle is that measurement matters. From the outset, MCC made it clear that the success of (anticorruption-focused) threshold programs will be measured by whether countries significantly improve their performance on WBI’s Control of Corruption index. As such, MCC requires all of the programmatic ac-

tivities under threshold programs to be results-oriented and include measurable performance targets and interim benchmarks that are linked directly to the MCA selection criteria. Indonesia's threshold program, for example, seeks to improve its WBI score from -.86 in 2005 (~45<sup>th</sup> percentile among low income countries) to -.25 in 2008 (~88<sup>th</sup> percentile among low income countries).<sup>22</sup> It targets WBI subcomponent indicators that measure the prosecution and conviction of corrupt officials, the frequency of undocumented payments and bribes associated with the awarding of public contracts, the frequency of undocumented payments and bribes associated with getting favorable judicial decisions, and the pervasiveness of money laundering through bank and non-bank channels.

Some have argued that it is unrealistic to expect threshold countries to achieve a passing score on the Control of Corruption indicator in a two-year time frame. However, the experience of current MCA-candidate countries belies this claim. Countries like Bulgaria, Ghana, Madagascar, Moldova, Tanzania, Ukraine, and Vanuatu and have all registered significant measurable improvements on the WBI Control of Corruption index in a two-year period. Tanzania, for example, improved its Control of Corruption performance from the 33<sup>rd</sup> percentile (among low income countries) to the 71<sup>st</sup> percentile between 2002 and 2004. During this period, the government increased the personnel and resources of the government's main anticorruption unit, investigated roughly 10,000 allegations of corruption, suspended 456 public officials, dismissed or retired 403 public officials, and turned 138 public officials over to law enforcement agencies. In addition, the government replaced the Public Procurement Act of 2001 with more effective legislation, introduced an electronic integrated financial management system to establish improved financial controls, and modernized customs procedures. Government revenues are believed to have quadrupled as a result of this anticorruption campaign.<sup>23</sup>

A final point bears mentioning for those who question the significance of a "passing score" on the WBI Control of Corruption index. MCC believes that for performance benchmarking to generate real competition and reform, targets must be achievable and relevant to developing countries. A passing score on the WBI Control of Corruption index is therefore defined as performance above the median *in a given income bracket*. Low-income countries are evaluated vis-à-vis their low-income peers, and lower middle income countries are evaluated vis-à-vis their lower middle income peers. MCC acknowledges that it is in some sense "only measuring relative performance," but believes that it is important to identify and support reform champions, even in countries where policy performance may not be particularly high in absolute terms.<sup>24</sup>

At the same time, MCC does not take passing scores on the WBI Control of Corruption index for granted. Anticorruption reform is a marathon, not a sprint, and even MCA-eligible countries have a long way to go in terms of curbing corruption. As such, threshold countries that meet the eligibility criteria before completing their threshold programs will be required to demonstrate successful imple-



mentation of their reform commitments in order to reach a compact and to receive MCA funding under a compact. MCA compact-eligible countries will also be required to maintain or improve their performance on the Control of Corruption index.<sup>25</sup>

### Leading Development Practice

Finally, MCC advances the global anticorruption agenda by setting a new standard for performance-based aid allocation. In Monterrey, Mexico, at the 2002 UN Summit on Financing for Development, an important exchange of views took place between developed and developing countries, civil society, the business community, and institutional stakeholders on international development issues. This summit focused on more assistance for development, but also increasing the *effectiveness* of that assistance. The “Monterrey Consensus” that emerged represented a new partnership between developed and developing countries: developed countries promised additional funding if developing countries could demonstrate a strong commitment to reform and establish an enabling policy environment for the effective use of donor resources. The U.S., in particular, promised to scale up foreign assistance through a “Millennium Challenge Account” to reward countries that “root out corruption, respect human rights, and adhere to the rule of law.”<sup>26</sup>

To become eligible for MCA compact funding, President Bush decided that countries would have to receive a “passing score” on the World Bank Institute’s Control of Corruption index. While many donors take corruption into account in making resource allocation decisions, MCC’s “pass-or-fail” approach significantly raised the profile of corruption as a policy issue. For the first time, a donor tied eligibility for assistance directly to performance on a third-party measure of corruption that was publicly available and subject to public scrutiny.

Other donors are noting this approach. MCC is seeing a growing interest among some donors to consider rating systems or report cards—similar to MCC’s scorecards—to determine which countries might receive assistance. The European Union created a 3 billion euro incentive fund for countries that demonstrate their commitment to good governance.<sup>27</sup> The UK’s Department for International Development (DFID) put in place a performance-based allocation scheme with a strong emphasis on public-sector management.<sup>28</sup> Shareholders of the World Bank, the International Fund for Agricultural Development (IFAD), the Asian Development Bank (ADB), the Global Environment Facility (GEF), the African Development Bank (ADB), and the Caribbean Development Bank (CDB) also made their funding contingent upon achievement of measurable targets in public sector management. Providing aid to countries simply will not work if they are not champions of their own development.

### III. Lessons Learned And Best Practices

While there is agreement that “one-size-fits-all” anticorruption interventions should be viewed very cautiously, there is an emerging set of principles and best practices based on lessons learned over the past twenty years of anticorruption reform. Five core principles inform MCC’s policy dialogue with candidate countries and development of MCC’s threshold programs.

#### **Principle #1: The Best Offense is a Good Defense.**

The most effective way to fight corruption is to address its sources, rather than its symptoms. Corruption prevention encompasses a wide range of activities: lowering tariffs and tax rates, removing price controls, reducing the overall burden of government regulation, strengthening budgetary systems, reforming salary scales, professionalizing the civil service, informing citizens of their rights, strengthening oversight institutions, and so on. For many countries, civil service reform is a particularly high priority. Singapore’s former Prime Minister Lee Kuan Yew is credited with saying, “Pay them well or we will pay dearly.”<sup>29</sup> Public-sector pay reform is indeed critical; however, research shows that it seldom has its intended effect of reducing corruption in the absence of complementary reforms.<sup>30</sup> In Singapore, the government brought public-sector wages closely in line with private-sector pay scales, but public officials were also rewarded financially for turning in those who offered bribes and rotated – geographically and functionally – to increase uncertainty and break up corrupt networks. In addition, signatures, authorizations, certifications, fees, and other regulations were dramatically reduced. This package of reforms facilitated a major reduction in corruption.<sup>31</sup>

Another central element of corruption prevention is reducing the monopoly and discretionary power of government officials. The International Finance Corporation estimates that “70% of the bribes paid to customs officials exchange hands when a trader wants to get a lower tariff band.”<sup>32</sup> Similarly, complex and confiscatory tax regimes lead to high levels of tax evasion and corruption in tax collection.<sup>33</sup> Therefore, to reduce tax-related corruption countries can lower tax rates, broaden the tax base, simplify and streamline tax payment procedures, consolidate taxes, and reduce special exemptions and privileges. In Georgia, the government reduced tax rates dramatically, cut the number of taxes from 21 to 7, broadened the base of the value-added and profit taxes, and eliminated many special exemptions and privileges. This increased tax revenues by approximately 4% of GDP and led to a huge decline in tax-related corruption. In 2002, approximately 44% of small and medium sized enterprises reported that bribery in tax administration was frequent. By 2005, that number had fallen to 11%.<sup>34</sup> Other examples of interventions to reduce monopoly and discretionary power include random case assignment and sentencing guidelines for judges, removing police officers from entry points into cities and towns, adopting “guillotine” approaches to regulatory reform, and introducing standardized entrance and exit examinations at educational institutions.

MCC takes corruption prevention seriously both in its threshold programs and in its policy dialogues with candidate countries. With encouragement from MCC, Burkina Faso, Cameroon, the Dominican Republic, El Salvador, Guatemala, Indonesia, Niger, Paraguay, and Yemen and have all set out to reduce the time, cost, and procedural complexity of business registration. Zambia's threshold program also seeks to reduce opportunities for corruption by reducing the number of days it takes to register property at the Ministry of Lands from 70 to 35, to export products from 60 to 30, and to import products from 62 to 30. These kinds of preventive anticorruption measures have the added benefit of increasing a government's operating revenues, improving service delivery, and building confidence in public institutions.

### **Principle #2: Sunshine is the Best Disinfectant**

Corruption is generally a clandestine enterprise. Illicit transactions take place in the darkest corners of business and government. It should therefore come as no surprise that many of the most well-documented anticorruption success stories are anchored in the age-old principle that “sunshine is the best disinfectant.”<sup>35</sup> Empirical studies consistently show that corruption is lower in countries with higher levels of press freedom.<sup>36</sup> Research and practical experience also suggest that a range of transparency-related reforms enable citizens to expose acts of corruption, hold elected officials accountable, encourage a more efficient allocation of public resources, and improve service delivery.<sup>37</sup>

For example, posting prices for government services, and making step-by-step procedural flowcharts, required documents, and processing times publicly available can reduce information asymmetries and thereby reduce opportunities for rent-seeking and corruption.<sup>38</sup> Public disclosure of campaign contributions, campaign expenditures, parliamentary votes, parliamentary debate, and draft legislation can impose some measure of discipline on elected officials.<sup>39</sup> Income and asset disclosure can expose “unexplained wealth” and force government officials to demonstrate that their wealth has been acquired lawfully.<sup>40</sup> Similarly, budget transparency can subject government decision-making to public scrutiny and creates a less hospitable environment for corruption.<sup>41</sup> In Uganda, posting school budgets on schoolhouse doors and advertising the rules that govern central government transfers in newspapers dramatically reduced corruption in the education system by empowering teachers and parents to monitor the handling of local government budgets.<sup>42</sup>

MCC's belief in the power of transparency figures prominently both in its threshold programs and in the ongoing policy reform dialogue it maintains with all candidate countries. MCC's threshold program with Ukraine calls for the creation of a fully functioning income and asset-disclosure mechanism; Jordan's threshold program seeks to increase transparency in local governance; Indonesia's threshold program will support a “know your customers campaign” designed to prevent money laun-

dering; and under Tanzania, Malawi, and Ukraine’s threshold programs, journalists will receive training in investigative techniques. MCC also emphasizes in its policy dialogue with candidate countries that no-cost and low-cost transparency-related reforms often yield the greatest “bang for the buck.”

### **Principle #3: Change the Risk-Reward Calculus of Corruption through Deterrence**

People respond to incentives, and the choice of whether or not to engage in corruption is no exception. As former World Bank economist Robert Klitgaard puts it, “[c]orruption is a crime of calculation, not of passion. People will tend to engage in corruption when the risks are low, the penalties mild, and the rewards great.”<sup>43</sup> Therefore, a central task of reformers is to change the risk-reward calculus of corruption. In most countries with high levels of corruption, the risk of being caught is usually low and the expected benefit of engaging in corruption is usually high. Research suggests that jail time and stiff penalties can significantly alter this cost-benefit calculation by creating an effective deterrent.<sup>44</sup>

For countries in the early stages of reform, deterrence usually requires sending a signal that the existing culture of impunity will no longer be tolerated.<sup>45</sup> The first – and perhaps most important – step in Hong Kong’s wildly successful campaign against corruption in the 1970s was to extradite and punish a notoriously corrupt police commissioner.<sup>46</sup> Similarly, when Nicaraguan President Enrique Bolaños came to power in 2001, he sent a powerful signal that the “rules of the game” under the previous regime had changed. Former President Arturo Alemán, who for most Nicaraguans, symbolizes the egregious abuse of public power, was prosecuted on corruption charges and sentenced to twenty years in prison. This was a particularly effective signaling device because President Bolaños had previously served as Alemán’s Vice President.

But “frying big fish” is only one of many steps needed to deter corrupt behavior over the longer term.<sup>47</sup> If the courts are unable to process a surge of “ordinary” corruption cases, illicit transactions become less risky and more common, which highlights the central importance of judicial efficiency, effectiveness, independence, and honesty.<sup>48</sup> MCC anticipates these bottlenecks in its threshold programming by building judicial capacity, transparency, and integrity. For example, in Moldova, MCC will help develop and implement a comprehensive automated case-management system, equip courtrooms with recording equipment and transcription software to make records more reliable, and improve the execution of judicial decisions. In Ukraine, MCC will help develop transparent disciplinary procedures for judges, increase monitoring of enforcement of court decisions, streamline inspections of court executors, train candidate and newly appointed judges and staff, and implement a functional registry of court decisions and case assignments by developing better guidelines and manuals for data entry. In

its policy dialogue with candidate countries, MCC also reinforces the importance of anticipating similar “second generation” reform obstacles.

#### **Principle #4: Political Will Matters**

Successful anticorruption campaigns usually share one thing in common: reforms are backed by strong political will at the highest levels of government.<sup>49</sup> High-level political commitment is essential because powerful vested interests that would like to preserve the status quo often resist, delay, and undermine anticorruption reform efforts, and reforms implemented in piecemeal or episodic ways rarely have their expected impact.<sup>50</sup> Political will is also important because of its “demonstration effect”: when public officials, citizens, and firms see those within the ruling elite going to jail for corruption, they are usually less inclined to engage in illicit transactions.<sup>51</sup> Research and experience suggest that useful barometers of political will include the staffing, funding, and independence of anti-corruption institutions; the application of credible sanctions without political bias; the extent to which the executive stakes his or her prestige and political future on the success of anti-corruption reforms; the government’s willingness to report both successes and failures; the government’s willingness to support “islands of integrity” and reform champions; and the continuity of reform implementation.<sup>52</sup>

Lesotho, Botswana, and Georgia are excellent examples of countries where the political leadership has demonstrated its resolve to fight corruption. In Lesotho, the government defied all the odds by successfully prosecuting corrupt government officials and Western corporations who offered and accepted bribes as part of the multi-billion dollar Lesotho Highlands Water Project. The government of Botswana has similarly reduced public tolerance for corruption by allowing its Directorate on Corruption and Economic Crimes to investigate allegations of corruption without fear or favor. In Georgia, “[m]inisters have been given the authority and responsibility to eradicate corruption in their ministries and are being held accountable for results. As an example, in July 2005, the finance minister resigned, following a case of corruption in the tax office. While the minister was not personally implicated, he assumed responsibility for not having maintained enough control.”<sup>53</sup>

Political will is central both in MCC’s policy dialogue with candidate countries and in its threshold programs. threshold countries must place their programs in the context of a broader national reform agenda and implement their programs in a wider policy environment to reduce corruption.<sup>54</sup> In its policy dialogue with candidate countries, MCC also underscores the importance of establishing a pattern of behavior that backs up rhetorical commitments.

At the same time, MCC acknowledges that sustaining political will is a huge challenge that cannot be taken for granted. Anticorruption reforms are fraught with risk and uncertainty. Political parties may fracture when vested interests are challenged; citizens who benefit from patronage may “discipline” their elected officials by voting them out of office; and champions of reform may resign if they or their family members face grave physical harm. MCC therefore places a premium on civil society participation. A robust civil society can deepen and sustain political will to combat corruption by mobilizing public support for reforms, arming reformers with useful information, shedding light on public abuses, exposing vested interests that undermine reform efforts, and persuading powerful elites that reform is in their political interests.<sup>55</sup> An excellent example of this can be found in Bangalore, India, where an NGO called the Public Affairs Centre created Citizen Report Cards to provide feedback to public service delivery agencies. These Report Cards have over time placed a tremendous amount of pressure on public officials. As a result, corruption appears to be declining and customer satisfaction has improved substantially.<sup>56</sup> MCC’s threshold programs similarly draw on civil society organizations to sustain political will. In Ukraine, NGOs will monitor the government’s implementation of its anti-corruption reform commitments; in Moldova, MCC will support a partnership between the government’s national anticorruption agency and a coalition of NGOs; and in Tanzania, civil society organizations will be trained to monitor and expose abuses in the public procurement process.

**Principle #5: Serious Reformers Need a Comprehensive, Transparent, and Predictable Legal Framework**

While even the best anticorruption laws can be undermined by weak enforcement, all the political will in the world can also be undermined by weak legislation.<sup>57</sup> In some countries, the absence of asset forfeiture laws prevents government authorities from tracing, freezing, confiscating, and repatriating corrupt proceeds. In other countries, high-level public officials enjoy legal immunity from criminal prosecution. Elsewhere, citizens may lack a statutory “right to know” because freedom of information laws do not exist, or citizens choose to remain silent when they witness acts of corruption because there are no legal protections for witnesses and whistle-blowers. Other countries lack statutes that permit plea-bargaining and a system for granting immunity or sentence reductions to witnesses that cooperate with the authorities. Consequently, criminal informants are often unwilling to implicate those who have committed more serious crimes.

In other parts of the developing world, restrictive rules of evidence seriously encumber the ability of prosecutors to pursue important corruption cases. In Indonesia, for example, undercover tapes, evidence recovered from computers, and financial records are not yet considered admissible evidence. In other countries, there is an urgent need to clarify vague, contradictory, and overlapping laws, as they grant officials undue discretionary power. Governance expert Susan Rose-Ackerman argues that

“computeriz[ing] all governing statutes and regulations should be a high priority on corruption-fighting grounds.”<sup>58</sup>

MCC recognizes that serious reformers need a comprehensive, transparent, and predictable legal framework. As such, the government of Moldova will use its threshold program to computerize all existing statutory and legal databases and integrate them into a comprehensive automated case management system. MCC is also working with Malawi and Tanzania to pass and implement tough anti-money laundering laws. In its policy dialogue with candidate countries, MCC also emphasizes that anticorruption legislation should never be pursued as an end in itself. Rather, it should be pursued as a means to an end, and for countries in the early stages of reform, legislative change is often not the best option. The window of opportunity for reform is narrow, and legislative delay can prevent champions of reform from achieving the “quick wins” that are needed to gain political support for deeper change.<sup>59</sup>

#### **IV. Conclusion**

MCC was founded on the principle that aid alone will never rescue countries from the scourge of grinding poverty, but it can be a powerful force for growth and poverty reduction when countries pursue good governance, invest in the health and education of their citizens, and expand economic opportunities. Research and practical experience suggest that corruption, in particular, retards economic growth, undermines poverty reduction efforts, and reduces aid effectiveness.

MCC is engaged in the challenge of fighting corruption. Drawing on lessons learned and best practices from the past twenty years, MCC creates a powerful incentive for reform through its transparent selection process, scales up and accelerates anticorruption reform efforts through its threshold program, and helps institutionalize the idea that foreign aid should be a two-way street by leading development practice.

*Questions or comments regarding this paper should be directed to MCC’s Department of Policy and International Relations at [developmentpolicy@mcc.gov](mailto:developmentpolicy@mcc.gov).*

## Endnotes

1. These indicators were chosen on the basis of decades of research on the policy determinants of economic growth, poverty reduction, and aid effectiveness. In selecting these quantitative measures, MCC also favored objective, analytically rigorous, and publicly-available indicators that enjoy broad country coverage, are comparable across countries, have a close link to policy, and are reasonably consistent from year to year.
2. Currently, 25 countries are eligible for MCA compact assistance: Armenia, Benin, Bolivia, Burkina Faso, Cape Verde, East Timor, El Salvador, Georgia, Ghana, Honduras, Jordan, Lesotho, Namibia, Nicaragua, Madagascar, Mali, Moldova, Mongolia, Morocco, Mozambique, Senegal, Sri Lanka, Tanzania, Ukraine, and Vanuatu. There are also 15 countries that are eligible for MCA threshold assistance: Albania, Guyana, Indonesia, Kenya, Kyrgyz Republic, Malawi, Niger, Paraguay, Peru, the Philippines, Rwanda, São Tomé and Príncipe, Uganda, Yemen, and Zambia. 5 compact-eligible countries – Burkina Faso, East Timor, Jordan, Tanzania, and Ukraine – were previously selected as threshold countries and have approved threshold Programs.
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  14. The government plans to release an MCA Action Plan and launch an MCA-Dominican Republic Web site to highlight the reforms they are adopting to become MCA eligible. Most recently, the government informed MCC that because of its desire to become MCA eligible, it would roll out a large measles immunization campaign that will reach 5 million people.
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16. 2005-2006 marked a turning point in the Government of Indonesia's war on corruption. A slew of high-profile corruption prosecutions of current and former Government of Indonesia (GOI) officials has energized the media and civil society groups and placed newfound pressure on the bureaucracy. The Jakarta Post characterizes the President's anti-corruption campaign as "shock therapy," and most Indonesians seem to believe that the President's approach will have a measurable impact on corruption. According to Transparency International's 2005 Global Corruption Barometer, 81% of Indonesians believe that corruption will decrease over the next three years. Out of 69 countries surveyed, Indonesia was the single most optimistic country regarding the anti-corruption efforts of its government.
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18. Pg. 1 of World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington D.C.: World Bank. According to the World Bank, "a large number of tax and customs officials have been dismissed... [and] higher salaries and stricter rules for hiring and firing in these agencies have created an incentive system that reinforces professional behavior and discourages corruption." The EBRD also points out that "in a move to increase efficiency and reduce corruption in the public administration, a civil service council responsible for coordinating civil service reform was established in August 2004. During that year 30,000 jobs were cut, with the savings in the wage bill financing a gradual increase in the remuneration of the remaining civil servants." See pg. 134 of EBRD. 2006. *Transition Report 2005: Business in Transition*. London: EBRD.
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from approximately 2.7% in 2002 to 0.5 percent in 2005. Anderson, James H. and Cheryl W Gray. *Anticorruption in Transition 3: Who is Succeeding ... and Why?* Washington D.C.: World Bank.

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According to Robert Simon of the Government of El Salvador, “We’ve worked very hard on the indicators. As you know, the MCC had 16 indicators, now 18. And from day one, we looked at that score card. And I think, in another meeting, Ambassador Danilovich mentioned the MCC effect, which is how countries really focus on specific things. One example, we have been doing a lot of effort in reducing the time and cost of companies that want to invest in El Salvador. In the last year and a half, the number of days that it takes to open a business came down from 90 to 40 to 26. And I will say, even though it’s something that we’re doing as a country, that we were doing it before, but obviously the fact that that is an indicator, or two indicators, that MCC looks at helped. So I think the MCC effect is, in a country like ours, giving us more reasons to do the things we need to do.” Millennium Challenge Corporation. 2006. “Millennium Challenge Corporation Holds a Public Meeting on the MCC Compact between the United States and El Salvador.” Hall of Americas, November 30, 2006: Washington, DC. <http://www.mcc.gov/press/events/2006/transcript-113006-elsalvadoroutreach.pdf>
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22. The Government of Indonesia has also set a target of 3.8 on Transparency International’s 2008 Corruption Perceptions Index.
23. LaFraniere, Sharon. 2005. Donors return as Africa confronts corruption. *The New York Times*. July 6, 2005. Recently-elected President Kikwete has also made the battle against corruption a top priority. A 2006 Afrobarometer survey shows corruption declining across the board in Tanzania, and a May 2006 opinion poll suggests that 84% of the population is confident in the performance of the new government. See Afrobarometer. 2006. *Combating Corruption in Tanzania: Perception and Experience*. Afrobarometer Briefing Paper No. 33. Economist Intelligence Unit. 2006. Tanzania: Country Report (June 2006). London: Economist Intelligence Unit.
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year, and as other governments make policy improvements, the standards for qualification become more and more difficult.

25. MCC's Board can suspend or terminate eligibility if a country's policies deteriorate or if a country fails to make continued progress on the indicators. MCC has already suspended two countries for significant slippage on the indicators used to measure country performance.
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43. Pg. 27 of Klitgaard, Robert, Ronald MacLean-Abaroa, and H. Lindsey Parris, Jr. 2000. *Corrupt Cities: A Practical Guide to Cure and Prevention*. Oakland, California: ICS Press and World Bank Institute.
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875 Fifteenth Street NW  
Washington, D.C. 20005  
[www.mcc.gov](http://www.mcc.gov)