

Anti-corruption in adverse contexts: strategies for improving implementation

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September 2019

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Abstract

Developing countries are characterised by political settlements where formal rules are generally weakly enforced and widely violated by the powerful. Conventional anti-corruption strategies have typically delivered poor results in these contexts because they focus on improving the enforcement of a rule of law and raising the costs of corruption facing individual public officials. Unfortunately, in contexts where the distribution of organisational power allows a wide range of powerful individuals and organisations to violate rules, a strategy that assumes that we can strengthen the enforcement of rules is likely to result in poor results in the short to medium term. An alternative approach is to identify sectoral anti-corruption strategies that target specific problems with a high developmental impact and that are also feasible to implement because at least some of the powerful engaged in these activities are likely to support their implementation *in their own interest*.

Our alternative approach identifies anti-corruption strategies from the bottom up. This involves identifying the characteristics of the corruption that is constraining particular development outcomes. By drawing on theories of rents and rent-seeking and theories of political settlements, we can assess both the developmental impact of specific anti-corruption strategies and the feasibility of implementing these strategies.

We argue that feasible anti-corruption strategies in typical developing-country contexts cannot be solely based on the conventional transparency, accountability and enforcement approach. In societies that have widespread rule violations, high-impact anti-corruption is only likely to be feasible if the strategy can motivate at least some powerful organisations to support the enforcement of specific rules. We identify four broadly defined clusters of strategies for creating effective anti-corruption strategies, which we describe as 1) *Aligning incentives*, 2) *Designing for differences*, 3) *Building coalitions*, and 4) *Resolving rights*. In each case, the anti-corruption strategy seeks to achieve the feasibility and impact goals in the way described. We argue that these clusters (and others that can emerge through further research) can provide a framework for organising research on the impact and feasibility of anti-corruption activities in priority areas in different countries.

List of Acronyms

ADB	Asian Development Bank
ACE	Anti-Corruption Evidence
BTM	Bangladesh Textile Mills Association
DCE	Discrete choice experiment
DFID	Department for International Development (United Kingdom)
EAC	East African Community
EPZ	Export promotion zone
ESPJ	Education and Skills for Productive Jobs (Tanzania)
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
MW	Megawatt
N	Naira (Nigerian currency)
NBR	National Board of Revenue (Bangladesh)
SDL	Skills Development Levy (Tanzania)
SEIP	Skills for Employment Investment Programme (Bangladesh)
SEZ	Special economic zone
SME	Small and medium-sized enterprises
VAT	Value added tax
VET	Vocational education and training

1. Introduction

Corruption is closely related to the weak enforcement of a rule of law. It involves violations of rules by bureaucrats, politicians and businesses who misuse power for their private benefit. Not surprisingly, corruption is strongly correlated with the weak enforcement of formal institutions in general, including property rights, and a weak adherence to the formal rules of democratic politics. All of these in turn also appear to be strongly correlated with the level of development of a country's productive structure. Countries that have high levels of corruption are likely to have weak property rights, a weak rule of law, variants of political clientelism with many informal political rents, *and* low levels of productive capabilities (even if they sometimes have high per capita incomes if they are rich in natural resources). These correlations raise important questions and challenges for policy (Khan, 1995; 2002).

Causality clearly runs in both directions. Low levels of development make it difficult to fight corruption and enforce formal rules, for instance because resources and incentives for enforcement are limited. At the same time, high levels of corruption can slow down development by reducing and distorting productive investments, thereby making it difficult to achieve the levels of development that would make further reductions of corruption possible. This means that while poor countries are unlikely to achieve very low levels of corruption, they need to achieve effective anti-corruption in critical areas to sustain their development and allow more significant anti-corruption efforts to become feasible over time. The higher levels of corruption and weaker enforcement of formal rules in developing countries is not an accident. The adverse distribution of productive capabilities implies a distribution of power in society where the powerful do not need or support the enforcement of a rule of law. This in turn constrains the effectiveness of strategies of rule-enforcement that are based on detection and punishment, because even after detection and prosecution, powerful rule-violators can often go free. Designing effective anti-corruption policies in these contexts therefore requires a strategic rethinking of anti-corruption strategies.

Two systemic problems linked to the nature of *political settlements* in developing and emerging countries make it difficult to implement the usual top-down anti-corruption strategies in these contexts (Khan, 1995; 2004; 2005a; 2005b; 2010; 2012). In more advanced countries, the distribution of power supports the enforcement of a rule of law, and here improvements in transparency and accountability systems can be expected to lead to better enforcement and therefore to a reduction in corruption across the board. But similar strategies are known to have produced much weaker results in developing and emerging countries (Rock and Bonnett, 2004; Johnsen, et al., 2012; DFID, 2015).

The first problem is that anti-corruption strategies that are based on the generalised enforcement of rules are only likely to be effective when the general enforcement of rules is aligned with the interests of powerful organisations in the country. When is this likely? Countries become more advanced as they acquire a more diverse set of productive organisations in different sectors and activities. As these organisations become more productive, they also become more powerful. They pay more taxes, fund political parties, employ more people and therefore begin to have a greater say in what politicians and

bureaucrats do. The growing complexity of the economy also means that more and more of these organisations begin to require the enforcement of formal rules to conduct complex businesses and transactions. The more complex the required rules, the greater the demand for generalised rule enforcement, rather than the enforcement of specific rules that benefit specific organisations. More economically developed societies therefore have a greater number and diversity of organisations that both have the *incentive* to want generalised rule enforcement and have the *power* to do something about it. In contrast, powerful organisations in less developed societies are likely to be less dependent on generalised rule-enforcement to organise their market and political transactions. They can feasibly interact with each other in informal ways and generate rents through political connections. If the most powerful organisations in a country do not need or want the generalised enforcement of formal rules, it is unlikely that a rule of law will emerge simply through enforcement efforts by a few agencies, even with external assistance.

Secondly, as countries become more productive and diversified, political parties can raise enough revenues through formal taxation and legal fundraising to maintain their party organisations and deliver to their political constituencies. Parties in advanced countries have to raise revenues from a great diversity of business interests and sectors and this sets a limit to special privileges that can be granted. These characteristics ensure that political parties have both the *ability* to be rule-following (because taxes and legal resources are substantial) and they face the *compulsion* to follow rules (because rule-violating parties can lose significant sources of funding) and this makes them rule-following for their own survival interests. It is not just the quantum of revenue but also the diversity of sources that is important. When many sectors and firms are powerful, special privileges for a few will be effectively opposed by many others. This explains why developing countries that have a lot of tax revenue from one or two sources (such as oil or gas, or a single manufacturing sector) do not necessarily become rule-following. The political leadership faces little effective compulsion from the few organisations paying taxes in these contexts to behave in rule-following ways as long as special privileges are provided to those who control these sectors. In addition, political parties can raise significant revenues in informal and rule-violating ways in developing countries, and when in power, a politically feasible way of rewarding their supporters is to allow them to violate more rules. In these contexts, it is unrealistic to expect political leaders to exercise ‘political will’ to enforce rules when their hold on power and their economic interests depends on doing otherwise. This does not mean that we should desist from continuously putting pressure on rule violators in developing countries to begin to follow rules, but it does mean that we should not expect this pressure on its own to result in rapid transformations of business and political practices.

Without broad support for generalised rule-following behaviour in a society from powerful economic or political organisations, anti-corruption strategies that assume that it is possible to enforce rules as soon as violations are detected and responsible individuals are identified are likely to be poorly implemented in practice. A feasible anti-corruption strategy in such contexts must be radically different. It must *sequentially attack specific instances of corruption where the anti-corruption strategy is feasible because it has the support of enough powerful interests involved in that activity to make its enforcement plausible, and to be of policy interest, the proposed anti-corruption strategy should have a strong positive*

impact on development. To be feasible, a combination of policy changes, institutional adjustments and organisational mobilisation must plausibly create sufficient support for the enforcement of specific anti-corruption strategies. If these bottom-up anti-corruption strategies also have a significant development impact, they can enable more productive investments and activities, better developmental outcomes and more inclusive growth, and can eventually help to expand the productive economy with an increase in the number of organisations interested in the enforcement of formal rules. Over time, this will make it more possible to find support for successively more ambitious anti-corruption strategies, and ultimately for strategies for the enforcement of a rule of law.

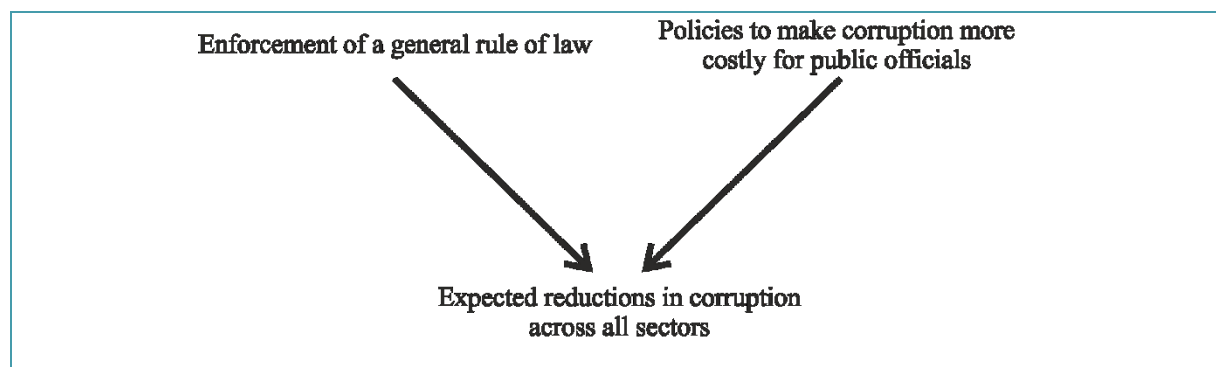
The impact of corruption and therefore priority anti-corruption activities cannot be directly identified by looking at the magnitude of the bribes involved in different activities. An activity with relatively small bribes can have a high negative impact. For instance, small bribes could distort the enforcement of regulations on food adulteration and result in many deaths and diseases. In contrast, activities with significant bribes may sometimes have low impact. For instance, some profit-sharing transfers from businesses to politicians *may* have a low negative impact on development if the productivity of the underlying investments is not too adversely affected. The impact of anti-corruption therefore has to be assessed by looking at the overall distortion caused by the corruption, not just the magnitude of the rent-seeking expenditure (Khan, 2000a). At the same time the anti-corruption strategy has to be feasible, which usually means that the policy or institutional change required has to be plausible in the political context and, if implemented, has to have the support of enough influential actors in the sector for it to be sustained. The priority areas for anti-corruption will therefore clearly differ across countries depending on the structures of their economies, their drivers of growth, and their national and sectoral configurations of power and interests.

The paper is organised as follows. Section 2 summarises some of the limitations of existing approaches to anti-corruption, section 3 outlines our alternative approach for identifying feasible and high-impact anti-corruption strategies. Section 4 summarises four important variants of feasible and high-impact anti-corruption strategies and, finally, section 5 concludes with a summary of the type of research and policy agenda that emerges.

2. Limitations of conventional anti-corruption approaches

Conventional anti-corruption strategies attempt to tackle corruption by improving rule-following behaviour, particularly by public officials. One component of this has been to strengthen ‘good governance’, including the enforcement of a rule of law and property rights. This has been supported by evidence that appears to show correlations between governance variables like the degree to which a rule of law is enforced and levels of corruption (Ades and Di Tella, 1996; Rauch and Evans, 2000; Treisman, 2000; World Bank, 2000; Lambsdorff, 2005;). Another component of these conventional approaches draws on microeconomic principal-agent models to argue that asymmetric information may allow public officials to subvert the public purpose by engaging in corruption in pursuit of their own self-interest. The policy response that follows from this perspective is to attempt to change the behaviour of bureaucrats with better information and monitoring, and through changes in incentives like better pay structures and stricter punishments (Rose-Ackerman, 1978; Klitgaard, 1988; Andvig and Moene, 1990; Huther and Shah, 2000; Spector, 2005).

Figure 1: Conventional anti-corruption approaches



Source: Authors

The vast majority of conventional anti-corruption strategies are therefore based on a combination of strategies to improve the enforcement of formal rules across the board, together with policies that seek to change the cost-benefit calculations of individual public officials in a context of asymmetric information, as summarised in Figure 1. However, these approaches have not delivered satisfactory results because both approaches assume that developing countries are generally rule-following contexts with occasional violations that can be addressed with improvements in good governance, transparency and accountability. In fact, generalised rule-following behaviour is more or less absent in most developing and emerging societies and cannot be immediately established for structural reasons that include the configuration of power in these societies. If we cannot immediately make societies substantially rule-following, anti-corruption strategies that assume that this can be done are likely to fail.

Moreover, strategies that seek to change the behaviour of individual bureaucrats are also likely to fail if they ignore the fact that these public officials are operating in networks and social contexts where the powerful are able to violate rules. How this happens may differ across developing countries. In some, the powerful at the top of the political and bureaucratic hierarchy have greater discretion to define and change rules according to their interests, while preventing lower levels from violating rules set for them. In other countries, higher and lower levels of the hierarchy may both violate rules independently. But these differences should not hide the common characteristic of both settings that rules cannot be credibly enforced on the powerful in these contexts. Indeed, individual bureaucrats or politicians who insist on following rules are likely to find their career prospects limited or they may even be removed or transferred to less important positions so as not to obstruct the flow of resources within powerful networks of bureaucrats, politicians and businesses.

The limitations of standard anti-corruption strategies are now widely recognised, and the underlying reasons are entirely consistent with our analysis of political settlements. For instance, a review by the United Kingdom's Department for International Development (DFID) of anti-corruption strategies shows that most fail because they ignore critically important policy *interdependencies*. These interdependencies include those between the *micro-level* calculations of individual public officials and their reinforcement by political, social and cultural structures at the *macro-level*; and the interdependencies between policies *targeted* by anti-corruption strategies and other policies and institutions that *contribute* to persistent corruption (Johnsøn et al., 2012; DFID 2015). These observations recognise the entrenchment of corruption in societies where rule violations are widespread, and where many activities involve informal arrangements. In these contexts – which are far removed from having a rule of law – policies that attempt to improve the enforcement of formal rules or change the behaviour of individuals with formal incentives are very likely to have limited immediate effects or to fail entirely.

A related aspect is that conventional anti-corruption strategies often confuse *policy variables*, which are variables that decision-makers can change (including some institutions and organisations), with institutional, organisational and political characteristics of countries that are *outcomes* of evolutionary changes that lead to important structural transformations over time (Khan, 2018). The latter cannot be immediately changed by policy. The quality of the rule of law in a country or the independence of its judiciary are examples of institutional characteristics that are outcomes of complex processes involving many interdependent institutions and organisations. They are *not* immediate policy variables. A policy-maker cannot 'decide' to improve the rule of law in a society where enforcement is weak. While the evidence showing correlations between corruption and 'variables' like the rule of law is not wrong, the latter are not policy variables, and the evidence is therefore not very useful for policy-makers. The correlations pick up characteristics that tend to go together: societies that have achieved a rule of law are likely to have low levels of corruption, but this does not tell us how they got there.

3. Rents, political settlements and an alternative approach to anti-corruption

Analysis of rents and political settlements provides related theoretical insights that are important for our alternative anti-corruption analysis (Khan, 2002, 2006a, 2006b). The aim of feasible anti-corruption is to identify policy changes that can successfully reconfigure incentives to reduce corruption and improve development outcomes, but that do so in such a way that the rules will be supported by enough influential stakeholders for adherence to be plausible. All anti-corruption strategies attempt to reconfigure incentives, but most of the time they do not ask two fundamental questions: who is going to enforce the new rules? And are the new rules likely to be distorted by the interests of those whose behaviour they are trying to change? In contexts where the rule of law is weak, these are vitally important questions and overlooking them explains the failure of most anti-corruption initiatives. Instead, given the weakness of formal enforcement structures in these countries, our approach is to investigate if it is possible to reconfigure incentives in such a way that at least some powerful players will support the enforcement of these rules *in their own interest*, to achieve improvements for themselves, while also achieving developmental outcomes. This combination of conditions is more demanding, which is why feasible anti-corruption with significant developmental impacts is hard to identify in developing countries. However, we argue that such instances *can* be identified, and they are the obvious starting point for feasible anti-corruption efforts.

To identify these opportunities, we need to understand the ways in which different types of rents are being allocated and appropriated in a sector or activity, the beneficiaries of these rents, and the social outcomes attained as a result. This starting point can help us to identify the rent-seeking processes through which different interests distort the achievement of development outcomes. Through this analysis we often find that the same activity attracts different types of rents and violations, and that different participants may violate rules for very different reasons. We need to understand these processes in some detail because what may appear to be a simple corruption problem is usually a complex one with different types of violations happening simultaneously. Secondly, we also need to assess the relative organisational power of the different interests involved in the activity to understand the potential support for and resistance to specific policy changes, and therefore the feasibility of constructing a solution that is likely to be self-enforcing.

The first part of the analysis is therefore to understand the diversity of ‘rents’ involved in the relevant sector or activity, and the *types of corruption* that may be associated with each. The work of Joseph Stiglitz and other economists has shown that different types of rents (broadly defined as incremental income flows associated with particular policies or institutions) can have complex effects on social outcomes (Stiglitz, 1989, 1996). Some rents are essential for markets to work well and for improved development outcomes (for

instance efficiency wages or health-sector subsidies), while other rents can destroy value and block development (for example monopoly rents or predatory extractions). The existence of rents (even socially useful variants) is always likely to induce rent-seeking activities that attempt to influence the allocation or protection of particular rents, imposing an additional cost on society (Krueger, 1974; Posner, 1975; Khan, 2000a). Corruption is a variant of illegal rent-seeking that is likely to emerge in contexts where the rule of law is weak, and is most damaging when it supports the persistence of rents, or distorts or destroys developmental rents (Khan, 2000a, 2000b, 2004).

State policies and institutions create formal rents when they introduce taxes or subsidies, allocate rights over resources like land or natural resources, create employment in public organisations, or introduce regulations that impose costs and benefits on different parties and so on. When the rule of law is weak, rent-seeking activities are likely to be informal and illegal and, like with all rent-seeking, they can further influence the allocation of rents across different beneficiaries. In every case, the allocation of rents and the conditions that are formally or informally attached to their allocation (and the enforceability of these conditions) determines the developmental outcomes that are likely to follow. For instance, the state may allocate subsidies to hospitals, but the development outcome depends on how politicians, hospital management, doctors, nurses, medical suppliers and others bargain over the allocation of these resources (the rent-seeking process) and the types of doctors, nurses, supplies and so on that are procured as a result (the outcome). Corruption usually describes a wide range of illegal or informal rent-seeking activities through which public officials, businesses and other organisations seek to influence the allocation of rents (Khan 2000a, 2000b, 2005a).

The economic consequences of corruption therefore depend on how it alters the allocation of different types of rents. Not surprisingly, corruption can have different effects depending on the rents being allocated by policies or institutions and how corruption distorts these allocations. Some corruption is a response to policies that restrict certain activities without any social benefit, for instance by restricting entry through licensing. They create rents for privileged firms but threaten the profits of others. These restrictions can generate corruption because excluded businesses will try to pay to work around these restrictions. In this case, anti-corruption only makes sense if it is combined with a policy of removing the restrictions that drove the corruption in the first place: stopping the corruption that allows businesses to work around welfare-reducing restrictions while keeping the restrictions in place would only make society worse off. On the other hand, other types of corruption can undermine potentially useful policies by diverting rents that may have induced a beneficial social outcome. For instance, government subsidies to the private sector to invest in cleaner or more productive technologies can fail if firms use bribes to obtain the resources but flout the conditions attached to these subsidies. However, in fighting this type of corruption, the underlying policies should *not* necessarily be thrown out. Here, we have to think of changing the policy design to ensure that the rents become more difficult to capture without fulfilling the conditions attached to them, and at the same time make it more feasible for firms to fulfil these conditions, if they were unrealistic to begin with.

In more complex cases we may simultaneously have different types of rents coexisting in an activity and careful analysis is required to identify what needs to be done. For instance, if there are different types of firms in a sector, generalised policies that define minimum standards for all firms may result in some finding these policies to be restrictive to the point of putting them out of business (which may sometimes reduce net social welfare). Other firms that may have complied with the standards may choose not to do so in future if corruption is a feasible alternative. In these cases, an anti-corruption strategy must consider the differences in the rent-seeking motivations of different firms and devise the policy mix that maximises the social benefit.

The second component of our anti-corruption analysis is to take into account the configuration of power across the interests involved in certain instances of corruption, as this can determine support for or opposition to particular strategies that seek to alter the allocation of rents. An important strand of recent research we draw on is the literature on how governance in developing countries is constrained by the configuration of their political settlements (Khan, 1995, 2010, 2012; Roy, 2012). This research has established that the poor enforcement of formal institutions in developing countries is not an anomaly that can be solved simply by investing in enforcement agencies, by supporting transparency initiatives or by improving agency capacities to enforce the rule of law. These top-down initiatives can sometimes help, but the configuration of organisational capabilities and powers in developing countries means that informal processes of rent allocation and informally enforced transactions between powerful organisations are likely to remain important for some time. This reflects the fact that powerful organisations in these contexts have ways of doing business that are better from their perspective than supporting a rule of law. In particular, informal networks of power such as patron-client networks are likely to continue to distort the operation of formal institutions in these countries.

The analysis of political settlements (Khan, 2010, 2018) therefore provides a framework for exploring how the distribution of organisational power can constrain or enable particular types of institutional and policy changes. Policies and institutions are only likely to be implemented if their enforcement is supported by a powerful-enough coalition in whose interest it is to enforce these rules, and which is powerful enough to ensure a high level of adherence. Assessing the relative power of different interests in a sector (both formal and informal) is therefore essential. Anti-corruption policies in contexts with a weak rule of law are only likely to be successful if at least some powerful organisations support their implementation. This is not likely if we are looking to rule out all corruption immediately, but it may be possible to target specific types of corruption if the anti-corruption strategy is aligned with the interests of certain groups that possess power. If research can find such opportunities, there is a chance that the activity of self-interested key participants in a sector can be aligned with the enforcement of a policy that reduces corruption and enhances developmental outcomes (Khan, 2013).

4. Evidence

Our assessment of the poor performance of standard anti-corruption strategies is consistent with the findings of a number of recent surveys of the corruption literature (Johnsøn et al., 2012; DFID, 2015). Analysis of different and overlapping types of corruption in various political settlements can help to explain why corruption appears to be so resistant to conventional anti-corruption strategies. Political settlements across developing countries are such that powerful organisations do not need a rule of law to do business and therefore do not effectively support the enforcement of a rule of law (Khan, 2010, 2018). In these contexts, quite specific policies may be required to address sectoral corruption if the evidence suggests there are coalitions that could (out of self-interest) support the enforcement of rules that have developmental outcomes. This assessment would depend on an analysis of the relevant political settlement that describes the relative power and capabilities of organisations affected by the proposed policy changes. Both the differences in rents across sectors and countries, and differences in the relevant political settlements, means that the same policy responses will not be feasible in every context.

A rents and political-settlements approach can also help to explain why the *effects* of corruption appear to vary so much across contexts. If quite different types of corruption are involved across contexts, the ‘average’ effects of corruption picked up by statistical analysis will depend on the mix of behaviours in the countries, sectors and time periods sampled. Corruption can therefore paradoxically appear to be compatible with rapid development in some cases (like the East Asian tigers in the 1960s or China in the 1980s) while being seriously damaging in many other developing countries (Rock and Bonnett, 2004; Khan, 2006a, 2006b). In the same way, statistical attempts to identify the efficacy of anti-corruption policies also pick up very weak results (Treisman, 2000).

Our two lenses can help explain this paradox. First, different policy combinations will be required if countries face *diverse corruption with different and overlapping rents* across sectors. Strategies that may work in one country or sector will fail in another, and pooled testing may give poor results for any specific strategy. Secondly, different policy combinations may be required to address the *same types of rents that exist in different political contexts*. This too would require adjustments for different configurations of power. These interdependencies mean that standard econometric approaches to identify the effectiveness of anti-corruption strategies are likely to fail because of inadequate data.

4.1. Evidence on corruption and the private sector

The ability of the private sector to do business in corrupt environments appears to vary widely across sectors and countries, as do the apparent effects of corruption that is driven by the private sector. Private-sector corruption can include behaviour and activities to overcome obstacles to doing business, but may also include corruption to influence formal or informal policies that prevent entry, allow the survival of inefficient firms, overpricing,

regulatory failures, investments in the wrong sectors, and so on, where the private sector is the primary driver of the problem.

A few policy instruments cannot address all of these problems. General improvements in governance, the rule of law and 'doing business' conditions can help, but progress is likely to be slow in developing-country political settlements for the reasons discussed earlier. Anti-corruption analysts therefore increasingly recognise the importance of country and sector specificities in designing effective programmes (Spector, 2005; Campos and Pradhan, 2007), which aligns with the results of the analysis here.

The private sector can be a victim or perpetrator of corruption, or both. Often it is a victim and is vocal against it, while at other times it is primarily a beneficiary, driving corruption through links with bureaucrats and politicians. The anomalous position of the private sector means that its support for anti-corruption initiatives through business associations and other means has usually been half-hearted and largely ineffective in developing countries. In many countries, almost all firms are involved in some type of corruption, and even firms that are victims will often not want to destabilise business arrangements by exposing their own involvement in corruption. In certain cases, the political settlement is such that almost all business operations involve some informal or corrupt activity, and this constrains firms from taking their complaints too far, because public officials can expose them in other areas. In this context, general anti-corruption strategies are unlikely to work, and even very specific ones need to be carefully designed to align interests with feasibility.

The types of corruption a firm can engage in are also likely to change over time, as the economy evolves, as firm capabilities change, as governments and policies come and go, and so on. Evidence and analysis of this is critical for identifying feasible and high-impact anti-corruption strategies in sectors, and to create incentives to induce potentially compliant firms to begin to support anti-corruption measures. Our work on private-sector corruption has demonstrated the usefulness of process analysis for identifying different types of rents and rent-seeking processes in particular activities, and therefore the necessary policy combinations required for effective anti-corruption strategies in these contexts (Khan, 2014; Mathieson, 2014).

The World Bank's *Doing Business* initiative has been valuable in identifying restrictions that constrain business by increasing transaction costs, which in turn can induce specific types of corruption as businesses try to overcome obstacles. However, it would be misleading to assume that private-sector corruption in general can be addressed simply by reducing unnecessary market restrictions and by improving the service-delivery functions of the state. Unnecessary restrictions are one of many drivers of corruption in the private sector. Moreover, the different types of corruption triggered by restrictions often do not satisfy our criteria of having a high impact, even if it is feasible to address certain behaviours through the simplification of procedures. Not enough attention has been given to corruption driven by other types of rents that the private sector has been implicated in, sometimes as a victim but often as a driver, which are often much more important in explaining damaging development outcomes.

4.2. Evidence on policy interdependencies that affect anti-corruption

Existing research shows that with the exception of a small number of technical measures like public financial management (PFM), the vast majority of anti-corruption interventions supported by international development partners have had weak and contested impact on levels of corruption (Johnsøn et al., 2012). Attempts to discover effective policy combinations through cross-country comparisons have also delivered limited results. One reason for this is that while there are clear interdependencies between anti-corruption policies and other factors and variables, it is very difficult to identify effective policy combinations using regression analysis. The interdependencies are too numerous to unravel using cross-country data, because the number of variables that may potentially be interdependent is large relative to the available data. Equally, just saying that ‘context matters’ does not help. Generating useful evidence depends on effective strategies for making the problem of interdependence tractable for analysis.

Societies are constituted differently – politically, institutionally and culturally – and this results in varying configurations of power across organisations. Using the framework of political settlements to look for feasible policy choices allows us both to identify and explain what is working in these countries, and to generate hypotheses on combinations of policies that may be effective and implementable. We have to make explicit not only the combinations of *policy variables* that could address specific *sectoral* rent problems, but also the particular configuration of organisational power – the *political settlement* – that makes it likely that a proposed solution is feasible to implement. An analysis of interdependence must therefore draw on an understanding of rents and corruption typologies as well as an analysis of political settlements, with the objective being to identify potentially effective anti-corruption policies to improve development outcomes *given the configurations of organisational power in that sector and society*.

For this reason, analysis of policy interdependence should focus on specific sectoral questions otherwise the number of interdependencies is likely to become unmanageably large. At the highest level of aggregation (the developing country as a whole), there are likely to be so many interdependent institutional and governance weaknesses that effective policy would require that too many difficult problems be fixed simultaneously. Lack of feasibility in this respect is one reason why ambitious ‘good governance’ reforms have not resulted in positive results in most developing countries. This too supports the recognition that anti-corruption has to have a strong sectoral focus and work from the bottom up (Campos and Pradhan, 2007).

5. The impact and feasibility of anti-corruption strategies

Measuring the developmental impact of specific instances of corruption is not simple, partly because of the secrecy associated with corrupt practices and partly because existing approaches often confuse the *magnitude* of corruption, as measured by the value of bribes or other rent-seeking expenditures or the level of fraud or other rule-breaking behaviour, with the *impact* of corruption. Standard approaches to the quantification of corruption include surveys based on perceptions or the observation of proxy characteristics correlated with the corruption. But each of these approaches has its problems (Søreide, 2006). For instance, surveys based on perceptions implicitly measure the magnitude of corruption but have the problem of subjective distortion. The definition of corruption is also very broad and does not distinguish between different types of behaviours. Using proxies (such as delays in health delivery, or leakages from budgets) implicitly measures the impact of corruption because they estimate outcomes. However, the problem with these outcome or impact measures is that variations (for instance in delays in health delivery) may be due to factors other than corruption. There is therefore a need for new types of evidence, and to develop the usefulness and applicability of existing proxy indicators and other approaches.

Furthermore, while the magnitude of corruption measures the extent of rent-seeking expenditures, it often ignores the *relevance* of the different types of rents that may be involved. A rents analysis shows that the impact of corruption depends not only on the magnitude of corruption but also on how these distort the management of specific rents that affect the achievement of important developmental goals. This is why the same *level* of corruption can have very different effects on development *outcomes* (Khan, 2000a, 2000b). Indeed, relatively small bribes in some activities (for instance to evade rules on building regulations or food safety) can do a lot more damage to human lives and welfare than bigger bribes elsewhere. This knowledge can help the prioritisation of policy in contexts where aggregate levels of corruption may take time to reduce, given the characteristics of the political settlement. If we can identify corruption that has a high negative impact and that is also feasible to reduce in the ways discussed, effective anti-corruption efforts can be designed in a targeted manner.

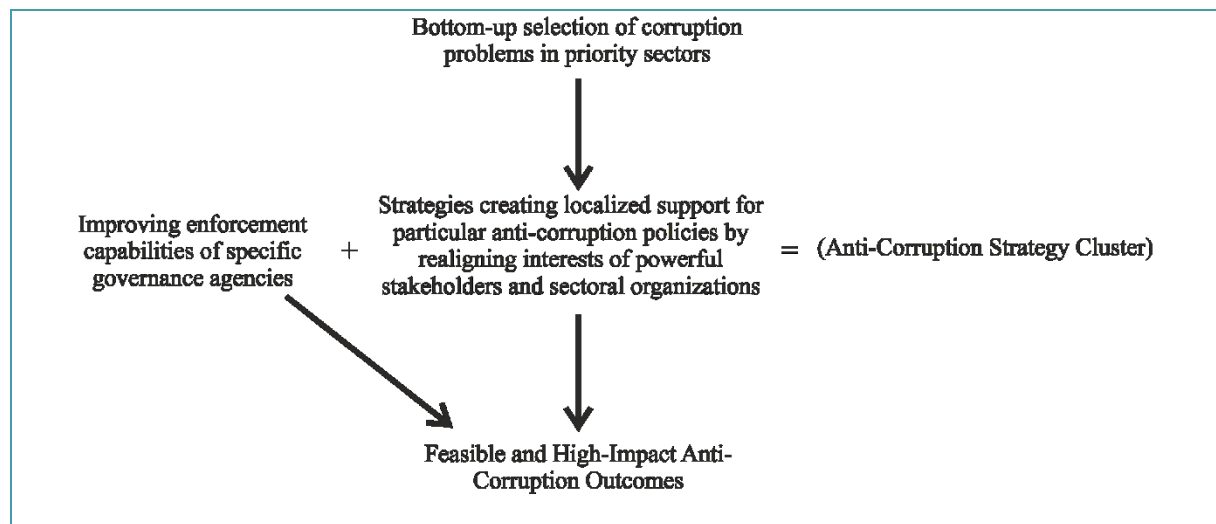
The *impact* of a potential anti-corruption strategy should measure the estimated effect of that strategy on development outcomes, which can help to determine the prioritisation of targeting feasible types of corruption in an anti-corruption strategy. The assessment of impact must estimate the effect of specific corruption processes on developmental outcomes, which could be economic growth, but could also be other outcomes like environmental protection, economic diversification, the inclusion of the poor or women, health outcomes, distributive justice and so on, depending on the characteristics of the sector or activity being assessed.

The *feasibility* of an anti-corruption strategy is a measure of the probability of successfully implementing the strategy. While targeting a low-impact variant of corruption can waste

policy resources even if it can be implemented, a policy that addresses a high-impact variant that is not feasible to implement can equally waste resources. Feasibility can be measured along a variety of dimensions: how many policies need to be changed, how many governance capabilities need to be improved, how much resistance there is to each of these changes from powerful organisations, and so on. Therefore the approach to assessing feasibility will depend on the type of corruption in the sector or activity being studied. The objective is not necessarily so precise as to rank the difficulty of implementation of different anti-corruption strategies, but at least to assess whether the investment in a specific anti-corruption strategy is justified given the likely support and resistance coming from powerful groups and therefore the likely risk of failure.

Ultimately, an effective anti-corruption strategy will have to satisfy an acceptable mix of impact and feasibility. The feasibility aspect is critically important but is often entirely ignored in many anti-corruption policy discussions. Given the weak capacity to enforce formal rules in the typical developing or emerging country, feasibility requires a sufficiently high level of effective support for the policy by the stakeholders involved in the activity or sector. Support is deemed effective when those who claim they support the anti-corruption policy can be seen to also have an interest in its implementation and have the organisational power (relative to other stakeholders) to support enforcement. If such support is likely to be forthcoming from at least some influential players within the sector, feasible improvements in governance capabilities may suffice to improve rule adherence in the sector and improve developmental outcomes. This approach to feasible and high-impact anti-corruption is summarised in Figure 2.

Figure 2: Feasible and high-impact anti-corruption strategies



Source: Authors

Our sectoral, incremental and bottom-up approach to anti-corruption requires identification of strategies that can create localised support for enforcement. This in turn involves identifying the incentives and characteristics of critical organisations involved in specific corruption processes. By analysing the rent-capture processes and the relative power and capabilities of the organisations involved, it is possible to assess the feasibility of creating

coalitions for anti-corruption in that sector or activity. In section 7 we discuss four broad clusters of anti-corruption strategies that can help to create coalitions to support anti-corruption in different contexts.

Our approach to anti-corruption supports a different and more ambitious theory of change than standard approaches to anti-corruption that are based on transparency, accountability and the enforcement of the rule of law. The proposition is that, in countries where levels of development and political settlements do not yet allow the effective enforcement of generalised formal rules, corruption levels will incrementally decline at an accelerating pace if we can identify sectoral anti-corruption strategies that can *sequentially target corruption in activities where anti-corruption is both feasible and has a high impact*. This is because these targeted strategies will enhance developmental outcomes, helping to create a more broad-based economy with a growing number of powerful organisations that will want rule enforcement in their own interest. Successively more ambitious anti-corruption strategies will then become possible until eventually strategies targeting higher-level institutional characteristics like the enforcement of a rule of law or society-level transparency and accountability become more likely.

Thus, both the incremental, bottom-up strategy described in Figure 2 and the conventional, top-down or systemic approaches to anti-corruption described in Figure 1 are likely to be required at different stages of development. The more ambitious top-down anti-corruption strategies based on the enforcement of a rule of law and transparency and accountability are likely to gain policy relevance at higher levels of development when productive capabilities become broadly dispersed in society. The greater the productivity and complexity of the economy, the more likely that a large number of powerful organisations will have an effective demand for a rule of law, be prepared to pay for its enforcement, and be engaged in the horizontal enforcement of formal rules on each other, which makes the occasional vertical enforcement feasible. When powerful organisations refuse to deal with peers who do not follow rules, enforcement agencies attempting to identify and punish rule violators are able to operate with a high chance of success.

These conditions are missing in most developing countries, however. In a typical developing country, a more important type of anti-corruption strategy is likely to be the bottom-up, sector-specific approach based on identifying feasible policy combinations that attract a sufficient number of productive organisations to play by the rules in specific activities and sectors, and to support external enforcement in these specific activities. The critical difference here is that the content of the policies and strategies is of great importance, because we need to identify strategies that are likely to be largely self-enforcing within the sector, with a limited requirement for vertical enforcement. However, most anti-corruption efforts in developing countries do not satisfy these requirements, and work on the false premise that rules can be enforced in the country if general enforcement incentives and capabilities can be improved. Our approach to anti-corruption in the SOAS University of London Anti-Corruption Evidence (SOAS-ACE) programme focuses on identifying opportunities of the first type, looking for feasible sectoral opportunities, as we believe these are the appropriate starting point for an effective long-term anti-corruption strategy.

6. Types of corruption and anti-corruption priorities

Our rents analysis allows us to distinguish between different types of corruption, based on Khan's (2006a) classification. This reveals some general characteristics of different types of corruption and indicates the feasibility and impact of anti-corruption strategies targeting each type of corruption, based on the analysis outlined earlier. While several types of corruption can coexist in particular sectors and activities, it is useful to assess separately the potential impact and feasibility of strategies that target individual types of corruption.

Corruption driven by market restrictions emerges when there are unnecessary or damaging market distortions created by states either deliberately or inadvertently, which are in turn evaded by businesses and individuals engaging in corruption. Corruption of this type is a response to restrictions like unnecessary red tape, barriers to entry, or regulations that are either unnecessary (from the perspective of social welfare) or that the state does not have the capacity to enforce but which can block productive business activities. These types of market distortions and restrictions create damaging rents by preventing entry into sectors or activities. Corruption of this type can paradoxically reduce the effects of damaging restrictions by using corruption to by-pass some restrictions. This type of 'greasing the wheels' is indeed efficiency-enhancing in a superficial sense, but the problem is that it generates incentives for the persistence of distortions and the creation of new restrictions. If this type of corruption is not addressed, the overall efficiency of the economy is likely to decline over time.

This is the type of corruption that is implicitly targeted in the World Bank's Doing Business surveys. Clearly, the anti-corruption strategy for this type of corruption *must be to simultaneously remove the market distortions*, otherwise society can be made worse off by an anti-corruption strategy that blocks the corruption that seeks to by-pass the restrictions, but that keeps the original restrictions in place.

In contrast, in **policy-distorting corruption** the underlying state policies and associated rents are potentially socially useful, but corruption can prevent these policies from achieving development goals. For instance, health, education, environmental or technology upgrading policies implicitly create rents for different types of organisations that are incentivised to provide important services or to engage in socially beneficial activities that will otherwise not happen. If these rents and the policies allocating them are distorted by corruption, socially desired outcomes may not be achieved. This is potentially a high-impact type of corruption in many developing countries. When corruption distorts the implementation of developmental policies the consequences can be very serious. Conversely, the failure to design policies and regulations in ways that can withstand likely attempts at distortions can result in seriously constrained development.

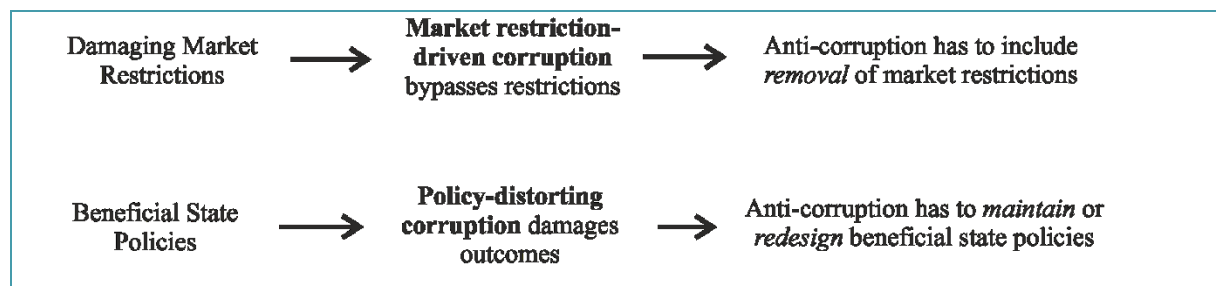
The impact of policy-distorting corruption can vary greatly across sectors and countries. In some cases, this type of corruption results in very limited policy distortion and mainly

redistributes the benefits of the policy between businesses and public officials. For instance, if public officials have the capacity to assist businesses to achieve greater productivity and profitability, and they have the capacity to discipline businesses if they fail to raise productivity, public officials can corruptly claim a share of the rapidly increasing profits of successful firms without this corruption significantly distorting the development outcome. This type of profit-sharing corruption emerged, for instance, in the granting of industrial policy support to South Korea's chaebol in the 1960s and 1970s and in profit-sharing corruption in China in the 1980s. This corruption was undesirable but it did not seriously distort policy because public officials had no incentive to support failure. The configuration of power ensured that public officials made more in kickbacks by withdrawing support from failing businesses and supporting successful ones. This corruption did not therefore constrain the countries' development even though it was of a substantial magnitude (Khan, 2000a).

In other cases, corruption can seriously distort policy, for instance by allowing failing organisations to keep on getting rents without delivering productivity growth or other services for which the rents were ostensibly allocated. A critical determinant of poor outcomes being sustained is the distribution of power between public officials and rent-receiving organisations that prevents the former from withdrawing rents even when outcomes are very poor. Thus, while policy-distorting corruption is always damaging, the effects can vary significantly across cases depending on the characteristics of the relevant political settlements. An assessment of the severity of the impact of policy-distorting corruption in different sectors and the feasibility of responses is an important part of identifying high-impact anti-corruption strategies.

Figure 3 summarises the critical differences between these two types of corruption. In one case the anti-corruption strategy is to *remove* the underlying restrictive policies that drive corruption, while in the other, the anti-corruption strategy should *maintain* the policy while redesigning it in ways that make anti-corruption feasible. This underlines why an analysis of the rents involved in different types of corruption is vitally important. Policies and interventions that are market-restricting and those that are potentially beneficial are not always clearly distinguishable. Nevertheless, analysis must attempt to identify the types of policies and rents that are involved. Without that, an anti-corruption strategy can inadvertently do more harm than good. Moreover, the same sector may have multiple players and policies so that some of the corruption in the sector may be driven by market restrictions and some may be policy-distorting. In these cases, which are not uncommon, a detailed sectoral analysis is required to identify the welfare-enhancing anti-corruption policy combinations.

Figure 3: Welfare-enhancing responses to policy-induced corruption



Political corruption describes rent creation and allocation through informal patron-client networks through which powerful groups maintain their power, particularly in political settlements where informal resource flows are a critical part of political allocations. As this type of corruption is driven by the reproduction strategies of competing political groups, it is difficult to fight it in developing countries where patron-client politics and informal rent flows play an important role in politics (Khan, 2005a, 2010; North et al., 2013).

The reduction of political corruption is a longer-term challenge and is related to our theory of change on the importance of creating a more diversified and productive society. The emergence of diverse organisations capable of paying significant taxes creates the tax base for competing parties to win elections by promising to spend a large formal budget. It also applies pressure on ruling coalitions to abide by rules in spending taxes as these are paid by organisations that need a rule of law to sustain their businesses. If this configuration of power does not exist, the most feasible strategy for fighting political corruption is to support the development of a diversified society with feasible anti-corruption strategies. The failure to understand the drivers of political corruption has resulted in many anti-corruption initiatives failing. If powerful political and business actors are engaged in reproducing their power and access to resources through sustained rule violations, transparency and accountability reforms are unlikely to have much effect. Rule violations are then very likely to continue to happen. An analysis of the political settlement provides the background information to identify the feasibility of different interventions in these contexts, without becoming demoralised by failures that are to be expected given the political settlements of these societies.

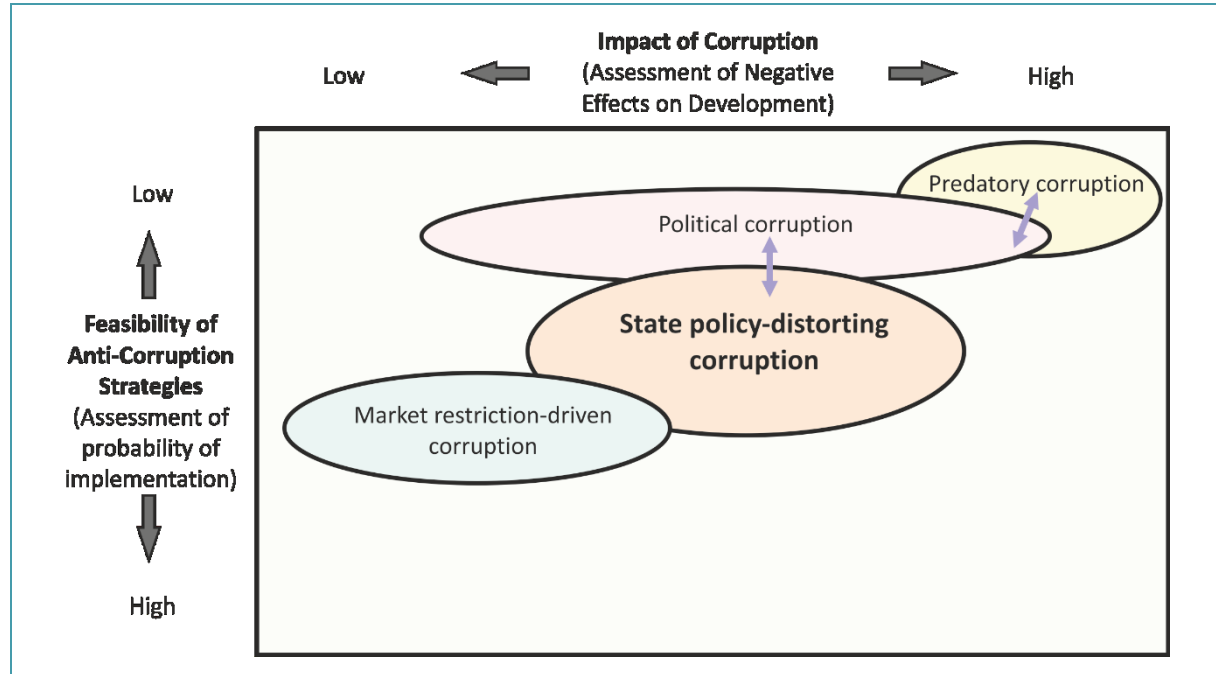
Finally, **predatory corruption** is a particularly damaging variant of corruption where coercion and violence are used by powerful groups to extract rents. This type of corruption becomes dominant at advanced stages of state failure, but some element of predatory corruption can take place in all societies. Fortunately, it is not the dominant form of corruption in most cases.

When predatory corruption becomes the dominant form of corruption, the society has become a warlord society and is close to or already engaged in high levels of violence. The strategy of developing sectoral economic activities still remains the most viable intervention here, but this is even less likely to have any impact on overall levels of corruption in these contexts. State-building activities and the organisation of a less violent political settlement become priorities for societies where predatory corruption has become dominant. Predatory corruption is only likely to decline if the ruling coalition acquires the legitimacy to rule without excessive repression. This, in turn, requires that the coalition includes previously excluded violent groups in a share of the rents. The longer time horizon that such a ruling coalition remains in power also gives it the capacity to rein in its own supporters engaged in predatory activities.

All of this is hugely challenging and is essentially a political and organisational task that seeks to achieve changes in the characteristics of the political settlement. Our understanding of the policies that can change political settlements is still very rudimentary, to say the least. Misguided policies that have sought to create new political settlements in conflict and post-

conflict settings have often resulted in damaging unintended consequences. Effective policy responses to high levels of predatory corruption are therefore extremely challenging given our existing state of knowledge.

Figure 4: Feasibility and impact of anti-corruption strategies



Source: Based on Khan (2014)

Based on the discussion above, Figure 4 locates anti-corruption strategies targeting each of these types of corruption in terms of their relative impact and feasibility. The sectoral corruption that we want to target is likely to involve several overlapping types of corruption, and this should be kept in mind in reading Figure 4. One should also remember that sectoral corruption may have mixed characteristics when assessing the feasibility of an effective sectoral anti-corruption strategy. For instance, if policy-distorting corruption in a sector also has characteristics of political or predatory corruption, the anti-corruption policy may have low feasibility even if its expected impact is likely to be high.

Market restriction-driven corruption is likely to be the most feasible type of corruption to address because this involves the removal of restrictions that may be feasible to target in many cases. High-powered political organisations are less likely to be dependent on these usually petty corruption incomes and may even be persuaded that the removal of some of this corruption may be in their own interest. On the other hand, the impact on development outcomes may not be particularly high either. In developing countries, development is usually blocked by the absence of productive capabilities and significant market failures, and mainly not by the blocking of activities of high-capability firms by unnecessary restrictions. In general, therefore, anti-corruption strategies that target market restrictions are likely to be *relatively* more feasible but also to have a more limited impact on development outcomes taken on their own.

In contrast, policy-distorting corruption can have a range of outcomes, the negative impact of which can be very high in many developing. But political interests are also more likely to focus on the allocation and management of these rents. This can make policy-distorting corruption difficult to address because it gets mixed up with political corruption. Nevertheless, strategies that target policy-distorting corruption have the most favourable levels and combination of impact and feasibility, and therefore are the most important type of corruption from the SOAS-ACE perspective. Many variants of policy-distorting corruption are relatively feasible to target while delivering a high impact if the corrupt behaviour is eradicated or reduced. However, some variants can be quite difficult to target because they may be very closely tied to political corruption. For instance, bank lending rules may be violated to benefit politically connected companies that also happen to be inefficient. Here, the corruption involved is not only policy-distorting but also has elements of political corruption and may therefore be difficult to address. This is shown by the arrow linking some policy-distorting corruption to political corruption in Figure 4. Political corruption describes a range of rent-creation and allocation strategies that are widespread in developing countries and that are linked to the nature of their political settlements. Some political rent allocations may have a relatively benign impact (if they are largely redistributive) and some may have a very malign impact (if they distort economic policies or result in political violence). In general, political corruption is much more difficult to address because powerful political organisations are involved. This means that despite the high impact of some of these types of corruption, anti-corruption strategies may not fulfil the condition of feasibility in many contexts. A further danger of political corruption is that at the margins it can change into predatory corruption, and this is shown by the arrow linking political to predatory corruption in Figure 4. This can happen, for instance, if the ruling coalition becomes increasingly repressive. This can trigger excluded groups into violence and warlordism, and can also create short-termism within the ruling coalition, inducing some of its members to engage in predatory activities and take their spoils to safe havens outside the country.

Predatory corruption is the most damaging variant of corruption. In extreme cases, predatory corruption can result in the cessation of most normal productive activities and investments. Societies where warlords dominate develop variants of war economies where developmental outcomes are heavily constrained. Predatory corruption is also typically the most difficult type of corruption to address. Powerful organisations involved acquire substantial violence potential, and violence usually leads to the entrenchment of zero-sum attitudes on the part of protagonists, making compromise and rent-sharing less likely to emerge.

Most sectors and activities in developing countries are likely to feature a mix of all of these types of corruption, and a process analysis of different types of rents is essential to uncover what is going on in each. In general, the biggest gains are likely to be achieved by anti-corruption strategies that target policy-distorting corruption, though several types of corruption may have to be simultaneously addressed in particular sectors and activities. In many contexts, anti-corruption strategies are likely to have to address combinations of market restrictions and policy design problems that drive different types of corruption in the same sector or activity.

7. Anti-corruption strategies

It follows from our discussion that anti-corruption strategies in developing countries are only likely to be feasible if they can induce critical participants in a sector or activity to begin to follow relevant rules out of self-interest. Without a significant level of self-interested buy-in, rule-following behaviour is difficult to impose in developing-country contexts if we rely solely on external enforcement. Clearly, these opportunities are likely to be limited, but they constitute a vitally important starting point for effective anti-corruption efforts.

In the subsections that follow we identify four types of anti-corruption strategies, each creating insider support for rule-following behaviour that can have a positive developmental outcome. The four types are indicative rather than comprehensive, and it is likely that other variants may emerge in the course of further research. Moreover, real-world cases may be classified under more than one type of strategy if they match the features of more than one pure type. Common to all four strategies is that, in different ways, they all create a base of support for rule-following behaviour amongst some of the critical participants in an activity. A variety of strategies are emerging under each of these four types, and therefore we refer to each as an anti-corruption strategy ‘cluster’.

7.1. ACE strategy 1: Aligning incentives

The poor design of developmental policies can deliberately or inadvertently create adverse incentives for rent capture that may in some cases be avoided with better policy design. This is most likely when the developmental policy also benefits many organisations that have some voice and bargaining power in society. The structure of incentives in some sectors may have evolved such that productive investments have become too risky, or the returns to productive activities have become too low or negative once all market and risk conditions are accounted for. Potentially productive organisations that may otherwise not have engaged in damaging types of corruption may engage in rule violations as normal business practice as a result.

If the evidence suggests that feasible rule changes would give the above firms sufficient returns for them to behave in rule-following ways to achieve better development outcomes, we can identify an anti-corruption strategy that is feasible and has high impact. The focus of research is to identify whether changes in the relative returns to different types of activities are feasible, and whether these are likely to create support for rule-following productive behaviour by critical insiders.

Incentive restructuring is most likely to be feasible in activities where market failures have justified policy interventions to allocate rents to achieve public policy goals. In many of these policy areas the incentives created can become dysfunctional for the achievement of these goals. The dysfunctional outcomes are typically associated with what we have earlier described as policy-distorting corruption. The recipients of public resources and contracts then fail to deliver on the policy goals but continue to operate through different types of collusive arrangements with public officials. These situations of policy-distorting corruption

are unfortunately frequently observed in developing- and emerging-country contexts. In a subset of these cases we may find that some of the organisations involved have a proven capability to deliver better outcomes, but they face adverse incentives because policy has been badly constructed or has ignored underlying risks and costs. The delivering-country context with its multiple market failures and high transaction costs creates many such dysfunctional policy outcomes where corruption has very damaging effects.

It is obviously not feasible to change incentives to achieve better outcomes in all such cases. Indeed, the task of research is to identify, on the basis of evidence, the promising areas for these types of anti-corruption initiatives. The feasibility of an incentive restructuring strategy will depend on the possibility of making productive activity sufficiently attractive for many or most organisations in the sector such that they no longer need to engage in rule violations and corruption to achieve satisfactory returns. If this can be achieved, there is a good chance of creating internal support for rule-following behaviour, and therefore for anti-corruption, in these specific activities, while achieving improved developmental outcomes. In these cases, the self-interest of a critical number of participants can be mobilised to support the enforcement of specific rules and anti-corruption policies that now benefit them, thereby also helping to improve developmental outcomes.

7.1.1. Examples

i) Bangladesh skills sector

Bangladesh has committed to spend more than \$1 billion over the next five years in skills programmes funded by the Asian Development Bank (ADB) and other development partners. However, the global evidence shows that success in skills programmes is low. A World Bank evaluation of skills programmes in India carried out in 2015 looked at a number of programmes over the previous five years with a spend of \$500 million and found a success rate of only 28% in terms of job placement after training. Even this dismal figure may be overstated as many skills providers are paid based on their employment success, and this creates strong incentives for overreporting employment. In Bangladesh, an early evaluation of the ADB-funded skills programme, Skills for Employment Investment Programme (SEIP), found a remarkably high employment success rate of 68%. However, in our preliminary investigations we spoke to several SEIP training providers and, off the record, they admitted to significant levels of overreporting of employment. The actual employment success is unlikely to be higher than in India and could even be lower given the poor quality of many training providers. Not only does this type of fraudulent overreporting result in a waste of resources, it also hides the data that could help to identify the source of the problem so that policy resources could be allocated better.

The irony is that Bangladesh has a large garment manufacturing sector that claims it is short of skilled workers and the training that we focused on targets this sector. To understand the types of incentive problems that may be generating fraud in this sector, we worked with a development implementation partner who had access to invoice data from a dozen training providers. Follow-up checks on trainees who were reported as being in employment by the training providers revealed significant overreporting of employment by some providers (in

some cases exceeding 50%), but with others engaging in almost no overreporting. This data, which would normally have been hidden without the detailed tracer checking of actual employment (as opposed to the reported employment in the invoices) raised a very important question: why were there such significant variations in the degree of overreporting across similar training providers servicing the same garments industry?

Here lateral thinking about incentives in the skills training market was necessary to understand possible causes and to develop a testable hypothesis. We know from theoretical and empirical work in the field that the productivity enhancement achieved through skills training depends not only on the quality and relevance of the training, but also on the organisational capabilities of employing firms. Enhancing worker skills does not add much to productivity in badly organised firms, but it does in well-organised firms. This is because when the production line is not working smoothly, a skilled worker cannot add more value relative to an unskilled worker from the factory gate. As our training providers were all providing basic skills to entry-level workers in the garments industry, and their training capabilities were vetted by the implementation partner, we can assume that there were no significant differences in the quality and relevance of the training delivered by the providers. Was there a difference in the organisational capabilities of the employing firms that could explain the different incentives of training providers?

To test this hypothesis, we constructed an index of the organisational capabilities of the firms to which trainees were being sent by the training providers. We used data on the unit value of exports from each firm, their compliance with building regulations and the type of firm (exporting, domestic market, tailor shop or self-employed) to construct an index for each firm. We then looked at the distribution of trainees going from each training provider to firms to construct a composite number for the organisational capabilities on the demand-side for each training provider. As expected, we found that training providers that were lucky enough to be supplying high-quality firms found their trainees quickly secured employment and they engaged in almost no fraud. But training providers that were surrounded by low-quality firms found their trainees had great difficulty finding jobs because these employers were just as happy to employ unskilled workers from the factory gate at a slightly lower wage. These training providers engaged in much higher levels of fraud, and their training quality was likely to deteriorate as well over time. Nevertheless, the evidence suggests that the corruption by training providers was not initially related to differences in *their* capabilities but rather to the differences in the effective demand for trainees that was due to differences in the capabilities of the firms they were sending workers too. The incentive problem was that the training providers were paid by outcome, but no amount of feasible effort could achieve a high employment outcome for training providers supplying to low-capability firms.

Our finding showed that the design of the skills programme was creating incentives for fraud, and that this fraud distorted the available data that could help us design training schemes better. Moreover, the evidence showed that if the incentives were aligned, training providers would not engage in fraud even in the Bangladeshi environment because they could make a decent return on investment. There is a critically important policy conclusion that emerges from this study: the incentives of training providers can be restructured, but it

requires a restructuring of the links between skills programmes and firm-capability development.

Public investments in skills programmes need to be tied to investments in improving the organisational capabilities of firms on the demand side. We already have examples of such programmes in Bangladesh, and we know that investment in organisational capabilities can result in improved firm organisation, and that this has a huge multiplier effect on the productivity achieved by skills training. However, before our research, the implications of this for skills training providers, and the incentives created for fraud, had not been identified. The research suggests the vital importance of joining up skills training with capability-development programmes, not only to address the adverse incentives that lead to fraud, which may be wasting no less than a third of the investment in skills programmes, but also to design a joined-up programme that actually creates a large numbers of jobs, and to achieve the productivity growth that can increase wages.

ii) Vocational training in Tanzania

Tanzania is growing rapidly and so is its population, which is expected to reach 90 million by 2030. The country needs to create employment for large groups of young people every year, many of whom come from the poorest segments of society. Around 850,000 young people enter the country's job market annually, but only 50,000 to 60,000 formal-sector jobs are created each year and many of those are in the service economy. As a result, between 2007 and 2016 the inactivity trends in the country have been increasing, especially among women, to reach 25% of the total population. Youth labour employment is also among the lowest in the East Africa region (Andreoni, 2018). Against this background, vocational skills development and the effective deployment of skills in productive organisations have been recognised as priorities for the government, particularly in relation to Tanzania's industrialisation ambitions. The World Bank as well as Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) and DFID have also invested millions of dollars in the sector over the years, including programmes like the GIZ-led Employment for Sustainable Development in Africa (E4D/SOGA) and the World Bank's Tanzania Education and Skills for Productive Jobs (ESPJ) programme.

Despite efforts by government, international organisations and the private sector to invest in skills development, the skills sector remains weak and the quality of trainees largely inadequate while frustration among the youth increases every day. Mistrust in the sector has also grown over the years with allegations of corruption in the use of funds, from the collection of the Skills Development Levy (SDL) to the governance of the financing system by government authorities and, finally, the delivery of training services by the public vocational education and training (VET) institutions. The SDL rate is also significantly higher in Tanzania than in comparable countries, and there are worries that this can create a competitive disadvantage and discourage formal employment.

As a result, companies and government institutions have increasingly diverged and companies have taken an exit option. Indeed, companies have disengaged from VET centres, are reluctant to run dual apprenticeships and internships programmes where uptake

remains very low, and have simply started lobbying for a reduction in the SDL – from 6% to 5% in 2013 and from 5% to 4.5% in 2016. Given this dislocation between different interests in the sector, international organisations have also found it very challenging to implement any skills development programme effectively. Concerns have been raised about flows and the use of new funds, and the idea of pumping more money into the sector has been questioned.

The SOAS ACE approach to the skills sector in Tanzania was to first conduct an in-depth rents analysis of the sector to identify potential vulnerabilities to corruption and lack of accountability along the chain – from financing to governance and implementation of skills training. Initial pilot interviews with multiple stakeholders revealed a very opaque system and lack of any evidence on the scale and breadth of corruption, despite several allegations of large amounts of funding being diverted from the sector. This rents analysis was a key step in tracking the funds, disentangling the formal and informal practices in the sector, and identifying the different interests of the stakeholders involved.

The rents analysis generated the first ever quantitative evidence on the volume of SDL collected and allocated over the last ten years (Andreoni, 2018). It also revealed a number of inconsistencies in the legal system (the VETA Act and amendments) which allowed the potential diversion of funds from the skills development sector. There is evidence that SDL collection significantly increased over the last decade, with a growing contribution from small and medium companies. Despite this, the funding allocated to VET centres and other education-related institutions remained roughly constant and the amount of SDL funds reported in government and private-sector negotiations is missing a large sum, above \$40 million. The underfunding of VET institutions also triggered a series of informal practices and opened new avenues for corruption. We discovered that VET institutions – especially in urban centres – had started using their training facilities to run short courses for which they were collecting fees up to five times higher than for long-term, SDL-funded courses. As a result, youths were overcharged for a number of short courses – often perceived as better – and companies who wanted to train or retrain their workforce had to pay these extra fees on top of the SDL.

Over the years, the lack of quality skills, as well as dysfunction and corruption in the financing and delivery system, also induced companies to engage in rule-breaking behaviour including: SDL avoidance or underreporting; violations of worker immigration laws with foreign skills being brought into the country despite being more expensive; reduction in formal employment to avoid a fixed levy on the payroll; misuse of incentive schemes like national internships and dual apprenticeships in which tax rebates were introduced. Given these rule-breaking behaviours, the private sector with its own representative organisations have always found it difficult to push for dramatic reforms and ask for more government accountability. The government has pushed back, pointing out large tax irregularities and the unwillingness of the private sector to play their part.

Against this complex background and misaligned interests, we looked for opportunities to re-align incentives for private and public actors to cooperate in the pursuit of their own interests to support skills development. For once, the government has a strong interest in

showing results in this sector – though it might not be willing to fully deploy the levy collected for the sector, it has already allocated part of the SDL to launch a rebate scheme which would allow companies willing to do on-the-job training in partnership with VET centres to get back a portion of the levy. VET centres are also looking to ‘formalise’ their targeted short-course training and generate more income and increase their salaries. All companies are keen to pay lower levies, but only a few are capable of using the incentives provided by the government effectively.

We looked for ongoing pilot experiences which were already successful in Tanzania (and the region) and found that some companies had promoted collaborative initiatives of this type, even without levy rebates. In the mining sector in Arusha (north Tanzania), the need for skills and the importance of keeping skilled wages low motivated mining companies to create a sector-focused training within the public-owned VET centre in Moshi. The success of this collaborative scheme and willingness of mining companies to contribute to skills development are due to the fact that the firms were likely to see an increase in productivity from skilled labour and would know how to organise these skills effectively.

The scalability of a rebate-based collaborative model like the one in the Moshi centre is made difficult by the fact that there are very few companies in Tanzania that could deliver proper on-the-job training and would be able to employ trainees afterwards, however. The majority of companies do not have sufficient technical and organisational capabilities, and are likely to abuse rebates, as has already happened in some pilot cases. To avoid this, and to design a feasible and impactful strategy, we conducted a stratified survey covering 300 medium-to-large companies to identify firms with adequate capabilities, while at the same time testing new sector-specific collaborative models for skills development through a discrete choice experiment (DCE). The results of large data collection and DCE can orient a new incentive model for collaborative skills training led by companies in collaboration with VET centres and will allow us to ‘design for differences’. This means making sure that the rebate system initially targets only companies with sufficient technical and organisational capabilities. Dynamic incentives for smaller companies can be also introduced to improve their capabilities and enable them to graduate and access the scheme.¹

iii) Restructuring incentives in the Nigerian electricity sector

Privatisation of the Nigerian electricity sector was a highly anticipated deregulation exercise in Africa for international investors and financial consortia. The reform launched in 2011 envisaged the privatisation of six generating companies and 11 distribution companies. This was done successfully with newer private independent producers adding to generation capacity which currently totals just over 12,000 megawatts (MW). The transmission sector was not privatised, however. Average power distributed is around 4,000 MW and peak distribution capacity is 5,400 MW as a result of poor-quality distribution networks, a legacy of the pre-privatisation era. This is compounded by the fact that transmission capacity is

¹ The SOAS-ACE evidence has informed the World Bank’s Tanzania ESPJ programme and has led to collaborative work to engage the Tanzanian government (Andreoni et al., 2019).

limited to 8,000 MW. Other logistical issues like inconsistent gas supply and pricing have added to the sector's inefficiencies and have led to disappointment with the outcome of privatisation.

The technical aspects mask another critical constraint to a well-functioning electricity sector in Nigeria, however. Both anecdotal evidence and the actions of the country's premier anti-corruption agency, the Economic and Financial Crimes Commission (EFCC), point to extensive rent-seeking, capture and corruption in the sector. The agency is currently investigating power projects worth \$16 billion, which were announced between 2005 and 2018 and span the tenure of all Nigerian presidents since the country's return to democracy, including the first term of current incumbent Muhammadu Buhari. The investigation targets all senior politicians and functionaries including ex-governors, ex-ministers and a former head of a large Nigerian bank. The accusation is that many of the power projects announced were not implemented as funds were allegedly diverted using a 'revolving door' of political connections. A report published in August 2017 by one of Nigeria's most respected civil society organisations identified corruption as the main reason why the sector has not progressed at the expected pace. According to the report, the country lost 11 trillion naira (N) through corrupt practices in the sector from 1999 to 2017 (SERAP, 2017). In the years since 2015, bail outs and guarantees to the sector have totalled over N1200 billion (The N701 billion Payment Assurance Guarantee, the N300 billion Power and Aviation Intervention Facility and the N213 billion Nigeria Electricity Market Stabilisation Facility) but with not much to show for it.

The privatisation process did not gain the confidence of investors either. Some investors were not allowed to conduct due diligence on companies they were buying, and it was worse for distribution companies that did not receive any sovereign guarantees while generating companies at least received partial risk guarantees. The absence of sovereign guarantees was a huge disincentive for genuine investors, leading to adverse selection where politically connected companies were the only ones that could risk bidding. Nigerian banks absorbed all the risks of these political transactions as international lenders were understandably reluctant to lend to the sector.

The dominance of politically connected companies in a sector that is loss-making in aggregate terms explains the widespread illicit rent capture reported across the Nigerian electricity value chain, involving both private and public actors. In many cases this has been the only way in which these entities could make a 'profit'. The process begins with politically influenced gas pricing agreements between suppliers and generators. The supply of gas is also a constraint (and is one issue being investigated by the EFCC) as there are insufficient pipelines and new projects have yet to be completed. Domestic gas producers also prefer selling abroad as the prices are better. The other point of collusion is through power purchase agreements (PPA) or the price at which generators are supposed to sell to the transmission company. Prices can be inflated in a manner that is well above production costs and engineering, procurement and construction (EPC) contracts for some of the projects under investigation were designed to include 'Waiver of Due Process Certification for Payment' leading to the suspicion that payments were made before projects had been completed and in an opaque manner. Further down the chain, a common complaint against

distribution companies has been the practice of billing based on 'estimated use' which has enabled suppliers to overcharge customers. This has only recently been abolished.

The technical inefficiencies meant there would be little or no return for (high) investments, which put off genuine investors in the national grid (except for one project with a partial risk guarantee from the World Bank). Consequently, the only firms willing to invest were politically connected companies that were confident of recouping their investments based on their proximity to powerful political coalitions that would enable them to engage in illicit practices. The sector is therefore in a low-level equilibrium where incentives to invest and upgrade in the national grid are absent, and technical inefficiencies have been exacerbated. Moreover, in a sector where demand is high and supply is severely constrained, there are strong perverse incentives for corrupt behaviour. For instance, buying diesel on the black market as fuel for captive generators is a huge corruption externality, as is 'tapping' into high voltage lines.

Our research identifies high demands for electricity in small and medium manufacturing hubs like Nnewi, Onitsha and Aba where informal 'power' businesses supply 'pay-as-you-go' electricity to entrepreneurs who cannot get what they need from the grid. There are also small and medium-sized enterprises (SMEs) that have kept capacities idle for want of power supply, that are typically forced to look for other, often informal and illegal, ways to access power. Informal power suppliers can be legal (where enterprising individuals buy large generators to supply electricity to users in a specific area) but often there are operators around high voltage lines who supply electricity that is essentially stolen. Even stolen electricity results in cost escalation for SME owners, however, with some SME owners having reported electricity costs (as a percentage of production costs) of up to 40%. In comparator countries like India, this cost is usually between 20% to 30%. A recent article in *Nature Sustainability* calculates the 'mean net cost of electricity' from diesel generators in Nigeria is \$1.6 billion per year (Farquharson et al, 2018). Once the environmental impact of diesel generators is added, the full social costs are much higher.

The ACE strategy here is to recognise the difference between long-term and short-term responses. The long-term response is to address the structural problems of transmission infrastructure, improving collection and gas supply to increase generation. This will take many years, possibly decades, and requires investments in expensive infrastructure that are not feasible at the moment. The immediate response is to use the ACE approach to address incentives that could feasibly improve generation and supply power to SMEs which will create employment while reducing corruption risks. But anti-corruption measures are only likely to be feasible here if the overall strategy succeeds in aligning the interests of a sufficient number of powerful and productive organisations to support the enforcement of rules that enable better outcomes.

The evidence suggests that it may be possible to restructure the incentives of potentially productive players, like SME owners, to become rule-following in their own interest. SME owners in clusters we have researched are already purchasing power legally (if informally) and are also paying for it over and above their metered use, which demonstrates their 'willingness to pay'. There is clearly effective demand for consistent power supply. The

Nigerian government's push for off-grid supply (which is currently mostly solar but could be extended to gas to meet the demand) and the newly launched policy of 'Eligible Customers' (where users with a monthly consumption of over 2 MW can purchase electricity directly from a producer, bypassing the distribution company) have created policy spaces that the ACE strategy can exploit. Our research promises to empirically establish both the effective demand for off-grid electricity supply in SME clusters, and also how this can be delivered in ways that cut out the need for SME owners to engage in corruption.

7.2. ACE strategy 2: Designing for differences

Another set of rule-violations in developing countries stems from rules that are difficult to enforce because they do not recognise differences across individuals or organisations engaged in a sector or activity. This heterogeneity is often much greater in developing countries because development is an uneven process. The same activity or 'industry' may involve individuals or firms with very advanced characteristics in terms of technology or capital, but also many others with very low capabilities or capital. The result can often be that almost all individuals or organisations in a sector may end up violating rules but for very different reasons. Some of these reasons may be 'reasonable', for instance because the rules simply cannot be adhered to by some individuals or organisations given their capabilities, or because the systems do not exist to enable certification or compliance in time or at reasonable cost. At the same time, other violators may be entirely opportunistic and extractive, taking advantage of poor enforcement to violate rules that they may have complied with, with very adverse welfare outcomes.

Anti-corruption measures are only likely to be effective in these contexts if there are feasible policy changes that can allow potentially compliant individuals or organisations to actually comply. The policy package may sometimes also require exit or upgrading strategies or other means of dealing with organisations that cannot comply, even with revised or simplified rules. For these organisations it is critical not only to achieve a broad base of support for the anti-corruption reforms, but also because without that, the enforcement of rules may result in significant immediate hardship or unemployment and a reduction in welfare. A package of policies that address these issues of heterogeneity can create support for rule adherence in a sufficient number of potentially compliant firms and organisations in a way that enhances welfare.

Many entrenched sectoral corruption problems in developing countries are of this type. In these activities, most firms and organisations in the sector may appear to be corrupt, but closer investigation usually reveals that they are violating rules for very different reasons. One reason why anti-corruption is so difficult in many countries is that even organisations that *want* to comply often find that they have to violate rules. This means that when deliberately extractive organisations violate rules, their peers are unable to strongly resist them or demand their prosecution, because everyone has something to hide. Even worse, when external enforcement agencies appear, all firms in the sector resist sharing information or assisting their enforcement activities. This creates an environment that allows even more egregious violations by a few deliberately extractive and exploitative organisations or individuals. For anti-corruption to have horizontal support among the

participants in a sector, there has to be a substantial potentially compliant group. Since this often does not exist, anti-corruption is only likely to be feasible if policy can assist the emergence of a significant compliant group. Policy combinations that enable compliance can create a powerful base of support that can help to sustain improved rule-following behaviour and anti-corruption enforcement in these activities.

7.2.1. Examples

i) Building regulations in the Bangladeshi garments industry

The role of corruption in the evasion of building regulations in the Bangladeshi garments industry came tragically to the fore with the Rana Plaza collapse in 2013, in which more than 1,200 workers, mostly in the garments industry, lost their lives. Since then a number of initiatives have been undertaken by international buyers, including the Alliance and Accord initiatives, to carry out inspections of factories and to agree on upgrading to comply with international standards. This work is now at an advanced stage, and many Bangladeshi factories have made much progress in satisfying the international inspections. But the process has also revealed important shortcomings in our understanding of regulatory compliance and the different ways in which corruption affects compliance outcomes in developing countries.

The garments industry, like many others, demonstrates huge internal diversity in Bangladesh, with world class firms, struggling firms that could become world class, and many smaller and undercapitalised firms that cannot easily upgrade but nevertheless provide significant employment opportunities to many people. Some of the incentives for corruption-driven evasion are driven by deliberate or inadvertent market restrictions created by regulatory policy. Regulatory requirements are typically much greater than the capacity of the state to certify in time, and perhaps greater than is required to achieve acceptable levels of safety in the context of a developing country. Here, many firms with export orders waiting for shipment often find they have to pay to get their certification, whether or not they are compliant. At the same time, a potentially long tail of low-capability firms, often engaged in subcontracting from the larger firms, are often not able to be compliant because they are undercapitalised and operating on very small margins. Shutting down these firms also triggers political costs for local politicians and economic costs for local bureaucrats and others who collect rents from such firms, and so the enforcement of regulatory rules on these types of firms is also resisted.

The corruption that keeps the above types of non-compliant firms in business, with the active collusion of local politicians and bureaucrats, therefore has some characteristics of political corruption. But in this case, the political corruption simply responds to an immediate problem (without finding any long-term solutions) because shutting down these firms may indeed have a high welfare cost in the absence of alternative employment opportunities. The diversity of reasons behind the corruption around building regulations then triggers a third and even more serious policy-distorting corruption. Here, firms deliberately evade rules that they may have otherwise complied with, knowing that the degree of violations in the sector are high enough for them to enjoy impunity. The case of

Rana Plaza was an example of the latter. This is a good example of how the absence of any peer pressure or horizontal support for enforcement within a sector can rapidly result in unacceptable levels of violations.

By identifying and measuring the relative scale of these different drivers of violations we can show the necessity of taking these differences into account. To achieve the support of a majority of firms in the sector, a number of issues need to be addressed. First, a broad-based stakeholder discussion is required to develop a consensus on the minimum building standards that will ensure safety but that are also feasible for the majority of firms in the industry to comply with. Second, if these standards imply that a tail of firms will be unable to comply, policy also needs to address an exit or upgrading strategy for these firms, particularly if it turns out that they employ significant numbers of workers. Finally, policy has to address certification capabilities on the side of the state, so that compliant factories can at least expect to get inspected and certified within the time cycle required for their exports. This policy combination would not normally be considered an anti-corruption strategy, but it promises to create sufficient internal support for adherence to regulatory norms. The usual anti-corruption policies focusing on detection and punishment have achieved little effect precisely because there has been little support within the sector for any enforcement of regulations.

Under pressure from international buyers, particularly in Accord, the industry has pushed through an external inspection regime and upgrading of facilities to achieve compliance. This has by all accounts been a very costly exercise for the bigger firms, and it has led to many middling-capability firms struggling to comply and quite a few lower-capability firms going out of business. The sustainability of external inspections as well as a regulatory regime based on internal buy-in are also questionable as a long-term strategy. The ‘designing for differences’ approach to anti-corruption can provide a framework for thinking through these evolving policies in a sustainable way based on the multi-pronged evidence-based approach outlined above.

ii) Tax incentives in Tanzanian export promotion zones

Tanzania is still largely dependent on its mining resources, which account for almost 50% of the country’s export basket. Large segments of the population are still employed in agriculture where levels of productivity are still very low. The industrial sector is small and very few companies are able to compete in regional and international markets, while a few conglomerates control supply chains and extract rents from them (Andreoni, 2019). Against this background, the government of Tanzania has centred its five-year development plan on industrial development. In particular, new emphasis has been given to attracting investments and using export promotion zones (EPZs) as institutional and incentive vehicles for industrialisation.

Tanzania is not the only country using these type of incentives, and indeed other players in the Eastern African region rely on special economic zones (SEZs) and EPZs to grant rents to private companies, including more advanced industrialisers like Kenya and Ethiopia. Tanzania loses substantial revenues annually due to these tax exemptions – losses

amounted to approximately \$1.16 billion at their peak in 2011 but declined to \$0.47 billion in 2016. The legal framework in Tanzania and in the East African Community (EAC) of which Tanzania is a member allows for tax exemptions. In Tanzania these exemptions can be granted through Government Notices, without requiring the approval of Parliament.

EPZ/SEZs are the main institutional vehicles for incentivising companies. EPZs were established under the 2002 EPZ Act, before the establishment of the East African Customs Union of 2005, which currently defines the customs rules of Tanzania. Companies intending to set up new investments and export 80% of goods produced are eligible to receive tax exemptions including corporate tax for 10 years; reductions in import duties and value added tax (VAT) on capital goods, raw materials and construction materials; reductions in VAT on utilities and wharfage; and an allowance for withholding tax on rent, dividends and interests. They also receive a series of other services delivered by the EPZ Authority related to visas, work permits, transfer of profits, dividends and royalties. Based on this generous package of incentives over 160 companies were licensed in these zones and were expected to create 50,000 jobs by 2018. The evidence on how much this specific mechanism has cost in terms of missed tax revenue is fragmentary, however triangulation of several data sources including Ministry of Finance Reports on Tax Exemptions and Annual reports by the Controller and Auditor General suggest the scheme might have been abused (see also Therkildsen and Bak, 2019). Preliminary investigations also suggest that the governance of the scheme was designed in such a way that its enforceability was unlikely. For example, the EPZ/SEZ legislation allows for companies to be licensed as ‘individual’ EPZs without being located in a dedicated zone. This makes the management of the exemptions vulnerable to corruption, especially the management of duties exemptions, while the production formula used to calculate export performance is not functioning both from a tax and company perspective.

Despite these challenges, and the limited number of companies licensed and operative, the last two governments have embarked on a multi-million-dollar investment in a new port in Bagamoyo – north of Dar es Salaam – which will also host a new EPZ. Given the significant public resources involved in the sector, and the fact that preliminary visits to EPZ/SEZ show very low levels of activity, we set up to research the functioning of this tax incentive scheme. We analysed the history of the scheme and informally approached companies to understand how the scheme was working for them. We paid particular attention to understanding why many companies licensed never started their operations, and why many of them have left since the launch of the scheme.

Several rounds of interviews and data analyses pointed to a number of problems in the EPZ/SEZ incentive scheme. First, many companies were attracted by the understanding that the 80% export requirement meant export outside Tanzania. However, with Tanzania joining the EAC customs union in 2005, the entire EAC market became ‘domestic’ and therefore by law they had to find new markets outside the EAC if they did not want to lose their fiscal incentives. Since 2010, and increasingly since then, attempts by the Tanzanian tax authority to start enforcing national and EAC laws and implementing checks on exports escalated the contradictions in the EPZ/SEZ incentive scheme. Given that many of the companies attracted by the scheme set up operations in the country to export in the regional market, many of them faced significant pressure because they were unable to operate internationally. A

number of them closed, while others had an even stronger incentive to bribe in order to survive. Only those companies capable of finding markets outside the EAC managed to survive, remaining rule-following became very difficult for these firms. This is because meeting the stringent export requirements is not simple for the less competitive companies. The fact that the tax authority used the same ‘production formula’ to estimate exports and import duty exemptions meant that a number of businesses that may have been able to comply became unable to do so.

We established a collaboration with the EPZ Authority to collect data on all the companies that were part of the scheme and to show a correlation between a firm’s export profile and cases of abuse of the system. This evidence supports the idea that instead of trying to increase checks, corruption can be better addressed if the EPZ incentive schemes take into account differences among firms. The SOAS ACE strategy suggests a redesign of eligibility criteria for access to tax exemptions, for instance by setting a qualification-criteria that limits access to the scheme to companies that have secured export contracts with international buyers. This would provide the EPZ Authority with a feasible mechanism to implement the EPZ/SEZ scheme in Tanzania and attract capable firms into the scheme. As for less capable companies which are already in the scheme, a different approach must be adopted, including supporting their export capacity or providing an exit option like the administrative development of an SEZ scheme with different and incremental export requirements for a limited period of time.

7.3. ACE strategy 3: Building coalitions

Sometimes anti-corruption efforts depend on constructing effective coalitions to assist with the enforcement of rules. However, not all collective action to fight corruption is likely to be effective in developing countries. This cluster of strategies identifies cases where collective action is likely to be effective, either on its own, or in combination with other strategies in line with our analysis of political settlements. In developing countries, the problem is that there is generally a rule *by* law, rather than a rule *of* law. This means that simply detecting violations and putting pressure on the state through the collective action of ordinary citizens is unlikely to assist enforcement on a sustainable basis. Collective action is only likely to have an impact if the organisations applying pressure for enforcement are at least as powerful, or more powerful, than the violating organisations and preferably also have some way of directly imposing costs on violators, for instance by not transacting with them or boycotting them in other ways. These conditions are hard to come by but given how often collective action is invoked in anti-corruption activities, it is useful to assess the likelihood that particular types of collective action may have sustainable effects.

While external enforcement capabilities are generally weak in developing countries, particularly against powerful violators, in some cases there may be equally powerful interests that are hurt by particular types of violations which can be mobilised to assist the enforcement of socially desirable rules. Given the widespread corruption in developing countries, these types of opportunities may often be a useful place to start. A feasible anti-corruption strategy may be to support collective action by relatively powerful groups whose own interests are aligned with the enforcement of particular policies or regulations.

However, the feasibility of this collective action and the organisations that need to be involved have to be carefully analysed and identified.

The organisation of collective action of this type is likely to require policy support, and again combinations of policies may be required, with the possibility of multiple ways of supporting the collective action. If collective action, even by a subset of powerful interests, is unlikely to sustain effective anti-corruption in the sector on its own, other supportive measures may have to be deployed in combination with the ongoing collective action. In some of these cases, the conclusion may be that collective action may be effective if it can be strengthened or targeted to different objectives, or armed with better information about the types and location of the infractions that are happening.

7.3.1. Examples

i) Bangladeshi textile industry fighting corrupt tariff evasion by fabric importers

The growing textile industry in Bangladesh has been supported with tariffs and other incentives to develop as an infant industry. However, tariff protection has had very limited effects despite high official tariff rates because large quantities of imported fabrics manage to evade tariffs or taxes when selling in the local market. There are two main routes through which tariffs are evaded. First, corruption at border posts with India allows imported Indian fabrics to evade duties. Secondly, an even bigger source of evasion is through illegal sales of imported fabrics from bonded warehouses. The garments industry in Bangladesh is allowed to import fabrics tariff-free in bonded warehouses for re-export after processing into garments. However, many garments factory owners deliberately overestimate imported fabric requirements or in some cases engage in more direct fraud to import fabrics without any intention of re-export. The scale of these activities requires the collusion of and payoffs to customs officials and bonded warehouse inspectors from the National Board of Revenue (NBR). The surplus fabric is then dumped in the local market, evading tariffs. The scale of this evasion has seriously hurt the emerging textile industry, which has engaged in sustained collective action to try to reduce the scale of the evasion.

The collective action of the textile industry has largely taken the form of pressure on the NBR to carry out raids on warehouses based on advance information that the textile industry collects, providing the NBR with machinery to check the thickness of yarn at border check posts (because different weights of yarn have different tariff rates) and generally to put pressure on the NBR to carry out their checks on bonded warehouses more rigorously. These collective-action activities carried out through the industry organisation, the Bangladesh Textile Mills Association (BTMA), have had some immediate effects on improving enforcement, but these have not been sustained. The bonded warehouse licence holders engaged in violations together with smugglers at the borders have proved to be more powerful in resisting and in paying off enforcement agencies.

The size of the textile industry in Bangladesh suggests that key players should have been more successful in their collective action than they have been. Is the distribution of power such that collective action in this area is not likely to support an anti-corruption strategy or

has the thrust of the collective action been in the wrong direction? One possibility is that the scale of the evasion is so big that the revenues generated can buy off a lot of enforcement agency efforts. If the scale of evasion is very big, it is worth asking if the tariffs are actually providing any significant effective protection to the textile industry. The NBR statistics on official imports of fabrics (which record imports that actually pay tariffs) show that these imports are very small relative to the size of the domestic market and the availability of imported fabrics. We are working with insider sources in the NBR and with the BTMA to estimate the scale of evasion and the effective rate of protection that is afforded to the textile industry by the nominally high tariffs.

The emerging evidence suggests that a more effective collective-action strategy for the textile industry may be to lobby to reduce tariffs down to a level where it is no longer viable for tariff evaders to pay the necessary bribes, and at the same time, the textile industry could seek infant-industry support in other ways. This is because the effective protection is already very low and is unlikely to be increased based on existing collective-action strategies. There is currently resistance within the BTMA to any strategy of reducing tariffs, but evidence on effective rates of protection, and on other alternatives for infant-industry support, could gradually help to make the BTMA collective action much more effective by targeting an alternative policy goal compared to the very poor results currently being achieved. Finally, any reduction in corruption that would strengthen the effective protection of the infant textile industry would only be welfare-enhancing if the strategy was one of temporary protection that would gradually be withdrawn as the industry became globally competitive and able to sell to domestic consumers at the same price as imported fabrics. This too would need to be factored into the policy discussions with the BTMA on feasible collective action that could reduce corruption but also have a positive impact on developmental outcomes.

ii) Smuggling in Tanzania

Despite its vast natural resources and the fact that a large part of the population is employed in the agricultural sector, in Tanzania staple commodities including rice and sugar remain scarce and their production is largely uncompetitive. Even in the case of rice, where production has increased in recent years, the country is still importing large amounts and price variations remain significant across regions and districts. In the case of sugar, the reported annual gap is around 150,000 metric tonnes, and no industrial sugar is available in the region. This means that several companies using industrial sugar as raw material in the manufacturing of food, beverages and pharmaceuticals – to mention just a few – have to import sugar to produce their products.

The allocation of import licences for commodities like sugar and rice is at the centre of the political economy of least developed countries such as Tanzania. Large segments of the rural population are involved in rice and sugar production and they depend on them as cash crops. These commodities are also part of the consumption basket of all citizens. Thus, and especially during elections, politicians are concerned about guaranteeing their full availability through imports. Powerful organisations and their clientelistic networks exploit domestic scarcity. In some cases, they create scarcity artificially by hoarding commodities, or

lobbying for import licences by creating a perception of scarcity. Given the availability of cheap sugar and rice from abroad, powerful organisations can capture rents by smuggling and other forms of customs-rules violations such as underreporting.

The unproductive rents capture from sugar and rice also generates an intricate web of domestic and regional conflicts among powerful organisations which unfold in complex corruption processes and government litigations around import duty exemptions. For example, for each country including Tanzania in the EAC customs union, sugar is a prominent sensitive item and accusations of smuggling and unfair trade practices in the region have led to several corruption prosecutions. Countries like Kenya with low levels of rice production have also signed bilateral agreements to import cheap rice. Lower-quality rice coming from other countries have then been mixed with Tanzanian rice by some traders and sold at the same price premium as Tanzanian rice across the region.

We set out to investigate the commodity-specific smuggling activities in the region, with a focus on Tanzania and two commodities – i.e. rice and sugar. We first collected eight-digit trade data over the last two decades for Tanzania and all its trading partners to assess the extent of underreporting. Mirror statistics revealed significant multi-million-dollar gaps between the declaration of sugar exports abroad and import declarations in Tanzania. We also found evidence of a certain degree of cyclicity. Underreporting is correlated with the political cycle, with pre-election years registering large gaps of smuggled sugar. The alignment between smuggling and elections suggests that these commodities might be used as policy rents and thus involve very powerful organisations. The evidence for rice is less dramatic, suggesting that smuggling of rice has reduced alongside the increase in domestic production over the last decade.

Building on this evidence, the SOAS ACE research moved towards a comparative rents analysis for each of the two commodities to explain why and how smuggling differed between these two commodities and how anti-corruption strategies might need to leverage different coalitions of interests and groups. We identified seven commodity-specific causes of corruption and different processes. They include the link with financing of political elections; evidence of smuggling of both rice and sugar through the Zanzibar smuggling route; and the political management of food scarcity and trade bans. The fact that each of these processes unfolded in different ways for the two commodities made us realise that this work requires further investigation of commodity-specific coalitions of producers in Tanzania who would have an interest in fighting smuggling.

In the case of sugar, the rents analysis revealed the existence of a potential coalition of the four main sugar producers already cooperating in the sugar board. This coalition of producers managed to lobby the government against traders and alleged smugglers and to secure exclusive import licences for the entire sugar gap in 2017. While this move raised some hope, and received the highest government support, the new import licensing scheme did not result in more domestic production and indeed the producers sold back their exclusive import licence to the traders. The government has since then moved towards considering another potential model, that is, government-controlled import in bulk. While

this scheme might overcome the sugar gap, it is still vulnerable to corruption practices and does not reduce the incentive for smuggling.

The SOAS ACE evidence suggests that while the government was originally moving in the right direction by allocating the import-licencing rent to the sugar producers, it failed in disciplining this rent. While collective action among the producers was important to prevent the rents going back to traders/smugglers, it also prevented the government from rewarding the sugar producers differently according to their willingness to use the rent productively. A feasible strategy for the sugar industry would be to peg the import-licence quota for the producers to their annual increases in production. Over time, the more sugar producers increased their domestic production, the larger would be their import quota. This strategy is feasible because it would leverage the self-interest of the sugar producers who do not want to lose their import-licence rents, but also allow those which are not willing or capable to scale up their sugar production to exit the sector gradually. The recent investment in sugar production by one of the most powerful businessmen in Tanzania incentivised by policy rents suggests this is a viable way forward and would make the collective action among capable sugar producers even stronger.

7.4. ACE strategy 4: Resolving rights

A further cluster of corruption problems can emerge because there are overlapping or contested rights of different parties, and the only resolution available to them is to engage in corruption to resolve disputes. Anti-corruption efforts in these areas will only have any insider support if policy finds ways of identifying, addressing and resolving the underlying conflicts. The problem here is deeper than the absence of a rule of law (which is also the case). That is because a rule of law may have impersonally adjudicated between parties on the basis of their legal rights, but a rule of law arbitration is likely to fail if each party to a dispute has a partial right or if there are errors in the documentation establishing the rights of all parties to a dispute. It is quite common in developing countries for several parties to be in conflict over land, resources or rents that result from (sometimes equally legitimate) overlapping claims over particular assets or interpretations of policies.

This type of conflict can sometimes emerge because policies and regulations are (often deliberately) badly designed and confer conflicting rights and rents to different people or sometimes to the same person. For instance, there may be several interpretations of the duty payable on a particular import. Resolving these conflicts requires bribes, and in the simplest case, where confusion is deliberately created to collect rents, this is just a variant of an artificial restriction-driven corruption. A more significant and less tractable case involves conflicts over rights deriving from documents establishing overlapping rights that may each have some legitimacy. In this case, the underlying problem is not just a market restriction or distortion, but something deeper involving conflicting legitimate claims. For instance, different systems of rights may have existed over land and the conflicts between these rights may not yet have been fully resolved. Moreover, taking advantage of this lack of clarity, opportunistic and extractive individuals or organisations may have manufactured fake documents knowing that it will be difficult to distinguish between genuine conflicts between documents and artificially manufactured ones.

For this type of problem, clarifications or changes in rules or improvements in administrative enforcement capabilities or even collective-action responses are likely to be inadequate for resolving existing disputes and may not suffice to rule out future disputes unless critical anomalies in the underlying rights can be gradually addressed. In the meantime, effective and legitimate conflict-resolution processes have to be devised that can find compromise solutions that offer parties an alternative, cheaper and more predictable mechanism of conflict resolution compared to competitively bribing land administration officials, judges and others.

7.4.1. Example

i) Corruption in establishing and protecting land rights in Bangladesh

Corruption in establishing and protecting property rights over land is a major source of harassment for millions of citizens in Bangladesh, and hundreds of millions across the developing world. According to one estimate, of the roughly 1.8 million cases pending in the courts in December 2000, 1.4 million were land-related cases, and the average time in court for a land-related case was 7.6 years (Barkat and Roy, 2004). These disputes take so long to resolve not because the records cannot be found, but rather because they can be found and there are conflicts between different records and between the records and possession. In other words, the problem is only partly one of shortcomings in record-keeping and is mainly to do with fundamental inconsistencies in the records.

Anti-corruption and governance reforms in this area have focused on the digitisation of land records and transferring the process of mutating land (recording changes in land rights with the land office after sale or transfer) into online ‘e-mutation’ systems. There is undoubtedly some corruption in land administration in Bangladesh that can be attributed to officers exploiting their asymmetric information to extract rents, particularly from less-educated citizens when they come to register or mutate their rights. In principle, e-mutation and other digitisation arrangements could reduce this type of administrative corruption. Unfortunately, these extractions are a small part of the problem in the sector. Moreover, the evidence is that poor and less-educated people face high costs in navigating through the digital systems, which in any case only allow the *submission* of applications online and do nothing to resolve conflicts with the documents of other individuals. A recent study of Jessore district in Bangladesh, which led the trialling of e-mutations, found that the time, cost and number of visits required to complete the e-mutation process actually increased compared to the paper submission process (Reza-E-Rabbi, 2019). This may just be a temporary problem, but the e-mutation process certainly does not deal with the problem of how to resolve inconsistencies in the land records themselves, which may reflect legitimate overlapping claims.

Our research here is identifying through case studies how conflicts in land records, possession and mutation records are actually resolved in different cases. Paradoxically, the confusing formal and informal institutional structure that has allowed multiple points of entry and corruption to contest these rights may well have emerged as a functionally useful safety valve that allows disputes to be gradually resolved through a process of attrition, even though at high cost in terms of corruption and time. Finding a sustainable resolution to this form of corruption requires a better understanding of the sources of the problem, beyond

the asymmetric information disadvantage that the e-mutation system is supposed to resolve. An understanding of the nature of these disputes may allow a public discussion of alternative dispute-resolution mechanisms as these would be the only sustainable alternative to the current 'conflict-resolution system' involving corruption and prolonged contestation and litigation.

7.5. Mitigation strategies when corruption is intractable but has high welfare costs

There are many areas where corruption is considerable and has significant welfare costs. The ACE approach is particularly useful in identifying areas where neither standard anti-corruption strategies nor the self-sustaining strategies that ACE looks for are likely to work. In some cases, the right response is to postpone addressing these problems, and focus instead on corruption problems that can be feasibly addressed. This allows us to build support for more difficult problems at a later date, and is our theory of change. However, in some cases, the corruption in question has significant adverse effects on poor people and parking these problems is not an option. Instead, we need to look for 'mitigation strategies' that can reduce the costs to the poorest of particularly intractable forms of corruption, even though we cannot find a feasible way to address this corruption immediately.

The example of the extractive sector in Nigeria fits this very well. The collusion of many powerful organisations in sharing the rents of the extractive sector, with broad patronage coalitions that spread the benefits across society, makes it very difficult to identify strategies that would leave a sufficient number of powerful interests better off by behaving less corruptly. However, ignoring the massive social and environmental damage that is caused by these activities is also not acceptable. Part of the ACE research is also to identify these intractable but important problems and to suggest mitigation strategies.

7.5.1. Example: the Nigerian extractive sector

Our scoping of the extractives sector in Nigeria suggests that systemic reform at the sectoral level is unlikely to succeed. The capture of rents related to the oil sector is both endemic among the politically powerful in Nigeria and provides rents for redistribution that allow some 'live and let live' coalitions to provide political stability. Oil rents are therefore deeply embedded in the reproduction of the Nigerian political settlement. Local residents involved in illegal artisanal refining also secure incomes higher than in opportunities in other sectors. A Chatham House report from 2013 estimates daily losses of crude at 100,000 barrels and yearly losses between \$3 billion to \$8 billion, largely due to illegal activities (theft) in the sector (Katsouris and Sayne, 2013). The fact that all tiers of this corruption pyramid are making significant rents means there are no obvious quick solutions of the feasible ACE type. Given the powerful interests involved, an alternative configuration of interests that would behave differently in their self-interest is not possible here. Hoping for behaviour to change without a feasible change in these perverse incentives is why sustained anti-corruption efforts have failed to date.

The involvement of the country's powerful political players in corruption in this rent-rich sector has had significant ramifications at the meso and micro level. If oil revenues are being hidden and transferred at the highest levels, lower-level thefts have to be either allowed, or are difficult to clamp down on. In some cases, these lower-level thefts have very high-level support and part of the rents are transferred up the chain. We are particularly concerned with the welfare and environmental impact of some of these activities because of their magnitude and their impact on the poor. These are the effects of oil-sector-related corruption associated with the theft of crude in poor areas of Nigeria that result in significant health and environmental damage. This aspect of corruption does not just damage Nigeria's economic growth but also the social fabric of the Delta region.

Our research of the meso and micro effects of oil-sector corruption (mainly through 'artisanal refining') in the Niger Delta aims to identify mitigating strategies. However, the integration of this theft as part of the national system of rent extraction from the oil sector makes us pessimistic about the chances of directly addressing this corruption. Addressing the larger causes of corruption will need systemic reform and in the medium to short term this looks difficult to achieve. Our research disentangles some of the flows of oil-related rents in the Niger Delta to identify areas where policy can reduce some of the harmful effects of this corruption. For instance, how feasible would it be to use the network of primary healthcare centres to offer inexpensive treatments for pollution-related conditions like skin allergies for artisanal refiners? As one of the important goals of poor people engaged in illegal artisanal refining is to build homes for themselves, could the intensity of artisanal refining be reduced using credit for housing? When very entrenched types of corruption cause great public harm, these are the types of mitigation questions that we need to address. The resources that are wasted in trying to reduce corruption in these types of areas could be better allocated to mitigation activities if the infeasibility of anti-corruption strategies in these areas was better recognised.

8. The research agenda

The SOAS ACE research agenda aims to put forward an alternative route to identifying feasible and effective anti-corruption strategies in developing countries. This is based on the development of our proposition that anti-corruption strategies that work in rule-of-law contexts will not necessarily work in contexts where the rule of law is weak. Transparency and accountability reforms implicitly assume that when rule violations are detected and accountable individuals are identified, there will be effective punishment or penalties if the court system is working reasonably well. This ignores the reality of political settlements in developing countries where the powerful are not subject to rules in the same way as the less powerful.

Indeed, misguided applications of anti-corruption strategies in contexts where they are not suited have not just wasted time and money, they have sometimes had unintended negative effects. In many cases, these initiatives have provided additional tools to the powerful to harass their enemies. There is no dearth of evidence on how anti-corruption commissions in developing countries are used to pick up members of opposition parties or how court rulings are systematically influenced, ignored or later overturned even in developing countries with apparently good institutions. These problems cannot be solved simply by ‘strengthening’ institutions (whatever that means) because institutions work in ways that reflect the underlying distribution of power in society. That is a much more difficult task that takes time.

The distribution of power in a society only changes gradually if policy can incrementally change the facts on the ground. Our anti-corruption approach attempts to do this by identifying welfare-enhancing strategies that involve greater adherence to specific rules by stakeholders who are involved in production or service-delivery decisions. The aim is not just to reduce specific instances of corruption, but also to change the facts on the ground by gradually increasing the number of productive organisations and improving service delivery. This, we believe, is the sustainable path to radical anti-corruption and governance changes in developing countries.

Together, the four clusters of anti-corruption strategies identified in the last section identify a research agenda for further work on policy-relevant anti-corruption. The approach can be used for examining corruption issues affecting both the public and private sectors and for identifying relevant interdependencies between policies that seek to address corruption. The aim in both our private-sector and public-policy research is to engage in a number of projects in different priority areas to generate evidence on the impact and feasibility of different types of anti-corruption strategies. The anti-corruption strategy that is the focus of each project will be located in one or more of the strategy clusters discussed above, and each study will also be focused on a particular priority area in one or more of our study countries, initially Nigeria, Tanzania and Bangladesh. The impact and feasibility evidence will build up an evidence base on the difficulty and desirability of anti-corruption strategies in each cluster, with further differentiation across priority areas and types of sectors and countries. Over the longer term, this evidence will help us to design better anti-corruption strategies not only in the particular sectors and countries being studied, but it will help to deepen our understanding of effective policy design for anti-corruption policies in a wide range of economic and political contexts.

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Disclaimer: This publication is an output of a research programme funded by UK aid from the UK Government. The views presented in this paper are those of the author(s) and do not necessarily represent the views of UK Government's official policies.

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