

**PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE  
PUBLIC GOVERNANCE COMMITTEE**

**STRENGTHENING ANTI-CORRUPTION AND INTEGRITY FOR PRODUCTIVITY,  
INCLUSIVENESS AND DEVELOPMENT**

(Note by the Secretary-General)

Meeting of the Council at Ministerial Level, 1-2 June 2016

**Background Document**

*Item 3: Enhancing Productivity for Inclusive Growth.*

*Breakout Group 3 – Enabling Environment (regulatory policy and competition, finance and corporate issues) for Dynamic and Inclusive Economies.*

JT03396562

Complete document available on OLIS in its original format

*This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.*

### **Corruption: A global threat to achieving inclusive growth**

1. Corruption remains one of the most pressing challenges of our time. Systemic corruption distorts incentives, undermines confidence in institutions and fair competition in markets, erodes public services, and undercuts democracy and social trust. In both developed and developing countries, corruption not only deprives people of the resources needed for effective services, it is also bad for business and undermines productivity, sustainable growth, and social inclusion (OECD 2015a; Aidt, 2009).

2. Therefore, corruption, understood as the abuse of entrusted power for private gain, creates major impediments to inclusive growth; it leads to unequal opportunities to participate in social, economic and political life, as well as unequal distribution of income, wealth and social well-being. Corruption fuels inequality as corrupt actors can use corruption to maintain their power and interests (You & Khagram, 2005), and because access to markets and public services are restrained and disadvantages perpetuated (Gupta et al, 2002). Corruption thus aggravates and perpetuates existing inequalities at all levels of government).

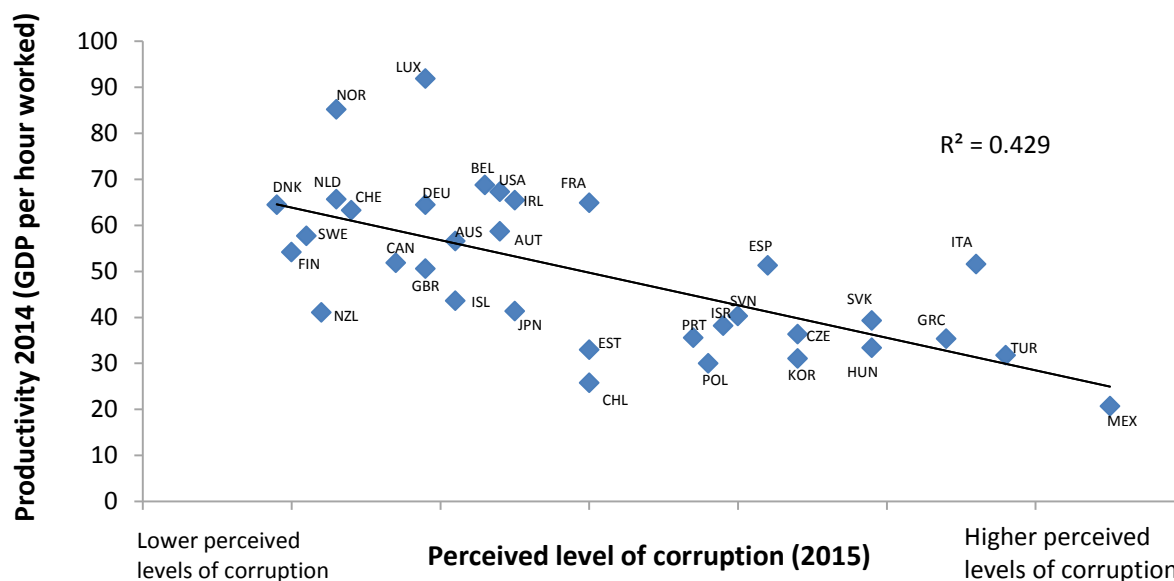
### **Corruption undermines productivity in both the public and the private sector<sup>1</sup>**

3. Integrity is crucial to productivity growth and inclusiveness. Laws, regulations, and public policies, as well as internal policies and procedures, are the rules of the game that constitute the formal governance framework of a country or an organisation. This framework determines whether resources are invested into productivity-enhancing activities or into unproductive activities – albeit lucrative for a few – such as rent-seeking or straightforward corruption to the detriment of the public interest, and sustainable and inclusive growth. By providing the right positive and negative incentives, the formal governance framework supports an environment where inclusive growth and sustainable development can be achieved (Acemoglu and Robinson, 2012; Rodrik et al., 2004).

4. In contrast, weak governance frameworks undermine productivity gains by creating transaction costs, opportunities for corruption, and incentives for unproductive rent-seeking activities. The importance of quality of governance in explaining the differences in productivity across countries is well documented (Hall and Jones, 1999; Olson et al., 2000; Islam, 2008). Figure 1 plots the inverted Corruption Perception Index 2015 from Transparency International against productivity, as measured by GDP per hour worked, for the 34 OECD countries. Without making any inference with respect to causality, the figure nevertheless helps to demonstrate that higher levels of perceived corruption are indeed observed together with lower levels of productivity, a relationship confirmed by a number of econometric studies controlling for other variables (Lambsdorff, 2003; OECD, 2016c; Olken and Pande, 2012).

---

<sup>1</sup> The statistical data for Israel in this section are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

**Figure 1. Perceived corruption and productivity in OECD countries**

Source: Data from Transparency International 2015 and OECD 2014a.

5. While the graph suggests that levels of perceived corruption and productivity could be related, from a policy perspective it is necessary to understand the causal mechanisms through which corruption might affect productivity. Fundamentally, the negative effects of corruption on productivity are likely to operate through incentives that bias decisions in both the public and the private sector. These biased decisions, in turn, can imply an inefficient use of resources and thus lower productivity.

#### ***Effects of corruption on public sector productivity***

6. In the public sector the effects of corruption on productivity are straightforward:

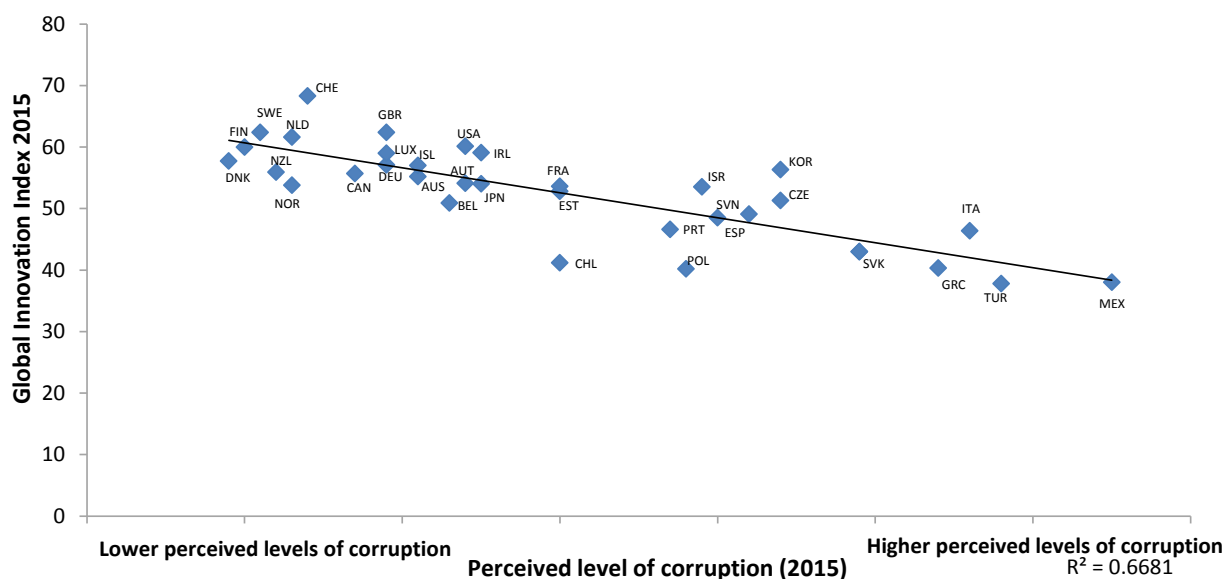
- *Corruption leads to biased decisions in public expenditures that could undermine public sector productivity and effectiveness* (e.g. “white elephant” infrastructure projects, public procurement contracts based on kickbacks and relationships rather than on value-for-money). Corruption also damages the quality of and access to essential public services such as education and health, which are key to both productivity and inclusiveness.
- *Corruption affects the productivity of the civil service* (e.g. hiring based on nepotism or favouritism rather than on merit and ability, preventing governments from attracting best talent). Corrupt public officials may also have incentives to create artificial bottle-necks and red tape to enable rent extraction (Lambsdorff, 2002).
- *Corruption negatively impacts the generation and collection of public revenues*, thereby hindering effective delivery of public services (Tanzi and Davoodi, 2000; Purhohit, 2007; Fjeldstad and Tungodden, 2003).

### *Effects of corruption on private sector productivity*

7. The effects of corruption on private sector productivity are linked to perverse incentives created by the availability of corruption as an option to make profit. Where the respect for rules is low, distrust and uncertainty are also likely to spread. Under such circumstances, private companies may prefer to invest more into unproductive rent-seeking activities in order to be part of the exclusive market of insiders (or to help “grease the wheels” of an inefficient public administration), rather than into developing innovations or entrepreneurial skills (Faccio, 2006, Fisman, 2016, Stigler, 1971; Krueger, 1974; Bhagwati, 1982; Murphy et al., 1993). Input misallocation is one of the determinants of poor productivity growth, and various empirical studies show that corruption distorts the allocation of scarce resources away from their most productive use, such as R&D (OECD, 2016c).

8. Well-connected incumbent companies may use their influence to create entry barriers to market newcomers, (‘capture’, which may or may not involve the payment of bribes), who often lack the same connections to established elites and to the public administration (OECD, forthcoming; García-Santanas et al., 2015; Gamberoni et al., 2016). Restrictions to market access and other barriers to competition reinforce the market power of incumbents and can cause a weakening of productivity growth and worsen inequalities. Corruption can also affect transactions between private sector entities, distorting company decisions including investment. Figure 2 below plots the Global Innovation Index against the inverted Corruption Perception Index for OECD countries only. Again, a clear correlation can be observed. Innovation, brain drain and low investment in R&D, and therefore technological change, are all associated with corruption (Mungiu-Pippidi, 2015; Salinas and Salinas, 2007).

**Figure 2. Higher perceived corruption levels occur along lower levels of innovation in OECD countries**



Source: Transparency International 2015 and Cornell INSEAD WIPO 2015.

9. Finally, corruption also affects productivity by distorting and deterring trade. Implementing appropriate governance structures, accountability mechanisms and integrity policies in customs administrations alone has the potential to reduce trade costs by between 0.5% and 1.1% for the same country groups. These measures seek to eliminate opportunities for customs policy capture, extortion,

offering bribes, as well as for numerous schemes allowing for the avoidance of taxes and tariffs, such as underreporting of exports and over-invoicing of imports. (OECD, 2016d)

### **The OECD's role in fighting corruption and promoting integrity**

10. Major scandals about wider integrity violations – such as most recently the “Panama Papers” – still erupt, corroding trust in government and in business. Such scandals highlight how opaque corporate structures can be hiding their true beneficial owners, facilitating not only tax evasion, but a wide range of crimes: such as corruption, fraud, embezzlement of state-owned assets, and money laundering.

11. Efforts to ensure the integrity of systems, and in particular, to lift the veil of corporate secrecy that allow some to operate below the radar need to be strengthened. Policies aimed at promoting public sector integrity are also about making economies more productive, public sectors more efficient, societies and economies more inclusive. It is about restoring trust, not just trust in government, but trust in public institutions, regulators, banks, and corporations. The OECD is playing a key role in addressing the challenges of preventing, detecting and prosecuting complex economic and financial crimes. It has developed expertise on all aspects of anti-corruption and integrity in both the public and private sectors.

12. Indeed, for over two decades, the OECD community has been a front-runner in the fight against corruption with a large array of standards, from the legally binding OECD Anti-Bribery Convention to other instruments on public integrity, public procurement, transparency and good governance, as well as on related issues such as tax evasion and bid-rigging. The OECD has developed policy options and tools to make the institutional framework conducive to enhancing productivity and inclusive growth by promoting integrity and reducing opportunities for corruption. A number of OECD policy committees (e.g. Public Governance Committee, Working Group on Bribery, Development Assistance Committee, Regulatory Policy Committee, Competition Committee, and Committee on Fiscal Affairs) provide platforms for inter-governmental co-operation on these matters. More recently, the OECD Integrity Forum has become one of the leading global platforms connecting government policies with private sector and civil society efforts and shaping the international agenda on integrity and anti-corruption.

13. In the area of transnational bribery, the rigorous peer monitoring of the OECD Working Group on Bribery in International Business Transactions (WGB), made up of representative from Parties to the Anti-bribery Convention, is a fundamental driver behind the implementation and development of the Anti-Bribery Convention obligations (Figure 3). With improvements made in response to WGB recommendations and peer pressure, foreign bribery is now a crime in 41 Parties to the Convention, and none of the 41 Parties now permits its taxpayers to deduct bribe payments from their taxable income, after 29 Parties reformed their laws as a result of WGB peer pressure. Likewise, 38 Parties to the Anti-Bribery Convention have established or improved corporate liability systems that allow companies (and not just individuals) to be held accountable for foreign bribery and other unlawful activity. Corporate liability is a major addition to the legal infrastructure needed to promote responsible business conduct. These changes have significantly enhanced disincentives for foreign bribery.

**Figure 3. Fighting Foreign Bribery: the Anti-Bribery Convention and the Working Group on Bribery**

The actors	The process	The results
<p>The 41 Parties to the OECD Anti-Bribery Convention:</p> <p>34 OECD Members and</p> <p>7 non-Members (including Argentina, Brazil, and South Africa).</p>	<p>Over 17 years of promoting better design and enforcement of anti-bribery laws addressing high-stakes corruption.</p>	<p>Foreign bribery is now a crime in all 41 Parties to the OECD Anti-Bribery Convention.</p> <p>Before the Convention, only 1 country had both a clear law prohibiting foreign bribery and a record of enforcement.</p>
<p>The Parties to the Convention are the source of</p> <p>64 % of outward FDI and</p> <p>50% of world exports.</p>	<p>Four phases of WGB review, each with a different focus:</p> <p><u>Phase 1</u> anti-bribery laws;</p> <p><u>Phase 2</u> application of those laws;</p> <p><u>Phase 3</u> enforcement; and</p> <p><u>Phase 4</u> outstanding recommendations and cross-cutting issues.</p>	<p>Corporate liability, or the ability to hold companies responsible for unlawful acts, was either absent, or not developed, in national legal systems.</p> <p>38 Parties have strengthened or created their corporate liability laws.</p>
<p>The Parties to the Convention are home to</p> <p>95 of the 100 largest non-financial global firms and</p> <p>all of the top 50 global financial enterprises.</p>	<p>Over 200 monitoring reports have been issued, along with nearly 1500 recommendations to improve the fight against foreign bribery</p> <p>Most of these recommendations have been fully or partially implemented.</p>	<p>No Party to the Convention now permits the tax deductibility of bribes and 29 Parties eliminated tax deductibility of bribes following the entry into force of the Convention.</p> <p>Similarly, the WGB has helped improve whistleblower protections.</p> <p>18 Parties have introduced or strengthened such protections in response, at least in part, to WGB peer monitoring.</p>

14. In a Declaration issued on the occasion of the recent OECD Anti-Bribery Ministerial meeting held on 16 March, Ministers emphasised the solid achievements of the Convention and the Working Group on Bribery, but also recognised that much more remains to be done, including strengthening enforcement and international cooperation in foreign bribery cases, and broadening membership to include all major exporters and foreign investors.

15. At the OECD, progress on tackling transnational bribery has been matched by extensive work on wider integrity systems – e.g. on values, effective competition, and dealing with bid-rigging, risk management and control, business integrity and measures to secure greater value for money in public spending – at the country level. In order to enhance integrity in domestic governance systems, the relevant committees have developed recommendations and frameworks in such key areas as managing conflicts of interest (OECD, 2003; 2005), the transparency of lobbying (OECD, 2009; 2010; 2012; 2014a), the regulation of political finance (OECD 2016a), public infrastructure (OECD, 2016b), and policy capture (OECD, forthcoming).

16. The OECD's work on anti-corruption is also tightly linked to its initiative to establish robust international standards on tax transparency, through the Global Forum on Transparency and on Exchanges of Information on Tax Purposes. 133 jurisdictions have committed to the standard on exchange of information 'on request.' Of those, 101 jurisdictions will introduce automatic exchange of financial

account information over the 2017-18 period.<sup>2</sup> Addressing transparency of beneficial ownership information is essential to fight both tax evasion and corruption but also other economic and financial crimes.

17. Corporate governance is another policy area where the work of the OECD promotes business integrity. It is to a large extent the duty and in the interest of business itself to ensure that the right actions to prevent corruption are taken at the corporate level, using incentives and monitoring to build a culture of doing business with integrity. The main building blocks of such a framework are laid down in the recently updated G20/OECD Principles of Corporate Governance (OECD, 2015b).<sup>3</sup> For business leaders who are entrusted with the future of their firms and the welfare of their stakeholders, these issues are increasingly becoming a priority.<sup>4</sup>

### **Towards fairer and more transparent societies**

18. The growing inter-connectedness of the world economies and the increased sophistication of financial and business processes imply that there is an urgent need to step up the efforts, continue promoting international cooperation, better identify emerging issues, sharpen the tools to improve the impact of current standards and undertake a more comprehensive and risk-based strategy to address the reasons that allow corruption to flourish more systematically in some areas (e.g. extractives, customs, health, sports, state-owned enterprises).

19. This will imply better integrating anti-corruption and integrity in governments' reform agendas and private sector's business models, and making bridges with issues such as tax evasion, bid rigging, corporate governance and responsible business conduct. It also implies focusing on developing the know-how for the effective implementation of the existing standards and guidance, including OECD legal instruments, the UN Convention against Corruption and others. For the details of implementation of these standards there seem to be no easy one-size-fits-all solutions, however, and an approach based on corruption risks assessments seems to be more appropriate.

20. The new OECD strategy for public integrity embraces these aspects and provides a guide for a comprehensive and coherent Integrity System (Figure 4). It is structured around three pillars:

1. **Building a coherent and comprehensive integrity system** by taking political and management responsibilities for a strategic integrity system for all public officials, based on core values and ethical standards.
2. **Fostering a culture of integrity** through a whole-of-society approach, and through investing in integrity leadership, a merit based public sector, and open organisational culture responsive to integrity concerns.

---

<sup>2</sup> <http://www.oecd.org/tax/automatic-exchange/commitment-and-monitoring-process/AEOI-commitments.pdf>

<sup>3</sup> The Recommendation of the Council on Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015c) also establish that the boards of State-owned enterprises should develop, implement, monitor and communicate internal controls, ethics and compliance programmes, including those which contribute to preventing fraud and corruption.

<sup>4</sup> The 2015 OECD report Corporate Governance and Business Integrity: A Stocktaking of Corporate Practices (OECD, 2015d) took stock of corporate practices tying business integrity considerations into corporate governance frameworks, strategy and operations. It also assessed what factors influence business decisions to implement business integrity measures in the private sector.

3. **Enabling effective accountability** through internal and external control, adequate incentives, and regulatory oversight to ensure compliance of the public sector, private sector and citizens with standards of integrity, and through transparency and active participation by civil society.

**Figure 4. OECD's strategy for in integrity system**

Building a coherent and comprehensive system	Fostering culture of integrity	Enabling effective accountability
1. Commitment at highest political and management levels 2. Clarify institutional responsibilities to strengthen the integrity system 3. Develop a strategic approach to mitigate integrity risks 4. Set high standards of conduct for public officials	5. Promote a whole-of-society culture of integrity 6. Invest in integrity leadership 7. Promote a merit-based professional public service 8. Provide training, information, guidance and timely advice 9. Support open organisational culture	10. Apply a control and risk-analysis based management framework 11. Respond to all violations of integrity standards 12. Promote accountability and integrity through external oversight and control 13. Safeguard integrity at all stages of the policy cycle

Source: Draft Recommendation on Public Integrity (2016).

### Next steps

21. Fighting corruption and promoting integrity at the national and international levels and throughout the policy cycle enhances both public *and* private productivity and supports inclusive growth. However, there are important challenges to translating existing frameworks into real change in order to achieve a culture of integrity and avoid impunity. Specifically, measures need to be based on risk assessments and adapted to the context and to specific sectoral and geographical conditions. Adequate institutional arrangements have to be in place to ensure that laws, regulations and policies are effectively implemented and mainstreamed throughout the government. Information about corruption offences needs to reach the relevant law enforcement authorities, and the special challenges arising from multi-jurisdictional crimes need to be addressed through improved co-ordination among law enforcement communities. Also, to enable collective action by those that are affected by corruption, the message needs to be reinforced that corruption corrodes economic and social well-being and needs to be addressed by the public sector, business, civil society and citizens alike.

22. With increasing demand by citizens for more integrity, major corruption scandals regularly emerging, and progress made on the tax transparency agenda, the fight against corruption has gained prominence. At the Anti-Corruption Summit in London organised by the Government of the United Kingdom on 12 May 2016, Leaders and participants committed to achieving Sustainable Development Goal 16, i.e. 'substantially reduce corruption and all their forms'. In their Declaration, they prioritised areas of actions around the following themes: 1. Corruption should be exposed—ensuring there is nowhere to hide; 2. The corrupt should be pursued and punished and those who have suffered from corruption fully supported; 3. Corruption should be driven out—wherever it may exist.

23. The OECD has a wide array of tools that can be used to help countries in their efforts, and these tools should continue to be continuously upgraded and further co-ordinated.



Potential areas of further work may also include action to:

- Move away from a reactive approach to integrity and anti-corruption, where reforms are implemented in response to scandals, and promote a proactive, comprehensive and strategic approach to anti-corruption policies and practices, covering prevention, detection and sanctioning. Ensuring resilient and transparent integrity and anti-corruption systems that reduce corruption risks is above all an issue of good management, leadership and co-ordination.
- Reinforce efforts to counter corruption in procurement, particularly in key sectors (e.g. major infrastructure projects, extractive industries, health, education, or defense).
- Improve management of corruption risks in official development assistance via improved guidance and monitoring to ensure its effectiveness and compliance by all the parties involved, and build sustainable institutional capacities in developing economies.
- Develop some specific work in highly sensitive areas like State Owned Enterprises (SOE) or sports.
- As appropriate and in consultation with Members, engage further with non OECD Members and encourage them to adhere to OECD standards.
- Promote the effective implementation and dissemination of the OECD standards.
- Address the linkages between corruption and other global threats such as terrorism and illicit trade.

## REFERENCES

- Acemoglu, D. and Robinson, J.A. (2012), *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*, Crown Business.
- Aidt, T. (2009), Corruption, institutions, and economic development, *Oxford Review of Economic Policy* 25(2), pp.271–291.
- Bhagwati, J.N. (1982), Directly Unproductive, Profit-Seeking (DUP) Activities, *The Journal of Political Economy* 90(5), pp. 988-1002.
- Faccio, M. (2006), Politically connected firms, *American Economic Review* 96, pp. 369-86.
- Fisman R. (2001), Estimating the value of political connections. *American Economic Review* 91, pp. 1095-102.
- Fjeldstad, O.-H. y Tungodden, B. (2003), Fiscal Corruption: A Vice or a Virtue, *World Development* 31(8), pp. 1459-1467.
- Gamberoni, E., Gartner, C., Giordano, C. & Lopez-Garcia, P. (2016), Is corruption efficiency-enhancing? A case study of nine Central-Eastern European countries, Unpublished manuscript.
- García-Santana, M., Moral-Benito, E. & Pijoan-Mas, J. (2015), Growing like Spain: 1995-2007, Working Paper.
- Gupta, S., Davoodi, H. & Alonso-Terme, R. (1999), Does corruption affect income inequality and poverty? *Economics of Governance* 3, pp. 23-45.
- Hall, R.E. and Jones, C.I. (1999), Why Do Some Countries Produce So Much More Output per Worker than Others? *Quarterly Journal of Economics* 114(1), pp. 83-116.
- Islam, N. (2008), Determinants of Productivity across Countries: An Exploratory Analysis, *Journal of Developing Areas* 42(1), pp. 201-242.
- Krueger, A. (1974), The Political Economy of the Rent-seeking Society, *American Economic Review* 64, pp. 291-303.
- Lambsdorff, J. (2002), Corruption and rent-seeking, *Public Choice* 113, pp. 97-125.
- Lambsdorff, J. (2003), How corruption affects productivity, *Kyklos* 56, pp. 457-474.
- Mungio-Pippidi, A. (2015), Good governance powers innovation, *Nature* 518, pp. 295-297.
- Murphy, K., Shleifer, A. & Vishny, R. (1993), Why is Rent-seeking so Costly to Growth?, *American Economic Review* 83(2), pp. 409-414.
- Olson, M., Sarna, N., and Swamy, A. V. (2000), Governance and growth: A simple hypothesis explaining cross-country differences in productivity growth, *Public Choice*, 102(3/4), pp. 341–364.

- Olken, B.A. and Pande, R. (2012), Corruption in Developing Countries, Annual Review of Economics 4, pp. 479-509.
- OECD (forthcoming), Safeguarding Inclusive Public Decision-Making by Curbing the Risks of Capture.
- OECD (2016a), Financing Democracy: Funding of Political Parties and Election Campaigns and the Risk of Policy Capture, OECD Public Governance Reviews, OECD Publishing, Paris. DOI: <http://dx.doi.org/10.1787/9789264249455-en>.
- OECD (2016b), Integrity Framework for Public Investment, OECD Public Governance Reviews, OECD Publishing, Paris.
- OECD (2016c), Strengthening Public integrity Systems for productivity and development Across the Economy, Technical background paper.
- OECD (2016d), Fighting the Hidden Tariff: Global Trade without Corruption, Background document to the 2016 Integrity Forum: <http://www.oecd.org/cleangovbiz/2016-Integrity-Forum-Background-Report.pdf>.
- OECD (2015a), Consequences of Corruption at the Sector Level and Implications for Economic Growth and Development, OECD Publishing, Paris.
- OECD (2015b), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris.
- OECD. (2015c), OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition, OECD Publishing, Paris.
- OECD (2015d), Corporate Governance and Business Integrity: A Stocktaking of Corporate Practices, OECD Publishing, Paris. <http://www.oecd.org/daf/ca/Corporate-Governance-Business-Integrity-2015.pdf>.
- OECD (2014a), Lobbyists, Governments and Public Trust, Volume 3: Implementing the OECD Principles for Transparency and Integrity in Lobbying, OECD Publishing, Paris.
- OECD (2014b), Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials, OECD Publishing, Paris.
- OECD (2012), Lobbyists, Governments and Public Trust, Volume 2: Promoting Integrity through Self-regulation, OECD Publishing, Paris.
- OECD (2009), Lobbyists, Governments and Public Trust, Volume 1: Increasing Transparency through Legislation, OECD Publishing, Paris.
- OECD (2005), Managing Conflict of Interest in the Public Sector: A Toolkit, OECD, Paris.
- OECD (2003), Managing Conflict of Interest in the Public Service: OECD Guidelines and Country Experiences, OECD, Paris.
- Purohit, M. (2007), Corruption in Tax Administration, In Shah, A. (Ed.), Public Sector Governance and Accountability series. Performance Accountability and Combating Corruption. World Bank. Washington, D.C., pp. 285-302.

- Rodrik, D., A. Subramanian and F. Trebbi (2004), Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development, *Journal of Economic Growth* 9(2)), pp 131-165.
- Salinas, M. and Salinas, J. (2007), Corruption, efficiency and productivity in OECD countries, *Journal of Policy Modeling* 29(6), pp. 903-915.
- Stigler, G.J. (1971), The Theory of Economic Regulation, *The Bell Journal of Economics and Management Science* 2(1), pp. 3-21.
- Tanzi, V. and Davoodi, H. (2000), Corruption, Growth, and Public Finances. IMF Working Paper 182, International Monetary Fund, Washington, DC.
- You, J.S. and Khagram, S. (2005), A Comparative Study of Inequality and Corruption. *American Sociological Review* 70(1), pp. 136-15.