Corruption and Governance in Early Capitalism: World Bank Strategies and their Limitations

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One of the most dramatic changes in the World Bank's approach to development over the last ten years has been its new commitment to governance improvements and in particular to fighting corruption in some of the poorest countries in the world. Driven by evidence that corruption reduces growth and investment in developing countries, the Executive Board of the Bank approved its anti-corruption strategy in September 1997, defining corruption as the "use of public office for private gain". According to the strategy, the Bank was to address corruption along four dimensions: preventing fraud and corruption in Bank projects, helping countries which request Bank assistance for fighting corruption, mainstreaming the concern with corruption in all of the Bank's work and lending active support to international efforts in fighting corruption. These concerns were reflected in the *World Development Report* of 1997 and have been central to the subsequent concern of the Bank with governance and institutional reform. More recently, the Bank has argued that "there is nothing more important" than the fight against corruption (World Bank 2000). The immediate effects of these policy announcements have been a much greater degree of concern with accountability within the Bank. At the same time, there has been a closer examination of the corruption and governance implications of Bank policies. Some older policies now have their anti-corruption content more openly expressed, in other areas there are new emphases. Thus Bank support for programmes involving liberalization, reforms of the civil service, "rightsizing the state" and privatization were given renewed impetus with an emphasis on the anti-corruption and governance improvement aspects of these reforms. In addition, there was a shift towards new areas for the Bank such as support for decentralization, devolution and democratization, and for greater civil society participation in monitoring developing country states.

While the renewed implicit recognition of the importance of the state in economic development is very welcome, the Bank's approach to corruption and governance failures is fundamentally deficient in a number of ways. First, it is still based on a perception of economic development where success is driven by efficient markets supported by non-interventionist states. This theoretical perception is not based on the historical evidence of late-developers, particularly in Asia, and as a result, the prescriptions it offers regarding the desired features of a state which can best carry out developmental functions is not necessarily appropriate for most developing countries.

Secondly, and closely related to the first problem, the empirical data showing a strong relationship between corruption and poor development is flawed. While it is undoubtedly the case that corruption imposes large costs on investors and on society, and high levels of corruption undoubtedly undermine the social fabric if it goes on for too long, there is no evidence that successful developers *first* fought and won the battle against corruption and then developed. Rather, the evidence strongly suggests that in all the successful developers, from South Korea in the sixties to China today, corruption was rife during the period of early capitalist development. Why is there no example of a developing country which was corruption-free at an early stage of development? The answer that poverty breeds corruption is wrong because poor people are often scrupulously honest. Rather, the process of capitalist development itself generates powerful incentives and motives for corruption. Without excusing corruption, international agencies have to face up to the fact that the construction of capitalism, while it may be necessary for the long-term prosperity of poor countries, is itself an ugly and confictual process. Attempts to attain a corruption-free, representative and accountable system of governance at this stage may not only not be achievable, but may divert attention from what actually needs to be done to improve the quality of state intervention to accelerate the transition and make it more socially acceptable.

The historical evidence tells us that the early stages of capitalist development are periods of great social disruption and serious and sustained political instability in most countries. There is also very often a great deal of justified resentment and conflict as a new capitalist class emerges and begins to enjoy a life of conspicuous consumption and political influence. It is also a period when new areas of production and expertise are being developed and markets and institutions often need to be reconstructed to serve new needs and require careful regulation and support. This combination of social discontent which creates strong incentives for clientelism and political corruption, and necessarily intrusive state regulation creates an environment where it is almost impossible to fight all corruption at the same time. Indeed to set the fight against corruption as a goal may exacerbate the sense of social injustice and instability since it is virtually impossible to achieve sustained reductions of corruption without overcoming the transition itself. The appropriate response must be to make sure that growth-reducing and anti-developmental types of corruption are attacked if the effort of governance reform is not to be dissipated in a series of futile gestures. The types of programmes which the Bank still recommends, now in support of anti-corruption, such as liberalization, downsizing the state, decentralization and even democratization may not be relevant for addressing the problems of state failure or even for fighting corruption in most developing countries facing this transition (though democratization in particular may be desirable for other reasons).

While all developing countries seem to have had a high degree of corruption, this does not mean that an analysis of corruption is unimportant. On the contrary, by examining the types of corruption in dynamic and not so dynamic developing countries, we can learn important lessons about which types of governance reforms are actually required to accelerate growth and attain relative prosperity. In successful developers, corruption could co-exist with growth because it was part of a system of “primitive accumulation” through which a new class of capitalists emerged with strong state assistance and often in collusion with state leaders. State functionaries shared in some of the new wealth but were also able to discipline capitalists to ensure that inefficiency did not sustain itself, infrastructure was not too badly constructed, and that domestic resources did not fly to foreign banks. In the less dynamic countries, while bureaucrats and politicians also captured wealth, paradoxically they often captured a lot less in absolute terms because they failed to discipline capitalists, failed to maintain social order, failed to construct good infrastructure, failed to control capital flight, and in the end, failed to generate growth. The subsequent sustainability of dynamic states has depended on how successful they were in institutionalizing the new power and wealth which capitalist development created while opening up (often very gradually) to greater popular participation in decision-making. Thus a historical examination of the data on corruption provides a very different set of prescriptions for states suffering from growth-reducing types of corruption and sustained state failure. It also suggests that none of the anti-corruption policies of the Bank necessarily helps poorly performing countries to acquire the state capacities or political settlements which allowed dynamic countries to grow rapidly. Indeed, some of the new policies may actually make the transition period more difficult. The challenge for international agencies such as the Bank is to question the ideological self-image of capitalism which has been driving policy in ways which have made the construction of capitalism more difficult.

The rest of this chapter is organized in the following sections. In the first section we look at the nature of the empirical evidence on which the Bank and other international organizations have based their anti-corruption strategies. Though this evidence is often presented to support mainstream approaches such as that of the Bank, a closer look at the evidence shows that it is incompatible with the mainstream analysis of market-driven development. Rather it is consistent with a very different story about the nature of capitalist development and the role of the state. In the next two sections we examine the main components of the Bank's anti-corruption strategy. In the second section we look at the strategy of reforming and downsizing the state. In the third section we look at the Bank's foray into apparently political areas such as reforms promoting decentralization, devolution and civil society participation. Finally, in the fourth section we argue that while the Bank appears to have been willing to take on board "political" reform as part of its governance improvement strategy, the mainstream approach on which it is based ignores critical aspects of the role of the state during the capitalist transition. Taking on board the historical evidence provides a very different set of strategies involving the strengthening of state capacity in developing countries to promote accumulation, discipline the market and maintain social order. Such a strategy would hit hard at types of corruption which are based on unproductive groups capturing resources by using their political and social power. It would not necessarily remove or even seek to remove all types of corruption and it would certainly not raise unviable expectations that this can be achieved if only the political will were there. A reduction of corruption across the board is unlikely without sustained economic development combined with the political and organizational reforms appropriate for more advanced economies.

1. The Anomalous Evidence on Corruption

It is not surprising that the relationship between governance failures and corruption on the one hand and development on the other is complex and varies substantially across countries. This is because state policies, the organization and structure of societies, the level of economic development and the types of technologies which are being used differ greatly between countries. Nevertheless, the dominant econometric relationships which have inspired much of the mainstream international interest in corruption-reduction have been staggering in the simplicity of the relationship they have identified. Typically, they have sought to show a relationship between an index of corruption and a measure of developmental success such as the rate of growth or the share of investment in the economy. There are serious measurement problems in trying to capture the extent of corruption in a country in one number. To make matters worse, corruption cannot be objectively measured and so the figures we have are actually subjective rankings of countries based on the perceptions of different groups of observers. Subjective indices are clearly not very satisfactory and in addition they suffer from the serious problem that observers may perceive corruption to be more serious in poorly performing countries than in more dynamic countries even if objectively they have the same degree of corruption. This may then give rise to the misleading conclusion that higher corruption was associated with poorer economic performance. There is no need to discount these exercises completely but we have to be aware of the limitations of the data.

The strongest empirical relationship which is observed is between corruption and per capita GDP. This relationship is unfortunately not very interesting because it tells us nothing about causality. It could be underdevelopment which was responsible for corruption rather than the other way around. A much more interesting relationship is between corruption and the rate of growth of GDP. If a relationship existed here, it would be much more compelling evidence that corruption had an effect on development. The econometric relationship here is much weaker but Mauro (1995) provided the first regressions which showed a significant relationship between these variables. However the negative effect of corruption on growth was initially found to be weak and disappeared when the investment rate was included as a variable explaining growth rates. In later work it was shown that some negative effect remained even when investment was included as an explanatory variable in the regressions (Mauro 1996). This result, and others which followed from it, provided the precise empirical basis for international agencies such as the IMF (where Mauro was based) and the World Bank to make corruption a direct policy target.

Apart from the size and significance of the effect of corruption on growth, a closer look at the data shows a much more important problem with the interpretation of the regression result. A graphical plot of corruption against growth shows that the asserted negative relationship is arguably based on an inappropriate exercise which combines countries at different levels of development. Countries have different levels of corruption depending on their level of development (remember that the strongest relationship of corruption is with the per capita GDP of a country). Thus most advanced capitalist countries have much lower levels of corruption than most developing countries. Most advanced countries also have reasonably well working economies and manage to chug along at a steady pace over the years.

In contrast, most developing countries (and particularly the poorest ones) have been in an economic mess over the last two decades or more, often with low or negative rates of growth. Their underdevelopment is associated with some of the highest corruption indices. However, a few developing countries have done extremely well, and have managed to far exceed the rates of growth achieved in the advanced countries. Of course, we expect developing countries to do this if they are ever to have a chance of catching up with the absolute living standards of the advanced countries. The problem is that these high growth developing countries did not have significantly lower levels of corruption than other developing countries (allowing for the fact that they were rapidly becoming richer) during their catching up period. Figure 1 presents these observations in a simplified diagram.

The downward slope of the fitted regression line could be explained by the fact that relatively few countries were located in box 3, the group of underdeveloped countries which were growing rapidly enough to begin converging with the advanced countries. Regressions are based on numbers of observations, and so the experience of the high-performance countries are swamped out as outliers even though they were often very populous countries and even though their experience is of great significance for understanding the process of development.

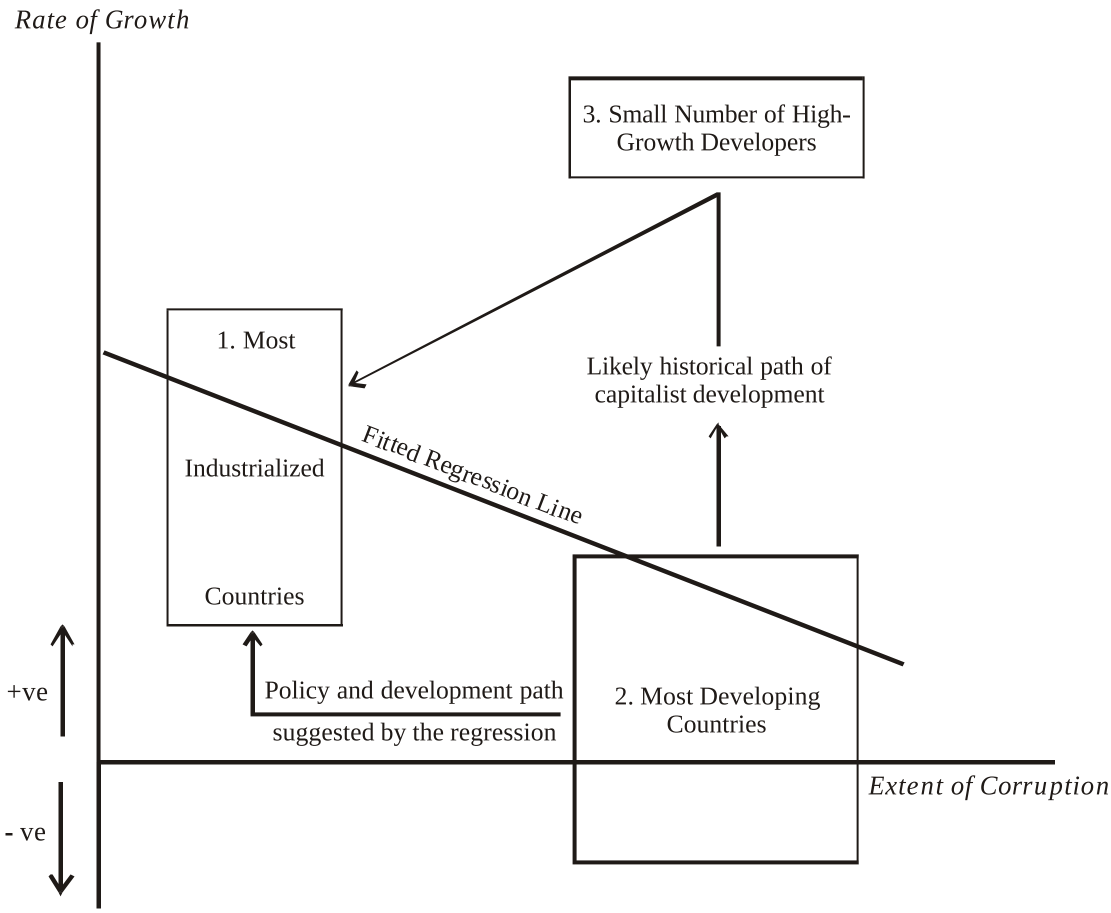

Figure 1 The Relationship Between Corruption and Growth

The policy conclusions which the Bank and the IMF derives from these regressions is summarized in the arrow going leftwards and upwards from box 2 to box 1. Simply by looking at the negative slope of the line, it is concluded that in order to move towards the performance of the advanced countries, poorly performing countries must *first* reduce corruption, even though there is no historical observation of this ever happening. In contrast, a historical examination of the data suggests a quite different trajectory shown by the arrow going from box 2 to box 3 and only subsequently to box 1. This trajectory suggests that a prior reduction of corruption is a misrepresentation of the conditions which led to developmental success, even though the successful countries must have gone through significant governance reforms which allowed them to take off. Our reading of the evidence does not reduce the importance of governance reforms, interpreted as reforms of the state, but forces us to treat with caution many of the policy conclusions which have uncritically become very widespread. Nor does such a reading of the evidence suggest that corruption is not a problem which we should be worried about. Rather it suggests that the real difference between developing countries which begin to converge with advanced countries and those which remain behind has more to do with political and institutional reforms which changed the *types* of corruption they suffered from and not just, or even primarily, the *extent* of corruption (Khan 1996a, b). The importance of distinguishing between types of corruption, and more generally, types of rent-seeking is developed further in Khan and Jomo (2000).

In the subsequent sections we will focus on how the World Bank has led other multilaterals in developing an anti-corruption strategy in developing countries based on the dominant interpretation of the relationship between corruption and growth summarized above. We will evaluate these strategies not only in terms of how likely they are to reduce corruption *per se* but also in terms of how relevant they are for promoting early capitalist development.

2. Bank Anti-Corruption Strategies: "Rightsizing" the State

Having identified corruption as a cause of underdevelopment with measurable effects on the growth rate and on investment, the Bank, together with other multilaterals, have identified a set of mechanisms through which corruption can be reduced. These mechanisms draw heavily from an implicit underlying neoclassical model of rent-seeking where corruption and other forms of rent-seeking are driven by a) the ability of the state to create rents which distort the economy and reduce welfare and b) the inability of society to discipline and punish those who seek to capture and share these rents both legally (through processes such as lobbying) and illegally (through processes such as corruption). The fight against corruption is therefore presented as a two-pronged one. The first prong is to limit the ability of the state to create rents which in any case lower welfare. The second prong is to combine this with mechanisms which reduce the incentives of bureaucrats to be corrupt, for instance by increasing salaries (which are lost if they are caught and fired) and improving the monitoring and judicial systems (to improve the probability of being caught and fired in the first place). The World Development Report of 1997 follows this scheme very closely, arguing that countries which have higher corruption have

a) A higher "policy distortion index" (for which read a greater divergence from a notional free market and lots of state-created rents). The logic is that the greater the "rents" associated with state restrictions, the greater the incentives for businessmen and ordinary citizens to bribe to capture these rents or overcome these restrictions.

b) A lower opportunity cost of being caught in the act of corruption (in the form of lower civil service to manufacturing salary ratios). The lower the opportunity cost, the greater the incentive of bureaucrats to accept bribes since even if they are caught and fired, they do not lose much.

c) A less meritocratic bureaucracy (more political appointments and fewer exam-based appointments). This means that bureaucrats have a short time horizon and are more willing to make money fast rather than be worried about their career prospects in the long run.

d) A lower predictability of the judicial system (measured by a lower probability of getting caught and being brought to justice). This too increases the incentive of corruption by making punishment less sure.

These observations, of course, mark no significant break with the policies which the Bank had been following for many years. Lowering the "distortion index" is entirely consistent with conventional Bank policies of rightsizing the state. These involved liberalizing the economy, getting rid of government interventions in the form of subsidies, tariffs and quotas, privatizing public sector enterprises which suffered from excess employment and distorted prices, and in general, getting the state out of all activities which either distorted the market or which in theory the private sector could do. All that was now being added was the recognition that not only did these distortions have the direct welfare costs which were well known, but in addition they had a much bigger indirect impact by encouraging corruption (and other forms of rent-seeking), making it even more important to attack these problems. However, the Bank did seek to distance itself from the more extreme neo-liberals by recognizing the role of the state in providing essential public goods including "law and order", primary education and health care and some infrastructure as well. Thus the emphasis on "rightsizing" rather than "downsizing" the state, emphasizing the importance of getting the state to focus on its core tasks (even increasing its capacity to do these things) while getting it out of regulating and creating incentives for industrialization and catching-up, for instance, which inevitably created rents and encouraged rent-seeking. At the same time, the Bank approach stressed the importance of having a well-trained professional bureaucracy which was well-paid, together with a monitoring and accountability system which ensured that bureaucrats were held to account and fired or prosecuted if they failed to perform their duties or if they broke the law (World Bank 1997).

While the Bank approach may appear to be a balanced one, it is actually based on a very specific interpretation of the role of the state during development and of the institutional drivers of development. Underlying these prescriptions is the belief that free and unfettered markets are the best driver of development in poor countries provided that the state created a basic legal framework and provided essential public goods. Any additional state intervention and the associated rents which such intervention inevitably creates is not only not necessary, but is a massive hindrance to development. But in fact the historical evidence of rapid late development tells a very different story. Despite significant differences in the details of policy interventions across the high-growth developing countries, a common feature characterizing virtually all of them was concerted rent-creating state intervention. State interventions were critical in managing the processes through which new capitalist classes emerged by acquiring capital and technology. The flow of real resources into the hands of newly emerging capitalists was orchestrated through a variety of mechanisms including state control over or ownership of banks, controls or distortions of prices, interest rates and exchange rates, and directly through taxes and subsidies. Even more important, particularly in the dynamic economies, was the discipline which the state could impose on the newly emerging capitalist class to ensure that these resources were not significantly wasted, and that potential capitalists who failed to become productive lost out and resources could be transferred to others. States also played an essential role in maintaining political stability through judicious resource transfers and redistributions, not always organized legally or publicly. Finally, states had to create new institutions for regulating markets and managing economic stability where pre-existing economic institutions were largely inadequate. Aspects of these processes have by been well-documented (Amsden 1989, Wade 1990, Aoki, Kim and Okuno-Fujiwara 1997, Khan and Jomo 2000).

From the perspective of these historical observations, paring down the state to a corruption-free rump which somehow provides “law and order” in a poor and conflict torn economy and which restricts itself to providing primary education and some essential infrastructure may be suggesting a blueprint which is both impossible to achieve (in its law and order objective) and which will doom the poorest economies to at best a moderate economic performance. The provision of a semblance of political stability may be impossible in most developing economies without the hidden political transfers which are a source of political corruption. And a state which actually disengaged itself from the task of accelerating capitalist accumulation and disciplining emerging capitalists would doom the economy to much slower progress. But what is even more serious, from the perspective of this chapter, the evidence suggests that the policy package of rightsizing does not even achieve the limited objective of actually reducing corruption (regardless of the subsequent effects on growth).

The evidence of the last two decades strongly suggests that liberalization and privatization are often associated with an increase in corruption rather than the reverse. This is most obvious in the case of Russia and Eastern Europe. It is also the case in less well recognized cases such as India, Pakistan and Bangladesh where the liberalization of the eighties and nineties were associated with very dramatic increases in corruption as reported in corruption indices. In a review of anti-corruption strategies for the Operations Evaluation Department of the Bank, Huther and Shah (2000) look at the relevance of the main strategies in developing countries. They argue that some strategies such as introducing ombudsmen and raising public awareness of corruption is unlikely to have any effect on countries where governance is poorest. But while they accept that privatization had negative effects in Russia (Huther and Shah 2000, Table 2) they still argue that reducing the size of the state, increasing citizen participation and (somehow) improving the rule of law are still the best strategies in countries with the worst governance record. In fact the systematic evidence that privatization and liberalization result in increased corruption is difficult to reconcile with the neoclassical perspective sketched above but not with a perspective which recognizes that the environment for corruption is closely related to the stage and pace of the capitalist transition. Liberalization and privatization accelerates the creation of capitalists and dramatically increases the stakes for those who want to enter the new class or expand their stake in it. Corruption and rent-seeking are bound to increase in this context, the irony is that without a strong state regulating the process the outcome is not even likely to be efficient, as the case of Russia, Pakistan and many other countries show.

What about the more pragmatic reforms suggested by the mainstream analysis: raising bureaucratic salaries and improving accountability? Here the theoretical justification has come under attack from within mainstream economics itself, and the evidence too is very disappointing. Higher salaries are theoretically expected to lower corruption because they increase the opportunity cost of corruption provided there is some probability of being caught and fired (Gould and Amaro-Reyes 1983, Klitgaard 1988). High wages for bureaucrats operate like efficiency wages. It may be efficient to not only pay civil servants the market wage for their skill level, but indeed a rent on top of that. This is because the work which bureaucrats do is often difficult to monitor and the rent (or efficiency wage) creates an additional incentive for honest service delivery given a sufficiently high probability of getting caught and fired. This incentive mechanism breaks down if the probability of getting caught, and/or of being actually fired when caught, is very low (Besley and McLaren 1993, Huther and Shah 2000). In that case, the higher salary is just a bonus since the bureaucrat can continue to be corrupt. The cross-national empirical evidence shows, as expected, that there is very little if any relationship between bureaucratic pay increases and the reduction of corruption (Treisman 2000, Rauch and Evans 2000). And finally, coming back to our bigger picture of growth and development, there is, as we have already pointed out, little evidence that bureaucrats and politicians in fast-growing economies were actually squeaky clean. Just think of contemporary China or South Korea in the seventies.

3. Decentralization, Devolution and the role of Civil Society

To complement its existing policies of liberalization and rightsizing, the Bank has been increasingly persuaded that it needs to support explicitly political reforms to increase the accountability of the state and to reduce the discretion available to bureaucrats. Thus anti-corruption strategies now include, in addition to the types of reforms discussed earlier, a commitment to decentralization to reduce the discretion available to bureaucrats and a commitment to more public oversight through support for democracy and a "vibrant" civil society (World Bank 2000: 21). Driving these reforms is an underlying model of a developing economy where society is composed of individuals with well-defined endowments who would go ahead and develop the economy according to their comparative advantage if left to their own devices. They only need the state to provide them with law and order and basic public goods and this they can ensure by holding the state accountable. Decentralization and devolution enhances their ability to do this by bringing government closer to the final customers of state services. As before, we need to examine how sensible these strategies are in terms of the relevance of their underlying theories for the real situations in which they are being applied. We can also look at the evidence to see if corruption is lower, and secondly if welfare higher in developing countries which have devolved and decentralized systems.

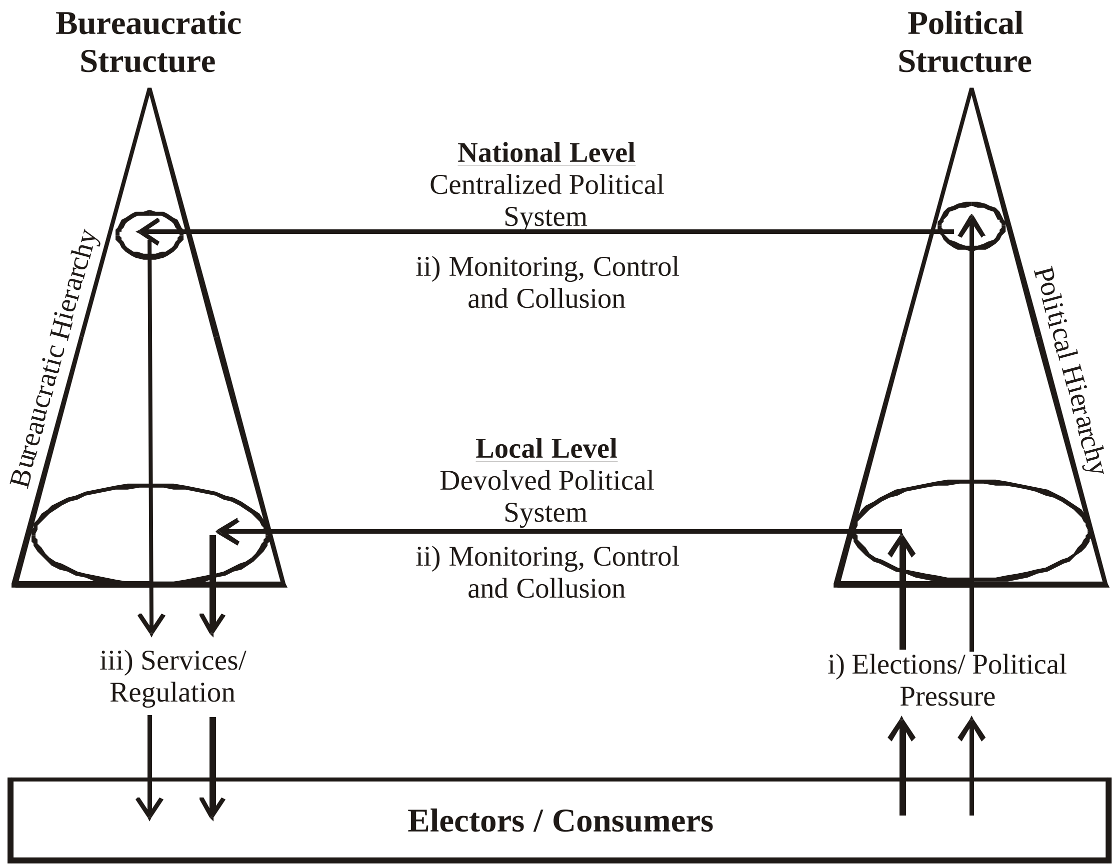

Figure 2 Devolution, Decentralization and Improvements in Governance

In the conventional service-delivery model of the state, the relationship between the electorate, politicians and bureaucrats is shown in Figure 2. In this picture, the electorate are the consumers of government services. They are supposed to elect and put pressure on politicians to translate their demands and requirements for services into policy. Politicians in turn are supposed to monitor and control the bureaucrats to ensure service delivery (but they may collude with bureaucrats to subvert the popular will). Note that the role of government in this perspective is simply to deliver services which the public collectively and democratically desire. Decentralization refers to administrative changes which give lower levels of government greater administrative authority in delivering services. Devolution involves in addition changes in political institutions so that electors vote for representatives at lower levels of government who in turn have effective control over lower level bureaucrats involved in service delivery. Clearly, no system is entirely centralized or devolved, but a devolved system has more aspects of service delivery and regulation managed by lower tiers of government who are in turn answerable to lower level politicians. Clearly not all services and regulatory functions are suitable for devolution. Some government activities like building inter-city highways may not be divisible to local government without loss of efficiency. Thus devolution refers to a greater proportion of divisible services being delivered through a devolved system.

If the state is primarily there to deliver services for the electors, decentralization, and in particular devolution will plausibly improve accountability and governance by bringing government closer to the people. This will make it easier for the latter to monitor and discipline the state. Service delivery should improve and corruption should decline. But this plausible argument requires a number of stringent conditions to hold if it is to be true. The effectiveness of governance from this perspective depends on the three sets of relationships marked in Figure 2:

i) First, the arrows from the Electorate to the Politicians indicate the role of elections and other political processes in communicating the objectives of the electorate to political representatives. How effective are these processes in communicating the real interests of the electorate? To what extent are these processes controlled by privileged groups within the electorate? If the electorate as consumers are to get the services they really want, the first condition is that the electoral process should reveal the real preferences of the electorate. To compare a devolved with a more centralized system, the relevant question here is whether the electorate is more likely to formulate general social interests in elections for *local* politicians rather than for national or regional politicians.

Public choice theory tells us that democracy is unlikely to reveal "social preferences" if individuals in society have widely divergent preferences (Mueller 1989: esp. 58-95). The view that democracy can allow the electorate to formulate clear demands even for service delivery ignores the possibility of deep divisions between classes and groups in society. These divisions are particularly intense during periods of rapid social transition. Under these conditions, democracy is even less likely to reflect "common interests". Indeed in developing countries democracy appears to systematically bypass the interests of the bulk of the voters. Instead, the political system typically reflects the interests of relatively small groups of organizationally powerful clients who control the electoral process financially and organizationally. For devolution to result in better governance even in terms of the service provision model, devolved elections have to result in a more accurate reflection of the popular will and break down the tendency towards the capture of political power by sectional interest groups.

Clearly devolution is likely to make *some* difference. The size of local constituencies is usually much smaller and so the same population will ultimately be electing a much greater number of politicians at the local level than at higher levels. Arithmetically, local politicians are likely to represent social interests to a greater extent simply because they are more numerous and a greater variety of interests are likely to be represented. On the other hand, the disparity of organizational and financial power can be as great within a village constituency as a parliamentary constituency since the latter is simply an agglomeration of the former. So while local politicians are likely to reflect the interests of a more broad-based elite than national politicians, it will still be an elite nonetheless. More importantly for development, the interests of this local elite need not be more developmental compared to the elite represented at higher levels.

The evidence from India's considerable experience with local government suggests that service delivery has been most successful in states such as West Bengal and Kerala where elections have been contested in the context of *centralized* party structures with strong developmental and welfarist goals. However imperfectly, these centralized party structures were better able to represent general interests precisely because they were mass parties and had a high degree of centralization in terms of agenda setting and mobilizational power (see for instance, Williams 1999). In other parts of India where the electorate is fragmented, devolution has usually not resulted in a more accurate reflection of popular demands. Devolved political power has reflected the interests of relatively small groups of well-organized elites.

ii) The second area where devolution could make a difference is shown by the arrows from Politicians to Bureaucrats which describe the exercise of control by politicians over civil servants. This control can either ensure that the latter carry out their duties and deliver what the public requires but it can also result in political intervention or collusion which benefits politicians and their clients, and sometimes bureaucrats as well. In extreme cases where politicians are excessively motivated by clientelism, the control exercised over bureaucrats by politicians can even be *against* the general interest. This argument has often been used and misused by dictators to subvert the political process, particularly in developing countries. The question for devolution and decentralization is whether local politicians are more likely to be able to control local bureaucrats in the public interest and less likely to direct them or collude with them to benefit sectional interests compared to national politicians and higher level bureaucrats.

There are a number of reasons why this expectation may be not hold in many developing countries. First, local politicians usually lack sufficient constitutional powers to effectively sanction bureaucrats. This problem may be exacerbated by the fact that in most developing countries, the educational and status gap between politician and bureaucrat may be far greater at the local government level than at higher levels. But more importantly, we have to ask if local politicians are more or less likely to engage in collusive corruption with bureaucrats compared to provincial and national politicians? There is no general answer to this question which is valid everywhere. But given what we have already said about unequal access and clientelism at all levels of society, the propensity for collusion should be no less at the local compared to higher levels. In addition, there are many more points of interaction between politicians and bureaucrats in a devolved compared to a centralized system, it is very difficult for the national press and senior investigators to watch what is happening at the local level and it is often easier for local elites to intimidate their opponents and get away with overt corruption than it is for national politicians. For these reasons, local level corruption is often no less and is sometimes proportionately much greater than corruption at higher levels. Clearly, there are no general reasons to believe that devolution will work to improve governance and reduce corruption in every case.

iii) Finally, the arrows from Bureaucrats to the Electorate shows the delivery of services which in turn are the source of welfare improvements or welfare reductions for final consumers. For the electorate to be able to respond to government there has to be a transparent chain of responsibility for specific services or interventions. The case for devolution and decentralization in terms of this relationship rests on the assumption that in devolved governments it is easier for the electorate to identify those responsible for particular decisions.

However, this expectation critically requires that there are no complementarities of local services with those provided by other units or funding requirements from higher levels of government. Otherwise, it would be relatively easy for local service providers to attribute their own failures to others, or indeed, their failures may actually be due to others. But in either case it would be very difficult for local consumers to decide without a lot of expenditure on information collection. In fact bureaucrats in devolved systems frequently invoke these arguments even in sophisticated advanced economies, sometimes justifiably and sometimes not. Indeed if we move beyond the simplest service delivery to look at the types of activities which a developing country state has to engage in, such as maintaining law and order, accelerating the creation and consolidation of an efficient capitalist class and encouraging technological progress, complementarities and spillovers between localities and regions means that there is no effective sense in which local monitoring of service delivery can attribute praise or blame to local bureaucrats. Not only that, the fragmentation of jurisdictions in the presence of complementarities can result in an excessive extortion of bribes by bureaucrats and politicians because bribe-collectors in each jurisdiction are unaware of the negative effects of their activities in other jurisdictions (Treisman 2000, Shleifer and Vishny 1993).

These theoretical caveats are supported by empirical work which has sought to find a relationship between devolution and decentralization on the one hand and corruption on the other. Treisman (2000) in a major cross-country study finds federal states to be more corrupt than unitary ones. Fjelstad and Semboja (2000) find decentralized fiscal administration in Tanzania to be highly corrupt because of weak monitoring from above. Goldsmith (1999) points out how decentralized systems make it easier to hide corrupt practices in developing countries. On the other hand, some studies conducted for the Operations Evaluation Department of the World Bank have found that devolution has reduced some types of corruption. Crook and Manor (2000) report that in Karnataka, India, devolution reduced grand theft even though petty corruption increased. In a cross-country regression analysis including both advanced and developing countries, Gurgur and Shah (2000) report that decentralization has a significant effect in reducing corruption. But they also point out that when the regressions are carried out for developing countries alone, there is no relationship between decentralization and corruption-reduction. The latter result is more significant because including both advanced and developing countries in the same corruption regressions has problems which we have touched on earlier. Finally, the fact that a configuration of factors allowed devolution to result in better governance and lower corruption in some cases does not contradict the general point that there is no *general* case in favour of devolution. To be fair, many Bank operatives in the field appear to be sceptical of the merits of pushing decentralization and devolution but the official position has strong backers within the Bank.

There is a much stronger commitment within the Bank to the general proposition that greater civil society participation in monitoring government will improve governance and reduce corruption. The reasoning here is quite straightforward. The chances of catching the corrupt are supposed to increase with greater transparency. This increases the expected cost of corruption for the bureaucrat or the politician. If this was the case, we would expect countries with more freedom of information and more participatory politics to suffer less from corruption and poor governance. Once again, the underlying view of the relationship between state and society is the mainstream one where individuals in society have to be vigilant to ensure that the state they have set up to deliver services does not rip them off. This picture has no analysis of divisions within society and how competing interests may quite legitimately try to exercise voice and influence over the state in their own interests. In reality, those who are monitoring the state may have specific interests of their own and not everyone in society may have the resources, the knowledge or the organizational ability to exercise voice. If we take into account the real divisions which exist in developing country societies, we have to ask which groups are most likely to exercise voice and influence as transparency and accountability increases, and whether these groups are productive groups or not.

Without in any way diminishing the desirability of democracy and participation as political values, such an analysis will be able to tell us if there is any reason to expect greater civil society participation in a particular country to actually result in general improvements in governance and corruption. In general, in most developing countries, capitalists are a very small group who lack social legitimacy because their wealth is often considered to be illegitimate and often actually is. They rarely play a predominant role in national politics or lead civil society organizations (though there are exceptions such as Thailand). Nor is the vast bulk of the population, composed of workers and peasants able to play this role as they are typically too disadvantaged in terms of education and resources. Thus civil society organizations are dominated by the relatively narrow middle and lower middle classes who have the resources, the education and the numerical strength to play a dominant organizational role. However well-meaning, inclusive and humanistic their voice often is, these groups do not represent the interests of the whole society and more than that, they are often unaware of the harsh realities necessarily involved in the creation and operation of early capitalism. Their voice does little to change the underlying realities of primitive accumulation and political management in developing countries but does add to the list of expectations which cannot be met. These considerations mean that the relationship between greater civil society participation and economic development can be quite complex and can vary greatly not only between developed and developing countries, but also within developing countries themselves, depending on the constitution and organization of social classes and groups (see for instance Khan 1998).

Once again, the importance of these considerations is borne out by the evidence. While it is difficult to measure the degree of civil society participation or how "vibrant" it is, the presence or absence of democracy offers a measurable proxy. The evidence on the relationship between democracy and corruption underlines why it is important to have a good analysis of social structure in developing countries. Case study evidence provides many examples of democratic developing countries where corruption is rife. Not only that, they also provide evidence of corrupt politicians whose corruption is well known, winning elections against clean campaigners who seek to unseat them, not least in the biggest and most sustained democracy in the developing world: India. Similar examples can be found in neighbouring Pakistan and Bangladesh. These cases cannot be explained by culture (which differs widely across the developing world), or the lack of information, since the corruption of particular leaders is often widely known and dissected in the press. Rather, we have to recognize that voting for machine politics patrons or mafia bosses is often a rational response on the part of voters in developing countries who can expect bigger payoffs and protection if they support the right factions than from a clean campaigner who is de-linked from the processes of political and economic accumulation. These case-study insights are confirmed by Treisman (2000) in his major cross-country regression analysis. He finds no evidence that corruption is lower in democracies. Democracy did have a small effect on corruption after many decades but these long term effects could have other explanations because only successful economic developers are usually able to sustain long-lasting democracies.

It is worth repeating that international agencies are not necessarily wrong to support greater civil society participation in developing countries as an end in itself, but they are wrong to raise expectations that this will necessarily improve the quality of governance or reduce corruption. If improvements in the quality of state intervention are sought, as indeed they should be, attention has to be focussed directly on what the state should be doing in a developing country trying to construct capitalism. The task of international agencies should then be to assist in developing state capacity in these areas. The focus on corruption is a damaging distraction even though corruption clearly imposes large social costs in developing countries. It is a damaging distraction because sustained reductions in corruption require development, and therefore the focus should be on improving the capacity of the state to govern in the interests of development. Such a strategy will have an incidental effect in reducing, as it must, growth-reducing types of corruption, but it is naïve to think that there will be substantial reductions of corruption in the short term.

4. An Alternative Perspective on Reforming the State

In the previous sections we have tried to show how the Bank's approach to improving governance has been based on a service provision model of the state. In this perspective, the quality of provision is dependent on rightsizing the state so that it only delivers what the private sector cannot, and on keeping bureaucrats and politicians under check through political decentralization and more civil society participation. We have indicated why this perspective on the state is inappropriate in a developing country context. We have also referred to some of the evidence which strongly suggests that the strategies being followed by the Bank are not likely to lead even to a reduction in corruption, let alone to the greater welfare which is supposed to follow from a market-led economy and a smaller, cleaner state. In this concluding section we will elaborate a little more on the types of fundamental economic and political problems which a developing country state has to address, and the types of capacity which it may have to develop if it is to carry out these tasks better.

In contrast to the service provision view of the state, we would argue that it is more appropriate to see the developing country state not only as the guarantor of social order but as one of the key agencies involved in creating a completely new social order. The capitalist transition is not something which happens naturally, nor is it something which is widely supported, particularly in its early phases. The construction and deepening of a capitalist society involves both supporting and promoting an emerging capitalist class and ensuring that this process of support is sufficiently disciplined for resources not to be wasted by the emerging "capitalists" turning out to be a class of unproductive conspicuous consumers. At the same time, the developing country state has to ensure that political stability is maintained at acceptable levels for the process of accumulation and investment not to get derailed. Both of these key areas of intervention open up massive opportunities for bureaucrats and politicians to share in or misappropriate some of the transfers which are necessarily involved in carrying out these tasks.

Looking first at the economics of transition, the developing country state does not just have to provide services like clean water to citizens, more importantly, it has to aid and accelerate the creation of a class of capitalists. This in itself involves the state in deeply divisive decisions. If the right decisions are made, a class of capitalists will emerge who will help in generating prosperity for their country. But regardless of their productivity, the beneficiaries of state interventions are inevitably enriched to rise beyond the reach of the average citizen. While this is deeply divisive, no developing country state can sit back and be genuinely "neutral" in aiding all sections of society if economic viability depends on the rapid growth of the capitalist sector. Virtually all developing countries states have used mechanisms such as allocating land for industrial development, influencing relative prices particularly between agriculture and industry, managing taxes and subsidies, influencing exchange and interest rates and so on, to assist the emergence of the nascent capitalist class.

The implicit transfers to the emerging capitalist class as a result of these policies has a significance which is well beyond even the very large sums involved because the individuals who emerge from this process as potential capitalists are able to permanently differentiate themselves from the rest of society. What would they be willing to pay to be beneficiaries of state policies at this stage? When society is differentiating into new classes in this way, the standard analysis of how much rent-seekers will be willing to pay becomes deficient. Rent-seekers in this context will be willing to pay not only a fraction of the rent they can capture from the state, but perhaps a very large fraction given the long-term benefits they can hope to get by positioning themselves as emerging capitalists in the transition society. The transition state has to follow a difficult path: it cannot be expected to give no support at all to emerging capitalism without derailing development very significantly. On the other hand, if it does intervene, it has to try and ensure that the emerging capitalists cannot influence the allocation of resources in ways which derail technology acquisition and productivity growth.

Ironically, if the state can ensure that emerging capitalists are efficient, it does not matter too much for economic dynamism if bureaucrats and politicians make some money in the process. Capitalists too, are usually only too happy to share some of their gains, particularly in the early stages of development. The real danger is when inefficient capitalists succeed in bribing or influencing the state to capture resources. When this happens, the cost to society is much greater than the resources wasted in corruption. The state may be systematically creating a class of conspicuous consumers rather than productive capitalists and wasting a huge amount of social resources in pampering a protected and unproductive class. Subsidies may be permanently captured by infant industries which refuse to grow up, and so on. The social costs of these policies are likely to dwarf the direct economic cost of the bribes. The institutional and political characteristics which have enabled a few developing country states to ensure that growth remained high during this transition period are not easy to summarize because what worked in each country depended on the internal social and political balance (see, for instance, Khan and Jomo 2000 for a discussion of some of these conditions).

Some general features of the dynamic countries do, however, stand out. States which were able to discipline capitalists at this stage seem to have had either a very strong capacity to over-ride coalitions which formed to protect particular inefficient capitalists or sectors, or they had allies in society who shared an interest in ensuring that the emerging capitalists continued to get resources but did not waste them. Building these capacities and alliances was not simple and most developing countries did not succeed. However, lessons can be learnt from the successful countries to promote progress towards greater developmental commitment in countries performing less well. This certainly does not mean that Nigeria, say, should be encouraged to attempt South

Korean industrial policy, but it does mean that appropriate policies and state capacities have to be developed in Nigeria if it is to manage the transition at the fastest rate feasible given its political and historical conditions. But such an agenda could not be further from an agenda of "rightsizing" the state.

The second and equally important challenge facing the developing country state is the maintenance of political stability in a context of intense social conflict and widespread resentment of the wealth and power of emerging capitalists. This resentment is widespread in developing countries not least because the processes of state support which assisted their emergence are widely known. This explains the apparent paradox that political instability is often greater in more open developing societies where information about the effects of government policies is more freely available and the possibilities of expressing dissent are greater. In these contexts, the maintenance of political stability usually involves political clientelism where powerful clients of political parties and the state get preferential access to resources and in return help to maintain stability. This in turn very often involves political corruption, since these resources obviously cannot be publicly accounted and audited. Political corruption of this type, while necessary for political stability, can be very damaging for the economy because these networks can also protect inefficient capitalists for a mutually beneficial price. The comparative evidence suggests that clientelism is not always consistent with a successful transition. Dynamic countries either suppressed clientelism or had fairly centralized versions of clientelism (Khan 2001, Khan and Jomo 2000).

These observations suggest an extremely important area of political reform in developing countries. Responding to the problems posed by clientelism requires a sustained long-term reform of political processes. This involves not just trying to reform political parties but also requires a political leadership which is willing to engage in difficult political struggles against the mafia-like patrons and protection rackets which are widespread in developing countries. In areas such as this, international agencies could potentially play an important role in assisting developing country states. But here we find a real incomprehension of the problems faced by these states and an unwillingness on the part of international agencies to address problems of real politics. In contrast to the anodyne support for civil society and democracy, a program of support for political reform which can make developing country states less vulnerable to clientelism would have directly positive effects for the economy. It would target precisely those types of political corruption which have a seriously negative economic effects and enable developing country states to maintain a higher level of efficiency during the difficult phase of early capitalism. For the fight against clientelism to succeed developing country states would have to maintain political stability through other means, and this would very likely require much more expenditure on transparent social programs and redistribution. But such strategies are not likely to find much favour in western countries committed to shrinking the developing country state and reducing international aid for developing countries.

To conclude, a historical approach to the problem of corruption and poor governance suggests that the Bank's approach does not address some of the most critical issues constraining the efficiency of state intervention in developing countries. Part of the reason for the Bank's failure in this area can be found in the dominant economic orthodoxy which does not address the problem of the capitalist transition at all. Part of the problem also lies in an inadequate understanding of the politics of the transition and the role of different types of political corruption and clientelism in influencing the efficiency of state intervention in developing countries. This problem is potentially even more difficult to address because it requires a recognition of the inherent injustices involved in the construction of capitalism, and the inevitably less than satisfactory methods of accommodating political dissent in developing and transition economies. It requires a recognition that the metaphors of level playing fields, of freedom and of fairness, to the extent that they describe features of advanced capitalist countries, describe the emerging capitalisms in developing countries to a far lesser extent. This is not primarily because there is insufficient civil society participation or democracy but because the construction of capitalism is inherently divisive and often rewards and deprives individuals in arbitrary ways.

Without understanding these issues it is not possible to understand the roots of political instability, of political clientelism and political corruption in different countries and how best to devise strategies which limit the growth-retarding effects of some types of clientelism and political corruption. It is understandable that this image of the capitalist transition is difficult to sell in advanced countries where funding and support for Bank policies have to be found. There is a very strong resistance to the idea that the rapid deepening of capitalism in a developing country can itself be the source of different types of corruption which can only be addressed if the transition is successful, if it is rapid and if social cohesion can be maintained during it. Sadly, if a better understanding of the nature of the transition which developing countries have to go through does not emerge, the transition will be more protracted and fraught with greater tensions and conflicts than need otherwise have been the case. What is even worse is that the imposition of governance reforms which are inappropriate for the problems which developing countries actually face could contribute to worsening political instability by raising impossible expectations.

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