

# ICPS newsletter<sup>®</sup>

## Eliminating corruption could improve the well-being of Ukrainians by 300%

*The results of a recent study into problems to do with corruption show that any country can achieve significant success in fighting corruption, regardless of its level of prosperity or geographic location. Daniel Kaufmann, the Director of Global Programs and Governance at the World Bank Institute (WBI) and the author of this study, presented his results at a roundtable called "Time To End Corruption" organized by PORA, a civic group, and the International Centre for Policy Studies (ICPS) in Kyiv on 15 June 2005*

According to Mr. Kaufmann's estimates, based on the most recent findings and analysis of corruption and governance,<sup>1</sup> the "Corruption Industry" worldwide could amount to about US \$1tn in transactions annually. Corruption is a fundamental impediment to the economic growth of nations, constituting a major "tax" on

foreign and domestic investment, reducing a country's competitiveness, and putting a brake on social and human development. What is more, it affects global security.

But adhering to the principles of good governance and control of corruption can lead an improvement in per capita incomes

in a country by 300% over the longer term. In many countries, reformers, local communities and investors are increasingly viewing governance as a key factor behind development and the investment climate. Moreover, aid donors have also come to see that aid flows have a stronger impact on countries with high quality institutional governance.

The data in Mr. Kaufmann's research shows that, on average, the world did not improve in terms of cutting down corruption over the past eight years. Unfortunately, for every country that improved, at least one other country deteriorated, and many stagnated in terms of getting corruption under control. Yet, some countries made significant progress, regardless of their original level of economic development or their geographic location. This proves that countries that make the commitment and take bold measures can progress rapidly. According to Mr. Kaufmann, the inability to address corruption can no longer be excused using arguments about "culture" or "history" or "poverty."

To study and compare levels of corruption in different countries worldwide, indicators were analyzed that reflect six key aspects of the institutional quality of public governance:

- **Voice and Accountability** – the level of political, civil and human rights;
- **Political Instability and Violence** – the likelihood of violence or changes in government, including terrorism;
- **Effective Government** – the competence of the bureaucracy in preparing and implementing decisions and the quality of public services;
- **Regulatory Drag** – the ratio of market-unfriendly policies;

### Corruption hurts personal development

"When competition is impeded in a society, in this case because of corruption, personal development is also impeded," says ex-Secretary of the Cabinet of Ministers Viktor Lysytskiy. And by fighting corruption, a Government can also help develop the potential of its citizens both today and in generations to come. "When people know that they are strong, that they can do anything, that they can learn anything they want to learn, then they become strong individuals. As a result of widespread corruption, Ukrainians, especially young people, have lost faith in themselves."

### Prices for Russian fuel are at the root of corruption in Ukraine

According to Serhiy Datsiuk, an expert from Hardaryka, a strategic consultancy, among all the minor reasons and evidence of corruption, the main problem is the illegal cash that comes from operations involving Russian fuels, because prices in Ukraine are below world prices. "As long as prices for Russian fuel are lower here than global prices, unrecorded cash will continue to flow into Ukraine one way or another, and this will multiply corruption." According to Mr. Datsiuk, a decisive blow would be for the country to switch to settling at world prices. "I understand that this is difficult, that this is a long road, but there is no other option. As long as we leave this loophole, all the efforts to patch up minor holes will be useless."

### A government official is not just a "servant"

First Deputy Finance Minister Anatoliy Maksiuta says society should view civil servants as equal partners, not as "public servants." "As a civil servant, I always saw the state as a bad employer who cared neither about the working environment nor about pay." This negligent attitude, he says, gave rise to a system that pushes state employees to take care of personal needs through corruption. "This seems to be the root of the problem. To combat corruption, we need to put the civil service on a proper social level."

### We need to blacklist businesspeople, not just officials

During the discussion, Daniel Kaufmann commented on the idea of blacklisting those engaged in corruption. "On its website, the World Bank has made public a blacklist of more than 300 individuals and firms that have been linked to corruption in WB-funded projects. This creates an enormous incentive by raising the cost of corruption. The idea of such a list is very important, but it has to be public and it has to be justified why people are on the list. In Brazil, any firm that has been linked to corruption in public procurement projects is going to be put on the list, in a public government website. Imagine the loss of reputation for that firm. So, it's an enormous deterrent."

<sup>1</sup> *Governance Matters IV: New Data, New Challenges*. Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi. The World Bank. May 2005. This research paper is available in the internet at: <http://www.worldbank.org/wbi/governance/pubs/qovmatters4.html>.

- **Rule of Law** – the quality of contract enforcement, the work of the police and the court system, and the likelihood of crime and violence;
- **Control of Corruption** – the use of public position for private gain, including both petty and large-scale corruption and state capture.

In analyzing the lessons of success stories and failures in combating corruption, Mr. Kaufmann came to the conclusion that it is impossible to fight corruption exclusively by such means as one-time anti-corruption campaigns, setting up anti-corruption and ethics departments, or developing yet more anti-corruption legislation and agreements that are often not implemented.

Instead, Mr. Kaufmann says, much more focus is needed in different areas:

- improving the participation of voters in governance, empowering them with an effective voice, and engaging the private sector, legislatures and communities in combating corruption;
- depoliticizing and reforming the civil service, promoting reform related to increasing transparency in public institutions: political, financial, budgetary, and economic transparency, using the internet to disseminate information, and making use of monitoring;
- reforming the judiciary;
- collaborating more effectively across borders, increasing the accountability of multinational companies, preventing corruption in international organizations and the donor community, targeting international technical assistance to combat corruption, and increasing the

priority given by the G8 and the G20 to combating corruption;

- drastically cutting down regulations and administrative hurdles to business. ■

*A leading expert, researcher and adviser on governance and development, Daniel Kaufmann supports countries in establishing good governance, introducing anti-corruption programs and building capacity and has published many studies on economic development, governance, unofficial economies, trade and exchange rates, investment, corruption, privatization, and urban and labor economics.*

*Materials from "Time To End Corruption" can be found online at: <http://www.icps.kiev.ua/project.html?pid=78> (in Ukrainian). For more information, contact Ihor Shevliakov at (380-44) 484-4400 or by e-mail at [ishevliakov@icps.kiev.ua](mailto:ishevliakov@icps.kiev.ua).*

## A shift in hi-tech policy could made Ukraine one of the world leaders

***That part of Ukraine's economic potential based on old soviet production capacities will soon be exhausted. Yet the development of future technologies is in a state of confusion: the existing scientific base and qualified specialists face administrative barriers and lack of state support for hi-tech investment. Better policy could bring hi-tech development to Ukraine, increase export potential and stop the country's brain-drain***

On 14 June 2005, the Verkhovna Rada Ad Hoc Future Commission and ICPS held a roundtable called "Government Policy to Support Hi-Tech Investment in Ukraine." Participants included lawmakers and representatives of the Government, foreign and domestic companies, independent experts, and academics. Key presentations were by Serhiy Loboiko, president of TECHINVEST, a venture capital firm, and Philippe Costemale, General Director of Jabil Circuit Ukraine.

In his introduction, ICPS economist Ildar Gazizullin said that sustainable economic growth might be secured by attracting investment and transferring high technologies, as the potential for the Ukrainian economy to expand its remaining soviet industrial capacities is rapidly shrinking. However, he noted, Ukraine has no strategy to support hi-tech development, having not identified priority areas with the greatest potential. As a result, the policy of encouraging investment is not effective because of contradictory criteria and goals and inconsistent implementation.

Policy instruments for attracting investment have failed because: (1) there was no analysis of the country's competitive advantages and potential, while state

funding for science was scattered among numberless R&D institutes and across many sectors; (2) infrastructure was lacking to attract investment and transfer new know-how into the economy; and (3) there were no effective mechanisms for monitoring outcomes and impacts of policies intended to stimulate investment.

According to Serhiy Loboiko, Ukraine has enormous potential for developing its IT sector. Computer technology has been developing in Ukraine for 50 years, and 30% of all R&D in the FSU took place in Ukraine. Although Ukrainians are among the best IT specialists in the world—fourth place in the 2002 BrainBench rating for the number of certified programmers and third place in the 2003 ACM programming competition—, the IT sector has little presence in the global IT market. In 2004, Ukraine's IT exports stood at a little over US \$110mn.

Mr. Loboiko says the policy of promoting IT exports should include: (1) promoting the history of IT in Ukraine and its technological and innovative potential; and (2) incentives for private investment into technological venture funds, R&D and design, business incubators, technoparks, including state co-investment, and transfer of suitable state-owned assets into private

management. Meanwhile, HR and scientific potential can be development through (1) joint scientific, educational and production facilities organized between educational institutions and major IT companies; and (2) transferring relevant state educational facilities and institutes into private management.

Mr. Costemale says Ukraine could become a key regional leader in attracting hi-tech investment during the next decade. Major companies whose combined global revenues in 2004 stood at US \$200bn are looking for an alternative to Asia by developing R&D institutions and production facilities in Eastern Europe. With its highly qualified and competitive workforce and borders with the EU, Ukraine has every chance to be considered.

But those exporting products made in Ukraine note four obstacles to doing business in Ukraine: (1) high import duty; (2) complicated customs procedures; (3) lack of a supplier base; and (4) VAT refund arrears. Mr. Costemale says establishing industrial parks and granting investors who manufacture in Ukraine and export 100% of their products free customs status could compensate for the cancellation of various exemptions connected to SEZs. ■

*Materials from this roundtable can be found online at: <http://www.icps.kiev.ua/project.html?pid=79> (in Ukrainian).*

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