

**GOVERNANCE AND CORRUPTION;
AN OVERVIEW OF CAUSES, CONSEQUENCES, REFORMS AND THE
ROLE OF THE INTERNATIONAL COMMUNITY**

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I. INTRODUCTION

Corruption is as ancient as it is universal. It is a global problem that affects all economies where each country has its own pattern of 'grey' or 'black' business and its own level of corruption tolerance. In 2002, the World Bank estimated that worldwide bribery totaled at least \$1 trillion per annum, which is just over 3% of the world's GDP. Corruption affects Sub-Saharan Africa, South-East Asia and Eastern Europe the most; usually taking on the form of pervasive and systemic corruption.

The academic study of corruption is primarily a late 20th century phenomenon. Over the past 10 years, there has been an explosion in the amount of empirical research into the topic suggestions on the consequences of corruption deviating from strong governance and corruption control, up to better development outcomes and economic growth. Indeed many governments, international institutions and members of civil society have begun to notice the roll of good governance in achieving economic goals.

The purpose of this paper is to evaluate the causes, consequences and possible reforms on the challenge on Governance and Corruption. This paper is structured as follows: Section II outlines the definition, causes and consequences of governance and corruption. Section III explores possible reform proposals aimed to the efforts on improving governance and reducing corruption. Section IV examines the role of the international community, focusing on the actions taken by international institutions to provide an impetus towards reform. Finally in Section V, I summarize the results and write a conclusion.

II. GOVERNANCE AND CORRUPTION

Good governance is referred as the "traditions and institutions by which authority in a country is exercised for the common good". This includes the process by which those in authority are selected, the government's capacity to effectively manage its resources and the respect

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towards the citizens. The World Bank Governance index⁴⁴ covers the following six dimensions of governance:

- i. Voice and accountability – measures political, civil and human rights.
- ii. Political instability and violence – measures the likelihood of violent threats to changes in government, including terrorism.
- iii. Government effectiveness – measures the competence of the bureaucracy and the quality of public service delivery.
- iv. Regulatory quality – measures the incidence of market-unfriendly policies.
- v. Rule of Law – measures the quality of contract enforcement and the likelihood of crime.
- vi. Control of corruption – measures the exercise of public power for personal gain and includes both petty and grand corruption.

Corruption is defined as “the misuse of public power for private or political gain.”⁴⁵ It is the abuse of public office for private gains, and encompasses unilateral abuses by government officials such as nepotism and embezzlement. There are two main indices⁴⁶ used to measure the level of corruption:

- i. Corruption Perceptions Index (CPI): It is published by Transparency International (TI) a Non-Governmental Organization (NGO) established in 1995 that advocates for the control of corruption worldwide. TI collects data from different surveys that report on business and expert perceptions of corruption. The CPI is formed from a compilation of corruption scores that on average have three years of data, and then ranks countries on a scale that goes from excellent (10) to poor (0).
- ii. World Bank Corruption Index: This index makes use of the underlying indices that make up the CPI; however, it uses its

⁴⁴ World Bank Governance index is an aggregate indicator that covers more than 200 countries and is based on more than 350 variables obtained from dozens of institutions worldwide.

⁴⁵ This definition is concerned with corruption in the public sphere. While private sector corruption does occur, it is a different phenomenon and occurs when individuals violate the norms of the private organization in which they operate. Public sector corruption in contrast deals with the misuse of public power and raises issues on governance, political authority, legitimacy and state-society issues

⁴⁶ Note that these indices are rough measures of the difficulty of doing business across countries and should not be used to make precise bilateral comparisons between closely linked countries (Ackerman, 2004)

own graft index by using a different aggregation method of presumed reliability rather than standardized weights⁴⁷

There are two main forms of corruption - state capture and administrative corruption. State capture or “*crony capitalism*” refers to the actions of individuals, groups or firms in both public and private sectors, to influence the formation of laws, regulations, decrees and other government policies for their own advantage, by illicit and non-transparent means. They thrive where economic power is highly concentrated, social interests are weak and the formal channels of political influence and interest are underdeveloped. The state itself can be characterized as serving the interests of a narrow group of individuals.

In the other hand, administrative corruption or “petty corruption” refers to the intentional imposition of distortions to the existing laws, rules and regulations, in order to provide advantages to either state or non-state actors as a result of the illicit and non-transparent provision of private gains to public officials. While administrative corruption does not necessarily reshape national policy on a macro scale, it is costly to its victims.

Causes of poor governance and corruption

Poor governance is strongly related with the level of corruption observed. Corruption is a symptom that something has gone wrong with the management of a state. Corruption is an endemic in developing countries because of the right conditions. Poor economic conditions and an average psychology of scarcity, only increases the motivation to indulge in rent seeking. This motivation is further enhanced by poor governance that increases the opportunities to be corrupt. The presence of government controlled activities has affected corruption through the following ways:

- i. Regulation and authorization: the presence of state control on permits, licences and authorizations on public services grants monopoly power to officials who can extract bribes in order to process permits faster.
- ii. Taxation: Tax collection and assessment is not transparent. By having complex laws and processes which are difficult to understand officials are prompt to involve an appropriate environment for the rise of corruption. The long administrative processes and discretion means that corrupt acts within

⁴⁷ For more information on the formulation of the World Bank Corruption Index aggregation, visit www.worldbank.org/wbi/governance

- iii. Government spending decisions: Investment projects approved and carried out by the state have often been selected so as to provide “commissions” to certain individuals in power and this leads to misappropriation of funds. Highly corrupt governments will usually select “white elephant” projects, which have little value in promoting economic development. These projects are usually engaged on inflated costs since firms selected to carry out the projects are not the most cost efficient.
- iv. Government provision of goods and services below market prices: Dual prices often exist; a low, state price and a higher, market price. Officials with access to these goods such as foreign exchange, electricity, water, housing and education may give preference to certain persons who have paid bribes. In China, for example, researchers reported that in 1989, the market price of coal was 674% of the subsidized price. Thus, the opportunities for payoffs were enormous and quite common (Ackerman, 1999).
- v. Quality of the bureaucracy: A study by Rauch and Evans (1997) found that the less recruitment and promotion based on personal merit, the higher the extent of corruption.
- vi. Level of public sector wages: A negative relationship has been found between wages and high levels of corruption (Rijckeghem & Weder, 1997). When looking at wages, there are two types of premises for corruption, for need or for greed. Low levels of public sector wages implies the need for additional income in order to maintain a sufficient level of sustenance. However, when the extraction of bribes and involvement of corruption is above and beyond the sustenance level, then it is for greed.
- vii. Penalty systems: On theory, corruption would be reduced if the punitive measures against those caught were high. In practice, there is a discrepancy between the penalties specified by the law and the penalties imposed.
- viii. Institutional controls: The most effective controls are those that exist within an institution. Strong institutional controls

- would allow for transparency, auditing, clear rules and effective supervision. If the checks and balances within the governing body are non-existent, then mismanagement and corruption can occur.
- ix. Transparent rules, laws and processes: Laws and rules are often complicated, opaque, and this leaves room for misinterpretation. Government processes, such as procurement, budgeting and other discretionary decisions are often not public.
 - x. Examples by the leadership: If top officials follow inappropriate governing practices and are involved in corrupt acts, there may be a trickle down effect to the lower levels of governance. Indifference by the government to corruption leads to even more corruption.

Other factors besides the public sector include;

- xi. Historical and social factors: Poor governance and high levels of corruption has been found to be larger of a problem in countries with higher ethno-linguistic fragmentation, especially when compounded with poverty or conflict.
- xii. Social economic inequalities and poverty: Poverty is both a cause and a consequence of corruption and poor governance. Low income levels and high inequality levels, cause individuals to engage in rent seeking behaviour and resort to bribery to obtain services (Agarwal, et al. 2002).
- xiii. Privatization: Privatization of natural monopolies and former state owned enterprises can cause corruption if there are no adequate laws to encourage transparency and accountability. These private organizations are likely to be owned by a small group of the elite that will exacerbate inequality and thus increase corruption.
- xiv. Growth of international transactions: International trade and globalization has, in some instances, provided an environment where the payment of commissions is highly profitable. Multinational companies usually do not wish to change a corrupt system that has been working to their advantage.

III. CONSEQUENCES OF POOR GOVERNANCE AND CORRUPTION

Impact on growth

There has been a lot of diverging on the causality between income levels and governance. Consider first the effect of per-capita incomes on governance: Countries with low income levels have been found to have higher levels of corruption when compared with countries with higher incomes per capita. This would imply that governments should forget about governance and focus on stimulating growth. By this causality, good governance is a luxury good that will be demanded once the citizens enjoy a high per capita income (Ackerman, 2004). This conventional wisdom has been tested empirically and results have found to be weak. Some implications of these findings are; ignoring reform in governance and waiting for countries incomes to grow is unlikely to succeed. Improvements in governance are unlikely to occur merely as a consequence of economic growth. Second, in the absence of positive feedback from incomes to governance, we are unlikely to observe a cycle flowing from rising incomes to good governance (Kaufmann and Kraay, 2003)

Consider the reverse causality; from governance to income. Initial institutional quality has been found to have an impact on economic growth in the long run. Kaufmann and Kraay (2002)⁴⁸ find a strong positive correlation between various measures of governance and per capita income. The World Bank estimated that corruption can reduce a country's growth rate up to a 0.5 to 1% per annum. If a country like Tanzania achieves a corruption score like the one of the United Kingdom, its GDP would increase by more than 20% (Lambsdorff, 2003). These findings confirm the importance of good governance for economic development.

Impact on investment

Investment is significantly affected by the level of uncertainty. Corruption raises the effective cost of investment to firms, and thereby discourages capital inflows and foreign direct investment (FDI).

⁴⁸ Kaufmann and Kraay constructed a set of governance indicators that covered a large sample of countries, mainly in Latin America and the Caribbean. See Figure 1A that shows the relationship between the control of corruption and per capita income. See Figure 2, which shows the Causal Effects of Governance on per capita incomes for Latin America and the Caribbean. They found two interpretations for the results; either most of these countries have been successful in raising living standards without the benefit of good governance; or the relatively high incomes observed are fragile because they are not supported by sound institutions (Pg. 194)

Transition economies having high levels of both state capture and administrative corruption average more than 20% less gross domestic investment⁴⁹ than countries with medium levels of corruption. A study by Mauro (1995) showed that a reduction in corruption by 2.38 points (on a 10 point scale) would increase a country's annual investment by about 4% of its GDP. This analysis is based in a production function that makes growth a function of investment.

Impact on productivity

A market based on illegal payoffs is inefficient. Corruption distorts markets and the allocation of resources making it to reduce efficiency. Corruption can lead to a climate of uncertainty whereby firms have to pay bribes to obtain short term certainty. And firms that are unable to pay bribes will resort in operating in the unofficial business sector, implying a loss in taxes. The presence of a large number of entrepreneurs supported by corrupt acts may hinder business development; where these small enterprises are usually the engine of growth.

Impact on human capital

Expenditures on education and health care are reduced by the presence of corruption (Mauro, 1997). Highly corrupt countries tend to under invest in human capital and over investments on public infrastructure. While these services (education and health care) are still provided, their provision is often distorted by payments of unofficial fees or illegal charges.⁵⁰ The high user cost creates a disincentive for using government facilities; this may partially explain the low school enrolment and high drop out rates in developing nations. Under investment in human capital implies that the chances for innovation and technological progress are diminished and so is economic growth.

Impact on taxation

As already discussed, tax assessment and tax collection might provide an environment where corruption can thrive when state controls are weak.

⁴⁹ Gross domestic investment in 1997 was 27% in countries with high levels of corruption compared to 21% in countries with medium levels of corruption (World Bank Policy Group, 2000).

⁵⁰ A World Bank country study found that parents were asked to pay illegal stipends for enrolling their children in school. Another study found that as much as 38% of total hospital expenses borne by households are in the form of bribes, (Abed and Gupta 2002 Pg.255).

Economies with high tax rate, riddled with corruption can be caught in a vicious spiral of high taxes, leading to tax evasion and corruptive behavior, which means the tax base is low, and government ability to provide adequate services is compromised, and so the government raises taxes once more.

Income inequality and poverty

Corruption does not only affect macroeconomic variables such as investment and growth, it also affects income distribution. When government officials use their authority for private gains, the economy is negatively affected. By doing this corruption distorts the government's role in resource allocation and income distribution. High corruption levels can lead to higher income inequality, resulting on poverty in the following ways (Gupta, Davoodi & Alonso-Terme, 2002): (i) Corruption impedes growth and slows the rate of poverty reduction (ii) Corruption increases income inequality and limits poverty reduction. (iii) Corruption leads to tax evasion and exemptions to those who are well connected. This reduces the tax base and the progressivism of the tax system, leading to further inequality. (iv) Asset ownership is concentrated among the elite few and can affect public policy and increase income inequality. The impact of corruption on income inequality and poverty is considerable.⁵¹

Impact on political legitimacy and democracy

Poor governance and corruption undermine the legitimacy of the state by distorting the fundamental role of the government. In these circumstances, citizens try and avoid paying taxes and firms operate in the unofficial sector in order to avoid the bureaucratic burden. A study in Central and Eastern Europe by Torgler (2003) revealed that people were more likely to pay their taxes when they perceived corruption levels to be low. This implies that the amount of trust placed by the citizens on the state is affected by the governance they observe. When there are high levels of corruption, the institutional capacity of the government is eroded as personal ties and relationships become more important. Poor

⁵¹ Gupta, Davoodi and Alonso-Terme find that a worsening in the corruption index of a country by one standard deviation (2.52 points on a scale of 0 to 10) increases the Gini coefficient by 11 points, which is significant. The papers findings suggest that distributional consequences of corruption can be mitigated by efficient spending in education, health, effective social programs, broad-based labor intensive growth and sound management of natural resources.

governance and corruption also undermine democracy as they subvert formal processes of elections and representation. A democracy needs a competitive environment to succeed. This competition also acts as a check on corruption and improves accountability of elected officials.

IV. REFORM PROPOSALS

When designing a strategy to fight corruption, it is necessary to make an individual assessment on the extent from and causes of corruption for that specific country or region. It is also important to review the possible opportunities that may be present to push for governance reform such as political change, external pressure and public and state support for reform. As Ackerman notes in her Copenhagen Consensus challenge paper (2004), using macroeconomic policies alone in a framework that does function correctly will not work. Thus, the following reforms are suggested (USAID, 1999):

- i. Societal reform: The focus is on changing attitudes and to mobilize political will for change among the civilians. Societal reforms foster structures that facilitate oversight, transparency and monitoring of civil society. Activities involve surveys, public relations campaigns, investigative journalism and civic advocacy organizations.
- ii. Institutional reform: The aim is to limit authority, improve accountability and change the incentives. Suggested activities include - privatization coupled with strong measures for transparency, efficient tax collection and assessment, liberalization by eliminating deadlocks to trade such as tariffs, procurement reform through prescribing an open bidding process and to increase competition in the public sector to improve efficiency.
- iii. Legal reform: These focus on improving accountability. Efforts are required in both the detection and sanctioning of corrupt acts. Suggested activities are – open budget processes that involve citizens, improved financial management, legislative oversight to provide a check of executive power, judicial reform, freedom of information of legislation and financial disclosure laws for public officials.
- iv. Political reform: Free and fair elections accompanied with guarantees of civil liberties to vote and run for office. Reform is also necessary in campaign funding so as to evenly distribute public funds to all parties and to limit private donations that may foster clientele ties and lead to corruption.

These reforms would require a sizeable investment which could be considered as an investment that would yield public benefits in the long run. For example, taxation reform in Ghana in the 1980's resulted in an increase in revenues from 4.5% to 12.3% of GDP. Other examples of positive outcomes are: Societal reform in Brazil through increasing democratic participation helped breakdown clientelist structures and increased accountability of public officials; information based reform focusing on publicity and monitoring of public funds at grassroots level in Uganda led to 75% of funds reaching their target areas, as opposed to only 20% prior to the reform. In Mexico, institutional reform led to providing 500 public service sector services using electronic means which improved transparency and public service delivery. Mexico undertook trade liberalization that eliminated deadlocks such as tariffs and reduced the percentage of imports subject to licensing from 92 to 22%. Administrative reform in Georgia led to the cutting down of 6,000 police officers. This meant improved wages and quality of law enforcement. While these examples paint a positive picture, failure in reform projects has occurred⁵². This re-enforces the fact that there is no "one size fits all" model in approaching this challenge and each country must design its own appropriate policy.

The role of the international community

The problem of poor governance and corruption entered into the agendas of major international organizations such as the International Monetary Fund (IMF), World Bank, World Trade Organization (WTO) and the Organization for Economic Cooperation and Development (OECD) in the early 1990's. What was once seen as a political problem, with no premise for international intervention was recognized to be an economic problem that would affect the outcome of projects carried out by these organizations. The end of the cold war was a significant turning point in the recognition of this challenge. During the cold war, countries could continue poor governance, as long as they were supporting the right political side. Once the international organizations, such as the World Bank and IMF publicly acknowledged the problem of corruption in Eastern Europe, the former Soviet Union and China, they could no longer ignore the problem elsewhere in the world.

⁵² For more projects and reform proposals with cost/benefit analysis, see Ackerman (2004: 38-40)

Other global developments that pushed this challenge into the agenda of international organizations were: (i) the increase in democratic governments that led to freedom of speech and they opened up a dialog to discuss the taboo of corruption; (ii) the increase in global market reliance and pursuit of economic efficiency which cannot not be achieved if market distortions, due to corruption, exist; (iii) the rise of anti-corruption agencies such as Transparency International that begun highlighting the economic effects of corruption on development; and (iv) the availability of empirical data to measure the governance and corruption and provide concrete information.

Official Development Assistance (ODA) and Corruption, International Financial Institutions' (IFI) provide developing countries with ODA to alleviate poverty and assist with debt relief among other secondary developmental goals. For countries that are engaged in some form of corruption, foreign aid may serve to increase the level of corruption by increasing the amount of resources available to interested groups, a secure source of foreign aid could be compared to having a diamond mine that may mask problems and postpone reform.⁵³

The rhetoric is that these development programs using ODA also reward good policies and efficient governments. This would explain why the World Bank continues to increase its lending to Bangladesh, even though Bangladesh consistently ranks near the top of world in corruption⁵⁴. This begs the question, should more corrupt countries receive less aid? Alesina and Weder (2002) examined this question and found that aid from Scandinavian countries and Australia appeared to be geared towards countries with less corruption and better governance. However, aid distributed by the United States was found to have a positive relationship with corruption. The authors do not claim that the United States favours more corrupt governments on purpose; rather other motivations for giving aid may override the importance of the level of corruption and governance. Scandinavian countries and Australia may have more flexibility when it comes to aid, as they do not have any colonial ties, and thus the political pressure is minimal. Alesina and Dollar (2000) support this argument, in their work they found that bilateral aid flows are weakly related to the recipient country's economic performance, and it is strongly related to the indicators of cultural and historic proximity.

⁵³ For example, in the Philippines', rent seeking by an oligarchy of business and political leaders was sustained by foreign aid from the United States. Technocrats in the government worked with the IMF and World Bank to keep aid and lending flowing (Ackerman, 1999:180).

⁵⁴ Bangladesh had a loan package that averaged around \$250 million over the previous three years (Finer 2003).

Alesina and Weder (2002) also found indications of ‘voracity effects with foreign aid.’⁵⁵ The causality between foreign aid and corruption was not clearly established as there were two possibilities; either the voracity effect explained the increase in corruption, or more corrupt governments are more able to successfully obtain aid through misinformation to donors. Their study found no evidence that shows that multilateral aid went disproportionately to corrupt governments. It is important to note that the study period was between 1975 and 1995, that is, when IFI’s began their efforts to control corruption in development projects in the 1990’s.

It is worthy to note that a study examining the relationship between foreign aid and corruption over the past ten years may yield different results. Corruption has a devastating effect on the efficiency of development projects. For example, a 20% loss of aid funds due to corruption would imply that a \$100 million project would have cost only \$80 million. If the investment has to earn a return of 10%, then the corrupt project would have to generate benefits of \$110 million as opposed to \$88 million, which implies that the rate of return should be 37.5% of used resources (Ackerman, 1999 pg.179). Such a high return is rare, and thus the presence of corruption reduces the number of projects worth undertaking. In order to reduce the corruption in development projects, the right projects have to be selected. The process of selection is often based on how best to target the problem and considers the social issues. The World Bank has focused most of its analytic energies at the project approval stage, with little effective follow through. There are problems with auditing since money is fungible and extremely difficult to trace accurately.⁵⁶ Another problem is that the successfulness of the staff is measured by the size and speed of disbursement of projects. Changing this policy to one that accommodates transparency and accountability may not be welcomed by all donors.

Ways in which international organization can assist in the reform process are;

- i. To mobilize and sustain domestic government efforts – if countries show a commitment to change, ODA and

⁵⁵ The ‘voracity effect’ refers to a positive shock which results in slow growth. This implies that large windfalls of foreign aid are associated with increased corruption and therefore, slower growth.

⁵⁶ Fungibility refers to the degree to which a given commodity is interchangeable. Within foreign aid, it refers to the likelihood that money will be spent in ways that it was not intended. Aid is used to substitute government funding by being diverted into spending on other sectors. The extent of fungibility of aid is important in assessing aid effectiveness however it is usually ignored in project assessment. Van de Walle and Cratty (2005) assessed the extent of fungibility of a road project in Vietnam, financed by the World Bank. They estimated that about one third of intended funds were displaced.

- international organizations may directly support reform efforts. If the country has a weak institutional structure that has been exacerbated by corruption, ODA can be made conditional on reform.⁵⁷
- ii. The creation of international treaties and laws that are focused on reducing the presence of corruption at the international level be creating sanctions against those caught participating in criminal, corruptive activities. The OECD and the United Nations have written agreements that have mainly focused on tightening up and harmonizing of trade and environmental rules to close loopholes. Efforts may also be focused on reducing the willingness of multinational firms to pay bribes and to encourage open procurement processes such as the anti-bribery convention enacted by the OECD⁵⁸ and the “Islands of Integrity” pact by Transparency International⁵⁹. Where the presence of natural resources has resulted in the siphoning of resources by corrupt officials, international initiatives, such as “Publish What You Pay”, and the Extractive Industries Transparency Initiative (EITI) are being used to combat this problem.
 - iii. International programs to control the flow of illicit funds to impede the transfer of siphoned funds. Asset recovery of funds from corrupt officials is cumbersome, and it is difficult to trace funds. International cooperation in the control of criminal activity can also assist in the reforming process.

International aid and lending organizations have taken a number of steps towards a reform. Since 1997, the World Bank Institute (WBI) has undertaken a multi-pronged approach to the problem of governance and corruption, which includes civil societies’ participation, political accountability, public sector management, institutional restraints and

⁵⁷ Tavares (2003) carried out a study to determine if foreign aid corrupts. Results showed that foreign aid decreased corruption in cases where aid was associated with rules and conditions that limited the discretion of the recipient country’s officials.

⁵⁸ The Council of the OECD (1999) signed an international convention, in which it requires signatories to outlaw bribery of foreign officials. The convention has had some success; for example, corruption in defense contracts is estimated to have declined from 15 to 5%.

⁵⁹ The Integrity Pact (IP) is a tool aimed at preventing corruption in public contracting and procurement. It consists of a process that includes an agreement between the government and all bidders for a public contract. The pact maintains that neither side will pay, offer, demand or accept bribes, and sanctions will apply in case of violations. The IP also introduces a monitoring system that provides for independent oversight and accountability (Transparency International 2006).

building a competitive private sector. The Bank has launched more than 600 anti-corruption programs in nearly 100 countries. Reform within the sectors has been quite impressive. The Bank has compiled a black list of nearly 100 companies and individuals banned from receiving contracts due to bribery, or theft, and 40 contracts, a total value of \$40 million (USD) have been declared misrouted. Procurement guidelines have also been revised to state that the Bank will reject a proposal for an award, “if it determines that the bidder has engaged in corrupt or fraudulent practices in competing for the contract in question”. Within its own walls, the Bank has instituted a ‘zero tolerance’ policy for staff integrity, in order to stop and avoid any corruptive practises within the institution. However, the rhetorical commitment of ‘zero tolerance’ for corruption in projects and programs has not always been meaningfully implemented. Corruption cases found within the Bank are often shrouded with secrecy and not openly reported. The Bank’s continued lending to countries with demonstrable corruption problems; that fact has been a hot spot for criticism.⁶⁰

These reforms will not be effective unless they are enforced by every meaningful agent including the Bank and other international organizations.

V. CONCLUSION

Economic development was once viewed as a cure for all social and economic ills. However, we have been able to observe over the past 40 years, the “take-off” phase for developing countries, particularly in Sub-Saharan Africa, has been more difficult than expected. Economic growth alone can no longer be expected to resolve all the problems affecting the South.

Institutional quality has been found to have long run effects on economic growth. Corruption, which was once seen as deviant and transitory, is now a deeply rooted and permanent phenomenon with corrosive effects.

It is a fact, that in the quest for sustained economic growth, corruption can no longer be ignored, as has been shown by its consequences on investment and productivity. Poor governance and corruption serve to exacerbate almost all of the global challenges that we face today;

⁶⁰ A case in point would be Kenya; where the WBI approved a \$25 million loan in January 2006 earmarked for institution reform and capacity building, and \$120 million for railway privatization. This was despite an outcry over allegations that public officials had plotted to steal millions of dollars from the treasury. In an effort to clear its name, the Bank has delayed loans of \$265 million until the government clear the pending corruption scandal and makes moves to deal firmly with corruption (Vasagar and Wrong 2006).

challenges such as poverty, communicable diseases, conflict, malnutrition, education, etc. If the state's political and bureaucratic institutions are weak, they cannot adequately address these challenges.

When examining possible reform, it is important to note that fighting corruption through 'fighting corruption' alone will not work. Reforms in governance will begin to occur only when governments display a sincere commitment to reform. So far, the reforms mentioned are weak, and will be difficult to prescribe drastic measures, such as military interventions to deal with kleptocratic states or internal revolutions. These measures are too risky to undertake, with high levels of uncertainty of results. There is a need for a strong instrument to meet the challenge of governance and corruption; international efforts, such as checking corruption in official development aid, supporting domestic reform and undertaking international initiatives to reduce bribery and corruption, could be the key. These organizations have the capability to bring better global society, if appropriate reforms are implemented and followed through to completion.

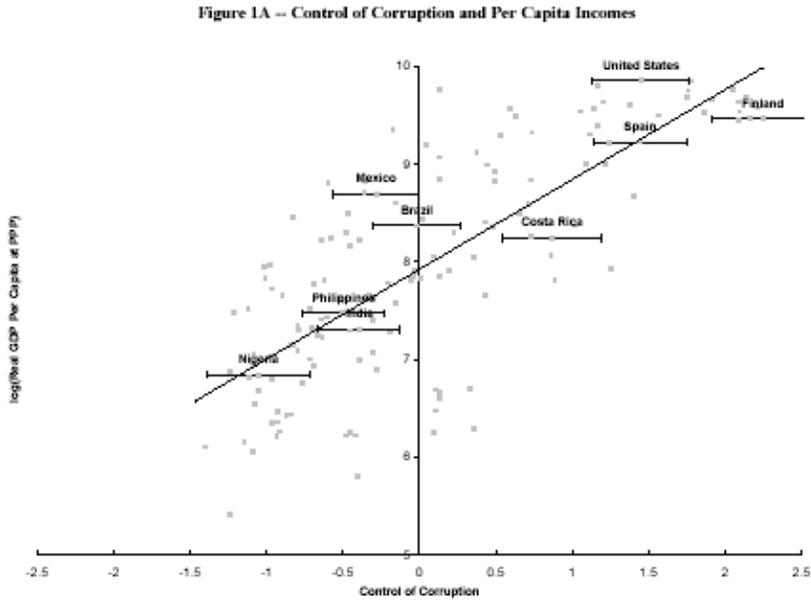
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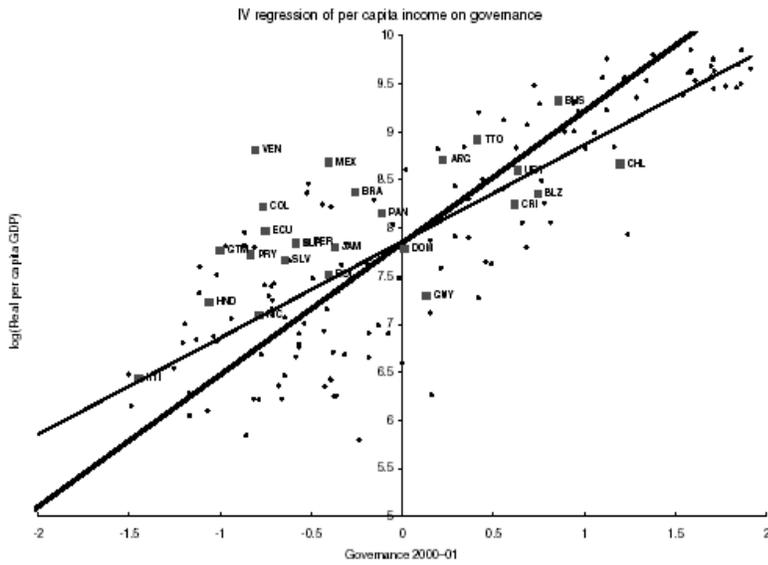
APPENDIX

Figure 1A: Control of Corruption and Per Capita Incomes



Source: Kaufmann and Kraay (2003)

Figure 2: Causal Effects of Governance on Per Capita Incomes



Source: Kaufmann and Kraay (2002)

THE MIGRATION PROBLEM IN POLAND: AN ANALYTICAL REVIEW OF THE WORKFORCE

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I. INTRODUCTION

Every year, thousands of young and relatively educated Polish workers leave their country to work abroad. This results in an increasing burden of an aging and largely inactive remaining population on the domestic workers.

This issue has been referred as to “the great migration” and a “skills exodus” in popular and academic literature. This phenomenon is causing fears of an unpredictable future for youth and the talented. Some people argue that Poland is well on its way to becoming a dismal collection of the old and the decrepit, with only those lacking initiative, staying behind to support them. Whether this is entirely true or not, Poland’s labour market is extremely flawed; wages remain very low, economic reform had been inadequate, and the contemporary political situation of the country is as uninspired as it is uninspiring. It seems inevitable this migration trend will continue in the same path, with no realistic possibility of change in a near future.

Yet there is hope for the country. Despite the migration of valuable workers, labour movements seem to be promising in delivering wanted results. In the other hand, the Polish working abroad send remittances to their remaining families and friends, boosting the economy with liquid assets, partially creating a Polish demand that is exceptionally strong, influencing an economic growth between 4% and 5%.¹ The increasing acuteness of problems exacerbated by migration may prompt the government into action. In the best case scenario, the majority of workers will return from abroad, invest money, fresh outlooks and increased human capital into Poland. However, whether this scenario materializes or the “great migration” becomes a disaster, hinges on the manner in which it is managed. Unfortunately, the lack of political will and capacity to enact

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¹ International Monetary Fund, “Republic of Poland – Concluding Statement of the 2006 Article IV Consultation Mission”; International Monetary Fund; available from <http://www.imf.org/external/np/ms/2006/052206.htm>; Internet; accessed on 27 Oct. 2006; World Bank, EU8 Quarterly Economic Report, September 2006; available from http://siteresources.worldbank.org/INTECA/Resources/EU8QERSeptember2006_MainReportFINAL.pdf; Internet; accessed on 1 Nov. 2006.

the domestic labour market seems unable to absorb this demographic bulge, the Polish youth have been quick to seek their fortunes abroad.⁶

It is also true that many migrants are relatively educated. The portion with a degree is higher among migrants than among the population at large.⁷ Again, this should not be surprising since the portion of degree-holders aged 20 to 35 is greater than amongst the entire population.

The primary destinations of these migrants are countries that have opened their labour markets: namely the UK, Ireland and Sweden. Due to historical ties and geographic proximity, Germany remains a popular destination for seasonal workers despite maintaining labour market restrictions. Austria and the Mediterranean countries have also attracted Polish workers.

In the other hand, this emigration is good news for the receiving countries. Several reports have contended that countries taking in EU-8 immigrants, mainly Poles, have benefited themselves in absolute terms, compared to EU countries maintaining restrictions of this character.⁸ The labour market impact of Polish immigrants is complementary, as they take poorly paid jobs, creating a strong labour supply at minimum wage, despite fears this migration has not had a negative impact on wages, unemployment rates or the social costs of host countries.⁹ The government of the UK, which has over half a million registered workers from the EU-8, has reported that very few Poles are seeking benefits and housing supports while an overwhelming majority (97%) are working full-time for minimum or slightly above minimum wage.¹⁰

Also the racially, religiously and culturally similarities makes it easier for Poles to be socially accepted. Therefore, political opposition to their arrival has been limited.

The demand for Polish workers does not look like it will decrease any time soon, since the benefits from this supply of labour in current host countries seems to motivate other countries in European Union to change their migration policies as their economies benefit from this. Meanwhile,

⁶ Edward Lucas, "Cheer Up: A Survey of Poland," *Economist*, 13 March 2006; 11.

⁷ Marcin Baba and Wojciech Przybylski, "Wjazd czy walka?" *Nowe Panstwo*; available from <http://www.nowe-panstwo.pl/>; Internet; accessed on 21 Oct. 2006.

⁸ Commission of the European Communities, "Report on the Functioning of the Transitional Arrangements set out in the 2003 Accession Treaty (period 1 May 2004-30 April 2006). Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions. (Brussels, 2006); 11-13.

⁹ Commission of the European Communities, 11; World Bank, *Labour Migration*; 18-21.

¹⁰ BBC, "Migrant workers: What we know," BBC News; available from http://news.bbc.co.uk/go/pr/fr/-/2/hi/uk_news/5384516.stm; Internet; accessed on 6 Oct. 2006.

remaining Euro-zone countries will have to remove existing restrictions by 2011, most likely causing an increase in demand for Poland's cheap labour.¹¹ Presently, recruitment campaigns that urge Poles to cross the border and join a foreign labour force are becoming a booming business.¹² This prompts the inevitable questions that will guide the following sections of this paper: why are Poles leaving the country, what are the implications for Poland, and what government intervention is needed?

III. THE CAUSES OF THE MIGRATION

The World Bank asserts that economic motivation is the driving force behind this massive migration. Polish wages are only about one-sixth of what UK wages are, and one-fifth of those in the EU-15 countries, while GDP per capita is only half the Euro-zone average (including the EU-8).¹³ The low wages are a result of several serious flaws in Poland's labour market. If left uncorrected, it is most likely that the wages will remain relatively low. In this section, major labour market flaws and their effect on wages will be examined. I will also discuss the reasons for the lack of faith on political leadership existence, which have a huge impact on economic variables.

Low wages and the labour market

In part, wages in Poland are low because of the high tax burden imposed on workers by those not working. Half of the population is composed of the old, the ill, and the unemployed.¹⁴ At 53.5%, Poland's employment rate trails other EU-8 countries, and is well below advanced capitalist economies.¹⁵

This is disturbing for several reasons. It indicates the presence of a large informal economy. In Poland, nearly a quarter of the economic

¹¹ Commission of the European Communities, 4.

¹² Tim Whewell, "Can Poland woo back its emigrants?" BBC News 6 July 2006; available from <http://news.bbc.co.uk/go/pr/ft/-/2/hi/programmes/newsnight/5154002.stm>; Internet; accessed on 1 Nov. 2006.

¹³ World Bank, Labour Migration; 16, 17.

¹⁴ This refers to all the people out of the labour force (46.5% of the population) and all the people who are part of the labour force but are unemployed. They make up 15.2% of the labour force and just under 7% of the population at large; Główny Urząd Statystyczny. "Miesięczna informacja o bezrobociu w Polsce we wrześniu 2006 roku"; GUS: Monitoring Rynku Pracy, 25 September 2006; available from http://www.stat.gov.pl/dane_spol-gosp/praca_ludnosc/index.htm; Internet; accessed 27 Oct. 2006; 1.

¹⁵ While the employment rate among remaining EU-8 countries increased to 60% between 1998 and 2004, Poland's employment rate plunged from 59% to 51% during that time; Economist, 4.

activity takes place outside of the formal sector, raising even further the tax burden for the legally employed.¹⁶ Secondly, there is a disproportionate amount of “economically inactive” people who claim to be sick. Nearly a quarter of the people not in the labour force claim illness or disability as a cause of inactivity. This figure is roughly twenty times as high as neighbouring Slovakia, and almost four times as high as the Organization for Economic Co-Operation and Development (OECD) average, and the problem persists despite reforms to disability benefit schemes.¹⁷ The number of “sick” people indicates corruption in the medical sector, as doctors likely charge premiums to diagnose an incredulous one in four non-working people (and one in eight Poles in general) as “too ill to be productive”. This has had a curious effect on the migration of workers from the medical sector. As Marek Okolski points out, doctors most likely to emigrate are those with limited ability to supplement their relatively meager wages with bribes.¹⁸ Indeed, it is anaesthesiologists and surgeons who lead the pack of emigrating medical specialists.¹⁹

The social tolerance of the decidedly unlikely sickness rate can partially be explained by a long-standing anti-authoritarian mentality among many Poles.

This attitude buttresses the belief that cheating the government, or working against the system, is not only acceptable, but somehow desirable. However, considering the virtually non-existent reports of social welfare abuses in the countries that Poles emigrate to, it is reasonable to assume that when compliance with the law entails better employment prospects, higher wages and higher standard of living, the historical tendency to work against “the system” can be overcome.

The burden of the old

Polish pensioners account for a large portion of dependents. However, for the past 15 years the burden of the old has been larger than it should, and current trends indicate that is not about to change. At the time of transition, the economy was reorganized for the free market leading artificially high employment rates to plummet. As part of an attempt to

¹⁶ Aleksander Surdej, “Managing Labor Market Reforms: Case Study of Poland,” Draft background paper prepared for the World Development Report 2005. (Krakow University of Economics, 2004); 13.

¹⁷ Organization for Economic Co-Operation and Development (OECD), “Economic Survey of Poland, 2006”; OECD Policy Brief, June 2006, available from www.oecd.org/publications/Policybriefs; Internet; accessed on 11 Oct. 2006; 9.

¹⁸ As quoted in Dominika Pszczolkowska, “Czeka nas milion emigrantow”; *gazeta.pl*, 11 May 2006; available from <http://serwisy.gazeta.pl/swiat/2029020,34181,3334402.html>; Internet; accessed on 27 Oct. 2006.

¹⁹ World Bank, Labour Migration; 23.

lower the resulting high rate of unemployment, many workers whose jobs disappeared along with state-run industries and collective enterprises, were pushed into early retirement. This was done as successive governments “propagated the economic fallacy that there exists a lump sum of jobs in the economy; so by sending the elderly on retirement, jobs are freed for the young.”²⁰ The immediate effect of this policy was that the working life of an entire generation of Poles was effectively shortened by a decade, with average retirement ages being 55 for men and 57 for women.²¹

Even now, retirement schemes remain generous. Unemployed men and women with a working record of 35 and 30 years, respectively, may retire early, if they worked in jobs where conditions are considered “adverse”. Aside from foregone productivity, the social costs of Poland’s retirement strategy continue to be significant. Currently, pensions and retirement schemes account for 50% of social expenditure, while the rate of pension contributions has grown threefold since the time of the transition, from 15.5% to 45%.²² On the bright side, as most developed countries worry about the aging proportion of their populations, Poland is in the unique position of being able to offset an increasing burden of the aged by raising a below-optimal retirement age. However, a recent OECD report shows that this is not happening. In fact, the growth of pre-retirement schemes and unreformed access to certain types of benefits has actually lowered the retirement age in recent years.²³

The burden of the aging population goes a long way to explain Poland’s low employment rate and high dependency ratio, which in turn, is translated into high taxes that provides a disincentive to work, and curtails foreign investment by raising per-unit labour costs. It seems equally clear that the burden will not become any lighter in the foreseeable future.

Low productivity

The low productivity of the Polish worker is a noteworthy consequence of socialist economic policies. On average, Polish workers are only about a third as productive as their American counterparts.²⁴ This is a huge counterweight to the low-labour cost incentive Poland offers. Worse yet, this low labour productivity actually leads to higher per-unit costs than in

²⁰ Surdej, “Managing Labor Market Reforms: Case Study of Poland”; 9.

²¹ Surdej, “Managing Labor Market Reforms: Case Study of Poland”; 9.

²² Surdej, “Managing Labor Market Reforms: Case Study of Poland”; 10, 12.

²³ OECD, 9.

²⁴ Bart van Ark, Edwin Stuivenwold and Gerard Ypma, “Unit Labour Costs, Productivity and International Competitiveness.” GGDC Research Memorandum; Available from Groningen Growth and Development Centre, Item 200580; <http://ideas.repec.org/p/dgr/rugggd/200580.html>; Internet; accessed 27 Oct. 2006; 11.

more technologically advanced countries. Predictably, this curbs foreign direct investment (FDI) and considerably slows down the rate at which industry develops and wages grow.²⁵

Using the motor industry as an example, Romy Husan notes: "... there have been no generalized, major investments outside the [technology frontier areas] by the leading manufacturers, and consequently, no transfer of the motor vehicle industry to low labour cost regions."²⁶ Husan also points out that this is despite the motor sector being the industrial sector that has attracted more attention from international companies in Poland than any other sector.²⁷

This begs the question: why are Poles relatively unproductive? When looking to answer that question, it is important to begin by examining two of productivity's main determinants: skills and knowledge gained at school, and skills and knowledge gained at work. In both regards, pre- and post-transition, Poland has considerable problems.

First and foremost, schools are not teaching what the labour market demands. When surveyed, foreign investors claimed that it takes an average of 6.5 months of training to bring a university level graduate to the same level of productivity, as a comparable worker in their home countries.²⁸ Other problems arise, as a result of sub-par technological abilities, and poor managerial skills possessed by Polish graduates.

The communist-era educational system is partly to blame for the lack of synthesis between what people know and what the labour market needs. In line with their ideology, communists emphasized vocational training over general education with many students receiving only specialized vocational training in secondary school. This left many people "ill-prepared for coping with the changing demands of a market economy", since their skills, concentrated in largely defunct sectors of the economy (eg. mining and steel), were rendered useless, and their lack of general education made them very difficult to retrain.²⁹

That being said, there has been no real efforts to change this educational system. This trend continues, even in light of the high long-term structural unemployment prompting the OECD to grant Poland the dubious distinction of a country that "really stands out in its meager

²⁵ Van Ark et al., 28.

²⁶ Romy Husan, "The limitations of low labour costs as an inducement to foreign direct investment: an example from the motor industry"; *European Business Review* 96 (1996): 29.

²⁷ Husan, 26.

²⁸ Feldmann, 281.

²⁹ Feldmann, 278.

provision of training for the unemployed.”³⁰ In addition to neglecting the unemployed, post-transition governments have reduced the amount of spending on education as a percentage of the GDP.³¹ Between 1995 and 2000, there was a drop from 5.5% to 5.2% of GDP spent on public education. This is unfortunate, since Poland has a fair amount of catching up to do, not just compared to western democracies, but even compared to other EU-8 countries. Around 42% of Poles possess only basic reading, writing and arithmetic skills, with only a quarter of the population possessing adequate prose literacy skills. By comparison, nearly half the population of the Czech Republic possesses adequate literacy skills.³² Ironically, a decision to completely eliminate vocational schools is now being blamed for a nation wide shortage of trades people.³³

Furthermore, the decline in educational spending has done nothing to improve the quality of post-secondary education. Apart from a handful of respected institutions, most fully-funded public universities are mediocre, riddled with an extensive bureaucracy and rife with cheating.³⁴ Indeed, Horst Feldmann, author of a report on labour market flexibility in three EU accession countries, concludes that although the number of tertiary graduates is increasing, “the Polish education system is still releasing many young people with insufficient qualifications to the labour market – in spite of the fact that the trend in labour demand towards higher qualifications has even accelerated in the past few years.”³⁵

The private sector is attempting to fill this gap, however, the OECD reports that a massive increase in the amount of private, tuition-charging higher, educational institutions has resulted in inequity, a misallocation of resources and a large gap in the quality control and accreditation system.³⁶

The problems plaguing higher education in Poland have resulted in comparatively low returns to education, with every year averaging a return of 7% increase in wages as compared to over 9% in the U.S.³⁷ The problem with the post-secondary education system is to identify a central cause behind the high proportion of educated people among migrants. It is not, as often argued, a significantly high level of education of Poles that accounts for the many educated emigrants, but the low returns to education, which cause the educated to leave.

³⁰ OECD, 8.

³¹ Feldmann, 278.

³² Feldmann, 279.

³³ Stefan Wagstyl, “Skills exodus worries Polish employers,” *Financial Times*, 9 Feb 2006, 6.

³⁴ Lucas, 11.

³⁵ Feldmann, 280.

³⁶ OECD, 7.

³⁷ Feldmann, 281.

Low regional labour mobility

History has bestowed the Poles, the world's fifth most dispersed population, with a high propensity to migrate.³⁸ Several waves of migration, from the post-WWII resettlement of Poles in western lands to the quarter million that left during the imposition of martial law in the 1980s, to the current emigration, have resulted into large groups of Poles often being on the move.³⁹ Paradoxically, this has not been observed on an intra-national level as Poland's regional mobility is very low. This suggests, that if people are going to move, they will not simply move to obtain work, but to obtain work that pays well. Given the relatively high wages in the West, relocating for employment has come to mean leaving the country.

Low regional labour mobility is also symptomatic of problems in the housing market where shortages, rent-controls and high mortgages make it difficult for people to find housing in cities. Increased benefits for regions with higher unemployment, and a high level of subsidy to farmers and their dependants, also act as disincentives for people to leave economically unproductive regions.⁴⁰

Politics and expectations of the future

The politics of Poland are the key in determining expectations about the future of the country. Like many post-communist countries, the politics of Poland are defined by conflict, unstable coalitions and a lack of ability or desire to undertake many necessary reforms.

According to Aleksander Surdej:

“Increasingly bad governance has been identified as the main obstacle to economic development, and to the legitimacy of democratic government, whereas corruption has been indicated as its worst consequence.”⁴¹

“In a mature democratic system, the tendency to exploit public positions for private gain is tempered by the desire to be re-elected, bylaws about admissible and inadmissible

³⁸ Martyna Bunda, “Wielki odjazd”; Tygodnik Polityka, August 2006; available from http://www.polityka.pl/polityka/index.jsp?place=Text01&news_id=171719&news_cat_id=602&layout=1&page=text; Internet; accessed 1 Nov. 2006; 2.

³⁹ Stefan Alscher, “Country Profile: Poland”; Migration Research Group; available from http://www.migration-research.org/dokumente/focus-migration/CP03_-_Poland.pdf; Internet; accessed 23 Oct. 2006.

⁴⁰ OECD, 9.

⁴¹ Aleksander Surdej, “Political Corruption in Poland: Sources of Corruption in Post-Communist Poland,” A publication of the Research Centre for East European Studies. (Bremen, 2005): 5.

behaviour, and by ethical codes. These three restraints do not function well in Poland.”⁴²

IV THE EFFECTS OF LABOUR MIGRATION IN POLAND

The effects of the migration have been becoming evident on recent trends; the fall in unemployment is the most evident upshot with the current unemployment rate of 15.2%, this being the lowest in several years.⁴³ The link between the emigration and this downward trend is clear, since the drop is mainly due to a drastic reduction in the youth unemployment rate. This drop on the unemployment rate is welcome by populist politicians, since it reduces the burden of the unemployed and takes some pressure off the labour market.

Another positive effect is the high amount of remittances sent by Poles from abroad. In this respect, Poles are leading the EU-8 countries with the amount sent home by workers, reaching a billion USD per quarter during the second part of 2005. This money keeps the domestic demand strong. It is encouraging to know that some of the remittances are also being increasingly spent on augmenting the human capital of household members, primarily by investing in their tertiary education.⁴⁴

In terms of labour, the demand for labour has grown, particularly for trades people and people with tertiary education.⁴⁵ Despite the still high unemployment rate, Poland is beginning to experience labour shortages in certain sectors.⁴⁶

The labour shortage is prompting some employers to boost salaries and/or offer bonuses to highly demanded workers, leading to a hike in wages. Consequently, wages have increased in certain sectors, but wages, on average, have not kept pace with inflation, and the average real wage has actually fallen slightly.⁴⁷

⁴² Surdej, “Political Corruption in Poland: Sources of Corruption in Post-Communist Poland,” 19.

⁴³ Główny Urząd Statystyczny. “Miesięczna informacja o bezrobociu w Polsce we wrześniu 2006 roku”: 1.

⁴⁴ World Bank, Labour Migration; 25, 26.

⁴⁵ Główny Urząd Statystyczny. “Popyt na Prace w I Polroczu 2006 Roku”; GUS: Monitoring Rynku Pracy, 25 September 2006; available from http://www.stat.gov.pl/dane_spol-gosp/praca_ludnosc/index.htm; Internet; accessed 27 Oct. 2006: 4.

⁴⁶ Whewell, <http://news.bbc.co.uk/go/pr/fr/-/2/hi/programmes/newsnight/5154002.stm>.

⁴⁷ Wages have risen particularly in the agricultural and construction sectors; World Bank, Labour Migration; 23. The real wage has fallen and in the second quarter of 2006 it was at 95.1% of the previous period; Główny Urząd Statystyczny, “Przeład podstawowych danych w kwartalach 2004-2006,” Tablica 1. 28 September 2006;

A closer look at some recent trends also reveals further cause for concern. Although unemployment, as a portion of the labour force has fallen, the size of the labour force has also decreased. Two hundred thousand people left the ranks of the economically active between mid-2005 and mid-2006.⁴⁸ Meanwhile, the amount of economically inactive people has risen by over 300,000 most of them are discouraged workers, retirees, and people staying home for domestic reasons. The proportion of long-term unemployed rose, as did the number of people quitting their jobs due to personal reasons or illness.

It is clear, that these statistics are not telling the whole story. The shifts of population in and out of the labour force are not corresponding to what should theoretically be occurring. Of the 700,000 people that left the ranks of the unemployed, 500,000 were absorbed by the Polish labour market. It can be presumed that the remaining 200,000 people went to work abroad. The fact that the youth unemployment rate dropped, corresponds with data that points to the predominance of youth among the migrants. That still leaves questions as to the increase of 300,000 people considered economically inactive. Also, every estimate shows that much more than 200,000 people are leaving the country to work. This means migrants are continuing to be classified as unemployed (perhaps explaining the exceedingly high long-term unemployment rate) or are classified as sick, retired, discouraged, or occupied with family duties. The latter two groups do not receive benefits and their numbers are relatively small.⁴⁹ That leaves benefit-recipients as a probably source of migrant labour, something that has been acknowledged as a growing problem by the country's political establishment.⁵⁰ The discrepancies in the profiles of the unemployed, the demand for labour, and the amount of people working abroad, suggests that this is indeed the case.

For example, demand for industrial workers and tradesmen accounts for the largest share of labour demand with more than one third of new jobs.

http://www.stat.gov.pl/dane_spol-gosp/praca_ludnosc/zatr_wyn/2006/02/; Internet; (Retrieved 31 Oct. 2006).

⁴⁸ Please see corresponding chart in Appendix A.

⁴⁹ Out of the 51.3% of the economically inactive who are considered of productive age, 17.8% were out of the labour force due to domestic duties and 7.7% were discouraged. It is likely that the number of people out of the labour force due to family duties is legitimate due to low-quality, high-cost childcare; Główny Urząd Statystyczny, "Miesięczna informacja o bezrobociu w polsce we wrzesniu 2006 roku": 15, 16.

⁵⁰ Yahoo News. "Polish leader admits some Poles abusing British welcome"; Yahoo, 7 Nov. 2006; available at http://news.yahoo.com/s/afp/20061107/wl_uk_afp/britainpolandlabour_061107185223; Internet, accessed on 7 Nov. 2006.

Yet, these workers comprise the largest portion of the unemployed.⁵¹ This is problematic because it means that either workers are not being matched up with jobs, perhaps due to lack of regional mobility, or that they are claiming unemployment, and at the same time, they are working abroad or in the informal sector. Either way, if this trend continues, nothing will change for the better of the economy; taxes will remain high, as employment rates stay low.

A falling amount of students attending post-secondary education seems to be another effect of this migration. The number of students has fallen by 4% since 2005, a figure that suggests that people are beginning to forfeit post-secondary education in order to work abroad.⁵² In the long term, a trend to this effect will mean a lower level of human capital. Even in the short term it is a very negative indicator, as it shows people are not training for the jobs that are available in Poland. A very low unemployment rate for people with tertiary education, and the growing demand for workers with that education level would suggest that more people, not less, should be attending post-secondary institutions.⁵³

Another source of further concern is the exploitation of the workers by western employers. Reports of slave labour camps, full of Polish workers in the Mediterranean countries, and groups of Polish trades people in Ireland, are being paid less than a third of the country's legislated minimum wage, highlight the extreme extension of this exploitation.⁵⁴ However, even in the legal realm, the reality is such that Poles are mainly working below their qualifications in jobs called "D" – dirty, dull and dangerous – and doing so for minimum wage.⁵⁵

V. IMPLICATIONS OF THE MIGRATION

How long will the emigration last? What will the net effect on the country be? How drastically should the government act? The answer to

⁵¹ Główny Urząd Statystyczny, "Popyt na prace": 4; Główny Urząd Statystyczny, "Kwartalna informacja o aktywności ekonomicznej ludności": 13.

⁵² Główny Urząd Statystyczny, "Miesięczna informacja o bezrobociu w Polsce we wrześniu 2006 roku": 15.

⁵³ The unemployment rate for tertiary graduates has fallen from 6.8% to 5.4% since the second quarter of 2005. All other levels of education have unemployment levels in the double digits. 17.3% of job vacancies is for specialists with a higher education and almost a third of all vacancies are for people with higher education; Główny Urząd Statystyczny, "Miesięczna informacja o bezrobociu w Polsce we wrześniu 2006 roku": 12; Główny Urząd Statystyczny, "Popyt na prace": 4.

⁵⁴ Lucia Kubosova, "Brussels moots EU penalties for black market employers," Euobserver.com, 19 July 2006; available at <http://euobserver.com/?aid=22134>; Internet; accessed on 20 Oct. 2006.

⁵⁵ Bunda, www.polityka.pl/

these questions is derived from a simple, cost benefit analysis of the migration issue. Simply put, people will choose to leave as long as their private benefits exceed their costs. When the social costs begin to exceed the benefits, the government should put practical policies in place to provide incentives for workers to remain in Poland.

When choosing to emigrate, a rational individual will weigh the costs and benefits of leaving. Costs will include the logistical cost of getting out of the country, the loss of family, social and cultural connections, the high likelihood of forfeiting career advancement, increased difficulty in establishing a family, and a lowered status as an immigrant.

Family and social connections are likely to be the biggest consideration for emigrants, but it is not as much of an aversion to emigration as it may have been in the past. Most people leaving Poland are only planning to do so for a short term, and the existence of cheap flights enable workers to return home frequently. Also, if they are young, it is likely they do not have a spouse and children to return to, and as far as social connections are concerned, the existence of large numbers of their peers working abroad may even act as an incentive.

The high likelihood of forfeiting a career is a more relevant consideration, since around 75% of those working abroad are working below their qualifications.⁵⁶ Again, the short-term duration of their terms abroad limit this consideration, and many people believe that they will leave the country to work for a while, make some money to buy a car or an apartment in Poland, and find work in their field when they return. This is the optimal, mind-frame of an emigrant.

The private benefits of emigration are access to employment, higher wages, improved living standards, and the ability to send money home and to support the family, etc. As well, most emigrants improve their language abilities and skill sets, while permanent emigrants can raise their children abroad, and confer upon them all the benefits of citizenship in a rich, well-functioning country. Again, it is crucial to underline the importance of expectations in determining the behaviour of migrants. If they believe their country will be able to offer them access to employment, higher wages and a better standard of living in the future, they will plan to return. If not, greater numbers may choose to leave permanently. In short, the likelihood of the best-case scenario described above diminishes along with expectations of positive change.

In terms of social benefits, the most obvious effect of this migration are remittances sent home from abroad. A billion USD per quarter is a

⁵⁶ Baba and Przybylski, www.nowe-panstwo.pl; World Bank, Labor Migration: 15.

significant infusion into domestic consumption.⁵⁷ Also, people tend to return from abroad with augmented human capital, a better understanding of well-functioning democracy, and advanced capitalism, better business practices and money.⁵⁸ This can, and should be, harnessed by the state to speed Poland's economic development. Unfortunately, these benefits are in danger of being eclipsed by the rise in social costs. The falling real wage, labour shortages, a declining taxpayer base, and widespread benefit abuses are threatening to become huge problems in the future.

VI. POSSIBILITIES FOR GOVERNMENT ACTION

Countries like Spain and Ireland have shown that migration, accompanied by a sound government with efficient policies in place, can help the country dramatically to improve its economic situation. In Poland, the key phrase "sound government policy" requires the political establishment to first, and foremost recognize the problem as one of domestic labour market flaws, and policy failures, rather than as a consequence of economic openness.⁵⁹ Second, there must be political will for reform, which requires a cohesive government and a shift of focus away from populism and power politics. Thirdly, reform efforts must be multi-faceted and range across several time periods. As such, the following policy suggestions will be organized as short-term, medium-term and long-term.⁶⁰

Short-term

The government can begin by reforming the social transfer system. Abuses must immediately be curtailed by tying social benefits to conditions such, as work training or retraining, participation in job-placement programs, and relocation for work when necessary. The work capacity of disability and sickness benefit recipient should be regularly reassessed and the illnesses qualifying for benefits should be reconsidered. People claiming an easily falsified illness should need a minimum of three diagnoses from separate doctors in order to be considered for benefits.

Curbing abuses to the social benefit system entails tackling corruption in the medical sector. This can be accomplished through a carrot and stick approach: a simultaneous increase in the wages of medical workers, and an

⁵⁷ World Bank, Labor Migration: 26.

⁵⁸ Lucas, 11.

⁵⁹ See Whewell, <http://news.bbc.co.uk/go/pr/fr/-/2/hi/programmes/newsnight/5154002.stm>.

⁶⁰ Many of the reform proposals draw from 2006 reports by the World Bank, the International Monetary Fund and the OECD. All of these reports are contained in the bibliography.

increase in punishments for corrupt behaviour.⁶¹ Retirement benefits must also be reformed. It is unacceptable that as Polish citizens are aging, their already low retirement age should be falling: the average age of a pensioner must rise. To this effect, all pre- and early-retirement programs must be fully phased out, while a retraining program aimed at middle-aged people is implemented.⁶²

Government should lower income taxes to counter the falling real wage, and make the gap between unemployment benefits and wages more significant, so people have a greater incentive to work in the formal sector. It should be noted that any temptation to cut overall unemployment benefits should be resisted, as Poland's level of benefits has already fallen below the threshold where the absolute value of the benefit is so low, that it actually raises the number of claimants.⁶³ In terms of tax reform, the government may want to consider supplanting an income tax cut with a consumption tax, as a form of indirect tax of migrant workers who are, in effect, using the country's social infrastructure at below cost.

Medium term

Tackling low regional mobility should be the next priority. First, the separate social security system for farmers, and the regional differentials in unemployment benefits should be eliminated. The existing differences simply give people an incentive to stay in unproductive areas. Next, the government should focus on the housing market, so that people moving for work also have somewhere to live. A good place to start would be to encourage private housing development by phasing out existing rent controls, and create development-friendly legislation. Currently, foreign investors are buying up apartments in Poland at a frenzied pace, driving up the prices of existing dwellings. New housing developments are being stymied by regulatory problems, and the resulting housing shortage is further boosting prices.

⁶¹ After several strikes, the Polish government has recently raised the wages of medical workers but the increases are too moderate to make much of a difference either to the corruption in the medical sector or to the propensity of medical workers to emigrate. See Agnieszka Domanowska, "Lekarze rowni i rowniejsi"; gazeta.pl, 3 Nov. 2006; available from <http://miasta.gazeta.pl/bialystok/1,35241,3718516.html>; Internet; accessed 6 Nov. 2006.

⁶² OECD, 9.

⁶³ A study on unemployment in transition economies showed that if benefits go below a certain value the amount of claimants actually increases. This happens as authorities, knowing that benefits are not enough to ensure survival, turn a blind eye to people who supplement their benefits through work in the informal sector; see Milan Vodopivec, Andreas Worgotter and Dhushyanth Raju, "Unemployment Benefit Systems in Central and Eastern Europe: A Review of the 1990s," *Comparative Economic Studies* 47 (2005): 621.

Bottlenecks and skills shortages should be remedied through a selective immigration process. This is preferable to target training people, because until wages increase significantly, people trained in demanded professions will simply continue to emigrate. Poland is in a very good position, because although it is an emigrating country, it is a magnet for immigrants from the east, primarily from former Soviet republics such as Ukraine.⁶⁴ Through effective immigration policy, Poland can benefit from labour mobility by strategically employing cheap, willing labour.

Long term

Of utmost importance, in the long term, is ensuring a path of eventual wage and per capita output convergence with other European countries. The only way wages can rise steadily and without being decimated by inflation is if productivity rises as well. In the longer term, productivity can be positively affected by augmenting the human capital of the population. On-the-job training programs should be encouraged through tax breaks, awareness campaigns, and incentives to businesses to upgrade the skills of their workers. Reform to the tertiary education system is necessary, if Polish universities are ever to turn out top-notch graduates.

The OECD rightly comments: "... an advisable reform would allow public Higher Education Institutions (HEI) to charge cost-related fees (not necessarily full-cost recovery) for all students, at the same time increasing the provision of grants to maintain accessibility."⁶⁵ The organization also advises undertaking measures to motivate teachers, as they claim many public-sector universities have "opaque" career structures that "do not depend closely on either teaching ability or research output."⁶⁶

Poland must also continue shrinking the public sector. The communist era left behind a large public sector and all the problems associated with it. Among these are a bloated and inefficient bureaucracy, high levels of regulation, corruption and waste. Poland must continue removing unnecessary public officials, shrinking departments and removing barriers to the further development of the private sector.⁶⁷

VI. CONCLUSIONS

There is not a tremendous amount of debate among leading economists as to what Poland's problems are and how they should be resolved. The

⁶⁴ Alscher, http://www.migration-research.org/dokumente/focus-migration/CP03_-_Poland.pdf: 2-5.

⁶⁵ OECD, 7.

⁶⁶ OECD, 8.

⁶⁷ OECD, 10.

Polish labour market has many evident flaws; unemployment is high, and youth unemployment is very high, wages are low, corruption is rampant, and the education system does not fully suit the needs of the market. The employment rate is the lowest in Europe and nominally, at least, nearly half the population is either retired, discouraged or sick. Meanwhile, the young and educated are leaving the country to work abroad, nearly always beneath their qualifications. Their absence is causing skills shortages and bottlenecks at home, giving a boost to wages, but an even bigger boost to inflation with a negative net effect on the real wage.

The solutions to these problems are also fairly clear, and as such, many policy recommendations in this paper are echoed in reports by the IMF, the World Bank and the OECD. Reforming the social transfer system, improving regional mobility, retraining the population, facilitating immigration, improving post-secondary education, and decreasing the size of the public sector, are steps that would undoubtedly improve Poland's economic development. These reforms would also turn the country into a net benefactor of labour mobility.

Considerably more contentious is whether the political resolve to implement these reforms exists or will exist in the near future. At present, there is no indication of such will. Through elections and opinion polls, Poles have consistently voiced their support for cleaning up corruption and dishonesty by voting for the Law and Justice Party (PIS) and for undertaking liberalizing reforms by voting for the Civic Platform Party (PO). They have also indicated that they want to be ruled by a coalition of the two. That these parties have not been able to form a coalition and give electors what they desire, speaks to the lack of maturity and petty quarrelsomeness that characterizes Polish democracy. Thus, until Polish politicians begin living up to the mandates handed to them by the country's electorate, the great opportunities of the labour migration will continue to be squandered.

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necessary reforms is steering the country towards the second less optimistic outcome.

II. THE SCOPES AND CHARACTER OF THE MIGRATION

It is hard to measure the scope of Poland's labour migration for two reasons. First, no centralized reliable data is available. Therefore, estimates from various sources can be quite different. Second, media reports about illegal workers indicate their existence, but there is no official data, extending the possibility that most figures underestimate the extent of the migration.²

Among data gathering organizations, the World Bank provides the most plausible numbers. The bank found that by 2002, 786,100 Polish citizens were staying abroad for more than two months.³ Every year, from 1994 to 2005, between 130,000 and 290,000 Poles stayed abroad for more than two months. Since the country's accession to the European Union (EU) in 2004, the rate of emigration quickened, and it is estimated that 1 million Poles have left since then. Also, if seasonal workers working abroad for less than two months are accounted for, the yearly rate of workers leaving Poland is between 300,000 to 350,000. These figures would indicate that just under 2 million Poles have left the country to work abroad over the past 12 years. Nearly 70% of workers stay abroad for less than a year, and the increase in emigrants since 2000 has been mainly in short-term workers. Meanwhile, the number of people staying abroad for longer than a year has remained stable since accession.⁴

The increase in the rate of emigration has prompted widespread fears that it is the young and the educated who are leaving Poland. Indeed, it is the young that are leaving, the vast majority of emigrants are between ages 20 and 35 and their proportion among migrant workers has been on the rise since 1994.⁵ This fact alone should not cause such alarm, given the case that young people are more mobile and willing to relocate. In addition, Poland had a small increase in births or a "baby boom" in the late 70s/early 80s, which is the generation that is currently entering the labour force. As

² See Flintan O'Toole, "The European Union's Two Faces on Globalization"; Open Democracy: Free Thinking for the World, 22 March 2006; available from <http://opendemocracy.net/>; Internet; accessed on 23 Oct. 2006).

³ World Bank, "Labour Migration from the New EU Member States," EU8 Quarterly Economic Report Part II: Special Topic. September 2006; available from <http://www.worldbank.org/eu8-report>; accessed on 1 Nov. 2006); 3.

⁴ World Bank, *Labour Migration*; 4, 14, 15.

⁵ World Bank, *Labour Migration*; 14.