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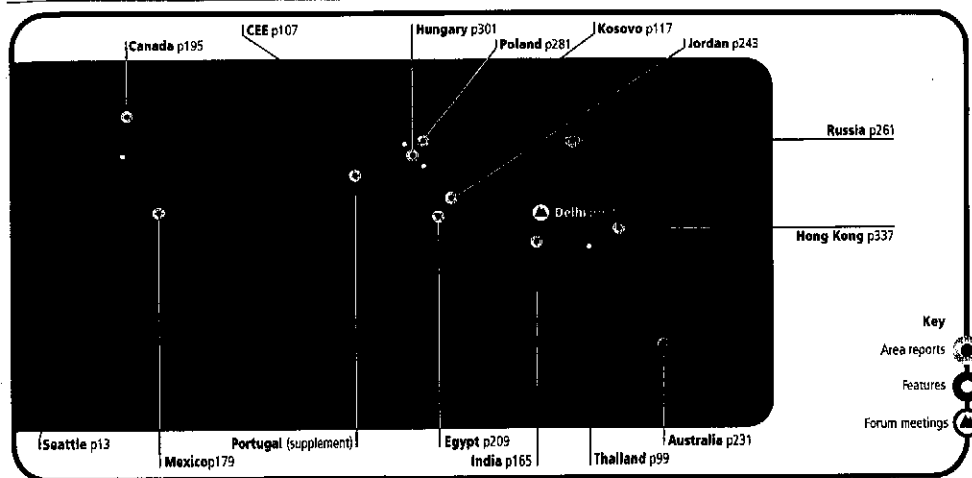
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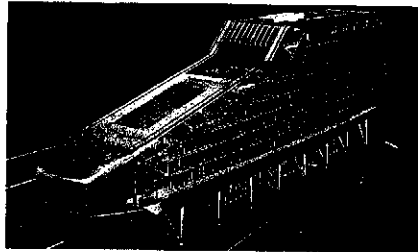
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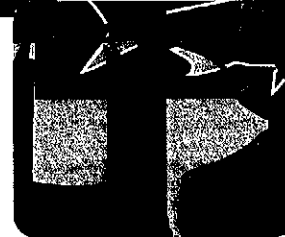
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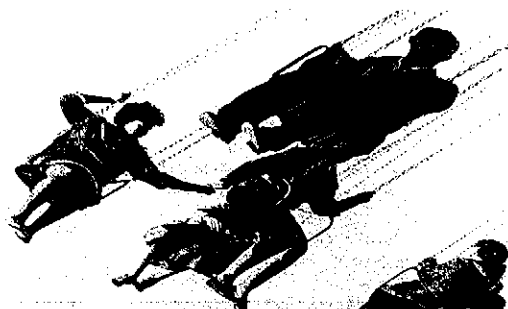
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DAVOS 2000

Corruption acts as a tax on the public, on companies that are its victims and undermines the business environment as a whole. Here Rob Jenkins explains how

# A TAX OF THE WORST KIND

Political and business leaders around the globe are today more than ever involved in seeking common solutions to the problem of corruption. Popular theories of the 1970s, which defended corruption as efficiency-enhancing, or at the very least a necessary evil, have been debunked by a mountain of research demonstrating its corrosive impacts. These include lost productivity, increased poverty, skewed public expenditure patterns and a host of other downstream ills.

One study found that a country which improves its standing by two points on the 0-10 "corruption perception index", created by the Berlin-based non-governmental organisation Transparency International, will see its investment rate increase by 4% and its GDP by about 0.5%. Another found that a strong correlation exists between high levels of corruption and poor-quality infrastructure, largely because insufficient funds are devoted to operations and maintenance, which are less lucrative sources of illicit income.

More recent research has argued persuasively that not only does corruption impose a kind of tax, on both firms and citizens at large, it also tends to undermine

the very institutions upon which functioning markets depend. Property rights and impartial mechanisms for enforcing commercial contracts are both imperilled when judges are for sale. If bank regulators take back-handers to look the other way when capital-adequacy norms are violated, rationality in the allocation of credit is dealt a fatal blow.

The persistent scale of worldwide corruption is a puzzle to many observers. At the beginning of the 1990s, as former Soviet-bloc countries joined developing nations as participants in World Bank and IMF market-orientated reform programmes, it seemed to many economists that corruption was well on its way to being eliminated. By cutting onerous regulations, and thereby reducing the discretionary powers of officials, economic liberalisation was supposed to tackle the root causes of corruption. Reducing import tariffs, for instance, decreases the incentive for smugglers to pay off customs officers. And by doing away with the artificial scarcities created by state-dominated economies, it was thought that bribe-taking bureaucrats might become an endangered species.

Things didn't quite turn out that way. Paulo Mauro, an IMF economist, argues that "the shift from command economies to free-market economies has created massive opportunities for the appropriation of rents [that is, excessive profits] and has often been accompanied by a change from a well organised system of corruption to a more chaotic and deleterious one."

## INVITATION TO CORRUPTION

My own first-hand research into the politics of economic reform in countries like India, Uganda and South Africa suggests two very good reasons why liberalisation has not stamped out corruption as originally hoped. First, the process of transferring assets and responsibilities from the public to the private sector is itself an invitation to such forms of corruption as sweetheart privatisation deals and lop-sided implementation of investment-promotion tax incentives.

The second reason stems from the continuous nature of reform programmes in most developing and transitional economies. The initial "big bang" reforms are usually followed by an open-ended process in which governments tinker with alterations to import-export rules, experiment with regulatory authorities, introduce corporate governance reforms and so on. This means the number of policy decisions, and their frequency, actually increases.

For each decision, policymakers can choose from a menu of legitimate options, each based on bona fide recommendations from consultants based in Washington, Paris or Geneva. Reformers, in short, have great discretion in determining how reform is to be implemented. Which options they choose in each case has implications for major business groups.

The opportunities for corruption thus continue to evolve and in some cases far exceed the possibilities during the era of state control. Even where reform decisions are taken impartially, advance notice can be

### ROB JENKINS

Jenkins teaches politics at Birkbeck College, University of London. He has conducted extensive research in Uganda, South Africa and India and is most recently the author of "Democratic Politics and Economic Reform in India"

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# DAVOS 2000

## A TAX OF THE WORST KIND

extremely valuable to private sector players, especially when regulations governing capital markets are concerned. Continuous reform makes inside information, on both timing and substance, a much sought after commodity.

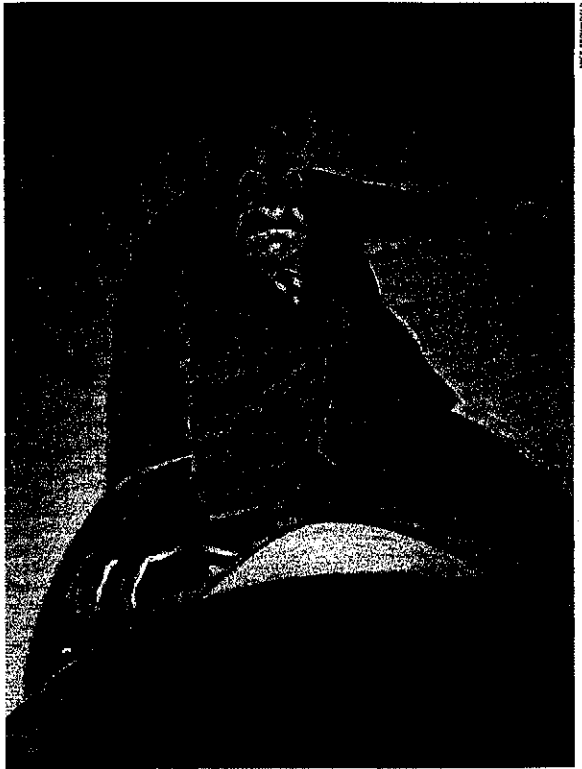
That the fate of both foreign and local firms hinges on these increasingly complex policy decisions highlights the importance of international factors in explaining why corruption has not only not vanished, but by some estimates actually increased. According to Michael Johnston of Colgate University: "A world in which capital, people, information and enterprises move freely and rapidly from place to place offers new development opportunities of many sorts, but also makes accountability more difficult. Because the agents of cross-border corruption are capable of doing business almost anywhere, it is difficult to hold them accountable anywhere."

Indeed, economic globalisation has had profoundly ambiguous implications for corruption. On the one hand, highly internationalised financial markets have "disciplined" countries which impose burdensome regulations or deviate from internationally accepted accounting norms. As we have seen, this does not eradicate corruption. But it makes a dent in some of the more obvious forms. On the other hand, porous borders allow in not only legitimate businesses, but also those based on illegal activities. Drug cartels and crime syndicates involved in the cross-border traffic in human beings have found their work made easier by the less restrictive policies of states seeking to integrate themselves into the global economy.

"Common border" immigration agreements among neighbouring countries - like the Schengen group in Europe - are only as strong as their weakest link. The same holds for customs unions. Once inside the enlarged boundaries, illegal immigrants (or untaxed goods) can move into the other countries. Criminal organisations target these vulnerable entry points. The funds obtained from those who pay for their help provide organised criminals with ample resources to bribe security officials who might otherwise be inclined to crack down on their other illegal business operations.

Once corrupted by foreign criminal organisations, a country's officials are less likely to administer impartial justice to legitimate businesses and are more likely to demand bribes for routine services. In an integrated world, organised crime, like financial crises, can generate severe contagion effects.

Recognising this, western governments have committed themselves to assisting efforts to combat corruption elsewhere. In 1998, then US under-secretary of state Stuart Eizenstat told a group of US business leaders that the international nature of crime and corruption had blurred the boundaries between foreign and domestic policy. America's support for anti-corruption reforms abroad enhanced "domestic security by fostering legal institutions in other countries with the capacity to combat transnational crimes such as terrorism, money laundering, drug trafficking and trafficking in



women before they reach our borders," Eizenstat said.

One reason why these threats have increased in recent years is that organised crime has become more adept at using information technology and telecommunications. Russian mafias and Chinese triads exploit increasingly high-tech means to facilitate and monitor the flow of money, personnel and contraband goods while their leaders can remain in "underworld-friendly" jurisdictions.

"The profusion of weakly regulated off-shore financial centres - which justify their lack of regulation on the grounds that the global market would put them out

**Drug cartels and crime syndicates smuggling human beings have found their work made easier by the less restrictive policies of states seeking to integrate themselves into the global economy**

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### A TAX OF THE WORST KIND

of business if they tried to impose more stringent standards – also provide a convenient place for corrupt officials to stash their illicit income. The sheer brazenness of these money-laundering havens, and their contribution to the spread of tax standards among on-shore banks, has generated a considerable backlash of late.

The most high-profile case is the Bank of New York's alleged role in helping Russian officials and "businessmen" to funnel more than \$10 billion out of the country. That Russia continues to receive sizeable IMF loans has amplified the outcry against practices which make such transactions possible. Nancy Birdsall of the Carnegie Endowment for International Peace and Devesh Kapur of Harvard University argue that transparency in the accounts of emerging-market governments – much wanted by the IMF and the US Treasury – is woefully inadequate. Their alternative: "Financial institutions should be required to report to a public database any deposit exceeding \$10,000 from a foreign national."

Aware of the objection that illicit funds will simply be diverted to off-shore havens, Birdsall and Kapur recommend that "any bank or investment firm that refuses to adhere to such a requirement should be denied access to international clearing houses, such as Cedel, the Luxembourg-based clearing house". They are not alone. Ludovic Aigrot, director of legal affairs at the Council of Europe, proposes that "intentional non-reporting of suspicious transactions ... be considered a criminal offence when committed by agents of a financial institution". Globalisation does not make governments powerless to curb abuses – if they act together.

### THE TIDE BEGINS TO SHIFT

Governments have in recent years appeared to learn this lesson for themselves. In 1997, the predominantly rich countries of the Paris-based OECD decided, after years of wrangling, to outlaw foreign bribery. Indeed, 1997 was the year in which the tide among international organisations began seriously to shift towards an explicit and aggressive stance against corruption.

In that year the World Bank issued a policy document on its role in helping countries control corruption. The UN General Assembly passed a resolution (51/59) on "Action Against Corruption". The United Nations Development Programme published a statement on the links between corruption and good governance, as did the IMF. Each of these organisations had long been reluctant to take a strong and explicit stand, largely for fear of having strayed into an area dominated by the principle of non-interference in countries' internal affairs. But, as with human rights and the environment, the contagion-effect thesis has led to a challenge to the principle of non-violability of sovereignty.

Lacking any enforcement power of its own, the OECD does not investigate or prosecute individuals or firms suspected of bribing officials outside their home countries. Individual countries are responsible for holding their own firms to account. The OECD Con-

vention on Combating Bribery of Foreign Public Officials in International Business Transactions, signed in December 1997 but not officially brought into force until February 1999, is an agreement among member states that they will enact appropriate laws and enforce them rigorously. Such agreement is necessary to prevent "free riders" – states whose firms would enjoy the advantage of being able to bribe their way into overseas contracts while their main rivals would be restrained by their own governments from doing the same thing.

This kind of differential treatment was exactly the complaint of US-based firms, which since 1977 have operated under the Foreign Corrupt Practices Act, on which the OECD convention was modelled. Businesses from countries with stronger law enforcement are suspicious of the capacity (and in some cases willingness) of other countries to constrain their firms to the same degree. The OECD's role is to monitor how well governments implement the treaty's provisions.

It is difficult to imagine that this system will remain free of conflicts among the member states for long. Firms that lose out on overseas contracts will inevitably begin pointing the finger at their foreign competitors, and by implication the governments that are meant to be monitoring them. But apart from these sorts of trust problems, which are common to most multilateral agreements, there are perhaps more serious shortcomings to the OECD agreement.

While the treaty covers bribes to holders of public office and to anyone who performs a service for the government or works for a public enterprise, it does not cover illegal inducements offered to private businesses in foreign countries. Eizenstat finds this silly, arguing that it "seems absurd that a bribe offered to officials of a state-owned airline is caught by the convention while those to officials of a privatised airline are not." As the world trend away from public sector ownership gathers steam, this omission will become all the more glaring.

The OECD's tough stance against firms of its member states have been welcomed by developing countries, which have felt unfairly singled out for moral condemnation. Those who have voiced this criticism have also warmly saluted the attempt by Transparency International (TI) to expand its research and advocacy work to include bribe-givers from developed countries as well as bribe-takers from emerging-market countries.

In 1997, TI began complementing its corruption perception index, which uses survey data from international business people to rank countries in terms of corruption, with a measurement of the "bribery propensity of leading exporting nations". By pointing

Businesses from countries with strong law enforcement are suspicious of the capacity, and in some cases willingness, of other countries to constrain their firms to the same degree

the finger at countries whose firms are more likely to use illegal means to obtain business abroad, TI has gone a long way towards highlighting what diplomats of developing countries have long maintained: that it "takes two to tango". There is always a bribe-payer and a bribe-taker in corrupt transactions.

The way the TI data were presented also helped to build a strong constituency for reform: country scores were expressed in terms of the potential impact of reduced corruption in individual countries on the trade performance of countries with which they traded. The index indicated, for instance, that an improvement of one point in India's corruption perception index would translate into a markedly improved trade performance for relatively clean exporting countries (like Sweden), but a strongly adverse impact for countries such as Belgium, whose score indicated a relatively high propensity to bribery in foreign dealings.

"Fighting corruption is part of a pro-business agenda," according to Bart Eides of the SIGMA programme (Support for Improvement in Governance and Management), a joint initiative of the OECD and EU in central and eastern Europe. "And to curb corruption, we cannot rely on governments and civil society alone ... the private sector must be actively engaged."

### DIVERGING INTERESTS

While this is certainly true in many instances, there are times when the interests of developing countries and the multinational firms they do business with diverge. Susan Rose-Ackerman, one of the world's leading authorities on corruption, recommends that developing country governments put as much effort into catalysing competition among foreign firms as into promoting transparency in government procedures.

"One way to reduce the pressure on individual firms and investors to behave 'responsibly'," she argues, "is to create an environment in which corrupt behaviour is not profitable. This implies a more competitive environment where other firms have an incentive to expose the corrupt deals of their competitors."

Rose-Ackerman advocates a more creative approach to using international institutions - for instance, adapting the WTO's Agreement on Government Procurement to deal specifically with anti-corruption issues, or, more controversially, developing dispute resolution mechanisms "to hear complaints by firms claiming to have lost business to rivals as the result of corruption". This would be modelled less on the WTO's dispute settlement mechanism, and more on the World Bank Group's International Centre for the

Settlement of Investment Disputes, a voluntary arbitration-style body that already considers cases relating to corruption.

Rose-Ackerman also recommends setting up a procedure through which firms that come under pressure for bribes from foreign governments could lodge an official report with the IMF. The IMF would not prosecute specific cases. But if a pattern of reports were to emerge, the IMF could "take a hard look at the country's institutions" with a view to possibly cutting off loans. While the Kenyan government's failure to take remedial action to stem corruption is a well-known case which ultimately led the IMF to withdraw support, similar loan conditions were applied to the Philippines and Thailand.

Rose-Ackerman envisages a complementary role for international business groups which could not only contribute funds to support, say, judicial reform in countries with a demonstrated commitment to reform, but also draw on their own experiences: "Businesses that have themselves been enmeshed in corrupt networks may provide useful advice on how to eliminate them." She argues that, "if this looks a bit like asking the safe cracker for advice on how to increase the security of banks, then so be it."

Among the most important advances has been an awareness that the one-size-fits-all anti-corruption initiatives of many agencies must give way to much more subtle distinctions. Oxford academics Andrew Goudie and David Stasavage argue that: "The extent to which the competitiveness of international markets gives multinational companies an incentive to offer bribes to gain an advantage over their competitors needs to be considered," since, "this factor may be more important in resource-rich economies like Nigeria or Angola".

Even among states in the same developmental category, differences can be vast. Research has indicated that a weak judiciary is the main cause of corruption in Albania, whereas in Georgia and Latvia inefficient regulatory regimes are largely to blame. Moreover, it is not always the level of corruption which accounts for the severity of its impact on a country's economy. Qualitative differences can matter just as much.

One World Bank study found that a country's success at attracting inward investment was less influenced by the overall amount of corruption than it was by the degree to which it exhibited a "high predictability of payments and outcomes". That is, if you get what you pay for, there is at least some kind of functioning market at work, however perverse, rather than dysfunctional anarchy.

For many countries this would represent an improvement on the current state of affairs. Firms, states, NGOs and international agencies increasingly recognise this and argue for incremental "context sensitive" reforms. Pragmatism is probably better suited than crusading vigour to a problem of such magnitude. It is enough of an accomplishment, for the time being, to have breached the international community's long-standing silence on corruption. ■

# GLOBAL GROWTH COMPANIES



Among the most important conceptual advances has been an awareness that the one-size-fits-all anti-corruption initiatives of many agencies must give way to much more subtle distinctions

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