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Anti-Corruption Initiatives from a Business View Point

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After years of being tolerated with a mixture of apathy, cynicism, and denial, corruption is now becoming a target of serious international action. As firms around the world face slimmer profit margins due to increased competition, the international business community is becoming increasingly aware that corruption is costing them money—profits. The added cost of corruption, particularly in developing countries where it is more pervasive, has made business change the way it operates globally. Corporations have learned a lesson from the Asian crisis and they are becoming more wary of where they invest and of the internal climate there towards business. As we face these new and severe realities, the business communities in many countries are signaling to lawmakers that they are tired of corrupt dealings and that it is time for change. Business is acknowledging that corruption is an issue that must be faced, and that they, the private sector, have a role in eliminating this disease. However, business is certainly not the only victim of corruption; the citizens of developing countries who are losing valuable resources are victimized to an even greater degree. The poor share disproportionately in the negative effects of corrupt behavior in the form of lost jobs and income. In the developing world, resources and funds that could go into infrastructure, education, and other elements integral to development end up lining someone's pocket due to the effects of corruption. Corruption scares away investment that could reach those areas and bring new prosperity.

At the same time, it has to be acknowledged that business is often the source of corruption or, at the very least, a participant in the misuse of public authority for private gain. Yet, even here the picture is more complex than it may seem at first glance. First, recall the old axiom that the bad tends to drive out the good. Firms that refuse to participate in corrupt transactions may find themselves forced out of certain markets or countries. This is especially the case when corruption is systemic. Of course, multinational companies have the option to leave a country entirely and, in many cases this is exactly what has happened. Domestic firms, especially small businesses are much more vulnerable. However, they too can leave the market. In some cases, they can shut down their firms and leave the country — emigrate to more hospitable locations. In other cases, they can emigrate into the informal sector or the underground economy¹. While corruption is not the only cause for either type

of emigration, it is surely a major contributor.

The world has witnessed the new focus being placed on corruption through a series of headlines publicizing the ousting of political leaders. Accusations of corruption have been leveled at officials around the world, including some in the US and other developed countries. The lack of communication and opaque markets have been identified as major contributors to the Asian crisis, which grabbed the attention of even the most developed markets. Today corruption is one of the leading causes for the lack of foreign investment in Russia and Ukraine. No one is arguing that corruption doesn't occur everywhere to some degree; however, there is a fundamental difference in how it affects developed versus transitional or developing economies. In developed countries the fight against corruption is a fight for fairness and increased efficiency in markets that are already well-structured. In developing and transitional countries corruption can be so pervasive that it can undermine the state and hinder development of democratic values and market systems.

Combating corruption is, of course, important in its own right since left unchecked, corruption has a corrosive effect on democracy and the general well being of a nation. In addition, combating corruption can serve as a lever or a tool for bringing about broader economic reforms and creating a level playing field on which business operates. These additional benefits can become an important part of the effort to mobilize support for anti-corruption programs. As society begins to realize that corruption harms everyone through lost jobs and lower incomes, it becomes easier to arouse public support for anti-corruption measures.

Corruption is essentially a waste of resources. International businesses invest based upon the presence of a predictable economic environment, a transparent climate that supports business, and a stable legal framework. Without these essentials, international investment, trade, and growth will be hindered and resources that could be directed at the developing world will never reach it. Corporations will simply look to invest their resources elsewhere. Corruption amounts to a lack of integrity and transparency, which together will undermine the very legitimacy of government and shake the public's trust in democracy.

Efforts to attack corruption have grown exponentially in just the last decade. Well-publicized cases of corruption in developing countries, in international organizations, and in the advanced industrial democracies have created a growing public demand to attack the issue vigorously. One development that merits special mention is that the World Bank's President, James D. Wolfensohn, has put anti-corruption programs at the center of many of the Bank's development efforts. It was just a few years ago that Bank employees were discouraged from addressing corruption because of its political nature and the specific injunction against the Bank's involvement in political development. Recently the World Bank joined with groups such as Transparency International, CIPE, and others to host an Internet based global dialogue on the causes and cures of corruption². After three successful months, this discussion came to a close on 2/1/2000, after attracting almost 1000 subscribers from more than 100 countries. Further evidence of the growing support for anti-corruption efforts is the success that Transparency International has had as an international non-governmental organization in establishing its programs and visibility in scores of countries around the world.

Measures of Corruption

There are a number of studies now that seek to measure the extent and nature of corruption. Perhaps the most well known are those of Transparency International. Their surveys, conducted regularly in a large number of countries, are based on the perceptions of businesspeople, risk analysts, and the general public. The results are ranked from 1 to 10 with one being the least corrupt and 10 the most corrupt³.

Excerpts from Transparency International Rankings – 1999

Countries are ranked from least to most corrupt

99 countries were ranked

Country Rank	Country
1	Denmark
2	Finland
3	New Zealand - Sweden
12	Australia
15	Hong Kong - Ireland
18	USA
19	Chile
22	France - Spain
28	Japan
34	South Africa
39	Czech Republic
40	Peru
50	South Korea
54	Philippines
70	Nicaragua
71	Argentina
90	Kenya
98	Nigeria
99	Cameroon

In addition to Transparency International's work, the World Bank has also sponsored a worldwide survey of 3,600 firms in some 69 countries. What is interesting about this survey is that it allows businesspeople to compare corruption to a list of other issues that affect their ability to do business. The survey asked firms to rank how seriously each of these

issues affected their ability to do business on a scale of 1 (no obstacle) to 6 (very strong obstacle). The survey reinforced Transparency's findings in that the developing country firms saw corruption as a much greater problem for them than did the developed country firms. In addition, the survey asked firms to rank as issues taxes, infrastructure shortages, terrorism, price controls, policy instability, six different types of regulations, crime and theft, and financing. In most of the developing and transition economies, corruption ranked well into the top of the list. In the Middle East and North Africa corruption ranked second (after infrastructure issues); in Central Europe it was third (after tax issues and financing); in Latin America and Africa it ranked first. Interestingly, in the countries of the former Soviet Union corruption ranked third (behind taxes and policy instability), while in South and Southeast Asia it ranked sixth⁴.

Root Causes of Corruption

Corruption occurs in a variety of ways. While there is general agreement that corruption is the abuse of public office for private gain, there are still many areas where peoples in different countries have different feelings about what is and isn't a corrupt practice. For example, most would agree that bribing a civil servant is corruption. However, hiring relatives (nepotism), giving contracts to supporters (cronyism), abusing privileged information to buy or sell stock (insider trading), and other such practices are viewed differently around the world. Following the Asian and Russian financial crises, the trend seems to be in the direction of a more inclusive definition of corruption rather than strictly limiting it to bribes.

One of the major breeding grounds for corruption can be found in the area of governmental applications of laws and regulations including, but not limited to, labor law, tax rules, customs and currency regulations, and health and safety laws. The World Bank expert, Daniel Kaufmann, has provided an illustrative list of the key areas that involve governmental discretionary powers and should be targets for reform.

Daniel Kaufmann's list

- Issuing licenses, permits, quantitative import restrictions (quotas), passports, customs and border-crossing documentation, and banking licenses.
- Implementing price controls.
- Blocking new firms and investors from entry to markets and providing monopoly power.
- Awarding public procurement contracts.
- Granting subsidies, soft credits, tax exemptions, and inflated pensions and allowing tax evasion.
- Imposing foreign-exchange controls resulting in multiple exchange rates, the overinvoicing of imports, and the flight of capital.
- Allocating real estate, grain storage facilities, and telecommunications and power infrastructure.
- Selectively enforcing socially desirable regulations such as those that apply to public health and the environment.
- Maintaining obscure or secret budgetary accounts, or otherwise facilitating "leakages" from the budget to private accounts⁵.

The World Bank survey referred to above also reported a number of other findings related to corruption:

- Firms reported that they rarely were able to go to another official or superior to get correct treatment when a government agent acts against the rules. (p.34)
- Despite this, firms in most parts of the developing world reported that dealing with government officials had become easier over the last 10 years. The most improvement was reported in South and Southeast Asia, while firms in the countries

of the former Soviet Union reported that the situation worsened. Most other regions showed a modest improvement. (p. 35)

- Almost 70 percent of firms in developing countries reported that they had foregone some investments because the costs of compliance with governmental regulations were too uncertain for investment planning. That is, it was not only the high level of costs of compliance, but also the uncertainty connected with these costs. (p. 37)
- Firms in developing countries, especially in former Soviet Union, reported that senior managers spent a considerable amount of their time negotiating with government officials about changes and interpretations of laws and regulations. (p. 38)

These findings point to a pattern related to the nature of corruption. It is rooted in the complex and frequently changing patterns of laws and regulations. Further, the discretionary power of government officials to interpret these laws and regulations presents the opportunity for illegal payments to occur.

One extreme example of these factors can be found in Ukraine. The Ukrainian Center for Independent Political Research (UCIPR) is one of the leading public policy research institutes in Ukraine. UCIPR currently produces a bi-weekly "Corruption Watch," organizes roundtable discussions on key economic policy concerns, and publishes "Research Update" a weekly bulletin intended to influence policymakers on vital reform issues. Through its research UCIPR has documented that during the communist period business managers responded to inefficiencies in the central planning system by cultivating personal relationships with government officials. These relationships with public officials have persisted and tend to be more predictable than the government's highly unstable policies.

Aggravating that problem today are over-regulation of the business sector, high taxes and frequent government inspections that often result in companies bribing officials to pass inspection. Firms must respond to an average of 78 government inspections annually, and some can experience as many as 100 inspections. Further, business activities are regulated by as many as 32 laws, 30 presidential decrees and over 80 resolutions. Thirty-two ministries and departments have the authority to issue licenses for various business activities. The over-regulation, high taxes and numerous inspections make the informal sector a more viable environment for business. Estimates vary regarding the size of the informal sector, ranging from 40% to as high as 75% of Ukraine's GDP⁶.

Corruption is also pervasive in the area of governmental procurement, including purchases made by state owned firms. Recently, allegations have surfaced that the French company Elf Aquitaine made payments to former German Chancellor Helmut Kohl and the French Finance Minister, Dominique Strauss-Kahn. While former Chancellor Kohl admitted that he accepted illegal payments he has refused to confirm the source and the French Finance Minister has denied the allegations⁷. Still the evidence is sufficient that both men face formal charges. The World Bank has been investigating evidence of corruption in bidding for Bank financed projects. This is a very important initiative that has already resulted in a several companies being barred from participating in Bank procurements⁸. Perhaps the most interesting case study was a remarkable story in the *Wall Street Journal* that reported on conditions under which a variety of companies, many of them American, pulled out of deals in Indonesia's power sector and how some made the deals. These cases are being followed up in the wake of the Asian financial crisis⁹.

Corruption in the area of political funding is one of the most difficult areas to identify. Linking a campaign contribution to a decision that benefits the donor is extremely difficult to prove unless one of the parties makes the decision to confess and supply evidence. Yet, it is commonly acknowledged that buying access through contributions is a frequent abuse of the system. Most of the developed countries have extensive systems of law and regulation about who can give, under what circumstances, and with what limits. In some cases, private financing of campaigns has been done away with altogether to be replaced by public funding.

Addressing the Issue: Anti-Corruption Programs

You cannot get at the root causes of corruption by merely weeding out corrupt individuals, be they public procurement officers, politicians, or business people. Corruption thrives in markets where legal systems are ambiguous, the rule of law is not embedded within cultural norms, and where laws and the judiciary allow employees opportunities to exert discretionary authority throughout various levels of government.

As economies begin to liberalize, corruption may emerge within the very process of change. For example, privatization is a key policy component in converting a government-dominated economy into one driven by private initiative. However, this transition process can corrupt public officials when it is combined with a mixture of low government wages and economic stagnation. Clearly, it is pointless to oust leaders for governing a corrupt system if there are not changes made to that system. Simply educating government leaders is not enough.

Even before speaking of specific measures to fight corruption, it is vital to draw attention to the key design issue that all such measures should follow, namely checks and balances. In a recent speech, Dr. John Brademas, Chairman of the National Endowment for Democracy, drew attention to this principle by drawing on his long career as a legislator. Dr. Brademas pointed out that¹⁰:

I am nonetheless a champion of a vigorous role for the legislative branch in assuring accountability of the executive. I don't want to say that the American constitutional arrangement is the only one that provides for a rational relationship between the legislature and executive, and I can think of a lot of deficiencies myself. On the other hand, by way of contrast to the American separation of powers, I have observed that a parliamentary democracy is less likely to produce aggressive legislative oversight of the executive because those controlling the executive are the allies of the members of parliament and will discourage criticism.

Especially important, as our friends in the European Parliament are learning, is that in a parliamentary system the parliamentarians often lack adequate staff and access to sources of independent information and analysis. I believe it is essential, particularly in curbing corruption by the executive, that a legislative body be equipped with legal authority, sufficient staff resources, effective access to information and intelligence, and the political will, if necessary, to challenge the executive.

The idea of having independent checks and balances, essentially an oversight mechanism, should infuse all of the various proposals for combating corruption. In fact, as will be shown below, this same principle has to be imbedded in corporate programs. The whole field of corporate governance centers on the idea of independent members on a board and that the audit function be carried out by independent auditors and reviewed by a company's independent directors. Recent suggestions on how to reform the International Monetary Fund (IMF) follow the same line of thought. One key suggestion is to form a high level evaluation office that reports to but is independent of the board of directors and is completely separate from the IMF executives.

Intergovernmental Efforts to Fight Corruption: Leveling the Playing Field

Without doubt, one of the major initiatives to attack corruption is the recent OECD "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions." By ratifying the convention, governments are pledging to remove the tax deductibility of bribes and payments and to make it a criminal offense to pay bribes¹¹. Until the OECD governments agreed on this measure, many countries allowed their companies to deduct the costs of bribing foreign governmental officials to get contracts or other favors.

The United States ended this practice with passage of the Foreign Corrupt Practices Act of 1977, but most other developed countries failed to follow the US lead. Once these countries actually adopt legislation to put the convention into practice in their countries, the "supply side" of corruption will be significantly reduced. In addition to the OECD convention, the Organization of American States, the United Nations, the European Union, and the Council of Europe have all adopted some form of convention or intergovernmental instruments to address corruption¹².

Corporate Governance As a Tool

Another related mechanism that is not only worthwhile in its own right but also helps to reduce the supply side of corruption is tough corporate governance standards. These are the practices that companies use to run their boards of directors, set policies for behavior throughout the company, develop business strategies, and generally steer the corporation. Although there is not one form of corporate governance there are certain internationally accepted principles that underlie sound business structures. Concepts that contribute to effective corporate governance include:

- Instituting independent auditing;
- Defining the concept of "conflict of interest" and how it affects members of boards of directors and senior management;
- Strong independent boards of directors, with a strong audit committee and internal audit functions;
- Laws and regulations guaranteeing shareholder rights, especially the rights of minority shareholders;
- Established and accepted standards of financial accountability and transparency within firms;
- Commitment to honest and fair dealings with all elements of the community (employees, suppliers, customers, and neighbors).

When these processes are fully implemented, it becomes much more difficult for a company to pay a bribe, practice nepotism, indulge in illegal campaign financing, or indulge in other forms of corruption. As was noted above, most of these recommendations follow from the principle of checks and balances and independent review. The OECD has also been a leader in this area with the development of the OECD Principles of Corporate Governance¹³.

Civil Society and Political Will

For systemic change to occur on the demand side of corruption, the entire structure of how the legal system functions and government policies are created and implemented must be improved. It is equally important that this restructuring process involve input from affected organizations and individuals in society, including the representatives of private business and nonprofit groups and academic experts on the policies being addressed.

Political will is crucial to enforcing initiatives against corruption. There is nothing easy about this process. Governments naturally will be reluctant to impose the stricter prohibitions on their own companies as required by the OECD convention and other international accords. They will run the risk that an even playing field will make their companies less competitive internationally. In many cases, prominent leaders in these countries may become implicated in corruption charges only to leave their successors operating still-corrupt regimes. That is why civil society organizations and the press must be in a strong position to push for reforms—real changes—when the political will flags. Education and increasing the flow of information to the general public are key instruments to obtaining widespread support for reform.

Business associations, think tanks (public policy research institutes) and other civil society

organizations can be key actors in attacking the problem of corruption. First, they can demand that government sign and enforce the new OECD anti-corruption convention and subsequent legislation. Representing their members, they can strive to make sure that standards are understood and clearly enforced, and that complaints and infractions of the law are investigated. They can also inform policymakers about discrepancies in the application of anti-corruption measures and help legislators define more effective laws.

Playing the role of "watchdog" is an important step that business associations and think tanks can take to ensure that the government is living up to its promises of reform. In this type of program and also in legislative alert type programs the business association reports back to its membership on the activities of government and whether or not policymakers are addressing the needs of business.

Business associations and think tanks can advocate for increased open-market reforms, and as reforms begin to take hold and privatization moves forward there become fewer opportunities for corruption. Reforms in government and the elimination of red tape will reduce the discretionary authority of government officials thereby curtailing one avenue that breeds bribery. Since state-owned firms do not necessarily have to be profitable, there is an environment ripe for crony dealings, and as these firms privatize and change to profit-making companies they will have to change their internal culture. Privatized firms will no longer want to lose profits to bribery and will become another force in the fight against corruption.

Business associations that fill the role of advocating business policy before government in an open manner perform a great service to anti-corruption efforts and the cause of democratic governance. So do their counterparts in the world of think tanks. The alternative scenario in many transition and developing countries is for firms to strike deals with government officials behind closed doors. Dealing behind closed doors is a breeding ground for corruption and prevents the creation of a level playing field where business thrives best.

In addition to political will, civil society has a major role to play in restoring a sense of ethics and ethical behavior as a social norm. In many societies, most notably in the former communist societies, corruption has reached a point where it has created a national norm or standard of behavior that corruption, especially petty corruption, is acceptable behavior. To cite but one case, Inna Pidluska of the Ukrainian Center for Independent Political Research points out that:

Since corruption was hypocritically ignored in the Soviet Union, and "petty corruption" in the form of "presents" that used to be given to all sorts of minor bureaucrats in exchange for better services (like in hospitals, schools, colleges, municipal service agencies, passport offices, etc) was (and in many cases remain) a norm, generations of Ukrainians have grown up with a perception of corruption as something natural for anyone who holds any sort of power or is in a position to distribute any sorts of benefits. To change this trend, a massive integrity-building program has to be delivered at schools and colleges as part of the curricula. To counter the challenge in a more short-term perspective, explicit lists of services to be provided by every state agency and the procedures need to be publicly displayed, and individuals should be educated about their rights to demand information and initiate public hearings on government agencies' performance. They should also be educated about benefits of being taxpayers and methods to control how their tax money is spent¹⁴.

Indeed, public education programs are becoming an important and accepted part of national anti-corruption programs. Transparency International has teamed up with other NGOs in a number of countries to carry out such efforts. In addition, the World Bank has been assisting countries to develop National Integrity Programs that have specific goals for various agencies as well as watchdog functions for civil society and the media¹⁵.

Case Studies

In addition to the programs described above, such as the National Integrity Program, there are many innovative efforts underway throughout the world, led by NGOs and business associations. The following are a series of examples of projects that have been implemented in different countries. Each was designed with local conditions in mind but all of them can serve as examples that others organizations and groups can adapt for their own use¹⁶.

Albanian Center for Economic Research (ACER), Albania — ACER has undertaken a project to identify the barriers keeping businesses in the informal economy from entering the formal business sector. Corruption is a major factor in keeping what could be legitimate business outside of the formal sector. This research program moves beyond identifying the barriers to business transition by addressing these barriers through advocacy and education. ACER has instituted a series of seminars and publications that will continue to focus on making the informal economy a prominent issue.

The National Association of Entrepreneurs (ANDE), Ecuador created a research and advocacy program targeted at eliminating some of the main opportunities for corruption. ANDE's focus has not been to blame past corruption on any one particular group but rather to initiate reforms that will change the direction of business and institute clean practices. Its studies showed that since the Republic of Ecuador was founded 167 years ago some 92,250 legal norms have been created of which 52,774 were in force in 1997. The sheer number of overlapping, unclear, and contradictory laws has created an environment of legal chaos and leaves the application and enforcement of laws to the discretion of bureaucrats. Since Ecuador is a civil code country (as opposed to a common law country), courts could not reconcile law or create precedents. To address this issue, ANDE recommended creating a seven-member judicial committee empowered to codify and reconcile Ecuador's laws. ANDE's advocacy campaign was able to secure inclusion of the committee into Ecuador's new constitution.

Center for the Study of Democracy (CSD), Bulgaria — *Coalition 2000* was created by the CSD based on the center's original groundbreaking work in Bulgaria. The Coalition involves a number of Bulgarian non-governmental organizations (NGOs) working in cooperation with government institutions and individuals. The goals of *Coalition 2000* include promoting public awareness of corruption, establishing mechanisms that support anti-corruption efforts, contributing to the development of democratic institutions, and serving as a "watchdog" over the reform process. CSD is organizing these efforts through a large-scale public advocacy campaign and the organization of expert working-groups. The working groups will develop policy amendments that help to deter corruption and focus attention on practical implementation of transparent and clear rules of the game.

Center for Economic Development (CED), Slovak Republic — CED implemented a program to eradicate corruption from the Slovak Republic's public and private sectors through a "Clean Hands" program based upon seminars, advocacy and research. CED analyzed the level of corruption by administering a survey to local entrepreneurs and business leaders. Based on the survey's results CED organized a series of advocacy programs to educate the business community on the negative impacts of corruption. CED developed a series of concise and easy to understand articles detailing the effects of corruption and the need for reform. These articles were subsequently published in CED's *Slovak Economic Sheet*, where they can be easily obtained and reprinted by local journalists. Following the fall of the Meciar government, the new government introduced many of the policy recommendations in the areas of public procurement and auctioning of licenses. In addition, CED's study on the linkages between tax rates, corruption and the growth of the hidden (informal) economy has caused the political leadership in Slovakia to take another look at how rules and taxes are administered. (see fn.1)

Corona Foundation — Colombian Confederation of Chambers, Colombia - Working closely with the Colombian Confederation of Chambers of Commerce, the Corona Foundation will develop an organizational ethics program in order to address the supply side of corruption. This project is aimed at reducing the degree of corruption in private-public relations, and more specifically, within the process of government procurement of goods and services. The overall goal of the project is to contribute to greater democratic and economic stability in Colombia by reducing the opportunities and incidences of corruption through building an awareness of the advantages of and a commitment to principles of transparency among private-sector firms. The multi-faceted program will include a survey of current perceptions and practices within private sector contractors, development of a model code of conduct and integrity agreement, development of training programs and seminars, pilot implementation, and the publication and dissemination of the initial results.

Entrepreneurship Development Foundation (EDF), Azerbaijan — As a starting point, EDF carried out a survey of the obstacles facing private business, and corruption came out as the top problem. The project is based on those survey results and is composed of four activities: the publication of special bulletins, creation of small business informational packets, corruption research, and polling. The special bulletins focus on topics relating to corruption and are distributed to both universities and policymakers. The corruption research initiative monitors articles in 24 newspapers for anti-corruption coverage, and an opinion poll will be conducted of the business community to keep informed of its needs. Two new components will be added: first, several part time Azerbaijani attorneys and businessmen will begin an in-depth analysis of 16 existing laws to identify the areas of undue discretionary power by government officials, often leading to corruption. Secondly, a series of 20 weekly economic training sessions for business journalists (emphasizing corruption issues) will be undertaken.

Center for Media Freedom and Responsibility (CMFR), Philippines/Regional — CMFR has undertaken the job of improving the flow of economic information throughout Southeast Asia. Just before the Asia economic crisis hit, CMFR organized a conference focusing on the dissemination of information that discussed the region-wide reforms needed for continued economic growth. CMFR identified the lack of information and the relatively untapped media resources that could be transformed into responsible organizations that keep government and business transparent. Program activities included focus group discussions, regional conferences and publication of papers.

Coordinating Analytical Center for Business Associations of Ukraine - The Center has developed a major advocacy program to attack the issues of multiple inspections and burdensome taxation systems described above. As noted, Ukrainian firms can face as many as 100 inspections and numerous taxes and fees. The Center advocated for and won a form of small business simplification program. Thanks to its work, a fixed (or flat) tax was introduced for small firms, and inspections were reduced from 100 to 22 per year. These innovative solutions were buttressed by a decrees issued by the State Committee for Enterprise Development that created an Inspection Register. Every inspector going to perform an inspection of a company has to sign the register giving his or her name; position; the name and position of a superior officer who authorized the inspection; telephone number and address of the relevant state inspection agency, as well as the purpose of the inspection. The result has been a considerable increase in the number of firms in the formal sector, probably due to the reduction in the transactions costs resulting from the improved business environment.

Liberal Institute of Rio de Janeiro (ILRJ), Brazil - The ILRJ created a project called "Reducing Transactions Costs in Brazil," based on the ideas of the new institutional economics. The project documented that Brazil's cumbersome bureaucracy and lack of transparency were creating much higher costs for business and much lower benefits for consumers than needed to be the case. Seven of the 11 specific recommendations in ILRJ's

study have been adopted by law or decree, and another was incorporated into a draft bill pending now. Policies adopted include: better dissemination of bidding rules; reduction of discretionary power of bureaucrats; better definitions of decision-making authority; more competition among contract bidders; broader criteria for evaluating proposals; and waiving bidding requirements only in urgent cases. The reason that these ideas were adopted was a combination of a clear intellectual argument, a deteriorating economy, and an aggressive communications and advocacy program including media coverage.

Recommendations and Lessons Learned

One of the most important observations that can be made is that efforts to establish democracy as a form of government are extremely important in the overall effort to eradicate corruption. Democracy assistance targeted at establishing transparency in government, bolstering the free media, creating a rule of law, and holding free and fair elections directly attack some of the root causes of corruption. The reverse is equally true: many of the anti-corruption programs described above contribute significantly to the development of liberal democratic systems¹⁷.

Equally important is the fact that economic reforms and the adoption of a market-oriented economy also are associated to a great degree with lower levels of corruption. As noted in the text above, corruption flourishes in those countries where governmental decision-makers, especially those at lower levels in the government, have a great deal of discretionary authority. However, a market-oriented economy is not simply an economy where government gets out of the way. This is one of the great myths hampering efforts to build sound economies in emerging markets. Rather, in a healthy market-oriented economy government plays a vital role in enforcing contracts, providing for a level playing field (antitrust and other pro-competition laws and measures), enforcing property rights, and a host of measures to ensure all firms are treated equally (domestic and foreign). Establishing these functions of government while reducing discretionary decisionmaking (usually behind closed doors) are a key part of both anti-corruption and building a sound market system. Recall that some 70 percent of indigenous firms reported that they had forgone investments due to over-regulation and unclear rules in the World Bank survey described above. These findings have been confirmed in a recent survey article by Wayne Sandholtz and William Koetzle that shows the linkages between democracy, market systems and low levels of corruption in a range of developing countries. They also find that countries that are more integrated into the international economy are likely to be less corrupt as well¹⁸.

Some very useful lessons have been learned through the experiences of the host of programs addressing corruption, including those run by civil society. The following list is by no means exhaustive but does offer a useful starting point to advance the worldwide effort to eliminate corruption. The list is separated into efforts to address the demand side that is usually associated with government, and the supply side, normally found in the private sector.

Demand Side Recommendations

In considering how the demand for corrupt payments can be restricted, one of the key elements is to restrict the opportunity for such demands or requests to be made. Efforts to eliminate opportunities for corruption should not be considered as an alternative for enforcement mechanisms or police actions. Rather, elimination of opportunities for corruption combined with tough enforcement is the most appropriate combination of responses.

1. Establish **sound procurement codes** that require open bidding and tenders to act as an antidote against corruption. Require all such bids to be open to public scrutiny. Both Transparency International and the European Bank for Reconstruction and

Development have advanced model procurement systems along these lines. Attached to this paper is a copy of Brazil's procurement systems reform that demonstrates that such efforts can be put in place even in developing and transition economies.

2. A related idea is to require third party monitoring on large procurements funded through the multilateral development banks or other foreign assistance instruments. Essentially, this would require recipient governments to agree to name third-party firms to monitor and report on construction of dams, procurement of goods and services and other large ticket items. The third-party monitor would not only conduct audits to verify that no suspicious payments were made but would also monitor building materials, quality of services and goods and other contractual obligations to ensure that all deliverables are up to code. The US Congress is currently considering legislation to this effect in the "Fair Competition in Foreign Commerce Act of 1999" (S 1169 by Senators McCain, Cochran and Burns).
3. Another worthy idea would be to require **independent audits**, on at least a selective basis, as a condition for receiving loans or development grants. The precedent for this action was set with the audit of the Russian Central Bank performed in the wake of the corruption allegations made regarding its handling of IMF loans. Such audits could be directed both at loans and procurement processes, thus providing an incentive to adopt sound procurement systems.
4. **Legal reform and simplification** is becoming a key aspect of removing barriers to business. As noted in my testimony, one key aspect is to simply reconcile overlapping and duplicative laws and regulations. When government officials have a large amount of discretion to decide which laws or regulations apply in given situations, they have a great opportunity to extract compensation for a beneficial decision. One immediate step that can be taken is to recommend formation of a **process of judicial review** by which independent commissions of judges have authority to reconcile or strike down such inconsistencies. Ecuador has initiated such a system.
5. Private sector associations and think tanks could create an **inventory of legal barriers and duplicative regulations** that need to be changed on a priority basis. The light of international exposure may help to force change.
6. Most of the emerging markets and developing countries have growing informal or gray economies. These exist because of the large number of conflicting laws and regulations that make it impossible for even the best of companies to legally comply, while small and medium sized firms simply can't cope with such a system. Efforts to simplify these regulations have proven to be very difficult due to resistance from the executive branch agencies, lack of expertise in rewriting legislation, and the like. One approach, used in both the United States and in developing countries, is to create a **small business exception**. That is to simply pass a law that stipulates that firms with less than a certain number of employees (from 10 to 100 depending on local circumstances) are exempt from certain regulatory requirements.
7. Taxes constitute a serious problem as well. Obviously all business persons in all countries complain about their tax burden but in many developing countries the costs of complying with all of the taxes leveled, especially in the area of labor and local government taxes, become unsustainable. As above, **different standards and rate schedules for small and medium sized companies** could be established. Also, a flat or fixed tax can be an effective way of reducing costs of compliance while avoiding corruption (see the Ukrainian example provided above). By reducing the tax burden, one automatically eliminates the opportunity for bribes and side payments. In addition, increasing tax compliance sets higher standards throughout the country.
8. **Paying civil servants a living wage** that is competitive with private sector salaries is another way to reduce the demand for extra payments.
9. Require that **real names with identification** be used to open banking accounts. The Chinese government has recently taken this action to expose government officials

and private individuals who have acquired large sums of money with no obvious sources of income. Care obviously needs to be taken with such measures since there is a real danger that a real names system could be abused so **privacy protection** measures are a necessary accompanying measure.

Supply Side Recommendations

Efforts to restrict the supply of bribes and other forms of corruption can also be very beneficial. It is essential to focus on the elimination of the underlying causes and opportunities for making such payments. Promotion of corporate governance standards along with efforts such as the OECD antibribery convention are extremely important in this context.

1. **Economic journalism training** is an essential aspect of any effort to prevent bribery or to reduce the supply of bribes. An independent media made up of journalists equipped with the tools of analysis to detect fraud or corruption, especially in privatization programs and in government procurement, can be a major deterrent to corruption.
2. Involving think tanks, business associations, and other nongovernmental organizations in the process is essential to building public understanding of the costs of corruption and the demand for change. (See case studies above; other examples can be found at www.cipe.org.) Such programs should contain an explicit **public education program** aimed at creating national norms or values that corruption is unacceptable and informing people what services they are entitled to as tax payers and citizens.
3. As noted earlier, the **OECD's antibribery convention** is one of the soundest measures taken recently to reduce corruption, even though several developed countries have not yet implemented domestic enabling legislation. Having gained widespread acceptance of that convention, it is time to return to the negotiating table and **remove one of the gaping loopholes: the exclusion of foreign subsidiaries of multinational corporations**. Parent companies should be held accountable for actions of their foreign subsidiaries, and should be held accountable within the parent company's home country. This is in keeping with the US Foreign Corrupt Practices Act and is an essential element of any antibribery regime.
4. Significant efforts need to be made to finalize the best possible set of **internationally accepted accounting** standards as can be realistically completed in the short term. Once these are set, efforts should immediately begin to negotiate even better standards. (For more resources on this issue see the International Federation of Accountants' web page — www.ifac.org.)
5. The OECD's convention on **corporate governance** (www.oecd.org) is a good start at developing international standards for good governance. Such standards are a key part of ensuring that all corporate transactions are transparent and in full compliance with accepted international standards.
6. Efforts can and should be made to **strengthen the general guidelines** contained in the existing OECD document by seeking a second round of negotiations. More explicit standards should be set out in the following areas at a minimum:
 - Countries should be required to **establish independent share registries**. All too often, newly privatized or partially privatized firms dilute stock or simply fail to register shares purchased through foreign direct investments.
 - Standards for **transparency and reporting of the sales of underlying assets** need to be spelled out along with enforcement mechanisms and procedures by which investors can seek to recover damages.
 - The discussion of stakeholder participation in the OECD guidelines needs to be balanced by **discussion of conflict of interest and insider trading issues**. Standards or

guidelines are needed in both areas.

- Internationally accepted accounting standards should be explicitly recommended. (Also see above regarding developing such standards.)
 - **Internal company audit functions** and the creation of audit committees composed entirely of **independent directors** needs to be made explicit.
1. Promote **freedom of information/access to information laws** for governmental information subject to privacy protection considerations.
 2. Promotion of **clear and transparent rules on conflict of interest** for the public sector. In many countries, it is still possible for government officials (or their children, spouses, or lawyers) to hold additional paying positions in private or state firms, or to accept consulting fees etc. from private firms. At a minimum, such relationships should be disclosed and the officials bared from making decisions affecting those firms. As a corollary, efforts should be made to limit officials' ability to leave office and move into high paying positions in firms doing business with the ministries or agencies that they served.
 3. Clear guidelines should be issued requiring **disclosure and setting forth standards** by which government agencies may award subsidies, quotas, and exemptions from fines.
 4. The OECD and other international organizations should work to promote the establishment of **Ombudsman's offices and Independent Auditing Agencies** (similar to the US General Accounting Office).
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Conclusions

While there are many instances of corruption to pick from in today's world, the Asian financial crisis stands out as an example of large scale, systemic failure that was driven, in some degree, by corruption and its correlates: lack of transparency in government and poor or non-existent corporate governance. As M.R. Chatu Mongol Sonakul, the Governor of the Bank of Thailand, has observed:

There is no doubt in my mind that for the Asian economic crisis to be solved in a sustainable and long-lasting fashion, the government and the corporate sector have to work together better. By this, I don't mean that not working together was the cause of the recent economic crisis. Probably it was the other way around, working far too well together and in collusion with each other...The Asian financial crisis showed that even strong economies lacking transparent control, responsible corporate boards, and shareholder rights can collapse quite quickly as investor's confidence erode¹⁹.

The costs of such systemic corruption can be considerable as was seen in Asia. However, countries throughout the world are paying an even higher cost in the form of jobs that were never created, firms that exist in the informal economy or were never created, consumer services that don't exist, and, most of all, the corrosion of democracy. Yet, evidence is building that corruption is being taken seriously, and that the "taboo" against discussing such issues is being broken.

Most importantly, there is a movement growing worldwide that is insistent on reform

including business associations and think tanks (such as those listed in the case studies), international non-profits such as Transparency International, and the governments of the OECD as well as those of some developing countries. These groups have the tools and they are building the political will to force reform.

Brazil's Model Procurement Law - Innovations of the 1993 Law

See "Brazil: Targeting Corruption in Public Bidding" by Arthur Maranhão, Luiz Pedone and David Fleischer, *Economic Reform Today*, Center for International Private Enterprise, No. 2, 1998 available at www.cipe.org

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1. The entire bidding and contract execution procedure is public. The principal acts—invitation, announcement of the award, contract signing—must be published, and the public must have free access to information concerning bidding procedures and contracts. Any interested party can administratively or judicially challenge government actions.
2. The object of the bidding must be described in sufficient detail as to allow for predetermination of its quality. Consequently, the specification or quality of the object of the bidding is not the responsibility of the participants in the competition and is no longer a criterion in weighing proposals.
3. Participating companies are required to provide financial guarantees, capital, access to market financial resources, and access to equipment and technical personnel. The law does not require prior experience with respect to the object of the bidding. The required amount of capital that would guarantee performance of the contract is set at 10%, a reasonable level that will not limit participation in the bidding.
4. The company that submits the lowest price is automatically awarded the contract. This provision reduces the discretionary authority of public officials.
5. The company may be required to demonstrate its capacity to perform the contract in advance, if it is suspected that it cannot carry out the contract. Delays in contract performance are subject to financial penalties and a prohibition against participating in other bidding procedures.
6. Additions to contracts are limited.
7. The bidding procedure can only be waived in narrowly defined cases and with detailed justifications.
8. Suppliers must be paid in chronological order. This means that the order of payments no longer depends on the contractor's influence in the public sector, and prevents the advance "sale" of accounts receivable.
9. Penalties and sanctions are established for public officials who disobeyed the law.
10. All bidding and contract execution procedures must be duly registered and are

subject to internal and external audits.

End Notes

1. To cite but one example, studies in Slovakia by the Center for Economic Development have found that the size of the "hidden economy" (informal sector) is between 20 and 40 percent of GDP. Further, when asked in a survey about the major reasons for the growth of tax evasion and hidden economy, corruption was ranked second out of a list of eight choices, ranking only behind the high tax burden and intricate tax system. Emilia Sicakova, *Transparency and Hidden Economy - Mutually Contradicting Phenomena*, Bratislava: Center for Economic Development, 1999 (available through CIPE at www.cipe.org).
2. Archived at the World Bank's web site - <http://www2.worldbank.org/hm/anticorrupt/0152.html>.
3. Selected from Transparency International's list which can be found at www.gwdg.de.
4. Aymo Brunett, Gregory Kisunko and Beatrice Weder, "Institutional Obstacles for Doing Business," Background paper for the World Bank's 1997 Development Report. Available at the Bank's web site, www.worldbank.org.
5. Quoted from Daniel Kaufmann, "Anticorruption Strategies: Starting Afresh? Unconventional Lessons from Comparative Analysis," in Rick Stapenhurst and Sahr J. Kpundeh (ed.), *Curbing Corruption*, The World Bank, 1999, p. 94.
6. Ina Pidluska, "Corruption versus Clean Business in Ukraine," in *Economic Reform Today*, Center for International Private Enterprise, No. 2, 1998. Available at www.cipe.org.
7. Charles Trueheart, "French Corruption Probe Widens," *Washington Post*, January 29, 2000, p. A16.
8. Paul Blustein, "Big Firms Accused of Bribery in African Dam Project," *Washington Post*, August 13, 1999, p. E01.
9. Peter Waldman and Jay Solomon, Power Deals With Cuts for First Family In Indonesia Are Coming Under Attack, *THE WALL STREET JOURNAL*, December 23, 1998.
10. Dr. John Brademas, Address to the "Washington Conference on Corruption," Feb. 22-23, 1999, held under the auspices of the OECD Development Center. Full text of Dr. Brademas' speech may be found at www.cipe.org under the special section on combating corruption.
11. The full text of the convention and explanatory materials can be found at www.oecd.org.
12. For a thorough analysis of the OECD guidelines and other conventions, see Nancy Zucker Boswell, "New Tools to Fight Corruption," in *Business View on Combatting Corruption*, a special issue of *Economic Reform Today*, No. 2, 1998. Center for International Private

Enterprise - full issue available at www.cipe.org.

13. The OECD Principles can also be found at www.oecd.org. For more information on Corporate Governance see John D. Sullivan, "Corporate Governance: Transparency between government and business," paper presented to The Mediterranean Development Forum 3, World Bank Meeting, Cairo, Egypt, March 7, 2000. The paper can be found at www.worldbank.org/MDF or www.cipe.org.

14. Letter to author. See also her "Corruption Versus Clean Business in Ukraine," in *Economic Reform Today*, special issue on "Business Views on Combating Corruption," Number Two, 1998, available at www.cipe.org.

15. See Peter Langseth, "How to Fight Corruption on the Ground," in *Economic Reform Today*, Number Two, 1998. Mr. Langseth provides a description of the World Bank's efforts and a case study of the program in Mauritius.

16. The project descriptions are drawn from programs that the Center for International Private Enterprise has supported or cooperated with using funds from the US National Endowment for Democracy. Further information can be found at www.CIPE.org.

17. Here I am following the distinction made by Fareed Zakaria in his article "The Rise of Illiberal Democracy," *Foreign Affairs*, November/December, 1997. Zakaria makes the distinction between electoral and liberal democracy. In the former, elections are held but democratic governance is wanting due to the lack of a liberal governmental process.

18. Wayne Sandholtz and William Koetzle, "Accounting for Corruption: Economic Structure, Democracy, and Trade," *International Studies Quarterly*, Vol. 44, pp. 31-50, 2000.

19. M.R. Chatu Mongkol Sonakul (Governor of the Bank of Thailand), "Corporate Governance and Globalization," presented at the Asian Economic Crisis and Corporate Governance Reform Conference in Bangkok, Thailand, September 12-14, 1999. Federation of Thai Industries, Thai Chamber of Commerce, Institute of Management Education of Thailand, Center for International Private Enterprise.

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