Luncheon Address

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The Issue

Corruption is a complex phenomenon and in many cases is the consequence of more deep-seated problems of policy distortion, institutional incentives, and governance. Therefore, it cannot be addressed by simple legal acts proscribing corruption. In virtually all countries, local laws forbid corrupt behavior. Yet, in more cases than is readily admitted, effective efforts to combat corruption have been limited. In many developing and transition economies, the judiciary, legal enforcement institutions, police, and other legal bodies are unreliable because the rule of law is often fragile and therefore can be captured by corrupt interests.

But corruption is not limited to these economies. In developed countries, tax incentives, standards of conduct, and general attitudes often lend themselves to providing the resources for corruption. Indeed, “the abuse of public office for private gain," as corruption is generally defined, takes place in both rich and poor countries and must be tackled as much in the places where payments originate as where they are received.

To assist governments, the business community, and other interested parties debate the issue, Transparency International (TI) has been publishing an increasingly comprehensive Corruption Perceptions Index (CPI). This index is a "poll of polls" drawing upon numerous distinct surveys of expert and general public views of the extent of corruption in countries around the world. Recent data show that the bulk of countries have poor scores, strongly suggesting that corruption is a serious issue that deserves much higher attention in the policy agenda of this region. TI has also started to publish a Bribe Payers Index (BPI) ranking leading exporting countries and industries in terms of the degree their companies are perceived to be paying bribes abroad. ¹ Indeed, where there is a recipient, there is a payer, and, strictly speaking, the spotlight and the issue needs to be focused at both ends—the supply and the demand side of corruption.

Implications

In the final analysis, corruption is as much a moral as a development issue. It can distort entire decision-making processes on investment projects and other commercial transactions and corrupt the very social fabric of societies. Statistical evidence illustrates that higher corruption is associated with: “(i) higher [and more costly] public investment; (ii) lower govern-

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ment revenues; (iii) lower expenditures on operations and maintenance; and (iv) lower quality of public infrastructure." The evidence also shows that corruption increases public investment by making it more expensive while reducing its productivity—not to mention the loss of resources to the countries resulting from uneconomic investments.

By the same token, corruption affects not only the size but the composition and associated quality of public investment programs. Corrupt administrations tend to spend less on education and other social expenditures because expensive infrastructure outlays crowd out spending on education and other social investments. This suggests that corruption tends to mortgage future generations, since long-term economic growth is directly related to educational attainment.

The secondary effects of policy distortions can be equally staggering. For instance, a survey undertaken by the World Bank in petroleum procurement and distribution in sub-Saharan Africa five years ago showed that existing practices generated resource outflows in excess of $1.5 billion—significantly more than yearly net disbursements of World Bank loans and credits to the region. This is particularly serious because the efforts to generate savings and surpluses fall far short of the investment requirements for that continent.

The fact that corruption lowers economic growth implies that economists should be more restrained in their praise of high public sector investment and stress the importance of greater attention to corruption as well as the quality and composition of public expenditures. The issue of corruption, and its effects on efficient and effective resource use, needs a much higher place in the policy debate.

By the late 1980s and early 1990s, most countries in Latin America adopted structural adjustment, economic liberalization, and "modernization" policies, aimed at coping with and preventing economic crises by developing building blocks to improve the agility and effectiveness of public sector management. A mixed reform record, however, has brought about recognition that the problems are more fundamental than originally thought and that a "second generation" of reform is needed.

In light of the growing recognition of complexities in the reform process, an increasing number of countries are beginning to tackle broader and deeper institutional issues, such as decentralization and sub-national government reform, judicial reform, and anti-corruption efforts. Some countries are going beyond these issues and are tackling issues such as "voice" and participation, "exit" and competition, and restructuring

2. VITO TANZI & HAMID DAVAODI, CORRUPTION, PUBLIC INVESTMENT, AND GROWTH 1 (International Monetary Fund Working Paper 97/139, 1997).
enforcement mechanisms for internal rules and regulations. Work in these new areas requires stronger, broader, and deeper commitments to sustainable implementation.

The Roots of Corruption & Corrective Action

Clearly, a more comprehensive approach is needed rather than the popular road of issuing declarations, policy statements, or even legislation. More importantly, to ensure better results, a greater focus is needed on the underlying causes of corruption and on mutually supporting mechanisms between governments, business practices in the private sector, and civil society.

In this regard, it should be understood that bribery encompasses payoffs for a wide variety of illicit activities: (i) getting around licenses, permits, and signatures; (ii) acquiring monopolistic power through entry barriers to competitors; (iii) access to public goods, including legal or uneconomic awards of public procurement contracts; (iv) access to the use of public physical assets or their outright stripping and appropriation; (v) access to preferential financial assets, such as credit; (vi) illegal trade in goods banned for security and health considerations, such as drugs and nuclear materials; (vii) illicit financial transactions, such as money laundering and insider trading; (viii) influencing administrative or legislative actions; and (ix) influencing judicial decisions. In all these cases, corruption occurs when economic opportunities for it prevail and political will to combat it is lacking. In a way, corruption is a symptom of fundamental economic and political problems. Addressing these problems effectively requires dealing with the underlying economic, political, and institutional causes.

At the root of many of the problems, one can find excessive discretionary powers. It stands to reason that the higher the professional levels in civil service, the lower the perceived levels of corruption. Quite apart from the wastefulness of corruption expenditures and associated misallocation of resources, valuable management time gets siphoned off through time spent with public officials.

As a result, efforts to reduce opportunities for discretion are often an important element for prevention. These efforts typically include liberalization policies such as reductions of trade restrictions, subsidies, price controls, and directed credit that have been undertaken in a growing number of countries in Latin America.

Similarly, on the enforcement side, weak institutions often require the help of independent oversight commissions with powers to investigate and, at times, prosecute or adjudicate, as has been instituted in Chile, Hong Kong, Singapore, and Botswana. More generally, and not surprisingly, corruption perceptions tend to be higher, the weaker the rule of law in the countries concerned.

Finally, proper interface needs to be formed between civil society, the private sector, and governments to help assess the issues and develop sup-
port for combating corruption and to develop more effective ways of doing business. More than any other field, corruption is not an area that lends itself to technocratic solutions developed by a few and executed by many; long-term and sustainable development requires a real commitment from all concerned and often needs home-grown and tailor-made solutions.

More broadly, a combination of actions on prevention, enforcement, and support from the local community could help in overcoming these problems. Many corrective actions are associated with deregulation and depolitization of economic activities, generation of information and data for greater transparency and associated accountability, build-up of appropriate legal institutions or set-up of parallel ones—or self-regulating bodies where this is not possible, and development of coalitions to promote coherent actions among different players in a society.

In the end, though, any effort will require a diagnosis of the specific problems, an ensuing prioritization and sequencing of interventions, and a monitoring of impact. Whatever course is taken, experience suggests that focus should be on a minimum, critical mass of interventions—a few initial examples—to get some early gains for later replication.

The Response

Aware of these developments, donors, nongovernmental organizations, governments, businesses, and citizens in developing and industrial countries are increasingly concerned about corruption. Fortunately, the opportunities to address corruption are greater than they have ever been. New global standards of behavior are emerging, driven partly by changing attitudes toward transnational bribery in industrial countries and partly by heightened awareness of the costs of corruption in developing countries.

Governments. Quite apart from economic and public sector reforms, a number of initiatives taken at the international level will have constructive repercussions in many countries.

- Twenty-five countries signed the landmark Inter-American Convention Against Corruption in March 1996, two years after the issue of corruption was put on the Summit of the Americas agenda by the leaders of the Western Hemisphere. The Convention requires countries to criminalize transnational bribery and all illicit enrichment. Other provisions include building commitments to provide greater mutual assistance and to establish a framework for cooperation on extradition. In addition, the Convention encourages countries to adopt a wide range of laws and regulations to prevent corruption. These measures include: conflict of interest rules, disclosure of assets by high public officials and their families, establishment of national organizations for the oversight of such laws, protection for whistleblowers, and open government procurement.

- Similarly, in late 1997, thirty-four countries signed the Organization for Economic Cooperation and Development (OECD) Convention on Bribery of Foreign Public Officials in International Business Transactions. The purpose of the Convention is to criminalize corruption of foreign
officials and end the tax deductibility of bribes, thereby removing the associated fiscal incentives. This historic first step provides a sound, though limited, framework for an international anti-bribery system. The convention was presented to national legislators for implementation during 1998, with a target date at the end of 1998 for entry into force.

- Multilateral development banks have begun to play a role in their respective areas of expertise and responsibility. The International Monetary Fund has started to restrict its operations in countries where the level of corruption is deemed to negatively affect their economic performance. The World Bank has initiated a more comprehensive program. First, it introduced sanctions on firms and governments engaged in corrupt practices. Under this arrangement, the World Bank would ban firms that offer bribes from future Bank-financed procurement worldwide. It would also cancel loans to governments whose officials solicited bribes. Second, the World Bank modified its procurement procedures to accommodate countries that seek to include a “no bribery pledge” in major international public procurement projects financed by the Bank. Lastly, the World Bank reoriented its disbursement procedures to strengthen borrower accountability for sound procurement and financial management.

While these are undoubtedly important steps, their proper implementation is key to delivering on the promise of accountable governments and hospitable business environments. Governments lack a common framework to harmonize anti-corruption efforts throughout their region. However, nothing prevents countries from developing their own action without a common framework in their region. After all, effective action in the fight against corruption will require more than imprisoning people.

On the multilateral development institutions’ front, action is being taken. The Inter-American Development Bank has started to tighten procurement guidelines and enhance support for public sector reform programs. In the future, other organizations, such as the World Trade Organization, should review and reform their programs to more forcefully combat corruption. Furthermore, the World Bank needs to strengthen its working arrangements with relevant civil society institutions and sharpen its country assistance strategies by mainstreaming anti-corruption efforts in its policy, public sector reform, projects, and other lending, as well as its economic and private sector work.

PRIVATE SECTOR. There are differences of opinion about the value of corporate anti-corruption programs and associated codes of conduct. Many in the business community believe that self-regulation is the right solution and that it is preferable to government regulation. Others argue that self-regulation is a sham and only government action can be expected to curb corruption. When seen as a component of a comprehensive anti-corruption program, however, corporate anti-corruption programs could provide a stimulus for more business-like and effective economic activity. They are not a substitute for government regulations; both are needed and each reinforces the other.
A "best practices" study of anti-corruption programs used by major American companies\(^6\) stressed that whether a code of conduct is only a piece of paper or it controls corporate behavior depends on the company's compliance program. Unequivocal commitment by top management is essential. Among the key elements of such codes, the study highlighted:

- A clear policy statement that the company prohibits employees and third parties representing the company from offering anything of value, directly or indirectly, to a government official to influence or reward an action.
- Detailed guidelines regarding gifts, entertainment, and travel expenses, and strict compliance with applicable laws and regulations regarding corporate political contributions and their disclosure.
- A system of internal controls and record keeping that ensures that company books accurately reflect its transactions, overseen by an audit committee composed of outside directors and associated internal reporting.

The key in evaluating the role of corporate anti-bribery codes is their interplay with government programs. The effectiveness of corporate codes is enhanced by governmental measures. Similarly, corporate codes reinforce the effectiveness of government anti-bribery programs. The main elements to build this synergy are:

- Criminal law. Managers tend to be concerned about their personal exposure to large fines and prison terms, which reduces extortion by local or foreign officials by making refusals to pay credible. The synergy between government enforcement and corporate compliance programs is further enhanced by the U.S. Justice Department's sentencing guidelines. These provide more lenient treatment for companies that conduct proper compliance programs, which is a strong incentive for companies to establish compliance programs and usually include auditing and monitoring arrangements, enforcement of disciplinary mechanisms, and appropriate responses and due diligence after detection. Several European countries, Australia, and Canada have or are in the process of adopting similar legislation.
- Tax treatment. When the tax laws treat bribes as tax-deductible, the message is that foreign bribes are a legitimate business expense—if not a subsidized activity. Denying tax deductibility for bribes requires corporations to distinguish between proper and improper business expenses, which means relevant corporate managers would be carefully scrutinized, as they could expose corporations to liability for tax fraud.

**Civil Society.** A growing number of structures, institutions, and associations—outside of state apparatus and profit-making businesses—are evolving for the joint and proactive pursuit of shared interests. Chambers of commerce, professional and religious associations, and various forms of non-governmental organizations are becoming players, shaping opinions,

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building coalitions, providing testimonies, and monitoring government and enterprises.

What legitimates civil society organizations is a concern about issues that are not adequately represented in the normal political process and a focus on problems that often go beyond the limited reach or capabilities of the nation-state, where market forces are unlikely to produce desired results. Moreover, the rules of civil society organizations do not arise out of self-interest or profit-orientation, but from genuine commitment to the public interest in a specific area, such as corruption.

Civil societies are the stakeholders and the parties ultimately affected by corruption. They must be engaged constructively to get their support for the necessary reforms. Only in this way can the necessary policy and institutional changes become viable and sustainable. Countries that have been hospitable and supportive of civil society bodies—through hearing arrangements in their regulatory and legislative procedures and involving them in oversight institutions—have enabled the organic and internally driven evolution of policies and institutions.

It is argued that if civil society gets involved as a partner and its efforts at monitoring the state are encouraged, this would contribute to the eventual elimination of corruption. The issue of partnership, however, is a complex one. Governments, multilateral development institutions, and private sector institutions are for the most part established and strong. Most civil societies are new and weak. The former have decision-making procedures and clear lines of communications; civil society has none of these. Governments and private companies have authorities to please and schedules to follow; civil societies have nothing of the sort, yet must respond organically to people's concerns. For the most part, there is a mismatch between civil society's capacity to act and the functions performed by the government and private sector.

That being said, a number of regions have made positive strides in key areas. In the United States, the United Kingdom, and many western democracies, there is a long record of transparency in decision-making and involvement of civil society; generally, the more pluralistic the societies, the lower the levels of corruption. Also in a growing number of countries, especially in Latin America, aside from the structural reforms under way, there are expanding civil societies, which engage in a growing number of strategic activities.

Leveling the Playing Field: The Role of Transparency International

Where the interface between civil society and the government and private sector is poor, there is a tendency to "crowd out" the economy into the informal sector and with it the levels of corruption. For this reason, Transparency International facilitates the interaction between different groups, particularly civil society with governments and the private sector.

Since effective action can only be sustained through the presence of institutions that catalyze the various interest groups in a non-partisan man-
ner, TI has been established as a not-for-profit and non-governmental organization to counter corruption in international business transactions. Over the years, it has fostered National Chapters to build alliances, enhance awareness, create support for actions to combat corruption, help overcome the resistance of those with a stake in the status quo, mobilize people and expertise behind meaningful action, and, in the end, improve the interface between governments, businesses, and civil society for effective governance.

If experience elsewhere is to serve as a guide for effective anti-corruption efforts, then a purely technocratic approach will not be feasible or sustainable. Thus, the process of reaching corrective actions will be as important as their content. Indeed, in this field, more than anywhere else, the wide ramifications of change can only take place as the result of a dialogue that is internally driven—in each country, in each situation. Only home-grown strategies developed in full partnership with civil society have any chance of success. Therefore, technical assistance and other efforts usually provided by the donor community have to move from the industry standard “best practice” to “good fit,” tailor-made solutions—designed to meet local institutional and cultural concerns. It is for each society to find answers to its own challenges. Others can assist by presenting options and practices and inform the process from which local anti-corruption coalitions—the primary actors—must find and forge their own solutions and associated strategies for reform.

To this end, TI’s mission is to:

* Curb corruption through international and national coalitions that encourage governments to establish and implement effective laws, policies, and anti-corruption programs.
* Strengthen public support and understanding for anti-corruption programs and enhance public transparency and accountability in international business transactions and the administration of public procurement.
* Encourage all parties to international business transactions to operate at the highest levels of integrity, guided in particular by TI’s Standards of Conduct.

TI’s strategy is to complete its mission by:

* Establishing coalitions of like-minded organizations and individuals to work with governments—wherever possible—to assist in developing and implementing national anti-corruption programs.
* Initiating an information center and conducting practically-oriented research into containing corruption; participating in public fora; and broadening public awareness of the damage caused by corruption, the need to counter it, and the means to reduce it.
* Building National Chapters of TI that foster anti-corruption programs in their own countries in accordance with TI’s approaches and core values and that help secure support for TI’s international program of action.

Over the years, TI has become well-known as a focus for efforts to reduce international corruption. It is evolving as a catalyst for govern-
ments looking for assistance in areas directly related to this subject, from investigation to book-keeping and from law drafting to law enforcement.

Aside from the support for monitoring of the international agreements, TI has been supporting studies and research and providing specialist advice to governments and other interested parties. Its current efforts focus on establishing “Special Integrity Programs,” which generally start with workshops aimed at diagnosing sources of corruption and identifying corrective plans of actions, followed by the implementation and monitoring of those plans. Initial experiences in this direction are illustrated in the following examples:

- In Argentina, the province of Mendoza, the local chapter of TI has been working with government support on the Island of Integrity Approach, whereby the regional authorities and enterprises interested in bidding for public works agreed to follow tender practices and contractual arrangements in a public tendering process. This action, together with the collection and monitoring of selected public procurement costs, reaped significant pay-offs because the costs of some public services in Mendoza became cheaper than in other parts of the country, which led to pressures to reduce costs elsewhere.

- In Panama, the local TI chapter has been invited to monitor the privatization process in a number of sectors and has been involved in the process of privatizing the Panamanian telephone company, Intel SA.

- More broadly, TI published the National Integrity Systems: The TI Source Book, which brings together a wide variety of experience in building integrity systems to contain corruption, and a companion volume, which assembles a wide variety of instruments used to monitor assets, set standards, and enforce effective laws.

Given these and other experiences, Transparency International and the World Bank have been working with a small number of countries, helping them diagnose corruption problems, build consensus for reforms, and introduce anti-corruption measures. Noteworthy has been the work of the Economic Development Institute of the World Bank, which, in partnership with TI, has conducted “national integrity workshops” and conducted training for economic journalists and parliamentarians in an increasing number of countries. Also, work is now underway to support the establishment of Anti-Corruption Undertakings and Integrity Pacts to give operational context to selected projects. Finally, an effort is being mounted with TI support to strengthen National Chapters and the network among them to enhance their capacities and effectiveness.

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Conclusions

In sorting out the issues and their solutions, it is difficult not to sound trite. That being said, there are five broad observations to be made:

First: Corruption is a highly sensitive issue. There is nothing right about it. It is wrong in principle, wrong in practice, and wrong wherever and whenever it occurs. But as we are all painfully aware, we are a long way from a transparent, level playing field. Different organizations and different countries draw different lines in the sand in different places. But the deeper truth is that legitimate investment and corruption do not mix. Corruption destroys billions of scarce dollars every year; it is the dry rot undermining aid. It distorts development, it frightens away genuine foreign investors, and it perverts societies.

Second: Living in an age of vanishing political borders, rapidly coalescing transnational global culture, and growing economic integration, an isolated existence is no longer a viable option—at least not without a prohibitive cost in economic development. International standards, such as those being adopted by major enterprises, international conventions such as those adopted by the OECD and the Americas, and guidelines adopted by international lending institutions are becoming an integral part of the global scene of increased transparency and growing concern about corruption. No country is immune to these global threats. It is thus incumbent upon all countries and institutions to deal with these issues; world economic development will bypass those who prefer to remain on the old course. Technological changes, growing information flows, and attendant increases in competition are increasingly forcing businesses to provide superior goods and services at competitive prices. Bribes may “sell” obsolete and high-priced goods but at the cost of losing competitive edge. In the end, success will only come to those able to develop knowledge in every field of their business, to innovate for superior performance.

Third: Corruption is a problem that all countries have to confront. Solutions, however, can only be home-grown. Fighting corruption is thus the business of everyone—governments, private sector, and civil society. An alliance between all of them is a true test of a country’s commitment to the elimination of corruption.

Fourth: Corruption also impacts corporate performance. It corrodes the reputation of multinational companies and adds to shareholder risk. Worst of all, it can ultimately lead to serious social unrest. The legitimacy of enterprises and their long-term viability rest on how they deal with this issue. Accordingly, no business that wants to succeed can be passive in the face of change; passivity is the route to competitive failure. In this regard, modern business is a dynamic force, one that has always offered new choice and new approaches in response to the evolving needs of societies. It is increasingly unlikely that any business can ignore the views of its customers, its shareholders, and society-at-large. As companies improve corporate governance, adopt codes of conduct, and respond to emerging legislation, they should not stop at compliance. The aim increasingly is to encourage openness and learning in the company. Progressive and suc-
successful enterprises welcome public scrutiny. The key is transparency and accountability; success is rooted in being better, not just good.

Fifth: To their dismay, governments have found in recent years that secretive decision-making by small elites can no longer be sustained. Contrary to the claim, often made by central banks, government officials, and even some in international organizations, that decision-making on technical or complex subjects is best left to experts without participation by those affected, policy decisions that fail to take into account important information and interests will lack the legitimacy that only public voice can sustain. Transparency plays many beneficial roles in both market and governance. All indications are that it increases the efficiency of markets and may reduce the likelihood of financial crises. In governance, transparency is logically necessary for accountability; such accountability is the political equivalent of the efficiency generated between firms. Since political authorities are monopolies, "competition" occurs between ideas and use of resources, rather than organizations.

But a culture of transparency will not come solely as the result of hectoring or even conditionality applied by the international financial institutions. It requires thinking beyond the disclosure standards that are being so widely discussed to question the incentives facing public sector activities.
Appendix: Anatomy of Anti-corruption Programs

Below is a wide but not exhaustive list of steps that might be part of an anti-corruption program. Not all steps are appropriate in every setting. It is essential to diagnose an individual setting, consider proposed solutions carefully, and work closely with allies in the government and other partners to coordinate strategies and identify individual activities that complement each other.

A. Prevention

* Economic reform
  - liberalization and deregulation where possible; a smaller more efficient government
  - privatization of parastatals in competitive sectors
  - a new look at tax and regulatory policy to match policies to enforcement capabilities
  - opening trade regimes to create “competition” and pressure for reform

* Administrative Reform
  - preparation of proper “checks and balances” in the public sector
  - establishment of “competing bureaucracies”—either horizontally, within one level of government, or vertically, among different levels of government—to deliver similar services where possible
  - assignment of responsibilities, including devolution to sub-national governments, with institutional capacity in mind
  - identification and support of “pockets of excellence”

* Civil Service Reform
  - move toward merit-based processes in civil service recruitment, performance evaluation, promotion, and termination
  - establishment of reasonable salary levels and gradation

* Budget Reform and Financial Management
  - review and audit of government procurement practices
  - service delivery surveys, as an audit device for budget execution
  - bypassing of government agencies: direct donor funding of community-level service, delivery projects, or private infrastructure projects
  - accounting, disclosure, and auditing standards for public and private sector institutions
  - prudential regulations, bankruptcy arrangements, and other oversight mechanisms for financial intermediation

* Reform in Tax and Customs Organization
  - functional organization of departments
  - establishment of benchmarks for performance
  - increasing data availability and transparency
• strengthening of taxpayer appeals mechanisms, both internal and external to the revenue departments

B. Enforcement

Procurement
• inclusion of “no-bribery-pledge” in bidding documents
• encouraging alternative legal institutions for settlement of disputes

Legal and Judicial Reform
• review of anti-corruption and conflict-of-interest legislation to ensure adequacy
• steps towards heightened independence of the judiciary
• strengthening incentives for and building skills of public prosecutors
• review of administrative law to strengthen transparency of and public input to rulemaking
• set-up of a special anti-corruption agency
• disclosure of higher-level civil servants’ and politicians’ income or tax return

C. Interfacing

Societal Support Action
• awareness raising and collaborative problem-identification through workshops
• generating and disseminating information and data
• review of libel legislation to strengthen the watchdog role of the press
• journalist training and support
• identification and support of “local champions,” including NGOs
• collective action by international and domestic institutions, involving political leadership, business communities, financial institutions, and NGOs

Political Process
• review of campaign finance laws
• support for political party formation and voice
• support for constitutional reform to strengthen civil liberties

Self-Regulating Arrangements
• issuance of codes of conduct for enterprises
• establishment of review boards or oversight committee
• sentencing guidelines reflecting enterprises’ self-corrective behavior