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THE COSTS OF GRAND CORRUPTION

by

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Any discussion of corruption must start with a definition because corruption is almost equated with "evil" in many people's minds. Perhaps the tidiest and most succinct definition appears in the *Encyclopedia of the Social Sciences*: "Corruption is the misuse of public power for private profit". This clearly includes all kinds of bribery of national or local officials or politicians, but excludes bribery which occurs solely within the private sector.

Similarly, it is useful to distinguish between "grand corruption", which involves senior officials, ministers, and heads of state and "petty corruption", which entails immigration officials, customs clerks, policemen, and the like. This is not simply a difference of scale. Petty corruption is usually about getting routine procedures followed more quickly - or not followed at all. Grand corruption involves influencing decision-makers.

To focus on grand corruption is not in any way to condone petty corruption, which can seriously damage the quality of life of the ordinary citizen - particularly that of the most vulnerable members of society.

Opportunities for corruption are influenced by certain characteristics of transactions. The first is their size;

unless the project or transaction is big, it is not worth bothering about. The second is immediacy of rewards. The possibility of receiving a bribe in two or three years is not very enticing. Finally, there is what can be described as mystification, meaning that the more complicated and technological a transaction is, the lower the chance that "awkward" questions will be asked about it.

Applying these criteria, the opportunities for corruption are greatest in transactions involving:

- * military supplies, aircraft, ships, and telecommunications equipment;
- * the capital goods portion of major industrial and agro-industrial projects and large civil engineering projects (e.g., dams, harbors, bridges, highways);
- * licenses for extractive industries;
- * consultants' fees; and
- * ongoing government purchases of bulk supplies, such as petroleum, fertilizers, cement, school text books, and pharmaceuticals.

Obviously, there are wide variations in the attractiveness of individual contracts.

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Who's the Least Corrupt?

		Score		Score			
		1996	1995	1996	1995		
Rank	Country (best=10)			Rank	Country (best=10)		
1	New Zealand	9.43	9.55	28	Greece	5.01	4.04
2	Denmark	9.33	9.32	29	Taiwan	4.98	5.08
3	Sweden	9.08	8.87	30	Jordan	4.89	-
4	Finland	9.05	9.12	31	Hungary	4.86	4.12
5	Canada	8.96	8.87	32	Spain	4.31	4.35
6	Norway	8.87	8.61	33	Turkey	3.54	4.10
7	Singapore	8.80	9.26	34	Italy	3.42	2.99
8	Switzerland	8.76	8.76	35	Argentina a	3.41	5.24
9	Netherlands	8.71	8.69	36	Bolivia	3.40	-
10	Australia	8.60	8.80	37	Thailand	3.33	2.79
11	Ireland	8.45	8.57	38	Mexico	3.30	3.18
12	U.K.	8.44	8.57	39	Ecuador	3.19	-
13	Germany	8.27	8.14	40	Brazil	2.96	2.70
14	Israel	7.71	-	41	Egypt	2.84	-
15	USA	7.76	7.79	42	Colombia	2.73	3.44
16	Austria	7.59	7.13	43	Uganda	2.71	-
17	Japan	7.05	6.72	44	Philippines	2.69	2.77
18	Hong Kong	7.01	7.12	45	Indonesia	2.65	1.94
19	France	6.96	7.00	46	India	2.63	2.78
20	Belgium	6.84	6.85	47	Russia	2.58	-
21	Chile	6.80	6.94	48	Venezuela	2.50	2.66
22	Portugal	6.53	5.56	49	Cameroon	2.46	-
23	South Africa	5.68	5.62	50	China	2.43	2.16
24	Poland	5.57	-	51	Bangladesh	2.29	-
25	Czech Rep.	5.37	-	52	Kenya	2.21	-
26	Malaysia	5.32	5.28	53	Pakistan	1.00	2.25
27	South Korea	5.02	4.29	54	Nigeria	0.69	-

Source: The Transparency International Corruption Perception Index, 1995 - 1996

The rank relates solely to the results drawn from a number of surveys and reflects only the perceptions of the business people who participated. Fewer countries were included in the index and fewer surveys were used in 1995, making the 1995 column at best a rough comparison.

An essential cog in the machinery of grand corruption is the local agent or representative. Sales directors of major corporations do not, generally speaking, travel around the world with suitcases full of \$100 bills. Instead, they appoint an agent, usually a man of high standing in his local community, to whom they typically offer a large 10-20% commission if a contract is won. In this way the corporation has no improper direct relationship with the decision-makers. The company's executives do not need to know how much of his inflated commission the agent passes on to others - or indeed whether he passes on anything.

In spite of this distancing between the payer and the recipient of the bribe, it appears incredible to many people that large, well-known, and apparently reputable organizations can become involved in bribery. The

explanation is that although in every country it is a crime to bribe officials within that country, it is not a crime - except in the US - to bribe a foreign official outside the bribe payer's own country. It is the combination of the non-criminality of such bribes and head-in-the-sand ignorance, which is facilitated by the use of an agent, that enables corporations to fuel the grand corruption engine.

● Raising Transaction Costs

So how much damage does grand corruption cause? The most obvious effect is the direct increase in the cost of the transaction. If a bribe of, say, 10% is paid, in the end not much of it generally comes out of the seller's pocket. He will merely build it into his price. Indeed, the fact that a bribe is being paid may well make it possible for the seller to increase his price by more than the bribe amount. If the sale involves imported goods or services, the cost increase of the imports will add to the foreign exchange the buyer requires to complete the transaction. In many developing countries such foreign exchange already is a scarce resource.

However, this cost increase is by no means as serious as another aspect: once the possibility of personal gain becomes a factor, it rapidly becomes the only factor that matters - pushing aside cost, quality, delivery, and other legitimate considerations in the awarding of contracts. The result is that the wrong suppliers and/or contractors are selected, and the wrong goods are purchased.

As a result of this kind of distorted decision-making, supplies or projects which are not needed at all are given priority over much more important national priorities for no better reason than the fact that they enable government decision-makers to obtain large bribes. Bearing in mind that military supplies are one of the categories of goods that most readily attract grand corruption, it is not surprising that they are so often bought unnecessarily.

Aside from the economic damage grand corruption wreaks, the moral damage is just as serious. It is quite common in developed countries to hear the argument that "we have to go along with their way of doing business. Bribery is part of their culture. What would be wrong here is all right there" - "there" being any developing country.

However, this excuse is indignantly rejected by honest Africans, Asians, East Europeans, and Latin Americans. Corruption certainly is more widespread in developing than in industrial countries. But it is not part of anyone's culture.

● Where Countries Stand

Transparency International (TI), the Berlin-based nonprofit coalition against corruption in business, has developed a useful Corruption Perception Index, which now covers 54 countries (see page 2). It is based on ten surveys per country made by other organizations, excludes all countries where at least four separate surveys are unavailable, and a score of ten indicates an entirely "clean" country while zero shows a country where business transactions are entirely dominated by extortion and bribery.

No country scores ten or zero: the extremes are New Zealand with 9.43 and Nigeria with 0.69. With a few exceptions, the countries in the top half of the list are those with well-established and strong democratic institutions. The reverse holds true for those nations that fall in the bottom half.

Grand corruption takes a heavy toll on democratic institutions. As Edmund Burke, the great Anglo-Irish statesman, counseled in 1777, "Among a people generally corrupt, liberty cannot long exist". He might almost have had foreknowledge of what would occur in some African and Latin American countries two centuries later.

While corruption has not necessarily led to the total collapse of democracy, it has resulted in a deterioration in the "quality" of democracy in some of these nations. For instance, it is obvious that corrupt ministers and officials cannot allow free speech and a free press to expose their activities. Nor can they allow a parliamentary opposition to do so. The wealth resulting from grand corruption also can play a significant part in enabling corrupt politicians to remain in power by corrupt means.

● We're Not Powerless

Given that grand corruption is a disaster both in material and in moral terms, what can be done about it? It would be unrealistic to imagine that it can ever be eliminated. But there are now groups of people in many countries, working with TI, who believe that it can be greatly reduced. According to Jeremy Pope, TI's managing director, corruption must be turned from a low-risk, high-profit business into a high-risk, low-profit one.

The first weapon must be criminal law. The 1977 US Foreign Corrupt Practices Act (FCPA) leaves the directors of US corporations in no doubt that if they directly or indirectly bribe a foreign official or politician, they are just as guilty as if they had bribed a fellow US citizen. No other country has similar legislation, but this should change before too long. The governments of the OECD countries have all agreed - some with

great reluctance - that cross-border corruption should be made a criminal offense. While some English lawyers have objected on the grounds that extraterritorial legislation is repugnant to English law, their argument is now weak because Britain is already bound by extraterritorial legislation against terrorism and drug-trafficking. It will, however, certainly take some time to bring this change into effect throughout the OECD countries.

Some opponents of the FCPA argue it has not been effective because some US corporations still give bribes. However, the test of good legislation should not be whether it is perfect but whether it has brought about significant changes for the better. The FCPA undoubtedly passes that test. Its effectiveness also deserves to be judged against the failure of other major trading nations to enact similar legislation - which at times must have tempted US exporters to take illegal action to match their competitors.

● Criminalizing Bribery

Making bribery a crime will clearly have a marked effect on corporate taxation. Until very recently the unintentional and unacceptable situation existed in all European countries that offshore bribes, however described, were tax-deductible as "business expenses", in effect subsidizing bribery. All OECD countries are committed to changing this situation; Britain has already done so. Although under the Anglo-Saxon common law system the accused is innocent until proven guilty, the same presumption does not apply in an argument with the tax authorities.

Criminalization also changes the position of auditors. Given that an external auditor has a clear duty to draw attention to the illegality of any payment appearing in a company's accounts, his failure to do so puts him at risk of being sued for negligence by any dissatisfied shareholder.

TI also has recently developed another interesting concept called "Islands of Integrity", which involves the use of an Anti-Bribery Pact (ABP) in major public contracts. The ABP commits all the parties to the contract - the government officials and corporate executives, both of whom sign the contract individually - not to solicit or offer any form of "inducement" in connection with the specific contract. Penalties for corrupt activities found to have broken the provisions of the ABP include long-term black listing and rescission of any contract awarded.

Some may object to the "Islands of Integrity" device on the grounds that those involved on both sides are doing no more than promising to do what they should

already be doing: not offering or receiving bribes. However, there is evidence that a specific anti-bribery commitment in a specific project contract that spells out special noncompliance sanctions is taken more seriously by all parties than a general all-embracing promise of good.

The US legislation to encourage and reward "whistle blowers" - those who report their employers when they are making excessive or fraudulent profits on a government contract - has attracted considerable attention in Europe recently. Current thinking is moving strongly in this direction, with the whistle blower seen as a very useful anti-corruption aid. But the future emphasis is likely to be more on protection than on reward for the whistle blower.

Financial institutions, particularly international ones that fund major projects in developing countries on concessionary terms, are also playing an important role. It is increasingly being seen as part of their responsibility to ensure that the funds they provide be used for their intended purpose, not siphoned off in deals between corrupt suppliers or contractors and public officials. For example, since becoming president of the World Bank, James Wolfensohn has moved anti-corruption procurement procedures to the top of the Bank's agenda. There is growing recognition that development aid, however important to many impoverished countries, will get little support in donor countries if it is seen to be wasted by corruption.

Finally, when considering the weapons available against grand corruption, the value of public debate must not be discounted. While action is needed on this pivotal front, it is a very healthy development that there is now so much more public discussion and understanding of this critically important subject.

●The Corruption Code of the Americas

Plagued by corruption and bribery scandals, the member countries of the Organization of American States have ratified an unprecedented convention against corruption.

While additional domestic legislation still needs to be passed in some signatory countries to make the code air-tight, it contains far-reaching definitions and enforcement mechanisms.

The code breaks significant ground by requiring the OAS members to criminalize bribery and illicitly obtained riches. Other key provisions are:

- a. The use of "bank secrecy" as a basis for denying investigative assistance to another country is explicitly prohibited
- b. Ratification of the code provides a legal basis for extradition on corruption charges even if no extradition treaty exists.
- c. The code's definition of corruption includes favors and non-monetary rewards, not only financial bribes. It also classifies as corruption an official's acts of omission if such inaction benefits those giving him a bribe or a favor.
- d. Illicit enrichment by public officials is deemed an act of corruption under the convention, and signatory members are bound to make this a crime under their legislation if it does not already exist.

In order to nip corruption in the bud, the OAS countries agreed to put in place several preventive mechanisms. These include registration and publication of the assets of certain government employees, protection mechanisms for both public officials and private officials who elect to become corruption "whistle blowers", and laws to deny favorable tax treatment to any person or company for the bribes they pay out.

Impressively, almost all of the OAS member countries have now ratified the convention. As its preamble states, the region's governments are clearly "persuaded that fighting corruption strengthens democratic institutions and prevents distortions in the economy and damage to a society's moral fiber". ■

This article was written by George Moody-Stuart For Economic Reform Today And Legislative Alert

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