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Comments: Vito Tanzi and Jules Kroll

VITO TANZI

Some years ago, the department I supervise in the International Monetary Fund (IMF), the Fiscal Affairs Department, was asked by the Ugandan government to assist it in the reform of its tax administration. The experts from the Fund soon came to the conclusion that it would be very difficult, or even impossible, to reform the existing tax administration, which was considered quite corrupt. It thus made the radical recommendation of replacing the tax administration with a totally new one. The government acted on this recommendation. It was simply easier to replace than to reform. Occasionally this same advice has been given to other countries—for example, Peru—which have followed the same strategy with good results. For customs administrations, where problems of corruption are often rampant, several countries have come to the same conclusion and some have asked private foreign companies to take over, for a period, the functions of a customs administration. This route has not yet been followed for tax administrations, which continue to rely on domestic personnel.

Augustine Ruzindana's paper reminds me of a conversation, a couple of years ago, with two senior officials from China, one of them from the tax administration. During a luncheon conversation, I had asked him whether the people I had seen driving Rolls Royces in Beijing were foreigners. He seemed a bit annoyed by my question and stated, proudly, that they were Chinese. I then asked if these people were major payers

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of income tax—since I had just been told of the difficulty encountered by the tax administration in identifying people with high incomes. He replied that probably they weren't. When I inquired why, I was told that it was difficult to prove that these people had an income. I then asked why the tax administration couldn't check whether they had declared incomes in past years. I was told that this was irrelevant, because they could have bought the Rolls Royces with inherited money. This anecdote supports the importance of a point made by Ruzindana, that public officials must disclose their assets when they join the government and the government must check what assets they accumulate while they have official positions. If this system works, it may identify cases in which public officials become mysteriously rich during their tenure in office. However, the system often does not work, because there are various possibilities for hiding accumulated wealth.

Some of this book's authors ask why there is so much interest in corruption now. Glynn, Kobrin, and Naím in particular discuss this issue at length and mention several reasons (chapter 1). One is globalization, which brings people from different countries into frequent contact and makes foreigners more interested in the issues of other countries. This interest is sharpened when corruption plays a role in the selection of foreign firms for domestic contracts so that the firms that do not play the game are left in the cold. This is the aspect that attracts most of the attention in the chapters by Mark Pieth and by Fritz Heimann and that has been attracting the attention of the Organization for Economic Cooperation and Development (OECD) and other organizations. Reportedly, US firms have lost tens of billions of dollars in contracts because they were prevented from giving bribes.

Globalization also contributes to the development of a more efficient market economy. The distortions created by corruption are more difficult to identify and have less of an impact on the functioning of markets when the markets are already much distorted by bad domestic policies. But in markets that are becoming more efficient and where the playing field becomes more level, the effects of corruption become more apparent. Also, because orthodox or market-oriented economics is more fashionable and more accepted now, there is much more interest in the effects of corruption on the allocation of resources and on competition. And as globalization proceeds and international competition increases, the international community becomes much more concerned with the potential for corruption to distort the playing field of international competition.

There has been some discussion about the costs and the benefits of corruption. I must confess that I have little patience for those who try to find benefits in corruption. These individuals are often addressing artificial or very unusual situations. Unfortunately, when corruption exists, it is often widespread. It affects not just some decisions or sectors but many decisions and most sectors. In these circumstances, public officials may even create the conditions (such as additional regulations) that will allow them to extract extra rents. Thus, in reality, corruption is likely to distort markets and to impose major costs on the economy.

Let me illustrate with an example. A few days ago I got a call from an acquaintance of mine from the south of Italy. This person wanted me to "recommend" her grandson for a vacant position as a musician on the provincial orchestra. She obviously believed, as many in the south of Italy do, that most public positions are allocated not through merit but through personal endorsements. Just think of an environment in which such "recommendations" and not ability could determine whether somebody is chosen to play in an orchestra! Assume that the same attitude could influence the allocation of positions not just as flutists but, say, as surgeons. In this case, the cost of corruption would not be measured just in missed musical notes but in botched operations.

The point is that once corruption becomes prevalent, it becomes impossible to confine it to areas in which it does the least damage or in which it even "oils the mechanism." It may extend to the choice of surgeons, to appointments to key official positions, to decisions regarding the safety of particular activities, to allocation of credit, and so on. In some countries, government positions are sold to the highest bidder, who can then recover the cost of getting the job once he is in the position. If a corrupt inspector, because of a bribe, approves an unsafe building or an unsafe bridge or if, because of corruption, unsafe equipment is used in sensitive activities, corruption will impose major costs on society. The same will happen if public works are undertaken just to generate bribes or if the quality of the work is very poor.

Corruption also distorts the role of the government. Elsewhere I have argued that corruption distorts the government's role in income distribution because the benefits from corruption tend to go to the better connected, who often are in the higher percentiles in the income distribution (Tanzi 1995). It certainly affects the stabilization role of the government because it tends to reduce tax revenue and to increase public spending. This happens when corrupt tax inspectors collude with taxpayers to reduce tax revenue and corrupt officials assign public benefits to individuals who are not entitled to them. Corruption also distorts the allocation of resources in other ways. In Italy, and especially in the south, before *tangentopoli*[1] some school buildings were built but were never used. And in many countries often roads are built that lead to nowhere or that benefit some important personality. The whole point of building these schools or roads is to give an opportunity to somebody to get a bribe related to the building contracts. In some cases the project may be

1. *Tangentopoli* means "bribe city" and is the name given to the corruption scandal that rocked Italy in recent years.

economically justified but may become much larger or more complex than it needs to be to allow a percentage of the larger cost to be transferred to some of those who authorized the work. Thus public spending not only grows, it is also unproductively spent.

In Italy and elsewhere, corruption must have had a positive impact on the size of public investment. My observations over the years in many countries have convinced me that corruption tends to swell public investments while reducing private investment. However, the increase in public investment is largely an illusion. Part of the expenditure classified as investment is, in fact, a transfer to those who have the power to make decisions.

Corruption comes in many forms. There is corruption at the highest level, including heads of state, ministers, and other senior policymakers. But there is also corruption at the bureaucratic level. Sometimes little attention is paid to the latter, although bureaucratic corruption may be prevalent even when there is little corruption at the top. (The converse is not true: it is unlikely that there are situations where corruption exists only at the top.) Corruption depends on many factors, and some of these continue to play a role even when corruption may have stopped at the highest levels. An interesting point made by Ruzindana was that in Uganda, while particular legal institutions were being created to combat corruption, there was also major reform of the economy. He has described some of these reforms. This is an extremely important aspect. If a country enacts anticorruption laws but does little else to alter the environment that promotes corruption, not much will change. There is a demand and a supply aspect to corruption. When there are many regulations and policies that are not fully objective and transparent, corruption will tend to flourish, or at least continue, even when institutions to combat it are being created.

In Italy, the political or high-level corruption originated in part from the fact that, according to some estimates, the political parties (and there were several of them) were employing tens of thousands of people to do their political work. This work involved doing favors for individuals—such as helping them in getting government jobs, pensions, scholarships, public housing, and job transfers–thus assuring their political support for the party. There was a small civil service working for the parties and somebody had to pay the cost. It could not be financed with the fees of the members of the party, which were small. So funds had to be generated in other ways. Public enterprises were pushed to make under-the-table "contributions." Those who won government contracts for public works were also pushed to "contribute," and so on. Some of these funds went to the parties; some found their way into the pockets of officials. This may imply that a system that subsidizes political parties with public funds may reduce the scope for corruption. Although campaign finance reform may not be amenable to international cooperative action, comparative international research on the relationship between corruption and the way political parties are financed would be useful.

The relationship between public-sector intervention in the economy and corruption is an aspect of the problem that has not received much attention, though Ruzindana touched on this. If the government controls financial markets, foreign trade, access to foreign exchange, and access to many goods provided at subsidized prices (such as telephones, water, electricity, credit, and imported goods), bribes will often play the role in allocating scarce goods and resources that prices are not allowed to play. An Indian official recently told me that in some parts of India, households frequently experience the loss of electricity. A few dollars "contributed" to the right employee in the electric company solves the problem immediately. The difficulty is that electricity provided at too low a price creates an extra demand and makes it possible for some employees of the electric companies to extract some rents.

There is also the problem of low wages. Wages are often mentioned as a reason for corruption or for the lack of corruption. Singapore is cited as a country in which the salaries of public officials (ministers and heads of departments) are very high to discourage corruption. At the other extreme, at the beginning of the 1980s I remember the minister of finance of Ghana telling me that the monthly wage of ministers was extremely low and not much above that of their drivers. Conditions such as these must contribute to both corruption and to attitudes that tolerate corruption. At the same time, it is important to avoid the mistake of assuming that simply changing the level of wages, without changing anything else, is enough to reduce corruption. If wages are increased but jobs are still assigned on the basis of nepotism and cronyism, and job security remains regardless of circumstances, raising the wage level will do nothing to reduce corruption. Singapore sharply raised the level of wages, but it also introduced many other changes—increasing public-sector transparency and accountability—that together sharply reduced the level of corruption. Today it is considered one of the world's least corrupt countries.

There is something that bothered me about some of the other papers in this book. My concern is similar to one that Dani Rodrik expressed. Corruption is a widespread phenomenon that generally happens *within* countries. But these authors discuss mainly the corruption that involves contracts between foreign companies and countries. This latter form of corruption is important, and I certainly do not wish to minimize it. It is good that work related to these corrupt contracts is going on. However, we should not have the illusion that eliminating this form of corruption would do much about corruption in general in these countries. At best, such elimination will solve a problem of particular relevance to industrial countries. Thus, all aspects of corruption should receive the same attention.

The last point I want to make, and a point that has been made but probably is worth repeating, is that the changes taking place in transition economies and in several developing countries undergoing structural reforms create conditions in which, in the short run, there are many possibilities for corruption on a large scale. Thus, corruption may have increased because of these changes. Maybe that is one additional reason we have become more interested in the issue of corruption. In these countries, much corruption is taking place, which, unfortunately, will give a bad name to market reform. But the changes taking place are those that reduce the opportunities for corruption in the long run.

References

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I would like to focus on just two points. First, it is impossible to review here all the collective wisdom this volume represents, so I would like to discuss my own experience and then try to distill one thought from that. Second, I have been preaching for a few years now about the danger in the increased activity on the part of the secret services and intelligence agencies of various countries. The intelligence community is looking for new markets, and that presents a tremendous danger that has not been focused on sufficiently. Unlike many of the other problems confronting us, this is something I believe those concerned about these corruption issues may actually be able to do something about.

The first point I would like to address is, why now? Corruption is not exactly new. Why suddenly are policymakers, academics and policy analysts, corporate affairs people, and brand-new organizations such as Transparency International involved in this noteworthy cause? This issue was raised by Moisés Naím, Patrick Glynn, Mark Pieth, and almost all the other authors.

There are three reasons, and I think we can build on those. First, when the economies of countries go through difficult times or crises—such as the savings and loan scandal in the United States, the bubble bursting and subsequent financial crisis in Japan, or the absorption of the costs of reunification in Germany—the water level in the stream gets lower, and the rocks that were always there emerge. And no one likes what they see because there is nothing to like.

In particular, where you have a free media and a democratic political system, people get very upset when these things come out. In many countries recently, governments have fallen, in part because of dissatisfaction on this issue. You find this also in countries in transition where people's hopes are dashed, or even in authoritarian political systems where people simply become fed up.

Let me give you some examples from my own experience. In the last 10 years, we have conducted investigations of "Baby Doc" Duvalier after he fled to France, Brazilian President Fernando Collor de Mello and his campaign manager, who were accused of malfeasance soon after taking office, and also the old Soviet regime to try to identify illicitly acquired assets hidden in foreign bank accounts. I could go through a litany of similar cases. Generally, the corruption was going on for a long time. And until there was either a transition to a democratic system or people simply got fed up because economic conditions were so terrible, no one was willing to do anything about it.

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Increasingly, however, I think conditions are improving for fighting corruption. But there is another reason this issue is so prominent on the US trade agenda. Why are certain companies backing this meeting? Why are very smart, very capable people focusing on this issue now? Above all, US companies have gotten their brains beaten in over the years because of the "genius" of the Foreign Corrupt Practices Act (FCPA), which has many problems that I will not review here. As American companies have increased their global activities, particularly in the "big emerging markets" identified by the Clinton administration for special marketing attention, they are increasingly running into situations where they are not able to win contracts in certain countries—either because they're inept, inexperienced, or afraid of going to jail for violating the FCPA. As a practitioner advising clients on how to deal with corruption, I must tell you that I have seen very few benefits to my American clients of the FCPA. The gymnastics they go through, trying to stay in business and keep up with their competition, are really quite something.

But progress is being made and will continue to be made only when it is unacceptable politically for the heads of state to engage or acquiesce in this sort of behavior. You can only solve this problem, in my view, on a top-down basis. Heads of state have to take the lead in combatting corruption. That, to me, is the clearest message to come through in part II of this book. Augustine Ruzindana talked about the importance of leadership and how that made the reforms in Uganda possible. If the leadership had not changed, no change would have been possible.

Next, what is needed is focus on the part of governments, companies, and nongovernmental organizations (NGOs) interested in this subject. Fred Bergsten was able to get us all in this room—at great expense in time and money—because this is a subject whose time has arrived. I believe some organization—whether it is the Organization for Economic Cooperation and Development (OECD), Transparency International, or someone else—needs to take charge and build on the achievements that have been made.

Most important, with respect to combatting corruption in developing countries and the economies in transition, everyone else is in 14th place after the International Monetary Fund (IMF) and the World Bank. If those organizations get tough on this issue, if there is serious auditing of loans, and if the crooks that run these countries are told they will not receive any more money unless they cooperate, then this corrupt behavior will stop. It is the World Bank and the IMF that have the resources to make it work; the rest is largely symbolic from my point of view.

Let me go to my second major point. My firm employs a number of people from around the world who came out of intelligence agencies. I have enormous respect for many of these agencies around the world, including our own. But I see a very dangerous activity that has been increasing for a number of years.

As one of the authors has already pointed out, the end of the Cold War has changed the world on a number of fronts. It has permitted democracy to emerge in some countries. It has also had some, I hope temporary, negative effects. When a totalitarian regime is toppled, corruption typically does not decrease: it increases. It's every man and woman for themselves.

Also, with the end of the Cold War, in a number of intelligence agencies, employees are seeking desperately to keep their jobs. Whether it is in Russia or elsewhere in Eastern Europe, there are many smart, capable people who have done some interesting things during their lives and are now looking for work or looking for new activities so they can keep their current jobs. The CIA is looking for new "markets." Such searches are even more dangerous in countries with state enterprises. When you combine state enterprises with a secret service, with bureaucrats and politicians—and it's a closed circle—look out.

Intelligence agencies should be kept out of this business. They should be focused on other, more serious problems. I am concerned about the possibility of their activities turning into "econo-war," with countries engaging in tit-for-tat games of spying, revelation, and scandal. This could then spill over into other, more serious issues.

Those are the two basic points I wanted to make: that the time is ripe for real progress in the battle against corruption but that intelligence agencies around the world, including the US Central Intelligence Agency, should stay out of the fight.

Let me conclude by reiterating that the problem can only be solved with leadership. We have to move beyond codes and lectures on ethics. We know what has to be done. The leadership in the countries where corruption is most prevalent have to stand up against it. We ought to focus our resources on what is achievable, and, while I think what the OECD has done is wonderful, I am getting too old to wait around for the year 2020 before they pass three more amendments. What we need is more focus.