

Chapter 5

The Corruption Menace

Corruption is one of the most damaging consequences of poor governance

Corruption is one of the most damaging consequences of poor governance. It undermines investment and economic growth, decreases the resources available for human development goals, deepens the extent of poverty, subverts the judicial system, and undermines the legitimacy of the state. In fact, when corruption becomes entrenched, it can devastate the entire economic, political, and social fabric of a country. There is an urgent need to create a zero tolerance for corruption, which must be embedded in international legislative frameworks, national policies, and local value systems. This chapter estimates the extent of corruption in the countries of South Asia, analyzes both the underlying causes and ultimate costs of corruption, and prepares a concrete anti-corruption agenda for the region.

Corruption is defined here as the use of public office for private gain. It can range from illegal cash transactions to seats in parliaments, and from dishonest judicial decisions to bureaucratic promotions (see box 5.1). While the focus of this chapter is on economic forms of corruption, it is well to remember that political and civic corruption are also important. Some of these issues are analyzed in chapters 3 and 7, respectively. Corruption in the private sector is tackled explicitly in this chapter only in the context of privatization, but it is also a significant concern in South Asia. Many of the key anti-corruption reforms suggested in this chapter would also be essential in tackling corruption in these areas. A wider anti-corruption agenda must include a concrete plan to tackle electoral fraud and the criminalization of

Box 5.1 A typology of corruption in South Asia

Corruption can take many forms. It can be political or bureaucratic. It can be in the private or public sphere. It can be limited within national boundaries or abetted by international laws. A list of corrupt acts would include bribery, extortion, influence peddling, nepotism, fraud, vote-buying, the use of 'speed money', and embezzlement.

While there exist many different forms of corruption, varying in participants, settings, techniques and cultural legitimacy, the main types of corruption in South Asia can be divided into three categories: petty corruption, middling corruption, and grand corruption. Over the last few decades, there is a growing perception in many parts of South Asia that corruption has 'floated upwards'—from petty corruption in the 1950s, to mid-level corruption in the 1960s and 1970s, to corruption at the very highest levels of the state in the 1980s and 1990s.

- Petty corruption is the oldest and most

widespread form of corruption in South Asia. It involves the provision of public goods and services being sold at a bribe price, usually by low level personnel. Such goods and services should be freely available or at a low price as an entitlement.

- Middling corruption normally takes place at the enterprise level and usually involves the bureaucracy. It often takes the form of queue jumping in industrial licensing, bribe-based awards of major contracts, kickbacks in government tendering, and tax evasion. Middling corruption is sometimes an antidote to policy distortions and may grease the wheels of the economy, but it is still arbitrary in its operation and replaces one distortion by another; those who pay the highest bribe are usually not the most efficient.
- Grand corruption, discussed in greater detail in box 5.7, is similar to insider trading. It involves corruption at the highest levels of the state, and usually involves foreign money.

Source: Khan, M. 1996.

politics in the political sphere; the lack of transparency in many fraudulent non-governmental organizations, claiming to represent civil society; and illegal businesses—such as, arms, drugs, and prostitution—in the private sector.

What price corruption?

The chain connecting corruption with human development has two main sets of links. First, corruption hinders human development directly by limiting access to basic social services and indirectly by reducing the potential for sustainable economic growth (figure 5.1). There is also a key link back. Low levels of human development contribute to an environment which breeds corruption and worsens governance still further. Thus, a mutually reinforcing vicious cycle is created in which corruption leads to

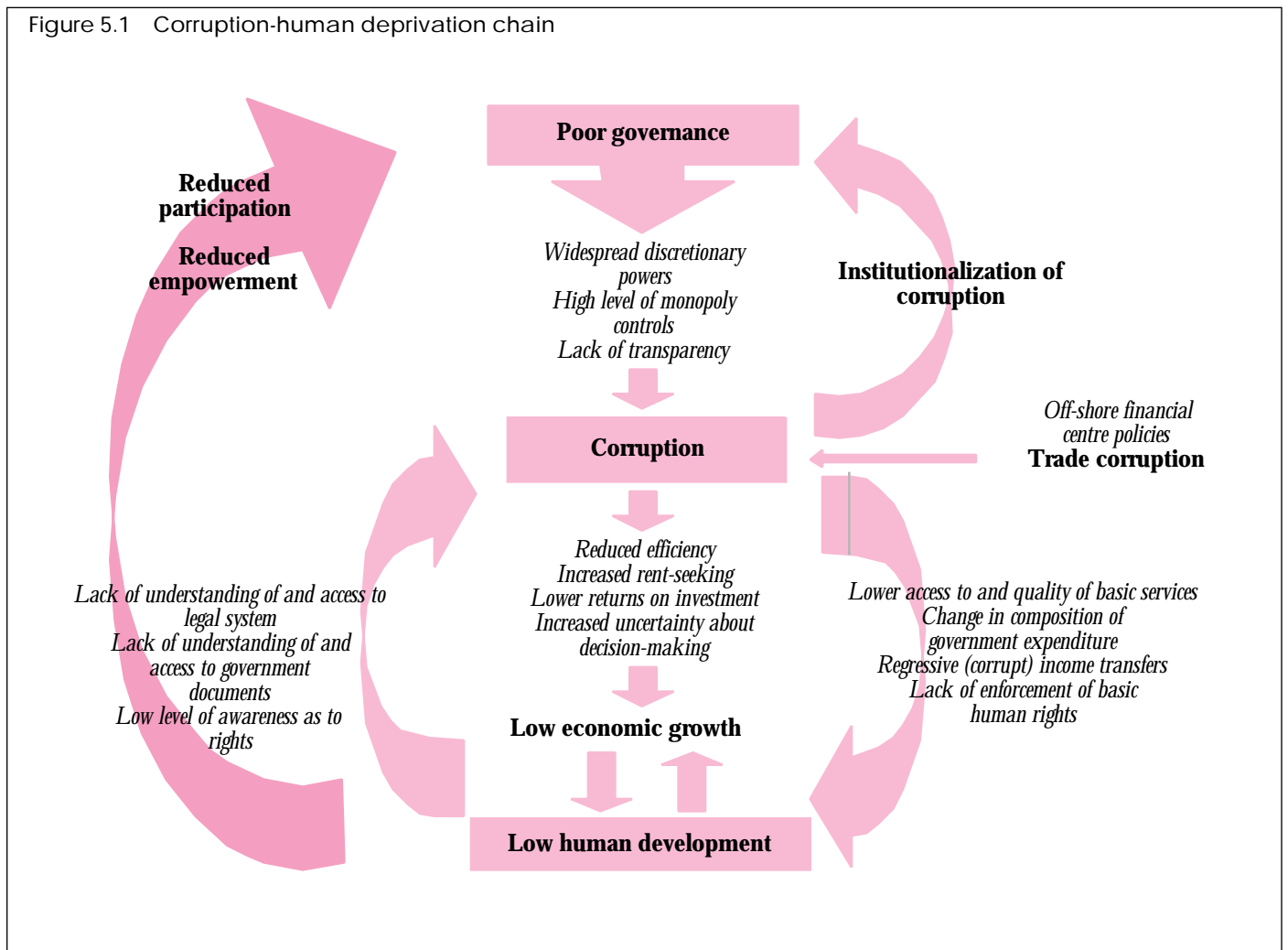
growing human deprivation and, as a result, still higher levels of corruption. This section clarifies these two chain reactions in the corruption-human development cycle.

Corruption and Economic Growth

Theoretically, corruption reduces economic growth through two main channels. First, corruption decreases the efficiency on which an economy depends. This is because corruption often leads to choices that are not optimal: students get jobs by altering university test results, workers are paid bribes just to perform routine tasks, and non-credit-worthy firms secure loans by bribing the bank manager, to name a few.

Government officials control access to scarce resources, allowing them to act as monopolists, and thereby earn (directly

Corruption leads to growing human deprivation



Box 5.2 Are the corruption optimists right?

Despite mounting evidence indicating the adverse impact of corruption on economic growth and human development, a revisionist view still exists that cloaks corruption in ambiguity. Two key arguments are presented by the 'corruption optimists'. First, corruption is culturally relative, and what is reviled as corruption in the West is interpreted differently within South Asian culture and value system.

The second argument often heard is that corruption 'greases the wheel' of development, that bribes and 'speed money' act as an efficient way of circumventing burdensome regulations and ineffective legal systems. The high-performing East Asian economies are often cited in this revisionist view since they experienced both rapid growth and high levels of corruption. Unfortunately, in the context of the more corrupt countries of South Asia, the arguments put forward by the corruption optimists are false.

The cultural relativism argument is weak on two counts. First, corruption is not a 'western' conception but has been recognized by South Asian thinkers for centuries. Texts dating back to Hindu chronicles and Buddhist scriptures, to the *hadith* (sayings) of the Prophet Muhammad (PBUH), testify that anti-corruption attitudes are deeply embedded within South Asian culture

and tradition. Second, regardless of cultural origins, and different notions of the public and private sphere, empirical evidence demonstrates that the use of official power for personal gain—whether termed a 'bribe' or a 'gift'—leads to economically and socially negative consequences. It is these massive social costs which should form the basis for an anti-corruption drive, rather than an esoteric debate about the nature of corruption in different societies.

Second, 'grease-the-wheels' argument is also flawed. Bribes are considered as 'speed money' which reduce delays in moving files and make it possible to jump slow-moving queues for public services. Unfortunately, corruption in South Asia leads to inertia, not momentum. Instead of speeding up administrative procedures, corrupt officials actually cause delays in order to attract more bribes. This is because the argument ignores the enormous amount of discretion that many politicians and bureaucrats have over the creation, proliferation, and interpretation of counterproductive regulations. Thus, 'instead of corruption being the grease for the squeaky wheels of a rigid administration, it becomes the fuel for excessive and discretionary regulations', often specifically designed to create opportunities to earn 'speed money'.

Source: Osborne 1997, Klitgaard 1998, and Kaufman 1997.

or indirectly) monopoly rents for themselves. The consequences are two fold: first, there is a direct welfare loss associated with the potential abuse of monopoly power by a corrupt government official; and second, there is a further wastage associated with the use of real resources in competing for these artificially contrived monopoly rents.

Considerable empirical evidence confirms today that corruption lowers investment and hinders economic growth. The argument, once fashionable, that corruption actually improves efficiency in developing countries is now rarely heard (see box 5.2). For instance, a recent study by Peruvian economist Paolo Mauro

(1995 and 1998) found that a corrupt country is likely to face aggregate investment levels of approximately 5 percentage points less, and per capita growth rates half a percentage point less, than a relatively uncorrupt country.

The evidence from South Asia is particularly stark. If corruption levels in India were reduced to those in the Scandinavian countries, investment rates could increase annually by some 12 per cent and the GDP growth rate by almost 1.5 per cent each year (Gandhi 1997). If Bangladesh were to improve the integrity of its bureaucracy to Uruguay's level, its yearly GDP growth rate could rise by over half a percentage point (Wei 1998). And if Pakistan were to reduce corruption to the Singapore level, its annual per capita GDP growth rate over the period 1960-85 could have been higher by nearly two percentage points—implying per capita incomes almost fifty per cent higher than existing levels (Wei 1998). Most worrying is that these growth losses have been increasing over time. A recent study in Pakistan has shown that the growth cost of corruption (as a percentage of GDP) may have increased from a quarter of one per cent at independence in 1947 to just under 2 per cent by 1997 (Burki 1998). Box 5.3 gives four key reasons why corruption in South Asia is particularly harmful in its effect on economic development.

Second, corruption acts as an additional tax on investment by lowering the potential return to an investor on both the initial investment and on subsequent returns. The secretive and illegal nature of bribes means that there is considerable uncertainty as to whether bribe takers will live up to their part of the bargain. Corrupt transactions are not enforceable in a court, and it is quite probable that the bribe taker reneges on his understanding with the investor or simply returns to demand another bribe (Bardhan 1997b). These considerations are reflected in the higher risk premium that foreign and domestic investors attach to investing in South Asia given the unpredictability of decision-making.

One recent study shows that investing in a relatively corrupt country, compared to a relatively honest one, is equivalent to an additional 15 per cent 'private' tax on investment (Kaufman 1997 and Klitgaard 1998). In Pakistan, lower corruption levels would have meant that the implicit corruption tax on foreign investment would have been reduced by 28 percentage points (Wei 1998). In India, current corruption levels mean that the implicit corruption tax on investment is almost 20 percentage points (Gandhi 1997).

A recent World Bank study (World Bank 1996a) on the hidden costs of doing big business in Bangladesh examined the implicit 'private' taxes in attempting to get a trade licence and a factory licence to set up a garment factory. First, to secure a trade licence takes over one year. As a result, businessmen end up resorting to side-payments of \$125-200 to conclude the procedures in a week. Next, a factory licence is secured, which 'should normally take a month, but actually takes much longer. A side-payment of \$500 for local authority approval, \$125-200 for clearance by the Chief Inspector of Factories, and

\$125 for the factory licence itself is required to push this through.' Overall, 'the costs of corruption (\$7,760) come to 340 per cent of the estimated initial official costs (\$2,291) of setting up a business'.

Finally, corruption also reduces the government's resources and hence its capacity for investment, since tax revenues are depleted by both the tax evasion of 'honest money' by corrupt means (for example, a bribe to the tax authorities) and 'corrupt (undeclared) money' by honest means (for example, the flight of corrupt assets to off-shore safe havens). This has two adverse effects: first, shifts away from investments in human development areas occur as bribe-takers are less likely to invest in activities with significant positive social benefits like education and health. Second, overall investment levels may fall, since the conspicuous consumption or flight of illegal earnings is probably higher than legal earnings. The high potential for capital flight of illegal earnings makes corruption more likely to be associated with a negative impact on the balance of payments.

Corruption reduces state resources and hence the capacity for public investment

Box 5.3 Why is South Asian corruption unique?

Corruption happens everywhere. It has been at the centre of election campaigns in Italy and the United Kingdom, led to the fall of governments in Japan and Indonesia, and resulted in legislative action in Russia and the United States. But if corruption exists in rich, economically successful countries, why should South Asia be worried about it? The answer is simple: South Asian corruption has four key characteristics that make it far more dangerous and damaging than corruption in other parts of the world.

First, corruption in South Asia occurs up-stream, not down-stream. Corruption at the top distorts fundamental decisions about development priorities, policies, and projects. In industrial countries these core decisions are taken through transparent competition and on merit, even though petty corruption may occur down-stream.

Second, corruption money in South

Asia has wings, not wheels. Most of the corrupt gains made in the region are immediately smuggled out to safe havens abroad. Whereas there is some capital flight in other countries as well, a greater proportion of corruption money is actually ploughed back into domestic production and investment. In other words, it is more likely that corruption money in the North is used to finance businesses, than to fill foreign accounts.

Third, corruption in South Asia often leads to promotion, not prison. The big fish—unless they belong to the opposition—rarely fry. In contrast, industrialized countries often have a process of accountability where even top leaders are investigated and prosecuted. For instance, former Italian Prime Minister Bettino Craxi has been forced to live in exile in Tunisia to escape extradition on corruption charges in

Rome. The most frustrating aspect of corruption in South Asia is that the corrupt are often too powerful to go through such an honest process of accountability.

Fourth, corruption in South Asia occurs with 515 million people in poverty, not with per capita incomes above twenty thousand dollars. While corruption in rich, rapidly-growing countries may be tolerable, though reprehensible, in poverty-stricken South Asia it is political dynamite when the majority of the population cannot meet their basic needs while a few make fortunes through corruption. Thus, corruption in South Asia does not lead to simply Cabinet portfolio shifts or newspaper headlines, but to massive human deprivation and even more extreme income inequalities. Combating corruption in the region is not just about punishing corrupt politicians and bureaucrats, but about saving human lives.

Source: Haq, K. 1996.

The damaging effects of corruption on investment and economic growth are widely recognized. But corruption also has adverse effects on human development. First, corruption reduces

the availability and increases the cost of basic social services. Access to core social services can be easily restricted with the intention to make corrupt gains. For instance, a government doctor may deliberately store away free medicines until he is bribed, a police inspector may deny a First Information Report to a victim until he is paid a kickback, and a head-teacher may refuse to admit a child in school until an under-the-counter payment is made. Since obtaining access to basic public services normally requires an illegal cash payment, corruption also raises the price of these services.

A detailed study in Bangladesh by Transparency International revealed the extent of additional side-payments required in order to obtain basic needs (TI 1997a). One in five primary school-going children were forced to employ teachers as tutors outside school hours in order to avoid repetition and low grades. One in three hospital in-patients had to use extra-legal means to obtain a hospital bed. And one in three land-holding households had to pay a bribe to register their land.

Second, in addition to a decrease in total government expenditure (due to tax evasion), corruption also shifts government expenditure from priority social sector spending to areas, where the opportunities for rent-seeking are greater and the possibilities of detection lower. The possibilities of corrupt gains from spending on new programmes are usually greater than expenditure on the maintenance of existing programmes, perhaps explaining the disrepair many health clinics and schools have fallen into in South Asia (Haq 1998a). Allocating government funds to a few large defence contracts or mega-projects may seem more attractive to corrupt bureaucrats and politicians than spending the same money to build numerous rural health clinics (Bardhan 1997b). As box 5.4 shows, the possibilities for corruption and non-detection are certainly greater when money is spent on fighter aircraft and large-scale investment projects than on text-books and teacher training, even

Box 5.4 Dealing in death: making money in the global arms bazaar

If you wanted to establish principles for a corrupt industry, something like the arms industry might emerge. Conservative estimates suggest that over \$3 billion are stolen by corrupt political and military elites and their cronies around the world each year on the back of the arms trade alone. Recently, Transparency International (TI) has commissioned work on corruption in the global arms trade. In TI's examples below, there are seven key characteristics that make arms procurement one of the most lucrative activities prone to corruption:

- First, corruption in arms procurement often has the tacit approval of governments in both the selling and buying of arms.
- Second, vast amounts of money are involved. The \$1.3 billion Bofors deal in India was big enough to carry \$250 million in life-changing bribes.
- Third, spending decisions are in the hands of a tiny group of unaccountable elites with limited transparency.
- Fourth, complex technology involved means that informed analysis is virtually impossible for understanding the strategic rationale of the proposed purchase and cost-performance comparisons of competitive weapons.
- Fifth, arms producers are desperate to sell arms in the post cold war era when individual contracts can make the difference between survival and disappearance; as a result, companies are under pressure to get the deal at any cost.
- Sixth, there is limited knowledge of what the 'right' market price for a military weapon is. When the trading range for an item varies by hundreds of per cent, there is no market, no transparency, and no means of comparing prices. In short, fertile ground emerges for both bribe givers and bribe takers.

- Seventh, arms procurement is also shrouded in a cloak of absolute secrecy. The weapons are secret, attempts to sell them are secret, even success is secret.

Details of arms corruption in South Asia are scarce. Media reports are often based on speculation rather than rigorous analysis. But one thing is certain: defence procurement contracts are rarely subjected to the extensive network of checks and balances that exist for civilian development programmes.

What can be done to put a halt to the massive corruption in the arms trade? Four key actions are a necessary starting point. First, the assumption of secrecy in the arms trade should be rigorously examined, with the presumption that it should be abandoned. There is an urgent need for greater transparency in the defence budgets of South Asia: defence budgets must give a detailed breakdown of where money is spent and why. Arms companies should also report as clearly and in as timely a fashion as for other commodities. Second, governments in both the arms importing and arms exporting countries must realize that they can prevent corruption only by acting jointly. Third, the UN arms registry must be strengthened, and should act as an information clearing house for arms procurement worldwide. Fourth, western governments must withdraw their tacit approval of corruption in the arms trade. This means condemning rather than secretly helping national companies to arrange corrupt arms transactions, and striking off laws which allow these firms to give bribes to politicians and businessmen in other countries legally.

Source: TI (various years) 1995, 1997a, 1997b, and 1998.

though the social returns from the latter may be higher. Similarly, there may be a temptation to choose more complex technology (where detecting improper valuation or over-invoicing is more difficult) than simpler, and more appropriate technology.

Third, corruption increases injustice. Basic human rights and freedom come under threat, as key judicial decisions are based on the extent of corrupt bribes given to court officials rather than on the innocence or guilt of the parties concerned. Police investigations and arrests may be based on political victimization or personal vendettas rather than on solid legal grounds. The vulnerable, such as ethnic or religious minorities, are particularly under threat as religious laws may be manipulated to indict them when the political and legal system can be easily bought over. In the Bangladesh survey by Transparency International, 90 per cent of respondents pointed to the police and the judiciary as the two most corrupt state institutions (TI 1997a). 40 per cent of the families involved in police-cases were compelled to pay a bribe to police officials; 50 per cent of households involved in court cases had to bribe the court officials, with 20 per cent also hiring witnesses. When corruption becomes entrenched, the basic trust between the citizen and the state disappears.

Links from human development to corruption

The many ways in which human poverty contributes to corruption and poor governance have only recently been emphasized. Figure 5.1 shows some of the critical links. The basic message is clear: the lower the level of human development in a country, the less likely will its people and government be able to combat corruption or improve governance. This is because well-educated and knowledgeable people are more capable of combating corruption at all levels—whether personal, regional, or national.

At a macro-level, poorer countries may often be unable to devote sufficient resources to setting up and enforcing an effective legal framework, and in some countries may even lack the human capital to devise more efficient and transparent institutional structures. Moreover, at a micro-level, illiterate people are less aware of their basic rights. They are unable to read key official or private documents that can ensure that they obtain adequate social services, are less able to understand the legal system and thus combat judicial corruption. Illiterate people may also be unable to obtain credit, are less capable of making informed political decisions that oust corrupt leaders and vote in honest politicians, and may be less able to resist corruption when faced with basic survival constraints.

Unfortunately, the prospects of combating corruption through a vibrant and aware civil society and a highly educated and competent government are somewhat bleak at present. In fact, as the last two Reports on *Human Development in South Asia* clearly demonstrate, the region has emerged as the poorest, the most malnourished, the least gender-sensitive, and the most illiterate in the world. South Asia now has 395 million illiterate adults and over 45 million children not attending primary school. It is little wonder that the region has become caught in a vicious cycle of low human development and high corruption. To break this cycle, we must first move from a knowledge of the consequences of corruption to its scale and causes. Only then can a viable strategy for combating corruption be devised.

The corruption equation

Corruption results from logical calculation, not irrational emotion. At the heart of the corruption problem lies a formula first devised by Robert Klitgaard, which equals corruption with monopoly power plus discretion minus accountability and low government salaries (Klitgaard 1988 and

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Corruption flourishes when monopoly control is combined with discretionary power

1998). Whether in Delhi, Dhaka, Islamabad, or Colombo, corrupt acts occur 'when a person has monopoly power over a good or service, has the discretion to decide who will receive it and how much, is not accountable', and has a low (legal) income level (Klitgaard 1998). The solutions to corruption require; reducing artificially contrived monopoly power, limiting official discretion, enhancing transparency, increasing punishments for violators, and reducing the direct incentives for engaging in corrupt activities.

Monopoly control and discretionary powers

Corruption flourishes when monopoly control is combined with discretionary power. Monopoly power without discretion (for instance, a bus conductor issuing tickets), or discretion without monopoly power (for instance, a government officer attesting documents) leaves few opportunities for corruption. But the combination is lethal: it allows government officials to transform the potential monopoly profits in a range of government functions into actual monopoly earnings, by restricting the quantity of a service, and accepting bribes to sell the restricted quantity of services at a higher monopoly price. Examples of corruption faced by ordinary citizens as a result of discretionary monopoly power are myriad. They range from the renewal of motor vehicle licences to the provision of passports, and from the filing of a burglary report to the bidding for a government tender.

The more discretion government officials have over the operation of business or people's lives, the more likely that corruption will flourish. Trade restrictions, government subsidies, price controls, multiple exchange rates, and foreign exchange allocation schemes are particularly well-known sources of corruption (Mauro 1997). Studies by both Kaufman and Wei (1998) and Mauro (1995) show that the indices of corruption and government regulation are positively correlated.

Several studies in South Asia have shown the existence of laws and regulations whose sole purpose seems to be the creation of corruption opportunities for government officials. For instance, it requires forty-seven different approvals to construct a building in Mumbai, India, and a small-scale entrepreneur has to handle thirty-six different inspectors each month and forty-six different documents (Gandhi 1997). In Bangladesh, toilets in factories must be 30 yards from the workplace—a regulation which made sense when toilets were primitive but is now outdated, and serves only as a bribe-seeking opportunity for factory inspectors (World Bank 1996a). Similarly, the need for a non-contamination certificate from the national Atomic Energy Commission (a process taking two months and costing Tk 25,000), is now used by Bangladeshi customs officials to extract bribes even on industrial items like maize starch, which is used for sizing in the textile industry.

An obvious way to tackle the corruption problem would be to simply eliminate the laws and regulations that breed corruption. In many cases, however, the solution to corruption is not that simple. Withdrawing the state provision of certain basic services can harm human development more than it can help anti-corruption efforts. For instance, corruption in the appointment of primary school teachers could be solved simply by closing down government schools, but the benefits of reduced corruption are likely to be outweighed by the decline in primary school enrolment. Furthermore, merely shrinking the economic role of the state is not the solution to many corrupt actions, since this merely shifts the locus of corrupt activity from the public to the private sector. In fact, badly designed and improperly managed liberalization processes in several South Asian countries have been sometimes associated with an increase in corruption, rather than a decline (see box 5.5). This clearly shows the need for both greater transparency in

the privatization process, as well as improved regulation of privatized companies in order to satisfy equity, safety and environmental concerns.

Punishing offenders

Corruption continues until the corrupt are caught and punished. Unfortunately, the level of accountability in South Asia is so low that many government officials choose to take bribes because they are almost certain that they will never be caught, and if caught would escape punishment because of legal delays. Accountability is low at four different levels: at the international level, within government agencies, by the judicial system, and even at the hands of civil society.

First, the treatment of corruption money by many Western governments smacks of double standards. Currently, the legislation in many countries—such as France, Germany, and Sweden—make it a crime to give a bribe to a national of that country, while legalizing and giving tax deductions on bribes given to foreigners for either political funding or for the implementation of projects. Recent attempts to devise more equitable corruption laws by the OECD and other international bodies are welcome, but much more needs to be done (see box 5.6). Furthermore, while drug money flowing from South Asia to the rest of the world correctly faces stiff legal challenges, there are no equally harsh laws preventing the laundering of corruption money. In fact, many off-shore financial centres actually welcome the flow of corruption money, while international banking secrecy laws actually work not just to protect genuine savings but grand larceny.

Second, most government agencies, rather than devising effective in-house checks on corruption, have often developed institutional mechanisms that perpetuate corruption rather than eliminate it. Officials who refuse to be corrupted by persuasion from colleagues or ‘friendly’ telephone calls from bosses

may be promoted less frequently, posted to remote outposts, or transferred to relatively unimportant departments, so that the corruption chain is not delinked. Most government departments and enterprises lack both effective in-house ombudsmen or private, independent auditors. The result: many such malpractices often remain unchecked.

Third, the judicial system is full of antiquated laws, fails to implement even exemplary formal statutes, and is often corrupt itself so that laws are not enforced fairly (Ackermann 1997). There

Box 5.5 Is privatization the panacea for corruption?

Liberalization, deregulation, and privatization are not magic wands that can eliminate corruption overnight. In fact, several countries—including Russia, China, and India—have found that deregulation actually can lead to an increase in corruption. This may sound theoretically implausible to those who proclaim government to be the main villain in the drama of corruption.

Below, three possible mechanisms are outlined whereby apparent deregulation attempts might either increase corruption or, at least, fail to reduce it. These assertions must, of course, be subjected to rigorous empirical testing before judging their validity in actual cases of deregulation in South Asia. But they lead to genuine concern that rather than reducing corruption, improperly managed economic liberalization might simply change the nature of corruption ‘away from those initiated and controlled by state actors to those initiated and controlled by actors in civil society’ (IDS 1996).

First, few South Asian politicians may be actually interested in implementing a policy that reduces the political and economic benefits they obtain from control over the allocation of rights. The rhetoric of deregulation might, therefore, be quite different from the policies that continue to maintain most government controls.

Second, the huge windfall gains accruing to potential private owners of state monopolies may increase rent-seeking among private-sector bidders, so

that corruption actually increases in a deregulatory environment. In addition, corrupt rulers may be especially keen to privatize state assets because of the opportunity for large one-time gains (UNDP 1997a).

Third, new regulatory powers may be created, paradoxically, in the process of deregulation. For instance, the (unexpected) formation of a government committee which determines the order and timing of deregulation might allow it to influence the discounted present value of the flow of rents from existing government-created monopolies. In order not to lose these rents, existing monopolists may bribe committee members (or use other corrupt means) in order to maintain their economic rents. Just as the privatization process can itself be corrupted, so can the regulatory agencies that are needed in a privatized world (UNDP 1997a).

Policy-makers in South Asia must take care to root out corruption in the privatization process if they are to maximize the benefits of liberalization. Bribes should not be allowed to determine the list of pre-qualified bidders. Accurate information about state assets should be presented to everyone, not just to a few select insiders.

Conflicts of interest between politicians involved in selling state assets and their cronies buying these assets should be avoided. The institutional structure of regulatory agencies should be determined before bidding, to prevent manipulation (UNDP 1997a).

Source: Hyat 1996; IDS 1996; UNDP 1997a; and World Bank 1992.

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are, of course, exceptions within the region. In India, for instance, the Supreme Court has recently played a key role in carrying out a corruption investigation in the controversial Bofors scandal, despite strong government opposition. However, even the most honest court officials are powerless if there are no effective, non-corrupt agencies to investigate and prosecute corrupt activity. Thus, courts often fail to combat corruption simply because corrupt officials never appear before them, or the evidence presented is too weak. See Chapter 3 for an analysis of the judicial system.

Fourth, despite a few recent initiatives—such as the Public Affairs Committee in India, the Human Rights Commission of Pakistan, the country branches of Transparency International, and citizen's action in India against former Prime Minister Rao—there are hardly any major civil society groups taking action against corruption. There is, for instance, no equivalent in South Asia to Hong Kong's famous Independent Commission Against Corruption, which

has considerable powers to combat corruption. The potential for such civil society action in South Asia is also considerably limited by the cloak of secrecy on most government information. Accountability by the people first requires citizens having the information to see whether officials are doing what they are supposed to be doing. The absence of detailed budget breakdowns, expenditure decisions outside the budget framework, the failure to disclose military spending, the limited data on revenue collection, and the absence of detailed information on new amendments and ordinances severely restricts the potential for concerted civil society action.

South Asia's 'perverse incentives'

The less bureaucrats are paid, the more it pays for them to be corrupt. This basic result is well supported by empirical evidence and country case studies. Studies for the World Bank's *World Development Report 1997* provide evidence that countries with poorly paid public officials are more susceptible to corruption. As

Box 5.6 The globalization of corruption

While many international donors are attempting to curtail lending to developing countries where corruption is rampant, there is also an urgent need to take note of the international dimension of corruption. The world community is as responsible for encouraging corruption as developing countries themselves.

Most western nations—with the commendable exception of the United States—regard commissions and bribes paid by their multinationals as legitimate expenses of business which are tax-deductible. In other words, western nations offer tax breaks and subsidies to their firms for the bribes that they give. Only a third of the 27-member OECD forbid outright tax deduction for foreign bribes paid by their nationals. These include the United States, Canada, Britain, and Japan. Many European nations including Belgium, Luxembourg, France, Sweden, Greece, and Germany still tolerate tax deductibility of foreign bribes.

There is an urgent need for the global community to change its current laws and practices and declare all bribes by their firms as a crime, punishable under law.

Recently, the OECD has passed the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. It is anchored around the criminalization of bribing foreign public officials by member states and abolishing tax deductibility of bribes. Although the Convention deals with the supply side of bribery, it is restricted to only international transactions, concerned only with the corruption of foreign public officials, and fraught with loopholes. Nevertheless, it is still of great importance. The Convention's signatories account for 70 per cent of world trade and 90 per cent of investment outflows.

Furthermore, most South Asian countries transfer more corrupt money

abroad each year than the aid they receive. This is because the offshore banks of western nations accept the flight of this corrupt money, give it protection under bank secrecy laws, and make handsome profits from it. While laundering drug money is a crime, sheltering corruption money is not. The difference between the two is simple: while drugs kill some people in rich nations, corruption starves millions in poor nations. Moreover, corruption money is easier to detect than drug money: while drug money is channelled via global cartels, corruption money from South Asia normally comes under a name and from lands where legal incomes are extremely low. It is therefore necessary to have international laws that treat safe havens for corrupt money on par with laundering outfits for drug money. It would also require western banks to cooperate in the search for corruption money.

Source: Haq 1997; OECD 1997, 1998a, 1998b; and 1998c; and Public Affairs Centre 1997.

chapter 3 indicates, there has been a considerable decline in the real civil service pay in several South Asian countries over the past fifty years.

As a result, a recent study found that India might need to increase public sector pay by 271 per cent and Sri Lanka by 496 per cent, in order to reduce their corruption levels to that of Singapore (Wei 1998). The study concluded that if officials are paid much less than people with a similar training elsewhere in the country, only those willing to accept bribes will be attracted to the public sector. Over time, the salary of senior civil servants relative to junior staff has also decreased, creating a disturbing incentive for a relative shift in corruption to higher levels of public administration.

Entrenched corruption

When corruption becomes entrenched and systemic, its negative influence on economic and social development multiplies. Trust between the state and its citizens collapses. Basic laws and contracts are no longer enforced. Contracts are no longer honoured. Vast amounts of resources and time are spent seeking bribes and corrupt gains rather than engaging in productive activity. Corruption extends from petty corruption at the lower level to grand corruption among the highest of the land (see box 5.7). Indeed, box 5.1 confirms the perception that corruption has floated upwards from petty corruption in the 1950s, to entrenched corruption at the highest levels by the 1990s. In such a situation, most citizens and investors see corruption as inevitable and anti-corruption reforms as futile.

The Indian Prime Minister Jawaharlal Nehru once stated: 'Merely shouting from the house-tops that everybody is corrupt creates an atmosphere of corruption. People feel they live in a climate of corruption and they get corrupted themselves'. Indeed, corruption breeds corruption—and a failure to combat it effectively can lead to an era of entrenched corruption.

An explanation of entrenched corruption propounded recently by economic theorists is the idea of 'multiple equilibria' in the incidence of corruption. The central idea is that the expected gain from corruption depends on the number of people. Initial conditions, it emerges, are vital: if an economy is jolted into a high average level of corruption, it will move towards a high-corruption equilibrium (Bardhan 1997b). However, despite the seemingly permanent nature of the entrenched corruption in many South Asian countries, it is possible to shift out of the high-corruption trap. Many countries—from France in the nineteenth century to Singapore in the twentieth century—have successfully completed the transition from high- to low-corruption societies (see box 5.8). Strong and visible political commitment to a solid anti-corruption agenda and strategy can bring about a similar transition in South Asia as it enters the next millennium.

An anti-corruption revolution

Fighting corruption in South Asia has become a rhetorical, rather than an actual, priority. The time has come for the

Fighting corruption in South Asia has become a rhetorical, rather than an actual, priority

Box 5.7 Grand corruption

Grand corruption is the misuse of power by heads of state, ministers, and top officials for private profit. The winners of grand corruption are Presidents, Prime Ministers, and Cabinet members. The losers are the general public. Any attempt to slay the corruption monster in South Asia must first attack the problem of grand corruption, which has caused such tremendous economic, social, and moral damage in the region.

Grand corruption is not unique to South Asia. For instance, the amount held in Swiss banks on behalf of African leaders alone is believed to be in excess of \$20 billion. But the recent examples of high-level political corruption in South Asia—in particular Pakistan, India, and Bangladesh—are among the most spectacular anywhere in the world.

Source: Haq 1996a; and Burki (forthcoming).

While the examples relate to particular governments, a more detailed analysis would almost certainly discover similarities across political parties and regional lines.

The magnitude of corruption in Pakistan exceeds Rs 100 billion a year, according to conservative estimates. A majority of the cases relate to non-performing loans provided by state-owned financial institutions to high-placed friends of the regime.

In India, the Bofors scandal involved several top political figures, including two former Prime Ministers. The Swedish arms company is alleged to have paid nearly \$30 million in bribes in secret Swiss accounts to top government officials.

Unless the wider institutional environment that breeds corruption is radically transformed, specific anti-corruption agendas are unlikely to meet with success

region's leaders to realize that combating entrenched corruption requires more than waiting for moral awakenings or economic miracles. A bold, concrete anti-corruption agenda needs to be devised and implemented. Any sensible plan to attack corruption must involve civil society, political leaders, government officials, business community, judges, foreign governments, and multilateral donors. While aiming at a substantial elimination of the major sources of corruption, any realistic plan must attempt to evolve a graduated strategy with a sensible, practical, step-by-step approach. Policy-makers must also realize that corruption is primarily a symptom of poor governance. Unless the wider institutional environment that breeds corruption is radically transformed—through economic, electoral, judicial, parliamentary, and bureaucratic reforms that restore people's trust in government, specific anti-corruption agendas are unlikely to meet with success.

Selecting strategies

Strategies to combat corruption must be based on an assessment of their impact as well as their feasibility. The first stage in the battle against corruption is to have strong political commitment; if this is missing, no anti-corruption plan will succeed.

If the requisite political commitment exists, the next stage is to examine the political and institutional feasibility of particular actions. Actions with a high feasibility can be subdivided by their high or medium impact on corruption. An anti-corruption agenda should focus on both. High feasibility-medium impact actions are necessary to 'pave the path'. They have important symbolic significance, and may be necessary to break out of a high-corruption equilibrium. Alongside actions that pave the path, are required policies that have a significant impact on corruption but can be accomplished relatively easily—'the easy short cuts'. These two actions build momentum for the third and final round

of actions—'learning to fly'. These are actions which have low feasibility since they will require tremendous political commitment to be carried out, but with a strong impact on reducing corruption.

The sequencing of the three sets of actions is important. First, symbolic actions must 'pave the path' by sending a shock to the system to jolt it out of the corruption trap. Second, 'the easy shortcuts' can root out some of the more obvious sources of corruption in a society, and thus lend real credibility to anti-corruption reforms. Finally, it is necessary to move into a new low-corruption trajectory by 'learning to fly'; this requires moving beyond marginal measures into fundamental reforms that squarely address the causes of corruption rather than the mere symptoms. The following are three basic routes to a low corruption path. They illustrate the key actions to begin an anti-corruption revolution.

PAVING THE PATH. The origins of an anti-corruption revolution lie in a few grand actions that establish credibility for the anti-corruption plan. Five basic actions can help convince people that the government is serious in combating corruption:

- *Begin accountability from the top*—An anti-corruption revolution must begin from the top if it is to be credible. 'The only way to break out of a high-corruption culture is for a few major corrupt figures to be convicted and punished. The government should identify a few major tax evaders, a few dishonest judges, and a few high-level government bribe-takers. Since a campaign against corruption can too often become a campaign against the opposition, the first big fish to be fried should be from the party in power' (Klitgaard 1998).
- *Set up exclusive corruption courts*—There are 22 million cases currently pending in the Indian judiciary. The Bangladeshi judiciary has a backlog of almost six