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Redesigning the State to Fight Corruption

Transparency, competition, and privatization

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A companion Note argued that, with norms of honesty constant, corruption depends on three factors: the overall level of public benefits available, the riskiness of corrupt deals, and the relative bargaining power of briber and bribee. Anticorruption strategies must operate in parallel, by reducing the benefits under the control of officials, increasing the costs of bribery, and limiting the bargaining power of officials. This Note proposes reforms to achieve these objectives, beginning with measures to increase the riskiness of corruption.

Risks and costs of bribery

Government policy can reduce corruption by increasing the benefits of being honest, increasing the probability of detection and punishment, and increasing the penalties levied on those caught. Such measures will usually require substantive law reform to tighten internal controls, strengthen external monitoring, and introduce more transparency.

Civil service reform

Reforming the civil service is an obvious first step. Often the pay structure needs adjustment. If officials are paid much less than those with similar training elsewhere in the economy, people willing to accept bribes will be disproportionately attracted to the public sector. Officials with discretionary control of large benefits may need to be paid much more than the going rate for people with similar skills, to increase their willingness to resist the high bribes they may be offered. But adequate civil service pay is only a necessary condition, not a sufficient one. Paradoxically, an official whose pay is boosted may demand higher bribes—to offset the risk of losing what is now a very desirable job. Thus, the incidence of bribery falls as fewer officials are willing to accept payoffs, but the size of the bribes paid increases.

Civil service reform must therefore include features tied to the marginal benefits of accepting payoffs. There are two parts to such a strategy. The first is to set civil service wages above the going private sector wage, or to grant public employees generous benefits, such as pensions, that they will receive only if they retire in good order. But, again, such reforms may not be sufficient, since they are not tied to the benefits of individual corrupt deals. Once an official steps over the line and begins to take bribes, these policies will encourage him to take ever-higher and more frequent payoffs. If he faces a high probability of losing his job anyway, why not take as much as possible? Thus, a second step is also necessary. Penalties should be tied to the marginal benefits of the payoffs received. The probability of detection and punishment and the level of punishment, given conviction, should increase with the level of peculation.

Furthermore, to be effective, antibribery laws must apply both to those who pay and to those who receive bribes. Convicted public officials should pay a penalty equal to a multiple of bribes received, and penalties for convicted bribers should be tied to their gains (their excess profits, for example), not to the amount paid. One effective deterrent is debarment procedures that prohibit corrupt firms from contracting with the government for a period of years.

Law enforcement and administrative penalties focus on locating corruption after it has occurred. They can deter civil servants from ac-

cepting or extorting payments if they create the perception that corruption carries high risks. The goal is to use a combination of carrots (desirable pay and benefits) and sticks (legal and administrative penalties) to deter payoffs.

External bodies and whistleblower statutes

Outside institutions can complement internal controls. An independent and honest judiciary, from lower-level clerks to judges, is essential for effective legal sanctions. As alternatives or supplements, other independent review and investigative systems have been proposed, such as an anticorruption commission, an ombudsman, or other independent administrative tribunals. Such external review bodies (Hong Kong's Independent Commission against Corruption, for example[1]) can be valuable, but they carry the risk of arbitrariness if they report only to the country's ruler.

Uncovering evidence of corruption is notoriously difficult because both sides to the transaction have an interest in keeping it secret. In fact, reporting the peculations of others can be dangerous. If corruption is systemic, a "whistleblower" risks being disciplined by corrupt superiors and attacked by coworkers, and may even end up being accused of corruption himself. Governments should consider promulgating whistleblower statutes that protect and reward those in the public and private sector who report malfeasance. The United States, for example, has a statute that rewards those who report irregularities in government contracts.

When corruption is systemic, solutions that appear reasonable in other contexts can have perverse effects. For example, some recommend rotating officials so that they are unable to develop the close, trusting relations in which payoffs may be more likely. But if the entire government agency is corrupt, superiors can use their ability to reassign staff to punish those who refuse to play along. A study of corruption in an irrigation system in India found that such practices were common.[2] They have also been observed in corrupt police forces in the United States.

Increased transparency

Those concerned with fighting corruption should support a free press, few constraints on the creation and operation of watchdog and good-government groups, and freedom of information laws. They should oppose restrictive libel laws, especially those that give special protection to public officials. Elected politicians ought not be immune from charges of corruption.

Within the public sector certain structures and systems can make government actions more transparent. Corruption is deterred because it is more difficult to hide. For example, strong financial management systems are essential that audit government accounts and make financial information about the government public. Open and fair procurement regulations are also necessary. Similarly, corruption among politicians can be deterred through campaign finance reform and conflict of interest rules. But restrictions on legal donations must not be so restrictive that they push candidates off the books. Legal controls must be combined with effective methods of financing campaigns from public money or private contributions.

Integrated approach

It is hard to evaluate the relative merits of these options in the abstract, because their costs and benefits depend on the context. But most cannot stand alone. For example, increases in civil service pay and benefits are pointless if credible monitoring systems are not in place to detect wrongdoing. Policies to increase the risks and costs of corruption are usually part of reform strategies designed to reduce the potential benefits. For example, when Mexico reformed its customs service, it not only simplified the underlying regulations, but also improved civil service pay and improved auditing and control.

Reducing discretionary benefits

The most promising anticorruption reforms are those that reduce the discretionary benefits under the control of public officials. This must be done without simply shifting the benefits to

private sector elites, where they will show up as monopoly profits.

Less intervention

The first and most obvious way to reduce payoff opportunities is simply to eliminate those programs riddled with corruption—though this is not an option for programs with strong public policy rationales. If the state has no authority to restrict exports or license businesses, there is no opportunity for bribes. If a subsidy program is eliminated, the associated bribes will also disappear. If price controls are lifted, market prices will express scarcity values, not bribes. If a parastatal that is the locus of corrupt payoffs is moved into the private sector, those payoffs will end.

Of course, many regulatory and spending programs have strong justifications and ought to be reformed, not eliminated.

Competition and market forces

In general, any reform that increases the competitiveness of the economy helps reduce corrupt incentives. Policies that lower the controls on foreign trade, remove entry barriers for private industry, and privatize state firms in a way that assures competition, all contribute to the fight against corruption. But deregulation and privatization must be carried out with care. Deregulating in one area may increase corruption elsewhere. For example, a successful effort to reduce corruption in the transport of agricultural products in one African country increased corruption and legal tariffs in neighboring countries on the same transport route.[3] The privatization process can itself be corrupted, as can new regulatory institutions. Rather than bribing the parastatal to obtain contracts and favorable treatment, bidders bribe officials in the privatization authority. This is not to say that privatization and deregulation are not, on balance, desirable in most cases, but only to caution reformers to be aware of the incentives for malfeasance along the way.

Economists have long recommended reforming regulatory laws in such areas as environmental protection by introducing market-based schemes and charging user fees for scarce government services. In addition to improving efficiency, these reforms reduce corrupt incentives. The sale of water and grazing rights, pollution rights, and import and export licenses can limit corruption by replacing bribes with legal payments.

Administrative reforms can also be important in lowering corrupt incentives. One such reform is the introduction of competition within government to reduce the bargaining power of officials. When bribes are paid for benefits such as licenses and permits, overlapping, competitive bureaucratic jurisdictions can reduce corruption. Since clients can apply to any of a number of officials and go to a second one if the first turns them down, no one official has much monopoly power, and, therefore, no one can extract a very large payoff. For qualified clients, bribes will be no larger than the cost of reapplication. Unqualified clients will still pay bribes, but even they will not pay much so long as they too can try another official. This model can be extended to law enforcement, giving police officers who control illegal businesses overlapping enforcement areas. Gamblers and drug dealers will not pay much to an individual policeman if a second one may come along later and also demand a payoff. The system may work better if the law enforcement officers belong to different police forces—local, state, or federal, for example—making collusion among officers less likely.

Clear rules, simple processes

When corruption is difficult to observe, administrative reforms can be designed to make its effects more easily observed. For example, the state might use private market prices as benchmarks to judge public contracts. Clear rules of proper behavior could be established so violations can be spotted even if the bribery itself is not. Procurement decisions could favor standard off-the-shelf items to provide a benchmark and to lower the cost of submitting a bid.

Corruption in the collection of taxes cannot, of course, be solved by failing to collect rev-

enue. In such cases, one solution is to clarify and streamline the necessary laws. The reform of the Mexican customs service, for example, reduced the steps in the customs process from twelve to four, and streamlined the remaining service to reduce delays. Rules should be transparent and publicly justified. A government could move toward simple nondiscretionary tax, spending, and regulatory laws as a way of limiting corrupt opportunities. But the value of such reforms depends on the costs of limiting the flexibility of public officials. Some risk of corruption often needs to be tolerated in exchange for the benefits of a case-by-case approach in administering programs. But even in these cases, transparency and publicity can reduce corrupt incentives.

Many corrupt situations have both winners and losers. The state could introduce ways for the potential losers to protest or to organize ahead of time, or make it hard for corrupt officials to organize themselves or bribe payers. Sometimes bribe payers view themselves as losers who would be better off in an honest world and are potential allies in an anticorruption effort. But when bribery makes both the payer and the recipient better off than they would be in a no-bribery world, control incentives must rest with outsiders (for example, disappointed bidders, taxpayers, consumers). The existence of losers with a large stake in the outcome, such as disappointed bidders, can facilitate efforts to limit corruption.

Conclusions

Some argue that bribes help firms and individuals circumvent government requirements—reducing delays and avoiding burdensome regulations and taxes. Payoffs seem to be nothing more than the grease needed to move the gears of complex machinery. But corruption cannot be limited to situations where the rules are inefficient. Incentives to make and ask for payoffs exist whenever a government official has economic power over a private firm or individual. It does not matter whether the power is justified or unjustified. Once a pattern of successful payoffs is institutionalized, corrupt officials have an incentive to demand larger bribes and seek new ways to extract payments. Therefore, even when illegal payoffs appear to facilitate commerce, governments and private citizens should not respond with tolerance. Instead, they must move vigorously to stem a "culture" of illegality. Illegal markets are always inefficient relative to a well-functioning legal market. Those with scruples will not participate, price information will be poor because of the illegality of the trades, and time and energy must be expended to keep the deal secret and to enforce its terms. In some cases, paying bribes may be more efficient than complying with existing rules, but corruption is always a second-best response to government failures.

Corruption can never be entirely eliminated. Under many realistic conditions, it is simply too expensive to reduce corruption to zero. And a single-minded focus on preventing corruption can impinge on personal freedoms and human rights. Such a focus could produce a government that is rigid and unresponsive. The aim, therefore, should be not complete rectitude, but a fundamental increase in the honesty—and thus the efficiency, fairness, and political legitimacy—of government.

[1] Robert Klitgaard, *Controlling Corruption*, Berkeley: University of California Press, 1988, chapter 4; Jon Quah, "Controlling Corruption in City-States: A Comparative Study of Hong Kong and Singapore," prepared for a conference on "The East Asian Miracle: Economic Growth and Public Policy," Stanford University, Palo Alto, CA, 1993.

[2] Robert Wade, "The System of Administrative and Political Corruption: Canal Irrigation in South India," *Journal of Development Studies* 18: 287–327 (1982).

[3] Glenn Rogers and Sidi Mohammed Iddal, "Reduction of Illegal Payments in West Africa: Niger's Experience," draft discussion paper presented at a workshop on "Good Governance and the Regional Economy in Francophone Africa," sponsored by USAID and IRIS, Dakar, March 1996.

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