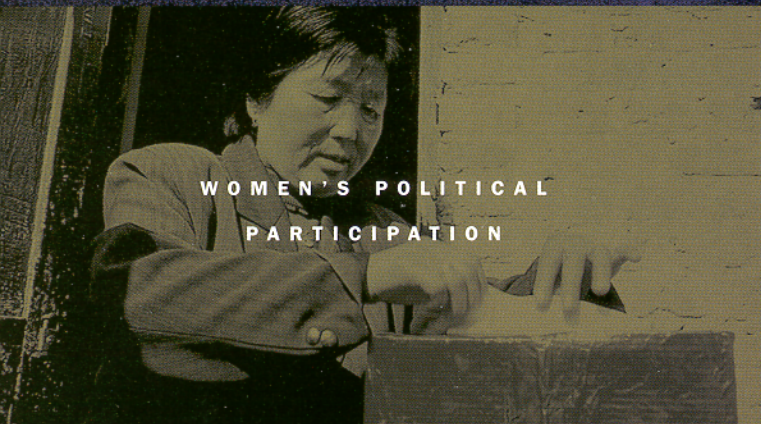
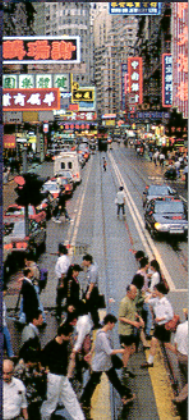




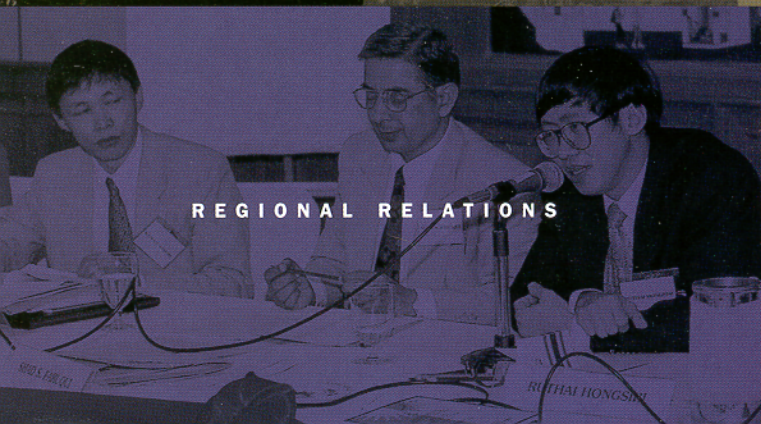
GOVERNANCE AND LAW



ECONOMIC REFORM AND  
DEVELOPMENT



WOMEN'S POLITICAL  
PARTICIPATION



REGIONAL RELATIONS





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### CONTACT INFORMATION

#### SAN FRANCISCO

465 California Street, 14th Floor  
San Francisco, CA 94104  
phone: 1 415.982.4640  
fax: 1 415.392.8863  
e-mail: [info@asiafound.org](mailto:info@asiafound.org)

#### WASHINGTON, D.C.

1779 Massachusetts Avenue, NW  
Suite 815  
Washington, D.C. 20036  
phone: 1 202.588.9420  
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# THE ASIA FOUNDATION

Working Paper Series

**CORRUPTION: CAUSES, CONSEQUENCES,  
AND POLICY IMPLICATIONS**

*A Literature Review*

Amanda L. Morgan  
Consultant, The Asia Foundation

Working Paper #9 • October 1998

THE ASIA FOUNDATION  
WORKING PAPER SERIES



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The views expressed in this working paper are those of the author and do not necessarily represent those of The Asia Foundation.

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## Foreword

Through its network of offices throughout Asia, The Asia Foundation has for many years provided support for training, capacity building, and program activities to local institutions and civil society organizations working on transparency and accountability issues. In recent years, however, growing evidence pointing to corruption's substantial costs to political and economic development has led the Foundation to address corruption issues more specifically and systematically. Moreover, as a result of changes generated in part by rapid economic growth and globalization, corruption is also being perceived by governments and international donor organizations alike as a primary factor distorting national economies and negatively affecting public prosperity. To formulate an effective approach to countercorruption programming, complementing other partners' ongoing activities while taking advantage of the Foundation's on-the-ground presence in Asia, the Foundation set out to explore the recent dynamics that are generating a new level of awareness of the economic and political value of integrity in government, the changing policy incentives and environment for dealing with corruption, current international trends and institutions supporting reform in government, and the scope and impact of corruption in Asia.

To this end, the Foundation has convened meetings in the U.S. and in Asia, bringing together researchers, activists, and Foundation staff to share information on corruption, establish a support network of interested groups and individuals, and to help design a regional countercorruption program building on The Asia Foundation's unique strengths. What became clear in these discussions is that serious advances against corruption require the integration of economic reform, administrative reform, and judicial and other institutional changes to reduce the opportunities for and increase the costs of corrupt behavior. Significant progress cannot be achieved without high-level political commitment backed by public demand for change. The economic crisis now affecting many Asian countries has served to highlight even more the systemic nature of corruption and the need for far-reaching reforms. The fact that there is now more open discussion of corruption and its negative consequences by constituencies both inside and outside of government presents an opportunity to move forward with a concrete reform agenda.

More specifically, in its countercorruption programming, the Foundation is focusing on three interrelated aspects. First, greater public understanding of corruption and its economic, social, and political costs is essential. For progress

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to be made, corruption must become a matter for legitimate public policy debate. The Foundation assists civil society organizations in Thailand, Bangladesh, Nepal, Sri Lanka, and the Philippines to improve their capacity to promote public dialogue by supporting public opinion polls and research to help define the scope and nature of corruption in these countries, and identifying corruption issues of greatest concern to citizens. Second, given the complex nature of corruption, a countercorruption reform agenda must be both technically sound and widely supported by key domestic interest groups. In Thailand and the Philippines, for example, the Foundation supports the work of private sector business associations to identify specific problems of corruption they face and how to address them. Finally, given the critical role of a committed leadership, the Foundation supports efforts on the part of think-tanks and other local organizations to engage government leaders to increase their commitment to reform.

Given the complex nature of the problem, the Foundation will continually refine its approach to corruption and maintain close working relationships with the network of international and local individuals and organizations working on corruption. This corruption literature review, written by Amanda Morgan, is part of the Foundation's efforts to gain a better understanding of the vast literature on corruption. With the current high level of interest on corruption, we believe it is worth sharing with our colleagues interested in this topic. This literature review is not meant to be comprehensive, but deals primarily with "political economy" issues and approaches, with a view to developing practical solutions. As such, it is meant to serve as a quick reference tool, while not necessarily reflecting The Asia Foundation's institutional view of any country or organization mentioned. Your suggestions and comments are welcome.

William S. Cole  
Director, Governance and Legal Reform Programs  
The Asia Foundation



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## Introduction

The literature on corruption is as vast as the topic is complex, testifying to the intractable nature of a problem that societies have been struggling with for thousands of years. Until recently, most corruption-related material focused solely on the incidence of bribery; some even argued that bribery could be beneficial to development. Now other types of corruption, many more deleterious than bribery, are starting to be recognized, and their consequences for sustainable development ascertained. In this respect, our technical understanding of corruption has greatly improved with new efforts to quantify actual political, social, and economic costs associated with corruption. This development points to the overall discernable trend in recent years to examine corruption not simply as an essentially moral issue related to the unfair distribution of a country's wealth, but as a major distortion of political, social, and economic decisionmaking.

The new literature that has emerged over the past several decades cuts across three central issues. The first addresses why policymakers, business leaders, and private citizens should concern themselves with the existence and elimination of corruption. Though the empirical evidence indicates that corruption hinders economic development, corruption was not absent in the highly successful East Asian economies. In fact, these economies were built around collusive relationships that facilitated growth by aligning business interests with government objectives. However, these same arrangements now seem to be undermining the sustainability of economic growth.

The second issue is how and when political, social, and economic forces contribute to the reduction of corruption. Lessons from past instances of successful countercorruption campaigns can be instructive in understanding how and when these forces actually result in countercorruption drives. For example, one conclusion that has emerged is that a sincere commitment by high-level leadership to countercorruption efforts is a crucial component of successful campaigns. It is not clear, however, why some leaders choose to back countercorruption efforts, with all the political costs and risks associated with them. In some instances, the occurrence of elite struggles to consolidate power at the political center compels the leadership to embark on an anticorruption campaign. In others, the need to establish political legitimacy motivates anticorruption activities. In general, the literature indicates that a form of political cost-benefit analysis on the part of a country's leaders seems to determine the existence or lack of an official policy, and actual action, on corruption.

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A third broad category focuses on what types of policies effectively counter corruption. Three types of reforms have been effective anticorruption instruments: 1) changing policies which induce or provide opportunity for corruption, 2) reform of incentive structures operating in administrative and political institutions, which encourage corrupt behavior on the part of state officials, and 3) reform of legal institutions to create enforcement capacity and strengthen the rule of law. The most successful anticorruption strategies are comprehensive, drawing from all three categories.

It is important to note a fundamental distinction between the technical steps to address and reduce corruption and the strategies to build political will and leadership commitment to take those steps. This distinction is not always clear in the literature. Most of the current literature focuses on the technical side of the issue; political will is either ignored or assumed to already be in place. However, many questions still remain concerning the mobilization of public pressure for anticorruption reform. How is it that some states are able to make significant economic progress despite the presence of corruption, while in others it is a major obstacle to development? How is it that regimes which are notoriously corrupt stay in power? Why is there an apparent lack of correlation between the length of time leaders retain their offices and the quality of their policies? Consequentially, how is it possible to build political will for anticorruption reform in places where corruption has been shown to be a successful strategy for maintaining political authority?

Understanding development within the context of these corruption issues is critical to formulating a strategy for mobilizing demand and building political will to counter corruption. First, the ability to articulate the adverse consequences of corruption on economic, political, and social systems is a crucial tool for engaging interest groups in anticorruption efforts and building coalitions for reform. Secondly, understanding why political leadership chooses on occasion to address issues of corruption is essential to deconstructing existing collusive arrangements. Finally, a better understanding is needed of how demand can be mobilized and a commitment by leadership secured and sustained for specific policy and institutional changes to address specific kinds of corruption. This requires knowledge of the types of policies that are most effective in reversing incentive structures that lead to corrupt behavior.

Given its embedded and intractable nature, efforts to analyze corruption abound, not only in the fields of economics and political science, but also in law, anthropology, sociology, and even psychology. This literature review,



however, is not a comprehensive examination of the vast literature or academic debates on corruption. Instead, it focuses specifically on political economy approaches to corruption, concentrating on understanding the fundamental causes and costs of corruption with a view to developing practical policy solutions. The ensuing discussion of the different trends in the political economy literature, the existing empirical data, and policy implications is meant to provide a quick reference and useful starting point for formulating specific reform agendas, whether at the national or local level.

The next section reviews the principal debates in the political economy literature on corruption. How should corruption be defined? Are standards of corruption universal or culturally specific? What are the causes of corruption? What are the effects of corruption on political development and economic growth? And, finally, which policies effectively address corruption? Section III introduces a typology of corruption and the causes, consequences, and potential solutions for each form, including: bribery, theft or pillaging of state assets, distortion of government expenditure, patronage, and cronyism.

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## Debates and Definitions

Rich but unresolved theoretical debates compose the vast majority of the literature on corruption. However, new empirical studies have begun to resolve long disputed issues. This is especially true with regard to the literature on the impact of corruption on development, pertinent to the goal of building political will to counter corruption.

In light of the difficulty in collecting data on corruption, given its intrinsic secrecy, it is not surprising that there have been few empirical works. In general, the studies that have been done on corruption draw their data from original surveys, interviews, and focus groups on public perceptions, and purchasable corruption indexes created for business-related purposes. Examples of the former include *Corruption and Democracy in Thailand* by Pasuk Phongpaichit and Sungsidh Piriya-rangsan<sup>1</sup> and "Corruption: The Facts" by Daniel Kaufmann.<sup>2</sup> Phongpaichit and Piriya-rangsan incorporate public opinion surveys, focus groups, and interviews to study the public perception of corruption in Thailand. Daniel Kaufmann uses surveys to generate data on elite perceptions of corruption in various developing countries.

Other studies rely on three main indexes which have compiled cross-country data on corruption for banks, institutional investors, or multinational firms.<sup>3</sup> The first data set was created by Business International (BI), a subsidiary of The Economist Intelligence Unit. Data is available for the period 1980 to 1983 and covers nearly 70 countries. The data set measures "the degree to which business transactions involve corrupt payments" on a scale of 1 to 10, as seen by BI's network of correspondents. The second data set originated with the World Competitiveness Report, a business publication produced by the World Economic Forum in Switzerland, and consists of a survey of top and middle managers in the most dynamic firms of the countries included in the study. Since 1989, the surveys have asked a corruption-related question about "the degree to which improper practices (like corruption) prevail in the public sphere." The subject pool generally includes more than 1,000 executives, and the survey covers a minimum of 32 countries.

The final data set was compiled by Peter Neuman and collaborators at *Impulse*, a German business publication. The index surveys representatives from the German business sector (typically exporters) involved in business with each of the countries covered. The respondents were asked to provide an estimate of the kickback per deal (as a percentage of the deal's value) that would have to be paid in order to conduct business in each country. This quantitative question is

less subjective than those that comprise the first two data sets. An additional advantage of this survey is the homogeneity of the subject pool. The data was published in 1994 and covers 103 countries. The degree of correlation among the three corruption indexes is quite high.<sup>4</sup> For example, all three have a strong negative correlation with the level of development in a country.

The rest of this section discusses principal debates within the theoretical literature, highlighting empirical evidence where available. The issues disputed in the literature include: the definition dilemma, the universality of corruption, the causes of corruption, the effects of corruption on economic development, and policy prescriptions for curbing corruption.

### *Corruption Defined and Redefined*

Controversy over corruption begins with its definition. The term “corruption” has been used to refer to a wide range of illicit or illegal activities. Although there is no universal or comprehensive definition of what constitutes corrupt behavior, the most prominent definitions emphasize the abuse of public power or position for personal benefit. Mark Philip identified three broad definitions most commonly used in the literature: public office-centered, public interest-centered, and market definitions. These three types of definitions are used as starting points for analyzing political corruption in Heidenheimer’s *Political Corruption* (1970) and its successor volume edited by Heidenheimer, Johnston and Le Vine (1989).<sup>5</sup>

Public office-centered corruption is defined as behavior that digresses from the formal public duties of an official for reasons of private benefit. J.S. Nye provides an example of a public office-centered definition:

Corruption is a behavior which deviates from the formal duties of a public role because of private regarding (personal, close family, private clique) pecuniary status gains; or violates rules against the exercise of certain types of private regarding influence. This includes such behavior as bribery (use of reward to pervert the judgment of a person in a position of trust); nepotism (bestowal of patronage by reason of ascriptive relationship rather than merit); and misappropriation (illegal appropriation of public resources for private-regarding uses).<sup>6</sup>

Nye’s definition avoids mention of the public interest, which Nye considers to be affected by corruption, rather than a component of the phenomenon of corruption.

Public interest-centered definitions, on the other hand, focus on behaviors which impact negatively on the welfare of the public. In the words of Carl Friedrich:

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... Corruption can be said to exist whenever a power-holder who is charged with doing certain things, i.e., who is a responsible functionary or office holder, is by monetary or other rewards not legally provided for, induced to take actions which favour whoever provides the rewards and thereby does damage to the public and its interest.<sup>7</sup>

Neither public office-centered or public interest-centered definitions provide a consensus as to the standards that should be utilized to determine what constitutes “private regarding pecuniary status gains” or actions that “damage the public and its interest,” for example. It is ambiguous whether these standards should be established from public opinion, legal norms, or norms derived from modern western democratic systems.<sup>8</sup>

Market-centered definitions base their analysis of corruption on social or public choice theory, utilizing an economic methodology within a political analysis. Two such definitions, by Nathaniel Leff and Jacob van Klavern, follow:

Corruption is an extralegal institution used by individuals or groups to gain influence over the actions of the bureaucracy. As such the existence of corruption per se indicates only that these groups participate in the decisionmaking process to a greater extent than would otherwise be the case.<sup>9</sup>

Corruption means that a civil servant abuses his authority in order to obtain an extra income from the public . . . Thus we will conceive of corruption in terms of a civil servant who regards his office as a business, the income of which he will seek to maximize. The office then becomes the maximizing unit.<sup>10</sup>

Philip concedes that market-centered definitions might adequately demonstrate under what conditions it becomes more or less likely that individuals will engage in corrupt practices. However, he discredits the ability of market-centered definitions to address what distinguishes corrupt from noncorrupt behavior. Philip goes on to argue that definitional disputes over political corruption are rooted directly in the lack of consensus over what comprises the “naturally sound condition of politics” from which corruption is a deviation.<sup>11</sup>

Many recent academic studies and international organizations have opted in favor of more minimalist definitions, sufficiently broad to encompass most cases of corruption. Increasingly, corruption is defined simply as “the misuse of public power for private profit or political gain.”<sup>12</sup> Similar definitions are used by Transparency International and the Asian Development Bank. The World Bank takes its minimal working definition—the abuse of public office for private gain—and fleshes it out by identifying specific abuses:



Public office is abused for private gain when an official accepts, solicits, or extorts a bribe. It is also abused when private agents actively offer bribes to circumvent public policies and processes for competitive advantage and profit. Public office can also be abused for personal benefit even if no bribery occurs, through patronage and nepotism, the theft of state assets, or the diversion of state revenues.<sup>13</sup>

Like most definitions, the World Bank's definition places the public sector at the center of the phenomenon.

Ultimately, as the Council of Europe noted, "no precise definition can be found which applies to all forms, types and degrees of corruption, or which would be acceptable universally as covering all acts which are considered in every jurisdiction as contributing to corruption."<sup>14</sup> However, "the abuse of public office for private gain" is increasingly used as a functional definition. This practice is supported by Kaufmann who found empirical support for relying on this minimalist definition as a workable definition for corruption.<sup>15</sup>

Corruption, once broadly defined, can then be further broken down in many ways and into many categories. Corruption can be described according to where it occurs: at the political or bureaucratic levels of the public sector, or within the private sector. It can be defined according to its intensity: whether it is isolated or systematic. Other specifications include: grand versus petty, local versus national, personal versus institutional, and traditional versus modern.<sup>16</sup>

Syed Hussein Alatas developed an extensive typology around his minimalist definition: "corruption is the abuse of trust in the interest of private gain."<sup>17</sup> He identified transactive and extortive corruption. The former pertains to an agreement between a donor and a recipient, actively pursued by, and to the mutual benefit of, both parties. The latter entails some form of coercion, usually to avoid the infliction of harm on the donor or those close to him/her.<sup>18</sup> He also identified: investive corruption involving the offer of benefits without an immediate link to a specific favor but in anticipation of a future situation in which a favor may be required; nepotistic corruption concerning favored treatment of friends and relatives in appointment to public office; autogenic corruption occurring when a single individual profits from inside knowledge of a policy outcome; and supportive corruption referring to the protection or strengthening of existing corruption often through use of intrigue (as in U.S. machine politics) or violence. As recognized by Paul Heywood, Alatas' schema has the advantage of providing a straightforward definition of corruption that is "neither rule-bound, nor tied to society's prevailing moral conventions or norms."<sup>19</sup>

All of these various ways of dividing the concept of corruption into

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categories offer varying degrees of utility in identifying causes, consequences, and solutions. They suggest that the type of corruption determines the prognosis for solving the problem.

### *Universality versus Cultural Relativity*

Another debate has centered around the universality of corruption across different cultural contexts. Do anticorruption efforts represent a uniform standard of good governance or a misguided effort to impose subjective standards and values on countries and cultures where they are inappropriate? For example, recent international efforts to standardize the treatment of corruption, especially bribery, by organizations including the Organization for Economic Cooperation and Development (OECD) and Organization of American States (OAS), have been met by resistance from many countries on the basis of cultural differences.<sup>20</sup> They argue that an international policy against overseas bribery will be unable to respect cultural differences inherited from divergent legal traditions and customs.<sup>21</sup>

A study by legal scholar John T. Noonan demonstrates that although bribery might be an ancient tradition, its longevity is not based on cultural approval: "Bribery is universally shameful. There is not a country in the world which does not treat bribery as criminal on its law books."<sup>22</sup> Even in highly corrupt countries, the practice of bribery is surrounded in secrecy and subject to public shame and potential prosecution if detected.

With this debate in mind, a more recent study by Joongi Kim and Jong Bum Kim focuses on the issue of what kind of cultural perspectives and legal traditions addressing questionable payments should be respected in the expanding global movement against overseas bribery, a current concern in international trade.<sup>23</sup> The authors argue for incorporating cultural differences into the growing international consensus against foreign bribery, with respect to differentiating between illegal payoffs versus permissible gifts, via the inclusion of "affirmative defenses" in international antibribery conventions.<sup>24</sup>

### *Corruption: the Chicken or the Egg*

The fundamental determinants of corruption vary across countries, mixing national policies, bureaucratic traditions, political development, and social history.<sup>25</sup> Various lines of literature have focused on cultural or ethical causes, such as the decline in religious beliefs or in public morality, or the existence of norms and values that emphasize family or group loyalties above adherence to abstract ethical codes. Other arguments point to the value conflicts in post-

colonial settings, where the standards and practices embedded within traditional relationships may differ from the institutions left behind by the departing colonial power. According to this view, corruption arises when standards of appropriate behavior are uncertain.

More current efforts to identify factors leading to corruption have utilized social science models and approaches. Economic approaches have addressed the incentives for officials to behave corruptly. One example of this approach is the principal-agent-client model.<sup>26</sup> Economic approaches model the corrupt employee as a rational actor who decides whether to engage in corrupt activity by balancing the potential benefits against potential costs and consequences. According to this analysis, policies that worsen the consequences of engaging in corruption by increasing severity of punishment and likelihood of detection will lower corrupt activity. Bardhan argues that the frequency of corruption in a society will change the balance of this equation in as much as it effects the marginal costs and benefits of corruption for an official.<sup>27</sup> Other important characteristics that might affect the incentives for corruption include: the predictability of the judiciary, the ratio of civil service wages to manufacturing wages, and the presence of merit-based recruitment and promotion.

Political scientists and experts in public administration have focused on institutional factors and the systemic roots of corruption. In this vein, an important characteristic of a system enabling corruption is a divergence between the formal and informal rules governing behavior in the public sector. The vast majority, if not all, of countries have rules against corruption (although not all countries have all the rules they may need),<sup>28</sup> but in cases of systemic corruption, formal rules become subordinate to informal rules. In some countries, the divergence between formal and informal rules results from the manner in which political authority is exercised and maintained. In other cases, the root cause may reside in weak public management systems and inappropriate policies. In both situations, reestablishing formal rules requires institutional strengthening.<sup>29</sup>

Political science analyses also address the opportunity for corruption within institutions. Robert Klitgaard has conceptualized the opportunity for corruption in a formula:

$$C (\text{corruption}) = M (\text{monopoly}) + D (\text{discretion}) - A (\text{accountability})^{30}$$

The opportunity for corruption is a function of the size of the rents under a public official's control (M), the discretion that official has in allocating those rents (D), and the accountability that official faces for his or her decisions (A).<sup>31</sup>

Other lines of research suggest a mixture of causal factors drawn from both

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political science and economic approaches. Ongoing empirical research by Daniel Kaufmann and Jeffrey Sachs (forthcoming) suggests that the determinants of corruption are complex. Poor institutions (including the rule of law and safeguards for property rights), civil liberties, governance (including the level of professionalization of the civil service), and economic policies, as well as other characteristics (including a larger country size) all seem to play an enabling role for corruption. Along these interdisciplinary lines, the World Bank points to both institutional and economic policy factors which create a nourishing environment for corruption. Corruption thrives:

where distortions in the policy and regulatory regime provide scope for it and where institutions of restraint are weak. The problem of corruption lies at the intersection of the public and the private sectors. It is a two-way street. Private interests, domestic and external, wield their influence through illegal means to take advantage of opportunities for corruption and rent seeking, and public institutions succumb to these and other sources of corruption in the absence of credible restraint.<sup>32</sup>

Opportunities and incentives for corrupt behavior develop whenever public officials have broad discretion in performing the tasks of their position and little accountability for their actions. For example, policies that create an artificial gap between supply and demand create opportunities for opportunistic middlemen, and the probability for being caught and punished affects the degree to which those opportunities are seized.<sup>33</sup>

The importance of identifying the specific determinants of corruption in a country targeted for reform has been stressed. Understanding the root causes of corruption is a crucial first step in developing policies that address the problem rather than its symptoms.

### *Grease or Sand?*

One of the key questions being addressed by recent empirical studies is the effect of corruption on economic development.<sup>34</sup> This longstanding debate has questioned whether or not corruption indeed has an effect on development, and if so, in what direction: Does it act as the “sand” or the “grease” in the wheels of government machinery?

Revisionists held the view that corruption may not be incompatible with development and at times may even encourage it.<sup>35</sup> In the 1960s, the theory was first introduced that corruption might improve investment and growth in countries with particularly officious bureaucracies by enhancing their efficiency.<sup>36</sup> This sparked a healthy theoretical debate on corruption's costs.



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Based on the assumption that bureaucratic delays are the product of preexisting rules, corruption, it is theorized, may serve as an effective method of cutting the red tape. As phrased by Samuel Huntington, "In terms of economic growth, the only thing worse than a society with a rigid, overcentralized, dishonest bureaucracy is one with a rigid, overcentralized, honest bureaucracy."<sup>37</sup> Along these lines, Leff and others argue that corruption provides a way to get around cumbersome regulations and gives poorly paid bureaucrats incentives to produce.<sup>38</sup> Furthermore, corruption may be economically negligible, in the short run, if it merely entails a transfer of economic rents from a private party to a government official. A bribe can be regarded as a market payment to ensure that resources are allocated to those who will most likely use them efficiently (those who can pay the highest price for the resources).<sup>39</sup>

Counter analyses maintain that corruption detracts from development. Michael Johnston writes, "corruption undermines competitive processes, focusing on short-run benefits in place of sustainable, broad-based development."<sup>40</sup> Furthermore, Gunnar Myrdal argues that corruption creates incentives for officials to erect additional bureaucratic obstacles in order to increase their opportunities to demand bribes.<sup>41</sup> According to the World Bank, the corruption as "grease in the wheels" arguments fail to account for any objectives other than short-term efficiency. In addition to the direct costs of corruption (in terms of public funds diverted to private pockets), corruption has many negative indirect consequences that are quite costly in the long run:

In the long run, expectations of bribery may distort the number and types of contracts placed for bidding, the method used to award contracts, and the speed or efficiency with which public officials do their work in the absence of bribes. It may also delay macroeconomic policy reform. In addition, the gains from such bribery may be inequitably distributed (accessible only to certain firms and public officials).<sup>42</sup>

The World Bank concedes that in some cases, bribes might increase economic efficiency for individuals or groups if they enable firms to escape overly restrictive regulations or confiscatory tax rates, especially in the short run. However, the effects on the system as a whole are all negative. Bribery can have the effect of delaying reform by defusing pressure and can lead to the detrimental evasion of good regulations as well as bad. Furthermore, smaller firms and poor sectors of society may disproportionately bear the burden of the dysfunctional system, which could have the undesired effect of driving business into the informal economy:

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A policy framework based on many legal restrictions and widespread bribery to avoid them is like a highly regressive system of taxes on the private sector, and few would argue for such a system in developing countries. And in some transition economies such restrictions have proliferated in an uncontrolled way with the express purpose of extracting rents. This causes a shift of economic activity to the informal sector.<sup>43</sup>

Another point of contention in the debate on corruption's effect on development centers around the uneven performance of countries with endemic corruption. Many point to the cases of the high-performing Asian Newly Industrialized Countries, which grew at high rates despite corruption, as proof that corruption is not always economically harmful. Several explanations for this incongruity have been raised. One explanation centers around the concept of predictability: whether governments reliably deliver what is "bought" through bribery. A second distinguishes between political and bureaucratic corruption. Highly concentrated corruption at the top of the political system (as in the Asian cases) is considered less distortionary than uncontrolled corruption at lower levels (as seen in the former Soviet Union).<sup>44</sup> Political corruption, as a lump-sum payment to a political party for example, is less costly to business, as it can be anticipated and amortized. Bureaucratic corruption, on the other hand, creates an uncertain environment in which investors never know when the next demand will arise and how much will be requested.<sup>45</sup> A third argues that Asia was not an exception to the rule that corruption slows growth, but that Asian growth rates would have been higher still absent corruption. Thus, this argument concludes, the Asian cases cannot be used as evidence to disprove the assertion that corruption is costly to development. Finally, others view the East Asian case as corruption with delayed costs, emphasizing the central role of corruption and collusive economic arrangements in the recent Asian financial crisis.

Other questions arising from the theoretical debate on corruption's effect on development include for example, whether corruption can be eliminated in developing countries or is an unavoidable stage in the process of development.<sup>46</sup> Recent empirical studies, however, significantly weakened the argument that corruption is beneficial to development.<sup>47</sup> Raw data from the three corruption indexes, as mentioned previously, suggests that corruption has a strong negative correlation with the level of development in a country, measured by the level of income per capita or the average years of schooling in the population over 25 years of age.<sup>48</sup>

This tendency has been expanded upon by increasing numbers of empirical

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analysts. Paolo Mauro presents evidence of corruption's negative impact on development, arguing that corruption can slow down development through a number of channels:<sup>49</sup>

*Incentives for Investment:* Investors are cognizant that their profits may be demanded by corrupt officials and view corruption as a pernicious tax complicated by secrecy, uncertainty, and unpredictability.<sup>50</sup> In an analysis using the Business International (BI) Indices of Corruption, a one standard-deviation improvement in the corruption index causes investment to rise by 5 percent of Gross Domestic Product (GDP) and the annual rate of growth of GDP per capita to rise by half a percentage point. This tentative evidence suggests that much of corruption's effect on economic growth takes place through its effects on investment. A study by Keefer and Knack obtained broadly similar results, using indices of institutional efficiency from the International Country Risk Guide (ICRG). They found a significant direct effect of institutional variables on growth, in addition to the indirect effect through investment.<sup>51</sup> A study by Shang-Jin Wei has quantified the cost of corruption to investors, demonstrating that investing in Mexico, a relatively corrupt country, instead of Singapore, a relatively uncorrupt country, is equivalent to an additional 20 percent ("private") tax on investment.<sup>52</sup>

A study of the association between levels of investment and investors' perceptions of corruption found a significant relationship between the exposure of corruption by the press and foreign direct investment. Financial media exposure seems to have a positive effect on foreign direct investment when investors are confident that exposure precipitates institutional reform. However, where investors believe that the government will resist reform, regardless of pressure from the financial markets, publicity decreases foreign direct investment.<sup>53</sup>

*Allocation of Talent:* Murphy, Shleifer, and Vishny (1991) argue that situations in which rent seeking provides more lucrative opportunities than productive work create a suboptimal allocation of talent: talented and highly educated individuals will be more likely to pursue rents than work productively, adversely affecting their country's growth rate.<sup>54</sup>

*Effectiveness of Aid Flows:* Corruption may divert funds from their intended targets. The literature on aid flows has debated whether the fungibility of aid flows ultimately leads to the financing of unproductive public expenditures.

*Tax Losses:* Corruption can contribute to loss of tax revenue in the form of tax evasion or improper use of discretionary tax exemptions.

*Fiscal and Monetary Health:* Corruption may negatively impact fiscal and

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monetary health. Budgetary consequences may arise from effects on tax collection and levels of public expenditure. An undesirably lax monetary stance could result from corruption in the form of improper utilization of directed lending at below-market interest rates by public-sector financial institutions.

*Public Service and Infrastructure:* Corruption may effect allocation of public procurement contracts, leading to inferior public infrastructure and services.

*Government Expenditure:* Corruption may affect the composition of government expenditure. Corrupt officials may favor public expenditures on goods and projects that maximize opportunity for rents. Shleifer and Vishny (1993) suggest that large expenditures on specialized items such as missiles and bridges, whose exact market value is difficult to measure, create more lucrative opportunities for corruption.<sup>55</sup> For example, Hines (1995) argues that the international trade in aircraft is particularly susceptible to corruption.<sup>56</sup> Mauro's study further lends evidence to a link between corruption and the composition of government expenditure. He found that corruption is correlated with lower levels of spending on education, an important finding in light of the evidence that educational attainment is an important determinant of economic growth. One interpretation of the shift away from educational expenditure is that it is a less lucrative industry for collecting bribes.<sup>57</sup>

Evidence of corruption's negative consequences for development is supported on a general level by Kaufmann's survey of elite perceptions of corruption in developing and transitional economies. Survey respondents rated public sector corruption as the most severe obstacle to growth. The majority regarded vested financial interests and corruption as a key reason for the lack of sufficient progress towards economic reform in their countries and do not share the view that there may be a convergence between corrupt interests and economic reforms.

In addition to these economic consequences of corruption, empirical evidence has shown a correlation between corruption and low levels of social interaction and weakness of the rule of law,<sup>58</sup> deep ethnic division and conflicts,<sup>59</sup> low levels of mass participation in politics and weak protection of civil liberties,<sup>60</sup> and relatively closed economic and political systems.<sup>61</sup> The net effect of these factors, and corruption in general, on political stability, has been more difficult to estimate. The evidence of corruption's impact on political regimes is varied. In some cases, corruption led to political instability (in Russia and Colombia, for example). In others, it undermined reform and contributed to the continuation of corrupt leadership in power, serving as a means of political



control and substitute for reform (in Paraguay, Mexico, and Zambia, for example). In still others, corruption has supported the rise of new political forces, some against corruption and others utilizing it as a means of consolidating their own political power.<sup>62</sup>

Recent efforts in accumulating empirical evidence on the effects of corruption have been fruitful. However, many issues have yet to be fully explored. Fortunately, data has increasingly become available for empirical study. Kaufmann lists the data available on corruption and bribery:

- firm level surveys, including cross-country comparative business surveys on perception of bribery and corruption and country-specific, in-depth surveys gathering hard data on bribery and its correlates;
- surveys on quality of service delivery;
- citizen polls;
- indices based on expert assessments;
- the procurement prices of publicly provided goods, including generic medicine and standard school lunches;
- balance of payments analysis, as in comparing official export statistics versus data from importing countries;
- estimates of the unofficial/black economy; and
- composite corruption perception indices, such as Transparency International's index.<sup>63</sup>

Additional empirical work to further develop our understanding of this complex issue is imperative. Understanding the full consequences of corruption is an important step in its eradication.

### *Curbing Corruption: Cures for the Common Cold*

Once the type of corruption and its determinants have been identified for a specific situation, anticorruption reform is a two-step process. Policies must be developed that address the fundamental causes of corruption, not just symptoms. Then the political will must be created to implement reforms.

Unfortunately, many anticorruption campaigns are never intended to succeed. In some cases, they degenerate into witch-hunts, a means through which political opposition can be deposed and the public gratified. In others, anticorruption is placed in the hands of an agency or commission that is not truly empowered. For example, following the International Monetary Fund suspension of lending to Kenya for "high prevalence and negative macroeconomic consequences of corruption" in August 1997, the Office of the Attorney

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General issued the following statement: “The Government has this morning formed an anticorruption squad to look into the conduct of the anticorruption commission, which has been overseeing the anticorruption task-force, which was earlier set to investigate the affairs of a Government ad hoc committee appointed earlier this year to look into the issue of high-level corruption among corrupt Government Officers.”<sup>64</sup>

Serious and sincere commitments to counter corruption involve comprehensive institutional or administrative reform, reform of economic policy, legal or judicial reform, and in extreme cases of patronage and cronyism, reform of the political system.

*Developing Reform Strategies:* Debates surrounding policy approaches to curbing corruption have been many. Laundry lists of anticorruption policies have not been in short supply. However, it is wise to be wary of formulaic solutions. Corruption must be accurately diagnosed before remedies can be prescribed. For this reason, discussion of specific policy strategies is left to Section III.

Ades and Di Tella conceptualize three broad types of policies: the lawyer’s approach, the businessman’s approach, and the economist’s approach.<sup>65</sup> These respectively refer to: producing more stringent laws and stricter enforcement of existing laws;<sup>66</sup> institutional reforms, such as wage increases for bureaucrats;<sup>67</sup> and policies focused on increasing competition within the economy, both among firms and civil servants.<sup>68</sup> A combination of all three of these ideas would form the basis of a comprehensive strategy for anticorruption reform.

An important debate with regard to policy has focused on the “economist’s approach,” or the relationship between economic liberalization policies and corruption. Academics and media commentators have maintained that economic reforms in transitional economies and in some emerging economies fuel corruption. Reforms such as liberalization and privatization, it is argued, allow the deeper entrenchment of vested interests and corrupt elites. For example, Robert Leiken states that “where corruption is systemic, market and administrative reforms . . . may even become counterproductive . . . Loosening government controls can facilitate illicit . . . economic activity.”<sup>69</sup>

Conversely, Johnston maintains that the incomplete nature of reform efforts and their inconsistent application are the true culprits of new corruption problems attributed to neoliberal reforms.<sup>70</sup> Kaufmann argues that half-baked, poorly designed, and inadequately implemented market reforms boost corruption, but well-designed, properly executed reforms do not. Well-designed

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reforms actually limit corruption. Deregulation and privatization limit opportunities for bribery extraction, and stiff competition constrains bribes.<sup>71</sup> A study by Kaufmann on the relationship between corruption and privatization in the former Soviet Union found that without privatization the incidence of corruption would be worse, and is worse in nonprivatized sectors.<sup>72</sup> The evidence indicates that economic reforms should be an important component of an anti-corruption strategy.

Johnston approaches the issue of countercorruption reform as a matter of moving between two equilibriums—from high- to low-corruption equilibriums, or “settling points.” Movement between these two equilibriums is a slow process dependent on changing the political and economic environment that allows corruption to thrive. The aim should be to “undermine the monopolies and organization of entrenched corruption, while strengthening the forces that elsewhere sustain the low-corruption alternative.”<sup>73</sup> Law enforcement and organizational reforms are fundamental to the process. Stronger political and economic competition can enhance accountability and create incentives for leaders to commit to counter corruption. Decreasing levels of corruption will encourage economic growth, increasing the range of economic opportunities and fortifying civil society interests, while weakening political and bureaucratic leverage that form the basis of entrenched corruption. Over time, these processes produce a low-corruption equilibrium and reinforce a virtuous circle of development.<sup>74</sup>

Additional lessons can be learned from historical examples of campaigns that successfully eliminated systemic corruption. For example, the Progressive Movement dismantled the power of U.S. urban political machines of the nineteenth century through tax reform and the removal of patronage appointees from office. Cities that were dominated by machines paid a high price in the form of inflated budgets and inequitable tax and spending systems. A plan was developed to assess property at market values to discontinue favoritism shown to wealthy property owners. This plan increased the assessed value of real estate, lowered the tax rate, decreased expenditure on a bloated bureaucracy, and increased city revenues.<sup>75</sup>

“Fatalists” argue that there are few countries that have significantly curbed corruption in less than a century. Hong Kong and Singapore are success cases from this standpoint, but fatalists ignore relative successes such as Botswana, Uganda, Chile, Malaysia, and Poland to name a few. These countries share several common features in their anticorruption campaigns. Anticorruption agencies, such as Hong Kong’s Independent Commission Against Corruption,

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have been credited with much of their success. Equally important, yet insufficiently recognized, are the complementary economic and institutional reforms that were simultaneously implemented. For example, Uganda's institutional approach under the Museveni government (which came to power in 1986) implemented economic reforms and deregulation, reformed the civil service, strengthened the auditor general's office, empowered a reputable inspector general to investigate and prosecute corruption, and implemented an anticorruption public information campaign. Absent economic and institutional reforms, watchdog agencies have been less effective, as in the case of Tanzania.<sup>76</sup>

These concrete experiences have contributed in part to the World Bank's effort to develop a strategy to comprehensively address corruption. The Bank identified three important components for anticorruption efforts:

1. A rule-based bureaucracy must be established with a pay structure that rewards civil servants for honest efforts. Merit-based recruitment and promotion systems should be in place to insulate civil servants from political intervention. Also, credible financial controls should be created to disallow the arbitrary use of public resources.
2. Opportunities for officials to act corruptly should be curbed by reducing their discretionary authority. In general, any reform that increases the competitiveness of the economy will reduce the incentives and opportunities for corrupt behavior. Policies that lower controls on foreign trade, remove entry barriers to private industry, and privatize state firms in a way that ensures competition are all effective when correctly administered. If price controls are lifted, for example, market prices will reflect scarcity values, not the payment of bribes.
3. The accountability of government officials should be enforced by strengthening monitoring and punishment mechanisms. Criminal law and oversight by formal institutions and ordinary citizens can be effectively utilized.<sup>77</sup>

*Implementing Reform:* Even the most well-designed anticorruption strategy is useless if never implemented. Therefore, building political will for reform is a crucial component of any strategy. This involves constructing a coalition that will support reform and the leaders who initiate it. Therefore, a crucial first step in anticorruption initiatives should be to increase the demand for reform from both governmental and business communities and the public at large.<sup>78</sup> Support can be generated by demonstrating to social groups, such as business people and the middle classes, the ways in which they can benefit from anticorruption efforts.

Rewards should be built-in to any program so that those who should



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benefit the most from reforms—e.g., the “emerging entrepreneurs and middle class,” see it in their own self-interest to be part of the solution. Once this class fully understands the real political and economic costs associated with corruption, as well as what they and society in general have to gain from further reforms, the necessary political will to effect and sustain fundamental reforms will then be in place.<sup>79</sup> Therefore, priority should be given to creating incentives that will drive and sustain anticorruption reform. High-level and public commitment to creating a society based on the rule of law must be established.

The composition of the support necessary to carry out a reform effort depends on the type of corruption and the factors driving it. Support is situation dependent: it may be derived from elite leadership or from mass consensus and public outrage. Either way, building political will must be developed in tandem with specific policy prescriptions. Phongpaichit and Piriyarangsan identify the need to develop political will as the most challenging obstacle against anticorruption reform, and argue that political will must be based on popular pressure.

The control of corruption will require three strategies. First, the formal machinery for monitoring officials and politicians needs to be drastically improved. Most of the means to do this are already well-known and have been recommended by official commissions. What is lacking is the political will to implement them. Second, this will can only be generated by popular pressure. We cannot expect the bureaucrats and politicians who benefit from the political system to reform themselves. Thus it will be important to bring about changes in the political structure and moral environment to enable people to exert greater pressure on those wielding power, through freedom of the press, decentralization of administrative power, greater transparency in government decisionmaking, and the reform of the political parties. Third, the public must be educated to exert moral and political pressure to outlaw corruption. The mobilization of such public pressure depends on a clearer understanding of the modern concepts of “public office” and “public service,” and a more widespread awareness of the social costs and political risks which corruption entails.<sup>80</sup>

This strategy implies that the public sector is not the only appropriate target for an anticorruption dialogue, but that civil society and the public at large must be addressed.

Other approaches focus on creating support for reform among the top leadership, rather than the citizenry at large. An Asian Development Bank Technical Assistance to the Government of Sri Lanka successfully initiated a reform of the

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public administration, driven by the president herself. The Hoover Initiative on Economic Growth and Democracy is currently engaged in similar processes with the governments of Pakistan and India. The authors of these approaches do not agree that the top leadership has no incentive to reform. They argue that leaders are chiefly concerned with maintaining their political authority, and will entertain the prospect of reform if it is a viable strategy for sustaining themselves in office.

Distributing inappropriate economic privileges to political supporters can be an effective means of maintaining political power in the short run. However, it is not a long-term sustainable strategy. This is exemplified by the defeat of India's Congress Party in the 1996 elections, despite pervasive corruption at all levels of the government. The governing coalition was not sufficiently large (as there is a shortage of spoils to be distributed) to overcome and compensate for public frustration over poor public policy and service delivery. In the Indian case, a restructuring of the system of public administration and governance to eliminate corruption and allow for service delivery is fundamental for the survival and reelection of any new government.<sup>81</sup>

Corruption leads to political instability as excluded groups vie for political power in order to attain economic privilege. Leaders who put an end to corruption trade off access to inappropriate economic privilege for true control over policy implementation and the delivery of basic goods and services. The ability to enact policies that increase public welfare will attract a new constituency of political supporters, impossible within the context of corruption-driven government bureaucracies. Thus, comprehensive countercorruption reform can provide an effective means for attracting political support and holding public office.

### *Summary*

These "academic" debates have had practical consequences for combating corruption. Developing and implementing effective policy tools have been stalled by the lack of consensus in defining what precisely corruption is, whether corruption is culturally relative, and what are its causes and consequences. Although the first two of these questions have not been resolved, one thing is clear: corruption is not good for development. Governments can no longer deny its pernicious effects. Debunking this myth has been a crucial first step for building political will for any anticorruption policy. Perhaps this new evidence has contributed in part to the marked increase in the activity of international organizations with regard to corruption. The international community's treatment of the issue on a practical level will contribute to domestic efforts seeking anticorruption reform.

The next step involves diagnosing what type of corruption exists in the particular political or bureaucratic system, and what available policy tools would address it most effectively. The following section identifies five forms of corruption, the characteristics of the systems in which they thrive, their political and economic consequences, and recommendations for policy solutions.

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## Corruption's Five Fatal Forms

*While corruption of some form or another may inhere in every human community, the system of governance has a great impact on its level and scope of practice. Systems can corrupt people as much as, if not more than, people are capable of corrupting systems—World Bank<sup>82</sup>*

The typology developed in this section catalogs five forms of corruption in order of severity: Bribery, Theft, Distortion, Patronage and Cronyism.

The existence of each type of corruption in a political system or bureaucracy is not mutually exclusive or necessarily independent. Coexistence frequently occurs, and it is not uncommon for the practice of two or more types to be interrelated. In fact, some forms act as mediums of action for the other forms. For example, while bribery, theft, or distortion can each exist on its own, patronage and cronyism utilize these three forms as tools of operation and implementation. However, the existence of the former three does not necessarily imply the existence of the latter.

While bribery, theft, and distortion can have devastating political and economic results when unchecked, antibribery, antitheft, and antidistortion measures can be approached technically. These three forms can be attributed primarily to weak public management systems and inappropriate policies that create a divergence between formal and informal rule structures. Addressing these factors is a technical problem, with largely technical solutions.

This is unfortunately not the case for patronage and cronyism. Patronage and cronyism are the worst types of corruption. They are systemically all encompassing, so that all institutional activity is subordinated to patron/client and crony-driven interests, and are thus fundamentally detrimental to the utilization of resources and information by distorting economic exchanges and calculations. These distorted systems arise through the manner in which political power is exercised and maintained.

In patronage- and cronyism-based systems, the maintenance of political authority is based on the ability of leadership to distribute spoils in exchange for support. This results in the subordination of formal rules to informal rules within political and bureaucratic systems, so that informal rules encompass and debilitate state institutions. The solution lies in establishing a comprehensive results-oriented management system, in which the output of government is sufficiently transparent to identify mismanagement or criminal activity and to make officials accountable for their actions. This requires a holistic change in the motivational structure of government, but promises to deliver a consistent and predictable system of law throughout the country.

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Despite the severity of patronage and cronyism and the significant frequency with which they occur, they are seldom addressed in the literature. This political dimension of corruption is not handled by standard indices and is seldom factored into corruption analysis. However, it is critical for understanding resource allocation and misallocation and political instability in countries such as India, Pakistan, the Philippines, and the former Zaire.

This section will address the five forms of corruption, considering the causes, consequences, and solutions of each.

### *Bribery*

Bribery endures as one of the most pervasive forms of corruption. Nations try their utmost to prohibit bribery and to punish contributors and participants, yet the practice persists despite the fact that addressing it is relatively straightforward. Many unsuccessful antibribery campaigns have addressed the symptoms rather than the underlying institutional pathology. Other antibribery campaigns (or witch-hunts) are aimed more at eliminating political competition than corruption, and never intended to succeed. Of all types of corruption, bribery has received the greatest attention from both the international community and the literature.

Recently, 29 nations of the Organization of Economic Cooperation and Development (OECD) agreed to a treaty outlawing the bribery of foreign government officials.<sup>83</sup> The November 20, 1997, signing concluded a lengthy negotiation process and holds all industrial countries to anticorruption standards adopted by the United States 20 years ago under the Foreign Corrupt Practices Act. Until recently, most industrialized countries brushed aside the idea of outlawing bribery of foreign officials, and some even provided tax deductions for bribes as an unfortunate but legitimate business expense. The OECD's efforts addresses the problem of bribery from the supply side by trying to reduce its practice through elimination of the source. While the treaty is an important step in the right direction, as long as there is a demand for bribery a supply will likely rise to meet it. Thus, it is important to address the demand for bribery, and the incentives that create this demand.

Bribery has been defined as "[giving] any article of value to foreign government officials in exchange for any act or omission in the performance of that official's public functions."<sup>84</sup> Bribery is not only the most widespread form of corruption, but it is one of the principle tools of corruption.<sup>85</sup> Rose-Ackerman observes that individuals and firms offer officials bribes for two reasons: to

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obtain access to government benefits and to avoid costs.<sup>86</sup> Many goods and services provided through central or local governments can be bought with bribery, or officials may expect bribes to supply them. Bribery can be utilized as a method of influence by firms bidding for government contracts, and as a means of directing government allocation of benefits. It can also be used to reduce taxes and fees, to acquire a license that conveys an exclusive right, to speed up government's granting of permission to carryout legal activities, or to change outcomes of legal processes.<sup>87</sup>

The most devastating consequences of bribery are usually not the cost of the bribes themselves, but the distortions they unleash within political and economic systems. For example, bribes compromise efficiency in the allocation of state resources. Examples of this arise in awarding of government contracts or privatizing state industries, as corruption favors those with connections over efficiency. Other inefficiencies can arise if officials increase regulations, delays, and unnecessary requirements as a means of inducing additional payoffs.<sup>88</sup> As previously mentioned, high levels of bribery increase the costs, risks, and unpredictability of doing business. Lower levels of investment result, and consequently slowed growth and development.<sup>89</sup> The principle enabling factors for bribery in many countries can be traced to weak public management systems and inappropriate government policies. These are problems which can be addressed technically, through straightforward changes in government policy to reduce both the opportunity and incentive for government officials to seek or accept bribes.

Policies and laws which allow discretion in government officials' decision-making should be reformed and streamlined to eliminate the opportunity for bribe collection. In general, policies that drive a wedge between supply and demand will create opportunity for official discretion and bribery. Eliminating opportunity for discretion, such as lowering controls on foreign trade, removing entry barriers to private industry, and privatizing state firms in ways that ensure competition, should be important components of an antibribery campaign. However, reducing official discretion should not be equated with ending regulatory and spending programs. They should be reformed, not eliminated. The 1997 World Bank Development Report catalogs several measures proven effective in reducing official discretion:<sup>90</sup>

- Clarify and streamline laws in ways that reduce official discretion. Mexico reduced and streamlined its customs process from 12 steps to 4 to minimize delays.<sup>91</sup>
- Contract for services with a private company, possibly a foreign firm with



no close ties to the country. Indonesia contracted a Swiss firm to pre-inspect, value, and help collect import duties at customs, reducing corruption.<sup>92</sup>

- Make rules more transparent. Simpler nondiscretionary tax, spending, and regulatory laws can reduce opportunities for corruption. When discretion is necessary in a program, transparency and publicity can be used as tools to blunt incentives for bribery. For example, police officers must have leeway to make on-the-spot law enforcement decisions, but public complaints can constrain abuses.<sup>93</sup>
- Introduce market-based schemes that limit the discretion of regulators. The sale of water and grazing rights, pollution rights, and import and export licenses can limit corruption while improving the efficiency of government operations.<sup>94</sup>
- Adopt administrative reforms that introduce competitive pressures into government. Opportunity for corrupt deals in the procurement process can be limited through open, competitive bidding. Individual officials' bargaining power can be decreased through creation of overlapping, competitive bureaucratic jurisdictions (in other words, eliminating an official's monopoly over a specific government good or service).<sup>95</sup> The relative bargaining power of the buyer and the seller of public favors affects the actual extent of bribery.<sup>96</sup>

Policies should also be employed to reduce the incentive for government officials to engage in acts of bribery, by making them accountable for their actions. If the likelihood of detection and punishment is increased, bribery will become less profitable.<sup>97</sup> Methods should include strengthening the mechanisms of monitoring and punishment, using not only criminal law but also oversight by formal institutions and ordinary citizens.<sup>98</sup> Independent watchdog institutions have played important roles in anticorruption campaigns to monitor officials and punish corrupt activity:

- Anticorruption commissions or inspectors general have been given authority to investigate allegations and bring cases to trial. For example, in Hong Kong, the Independent Commission against Corruption, a long-term credible commitment to counter corruption, successfully ended large-scale syndicated corruption. Singapore's Public Service Commission had equal success.<sup>99</sup> Botswana has a similar institution.
- Ombudsmen can provide venues for citizen complaints, increasing the accountability of government agencies. For example, South Africa's Ombudsmen Act of 1991 appointed a public protector to investigate and report alleged abuses by public officials, publicizing offenses usually shrouded in secrecy. This office was not granted the capacity to initiate legal processes, but refers cases to offices that can.

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- Internal anticorruption units have been created within public agencies, such as the School Construction Authority in New York City.
  - Whistleblower statutes provide incentives and protection for public employees to report malfeasance of co-workers or government contractors. A U.S. statute, for example, rewards workers for reporting irregularities in government contracts.<sup>100</sup>

These watchdog organizations should investigate and punish all partners in a bribe—both the supply and demand, so to speak. Stringent sanctions and heightened expectation of discovery, for both public employees and private firms, corporations, or individuals, can turn bribery into an unprofitable activity.

Since the determinant factors of bribery lie largely in the structure of institutions and policies, it is one of the easiest forms of corruption to address. Overall, policies which realign the incentives of the civil service, increase the transparency of governmental processes, clarify rules and simplify processes, increase competition in the economy, decrease intervention by government officials, and increase the likelihood of detection and punishment will be effective tools for reducing the incidence of bribery.<sup>101</sup>

### *Pillaging of State Assets*

The pillaging or theft of state assets, like bribery, is one of the more straightforward forms of corruption to address. It can be largely controlled through realigning the incentives in public administrations and creating “credible financial controls to prevent the arbitrary use of public resources.”<sup>102</sup> Pillaging includes: spontaneous privatization of state assets by enterprise managers and other officials in some transition economies; the petty theft of items such as office equipment and stationery, vehicles, and fuel—the perpetrators of which are usually middle- and lower-level officials, in some cases compensating for inadequate salaries; theft of government financial resources such as tax revenues or fees; stolen cash from treasuries; extended advances to themselves that are never repaid, or payments drawn for fictitious “ghost” workers.<sup>103</sup>

The underlying causes of pillaging can be attributed to the same culprits as bribery: weak public management systems and inappropriate or inadequate government policies. Theft of state assets can be eliminated if the opportunities for thievery are addressed through institutional reform. Civil servants salaries should be competitive to reduce the incentive to supplement their income. An auditor general should be empowered to investigate officials and monitor book-keeping, to accurately account for state resources. Privatization should be conducted in open, transparent processes. Credible financial controls should be

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created to prevent the arbitrary use of public resources, an example of which is the strategy pursued by the Nonprofit Public Affairs Center in Bangalore, India. Asset control systems should be created or strengthened. And finally, punishment of offenders should be sufficiently high to deter the practice of pillaging.<sup>104</sup>

Developing good financial management systems is an important method for preventing, detecting, and facilitating the punishment of fraud and theft. Systems should delegate clear responsibility for resource management, include mechanisms for revealing improper behavior and unauthorized spending, facilitate audits by creating audit trails, and provide protection for honest officials. By reducing opportunities for theft and increasing the probability of discovery, good financial management systems change the risk calculation for theft from “high profit/low risk” to “high risk/low profit.”<sup>105</sup>

#### *Distortion of Government Expenditure*

This type of corruption occurs when government spending decisions are made in order to maximize the personal benefit of decisionmakers instead of the public welfare. A normal plan for developing a nation's economy centers around a strategic vision, and spending decisions are made to realize a set of public policy goals. These goals might center around cultivating national resources, from human capital to infrastructure, or delivering basic services such as clean water, electricity, and sanitation. Distortion of government expenditure makes these development goals irrelevant. Decisionmaking on public expenditure becomes unrelated to any national vision for strategic development (if a strategic vision even exists). That is to say, government spending becomes a function of private rather than public interests. For example, the recent financial crisis in Indonesia has shown that, in many instances, World Bank development funds have been misdirected to companies run by Suharto's family members. This is qualitatively different from patronage, in which a locally elected politician tries to capture money from the national government for local development projects to appease his or her constituency and win electoral support.

The consequences are not just slow growth but erratic or even stunted development, as spending decisions are not related to the needs of the population. The distortions from this type of corruption are greater than from the theft of public assets, for example. If a billion dollars are stolen from the government treasury, there is a billion less to spend on public goods and services, which might have the effect of slowing down the rate of development. However, if no money is stolen but government decisionmaking is not based on a coherent set of public policy goals, public spending of any amount has little

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relation to public welfare. The impact of corruption on development will be far greater. The comparison with pure bribery is similar:

A 10 percent bribe on the cost of a good public investment project depresses the project's economic rate of return only slightly. A bribe that saddles the country with a white elephant investment may result in economic costs far exceeding the corrupt payment, particularly if the policy environment causes a value-subtracting investment to appear nominally profitable.<sup>106</sup>

Similarly, Dieter Frisch, former Director-General of Development at the European Commission, observes that when a country takes on additional debt to initiate noneconomically viable projects, the additional debt includes not only the 10 to 20 percent extra cost due to corruption, but 100 percent of the value of the investment. The entire investment, originating in dishonest decision-making, goes to supporting unproductive and unnecessary projects.<sup>107</sup>

As previously discussed, Paolo Mauro presents empirical evidence that corruption distorts the composition of public expenditure. Large capital intensive projects in which actual costs are difficult to estimate are favored. Furthermore, education spending is reduced, as there are few kickbacks to be collected from reading, writing, and arithmetic. This finding is a particularly important piece of the puzzle linking corruption to development, for heightened education spending is one of the key variables found to support economic growth and development.<sup>108</sup>

The greatest obstacle to eliminating corruption through distortion of government spending lies in mustering the political will to reform. The leader's strategy of maintaining political authority matters. If political support is dependent on distributing spoils to a small, elite coalition of insiders, political motivation of leadership must be addressed, for distortion contributes to a successful, stable strategy of maintaining political authority. If leadership relies on mass support, then reform provides a vehicle to increase public welfare and consequently political support through more effective delivery of public goods and services.

A government with the "will" to reform should develop a strategic vision or set of realistic public policy goals it wishes to accomplish, based on resource constraints. The strategic vision serves as a development path for all of government. Policy goals must be matched to affordability. Well functioning budget process should be developed to achieve macroeconomic targets. Resources should be allocated strategically.<sup>109</sup> And an output- or results-oriented management system should be developed to address the problems of ineffective

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or inefficient implementation of policy goals by the civil service. On the surface, therefore, the distortion of government expenditure is a technically straightforward dilemma. However, the political dimension exponentially complicates reform efforts, and is consequentially a variable we can no longer afford to ignore.

### *Patronage*

Patronage or clientalism is an instrument through which political power is acquired and maintained by granting economic advantages to backers in exchange for political support. These economic advantages may include employment in bureaucracies or state industries, access to public goods and services, property rights, and even the right to participate in the market system. Max Weber's observation concerning the relationship between political domination and economic regulation, the principle medium through which patronage functions, has great predictive power for understanding the recent emergence of patrimonial domination in the post-colonial developing countries of the twentieth century.<sup>110</sup> Weber wrote, "In the pure type, patrimonial domination regards all governing powers and the corresponding economic rights as privately appropriated economic advantages."<sup>111</sup> For example, one-party regimes, such as the Institutional Revolutionary Party (PRI) in Mexico during the greater part of the twentieth century, use widespread political corruption to dominate access to scarce economic opportunities, distributing economic benefits only as wide as necessary to maintain political control.<sup>112</sup> Government abuse of these "economic rights" leads to severe distortion and malfunction of political and economic systems.

The consequences of patronage for economic and political systems are clearly delineated in the following excerpt from, "India: Asia's Next Tiger," by Hilton Root:

Patronage-based regimes have a tendency to regulate economic activity with a view to expanding patronage networks. This serves to undermine the formal rationality of the technical legal order, making it difficult for business to access that order for economic calculations. Political or administrative regulations offer opportunities for strategic interventions, allowing those who exercise patrimonial political control to shape the structure and performance of the economy in ways that are inconsistent with efficient economic behavior. Regulatory discretion enables political leaders to make market participation dependent upon political contracts. Hence, the difference between distribution and production narrows and both become politically exercised rights. Property rights, then, may have limited independent status and are subordinated to political imperatives. They must be

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enforced through political power rather than through neutral legal mechanisms. Once the opportunities for profit are subject to administrative discretion, the outcomes of economic competition can no longer be predicted by neo-classical models.

Instruments of administrative discretion that offer patronage opportunities to governments are numerous. The most important is a discretionary tax apparatus, highly valued by patronage driven political masters because it can be used to control the acquisitive activities of citizens. Discretionary tax levies interfere with ordinary business calculation and are the single most important motive for firms to shelter their production by cooking the books, exchanging goods in the black market, and contracting informally with their trading partners.

The Indian economy before liberalization illustrates many of the ways political and institutional arrangements are employed by both government and economic actors for personal economic advantage. Patronage motivates politicians and their clients to deliberately fashion imperfect information in markets in order to profit from them . . .

Clientalism will inevitably resemble corruption when the right to participate in the market system is allocated according to the discretion of political sponsors. The two run counter to universalistic, rule-bound methods for conducting public business. Schools and clinics are built for supporters rather than those truly in need. Appointments are distributed to support relatives or to repay debts. Ostentatious wealth is acquired by those who subvert or circumvent the government. Nevertheless these costs are generally ignored as distributional by development economists.

Maintaining the loyalty of clients requires the constant flow of redistribution goods, motivating government actors to intervene in the economy and favor policies that enhance discretion over rules. Additionally, government will not be responsive to general interests when favoritism and personal preference replace precedents and rules. Hence policies and the institutions responsible for their formulation cannot be easily disentangled. Inevitably the choice of economic policies will reflect the institutional dynamics of patronage.

Patronage politics will engender an economic system that is primarily a system of distribution providing limited incentives for production. Decision making is biased towards political over economic goals, generating a weak economy, and thereby depriving political sponsors the resources they need to stay in power. Governments that attempt to stay in power through expanding clientalism only do so at the expense of ballooning inflation and deficits. Finally, clientalism ultimately conflicts with the ability of the bureaucracy to perform its task of



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creating public goods, which ultimately undermines legitimacy. On both accounts patronage politics is a formula for continuous political instability and economic uncertainty.<sup>113</sup>

Efforts to dismantle a system of patronage must take into account the driving force behind it—political motivation. Patronage politics have been an effective political strategy. Through patronage, leaders are able to achieve and maintain political authority by distributing spoils. Reform must begin with the commitment of the leadership to a new strategy of maintaining political authority.

The leadership must win political support not through distribution of spoils to an elite coalition, but through the delivery of public goods and services to the population at large. Institutional reform of the civil service is essential to this proposition. Reforms should seek to establish an output-oriented, rule-based management system. Incentives governing the civil service should be realigned to promote transparency, predictability, and accountability for performance. Recruitment, promotion, and termination of officials should be merit- and performance-based to shield officials from political intervention.<sup>114</sup> The pay structure should reward honesty and be competitive with the private sector. A bureaucracy that is capable of implementing public policy in place of distributing spoils must be created, or service delivery and policy implementation will remain in the realm of the impossible.

### *Cronyism*

Cronyism undermines and supplants traditional government institutions, so personal relationships, rather than formal institutions, laws, or procedures serve as the basis of economic and social relations. Not only is cronyism an extreme form of corruption, it is in fact a “discrete economic system,” in which the allocation of rents to elites is a function of their loyalty to individuals in power.<sup>115</sup> Corruption in this extreme form closes legitimate channels of political access and accountability while creating (and concealing) new ones.<sup>116</sup> Cronyism can be distinguished from patronage by its heightened degree of personalization, centralization, or domination of rent distribution activity by an individual ruler or ruling family.

The devastation of cronyism is both political and economic. Cronyism causes severe microeconomic distortions that interfere with the economy’s responsiveness to market indicators and undermines its capacity for change in a crisis. Ultimately, cronyism results in political instability, as excluded groups must fight for political power in order to access rents produced by cronyism’s distorted pattern of property rights.

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The case of the Philippines is a perfect example of the scenario of a small coalition distributing rents in place of public goods and services, as a strategy to maintain political authority. This case demonstrates how cronyism can arise as a successful short-term strategy, even with a democratic tradition complete with a system of checks and balances on executive authority, including an independent judiciary, a freely elected Congress, and a professional civil service. President Ferdinand Marcos consolidated his personal power by suspending Congress (which was dominated by elite interests), political parties, and independent institutions, and assuming full control over the state budget. The liberation of decisionmaking from political considerations for the sake of technocratic objectives was the justification given for these actions. This allowed Marcos the opportunity, for the first time since independence, to promote rapid political and socioeconomic change. However, he did not use this opportunity to establish regime legitimacy or broad-based public support.

Instead of implementing fundamental social reforms, the government created an alternative elite. The new regime's political lifespan was based on Marcos' ability to win support through the distribution of economic favors. This, coupled with deinstitutionalization and the concentration of power in Marcos' family, created a ripe environment for cronyism. "In the name of technocracy and social equity, Marcos had created a state of patronage. A Congress of many patrons was replaced by a centralized system of disbursement dominated by a single godfather."<sup>117</sup> Thus, in place of policy development and implementation, Marcos focused on counterbalancing the power of the traditional oligarchs by constructing a rival elite, creating interests dependent on the fate of the regime.

The lack of property rights and absence of impersonal contract enforcement under cronyism accounts for its tremendous economic and political consequences. Property rights are the principle good distributed in exchange for political loyalty. In a state characterized by the personalization of power rather than the rule of law, property rights are maintained at the pleasure of the ruler, they are not transferable, and their value depends on political connections rather than market mechanisms. When judicial independence is absent, the risk of contract nonenforcement increases, creating uncertainty that reduces the value of property rights of groups that do not have the ruler's goodwill. Even more efficient producers will not risk competing against the ruler's cronies, permitting the ruler to allocate and enforce rights. Furthermore, economic privileges allocated on the basis of personal relationships are not transferable. Therefore, the economic value of those rights decreases, while the value of establishing personal relationships increases. The net result of these processes is foregone economic

opportunities, the loss of ventures that would be profitable in a competitive economy, and a reduction in the liquidity of the economy (as loyalty-based goods are not easily transferable).<sup>118</sup>

Cronyism heightens the stakes of political competition. The economic well-being of cronies is closely tied to the fate of the regime, as political defeat could lead to confiscation and the redistribution of economic gains. Given the high stakes, cronies will fight to the death, utilizing violence, repression, or whatever means necessary to support the regime and maintain their privileges:

When regime opponents have lost their property as a result of political rivalry, the expectation of renewed confiscation when power again changes hands means parties will dig in and fight it out to the death rather than allow regime change to place their wealth at risk. Because challenge to the status quo implies a possible redistribution of property rights, moderation toward dissent will seem to risky. Thus, under cronyism, political dissent is likely to seem more dangerous and will be more severely punished than when property rights are allocated by impersonal market forces.<sup>119</sup>

The ultimate result of cronyism is political instability. Excluded groups must gain political power in order to access rents produced by property rights. In the case of the Philippines, only members of the martial law coalition fully enjoyed property rights. The opposition ultimately overthrew the government to access the economic rents denied under Marcos.

The deep entrenchment of interests under cronyism intensifies the difficulty of engaging the leadership in reform efforts. Cronyism is utilized, rather successfully in the short run, as a strategy of maintaining political power. Reform entails a comprehensive shift in political strategies, from rent distribution to the delivery of public goods and services. Once this commitment is made, a result-oriented system of management must then be developed in government bureaucracy. A system of law must also be in place to guarantee neutrality, consistency, and predictability under the law. Without a functioning public administration and the rule of law, the implementation of government policy will not occur, and the leadership will be unable to garner legitimate political support from a wider constituency.

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## Conclusion

This paper reviewed the principal issues and debates addressed in the literature on corruption and presented a categorical system for analyzing forms of corruption. Key debates in the literature have centered around: the definitional dilemma, cultural relativity, causes, consequences, and anticorruption policy. Although the theoretical literature is expansive, many questions remain unresolved. Emphasis should be placed on developing empirical studies to broaden the understanding of corruption's causes, consequences, and solutions. Furthermore, increasing our comprehension of the political motivation of corruption, and the patronage- and cronyism-driven systems in which it is most destructive, represents an important niche waiting to be filled within the corruption literature.

Corruption refers to a vast set of behaviors and practices, each with their own set of causes, consequences, and solutions. These practices can be broken down into five general categories: Bribery, Pillaging of State Assets, Distortion of Government Expenditure, Patronage, and Cronyism. Developing effective anticorruption strategies requires the simultaneous development of technical solutions and political will. This task is most formidable in countries in which corruption is used as a tool to acquire political support and exercise political power. Strengthening institutions and weak public management systems, and reforming policies which create discretion and opportunity for corruption, are important components of any anticorruption strategy. These measures can help realign the incentives that rule the behavior of political and bureaucratic officials, creating a government with the will and capacity to implement public policies in place of corrupt deals.

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*Amanda Morgan received her B.A. and M.A. from Stanford University. She is currently in Mexico on a Fulbright Fellowship.*

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## End Notes

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- <sup>2</sup>Daniel Kaufmann, "Corruption: The Facts," *Foreign Policy*, Summer 1997.
- <sup>3</sup>Alberto Alesina and Rafael Di Tella, "The New Economics of Corruption: A Survey and some New Results," *Political Studies*, Vol. XLV, 1997: pp. 496-515.
- <sup>4</sup>Alesina and Di Tella 1997: 498.
- <sup>5</sup>Mark Philip, "Defining Political Corruption," *Political Studies*, Vol. 45, number 3, special issue 1997.
- <sup>6</sup>J.S. Nye, "Political Corruption: a Cost-Benefit Analysis," in A.J. Heidenheimer, M. Johnston and V. Le Vine (eds.), *Political Corruption: a Handbook*. New Brunswick: Transaction, 1989, p. 966. Other definitions which relate corruption to the behavior of a public official include: Susan Rose-Ackerman, "an illegal payment to a public agent to obtain a benefit that may or may not be deserved in the absence of payoffs"; and "the sale by government officials of government property for personal gain" in Shleifer, Andrei and Robert Vishny, "Corruption," *Quarterly Journal of Economics*, Vol. 108, number 3, (August 1993): pp. 599-617.
- <sup>7</sup>Heidenheimer et al. 1989: 10.
- <sup>8</sup>Philip 1997: 441.
- <sup>9</sup>Nathaniel Leff, "Economic Development through Corruption," in Heidenheimer et al., *Political Corruption*, 1989: 389.
- <sup>10</sup>Jacob van Klaveren, "The Concept of Corruption," in Heidenheimer et al., *Political Corruption*, pp. 25-6.
- <sup>11</sup>Philip 1997: 445.
- <sup>12</sup>Robert S. Leiken, "Controlling the Global Corruption Epidemic," *Foreign Policy*, number 105 (Winter 1996): 55-73.
- <sup>13</sup>World Bank, *Helping Countries Combat Corruption: The Role of the World Bank*. Washington, D.C.: Poverty Reduction and Economic Management Network of the World Bank, September 1997.
- <sup>14</sup>World Bank, *Helping Countries Combat Corruption*, 1997.
- <sup>15</sup>Daniel Kaufmann, "Perceptions About Corruption Among Elites in Emerging Economies," Draft, World Bank, March 1997.
- <sup>16</sup>Paul Heywood "Political Corruption: Problems and Perspectives," *Political Studies*, Vol. 45, number 3, special issue 1997.
- <sup>17</sup>Syed Hussein Alatas, *Corruption: its Nature, Causes and Consequences*. Aldershot; Brookfield, Vt., USA: Avebury, 1990, pp. 3-4.
- <sup>18</sup>Alatas 1990.
- <sup>19</sup>Heywood 1997: 426.
- <sup>20</sup>Efforts by the OECD and OAS have attempted to internationalize the pioneering

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achievement of the United States' Foreign Corrupt Practices Act (FCPA). Adopted in 1977, the FCPA prohibits certain types of payments to certain foreign officials and requires stringent accounting and reporting standards by U.S. firms. Violators are punishable by criminal and civil penalties, including fines, imprisonment and injunctive relief. To date, the United States is the sole nation with laws specifically punishing the corruption of foreign government officials (Joongi Kim and Jong Bum Kim, "Cultural Differences in the Crusade Against International Bribery: Rice-Cake Expenses in Korea and the Foreign Corrupt Practices Act," *Pacific Rim Law and Policy Journal*, Vol. 6, number 3, July 1997, p. 572). See George C. Greanias & Duane Windsor, *The Foreign Corrupt Practices Act (1982) for a history of previous legislative efforts to end corporate bribery*. See Jeffrey P. Bialos and Gregory Husisian, "The Foreign Corrupt Practices Act: Dealing with Illicit Payments in Transitional and Emerging Economies," in *1 Foreign Corrupt Practices Act Rep.* 103.023 (Feb. 1996).

<sup>21</sup>Basis of cultural difference arguments include Samuel Huntington, "The Clash of Civilizations?," *Foreign Affairs*, Vol. 72, number 22, Summer 1993; and Samuel Huntington, "The West Unique, Not Universal," *Foreign Affairs*, Vol. 75, number 28, November/December 1996.

<sup>22</sup>John T. Noonan, Jr., *Bribes*. New York: Macmillan, 1984, pp. 702-3.

<sup>23</sup>Joongi and Jong 1997.

<sup>24</sup>Affirmative Defense allows for the payment, gift, offer or promise of anything of value that is in accordance with the written laws of the foreign country (Joongi and Jong 1997: 574).

<sup>25</sup>World Bank, *Helping Countries Combat Corruption*, 1997: 12.

<sup>26</sup>Robert Klitgaard, *Controlling Corruption*. Berkeley: University of California Press, 1988, pp. 69. Also see, Steven Shavell, "Risk Sharing and Incentives in the Principal and Agent Relationship," *Bell Journal of Economics*, Vol. 10, Spring 1979: 55-73; Susan Rose-Ackerman, *Corruption: A Study of Political Economy*. New York: Academic Press, 1978.

<sup>27</sup>Pranab Bardhan, "The Economics of Corruption in Less Developed Countries: A Review of Issues," Center for International and Development Economics Research Working Paper No. C96-064. University of California, Berkeley: February 1996.

<sup>28</sup>World Bank, *Helping Countries Combat Corruption*, 1997: 13.

<sup>29</sup>World Bank, *Helping Countries Combat Corruption*, 1997: 13-14.

<sup>30</sup>Klitgaard 1988: 75.

<sup>31</sup>Klitgaard 1988: 75.

<sup>32</sup>World Bank, *World Development Report 1997*, New York: Oxford Press 1997, pp. 102-3.

<sup>33</sup>World Bank, *World Development Report 1997*, 1997.

<sup>34</sup>For an overview of literature on economic effects of different forms of corruption see Susan Rose-Ackerman, "When is Corruption Harmful?" Background Paper for World Development Report 1997, August 1996. See also Bardhan 1996; Klitgaard 1988: 21-48.



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- <sup>35</sup>Daniel Kaufmann, "Corruption Some Facts."
- <sup>36</sup>Ades and Di Tella 1997: 496-497. See also World Bank, *Helping Countries Combat Corruption*, 1997: 14.
- <sup>37</sup>Samuel P. Huntington, "Modernization and Development," in *Bureaucratic Corruption*, ed. Monday U. Ekpo. Washington, D.C.: University Press of America, 1997: 321.
- <sup>38</sup>Nathaniel Leff, "Economic Development through Bureaucratic Corruption," *American Behavioral Scientist*, 1964: 8-14.
- <sup>39</sup>World Bank, *Helping Countries Combat Corruption*, 1997: 14.
- <sup>40</sup>Michael Johnston, "The Vices-and Virtues-of Corruption," *Current History*, September 1997: 273.
- <sup>41</sup>Gunnar Myrdal, *Asian Drama: an Inquiry into the Poverty of Nations*, Vol. II. New York: Pantheon, 1968. Also see Rose Ackerman 1978.
- <sup>42</sup>World Bank, *Helping Countries Combat Corruption*, 1997: 14.
- <sup>43</sup>World Bank, *Helping Countries Combat Corruption*, 1997: 14.
- <sup>44</sup>Bardhan 1996: 17.
- <sup>45</sup>Hilton Root, *Small Countries Big Lessons: Governance and the Rise of East Asia*. New York: Oxford University Press, 1996. pp. 165.
- <sup>46</sup>Daniel Kaufmann, "Economic Corruption: Some Facts." Paper presented at the 8th International Anti-Corruption Conference. Lima, Peru: September 7-11, 1997.
- <sup>47</sup>See S. Borner, A. Brunetti, and B. Weder, *Political Credibility and Economic Development*. New York: St. Martin's Press, 1994; Paolo Mauro, "Corruption and Growth," *Quarterly Journal of Economics* 1995; Philip Keefer and Stephen Knack, "Why Don't Poor Countries Catch Up? A Cross-National Test of an Institutional Explanation," *Economic Inquiry*, Vol. 35, number 3 (July 1997): 590-602; Shang-Jin Wei, "How Taxing Is Corruption on International Investors?" National Bureau of Economic Research Working Paper No. 6030, 1997.
- <sup>48</sup>Ades and Di Tella 1997: 498.
- <sup>49</sup>Paolo Mauro, "The Effects of Corruption on Growth, Investment, and Government Expenditure: A Cross-Country Analysis," *Corruption and the Global Economy*. Washington, D.C.: Institute for International Economics, 1997.
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- <sup>51</sup>Philip Keefer and Stephen Knack, "Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures," *Economics and Politics* Vol. 7, number 3, November 1995: 207-27.
- <sup>52</sup>Wei 1997.
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- <sup>56</sup>James Hines, "Forbidden Payment: Foreign Bribery and American Business". NBER Working Papers No. 5266. Cambridge, MA: National Bureau of Economic Research, 1995.
- <sup>57</sup>Mauro 1997.
- <sup>58</sup>Robert Cooter, "The Rule of State Law Versus the Rule-of-Law State: Economic Analysis of the Legal Foundations of Development," in *Proceedings of the Annual World Bank Conference on Development Economics 1996*. Washington D.C.: World Bank, 1996. Cited in Michael Johnston, "What Can Be Done About Entrenched Corruption?" Paper prepared for the Annual World Bank Conference on Development Economics, Washington, D.C., April 1997.
- <sup>59</sup>William Easterly and Ross Levine, "Africa's Growth Tragedy: Politics and Ethnic Divisions," World Bank, Policy Research Department, Macroeconomics and Growth Division, Washington, D.C., 1996. Cited in Johnston, "What Can be Done About Entrenched Corruption," 1997.
- <sup>60</sup>Jonathan Isham, Daniel Kaufmann, and Lant Pritchett, "Governance and Returns on Investment: An Empirical Investigation," Policy Research Working Paper 1550. World Bank, Policy Research Department, Poverty and Human Resources Division, Washington, D.C., 1995. Cited in Johnston, "What Can be Done About Entrenched Corruption," 1997.
- <sup>61</sup>Kimberly A. Elliot, "Corruption as a Global Policy Problem: Overview and Recommendations," in Kimberly A. Elliot, ed., *Corruption and the Global Economy*. Washington, D.C.: Institute for International Economics, 1997. Cited in Johnston, "What Can be Done About Entrenched Corruption," 1997.
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- <sup>63</sup>Daniel Kaufmann, "Anti-Corruption Strategies: Starting Afresh?: Unconventional Lessons from Comparative Analysis," Working Paper, World Bank, 1997.
- <sup>64</sup>Gado, *The Daily Nation*, October 28, 1997: pg. 6. In Kaufmann, "Anti-Corruption Strategies: Starting Afresh?" 1997.
- <sup>65</sup>Ades and Di Tella 1997: 497.
- <sup>66</sup>An example of the lawyer's approach is Italy's judge Antonio Di Pietro, who advocates judicial reform that would allow for plea bargaining and would give judges the ability to grant immunity from prosecution to those that cooperate with investigations as a means of corruption control (Ades and Di Tella 1997: 497).

- <sup>67</sup>See Becker and Stigler, "Law enforcement, malfeasance and the compensation of enforcers," *Journal of Legal Studies*, Vol. 3, number 1, 1974: 1-19.
- <sup>68</sup>See Rose-Ackerman 1978. Also Alberto Ades and Rafael Di Tella, "Competition and Corruption," *Applied Economics Discussion Paper Series No. 169*, Oxford University, 1995. Also Christopher Bliss and Rafael Di Tella, "Does competition kill corruption?" *Journal of Political Economy*, Vol. 105, number 5 (Oct 1997): 1001-1023.
- <sup>69</sup>Robert Leiken, "Controlling The Global Corruption Epidemic," *Foreign Policy*, number 105 (Winter 1996): 55-73.
- <sup>70</sup>Johnston 1997: 270.
- <sup>71</sup>Kaufmann, "Anti-Corruption Strategies," 1997: 12.
- <sup>72</sup>Simon Johnson, Daniel Kaufmann, and Andrei Shleifer, "The Unofficial Economy in Transition," *Brookings Papers on Economic Activity*, Fall 1997.
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- <sup>74</sup>Johnston, "What Can Be Done About Entrenched Corruption?" 1997.
- <sup>75</sup>World Bank, *World Development Report 1997*, 1997: 105. See Jack H. Knott and Gary J. Miller, *Reforming Bureaucracy: The Politics of Institutional Choice*. Englewood Cliffs: Prentice-Hall, Inc., 1987: Chapters 2 and 3.
- <sup>76</sup>Kaufmann, "Anti-Corruption Strategies," 1997: 15. For more detailed discussion of some of the mentioned cases see Appendix.
- <sup>77</sup>World Bank, *World Development Report 1997*, 1997:105.
- <sup>78</sup>USAID, "Corruption White Paper Executive Summary," Draft. April, 1997.
- <sup>79</sup>USAID 1997.
- <sup>80</sup>Phongpaichit and Piriyaarangsarn 1994: 188-189.
- <sup>81</sup>Naazneen Barma, Ekaterina Drozdova, Oren Ipp, and Amanda Morgan, "Technical Assistance to the Government of India: Proposal for Reform of the System of Public Administration," submitted in partial fulfillment of the requirements of the International Policy Studies Master's Program, Stanford University, June 1997.
- <sup>82</sup>World Bank, *Helping Countries Combat Corruption*, 1997: 20.
- <sup>83</sup>Edmund L. Andrews, "29 Nations Agree to Outlaw Bribing Foreign Officials," *The New York Times*, Vol. CXLVII, number 50,983: November 21, 1997, pp. A1, C2. For background on OECD policy leading up to the treaty see "Recommendations of the Council on Bribery in International Business Transactions," OECD, 829th Sess. (May 27, 1994) available at <<http://www.oecd.org/dat/cmis/bribrecm.htm>>. See generally David Buchan and George Graham, "OECD Members Agree on Action to Curb Bribery of Foreign Officials," *Financial Times*, April 30, 1994, pp. 2. Multilateral anti-bribery efforts include the World Trade Organization, the United Nations, Asian Pacific Economic Community, European Union, the Organization of America States (OAS), and Transparency International. The OAS, for example, sponsored an international convention making bribery, including international bribery, a crime. The convention was adopt-

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ed by 34 member countries which are obligated to criminalize transnational bribery. See Appendix for more detailed discussions of anticorruption activity of these organizations.

<sup>84</sup>Inter-American Convention Against Corruption, OAS, March 29, 1996, 35 I.L.M. 724, 1996.

<sup>85</sup>World Bank, *Helping Countries Combat Corruption*, 1997.

<sup>86</sup>Susan Rose-Ackerman "The Political Economy of Corruption-Causes and Consequences," *ViewPoint*, Note No. 74, World Bank: April 1996.

<sup>87</sup>World Bank, *Helping Countries Combat Corruption*, 1997.

<sup>88</sup>Rose-Ackerman, "The Political Economy of Corruption-Causes and Consequences," 1996.

<sup>89</sup>Mauro 1995; Keefer and Knack 1995; Wei 1997; and Busse, Ishikawa, Mitra, Primmer, Doe and Yaveroglu 1996.

<sup>90</sup>World Bank, *World Development Report 1997*, 1997: 106.

<sup>91</sup>World Bank, *World Development Report 1997*, 1997: 106.

<sup>92</sup>World Bank, *World Development Report 1997*, 1997: 106.

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<sup>97</sup>Rose-Ackerman, "The Political Economy of Corruption-Causes and Consequences," 1996.

<sup>98</sup>World Bank, *World Development Report 1997*, 1997: 105. See also Root 1996: Chapter on Singapore.

<sup>99</sup>Root 1996: 47-48, 57-58. See Appendix for greater detail on anticorruption commissions.

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# Focus on Thailand

A S I A N

P E R S P E C T I V E S  
S E R I E S

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Opening Remarks  
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It is important to keep in mind that Thailand is experiencing remarkable social change. The nongovernmental organization (NGO) community has mushroomed, there is more political activism, and some of the traditional behaviors that have been so important historically for maintaining stability—nonconfrontation, harmony, respect for authority—may be changing.

**WILLIAM P. FULLER**

**President**

**The Asia Foundation**

# Introduction

**A**sian Perspectives: Focus on Thailand is the fifth in an ongoing series of seminars sponsored by The Asia Foundation. Convening in March 1998 at the Reid Foundation Building in Washington, D.C., the seminar focused on economic and political change in Thailand, particularly regarding the financial crisis and prospects for reform, the issue of corruption, and the status of the new Thai Constitution and its potential impact on politics.

## Opening Remarks by William P. Fuller

I want to welcome you to The Asia Foundation's Asian Perspectives Series, Focus on Thailand. The aim of the series is to provide an opportunity for specialists—professionals from the region—to come to Washington and help us understand the complexities of development in the region and future challenges. The issues are difficult and complex, and I want to mention just a few to set the context for our panelists.

Turning first to financial reform, Thailand certainly is moving forward: Government spending has been reduced by 20 percent, interest rates have remained high, the banking industry has been opened to foreign investors, a number of insolvent financial houses have disappeared from the scene, and a tight timetable has been imposed on solvent banks to recapitalize. The baht is up, the stock exchange is up, and the current account deficit has now turned positive. These are good signs. But on the other hand, there are tremendous costs: The economy may contract approximately 2.5 to 3.5 percent this year. It is estimated that thousands of businesses may go under and that the unemployment created by the crisis could increase by perhaps 2 million people.

Looking to the longer term, how is Thailand going to move to higher tech, higher value-added production that will be competitive, given existing wage pressures? There is still much that remains to be done in the banking sector, including rescheduling \$60 billion worth of debt on a more sustained basis and finding funds to recapitalize the banking sector.

A number of these challenges are also related to politics. The current government in Thailand is a relatively fragile coalition—indeed, the Prime Minister recently escaped a no-confidence move in Parliament. Part of the political and economic puzzle also relates to the issue of corruption. How is Thailand going to change its public and private institutions so that there is more oversight and accountability? It is also important to keep in mind that while Thailand is undergoing a financial crisis and political changes, it is also experiencing remarkable social change.

The nongovernmental organization (NGO) community has mushroomed, there is more political activism, and some of the traditional behaviors that have been so important historically for maintaining stability—nonconfrontation, harmony, respect for authority—may be changing. These may be giving way to other values, including a more aggressive competitiveness, more confrontational approaches, and perhaps a clearer sense of equality and individuality.

Our speakers include Mr. Vicharat Vichit-Vadakan, Secretary General of the Financial Sector Restructuring Authority and Deputy Chairman of Thailand's Securities Analysts' Association. He is deeply involved in Thailand's financial-reform efforts and has enormous experience. You will see from his background that he has served with the Thai Stock Exchange, in the Prime Minister's Office,

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with the Ministry of Finance, and with the Securities and Exchange Commission.

Dr. Pasuk Phongpaichit, Professor of Economics from Chulalongkorn University in Bangkok, is a consultant for the Special House Committee on the Illegal Economy and Its Suppression of the National Assembly. She has done considerable research and writing on the topic of Thailand's economy and corruption, some of which has received support from The Asia Foundation. She has been instru-

mental in bringing the issue of corruption into the public policy debate.

Our third speaker, Dr. James Klein, The Asia Foundation's Representative in Bangkok, has been an observer of Southeast Asia for the last 25 years. He has resided in Thailand for a long time, beginning as our assistant representative in Bangkok, going on to be our representative in Malaysia and in Cambodia, and has been based in Bangkok for the past two years. ●



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# Thailand's Economic Reform: Prospects and Problems

by **VICHARAT VICHIT-VADAKAN**

The economic crisis in Thailand really did not come as a complete surprise; it was not totally unanticipated. I think only its timing, its magnitude, and its pervasiveness were. We had several high-growth-rate years in the late 1980s and early 1990s. Between 1988 and 1990 we had double-digit growth; between 1991 and 1995 we had growth of more than 8 percent. During these high-growth-rate years, efforts were made to initiate an economic and financial restructuring process in recognition of the fact that Thailand was not sufficiently competitive in many fields. Admittedly, these efforts were preliminary and exploratory in nature. The government, for example, initiated a reassessment of financial-sector development and a few years ago a financial master plan was drafted to prepare for economic liberalization. A similar reassessment was made for the telecommunications industry. In addition, there were some serious discussions about restructuring the Ministry of Finance, but little, if any, implementation followed.

In my own involvement as Secretary-General and Chairman of the Securities Industry Association, I commissioned a study to look into the declining competitiveness of Thai investment banking firms. In retrospect, it was clear that the writing was all over the wall. But industry players at that time did little to start serious restructuring. Times were too good, business as usual was making a lot of money, and while most people in the industry agreed that changes were required, I think few felt the urgency. We also discussed

our study with the authorities, but the message was not well received. The typical reaction by the authorities at that time was that the industry players were too greedy, they were asking for too much too soon. Regulating authorities were either too confident or too defensive to heed calls for greater and faster liberalization. They argued the industry was ill-prepared, and they were probably right; they felt that they had the luxury of time to implement changes at their own pace. In this regard, I think they were dead wrong.

The economic crisis struck Thailand with a vengeance. From previous highs of double-digit gross domestic product (GDP) growth, last year we saw slightly negative growth of minus fourth-tenths of a percent and this year's growth is projected to be approximately negative 3 percent. The onset of the crisis was attributable to Thailand's enormous short-term private foreign debt of about \$74 billion, which has eroded export competitiveness; a current account deficit that was running at an unsustainable level of about 8 percent of GDP; and rapidly depleting international reserves. All of these led to capital flight and mounting pressures on the baht. The Bank of Thailand failed to defend the currency and the baht was allowed to float on July 2, 1997, resulting in a sharp depreciation since then.

Both the private and the public sectors in Thailand were unprepared for the globalization of financial markets. While the war on currency and competitiveness was waged in offshore markets, Thailand was still doing business as

usual until the devastation of the war knocked hard on our doors. Even then we thought we could fight back with our conventional war room strategies. In spite of the International Monetary Fund (IMF) rescue package of \$17.2 billion, the baht depreciated to a level far below expectations before returning to stabilize at current levels. The financial sector was hard-hit by mounting nonperforming loans. A rapid loss of depositor and creditor confidence led to a run on financial institutions.

Fifty-eight finance companies with assets of over \$20 billion were initially suspended and 56 out of the 58 are now permanently closed.

The financial system was fast succumbing to a deterioration in the quality of assets. Plagued with nonperforming loans and a liquidity crunch, few financial institutions are likely to survive the crisis without massive recapitalization, and I am still worried that few will be able to refinance adequately. Under these circumstances, the Financial Sector

Restructuring Authority (FRA) was established by emergency government decree last October to restructure a sector of the financial system that was devastated by the crisis. The agency is predicated on the philosophy that financial crises are virtually impossible to avoid and that they must be dealt with in a decisive and summary manner in order to restore confidence in the financial system.

The FRA closed down 56 finance companies last December and is moving to dispose of the assets of these companies in the marketplace. Not unlike the approach

adopted in the United States by the Resolution Trust Corporation to deal with the assets of the failed Savings and Loans Associations, the FRA will be auctioning off close to \$20 billion in assets over the remainder of the year.

The objectives of the exercise are two-fold: First, to revive these nonperforming assets by returning them to the marketplace at market-determined valuations and prices; second, to move in a determined manner to quickly address problems

in the financial sector, thereby restoring confidence.

The task mandated to the FRA is groundbreaking in Thailand. Never before has anything of this magnitude been attempted. To deal with the problem in a quick and summary manner is an approach not traditionally associated with the Thai way of compromise and gentleness. The impact of FRA asset sales—the revaluation of asset prices, particularly in the property and real estate sectors—could have wide-ranging implications for those currently holding property and on financial institutions

that have extended credit against property as collateral. But I think the crisis has also changed traditional Thai attitudes and perceptions in many ways. The FRA process is receiving strong government and public support. If the marketplace proves to be effective, the FRA process could establish new market valuations for assets at levels that could encourage enterprise and business activity. The previously inflated valuations of assets had in essence killed market activity and led to the problems currently faced by the financial and real estate sectors. The FRA approach of relying on

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the marketplace to deal with distressed assets should bring strong benefits in the medium and long term, even though, admittedly, the impact will be painful in the short term. The FRA also confirms the government's commitment to a quick resolution of problems in the financial sector and a forward-looking attitude that should bring about a faster recovery.

The FRA is marketing the sale of Thai distressed assets to both the domestic and international investment communities. We have commissioned an American investment banking firm, Lehmann Brothers, to advise us on the packaging, marketing, and sale of these assets. We expect the first sale to be announced at the end of April, to be followed by a series of sales throughout the year. Visit our web site at [www.frathai.com](http://www.frathai.com) to keep updated on the latest developments. Admittedly, the FRA solution is untested and unproven in the Thai context. If it is successful, it could very well be the best way to deal with distressed assets and return confidence to the financial system. If it is not successful, we would have to seek other approaches to solving the financial crisis. But in any case, we would have given a very clear and unequivocal message to the world that we are committed to taking a no-nonsense attitude to financial reform.

There is a bit of concern that the FRA's chances of success are slim given the current state of the economy. It is actually a "Catch-22": The economic crisis may kill the FRA process, but without the process, the economy will be slow to recover. I am encouraged by recent developments in the economy that point to a potential full recovery. Since the beginning of the year, inflation has not been a major threat, in spite of a deep depreciation in the currency. This is because of weakening world oil prices and weak domestic demand, leading to a significant decrease in both private and public consumption. The depreciation of the baht, however, has made Thai exports more competitive, while the slowdown of the economy reduced imports by some 14 percent in 1997. Since September of last year, Thailand

has maintained a trade surplus for six consecutive months, a first-time record. The current account deficit, which stood at 8 percent of GDP in 1996, turned into a surplus in the second half of last year. The baht seems to have stabilized at approximately 40 to the dollar. So the macropicture appears to have improved and stabilized. But again this is not the time for complacency. The path to sustained recovery is still wrought with pitfalls. Inflation may soar as the economy contracts, interest rates remain high, and a liquidity shortage persists.

At the microlevel, Thai companies weighed down by enormous foreign currency debt may go under in a massive way, compounding both the economic and social problems of employment and poverty. It is therefore critical that Thailand continues on the path of reform that it has already taken and not go off on tangents. In the area of financial-sector reform, the focus must continue to be quickly addressing the problems of nonperforming assets in the financial system, moving to recapitalize or close down problem financial institutions, and adopting international best-practice standards in financial supervision and banking.

Political stability is essential to carrying out financial and social reform. Thailand was fortunate to have already moved toward fundamental political reform, despite the imperfections that may still exist. Currently, we are also fortunate to have a government that has the strong support of the public and the press, and which is committed to carrying forward the necessary reforms. The momentum for reform must be sustained in the areas of economic and social restructuring. Although we may be rightfully critical of the shortcomings of economic development programs in addressing social and income inequality in the past, it is nevertheless incontestable that the high growth rates of Asian economies over the past few years, including those of Thailand, have played an instrumental role in spearheading the war against poverty in the region. In this respect,

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Thailand must ensure that previous efforts, which have raised the standards of living of those below the poverty line, do not come to naught, with people returning to the poverty levels of a decade ago. This is the opportune time to redress mistakes or omissions made in past economic development strategies and to tackle the problem of income inequality and distribution.

We must advance our efforts to minimize the impact of the economic and financial crisis on the poor and disadvantaged while we continue with financial and legal reform and the restructuring of the corporate sector, which is much needed. With a balanced approach we can expect to reap and keep the benefits of our reform efforts. 🌱

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# Corruption and Its Effect on Thailand's Economy and Political Institutions

by PASUK PHONGPAICHIT

In Thailand and in much of Southeast Asia, we have just been through a remarkable period without precedent. We have multiplied the size of the economy by nine times in 30 years, a jump that took one-to-two centuries in the West. Since just 1983, Thailand has tripled the size of its economy, changed the economic focus from agriculture to industry, and turned society upside down in the process. One thing we discovered is that when you are too busy building the economy and changing society so fast, politics and governmental administration simply cannot keep up. Institutions and habits are difficult to change, and there is no good advice or pattern to follow, because no other society has ever grown this quickly. When the economy is going so well, all the attention and resources are focused there and the state of politics and government tends to be neglected. You only stop to think when you hit a brick wall, as we and much of Asia have, and only then do politics and administration get the attention they need and deserve. This is the background to the new constitution that the Thai parliament passed last October.

It is a remarkable and very ambitious new charter that came into being because, when economic growth slackened a few years ago, some important and influential people turned their attention to political reform. So when we hit the crisis last year, many more people supported the new constitution, because it seemed to promise one way out of our troubles.

The new charter is important in many ways. It makes many changes that in the near future we hope will improve the state of Thai politics and administration. These changes include a better definition of human rights, a system to monitor and punish corruption, reform of election laws, restrictions on abuse of power by police and others, and much more. This constitution is important not just for what it says, but even more for how it was created and passed. You know that Thailand has a background of absolute monarchy and military dictatorship. Against such a historical background, people often lack confidence in their ability to achieve change. This charter was written and passed in the heat of opposition from many established interests who feared that they would lose both their power and their profit opportunities under its provisions.

The process of approving the charter was significant in several ways. First, it provides a precedent and model for people who are outside the formal political system to force major changes. Second, it brought together many people who had never had the chance to meet and work together before — Mr. Vicharat and me, for instance. It created a network that is very important because it spans backgrounds, political colors, and generations. Most importantly, this grouping includes some senior and highly respected people who wield a lot of informal influence in our society, as well

as a lot of committed and talented people from a younger generation. This combination of wisdom and energy is very powerful. The result is that we have a charter, but we also have a model and momentum for achieving even more.

Because of the economic crisis, Prime Minister Chuan Leekpai earlier this year asked former prime minister Anand Panyarachun to draw up a medium- and long-term plan for reform to ensure that the crisis would not happen again.

This is quite an extraordinary event in our political context—a prime minister asking an ex-prime minister to help him out, and the ex-prime minister agreeing. Anand Panyarachun has since become the foremost crusader for good governance and he played a lead role in formulating the new constitution. His medium- and long-term planning is divided into four areas: The macroeconomy, economic restructuring, social reform, and good governance; the last is Anand Panyarachun's personal initiative. I won't go into the

details of these programs, partly because the work is still in progress and you will simply have to believe me that the initiative is unprecedented and ambitious. Anand Panyarachun has assembled a wide range of people to put together these plans—I have been invited to help on the governance issue. Now, I am not a politician, nor an administrator, and I am not much of an activist. I am a university economics professor; I have concentrated my energies on doing research because I think I am quite good at it and because we have very few committed researchers.

In the early 1990s, around the time Anand Panyarachun

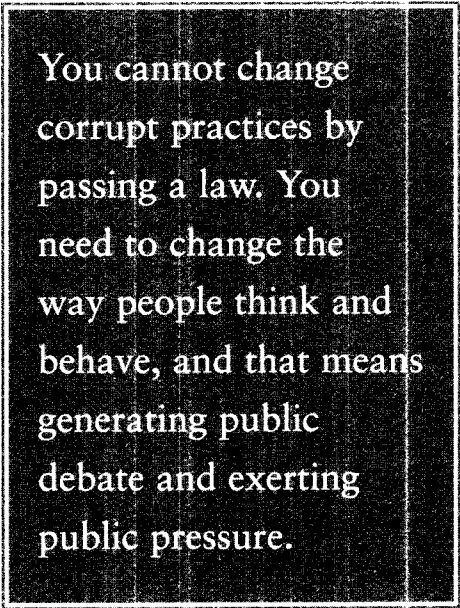
was prime minister, I became interested in the topic of corruption and how it affects our economy, our politics, and our society. I began to recognize that although we were taught to give recommendations on economic policies, our advice was never followed because corruption tended to get in the way. With my team, I published a study on "Corruption and Democracy in Thailand" in 1994 and another one on the illegal economy that will be coming out in June.

In all the studies that we have researched and completed, The Asia Foundation has contributed greatly by providing financial and moral support.

Through our research we were interested in discovering the extent and nature of corruption in our society, as well as generating debate as a way of initiating change. Corruption, as our study shows, has a strong cultural aspect. Many practices were acceptable in the past and still have a great measure of social acceptance today. You cannot change such practices by passing

a law. You need to change the way people think and behave, and that means generating public debate and exerting public pressure. What our research showed was that corruption is so widespread in Thailand that some people have wanted to use our work to prove that Thailand is more corrupt than other neighboring or comparable countries, but I am not sure that is the case.

Rather, I think the research proves that Thailand is a country where such research and debate can take place. When we started our research only a few years ago, we did face some opposition and some difficulty. Several people



**You cannot change corrupt practices by passing a law. You need to change the way people think and behave, and that means generating public debate and exerting public pressure.**

criticized our work as peripheral and irrelevant, and some rather powerful people reacted against it very strongly. After the first report, one of the leading political parties threatened to sue us and cut back our research grant at the university. Following the second report, the police threatened to sue us, which I can tell you is quite scary. To have come from that situation to a situation in which the Anand Panyarachun project is formulating some very ambitious plans to tackle corruption, all within just a few years, is quite remarkable. Now we are only discussing plans—it all may come to nothing, but this is the first time we have gotten as far as this; that is, getting a group of prominent people to take an interest in the anti-corruption question. It would be nice to think that we can cure corruption by pressing a switch, passing a couple of laws, sacking some people, but it is much more difficult than that. Corruption is a cultural issue and personal relationships are still more important than legislation, so we need to change this culture. To be able to succeed we must get the people on our side. We need to mobilize the public against corruption in a grand way and to pave the way for reform.

While an economic crisis is a very painful and traumatic period, there are many people, including me, who in some ways welcome the crisis because it provides an opportunity to stop and think, and to try to put some things right. While everyone was making lots of money, no one thought too much about corruption and other issues of governance. When the economy crashed, some realized that the corrupt

way certain people were making money was a contributing factor and they started to pay attention to it. Enough people now believe that we must straighten out our police, customs service, and other notorious government offices—public-sector reform is a must. We must halt the abuse of the ministerial office, we must improve the supervision of our financial system, and we must improve standards of corporate governance.

Regarding bureaucratic reform, one of the issues discussed by the Anand Panyarachun's Committee was how to root out the buying of positions, which is very widespread. In the area of corporate governance, three areas were identified that need to be targeted for reform. One, within the corporate sector itself, namely between shareholders, directors, and managers, the selling of shares or loaning among themselves or among relatives must be stopped. The concept of "conflict of interest" must be established. Second, professionalization of auditors' roles is required. Third, antitrust legislation must be considered.

Four major patterns of corruption need to be addressed: syndicated corruption; procurement kickbacks; rent-seeking, maintenance (or concession privileges); and bid fixing. This is a very tall order indeed and there will be lots of opposition. We will not get it all right the first time around. But Thailand is a very responsive and flexible society. When we concentrate, we can change things very quickly and we know we can draw on the support of outside friends. ●

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# Thailand's New Constitution and Efforts at Political Reform

by JAMES R. KLEIN

Thailand has had 15 constitutions in 65 years. This track record does not mean much to most people who follow Thailand because most of those 15 constitutions have been inconsequential. The 1997 constitution, however, is a revolutionary document—it totally changes the rules of the game in Thai politics. I think the issue that needs to be stressed is that this process began before the onset of the economic crisis in Thailand. While the crisis unfolded, the constitutional debate raged. For instance, certain politicians called the constitution a Communist document, among other things.

The constitution was approved by parliament in mid-September and promulgated October 11, 1997. When the draft was debated nationwide in a number of public hearings, the baht was falling and the IMF was called in. There were demonstrations throughout the city, typically around the university campuses and in front of Government House. Surprisingly, in the central business district of Silom Road, where all the banks and finance houses are, the business community members of the middle class held big demonstrations. People chanted, “We want this new constitution.” It took a long time for the international community to recognize that there was an economic crisis happening in Asia. I do not think the international community was fully aware of the political revolution that was going on in Thailand.

When Thailand changed from an absolute monarchy to a constitutional monarchy in 1932, the new constitution

then and all subsequent constitutions did not change any rules of the game, other than to place political power in the hands of a bureaucratic elite, as opposed to a royal elite. The 1997 constitution, also called the “people’s constitution,” for the first time takes control away from the bureaucracy. In five years, the bureaucratic polity simply may not exist. Beyond all the new civil liberties—the new rights and freedoms and the gender sensitivity it contains—there are three major changes. If these three issues do not work, you can forget about all the other parts of the constitution.

The first part is what I call “constitutional supremacy.” Thailand has never, technically speaking, had an independent judiciary. The judiciary has always been part of the Ministry of Justice. And although the judiciary has had a great deal of success in remaining largely independent of political interference, there has always been the possibility of political interference in the judiciary because the constitution was never viewed as the supreme law of the land. Because Thai constitutions have always had this neat little phrase: “in accordance with the law,” this characteristic gave bureaucrats, who wrote the law, the ability to restrict any right, any freedom, in any way that they wanted to. At the same time bureaucrats were restricting rights and freedoms, they were also building a series of administrative laws, rules, and decrees that were a regulatory nightmare and offered the bureaucracy tremendous opportunities for rent-seeking and other forms of corruption.



One of the things that the Thai people have wanted to do, therefore, has been to take control away from the bureaucracy. This is done in the new constitution by creating the constitutional court. Since 1946, Thailand has had what is usually referred to as a constitutional tribunal—primarily a political body, that would decide whether a law was unconstitutional or not. Although the Supreme Court in the United States is always reviewing laws, this is just not done in Thailand.

It was not until 1946 that the Supreme Court decided that a war crimes act was unconstitutional. Parliament did not like that decision so it ordered a new constitution prohibiting courts from making those decisions. Usually the president of Parliament—the President of the Senate—is also the President of the Judicial Commission. Other Commission members would include the head of the national assembly, the attorney general, and a lot of other people who have full-time jobs.

The new constitutional court is a full-time job in itself—a nine-year appointment. You cannot be a politician, a senator, a civil servant, a serving military officer, you cannot have any other job, period. If you are a doctor, a dentist, or a lawyer, you have to close down your practice and spend the next nine years as a constitutional court judge. If this works, for the first time Thailand will have a mechanism to adjudicate whether politically inspired law is against the fundamental principles of the constitution.

The second issue concerns an elective civil-society Senate.

In 1932, when the People's Assembly was established, it was half elected and half appointed. The appointed half included representatives of the People's Party and senior, nonroyal bureaucrats. Over the years, Thailand has had both a unitary legislature and a bicameral body with a Senate and a National Assembly. Invariably, the Senate has always been an appointed body. It has usually been heavily filled with senior bureaucrats and military officers, and its primary purpose

was to balance the elected house, just in case the house got a little bit too liberal in its thinking.

For the first time, under this new constitution there is actually going to be an elected Senate—the 200 senators will be representing geographic districts throughout the country. What is interesting is who these senators are going to be: They cannot be a member of a political party, indeed, they cannot have been a member of a political party for the preceding three years. They cannot be a member of parliament, a member of a local elected body, a serving civil servant, a

serving military officer. They can be in business. But there are lots of rules and regulations that a typical provincial businessperson might not want to follow, such as you cannot have any concessions for government contracts, etc. A lot of people would like to be a senator in order to buy their way into a nice new road contract or a spillway or a dam, but that is not going to be possible under the new constitution.

Because of the limitations placed on the individuals who can run for senatorial office, there will be a lot of civil-society folks as members, and this is why I am calling it a

**Power in Thailand has always been a balance between the military and the bureaucracy, and in the last few years, the business sector. Now you are going to have a power base for civil society, and that is going to be the Senate.**

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“civil-society Senate.” The civil-society Senate will have an awful lot of power — it will be appointing (or will have advice and consent) on a number of new institutions, for example, the National Human Rights Commission, the National Counter-Corruption Commission, and the Constitutional Court. If this “civil-society” Senate works, it will create a balance of power. This is the critical issue to be looking at, because power in Thailand has always been a balance between the military and the bureaucracy, and in the last few years, the business sector. Now you are going to have a power base for civil society, and that is going to be the Senate. And how strong is that Senate going to be? We shall see.

For the first time in any Thai constitution, civic participation in public policymaking is mandated. Citizens are going to have a lot more participation on public-policy issues, particularly at the local level, because public hearings are required. The Asia Foundation has been working on the concept of public hearings for six or seven years. A major issue recently has been the PTT — Petroleum Authority of Thailand — Yadana natural gas pipeline project, running from Burma into Thailand. This is a very unfortunate situation in which the planning and construction of this pipeline were done under the old rules of the game, but the project is now being discussed and debated under the new rules of the game. This project did not have an environmental feasibility study, it did not have public hearings, and although it had a lot of public relations by the oil companies, it did not have public participation in the policymaking. In the future, this process now must happen before a project starts. This process takes away the power of the bureaucrats, because they will now have to sit down with members of local communities and get the communities’ consent to build a pipeline or a highway.

The constitution now also mandates decentralization. Thailand’s Ministry of Interior is quite powerful. It appoints the governors of each of the provinces and essentially runs

the government all the way down to the village level. Under the new constitution there will be decentralization. Governors may well be elected. Interestingly enough, the constitution also mandates the development of new legislation that will specifically address fiscal issues. If you are going to decentralize, where is the money for local administration going to come from? Tax revenues will have to be split up.

The third issue concerns the constitutional mechanisms which promote accountability and transparency. It is all well and good to have a nice document that says all of these nice things, but if there are no mechanisms to ensure some accountability and transparency, then the document is not worth the paper it is printed on. Previous Thai constitutions have had extremely weak mechanisms to promote accountability.

The new constitution creates a National Counter-Corruption Commission. Although Thailand has had a corruption commission since the mid-1970s, like a typical paper tiger, it had very limited investigatory powers and absolutely no prosecutorial powers. If the commission received a complaint, it could investigate and it could file its report with the superior of the individual who was under investigation. Typically the superior would set up a committee and sometimes those committees went on for years and years; sometimes they just let the issue die.

The new Counter-Corruption Commission is very different. First of all, the members of the commission are going to be appointed by the senate, which itself is “not political.” All of the same restrictions will apply: If you want to be a Constitutional Court judge, a Human Rights Commissioner, or a National Counter-Corruption Commissioner, you cannot be a politician, a senator, etc. So the Counter-Corruption Commission will end up with a group of individuals that probably will be quite strong and independent. They will have a nine-year term, so you cannot get rid of them very quickly.

The new National Counter-Corruption Commission will have powers of investigation that are quite liberal, as well as prosecutorial powers. In general, prosecution will be done by the Attorney General's office. But if the National Counter-Corruption Commission determines that the Attorney General has made a political decision not to prosecute someone, it can hire its own prosecutor and proceed to prosecute the case. The tricky part of counter-corruption is that if you follow the criminal-procedure codes in Thailand, the evidence that you need to prosecute someone in a court of law does not exist, such as invoices and receipts for corruption payments. Business people do not utilize invoices and receipts. Most transactions are "under the table" — so there is no documentation trail. What the Thais have done, beginning a number of years ago, is to focus on the issue of unusual wealth. Unusual wealth simply means, "Why do you suddenly have all of these new houses and this Mercedes Benz and all these big bank accounts?" Under Thai law you must explain, you must show documentation of how you acquired this wealth, otherwise, it is assumed that you got it through corrupt actions.

The most interesting part of the constitution, and one that most Thais that I talked to really like, is the assets-and-liability declaration. Thai politicians for years have had to submit a declaration of assets and liabilities, and present that to the Counter-Corruption Commission, detailing what they own and what they owe. The commission seals it up and no

one ever looks at it again. Only if a formal complaint is filed and your case goes to court, would the commission unseal that declaration. The new constitution requires the Counter-Corruption Commission to actually examine the assets-and-liabilities statements submitted. The commission is supposed to examine those and based on that information it can choose to proceed with investigations.

The hook on all of this is how civil society keeps the

National Counter-Corruption Commission honest. The constitution states that within 30 days of receiving all of these documents, the commission must publicly release those pertaining to the prime minister and all ministers. Thai newspapers had a field day with this material after it was released. The assets declaration requires not only that the minister declare assets, but the minister's spouse and children must also declare. In the press, questions arose like: Why do the wives have all the money? Why don't ministers pay any income taxes? They have millions and

they only pay a little bit of taxes. The *Bangkok Post* ran a series for nearly three-months and every day there would be a little column detailing a minister's cash-on-hand, naming his bank, how much land they owned, where the land was, how much it was valued at, publicly owned stock, privately held stock; including the automobiles, the Jaguar, the Mercedes Benz, etc.

I think the publicity of these assets helped Dr. Pasuk's project a lot. People now have a general idea about how much money some of these people have. And interestingly,

The new constitution requires the Counter-Corruption Commission to actually examine the assets-and-liabilities statements submitted by all politicians, and eventually by senior bureaucrats and other individuals.

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some of them don't seem to have as much money as they used to. People are already complaining that some of these assets-and-liabilities declarations seem a little bit funny. It is this type of openness and transparency that hopefully will make the National Counter-Corruption Commission a viable institution that could actually go out there and prosecute people. What is the potential impact of political reform? There are going to be certain politicians who are not going to run because they are not going to want to have their assets-and-liabilities statements made public. There was a certain former minister who decided not to become a minister in this particular government, simply because as a nonminister his assets and liabilities were not published publicly.

The other change in the countercorruption rules is that for the first time you can have impeachment in Thailand.

Under the new constitution, because of corrupt acts or other issues, you can now impeach a minister, a member of parliament, a senior bureaucrat, a judge, or a countercorruption commissioner. After they are impeached, they can be criminally prosecuted and thrown in jail.

Those three key changes in this constitution will make all the rest of it happen. That is, constitutional supremacy: For the first time you have a constitution that is the supreme law of the land. No longer will Thailand be a country under rule by law; Thailand will now be a country under rule of law. In addition, there will be citizen participation in government. This is already happening: already people down in the villages know they want to be participating in government. Finally, Thailand is going to now have actual mechanisms to go after those shady individuals who are profiting at public expense. 🌟

# Questions and Answers

## Focus on Thailand PANEL



Will you elaborate on the sources for recapitalization of the financial institutions? For example, would this be done by a government bond?

What are the different sources that would be used for recapitalization?

**Mr. Vicharat:** I think the Thai government is attempting to remain uninvolved in the recapitalization of the private sector, unless it is extremely necessary. In some cases, the government has had to take the initial step of going in to take over the failed financial institutions. For example, a few of the banks were taken over not too long ago and the government, through the Financial Institution Development Fund, had to recapitalize these banks. But the intention was that this would be a temporary solution. Ultimately the banks would then be sold to the private sector. The government has taken this approach because the requirement for recapitalization in the Thai banking industry is huge and the government does not have the money to accomplish that task, nor does the Thai private sector. The amount is so daunting that given the current liquidity crunch in the Thai market, I think there is little chance that it could be recapitalized from internal sources. This is why there has been a further liberalization of the financial sector, in recognition of the need for funds from foreign countries. Whereas before, foreign companies could not hold more than 25 percent in a Thai bank, now with Ministry of Finance approval, foreigners can now own up to 100 percent. So there is a strong recognition that recapitalization will have to come from foreign sources.



Please explain a little more about how you are going to go about trying to liquidate these large amounts of nonperforming loans. You mentioned it was about \$74 billion. How would you go about refinancing or liquidating them?

**Mr. Vicharat:** Actually the FRA has been mandated to tackle only a portion of the problem within the financial system, but even with the figures that I mentioned to you, it is already a daunting portion. We have about \$20 billion of face value in assets to auction off during the remainder of the year and we will be doing it through an open-market process. We will be holding auctions and sales of these assets through a competitive-bidding process, inviting investors from all around the world, domestic and international, to participate in the auction of the distressed assets. And we are relying on the marketplace to absorb as much of it as is possible, in the belief that asset prices, asset valuations, need to reflect true market demands. The market is the best indicator of what asset valuations should be and the sooner we go about doing it, the sooner we let the marketplace come back into the picture, the better it is going to be for the economy. We are hoping that with this initiation, asset prices will come to a level allowing property to have value again. Then people can start to buy and sell real estate, developers can come and develop land, people can buy houses and buildings at more reasonable prices, and the market mechanism will take over again, and that should trigger the recovery.



What will it take to ensure that the FRA's mission is achieved? For many years those of us who admired Thailand's economic success have talked about the maintenance of sound fundamentals in the economy. We have pointed to two institutions, in particular the Bank of Thailand and the Ministry of Finance, for their insulation from the corruption that Dr. Pasuk has referred to, in contrast with many other government agencies that are not so insulated. How is the FRA to survive, especially when so many asset holders are seeing the value of their assets directly affected in the short run by the actions of the FRA, possibly reducing asset values?

*Mr. Vicharat:* It is a question I go to sleep with every night. It really is a critical question, because if we fail here, then I think we fail to bring back confidence in the Thai financial system. The task that the FRA is working on is actually fairly simple. Policy has already been set, we just have to make sure that we implement it correctly and effectively. It is going to be this single-mindedness that will make the agency successful. The FRA is structured as a private, independent organization, even though it was set up under government emergency decree. There will always be political pressure on the things that we do. Our process will be criticized, but we have tried to tackle that in the best possible manner by keeping the agency independent from political interference and by obstinately going about our job.

The FRA is making its actions as transparent as possible, disclosing everything that we do to the public and the press. We consult a lot with creditors, debtors, and financial institutions domestically and abroad to try to get consensus and support for the FRA. As people look back at the FRA process five or ten years from now, they will say that the agency is one of the most transparent organizations in Thai history. We have nothing to hide, we want to make sure that by being transparent we also get protection from the public

and the press. If you've been following the Thai press since the FRA was established, I think the support is there and we have to make sure that support continues.

Touching a bit on political reform, we started our political-reform process before we recognized we were having a lot of problems in the economic field. But the economic crisis helped push forward the political-reform process. I doubt very much if we would have been at this point in the political-reform process had the economic crisis not developed. Now that the process is beginning and a new charter has been promulgated, I think the constitution will in turn allow reform to take place. These developments support each other in a rather curious way and we have got to keep that momentum going. The minute we think there is no longer any crisis, the minute we think that we can go back to business as usual, we will have lost that momentum and we will have lost a great opportunity to change things.

I have confidence in this government, particularly Chuan Leekpai and Minister of Finance Tarrin Nimmanhaeminda, who is also overseeing the FRA. Tarrin's future as a politician is at stake here. He is commanding quite a lot of respect from all quarters for his political will. I think that the FRA will be under strong pressure from all sides and I do not envy Tarrin Nimmanhaeminda for holding this position. But I am sure that the composition of the board and the political climate under this government will help the FRA and the Finance Minister to be insulated from all kinds of pressure, but we still have to wait and see.



Two months ago there was an attitude in certain circles in Thailand that we have become too integrated into the world economy. But it seems that in order to get rid of the problem, we have to be even more globalized. What is the current state of mind of people in Thailand, particularly intellectual people? Are they happy being integrated? What has the FRA done to allay fears in

the minds of intellectuals and the press particularly?

The other question that I would like to ask the presenters is that you seem a bit contradictory. Mr. Vicharat said that the crisis came as no surprise—except for the magnitude and the timing. Whereas Dr. Pasuk seemed to say that Thailand has changed very fast, but that institutions and habits are very slow to change—that is to say, a lot of things that have happened were not anticipated or expected. Our knowledge, habits, or institutions seem to lag behind changing realities. How would you reconcile these two interpretations of the cause of the crisis?

*Mr. Vicharat:* On the question of continuing on the path of integration and globalization, I still strongly believe that we cannot turn back, that there is really no room for us to backtrack. In this regard, I see some light at the end of the tunnel. If you had talked with people in the private sector as I have, you would have heard expressions of concern that globalization may have been too fast and may possibly have hurt the economy, as well as concerns that society was ill-prepared for the liberalization and therefore we ran into this crisis. So I would pose the question, ‘Would you like more or less liberalization as you look into the future?’ The answer that I got, 90 percent of the time, was ‘We’d like to see more.’

I think this is where there is some hope. Even with the rather difficult times we have gone through, because we were ill-prepared for liberalization, we are not thinking of backtracking. We still see that as the way to go into the

future, except that we have to be more prepared than we were in the past. I think that is the kind of attitude that will take us out of our economic predicament.

On the issue of reconciling different perceptions, I went through the same experience myself as did the people in our industry when we saw that the good old days were not going to be indefinitely sustainable. But during good times people do not want to change the way they are doing business. In a crisis, you finally realize that the things that you should have done five years ago you have to be doing now. This is when there is a clear reconciliation in the minds of many people that changes have to be made and we have got to put in the necessary infrastructures and do the necessary restructuring. I hope we will not be as confused as we were before and will try to move on with reform.

**Q** So business is seeking integration and more reform, but what about the broader public?

*Dr. Pasuk:* There is a debate going on between globalizers and localists. Policymakers, lots of businessmen, the present government of Chuan Leekpai, even Anand Panyarachun to a large extent, are globalizers. Public reaction against the increased role of foreign investment in the financial sector was rather antagonistic, but I think it has died down a bit now and a lot of people realize that our economy would not be able to get out of the crisis without foreign participation. Their limit is on the issue of land. The question of land is a

**[During a crisis] there is a clear reconciliation in the minds of many people that changes have to be made and we have got to put in the necessary infrastructures and do the necessary restructuring.**

very emotional thing. The government has now relaxed the rule on foreign participation in the financial sector and I think most people will become reconciled to that.

Who are the localists? These are people who would like Thailand to pursue a more balanced development strategy, believing we focused too much on the city and perhaps neglected the countryside and agriculture. Now even stock-brokers on television will come on and say, 'We must promote our agriculture because we cannot export our way out with manufacturing.' And now our rice is doing very well in the world market, as are all of our agricultural goods. People who want Thailand to become more balanced in terms of its development strategy and pay more attention to agriculture are now receiving quite a lot of publicity and there are lots of books coming out asking people to pay attention to these issues. I think a lot of people realize that a more balanced strategy is better than focusing one way or the other, but it may become a political issue in the next election.

**Mr. Vicharat:** Behind this intellectual debate is a very critical issue that needs to be addressed very quickly: Rethinking the concept of sovereignty and national interest. In the future, if we cannot define in more appropriate terms what we mean by sovereign interests, what we mean by national interests, it will be very difficult to move forward. This issue is not only relevant for Thailand, but throughout the region. We must come to some intellectually acceptable definition of

what constitutes the right form of thinking on sovereignty to take us into the next century.

**Dr. Fuller:** I wonder if you could tell us a little bit about how government is responding to this particular issue of trying to moderate the impact of the crisis on the public, and for that matter, the private sector and the NGO community as well.

**If we cannot define in more appropriate terms what we mean by sovereign interests, what we mean by national interests, it will be very difficult to move forward. This issue is not only relevant for Thailand, but throughout the region.**

**Dr. Pasuk:** The immediate task facing the government is that there is a lot of concern over financial reform and so in the press you tend to see policies that are focusing on that. You see very little addressing the issue of poverty and unemployment. However, Chuan Leekpai has asked Anand Panyarachun to set up various committees to look into some of these problems. Every week at the Thai Development Research Institute, we have a meeting to discuss the problems of industry restructuring, social reform, and the issue of governance. Last week we were looking at the plan of social

reform that was offered by various NGO groups and some of the technocrats. There was a suggestion to strengthen local government and village organizations to cope with the current social issues and to find a way to channel the government budget to these village organizations so that they have access to money directly, in order to improve their economic conditions right now. We must find a way to do that, because the present budgetary system is not able to channel



money to village communities directly, and we have to go through the Tambon Administrative Organization (TAO) or the village council. This is a problematic situation, because the TAO is controlled by the Ministry of Interior.

One of the issues that has not been discussed very much is the question of unemployment among youth—the lost generation of the 1990s, kids who left their villages about 10 years ago at the age of 12 or 14, because of the economic boom. They were employed in unskilled or semi-skilled jobs in construction and factories, but now are out of jobs. They cannot go back home, and even if they do, they will not be able to fit in with village life and agricultural ways. What to do about them? These are the people who have picked up the bad habits of the city, things like drugs and sex services, and they are likely to go into drug trading, sex services, small-time robbery, and things like that. No one seems to have focused attention on that and so the issue has just come up in the last few months.

*Mr. Vicharat:* The issue of unemployment and poverty is actually a very real issue in the financial sector as well. When the FRA closed down 56 finance companies, we effectively put 20,000-30,000 people in Bangkok out of work. That has had a tremendous impact on the middle class. In Bangkok there is now even a market for the formerly rich, where they go to sell off their Mercedes Benzes and their Guccis. The problem is pervasive, it is widespread, and it is not only in the financial sector. A lot of major Thai corporations are reducing their scale of operations, many will be closing down, and some of them who will not be able to restructure will go into bankruptcy. So we are going to see a lot more unemployment problems. But I feel that to deal with it effectively, the government has to have a policy regarding unemployment, social development, and income distribution. But the issue has always been the implementation rather than the establishment of policy. Thailand has

never had any shortcomings in creating good policies, but we have very few implementers among us. In this particular area implementation must be done by the NGOs, not by the government itself. I would like to see a lot more activity at the community level to address issues of unemployment and income redistribution. We have to start encouraging greater activity within this third sector so that we have a more balanced approach to addressing economic problems; we cannot rely on the government alone. The private sector is doing its part, but the third sector is going to become more and more important as time goes on.


**Q** To what extent is the realization of the need for political and economic reform really becoming a genuine consensus across the entire spectrum of the political leadership and, in particular, is there any evidence that the elite and political parties now in opposition are actually internalizing these desires for reform as well? In short, how vulnerable, how fragile, is this new consensus in favor of reform?

*Dr Pasuk:* It is a dilemma in the sense that we need the crisis for reform. It is said that if we get out of the crisis too quickly, the momentum for reform may be lost. If the 50 families that used to control the financial sector can come back in two years, we will probably have it the same old way. However, I think the crisis will be longer than two years, unfortunately, but fortunately for reform. Second, I think there are enough people outside the government who are influential and have the political will, but who have no real vested interest in the whole political process, to continue with reform. I think Anand Panyarachun has become more active politically, but he is outside the government. It seems to me that he has taken up this initiative on the issue of corruption, which surprised me. He said he will continue regardless of whether this government falls or whether or

not the government accepts the recommendations, because a lot of these reforms require a political movement outside the formal political process.

So I think the reform momentum will continue whether or not this government stays. But more than that, I think that within this government there are a few people who really feel that Thailand needs a change or else we will go under. The opposition will, I hope, be discredited and fewer of them will come back in the next election, but it will be difficult, because of the conflict between the city and the country.

**Mr. Vicharat:** I think the prospects now are better than they have ever been, and we have to work with what we have. The crisis demands great equality in the public's demands for the performance of politicians and as long as this crisis remains, people will be more demanding in their perceptions of who should be leading the country. This is the best opportunity we have and we must make it work.

 Some foreign businesses in Thailand are beginning to talk about merger and acquisition deals, but they are running into very serious transparency problems with corporate governance and it is very hard to get down to the real financial situation. They have begun to see the kind of corporate culture clash that I think we are going to see in a lot of East Asia, as foreign money, particularly Western money, comes in and tries to merge a different way of doing business, a Western way of doing business relative to the Asian way of doing business. I wonder if you can comment on how that is going to be worked through and whether you think that is going to be a major problem? Furthermore, how is the success of the new bankruptcy and foreclosure laws evolving and how do you see that working in terms of providing greater confidence for foreign investors?

**Mr. Vicharat:** I think you are quite right that even though there is great instability in the Thai financial system now and lots of people are looking at investment options in Thailand, there is still a hurdle to be crossed: The issue of transparency. This is where Thailand has to introduce best-practice standards into Thai corporate culture. There is a lot of effort now being made to address that and to implement the necessary corporate governance mechanisms. But we are beginning to see more and more deals, some of which will be announced fairly soon. We saw ABN-AMRO going in to take over Bank of Asia, we saw another foreign firm going into participation with a Thai steel company, and I think we will be seeing more and more foreign investments going in. But it is going to take time and we also have to put our house in order in other areas, particularly in the area of legal reform. You also mentioned the bankruptcy law. I think it is going to be passed this week, introducing the American concept of Chapter 11 into Thai law. The foreclosure laws are going to be amended and the policies improved. I think the government has made a strong commitment to move forward and we have to bring our legal system up to par with other developments. You will see other amendments made in regard to the bankruptcy process itself, the foreclosure process, and the judicial process. There is talk now of setting up a business court just to look at bankruptcy and foreclosure issues. The momentum is there and we have to keep that momentum going.

**Dr. Pasuk:** The Japanese are very optimistic about Thailand. Japanese manufacturers in Thailand are doing very well with the devaluation and they are expanding their activities. There was a slowdown for a little while, but now they are expanding again and they are so optimistic that they said to me that they think Thailand could grow at the rate of five percent per annum in two years. I think some American investors are also coming in and our agricultural exports are doing quite well, so that will help a lot.

**Q** What options do you see available for the unemployed, both unskilled and semi-skilled, who were drawn principally to the Bangkok area for manufacturing jobs? If they are not going back to the countryside and there are not many strategies available right now for retraining, what activity is there in the informal sector? What options are available from your perspective for these newly unemployed people?

**Dr. Pasuk:** A lot of effort is being made to accommodate those who can go back home — to help them get employment with their family lands or to do self-employed work. There are still a lot of things they can do in the countryside. The Ministry of Interior is spending a lot of time dealing with these problems. For those who cannot go back, because they are too young or because they do not have any more land, it is a big problem and perhaps this is where some assistance from outside can help with retraining programs. They need subsidies in terms of some unemployment benefits in order to keep them going and to get some training while they are unable to find jobs, because the informal sector will become more limited with so many of them out of work. Although the World Bank is talking about some funds for a safety net, we have not seen a definite plan or program yet.

**Mr. Vicharat:** The issue of unemployment and its social effects will be Thailand's most critical problem over the next few years and that is why it is so urgent to deal with financial and economic reform, because there are very few alter-

natives for the unemployed to turn to; retraining takes time. Thailand is also in the present situation because a lot of its industries are uncompetitive and it takes more than just worker retraining, it takes a restructuring of the corporate sector to make it more competitive. So the sooner we address the issues of economic reform and restructuring, financial-sector reform, and corporate-competitiveness reform, the faster we will be able to turn around the econo-

my, and therefore be able to alleviate social and unemployment problems. In the meantime, we have to take intermediate measures to help alleviate the situation, but I do not feel there is anything in place at the moment to effectively cope with the problems of unemployment.

**Q** In the regional context, one of the striking realities about Southeast Asia over the last 20 to 25 years has been the growth of regional institutions, principally ASEAN and the transfer of national sovereignty to a kind of regional

sovereignty. How is the current crisis playing against that? Are you seeing stresses and strains within the regional context? Is it drawing the region together? What does that mean for definitions of sovereignty and national interest?

**Mr. Vicharat:** I think this is going to be an issue for Thailand and we have to get this resolved before we move on. Globalization requires that we think about what we should accept or not accept, which goes far beyond our original perceptions of what is in the interest of Thailand.

The crisis demands great equality in the public's demands for the performance of politicians and as long as this crisis remains, people will be more demanding in their perceptions of who should be leading the country.

We are operating now, for example, under a situation where we have to accept a lot of the conditions that are laid down by the IMF and the World Bank. How do we reconcile that with our perception of what is in the national interest? If we do not go the right way, we may be in a lot of trouble, as some of our neighbors are. This is an issue that needs to be re-thought and there is no better place than the intellectual community in America to help us think through issues like this. I have no answers, but I feel it is a critical issue that must be answered.

*Dr. Pasuk:* In the end, I think, the crisis will draw us closer to the United States and Europe, but we shall also see increased regionalism. The Thai are very good at implementing dual policies because we do not always put all our eggs in one basket. We will see greater regionalism on the issue of currency policy and closer relationships between the central banks of the region, again relating to the question of currency and how to help one another in times of crisis. The present crisis has shown that the country and the region must find a way to cope with the problems themselves first before looking to the U.S. or Europe; Europe is now paying no attention to Southeast Asia. The United States will still have an interest in the region, but its attention in recent years has been focused on China and Latin America. The underestimation of the impact of what happened in Thailand has shown that there are not many people in the U.S. who are watching or deeply understand what is going on in Southeast Asia. And that realization also makes people in that part of the world feel that they have to think about things themselves

The present crisis has shown that the country and the region must find a way to cope with the problems themselves first before looking to the U.S. or Europe.

more. That is why I think you will see that we will become closer to the United States, because the U.S. is the world power, and it is still our largest market, our good old friend. Whatever happens, we still have to rely on a world power for leverage on certain things such as trade negotiations and in our geopolitical dealings in the region, and at the same time, you will also see greater regionalism. The crisis has given rise to new ideas about how the roles of China and Japan may change. China's reaction to the currency crisis

has earned quite a lot of credit in the region. We were a bit disappointed about Japan being so much a part of the United States, but we still have to rely on Japan, because it is the most important in terms of the overall foreign direct investment in Thailand now. And I think we will see a greater role by Japan in initiating some changes on the currency policies in the region.

*Dr. Fuller:* What are some of the things that you worry about when you look at other parts of the region? It is true we have not talked about Japan, China, and other parts of Southeast Asia and the secondary effects of difficulties there on Thai markets. Secondly, if we could ask you to look out five years and give us your best expectations: How long is the transition, the workout, going to take? And Dr. Pasuk, I wonder if you could return to this topic of values for a moment and perhaps categorize some of the changes that you have seen in the value structure of Thailand, and how that may be supportive or not supportive of further political change and perhaps more transparency, more openness, and less corruption.

**Mr. Vicharat:** The most critical issue facing Thailand from a regional perspective is the issue of competitiveness. We have to accept that we have lost competitiveness in a lot of our real sectors. It is not only the financial sector, but also out in the real sector and we have to address that issue very quickly because the competition is very strong regionally. When China devalued the renminbi in 1994, that started to paint the picture on our wall: If we did not become a lot more competitive, we could not compete in our export sector, and that is exactly what happened. So we have to deal with the competitiveness issue.

Five years down the road, I hope if the momentum for reform continues, we will see a very different Thailand. I think we will have sorted out the problems within our financial system. The financial monopolies in the hands of some families will have been diluted to a large extent. I think if we are successful in building our competitiveness, we will see a major restructuring in the corporate sector as well. There has been a tremendous amount of complacency within the corporate sector itself and I think events this year will address those issues.

But the most difficult problem facing Thailand is restructuring the public sector. There has always been a lot of talk about reforming the government, reforming the bureaucracy. In the past, I have seen very little implementation. We hope we have the commitment from this government and future governments to continue with reform in the public sector, but that is going to be the biggest question mark. That is going to be the picture that is most unclear as I look five years ahead.

**Dr. Pasuk:** The expectations of people regarding the roles of politicians have been changing very rapidly. People are demanding that politicians play a greater role in doing things for society and not only for themselves, they are demanding that economic policymaking become more transparent. At present, the prime minister has asked Anand Panyarachun to

look into how to stop the collusion in bidding for government contracts. On the issue of corruption, people are still confused about what is corruption and what is not. However, in our study we found that although they are confused about small things, like whether it is corruption to give a small bribe to a traffic policeman to get out of having to pay a fine, they are quite clear that politicians should not take commission fees on contracts. And they are very clear that politicians should not appoint their brother to be a senator.

Politicians, however, are changing too slowly — the people are changing faster. However, I believe that the proliferation of civil society in Thailand has become rather strong, much stronger than any other country in the region, maybe with the exception of Korea or Malaysia. And this civil society will push for change.

**Q** I've been a little surprised at the amount of optimism that has been expressed, not about Thailand's economic recovery, but about political reform, about the ease with which some of the problems like rural poverty might be addressed through new government programs and so on. If the new constitution does work, what happens to governance in Thailand? Is there going to be much capacity to get anything done? Is there going to be a government with the capacity to act in the face of vested interests, to do the kinds of things that are going to be necessary to increase equality in Thailand?

**Dr. Klein:** I think most Thais are very optimistic about the process, except the opposition politicians, and they are very pessimistic about the process. There is a very strong and growing civil society in Thailand that 10 years ago really did not exist. There were attempts at constitutional reform in '46, '73, '74, and the early '90s, but it did not happen because the social support was not there. It is there now and that is a key factor, because civil society exists in Thailand.

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In Malaysia, Indonesia, Burma, or Vietnam you are not going to find those types of organizations. In Thailand they are strong, in the countryside, and at the grassroots level. Rural people tend to send corrupt politicians to parliament, although now there is a change at the rural level in part because this constitutional debate was carried out in the countryside.

That was one of the most remarkable things about the constitutional drafting process: For nine months it was all that anybody talked about, although few understand it, because it reads like a legal document. One of The Asia Foundation's projects right now is to try to convert this document into simple language. One of the programs that the Foundation supported was the Women's Network for the Constitution, a consortium of about 45 NGOs that wanted a gender-sensitive document. They fanned out throughout the countryside for seminars, workshops, and public hearings on constitutional issues. There were two months of public hearings on the draft constitution and how it should be amended, and changes were made, although it is not a perfect document. Ten years ago, however, you would not have had this type of open public debate.

*Dr. Pasuk:* The issue of equity concerns the problem of income distribution in Thailand. Education differentials are significant—80 percent of our labor force still has only an elementary education. But things are changing quickly—now compulsory education up to the lower secondary level has been implemented. Many efforts are being mobilized to get kids to remain in school longer and there are scholarships being provided for families who cannot afford to keep their children in school. Now people can borrow money at a very low interest rate to go to secondary school and repay it after they get a job, which helps a lot of people. However, it is still not good enough, because it does not help the very poor, who cannot afford to pay the interest, but it does

make some difference. One outcome of this change in the availability of educational opportunities has been a reduction in the number of girls entering the sex industry within Thailand. The result is that Thai agents now acquire girls outside Thailand to provide sex services, although there are a lot of campaigns against this practice.

The other major issue is land rights. Somehow, bureaucrats have this mentality that they do not want peasants to own land, although peasants are constantly protesting in front of parliament or Government House over the issues of land, agricultural promotion, and greater autonomy in the management of local resources. No government can withstand this kind of pressure very long. Changes need to be made, although it may take some time. Throughout this process, it is important to retain this framework of parliamentary democracy so that this civil society can push for change.

*Mr. Vicharat:* I think the new constitution is unique—it is about as revolutionary as the 1932 constitution that established the constitutional monarchy. We have to take an unconventional approach to thinking about how we go forward with this new constitution and really start with a clean slate—which is an opportunity that it provides whereas other constitutions did not. If it means that in the future we will have government downsizing, I think that is all the better.

*Dr. Pasuk:* Just to show you the extent of change which is taking place in Thailand, recently Dr. Ukrit Mongkolnavin was chosen by the present senate to be a member of the Constitutional Court. However, certain people came out to oppose this on the grounds that his political stand is not liberal enough, and they cited his past behavior during 1973 and 1976 as evidence of his biased political stand and that he is not suitable. This forced him to voluntarily come out in public to try to clear himself. It is like a voluntary public

hearing. This process was ongoing for a little while. He came out to answer to the allegations of the opposition, and the opposition came out with more evidence. He came out with more apologies and tried to talk about himself, and his supporters also came out to support him. But in the end when all this evidence came out in public, I think he was forced to decline. This is very, very unprecedented in Thailand. Apparently he did not earn his Ph.D., but received an honorary doctorate.

There is a qualification in the constitution which states that if one comes from academia, you must be a full professor to be recruited into the commission. He was an honorary professor and that was a legal point.

**Q** Some observers have noted that the new constitution seems to be prodemocracy, but antipolitical. Constitutions can sometimes react or overreact to the excesses of the past and I am wondering if this constitution has not overreacted to the past abuses of politicians and political parties.

Is it putting too much reliance on a very nascent civil society? What does the constitution suggest, both implicitly and explicitly, about the future of political parties in Thailand?

**Dr. Klein:** I do not see this as an antipolitical party document, I see it as a charter that attempts to bring balance back into the system. If you are a politician, you are going to see this as an antipolitical document, although I think it provides balance. There are three organic laws governing

the political system that will define the boundaries of political and electoral activity. The reforms are attempting to eliminate the abuse of the system, to keep the godfathers from controlling the political parties—that is the bottom line. Many of the political parties had in essence been taken over by provincial businessmen who made their fortunes under shady government contracts, underground lotteries or smuggling and tried to buy political legitimacy, which is a

process that has corrupted the party system. This charter is supporting the political party system by cleaning it up, because it was really dirty. So there are a lot of politicians who do not like it, but they will not be running in the next election.

**Dr. Pasuk:** It is true that this constitution is a reaction to the present political system and to that extent it is against so-called “dinosaur politicians”—we have lots of these very corrupt politicians who have been brought into the system through the old political structure. The constitution is designed to weed them out

and hopefully it will bring in new blood, more professional politicians. After we use this constitution for the next five to 10 years, there will be a movement to change it again. One of the flaws in the charter is that it prevents people who do not have bachelor's degrees from becoming parliamentarians. There was a very strong reaction from city people who were sick and tired of provincial businessmen who perhaps had not gone to school, but rose as wealthy entrepreneurs and cheated their way into politics by buying their educa-

There were two months of public hearings on the draft constitution and how it should be amended, and changes were made, although it is not a perfect document. Ten years ago, however, you would not have had this type of open public debate.

tional certificates or supporting their sons or colleagues to become politicians. One of the criticisms is that this change is going to discriminate against a lot of people from the countryside who are qualified to be good politicians, but who may not have completed an undergraduate degree.

The other flaw that I can see is the party list: The new constitution has a provision that about one-third of the parliament can come from the party list. Therefore, we have a two-tiered system of elections:

When you go to the polls, you cast a vote for a party and you cast a vote for a parliamentarian.

When you cast a vote for the party, that means you choose from the party list, a candidate on the party list who is not running in the election. A lot of people who would be invited to join the party list would be businessmen and retired technocrats. So one wonders whether they will be good politicians. Will they buy their way onto the party list? I can see that in five years there will be agitation for change if it turns out that the system doesn't

work. However, at the moment it is still the best constitution we have ever had.

**Mr. Vicharat:** I find it hard to imagine that one could overreact to the past abuses that politicians have committed. The bottom line is that the new constitution is demanding accountability and transparency, which is critical. The abuses have been enormous in the past and the constitution addresses that issue quite fairly.

**Q** This is a constitution that does a lot of defining about who cannot participate. What I have heard is that there is a lot more in this document that prohibits rather than enables. Is this a constitution that establishes the legitimacy of the government? Is this a constitution that defines that power is from the people, as our constitution does? Is there really a "we the people" feature

of this constitution in a meaningful sense? If that is not there, then it seems to me it is not a revolutionary document.

Freedom of the press and the politicization of people over the last few years, particularly with the televising of the constitutional debates, has enabled people to learn quickly and they are the ones who are going to create changes.

**Dr. Klein:** I think you need to look at the third part of the charter: Citizen participation in governance. That is the revolutionary aspect of this constitution, because people are given basic rights and freedoms to participate in the policymaking process. Under the state duties section of the constitution, it says the government must have public participation in the process. Thai citizens in the past participated only by voting, although occa-

sionally they demonstrated against the military. This document enables public participation and it does not just say that people have the right to do this, it says they have a duty to participate. So, it is good from that standpoint. As for any pro-democracy, antipolitics bias, as they say, "It ain't a perfect world."

In the past, when things went bad in Thailand, nothing happened in terms of reform, because there was nothing coming into the system to force reform, other than what the bureaucracy wanted to pursue. What this charter does is



create a system under which the reform process can be discussed. Like Dr. Pasuk's work, five years ago you did not talk about corruption in Thailand if you wanted to stay out of jail or you wanted to have your car go safely down a road late at night. But now it is a public-policy issue and anybody can talk about it. There are going to be problems under this new system, but the issue is that now you can talk about them, as well as about options for reform. That is very different from the old system, in which people could not talk about the problems and they had no part in resolving them. Although constitutional reform did not work in the 1970s, that is because liberals in the bureaucracy were unable to change the structure in 1973, '74, and '75. Now they are systems for reform and that is one of the reasons structures are being changed.

*Dr. Pasuk:* There will always be corrupt politicians. Before we could not expose them and we could not bring them to trial. Under the new constitution we can—that is why your system is working. America has corrupt politicians too, no doubt, as well as the United Kingdom and France or anywhere else. It is not unique to Thailand that we have corrupt politicians. But at least those countries have a legal frame

work, through which you can bring them to trial. But we never had this and the new constitution is creating that. One of the philosophies of this constitution is to try to establish the rule of law in Thailand. Up until now we did not really have a system of law, because we never had an independent judiciary. But there are many provisions in this constitution that will enable us to pursue reform and bring Thailand under the rule of law. Freedom of the press and the politicization of people over the last few years, particularly with the televising of the constitutional debates, has enabled people to learn quickly and they are the ones who are going to create changes.

*Mr. Vicharat:* There is a saying that where you stand depends on where you sit. For Thailand and Thais, our back is really against the wall and there are very few options for us, so we've got to adopt a very unconventional approach and unconventional thinking. There is no room for skepticism, that is a luxury that will come later. We have to move forward with a very strong commitment to optimism and that is the only position we can take from where we currently sit. 🍀

# The Participants

## **William P. Fuller**

President, *The Asia Foundation*

Dr. Fuller is president of The Asia Foundation. Prior to joining the Foundation in 1989, he served as Deputy Assistant Administrator of the U.S. Agency for International Development (USAID), where he was responsible for U.S. foreign assistance in the Near East, and as Director of the USAID mission in Indonesia.

From 1971 to 1981, Dr. Fuller served with the Ford Foundation in Asia, first as an advisor to the National Education Commission and Ministry of Education in Thailand, then as the Foundation's Representative in Bangladesh. Dr. Fuller has also worked with the World Bank-UNESCO Cooperative Program in Paris and with UNICEF in Beirut, Cairo, and New York.

He received a B.A., M.A., and Ph.D. from Stanford University. He also holds an M.B.A. from Harvard University.

## **James R. Klein**

Representative of Thailand, *The Asia Foundation*

Dr. Klein serves as The Asia Foundation's representative in Thailand. For 25 years, he has closely followed political, economic, and social currents in Southeast Asia. Prior to his current position, Dr. Klein served as The Asia Foundation's Representative for Cambodia and Malaysia. He has also served as the Foundation's Assistant Representative in Thailand and Director of the Laos Programs.

Dr. Klein holds a Ph.D. in Southeast Asian History from Northern Illinois University.

## **Pasuk Phongpaichit**

Professor of Economics, *Chulalongkorn University, Bangkok*

Dr. Pasuk is Professor of Economics at Chulalongkorn University in Bangkok, Thailand, and a consultant for the Thai National Assembly's Special House Committee on the Illegal Economy and its Suppression. She is the author of several works on the Thai economy, Japanese investment, and corruption.

Dr. Pasuk's studies on corruption (supported by grants from The Asia Foundation) *The Illegal Economy: Money Laundering and Thailand's Public Policy* (1998), and *Corruption and Democracy in Thailand* (1994) provide the essential data required to design policies which can eliminate illegal sectors such as the trafficking of women, prostitution, gambling, and narcotics, and reduce the corruption which enables them to exist.

Other recent publications include *Thailand: Economy and Politics* (with Chris Baker, 1996), and *Thailand's Boom and Bust* (with Chris Baker, 1998). Dr. Pasuk holds a Ph.D. in Economics from Cambridge University.

## **Vicharat Vichit-Vadakan**

Secretary-General, *Financial Sector Restructuring Authority, Thailand*

Mr. Vicharat is currently Secretary-General of the Financial Sector Restructuring Authority (FRA), Deputy Chairman of the Securities Analysts Association, Chairman of the Asian Securities Analysts Federation, and Advisor to the Board of Directors for the Eastern Water Resources Development and Management PCL.

Previously, Mr. Vicharat was Vice-Chairman of the Board of Governors for the Stock Exchange of Thailand and has held senior positions in the Office of the Prime Minister's Budget Bureau, the Ministry of Finance, and the Securities and Exchange Commission of Thailand.

He has also represented Thailand as Member of the Governing Council in the ASEAN Valuers Association. Mr. Vicharat received a B.A. and an M.A. in Political Science from the University of California at Berkeley.





THE ASIA FOUNDATION

465 California Street, 14th floor  
San Francisco, CA 94104 USA  
*Phone* 1 415.982.4640  
*Fax* 1 415.392.8863  
*E-mail* [info@asiafound.org](mailto:info@asiafound.org)

1779 Massachusetts Ave., NW  
Suite 815  
Washington, D.C. 20036 USA  
*Phone* 1 202.588.9420  
*Fax* 1 202.588.9409  
*E-mail* [info@dc.asiafound.org](mailto:info@dc.asiafound.org)

[www.asiafoundation.org](http://www.asiafoundation.org)