

Make Poverty History: Tackle Corruption

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EXECUTIVE SUMMARY

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- Corruption is a blight on social stability and economic growth. The abuse of political power for private benefit is profoundly unjust to those who are honest or poor. This is now recognised in a new UN *Convention Against Corruption*, which entered into force in December 2005.
- The recently published *2005 Corruption Perception Index* offers credible estimates of corruption levels in 159 countries. It reveals huge international differences. Poor countries tend to be more corrupt than developed, affluent countries. Some countries have improved standards of probity in government over time (including highly ranked Australia and New Zealand); others have let matters slip (including the United States, Japan and major European Union countries). Most Third World and many ex-communist regimes are graft riddled. In Australia's neighbourhood, corruption is pervasive, including in Indonesia and Papua New Guinea.
- Countries with poorly protected private property rights, over-regulated markets, and a poor rule of law tend to suffer more from entrenched corruption.
- Rich natural resources, notably oil and gas, facilitate corruption and hence political instability, and possibly even government failure. This is a serious concern for the West, which will for some time yet depend on resource imports. The *Corruption Perception Index* also shows that, unfortunately, Western military intervention in Afghanistan, East Timor and Iraq has not been able to create honest government—rather the opposite.
- Foreign aid also tends to facilitate corruption. Attempts to improve accountability in foreign aid, though costly, are becoming more common, because simply disbursing aid to kleptocratic regimes has debased the institutions essential for economic growth and has entrenched corrupt elites.
- Ruling *privilegentsias* frequently draw on nationalist and socialist sentiments to defend their privileges and to combat openness and transparency. Anti-globalisers now lend them support.
- For a long time, corruption was accepted with fatalistic resignation. But now the global spread of originally Western, liberal worldviews has changed attitudes in many parts. There is now a new optimism among the emerging middle classes of many countries that graft can be cured. Countries as disparate as Singapore and Estonia have demonstrated that this is the most promising path to promoting economic growth and thus eradicating poverty.

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'*Optima corrupta pessima*' – 'The best things, once corrupted, become the worst'.
Latin proverb

'The more laws are decreed, the more will become thieves and bandits'.
Lao-tse (4th or 3rd century BC)

Corruption, justice and prosperity

The above quotes illustrate that corruption—the abuse of political power for private gain—has been a bane of ordinary people in East and West since time immemorial. There was a tradition of fatalistic acceptance that greasing the palms of officials is necessary to grease the wheels of government. A little graft was considered an expression of good will toward underpaid officials or a legitimate form of competition. Resignation about corruption was accepted by most religions. It is for example mirrored in many passages of the Talmud and the Bible, beginning with Genesis (IV, 2): 'God looked upon the earth and, behold, it was corrupt; for all flesh had corrupted His way upon the earth.'

Nowadays, corruption is increasingly seen as an affront to the notion that all men are born equal to pursue their happiness with all the means they can legitimately marshal. This individualistic notion gained popular acceptance originally in the West during the Enlightenment. It had consequences for the roles of citizens and rulers. These were, for example, spelled out with great clarity in the pioneering 1776 *Pennsylvania Declaration of Rights*: 'All power being derived from the people: therefore all officers of government, whether legislative or executive, are the trustees and servants and in all times accountable to them'. In other words, the citizens are the principals and the officials no more than their agents, who are expected to act honestly. Since the Second World War, this democratic spirit has been spreading around the globe—albeit often as an aspiration, rather than a reality.

The philosophers of the 18th century, such as Adam Smith, fought a major struggle of their time when they characterised corruption as morally wrong. Their teachings are now spreading around the world and underpin a new optimism that graft can be cleaned up. The Organisation of Economic Cooperation and Development (OECD) and the World Bank have urged member governments to make bribe paying to foreign officials and firms a criminal offence. At the end of 2005, a United Nations *Convention Against Corruption* came into force, which is intended to make money laundering more difficult and the retrieval of stolen funds easier. Given the past record with UN conventions, it is not yet clear whether poor countries will embrace the Corruption Convention's laudable standards. Exporters from OECD countries have sometimes argued that this puts them at a competitive disadvantage vis à vis corrupt local competitors, but some OECD governments have nevertheless made corrupt dealings by their nationals a punishable offence. They have done so because they recognised that corruption creates unjust privileges for well-connected elites in government and industry, and unjustly disadvantages all other citizens. Corruption is also an obstacle to genuine competition by price and quality, and hence to economic growth.¹

Those who tolerate or even promote corruption debase the institutions, which are an essential condition for economic growth. They perpetuate poverty, injustice and misery. Competitors, who rely on corruption to promote their business, betray the fundamental conditions of the market economy, for the modern division of labour depends on the exploitation of what people know, and not on who offers the biggest bribes. Wealth creation is based on technical and commercial knowledge and its effective communication through market signals that guide effective specialisation and innovation. For this to happen, markets have to be based on trust among strangers. Corruption poisons this foundation. It invites decisions to be made on the basis of whom one knows and not what is known to be best. Corruption in business also invites costly regulations, which make the market signals less efficient.

**Corruption—
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gain—does
not have to be
tolerated.**

The development experience over the past half-century shows that poor economic growth is not the consequence of a lack of natural resources, capital or other resources. All economies that have failed to grow have in common that poor rules of coordination of social and economic life—institutions—stood in the way of saving, investment, resource exploration and other entrepreneurial efforts to mobilise productive forces. The *doyen* of development economics, the late Lord Peter Bauer, said it clearly: ‘Economic performance depends on personal, cultural, and political factors, on people’s aptitudes, attitudes, motivations, and social and political institutions...’² The institutions matter so much because the growth process requires the coordination of many people with special knowledge, who incur transaction costs and take risks to explore new and better ways of doing things. One hardly has to add that economic growth has wiped out many traditional ills which have long plagued humanity: high child mortality, arduous toil, recurrent hunger, disease, grime, ignorance, perpetual discomfort and boredom, early aging and short life spans.

What matters for economic growth is not only the quality of the institutions, but also how effectively and even-handedly they are applied and enforced. Some rules are enforced within societies: cheaters are, for example, shunned spontaneously and lose their reputation, liars are reprimanded, and so on. Other rules are designed and enforced by political action from above: Governments legislate to protect life and private property; they organise a judicial system and a police to enforce these rules. Activities, which cause harm to others, are made subject to government licenses; and so on. In the case of such political rules, societies empower agents of government—for example the judiciary, administrators, and the police—to enforce the rules. These agents are given monopoly powers of legitimate coercion, and it is essential for justice and prosperity that these powers are applied without fear or favour, and without the agents of government exploiting them to their own private advantage.³

Communities, in which coordination is achieved mostly by rules internal to society and by spontaneous enforcement and therefore with limited reliance on the external rules of government, tend to operate more effectively in attaining economic growth and equal opportunity than communities that are governed by a heavy hand and subjected to numerous prescriptive rules. This is so precisely because the agents of government often yield to the common human temptation of self-seeking opportunism and act corruptly. After all, the agents of government are always able to exploit the public’s lack of knowledge of all the details and circumstances of particular matters to promote their own interests at the expense of the general public (corruption).

Once entrenched, corruption has pervasive effects and perpetuates itself. One example is the open or secret sale of commissions and positions, such as jobs for school teachers and policemen. I have seen first hand in Indonesia how parents have to buy jobs for their educated sons and daughters, often at a considerable financial sacrifice. Once the job is acquired, it ‘belongs’ to the successful candidate who then does not need to retain it by ongoing performance. In addition, the ‘investment’ has to be retrieved by the family through selling preferential treatment or collecting ‘dues’, which are a return on the investment in the job. Calls for promotion by exam and merit are then perceived as moves to deprive officials of rightful returns on their past ‘investments’. Such reforms cannot be enforced from the outside; they can only be tackled by local reformers.

It is a well-established fact that the incidence of official corruption correlates with economic freedom, that is, how reliably the institutions secure private property rights and the freedom of their use and how impartial and reliable the country’s rule of law is. Heavy and detailed regulation, which affects private incomes and wealth all the time, is a precondition for pervasive graft. Indeed, one cannot resist the conclusion that some regulations are put in place predominantly to enable people in power to extract bribes. Economics Nobel laureate Amartya Sen, who correctly perceives the economic development of poor countries as liberation, has argued that unilateral deregulation in developing countries is justified by the collateral reduction of corruption, irrespective of

Measurement and international comparison are useful for fighting official corruption.

whether it confers other benefits.⁴ Honest government also contributes to trust among the people.⁵

The central role of institutions for economic growth, which was identified by Adam Smith, was not understood for a long time during the 20th century, neither by theorists nor by policymakers. Austrian institutional economists, such as Peter Bauer, were in a small minority. But since the 1980s, the evolutionary-institutional approach has gained ground and has had the major influence on policymaking and reform.⁶ Recently, even some international organisations have begun to pay serious attention to institutions and their honest application. Thus, the 2005 issue of the International Monetary Fund's *World Economic Outlook* focuses on 'Building Institutions' (chapter 3) and states: 'Higher growth depends on ... stronger property rights, lower corruption, and better governance'.⁷ This should have important consequences for their policies, for example how foreign aid is transferred to countries with poor institutions.

One fundamental point bears reiterating: Differences in public attitudes to corruption and economic freedom spring from a fundamental dichotomy of worldviews. The modern Western view, which holds individuals to be the principals and their interests as predominant in the business of governance, contrasts with the view of political elites in most traditional and non-Western societies. They consider themselves as the principals and 'their' people as a resource to be exploited to promote their power and wealth. Globalisation now spreads the individualist worldview. People around the world now attack the selfish interests of the powerful elites as corruption and their voice can be less and less suppressed.

Measuring and comparing corruption

Scientists can always learn a lot, and give better advice, when the phenomena about which they theorise can be quantified. This also applies to the nexus among economic growth, economic freedom and corruption.

The measurement of national incomes and products (GDP/GNP) can rely on a well-established methodology and accepted standards, which have been refined by international organisations over many decades. International comparisons of per capita incomes may be based on exchange rates or estimates of purchasing power parities, which for most purposes reflect reality more realistically. Of course, national accounts statistics come with a margin of error, but they have proven sturdy and are widely accepted.

The quality of the institutions that make for economic freedom is more difficult to measure and compare internationally, for of necessity it involves subjective judgements and relies on small samples. As more economists became aware during the 1980s that the institutions of economic freedom were of great importance, several efforts were initiated to estimate the quality of property rights and governance, the freedom of labour, capital and product markets and their openness to international competition. Since 1986, the Fraser Institute in Vancouver, Canada, has coordinated a major international effort to develop an agreed methodology and gather relevant information about standards of economic freedom. The data have found wide acceptance and have furnished valuable insights in support of free markets and personal choice. A similar effort has been carried out by the Heritage Foundation in Washington, DC, in conjunction with the *Wall Street Journal*. Although the methodologies differ, the results of both undertakings tell virtually the same story: Economic freedom is good for growth and high living standards.⁸

The degree of corruption in rule enforcement did for a long time not receive the same attention. This gap has been filled over the past decade by a project to estimate annually the levels of dishonest dealings in politics and administration, the Corruption Perceptions Index (CorrPI). It is being compiled—in cooperation with Transparency International, a think tank which publishes annual *Global Corruption Reports*—at the University of Passau in Germany under the direction of Professor Johann Graf Lambsdorff.⁹ The Index—in conjunction with the analyses and case studies in the annual *Global Corruption Reports*—is intended to strengthen the resolve of the electorate and its political, judicial and administrative agents to fight corruption.

As of 2005, the information covers 159 countries, albeit on a rather uneven basis of primary surveys. For a considerable number of countries, the CorrPI scores go back to the early 1980s, so that some long-term trends can be gleaned from the data base, as long as one keeps in mind that there have been changes in coverage and the quality of information over that time.

Because actual corruption is impossible to know and measure, the estimates of corruption are based on the perceptions of experienced businessmen and local analysts. Legal statistics, for example convictions for graft, cannot be used, because they may reflect standards of probity, the quality of surveillance or the commitment of courts to enforce the law. The 'Corruption Project' has found time and again that foreign and domestic business leaders and analysts tend to have an accurate perception of the standards of probity in a country's governance.¹⁰

The incidence of corruption around the world

The 2005 Corruption Perception Index, published in late October, will offer policymakers numerous relevant insights. It certainly puts quantitative substance to the introductory considerations touched upon in the opening paragraphs of this paper.

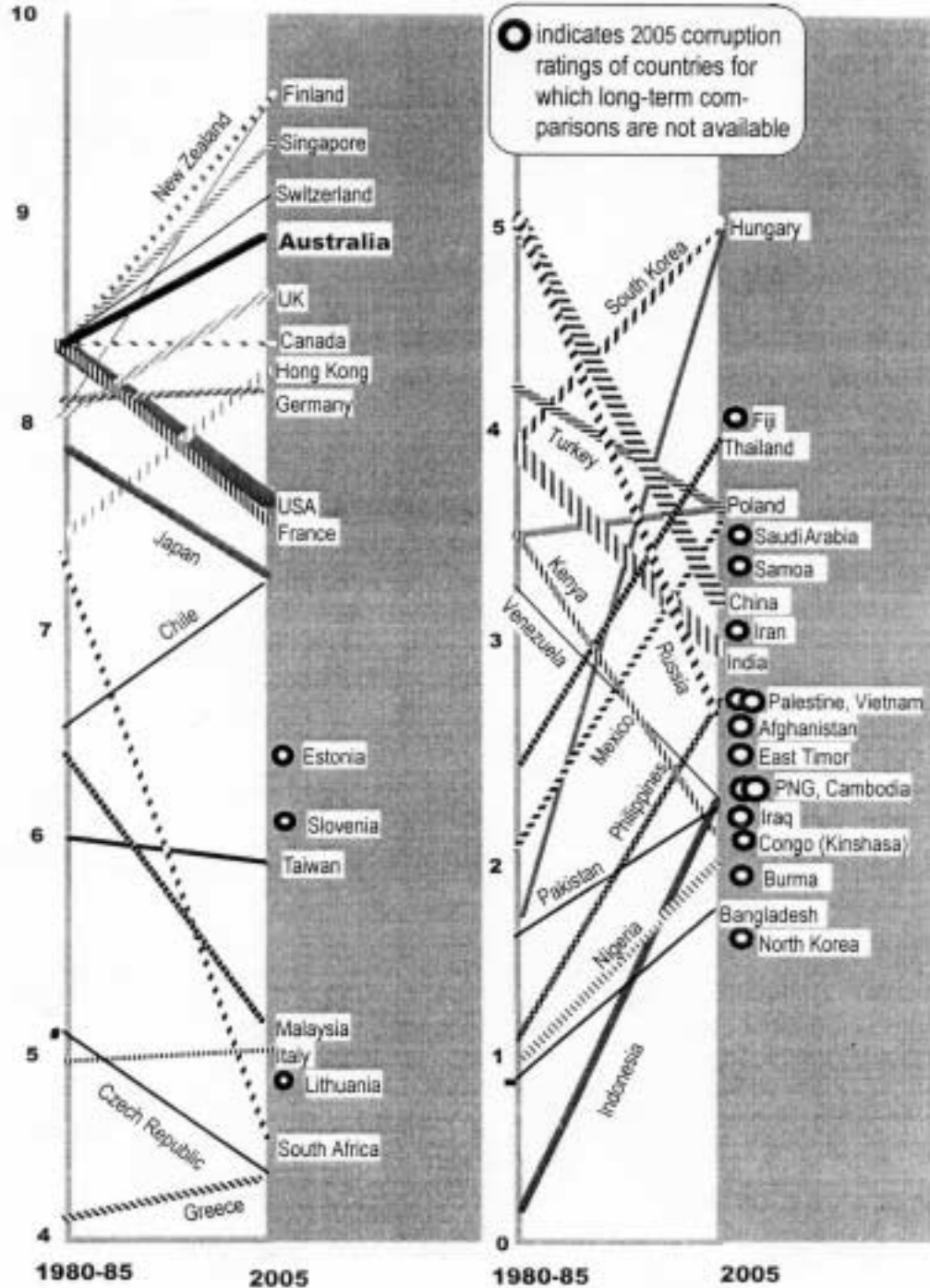
Graph 1 (p.6) shows 2005 estimates of the CorrPI compared with averages for 1980–85. In addition, the graph contains 2005 estimates for some countries, for which such long-term data series are not available.¹¹ The highest ratings reflect the best standards of probity in government, and vice versa. Intertemporal comparisons of corruption have of course to be handled with a grain of salt because of changes in methodology and their subjective nature. Nonetheless, the information is most instructive:

- The dominant impression is that the developed, affluent countries generally rate much better on the CorrPI than the less developed countries. The association between income levels and corruption levels does of course not tell us anything about causation, but it seems plausible that there is circular interaction: Countries are poor because their rulers are highly corrupt; and poor living standards invite corruption.
- Nevertheless, standards of honesty in governance have in many instances changed over recent decades in rich and poor countries alike. Some have improved on early-1980s levels of corruption; others have let standards slip. Thus, corruption is perceived to have been on the rise in relatively well-governed countries (shown in the left-hand panel of Graph 1), such as the United States, France, Japan, South Africa and Malaysia, as well as in traditionally much more corrupt countries (shown in the right-hand panel of Graph 1), such as China, Russia, Turkey and Kenya. Other countries have managed to improve their ratings, for example Australia, New Zealand, Finland, Chile, Hungary, and Indonesia.
- Australia was ranked amongst the least corrupt nations (in eighth place in 2005), having improved its rating since the early 1980s. New Zealand ranks even better in 2005 (equal second after top-placed Iceland), having improved even more over time.
- The well-placed Anglo-Saxon and North European countries (not all shown in the graph) have generally improved, though not the United States.
- Some European countries, such as Germany and France, which have been plagued by economic stagnation and political discontent and which attain only middling corruption ratings, seem to be drifting towards serious problems in governance.
- The European Union project of welding together governance cultures with widely differing honesty standards is confronted with huge and sometimes widening gaps in the quality of governance. Divergent corruption standards will make it harder to meet the EU objective of income equality. The objective will probably require high and sustained transfer payments from the honest and affluent to the corrupt and

The Corruption Perception Index 2005 has been compiled for 159 countries.

There is much more corruption in poor than in rich countries, such as highly rated Australia.

Graph 1: Corruption Perception Index 2005
 Selected countries, 2005 and averages 1980-85
 Ratings from 1 (most corrupt) to 10 (least corrupt)



Sources: Global Corruption Report 2005, ICGG website

poor. Perceived differences in corruption—and differences in the alacrity with which subsidy takers in different countries exploit the rules made in Brussels—have indeed begun to play a major role in the growing popular rejection of an ‘ever closer and wider’ European Union.

- The communist countries had very low standards of probity. Since the fall of communism, they have coped with endemic corruption in differing degrees: Hungary is a remarkable example of success; Estonia, Slovenia and Lithuania now rank among the less corrupt developed countries. On the other hand, perceived honesty standards in Russia, Poland and the Czech Republic have slipped badly. This probably reflects, at least in part, greater transparency of the apparatus of government. Yet, even if part of the deterioration is attributed to a growing recognition of the problem, these cases suggest that coercive central-command systems still linger or that the void, which the abandonment of central planning left behind, has not been filled by institutions and enforcement mechanisms that support an effective market economy and a free society. Constructing an effective order may prove to be even more difficult than undoing socialised ownership and pervasive regulation.¹²
- Developing countries in general suffer from high levels of corruption. The notable exceptions are now-affluent Singapore, Hong Kong, and Taiwan. South Korea—once considered one of the most corrupt regimes in the world—now explicitly targets a top rating on the CorPI as a policy objective.¹³

Corruption and underdevelopment

The still woeful standards of honesty in Third World governance go a long way to explain the persistence of poverty. The morality of corruption control, which the writers of the 18th century European Enlightenment emphasised, has apparently not yet been widely understood in most of the Third World. Corrupt practices are still ‘deeply steeped in local tradition and culture... They are, moreover, at the core of the... political system ... [Reforms] can potentially threaten the interests of the wealthy and powerful elites’, as Francis Fukuyama wrote in his Foreword to last year’s Global Corruption Report. He observed further that ‘even the most optimally designed institutions will not prevent corruption if a society’s norms say it is acceptable to take bribes, or if the country’s elites regard politics as an arena for self-enrichment’.¹⁴ He adds that even when enlightened outsiders point out the urgent need to fight corruption, it can ultimately only be stopped by local polities. If one thinks through this line of argument, one has to conclude that, in the era of globalisation, poverty is a matter of choice. Alas, the choice is made by the political elites and their powerful cronies—and the poverty persists for the down-trodden masses!

In some poor countries, political leaders have emerged who placed a high priority on overall economic growth and took the long view that prosperity for all is a source of legitimacy and strength. Sometimes, they were inspired by international threats and rivalries, such as in East Asia when communist China loomed large, and by a genuine concern to lift the people from poverty. The desire for economic growth motivated policymakers to institute the rules of a free, open economy and to invest in education. As a materially secure middle class emerged, political freedom was seen as highly desirable and newly affluent generations began to stand up to traditional corruption. With a growing economy and a broader tax base, governments were able to pay civil servants better, which also helped to reduce corruption. This happened not only in Singapore, Hong Kong, Taiwan, and Korea, but is also happening to some extent in Chile, Mauritius and Botswana, countries that are graduating from the Third World to the First. The process often began with the actions of autocrats—such as Lee Kuan Yew in Singapore, Park Chung Hee in Korea and Augusto Pinochet in Chile—and produced sustained economic growth, a gradual improvement of the political, economic and civic institutions, and their non-corrupt implementation. Like before in European history, economic reforms initiated by autocrats have had unintended long-term side effects for political freedom.

For the ex-communist countries, poor corruption ratings have become even worse, but some have cleaned up their administrations.

Developing countries that cleaned up corruption are graduating from the Third to the First World.

Corrupt regimes deny citizens their freedom and default on official debts.

The great challenge now is to persuade traditional and new elites in other developing countries that economic growth requires not only institutional reform (the shaping of those rules that underpin economic freedom), but also a decisive attack on corruption (the transparent, even-handed application of these rules). This is not easy because the takeoff into economic growth typically brings new opportunities for corrupt dealings, and bureaucracies multiply, creating regulations which offer still more such temptations.¹⁵ Bribes also become more costly. Where the standard pay-off for a favour from a public official may once have been the equivalent of a radio, officials now demand a family holiday in London or a villa in Sydney. On this critical front, the Global Corruption Reports and the CorrPI equip the young generation of corruption fighters in transition economies with valuable inspiration and benchmarks.

Perceived corruption in government is very high in Africa. African underdevelopment has this year become the focus of renewed major efforts to disburse more official aid and cancel overdue debts. It does not surprise that corruption-riddled governments of stagnating economies show little inclination to repay loans. The highly indebted, poor African countries—as well as Burma and Vietnam—invariably also display the worst corruption ratings. When outstanding loans from the World Bank and other official agencies are simply forgiven or serviced by the taxpayers of affluent countries, this creates ‘moral hazard’, the invitation to act irresponsibly. It also encourages both greater and more entrenched corruption and new borrowing to support the extravagant living standards of the elites.¹⁶ Such regimes also typically deny the citizens economic freedom.¹⁷

Economies with corrupt political, judicial and administrative regimes are of course still able to compete internationally in export markets and in attracting internationally mobile capital, know-how and enterprise. When bribes are extracted, internationally mobile capital and enterprises only stay as long as local production factors, including government administration, absorb the corruption costs. Corruption means that local workers and landowners must themselves contend with lower incomes than they otherwise would. Local incomes thus remain low. Although wages tend to be higher in export-oriented factories than in local industry, anti-globalisers are nevertheless able to point to low and stagnant wages. International corporations and globalisation can then be denigrated. In addition, official tax collections remain low, so that government services are minimal and infrastructure cannot be built. Civil servants are poorly paid, which also encourages corruption. The real culprit—corruption—is less visible. In any case, it is always politically safer to blame foreigners and capitalists.

In China and India, corruption ratings are thought to have deteriorated since the early 1980s (Graph 1), but improved somewhat more recently in the wake of the progressive opening of the two economies. China had a perceived rise of corrupt practices since the beginning of economic reforms in the early 1980s, but this is probably a reflection of improved transparency and a realisation among the people of China that corruption is an evil that can be fought.¹⁸ Workers and tax collectors in both countries will, however, only be able to obtain a larger share of the income from their efforts if effective corruption controls are put in place and are enforced consistently and convincingly. If the corruption burden is not reduced, political recriminations, slower growth and social conflicts are likely, as educated middle classes gain more influence in both countries.

In Australia’s wider neighbourhood, the levels of perceived corruption are also high. The CorrPI for Indonesia, East Timor and Papua New Guinea, the Philippines, Laos, Sri Lanka, Thailand, Samoa and Fiji (Graph 1) are cause for immediate concern. Pervasive, severe corruption, as Africa has shown, can lead to state failure, a phenomenon which has now come to the forefront of international concerns. Aid donors are therefore trying to insist on conditions for aid to failing states, to date to no avail. Corrupt regimes, by failing their citizens, become sources of illegal mass migration at levels which Western democracies cannot absorb without damage to their own citizens. Moreover, poor, frustrated young people may become recruits for terrorism, criminality and internal political destabilisation, as has been evident from Africa and the Middle East to the Solomons.

The poor, the workers and frustrated exporters bear the burden of graft.

Another political warning signal made evident by the corruption data concerns petroleum and gas rich countries. Saudi Arabia, Iran, Algeria, Libya, Russia, Azerbaijan, Indonesia and Nigeria suffer from extreme levels of corruption (Graph 1). To the extent that annual corruption data can be relied on, standards have even slipped in recent times. In Venezuela, another major oil supplier, corruption has increased markedly under the Chávez regime. Malaysia, a much better performer, apparently also allowed probity standards to slip during the Mahathir era. Oil and gas wealth evidently allows ruling elites to intervene more intrusively in the economy, as well as to appropriate a high share of resource rents accruing to their countries. Most major oil and gas exporters have not distributed income and wealth equitably, rather the opposite. This points to potential social and political instability in the future and hence possible disruptions of energy supplies. However—as international *contretemps* with leaders of such regimes (the House of Saud, Malaysia's Mahathir, Iran's ayatollahs, and Venezuela's Chávez) indicate—there is little that the West can do directly to reduce corruption in resource-rich regimes.

Recalcitrant rulers can easily find arguments and political support for persisting with traditional national power plays and opposing the Western vision of openness and transparent governance. Yet, resisting the pressures of global competition harms the broad population and the not-so-well-connected. It is most regrettable that some aid lobby groups, who emphasise the need for debt forgiveness, official aid and 'fair' (rather than free) trade, such as Oxfam, signal to those leaders that they can persist with their ways.

Another feature brought out by the 2005 corruption data is that Western military intervention—in Afghanistan, East Timor and Iraq (Graph 1)—does obviously not lead to acceptable probity standards.¹⁹ The evidence on corruption, growth and hence poverty eradication, and social stability suggests that military intervention is all too easily followed by economic failure and social unrest. Intervening agencies all too easily become tainted by the corrupt cultures of failing states. Military governments are imbued with a culture of hierarchical command and control; they tend to distrust decentralised competition and economic freedom. They readily opt for interventionism, which has the unintended side effect of reinforcing the very causes of future economic stagnation and instability.²⁰

No outside intervention in failing regimes should in future be attempted without explicit plans how to liberalise the economic institutions and ensure non-corrupt standards of governance. This is a much more difficult task than delivering loans and capital goods, or setting up technical colleges. It is also much more important. Failing states typically lack the expertise and the skills to run non-corrupt administrations and judiciaries. Only the simplest and most modest forms of governance should therefore be attempted. Alas, the bureaucrats in the United Nations, the World Bank, the European Union and most aid agencies tend to advocate ambitious administrative structures for Third World countries. They then falter because of lacking local capacities to govern, and to govern honestly. Perfectionist administrations—as were, for example, put in place in post-independence Papua New Guinea or are attempted in East Timor—are invariably condemned to failure.²¹

Aid and abet corruption in poor countries?

Should corrupt regimes in future be excluded altogether from foreign aid? The new 'Millennium generosity' points to big increases in official Western aid to the poorest and often most corrupt countries. Governments in Africa south of the Sahara, which are currently receiving US\$80 billion p.a. in official aid, are to be given \$125 billion a year by 2010. However, the US\$1 trillion transferred to governments in Sub-Saharan Africa over the past 50 years has produced woefully little benefit for the majority of Africans.²² Indeed, with few exceptions, African per capita incomes have fallen. Many instances have been documented where copious aid led to high-cost waste, while simpler, cheaper solutions were overlooked. One typical example is the public health service 'in the poorest countries [which] spend \$50,000–100,000 on each life [of a child] saved, [although studies show] that child deaths could be averted for as little as \$10 each'.²³ Such failings can be explained by corruption in aid agencies and African governments. The

Western military intervention has installed corrupt regimes and done little for economic freedom.

**Foreign aid
often rewards
corrupt officials**

...

**... and weakens
democracy.**

consequence is that income is being redistributed from the poor to kleptocratic elites, creating corruption-poverty spirals. Foreign aid can then be counter-productive. Peter Bauer probably expressed it most poignantly when he said: 'To give money to the rulers on the basis of the poverty of their subjects directly rewards policies of impoverishment.'²⁴ He concluded that 'development aid is ... clearly not necessary to rescue poor societies from a vicious circle of poverty. Indeed, it is far more likely to keep them in that state.'²⁵

Governments that obtain a significant proportion of their budget revenues from foreign aid, as is the case in Sub-Saharan Africa and the South Pacific, need to do little to cultivate the national revenue potential by promoting growth and need to pay no attention to the aspirations of ordinary citizens. Aid creates a torrid climate for those who aspire to democracy.

The performance of the highly indebted, poor countries in Africa contrasts with the East Asian experience, where foreign aid per capita has been negligible. It should be noted that the tax-paying citizens of many fast-growing East Asian countries have by now obtained a good measure of democratic control.²⁶

The compilers of the Corruption Perception Index have of course also asked whether foreign aid to corrupt regimes should be stopped. Their answer is that the poorest cannot simply be written off. 'If a country is believed to be corrupt, this should serve as a signal to donors that investment is needed in systematic approaches to fight corruption.... [Donors must] pay particular attention to 'red flags' and make sure appropriate control processes are set up'.²⁷ This procedure is onerous for donors and likely to be highly unpopular with recipients, as PNG Prime Minister Michael Somare recently told Australians in no uncertain terms, during a television interview. Criticisms of neo-colonialism and cultural inappropriateness are then easily invoked. But when it comes to rigorous accountability, there can be no room for cultural relativism.

Multilateral aid agencies have poor accountability to the taxpayers who support them. They often count 'success' by the millions of dollars delivered. UN Secretary-General Kofi Annan's economic advisor, Jeffrey Sachs, who has been advocating huge increases in foreign aid, has complained that too large a share of past aid has gone to foreign advisors. But accountability involves monitoring of the aid disbursement to ensure its effective use. This inevitably requires the intensive deployment of foreign experts in joint working parties of officials from donor and recipient countries. Such joint operations can serve as schools for honest and effective administration. The Australian-inspired joint body to administer Australian tsunami aid to Indonesia could well become a model worth studying and maybe emulating.

The cheer squad for corruption

Eradicating corruption is as vital to prosperity and stability as it is still unpopular. Although it is increasingly evident that graft is a cancer that can be cured, although business decisions to relocate capital and enterprises are now informed by political risk analyses and although many young Third World citizens agitate energetically against kleptocracy, the battle of ideas is far from won. The *priviligentsia* will defend its entrenched positions and privileges. They will argue against openness to trade, investment and ideas and condemn globalisation. As long as the battle between individualism and collectivism is kept alive, the self-seeking cheer squad for corruption can rely on intellectual support. The corrupt can normally hide their dealings behind supposedly noble motives where there are few highly educated citizens, the press is subdued, political life is not transparent and revenue is easy because of resource wealth or copious foreign aid. When confronted by allegations of corruption, leaders resort to feigning offence and blame foreign businesses, journalists and think tanks. In polities without freedom and a certain level of education, the ruling classes can easily deflect criticism and maintain resistance to changing their ways.

International comparisons, such as the Corruption Perception Index provide valuable evidence and equip honest political leaders at home and abroad with a powerful instrument for the fight against the cancer of corruption.

**The aid lobbies
and anti-
globalisers make
life easier for
kleptocrats.**

Endnotes

- ¹ Sometimes, distinctions are made between mild (and acceptable?) and massive (and unacceptable) corruption and between 'facilitative corruption' and 'blocking corruption'. Such distinctions are far from clear-cut and not operational. Moreover, relativism in treating different types of corruption can easily lead to undue tolerance. In reality, milder and facilitative forms of corruption tend to metamorphose into massive and blocking corruption.
- ² Peter Bauer, *From Subsistence to Exchange and Other Essays* (Princeton: Princeton University Press, 2000), 45-46.
- ³ Rule systems, to be effective in safeguarding freedom, have to be universal, i.e. general, abstract, certain, open and system-consistent (Kasper, 1998, *op. cit.* 51-54). Corruption detracts from all these essential criteria of economic freedom and must therefore be considered a direct affront to liberty.
- ⁴ Amartya Sen, *Development as Freedom* (New York: Anchor Books, 1999).
- ⁵ It is interesting that people answer the question 'generally speaking, would you say that most people can be trusted or that you can't be too careful in dealing with people?' in the *World Values Surveys* predominantly in the affirmative in northwest European countries, but few agreed in African and Mideastern countries (World Values Study Group, *World Values Survey 1981-84, 1990-93, 1995-97, and 1999-2001* (Ann Arbor, MI: Interuniversity Consortium for Political and Social Research, 2004).
- ⁶ The revival of public choice, institutional and evolutionary economics was based on the rejection of the simplifying assumptions, which underpinned the long dominant economic paradigm, neoclassical theory. In particular, the (absurd) assumption of perfect knowledge has blinded neoclassical economists to the importance of institutions and the consequences of corruption, since they used to assume that citizens always know what their political agents are up to and that the agents act unfailingly in the principals' interest. Standard neoclassical economics focuses on equilibria and end states, whereas the above-mentioned approaches look at processes: how innovative knowledge, enterprise and competition evolve and attain material betterment for the many.
Institutional economics, which has its roots in Austrian economics, has had a huge impact on economic reform since the 1980s; however, it has, as yet, hardly been absorbed in academic teaching, economic theorising and econometric model building. See: Wolfgang Kasper, *Property Rights and Competition*, Policy Monograph 41 (Sydney: The Centre for Independent Studies, 1998), 6-42; Wolfgang Kasper, M.E. Streit, *Institutional Economics: Social Order and Public Policy* (Cheltenham, UK: E. Elgar, 1998); and Niclas Berggren, Nils Karlson, Joakim Nergelius (eds.), *Why Constitutions Matter* (New Brunswick-London: Transaction Publishers, 2002).
- ⁷ International Monetary Fund, *World Economic Outlook 2005* (Washington, DC: IMF, 2005), 125.
- ⁸ The most recent reports are: James Gwartney, Robert Lawson, *Economic Freedom of the World, 2005 Annual Report* (Vancouver, BC: The Fraser Institute, 2005), [the data are available on www.freetheworld.com]; and M.A. Miles, E.F. Feulner and M. O'Grady (2005), *2005 Index of Economic Freedom* (Washington, DC: Heritage Foundation and Dow Jones & Co, 2005) [www.heritage.org/index].
- ⁹ Transparency International publishes comprehensive annual reports, of which the latest is: Transparency International, *Global Corruption Report 2005* (London: Pluto Press, 2005) [gcr@transparency.org]. -- For data and definitions of the CorrPI see: <http://www.ICGG.org>; and <http://www.transparency.org/surveys/index.html#cpi>; and J. Graf Lambsdorff, 'Corruption and Rent-Seeking', *Public Choice*, vol. 113:1/2 (2002), 97-125. Also A. Shleifer, A. and R.W. Vishny, 'Corruption', *Quarterly Journal of Economics* vol. 108 (1993), 599-617.
- ¹⁰ Before a country is included in the CorrPI, at least three separate surveys are required, for example work by the World Economic Forum (*Global Competitiveness Reports*), the Economist Intelligence Unit, Global Risk Services (a US consultancy), Political and Economic Risk Consultancy of Hong Kong, and the World Bank's Business Environment and Enterprise Surveys.
- ¹¹ The work spreadsheet of all CorrPI data is available on: http://www.ICGG.org/corruption_perception_index/older_indexes/overview [CSV file]. It is hard to read. The website also contains much more accessible Excel-formatted tables for recent individual years.
- ¹² There is currently a major debate in Austrian economics whether secure private property rights, free markets and the rule of law will emerge spontaneously, once coercive and detailed government controls are removed. Some argue that political entrepreneurs will interpret the

feedback from international economic competition constructively, motivating them to supply better institutions of economic freedom. They can point to the history of gradual economic liberalisation in Europe since the 17th century and East Asian liberalisation since the 1960s. Others, including this author, fear that the feedback into institutional innovation is rather imperfect and often too slow—a generation of economic trauma is too high a price to pay for institutional progress.

- 13 Count Lambsdorff writes in a circular letter launching the 2005 Index: 'The South Korea government ... announced its goal to belong to the top ten countries [in the Corruption Perception Index] ... They improved their ranking from 47 in 2004 to 40 this year. This is ... evidence that the right type of competition has been initiated' by the Corruption Project.
- 14 Francis Fukuyama, 'Foreword', in: Diana Rodriguez, Gerard Waite and Toby Wolfe (eds.), *Global Corruption Report 2005* (London: Pluto Press, 2005), xii.
- 15 Wolfgang Kasper, 'Rapid Development in East Asia: Institutional Evolution and Backlogs', *Malaysian Journal of Economic Studies*, vol. xxxv, nos. 1&2 (1998), 45-65.
- 16 I. Harper, H. Hughes, S. Gregg, *Noble Ends, Flawed Means: The Case Against Debt-Forgiveness*, Issue Analysis, no. 8 (Sydney: The Centre for Independent Studies, 1999).
- 17 Johan Norberg, in eloquently discussing 'The African Morass', shows the close interdependence between corrupt governance, over-regulation and economic malaise. J. Norberg, *In Defence of Global Capitalism* (Sydney: The Centre for Independent Studies, 2005), 62-67.
- 18 Officials of the People's Republic assert that China has been following the 'Singapore model' since the mid-1990s. However, the leadership appears to have overlooked one important aspect of that model: Singapore emphasises clean government and pays public servants well.
- 19 Transparency International's Global Corruption Report 2005 focussed on corruption in big infrastructure projects and post-conflict reconstruction. It makes for sobering reading. (Transparency International, 2005, *op. cit.*).
- 20 The experience of post-war, prospering Germany was an exception, because economic liberalisation was driven by liberal German reformers, often against the express wishes of the Allied military.
- 21 On the issue of aid and corruption in Pacific island nations see: P. Bauer, S. Siwatibau, W. Kasper, *Aid and Development in the Pacific* (Sydney: The Centre for Independent Studies, 1991); H. Hughes, *Aid Has Failed the Pacific*, Issue Analysis no. 33 (Sydney: The Centre for Independent Studies, 2003); and H. Hughes and S. Windybank, *A Tale of Two Nations*, Issue Analysis, no. 58 (Sydney: The Centre for Independent Studies, 2005).
- 22 F. Erixon, 'Why Aid Does Not Work, Viewpoint', *BBC News* [<http://news.bbc.co.uk/go/pr/fr/-/1/hi/sci/tech/4209956.stm>].
- 23 P. Stevens, 'UN Plan to Keep Poor in Their Place', *Bulletin of the Campaign to Fight Diseases*, 27 September 2005 [admin@fightingdiseases.org, accessed 28/9/2005].
- 24 P. Bauer, 'Interview with Lord Bauer', *The Caian* (13 May) (Cambridge, UK: Gonville and Caius College, 1985), as cited by J.A. Dorn, 'Remembering Peter Bauer', *Cato Journal*, vol. 25: 3(2005), 439.
- 25 P. Bauer, *From Subsistence to Exchange and Other Essays* (Princeton NJ: Princeton University Press, 2000), 45-46.
- 26 Wolfgang Kasper, 'The East Asian Challenge: What Can Australians Offer Their East Asian Neighbours? In H. Hughes *et al.*, *Australia's East Asian Challenge* (Sydney: The Centre for Independent Studies, 1994).
- 27 Corruption Perceptions Index 2005 website: *Frequently Asked Questions*. Question 5, accessed 25 Oct. 2005.

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