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## Corruption and Ethics

Corruption and the Rule of Law

The Battle of the Next Decade

Exploding  
the Myth of Corruption

From Stagnation to  
Sustained Growth

Christianity and  
the Markets

The Character Issue  
in Politics



**The Institute** is an independent non-political non-profit institute that promotes economic growth, employment and entrepreneurial activity. It believes that this can best be achieved with a free market economy and a society that embraces the rule of law, the right of private property and the values of family, learning, honesty and hard work.

These beliefs lead to the following policy positions:

- For a balanced budget
- For the rule of “the law”
- For the privatization of the public corporations
- For a smaller government and lower taxes
- For an efficient justice system
- Against government management of the labor market
- Against a minimum wage
- Against price controls

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# Introduction

**For a country corruption is not a “zero sum game”. The players may play...the corrupter and the corrupted ...and both may gain. But the taxpayer/citizen...the non-player...loses and those public losses exceed the private gains.**

In Venezuela, for instance, it is the major ingredient in that country's present political crisis. This country had 40-years of democratic government but is considering a more authoritative form under which President Hugo Chavez could become the popularly elected Fidel Castro of Venezuela.

In late November 1999 Cedice, a Venezuelan economics institute, and the Atlas Foundation of Fairfax, Virginia sponsored a 3-day International Seminar, “Corruption vs. the Rule of Law: The Battle of the Next Decade” in Caracas. Two directors of the Institute, Leandra Esfakis and Ralph Massey, attended that Seminar and their reports are the first four articles in this issue.

**An exchange between individuals can be a “win-win game” where the parties both gain and there are no adverse effects on others. This characterizes most free market and personal non-market exchanges. Especially in the latter case the issues of morality and character and the power of the state can produce the most difficult issues faced by mankind.**

There is a strong justified resistance to the invasion by the state into matters of conscience and human intimacy. This is the very essence of liberty and freedom as we know it today.

These moral issues are hardly ever simple and their complexity can be seen in the yearlong agony of the President Clinton-Monica Lewinsky affair. Unfortunately for the United States even a consensual sexual relationship under those specific circumstances constitutes sexual harassment in the workplace; and testimony in a court of law...testimony deemed relevant by a judge...requires truthfulness. This was uncomfortable for "liberals" to contemplate; and it highlights the never-ending problem of dealing with the need for moral values, ethical standards and trust in a society.

The "morality" of efficient markets and the character issue in politics are the subjects of the last two articles in this issue.

## Corruption and the Rule of Law

Mario Vargas Llosa, one of the two greatest living authors in the Spanish language, was the keynote speaker. He spoke at a critical moment. Venezuela is recognized as one of the most corrupt democracies in the world...and in less than a month will vote on a new constitution that could facilitate the installation of a totalitarian state.

During a recent radio program President Hugo Chavez of Venezuela described Mario Vargas Llosa as an "illiterate". Today the press noted his arrival in Caracas with the headline "The Illiterate Arrives."



The author said that politics is swept by confusion. People are experiencing poverty, economic "marginalism", exploitation and corruption; and they blame this on "neo liberalism", the new emphasis on markets and competition. The author stated that he was a "liberal" and that liberty historically was the dynamic force that tamed nature, fostered trade and produced individual freedom.

**The truth is that the fastest progress...political, economic and human...has been made in countries that have united political democracy and economic liberty.** The three most prominent examples in the world are Ireland, New Zealand and Spain. In twenty years, for instance, Spain has swept away the Franco regime and in its place there is both economic prosperity and democracy. In New Zealand, a democratic country, a socialist labour party started an economic revolution.

**In contrast in Latin America the move away from dictatorship to democracy that occurred several decades ago did not result in the creation of honest and competent institutions and true market economies.** Where privatization occurred it often created private monopolies that were no better than the previous public monopolies...privatization did not produce the same results as it did in Great Britain under Margaret Thatcher. In Venezuela the state set the rules of the game that fostered corruption and paralyzed society and the creation of wealth.

Charismatic leaders who have not produced progress have dominated Latin America. It needs quiet patient leaders such as President Cristiani of El Salvador in the late 1980s who can transform their countries. There have been other examples but their work has gone largely unnoticed by the

world at large. The charismatic leader of Latin America, the caudillo, typically has not produced progress and economic opportunity.

**But...today the world is a better place where even disadvantaged countries can experience progress. In today's world countries can import both capital and ideas and produce a rhythm of growth as has been the case of Spain, Ireland and New Zealand. Countries can create liberal institutions.**

## **The Battle of the Next Decade**

On the first full day of the Seminar twenty-two speakers from nine countries discussed "The Battle of the Next Decade". These centered on Venezuela that on December 15th will vote on a new constitution that will create a more authoritarian form of government. The highlights of twelve hours of formal meetings are as follows --

- The Foreign Minister of the present government, the architect of the referendum, stated that in this 40-year-old democracy ethics were overlooked until the impact of corruption made daily life unmanageable. Corruption has made essential supplies and services in the hospitals and schools unavailable. It has led to unemployment and the rapid physical deterioration of the country. The huge public administration is a corrupting power that has created private fortunes three times greater than the external debt of the country. He believed that

democracies are more prone to corruption and this is why the constitutional change is proposed.

- An American college professor from Africa spoke of Africa where the politicians saw independence as an opportunity for self-aggrandizement. Here corruption is so widespread that career choices are made on the basis of a job's corruption opportunities. For instance, a Ph.D. in engineering will take position in customs because it is more attractive than college teaching.
- An economist from Mexico described a country whose political choices over 200 years limited the number of growth years to 72. Mexican income per capita was 75% of the U. S. level in 1800, 27% in 1910 and 7% in 1995. From the days of Spanish Conquest a "dense and robust" political system was developed to control resources and take rents. Now a cycle of corruption is part of each 6-year presidential term. Institutional changes have not been made and the crises will continue.
- A Venezuelan economist observed that corruption was a tax that every citizen pays.
- An American described how the International lending agencies such as the World Bank and the Inter American Bank aided and abetted corruption in less developed countries. These agencies lent funds without adequate accounting and controls; and one-third of the projects ended in failure. These agencies now are in the forefront of the international anti-corruption movement, as the adverse impact of their lending practices on themselves becomes more apparent.



- A brilliant Peruvian economist analyzed the relationship between corruptors and the corrupted. He suggested that we should look past the issues of culture, tradition, etc. His complex analysis led to the conclusion that corruption was the cost of legality. The importation of laws and legal structures...the increase in the number of laws...raises the cost of being legal and lowers the relative cost of bribery. The cost of corruption is heaviest for the poorest people in society.
- **A Venezuelan discussed several formal studies. These showed that the amount of corruption in a country is inversely related to investment and growth...the greater the amount of corruption the lower the level of investment and growth. Furthermore, politicians select those investment projects that have more and bigger corruption opportunities. They favor new and more capital intensive projects and avoid investments in humans, social infrastructure or the maintenance of existing capital projects.**
- An Italian presenter described his country as the most corrupt in Western Europe. Corruption feeds on a public distrust of public officials and the existence of 100,00 laws...ten times greater than France. Bad public administration and corruption are positively related and the latter becomes self-sustaining. The only bright spot is a recent increased public awareness. The "Clean Hands Inquiry" started an investigation of 6 Prime Ministers and 500 parliamentarians and resulted in the complete collapse of the existing political parties.

The collective weight of the testimony clearly demonstrates that the end of corruption as a major economic force will be



a "Battle" and this battle will last at least a "Decade".

## EXPLODING THE CORRUPTION MYTH

Neither race nor culture determines whether a nation becomes corrupt. Speakers from Latin America, Africa, Europe and the U.S.A examined the causes and evidence of corruption in their countries. The recurring observation was that corruption was not a preserve of any ethnic group or nationality.

**Rather, it is the proliferation of laws, regulations and requirements that make compliance more costly than the alternative of bribing the government official employed to enforce such rules. And the burden of complying or avoiding compliance falls most heavily on those least able to afford it: the poor, the self-employed and the average salaried worker.**

The proliferation of laws and regulations leads per force to the proliferation of bureaucracies to enforce the regulations against the consumer who needs to obtain a license or permit, or to comply with some rule for qualifying for such a license or permit.

In Italy a proliferation of regulations has resulted in contradictory rules being applicable to the same fact scenario: compliance, in fact, could mean finding a friendly bureaucrat disposed to apply the regulation that produces a favourable result.

But the problem is not just Italy's. An American speaker noted that in the U.S.A., the laws and regulations of the Internal Revenue Service comprise over 33,000 pages and that the average tax return to the IRS is never more than 50% correct. One must question the legitimacy of a compendium of laws with which the average citizen plainly cannot comply. Nonetheless the default makes him liable to criminal prosecution.

In addition to the legislated hurdles, the consumer is also compelled in many instances to discover and comply with less transparent ones: internal bureaucratic practices or government policy not in fact legislated.

It is clear that basic conditions for corruption, or non-compliance are:

1. An abundance of legislation, sometimes contradictory and onerous.
2. The application of unwritten norms that are not readily transparent.
3. The inconsistent or arbitrary application of real or assumed authority.
4. The uncertainty created by the above.

The conditions listed here prevail in most western democracies, to a greater or lesser extent. The Latin American countries are simply the most notorious examples of corruption as the norm. The "coima", "mordida" or bribe is the currency that expedites or just makes it possible for businesses to function and daily life to proceed.

Such conditions bring the Rule of Law into question, and contribute to the erosion of respect for the law. This

erosion is a social cost paid by all to the detriment of the quality of life.

In immediate terms, the cost of excess or inept regulation goes beyond the overhead of office space and salaries for government officials.

The license applicant first pays the cost, in time and money spent in complying with, or bribing officials to avoid the requirements, or paying penalties for noncompliance. This increases his cost of doing business. Companies and the self-employed will pass on these costs to the consumer, increasing his cost of goods and services.

It is a cost paid by the salaried worker, in opportunity lost or postponed, because the status quo makes his change of status from employed to self-employed more difficult.

It is a cost paid by the poor who cannot afford either the compliance costs or the bribes, and confirms their marginalized status in society.

At the same time, the governments need to enforce compliance increases to support the bureaucracy now in place. If the department does not produce the required revenue, the government will be tempted to increase the fees or penalties payable, or implement a new revenue-producing program. Thus begins a new cycle of the same problem.



# From Stagnation to Sustained Growth

The Seminar ended yesterday with a speech by Maurice McTigue, a former minister in the government of New Zealand. He painted a "nuts and bolts" picture of how his country transformed itself from socialist stagnation to sustained growth.

At the end of World War II New Zealand was the third wealthiest country in the world measured in net income per capita. In the next thirty years it dropped to 27th. In 1984 it was the most socialized of all the countries in the OECD (The Organization for Economic Cooperation and Development). Wage and price controls were complete. Exchange control approval was needed to subscribe to a foreign magazine and one had to resign his citizenship to purchase a foreign security. For a 20-year period its growth per capita was about 0.5% per year.

The Labour Party in 1984 looked at the success of Singapore and Hong Kong and decided to change. It followed five principles:

- **A free and open democracy where everyone could be Prime Minister.**
- **Governance by law rather than by administrative edict.**
- **The sanctity of the law. Justice was equal for all regardless of means and everyone had the right to a trial by his peers.**

- **Results-based government accountability rather than financial accounting only.**
- **Decisions were made on the principle that "If the answer is complicated, try again and make it simple."**

Some results are worth noting.

- A campaign for Prime Minister, for instance, was limited to expenditures of \$20,000 forcing each candidate to make a maximum personal appeal during a limited period of time...the opposite of the current situation in the United States today.
- In the Department of Labour, for instance, there were 34 programs to aid the unemployed. It was determined that only four of these actually produced the intended results. Thirty programs were dropped despite the strong objections of powerful special interest groups.
- To reduce the opportunity to corrupt, the principles of licensing were changed. For example, previously the number of taxi licenses was limited thus increasing the value of the permit to the holder. The system was changed to qualitative licensing. All who could meet certain standards for providing taxi service could get a license.
- Government revenues came from a wide number of taxes and levies. These included an income, sales and inheritance taxes, import and export duties, licensing fees, etc. This complex system was structured to raise income, change behaviour and provide social benefits. The system now had one objective...raise revenue. Thus the number of taxes was reduced to two, an income tax and a consumption tax, and social benefits were provided by direct payments.

- Privatization of the utilities took a remarkable free market twist. The telephone system had a reputation of poor non-responsive service. It took 6 months to get a telephone and service was frequently interrupted. Despite the fact that 87% of the public was against privatization, 100 per cent of the shares were sold to a foreign-led consortium. No provision was made for a public utility commission. The purchaser was not given a monopoly and was required to give access to the system to any one desiring such access. A level of service was guaranteed with a \$50 cash payment to a customer if it was not provided as publicly specified.

The change was dramatic. When the stock of the telephone company was sold it had a sales value of \$4.2 billion...today the market value is \$16.8 billion. And...the country effectively positioned itself to enter the age of modern telecommunications.

The bottom line is that the annual rate of economic growth per person increased from 0.5% before the reforms to 6% after them.

When Maurice McTigue delivered the last word of his amazing "How We Did It" story, every person in the audience stood to applaud.



# Christianity and the Markets

The July 1999 issue of the Bahama Catholic included an article "Christianity and the Market" by Leonard Pluta, professor of economics at St. Francis Xavier University, Antigonish, Nova Scotia. The author examines the historical conflict between Catholicism and free market economics and states that theologically the conflict need not exist. But in the end he redefines and restates the conflict in modern terms. With respect to the economic content his analysis appears "incomplete" since he does not consider many significant advances in economics.

## *The call for a New Evangelism.*

According to the Professor the historical conflict is rooted in two major themes:

- From the parables of "Lazarus and the Rich Man" and the "Two Servants" there is the inherent conflict between "salvation and the acquisition of wealth."
- From the parable of the "Rich Young Man" there is the Christian ideal, "a complete sharing and distribution of material goods based on needs rather than ownership." He states that this ideal has been the basis of Christian communities from the very beginning, the blueprint for Karl Marx's perfect communist society and the rationale for 20th century socialism. Francois Furet, the French historian, notes that in the 1930s left wing Catholics founded the "Esprit" party... "though philosophically

incompatible with Communism, it shared the communist's militant spirit and hostility to capitalism."

At this point the author seemed on the verge of becoming a born-again free marketer. He described the sheer efficiency of free markets and the overwhelming failure of communism and socialism. Furthermore, he "reluctantly" acknowledged that free markets are compatible with Christianity because they embody and apply the fundamental Christian doctrine of free will.

However, the Professor pulled back from such a leap for a number of reasons. He contends that ---

- Unprecedented market freedom in the long run creates family breakdowns, inequitable distribution of income, unemployment and underemployment of youth and moral devastation, dishonesty and ill will. Free markets are efficient in the short run but they promote immoral values that destroy this efficiency in the long run.
- He states that economists following in the intellectual path of Adam Smith employ theories and techniques that are simplistic and do not account for the complexity of man. He contends that modern economists view man as "a pleasure-maximizing, pain-avoiding machine deriving its pleasure from consumption of goods and services and the pain from work."

He expects the self-destruction of free markets in the same way that Karl Marx predicted the decline of capitalism...both allegedly carry the seeds of their own destruction. In conclusion he calls for a New Evangelism that "will impose moral, social and legal limitations on the markets" and this presumably will save free markets.

## *Another view.*

It is true...

- Economists do use theories that are gross simplifications. Raise the price of a good or service, for instance, and the demand will decrease. However, in a wide range of applications these theories produce valid predictions of what will occur in real life. That is the definition of a "good" theory.
- Economists tend in many cases to describe relationships in mathematical terms and use complex statistical techniques on tons of data. Unfortunately, the world is complex.
- And some apply their "scientific" techniques to issues that would appear to be inappropriate such as marriage, family size and gun control. This may offend some moralists.

But...this scientific inquiry into the material welfare of man over the past half century has produced insights that are important to moralists, the world and particularly to the Bahamas.

- Economic growth is dependent on innovation and change and man's creative nature produces new ideas if given the chance.
- The market...free of political control...was an important step in creating the industrial revolution and the growth in material welfare since then.
- Private property and the rule of law are essential to free markets and economic growth.



- Investments in human capital are more important than investments in physical capital.
- Societies differ in their culture and institutions and some are more conducive to the development and functioning of free markets.

All of these affect the cost of economic transactions and it is the reduction in these costs that spurs economic growth. Quite rightly the economist can argue that –

- The underemployment of youth is not due to free markets...but to the failure of adult fathers and mothers to invest materially, emotionally and spiritually in their children, the failure of schools to demand and provide learning and the success of politicians in passing minimum wage legislation.
- Economic change makes some products and services obsolete and devastates those producing them.
- Free markets need a strong government to guarantee the prompt and equal application of the law. Its effectiveness is diminished in a society where justice is personal and dishonesty is widely accepted.
- Ultimately free markets are most effective at producing rigorous growth where the values of family, parental responsibility, honesty, hard work and learning are cherished and practiced.

In one sense this makes the assertive articulate free market economist an evangelist.

# The Character Issue in Politics

An astute commentator on the Bahamian scene recently wrote about the presidential campaign of George W. Bush. Specifically he hoped that Mr. Bush would break from the conservative line of narrowly defined sexual and social issues...the so-called "character" issues...and the "union of social conservatives and free marketers". He contended that such social conservatives create pockets of "Third World" underdevelopment.

This thesis appears tenuous at best. The relationship between political themes, specific government programs and concrete results was not established. In addition, the shortness and style of the article gave the impression that the dialogue was intended to dazzle the reader with words rather than substance.

"Character" is important and unfortunately American political campaigns never seriously examine it. Presidential campaigns are dominated by TV images, sound bites and well-crafted and researched expressions or statements.

## *Ethical standards.*

Let us look at it from an economist's point of view.

- **Every society no matter how small develops commonly accepted rules of behaviour or ethical standards that govern individuals as they confront each other and the world around them.**

- Since the Middle Ages the world has experienced an incredible and seemingly accelerating growth in material welfare.
- Equally impressive is the fact that the improved material welfare has not been evenly distributed among societies. A prosperous Singapore, for instance, seems to have developed naturally next door to an impoverished Burma.

This is the subject matter of modern economics.

This economic inquiry supports the conclusion that the greatest sustained growth in the world today occurs in societies that --

- Manufacture and sell goods and services in markets free of political control and manipulation
- Support the rule of law and the protection of private property
- Value the family, parental responsibility, honesty, hard work and learning
- Invest in human capital

Accepted ethical norms whether "good" or "bad" become embedded in the psyche of both the individual and collective consciousness of society. They become institutionalized...a part of the institutions that govern...a part of the heritage.

As an illustration one observes that with one exception government corruption is endemic in Latin American. Argentina, Brazil, Colombia and Venezuela are countries rich in natural and human resources. Yet sustained economic growth does not occur in large part because of



the corruption of public officials and the institutional structure that makes such corruption possible. Disciplined fiscal and monetary policies are not sustained...despite the warnings, financial aide and good intentions of foreign governments and international agencies. All of these countries have a Catholic heritage that somehow did not produce a more "ethical" public life.

Chile is the only country that has broken from this Latin pattern to any significant degree. Here the 20-year rule of General Augusto Pinochet produced profound and beneficial economic and business changes. Unfortunately these changes are obscured by the severe measures taken against its Leftist and Communist opposition. Now the World pursues these human rights violations rather than examining, evaluating and mimicking the innovative economic changes.

This illustrates what makes such analysis difficult...we are dealing with a society's culture and institutional structure. Whole nations...like individuals...have an almost infinite capacity to rationalise.

For instance, after World War II the myth perpetuated for almost 50 years was that the German savagery against the Jewish and Slavic peoples was conceived, directed and implemented by the zealous few at the top of the German government. In fact, it developed over the prior century and had wide acceptance in principle by the German people. But it was useful and expedient immediately after the War to adopt the "few rotten apples at the top" explanation.

## *The Bahamas.*

In the case of the Bahamas the country also has a profoundly Christian tradition.

Nevertheless...

- Two Commissions of Inquiry substantiated significant public wrongdoing but neither has led to criminal prosecutions for wrongdoing.
- Several years ago a Bahamian executive in a major bank apparently embezzled \$750,000 from the pension fund of the bank's Bahamian employees. Both criminal and civil actions were initiated. However...to this date neither has been pursued beyond their initial steps.
- Pilferage by employees and customers in the major retail establishments is five times higher than in the United States. Yet it is terribly difficult in the present justice system to take effective legal action against such behaviour and the broad adverse impact is profound.

**This strongly suggests that there are broad Bahamian cultural and institutional characteristics that support such behaviour. The reality is that this behaviour limits economic growth.** Unfortunately public life in the Bahamas...like that in the U.S. and Latin America...does not support discussion, leadership and action in such areas. Politics is a world of "photo opts", sound bites and slogans.

**Yet it is hoped that astute Bahamian journalists and commentators will deal with the substance of "character"...they will treat character and ethical behaviour as a means for effecting positive change...and hopefully be effective in initiating**

"Competition in the service of consumers is the one and only sure way to produce a prosperity permanently spiraling upward. All political spendings for purposes beyond the protection of life and property are a snare and a delusion."

Percy L. Greaves, Jr.

The quote of the week  
from the Institute's Website –

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



## *Highlights*

For a country corruption is not a "zero sum game". The players may play...the corrupter and the corrupted...and both may gain. But the taxpayer/citizen...the non-player...loses and those public losses exceed the private gains.

The economic impact is indirect and cumulative. In reality the greater the amount of corruption in a country, the lower the level of investment and growth.

It grows through the proliferation of laws, regulations and requirements and becomes self-perpetuating...corruption breeds more corruption.

Unfortunately for the individual, compliance becomes more costly than the alternative...paying a government official not to enforce the law. And the cost of compliance or bribery falls most heavily on those least able to afford it...the poor, the self-employed and the average salaried worker.

New Zealand solved its stagnation problem with a bold ingenious program of reform. Economic growth per person increased from 0.5% before the reforms to 6% after them. New Zealand should be a role model for the Bahamas.

Every society has commonly accepted rules of behaviour that govern individuals as they confront each other and the world around them. As in the case of the Bahamas, a country's ethics may promote private gain at public expense.