

Corruption in the Philippines: Framework and Context

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This paper proceeds from the more recent literature on corruption as a principal-agent problem whose significance for development depends on dimensions related to the nature of the corrupt transaction itself such as distinctions based on the agents involved, scale, type of deal, predictability, industrial organisation, etc., all of which affect, for better or worse, the nature of the relationship between principal (as represented by the public interest) and the agent (politicians and bureaucrats). Corruption may thus be regarded as an incentive-design problem.

The paper also argues, however, that there is a larger dimension to corruption determined by the historical and social context. Here, the ultimate factors are those affecting social cohesion (e.g., income and wealth, education, ethnic and other differences), the economic strategies pursued by the government (e.g., minimalist versus interventionist), the political system (the autonomy of the bureaucracy, the degree of centralisation), the extent of market transactions (local, global) and the rate and sources of economic growth. It is these factors that determine the credibility of

the formal institutional constraints (however designed) on the behaviour of public officials and private agents alike.

This framework is used to examine how and why the dominant types of corruption in the Philippines have evolved from nepotism, to smuggling, to public-works contracts, to debt-financed schemes asset-privatisations, until the recent descent into underworld-related activities. The unprecedented governance breakdown under the Estrada administration is then explained as the result of a confluence of a growing sense of public interest (the result of education, urbanisation, political experience and expanding market transactions) on the one hand, and the drying up of innovative sources of rents that continued economic growth would have provided.

1. Introduction

The most common definition of corruption is “the abuse of public power for private gain.” This definition can be disingenuously general, depending on how broadly one construes “public power” and “private gain.” By comparison, Shleifer and Vishny’s [1993] reference to the “sale of public assets for private gain” is more restrictive, since it unduly limits the transactions to those mediated by money-

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exchange. Rose-Ackerman [1998] gives a definition that is suited mostly to bribes: “an illegal payment to a public agent to obtain a benefit that may or may not be deserved in the absence of payoffs.” Hutchcroft [1999:227] endorses a definition by Nye [1997] that is more explicit, although less succinct: “behaviour which deviates from the formal duties of a public role

because of private-regarding (personal, close, family, private clique), pecuniary or status gains; or violates rules against the exercise of certain types of private-regarding influence”.

As is evident from the above examples, the typical definition of corruption involves the notion of the “public” in a fundamental sense. For this reason, it is customary to regard the main locus of corruption as government and as invariably

involving public officials. Recent usage, however, also speaks of “private corruption” as occurring in business firms or as it deals with organised crime. Some examples are overpricing practised by supply managers, excessive charging of personal bills at company expense and so on. A case for including these acts under corruption can be made to the extent that they occur in the context of firms having a *public dimension*, e.g., that are widely held publicly, or to the extent that certain rules protecting the general public proscribe such behaviour, e.g., trading on insider information. Otherwise, these acts would be in the nature of private damages and the subject of civil liabilities. By extending the concept of principal and agent defined below, however, a good deal of breach of trust in the private sector may also be subsumed under corruption. For this paper, however, corruption shall refer only to cases involving acts of public officials or pertaining to public assets.

2. Corruption as a breakdown in a principal-agent relation

Public corruption is not a thing but a *relation*; more precisely, it is the breakdown or *rupture* (*cor* + *rumpere* = completely breach) of a presumed relation between social agents. The fundamental relationship affected in corruption partakes of the nature of the well-known principal-agent (henceforth, the PA) problem in economics which refers to a situation where one party (the “agent”) is contracted to promote an outcome in behalf of someone else, namely the “principal” (see, e.g., Arrow [1986]). The agent’s action or characteristic, however, potentially affects not only the principal’s but also his own interest. When the agent’s action or characteristic cannot be directly observed by the principal, or where the outcome is affected not only by such an action or characteristic¹, there is a problem of ensuring that the agent takes the appropriate action (or possesses the characteristic) that will promote the principal’s interest.

In the case of corruption, the principal is understood to be the *government*, which embodies public interest in its laws, policies and strategies. Government performs functions and distributes resources to attain its goals. The performance of such functions, however, is devolved upon real people, bureaucrats and politicians (or even private individuals as such concessionaires) who may be presumed to act

in their own interests. A contract implicitly exists between government and its agents for the latter to discharge their functions in the former's behalf. Since the actions and qualities of such agents can be observed only imperfectly, however, government cannot be sure that its agents always perform fully in its interest.

Depending on the context, the principal in the corruption relation may be either the highest echelons of government, with the agents referring to officials at different levels designated to carry out certain tasks, or the principal can be the electorate or public at large, with politicians as their agents. It is obvious that the PA problem exists on several levels, with society at large (the public or the electorate) being the ultimate principal, and both politicians and bureaucrats existing as agents on the lower levels.

More broadly construed, however, the rules governing the PA relationship between politicians (or government) and bureaucrats (or the civil service) are found

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in the entire system of bureaucratic recruitment, compensation, promotion and procurement, all of which are designed by politicians. Included in these *formal constraints* are the larger laws governing the behaviour of public officials and the penal system punishing errant behaviour. Finally, one cannot discount the various *informal constraints* that internally regulate bureaucratic behaviour such as professionalism, a

moral viewpoint, a sense of duty and *esprit de corps*, distinct factors that to some extent transcend pecuniary compensation.

Similarly, the relationship between the public (as embodied by the electorate) and politicians is governed by the political system as typically set out in a constitution which includes the *formal* mechanisms for election and recall. The 1987 Constitution, for example, provides for the conduct of regular elections and occasional plebiscites, but more innovatively, also for electoral recall and constitutional amendment under a people's initiative.² The independence of the government's branches and the checks and balances among them (e.g., impeachment), the dichotomy between government and opposition, and laws and the penal system as they relate

to corruption and plunder form part of this formal system. Compared with the bureaucracy, however, the difference between formal and informal mechanisms is less distinct at the political level. Constitutional guarantees of the freedom of speech, freedom of the press, freedom of assembly and ultimately, the right to rebellion do not directly define formal mechanisms to reward or punish erring politicians, merely leaving open the door for more informal mechanisms to function, including the threat of exposure to public or media criticism, social ostracism and collective action. The events of EDSA 2, for example, must be understood primarily as an informal recall-mechanism at work: large-scale collective action in the wake of a failed formal mechanism (the impeachment process) turned public opinion, forcing a mass resignation of the cabinet and the effective resignation of the president.

In many ways, the control mechanisms shaping the relationship between politicians and the electorate at large are among the most *weakly defined*. Combined with the inherently large discretion accorded to politicians and the peculiarities of Philippine political economy, this provides fertile grounds for corruption.

Understanding corruption by proceeding from the principal-agent problem is neither to redefine nor to decriminalize it, in much the same way that understanding why crime exists is not tantamount to condoning it. The approach itself does not change the thing viewed but puts its basic elements and characteristics into sharper focus.

Posing the problem of corruption as a principal-agent relation entails positing agents as acting in their self-interest, behaving so as to maximize their own welfare. Unless such maximizing behavior is curbed one way or the other through formal or informal constraints, corruption as commonly defined would be a "natural state." This would be even truer when agents pursue their self-interest in the context of various relationships established with other individuals while discharging their official functions as agents for the principal. Additional considerations may affect the agent's objectives in each of these relationships, and private-regarding behavior by public agents would be the norm. At this level of analysis, one may better understand the reasons for corruption by examining the agent's utility function, the arguments that enter it and the weights or importance that the agent attaches to each of them. This type of rigorous examination does not seem to have been done before, although earlier sociological studies of corruption have

traced it to the particularistic behavior of agents or to culture in general. (See Corpuz [1957, 1965]; Cariño [1977, 1979, 1986]; Endriga [1979]; and Cariño and de Guzman [1979].)

Factors affecting the principal-agent relation

It must be said at the outset, of course, that this paper's use of the PA framework goes beyond its restricted economic application where it is used primarily to solve for the compensation scheme that aligns the agent's actions to the principal's objectives. Instead, it will be used here primarily as a heuristic. By initially positing the requirements for an ideal relationship that ought to exist between principal and agent and then comparing it with the corrupted or "broken" one that actually exists, one is able to determine the sources of difficulties that prevent such a relationship from functioning.³ What follows describes and analyses some of those factors.

1. Complex environment and the development context

A complex environment is ubiquitous in any PA problem. If all contingencies could only be foreseen, then a perfect (if lengthy) contract could be written, specifying exactly what the agent should do if such and such an event occurred. But contracts cannot be specified too tightly, since a complex or changing environment may require a different set of actions from what has been stipulated. A greater or lesser degree of *discretion* must therefore be typically allowed the agent or person in charge. This very discretion, however, is what allows the agent to behave in ways other than those that promote the interests of the principal.

The difficulties posed by a complex environment maybe seen in persistent attempts to prescribe behaviour, as in, say, the voluminous rules for procurement laid down by the Commission on Audit. These may work well enough to regulate behaviour in predictable, repetitive contexts (e.g., activities connected with processing of passports or drivers' licenses). But as one moves to more complex environments, especially as these pertain to developing countries, it becomes clear that the constant expansion and elaboration of such rules to prevent abuse cannot go on indefinitely. To do so would seriously impair the initiative of agents, reducing them

to simple robots and becoming barriers to efficiency itself. In general, therefore, a trade-off exists between the discretion needed by agents to perform other than merely perfunctorily in a complex world and the specification of behaviour needed to prevent abuse. The constitutional concern over the possibility of “grave abuse of discretion” summarises the dilemma.

2. Information and bounded rationality on the part of principals

Even in a complex environment, the PA problem would be more tractable if the principal was always able to determine exactly what has occurred and how the agent has acted. There is a limit, however, to the extent that principals will find it worthwhile to observe the actions of their agents; agents will typically be better informed of their own actions than the principals are. Rationality is ultimately bounded or limited because its uses are multiple and competing. The electorate, for example, does not always invest in the information required to make the best electoral choices (nor even take the time to vote) and it cannot continuously inform itself of all that takes place in government. After all, people work and consume mostly in a private capacity. In this sense, exhortations to nationalism and civic duty really represent attempts to persuade the public to make the investment in political information they would otherwise not make. As will be argued in the last part, the democratic election of undesirables like Estrada is due in large part to information failure.

Taken together, bounded rationality and a complex environment give rise to monitoring costs, which simply refer to valuable resources used up whenever principals try to ascertain the behaviour of agents closely. It is, of course, possible to designate special entities to monitor the behaviour of agents as part of the arrangement; this is the purpose of entities such as the COA, the ombudsman (*tanodbayan*), the anti-graft court (*sandigang bayan*) and special anti-corruption commissions. It is equally obvious, however, that such arrangements are costly and expend scarce resources.

3. Personalities versus parties—non-shared goals between principal and agent

If actions could only be prescribed beforehand and verified, then the agent's subjective beliefs and values would become immaterial and irrelevant. As more discretion and authority are devolved upon an agent, however, (necessitated, say, by an increasingly complex environment), it becomes more desirable that the agent possess values that reflect those of the principal more closely. Arrow [1974:23] writes,

Trust is an important lubricant of a social system. It is extremely efficient; it saves a lot of trouble to have a fair degree of reliance on other people's word. Unfortunately, this is not a commodity which can be bought very easily.

Character and values are more important among politicians than run-of-the-mill bureaucrats since the former typically exercise more discretion and scope for judgment than the latter, whose behaviour is usually more readily prescribed. Much has been written in this country regarding the need to base politics on issues rather than personalities; it is probably more accurate to say that stances on

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issues are as important to the extent that they *also* reveal character and values. The more complex the environment, the less easy it is to prescribe definitive issues.

To what extent can "character" and "values" be predicted? The advantage of political parties built on ideologies is that they expressly contain a well-defined process for sorting out candidates based on the degree to which these share the party's goals. Political parties place their seal of approval on candidates who have undergone a process vetted by *informed* party observers and insiders. This reduces the information costs on the part of the individual voter who no longer needs to familiarise himself with the individual candidate but takes the word of the party. An offshoot of mass media and entertainment, however, is to convey the misimpression that the

electorate can actually get to know candidates' character and values directly and intimately (witness the Estrada myth of being the defender of the poor, conveyed through cinema, or the reputation of media personalities developed through investigative and public assistance programmes on television). This direct appeal to voters and the false intimacy generated by mass media is an element of modern political culture that has become particularly conducive to political demagoguery and irresponsibility since first, it can obviously be false and second, unlike a party system, it provides for no intermediate mechanism to hold politicians accountable to shared values during periods between elections.

4. Incoherent principal interests and social cohesion

A complication suggested by applying the PA framework is the latter's presumption that the principal's objectives are clearly known and all that remains is to find a design to attain such objectives most effectively. Applied to the political sphere, this presumes there is a *common standard* of public interest that the electorate applies to the behaviour of politicians. In practice, however, it is well known that a problem exists in aggregating social preferences. Where the notion of what constitutes public interest is either vague or disputed, reward-and-penalty mechanisms are unlikely to function smoothly since arguments can always arise over whether the official had indeed fulfilled the putative public interest.

This problem of incoherent principal interests is particularly acute for the Philippines because of a long-standing *heterogeneity of social interests* along various lines including ethnic-linguistic dimensions, religion, geography, wealth and urban-rural distinctions, a phenomenon that writers as early as Corpuz [1965] have long recognised as obstacles to "national unity" and social cohesion. Poverty and a highly unequal distribution of wealth can result in widely differing conceptions of acceptable behaviour on the part of public officials, the most vivid recent experience being the divergences between EDSA 2 and EDSA 3.

Nor is this isolated. Thanks to a long history of colonial oppression and unresponsive governance, large groups of the population continue *not to regard* institutions of government and broadly defined national interest as representing values superior to narrower parochial or clan and family interests. As a result, acceptable

behaviour on the part of public officials is evaluated using a different metric from that corresponding to the largest public good as expressed in laws and rules.

There are forces that tend to create a common experience and value-system among the people such as education, exposure to mass media, urbanisation, information, greater contact with the formal economy and the functioning of government.

5. A perversion of the relationship clientelism

The lack of social cohesion and the predominance of particularism imply that the goals of the principal that is society will either conflict or be ill-defined. This vacuum in the objectives of the principal weakens control over agents and gives rise to the possibility that the objectives of the agent may be substituted for those of the true principal. Putative public officials may thus attain substantial autonomy and discretion in pursuing private objectives, subject only to the condition that they fulfill the minimum actions necessary to remain in office. Local politicians may thus dominate local politics indefinitely by fulfilling the implicit minimal requirements of crucial electoral constituencies (*e.g.*, the urban slum-dwellers, farm workers or tenants).

In the extreme, the supposed principal-agent relation between the public and public servants can be so perverted that the latter become the principal and the former the agents, making clientelism possible. In clientelism, the PA problem is reformulated as one where the politician designs an incentive scheme, say, through various income transfers and other forms of patronage, to induce the crucial constituency to perform his bidding, namely election. For obvious reasons, this type of relationship is more likely to prevail in local than in national contexts where transfers are more difficult to target, and among politicians rather than bureaucrats, since the latter's tenure depends more proximately on politicians than on dealings with the general public.

6. Violated participation constraints and adverse selection.

Any solution to the PA problem assumes that an eligible payment scheme can be found to compensate the agent at least equal to the income in the agent's next

best alternative occupation, thus meeting the agent's "participation constraint". In reality, however, the existing compensation for public officials at certain levels, especially at the higher decision-making levels, often fails to achieve this, with the levels of statutory compensation falling below realistic alternatives for the pool of qualified talent. An important reason the design of incentives does not work is that it simply fails to compensate agents sufficiently. Tell-tale signs of this are the increasing difficulty in recent years of filling sub-cabinet positions in the executive branch and the high number of vacancies (about a quarter of all positions) in the judiciary.

This same circumstance is an important motivation for the agent to attempt to get around the scheme. A situation of "adverse-selection" may then arise, since only those who *expect* to violate the scheme are attracted to public service. Hence, bureaucrats of agencies such as the bureau of internal revenue or the customs may be curiously attracted to careers that obviously offer little by way of legitimate pay, expecting that the differential will be made up through corruption and other forms of post-contractual opportunism.

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7. Scope of action and competition

An important condition for the existence of corruption is government's position as a virtual monopolist in the provision of many goods and services, raising the potential for obtaining rents by influencing the decisions of government agents. If government were no more than one among many competitors rather than a monopolist, no premium would attach to the decisions it makes, and little or no resources devoted to influencing the exercise of its prerogatives. A related point is that a smaller scale of government would reduce the scope for corruption. This has been extrapolated into the proposition — discussed under political economy-context below — that a reduction in the size of government is an indispensable ingredient in the reduction of corruption. But one must balance the real requirements of development in which a government's role is indispensable against this. In the same

manner, removing all discretion would drastically reduce opportunities for corruption but would more likely impede efficient responses to complex environments.

Rather than directly reduce public agents' scope of action through closer prescription, it is also possible to use *competition* as a means of eliciting appropriate agents' behaviour. This can take various forms ranging from combined public and private provision, contracting and concessions and management contracts to complete privatisation (examples being water concessions, power sector reforms and various others).

Besides providing for forms of economic competition, however, mechanisms also exist to promote competition in the political sphere, the most obvious being electoral contests. Added to these are intra-regime competition between political parties as well as the various checks and balances between branches of government. In the Philippines, however, the peculiar characteristics of politics such as the absence of party-based politics and strong central powers vested in the executive relative to the bureaucracy and other branches of government work to reduce the effectivity of the pressure of competitive politics.

8. The relational context

Finally, both principal and agent can behave in a corrupt manner because they can introduce more arguments to their utility functions or increase the levels of these arguments or both. By definition, however, these actions are illegal and are subject to penalties. Self-interested agents, therefore, will persist in their corrupt

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behavior, or much more of them will do so, only if the increase in the number and levels of the arguments of their utility functions through corruption are not counterbalanced by negative factors.

This requirement can be satisfied by one or both of the two following conditions. Firstly, there is social acquiescence or acceptance of corrupt behavior or of its fruits. Secondly, the probability of being caught and meted the appropriate sanctions are negligible, if not nil. It is the social and political contexts that determine

the satisfaction of these conditions. Nevertheless, even if society abhors and ostracizes grafters and corrupters and absolutely convicts them when caught, low-level corruption may continue to exist as the evidence on the ubiquity of corruption indicates. Under no environment will all grafters and corrupters be caught and convicted with absolute certainty. Thus, some individuals will continue to find it beneficial to engage in corruption. From all this, it is easy to see why corruption tends to breed corruption. Increased corruption may lead society to be indifferent and eventually, to accept corruption. Increased corruption may also lead to the corruption of the monitoring and prosecuting institutions of society leading to a massive failure of the justice system. In other words, corruption tends to lay the foundation for its own survival and growth.

Taxonomy

The explosion of literature on corruption has introduced a plethora of approaches, concepts, typologies and analyses, as well as corresponding policy recommendations. The following is, to our knowledge, the first attempt to bring together systematically the largest number of these approaches.

By type of agent and initiator.

Corruption is defined by the location in which it occurs in the public sector, which in turn, is largely decided by the degree of discretion exercised by public officials. Public-sector corruption may involve either bureaucrats or politicians. Bureaucrats and administrators are thought to be interested primarily in pecuniary gain, while politicians are thought to have both pecuniary and political interests at stake. In the Philippines, earlier literature (typified by Cariño et al. [1978]) focused on *bureaucratic corruption*, viewed primarily as a problem of ethos and example. That literature implicitly adopted the technocratic viewpoint that the political leadership would take an active interest in reducing or eliminating corruption in the regular bureaucracy as part of improving the effectiveness of governance. More critical analyses of the quality of political leaderships themselves, however (especially after

the fall of dictatorships and exposure of their excesses), led to an interest in systematic corruption among *politicians* themselves.

Political corruption is distinct from bureaucratic corruption, partly because of the levels at which it occurs, and partly because of differences in goals. Hence, for instance, fewer bureaucrats would be interested in expanding influence and patronage beyond what maximising pecuniary advantages would dictate. Vote-buying, corruption of the electoral system, political or regulatory harassment of opponents are associated with distinctly “political” rather than bureaucratic goals. A conflation of relationships is also possible when bureaucrats collude with politicians.

It is likewise possible to distinguish corruption according to the initiating agent. In the case of bribery, the initiative obviously lies with the donor. On the other hand, extortion is initiated by the public official.

Corruption with theft and without [Shleifer and Vishny 1993] is a distinction determined by whether the corrupt official remits the lawfully stipulated amount (e.g., a license fee) to the government. If the regular amount is not passed along, then there is theft, as when a revenue collector underassesses taxes and keeps a portion of the actual payment for himself.

In terms of scale and level, the dominant influence of *political* (as opposed to bureaucratic) corruption in the Philippines is almost self-evident. This is to be expected, given the wider discretion, vaguer mandate and weaker controls in the political selection process as determined by strong local power and a weak party system. Compared to corruption at the political level, bureaucratic corruption is clearly of subordinate importance, which itself reflects the characteristic but almost universally noted weakness and lack of independence of the bureaucracy in the Philippines (a fact evident in the frequent intervention of politicians in bureaucratic selection).

Indeed, the bureaucracy very often serves as the instrumentality and conduit for political corruption, as when high-ranking politicians use their influence over bureaucrats to evade rules and regulations. A trivial but clear example is the exemption of the former president’s housing project from building and environmental regulations (as reported by the Philippine Center for Investigative Journalism). Other recent instances include the intervention in tax cases facing a presidential crony

(*Ipahingi na ninyo ito sa akin*) and the failed attempt to influence the investigation of the BW insider-trading scandal. More generally, the utilization of pork-barrel funds by elected politicians to earn corruption rents must be facilitated with the knowledge and consent of at least some bureaucrats in the public works agencies. It is difficult to imagine that any serious move to limit the regular forms of corruption in the bureaucracy can succeed without first demonstrating a credible commitment to drastically reducing political corruption.

A good deal of the scale of and motivation for political corruption results from the nature of the PA relationship implied in political contests, especially the large amounts of funds required to run for public office in the absence of clear and credible guidelines on campaign spending and contributions. Such a circumstance motivates corruption in office to raise sufficient amounts for future campaigns and contests or to recoup huge expenditures raised from one's own pockets or by third parties.

By scale and level.

One might distinguish between *petty corruption* and *grand corruption*, which Rose-Ackerman [1998] defines as “a substantial expenditure of funds with a major impact on a government budget and growth prospects”. More often than not, of course, the scale of corruption is related to the *level* at which it occurs, since the discretion and prerogatives of public officials — and hence the resources they control — increase with the rise in the hierarchy. Hence, a public works director for local projects will *ceteris paribus* possess less opportunity for large-scale corruption than a cabinet secretary. However, this conclusion may change depending on the degree of decentralisation of the bureaucracy.

Grand corruption occurs especially when large assets or transactions are involved, as in the massive privatisations that have occurred in liberalisation episodes in many countries. Some authors have argued that as a result of the liberalisation and privatisation episodes occasioned by the neo-liberal trends in many countries, the scale of corruption has increased.

For the same reasons that political trumps bureaucratic corruption in the Philippines, the significance of grand corruption also dominates that of petty corrup-

tion. It will be rare that grand corruption involving enormous sums (e.g., Amari, the Centennial Expo, the BW scam, PCI-Equitable sale, etc.) will remain a purely bureaucratic phenomenon without the participation of political types (although the unobtrusive sale of export-credits at the DOF may be an exception). This hypothesis is based simply on the greater degree of discretion exercised by politicians (to which may be included higher-level political appointees) as compared with civil service employees. Politicians will also be better informed about the potential for policy-shifts that afford new rent opportunities (e.g., new projects and privatisation initiatives).

By type or object of transaction.

There are various ways to list the objects of corrupt transactions. Gray and Kauffman [1998] enumerate the things private parties can purchase from a politician or bureaucrat such as government contracts, government benefits, public revenues, time-saving and regulatory avoidance, influencing outcomes of the legal and regulator process. An even longer list is given by Rose-Ackerman [1996] which deals with various *stages* or *methods* involved in a transaction rather than the ultimate object of the bribe itself (e.g., inclusion in the list of bidders, restructuring of specifications and selection as winning contractor are listed as separate items — all of them pertaining to bidding). The World Bank [1997:9] also enumerates the “things” that bribes can buy: government contracts (choice of firms), government benefits (subsidies or access to funds), lower taxes, licenses, time and legal outcomes.

This paper proposes the following list of types or objects of corrupt transactions: (a) bids, purchases and auctions; (b) sale of policies and rules; (c) rules evasion; (d) bureaucratic or political facilitation; (e) bureaucratic or political harrassment; (f) political favours and support.

The first and most easily analysable transactions are those involving *bids* and *purchases*, including over- and under-pricing and collusion among potential bidders of services, franchises, concessions and asset sales. The nature and consequences of these transactions are easiest to comprehend since there is an obvious bench-

TABLE 1
Corruption by object of transaction

Object of transaction	Examples
1. bids, purchases and auctions	bid-rigging, overpricing, over-purchasing
2. sale of policies, laws and regulations	changes in ownership rules
3. rules evasion	customs-releases; tax evasion; bribes to cops
4. bureaucratic or political facilitation	queue-jumping; "grease money"
5. bureaucratic or political harrassment	"AC-DC"; proxy wars; tax harrassment
6. political favour or support	nepotism; vote-rigging

mark against which they may be compared, namely, the next-best or competitive supply price.

The second important type of transaction is the *sale of policies or rules*, among them industrial priorities, fiscal policies, regulatory rules, judicial decisions, electoral rules, etc. The bottom-line efficiency effects of such corruption are difficult to predict beforehand. Rose-Ackerman [1998] notes that it will depend on the efficiency of the rules themselves. If rules are over-extended to begin with, they would be welfare-enhancing to the extent that exemptions are made. The *jueteng* scandal that precipitated the downfall of the Estrada presidency is in this category.

Unlike policy-for-sale, the purpose of *rules-evasion* is not to alter the rules themselves but to modify their application for individuals who are in principle unqualified for the benefits or are liable under the rules. Corruption to excuse tax evasion or bribes made to officers of the court are in this category.

Bureaucratic or political *facilitation* is the third type of corrupt transaction related to what Rose-Ackerman [1998] calls "corruption to lower costs" and what Alatas [1997] calls "transactive" corruption. Examples range from petty corruption in lower-level agencies (e.g., car registration) to buying political influence to smoothen deliberations on franchises given out by congress. One way to distinguish this from

other cases is that here, the private agent is in principle *entitled* to the service or good being provided. Otherwise, it would fall under the previous category. Hence, an illicit exemption from a tax would be liability evasion rather than a case of facilitation.

While the parties involved in facilitation and harassment are the same, i.e., private agents and public officials, the significance can be completely different. The case of harassment corresponds to what Alatas calls “extortive” corruption, as when tax collectors summon taxpayers and go over tax returns minutely as part of a shakedown or when politicians initiate an investigation of their potential

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size of the
government's
operating budget

opponents as part of a vendetta. In the Philippines, the well-known technique of “AC-DC” (attack and collect, defend and collect) also falls under this category. A particular nuance of “weak states”, where laws and regulations are only haphazardly applied to begin with, leads to the ironic possibility that harassment may occur through a strict application of the law itself. Formally, this is the category wherein the *jueteng* scandal of 2000 originated. Payoffs to

public officials were in the nature of protection money based on the non-application of existing laws, although the immediate reason for Singson's turnaround was a problem in bids and awards.

Finally, *political favours and investment* are transactions distinguished by the fact that the result is not an immediate pecuniary benefit but a *political* one.

In the local context, all transaction types mentioned can be observed. Two types in particular, however, have received significant coverage, namely: (a) bids, purchases and auctions and (b) the sale of policies, which are the topics of two other papers in this issue.

The pervasiveness of corruption in bids and purchases is traceable to the customary function of government of purchasing supplies in the course of its mandate to provide public goods and services; much of this type of corruption has become virtually established practice among contractors for government departments such as Public works, Defense, Education, Health and others where procurement is a

routine element, to the extent of attaining the status of a fixed markup over costs. The natural limit to this type of corruption is the size of the government's operating budget, augmented by occasional bulges in capital spending (supported to some extent by foreign development assistance).

The prospect of new and larger corruption rents stemming from shifting policy and project initiatives, especially as these relate to privatisation and liberalisation has changed in recent years. The privatisation of government-acquired assets is an important example of such an opportunity. At this point, the potential size of the corruption rents is no longer related to the size of the agency's budget but to the much larger discounted stream of *private benefits* flowing from the private use of the asset. For instance, the value of a piece of idle public land to the private individuals bidding for it would be much higher (e.g., as location for a mall); this would determine the potential corruption rents to public officials.

It is also worth noting that until recently, competitive bidding was not universally practised in asset disposition and franchise awards. The corporatisation of many government functions has allowed many of these agencies to skirt the competitive selection of BOT contractors through the fiction of corporate "joint ventures", allowing them to handpick their partners and tailor-make the terms of contracts to suit private interests unduly. A prominent example of this was the contracting of power plants at the height of the energy crisis, which guaranteed minimum off-takes. Second, owing to oversight or less benign reasons, some regulatory agencies have not resorted to bidding in the award of franchises but have chosen to assign these bureaucratically (e.g., the service-area scheme in telecommunications or the attempted monopolisation of port services), opening up opportunities for corrupt deals. The PAGCOR's biased assignment of the Bingo Two-Ball franchise is a recent example. A more transparent process would have been to award the franchise through bidding or to adopt a virtually free-entry policy. Either tack would have eliminated corruption rents.

Changes in regime or policy environment are also the source of gains from policies for sale. The most recent visible example of this was the distortion of aviation rules under the Estrada administration to favour Philippine Air Lines.

Timing, type and predictability of corruption rents.

Regarded purely as financial flows, the timing of returns from corruption may have an effect on the nature of bribes. Returns may be *performance-related* or *transfer-related*. An example of the former is when bureaucrats are bribed to a task needing performance or when a constant percentage of flows from a project is received as a retainer. By comparison, corruption rents may be obtained “up-front”, an arrangement obviously more advantageous to corrupt officials who may, as it were, “take the money and run.” From the aspect of efficiency, however, the latter is less socially advantageous since it creates powerful incentives to force the government to undertake nonviable projects, as was frequently the case in the crony deals of the later Marcos years. Commissions were earned regardless of the inherent viability of projects.

From the viewpoint of a bona-fide project proponent, an important distinction is whether bribes take the form of returns that are predictable or not. Campos, Lien and Pradhan [1997] argue theoretically and provide some empirical support for the proposition that unpredictable amounts of rent discourage investment more than predictable amounts which approach the nature of a tax. The predictability dimension cuts across distinctions whether the return is performance- or transfer-based.

A related but less noticed aspect of predictability is the (un)reliability of the recipient of a bribe himself or herself (also mentioned by Bardhan [1997]). Uncertainty obviously increases if bribed parties are unable to deliver on promised results. This may occur when, for example, a department head undertakes to deliver on a contract which is intercepted by a congressional investigation. Unlike normal contracts, corruption agreements lack a credible enforcement mechanism since they are *de facto* illegal. This need for effective enforcement is one source of demand for the services of organised crime and one reason why corruption and criminality are sometimes linked.

A final issue that may be raised involving payment-forms with implications for efficiency is whether corruption rents take the form of *cost-plus* or *fixed-price* arrangements, a distinction taken from the literature on contract design (e.g., Laffont and Tirole [1993]). Cost-plus corruption contracts preserve the project's quality

and benefits to users as contained in specifications, although it will cost more than the results of a transparent bid. On the other hand, a fixed-price contract, when tainted by a corrupt bid, will eat into the project's quality and user-benefits, although it will outwardly preserve the "fair" price to government. The choice, therefore, is between a cheap but substandard road and one that is standard but overpriced. From the viewpoint of the ultimate project beneficiary, of course, the cost-plus arrangement is to be preferred.

By industrial organisation.

The *locus classicus* for the analysis of industrial organisation of corruption is the influential paper by Shleifer and Vishny [1993], who point out the possible differences in economic impact of corruption depending on whether its supply is competitive, monopolised or bilateral-monopolist. They suggest that a competitive structure of corruption in which several agencies are equally placed to provide the same service is the least distortive, since this tends to make corruption rents vanish. A monopolistic structure (they give the Marcos regime as a prominent example) is more distortive by comparison, because of the absence of competition. It is when agencies have overlapping mandates, i.e., are in the position of overlapping monopolists, that corruption yields the most inefficiency. When the approval of several agencies is required, each acts to maximise the amount of a bribe demanded for itself, thus discouraging an otherwise social activity (e.g., investment), even if the total amount of bribes paid may actually be less than under a monopoly. This is otherwise known as the "common-pool" problem since it is akin to the monopolists seeking to draw as much as possible from a source which none of them owns, resulting in a premature exhaustion of the resource. Shleifer and Vishny [1993] suggest that the return of democracy in the Philippines may have resulted in just such a situation.

In a 1998 paper, Rose-Ackerman attempted to extend the typology of corruption begun by Shleifer and Vishny to a characterisation of various corrupt states with differing outcomes (see table below). Her typology is according to whether the number of recipients and bribers are few or many. This leads to four cases,

TABLE 2
Types of corrupt states

	Multiple bribers	Few bribers
Few recipients	kleptocracy	Bilateral-monopoly state
Multiple recipients	competitive-bribery state	Mafia-dominated state

Source: Rose-Ackerman [1998].

namely: kleptocracy, bilateral-monopoly, competitive-bribery and Mafia-dominated states.

In a *kleptocracy*, the head of government organizes the political system to maximize the possibilities for extracting rents and reallocates these rents for personal use, although this is not incompatible with striving for productive efficiency. This most likely characterised the Marcos dictatorship. The efficiency of a *bilateral-monopoly* is determined by the possibilities for rent extraction which are shared by briber and ruler. Their relative strength will determine how gains are shared as well as the overall size of the pie. In some states, rulers form an alliance with the mafia and extort a share in their gains. In others, firms may form an alliance with a country's rulers to share the wealth. States *dominated by organised crime* are weak and disorganized, with many officials engaged in freelance bribery. The private group (domestic mafia or large corporation) dominates the state, buying the cooperation of low-level officials but unable to organize the state into a unified body. Finally, under *competitive bribery*, many corrupt officials deal with large numbers of ordinary citizens and firms. This encourages others to accept bribes until all but the unreconstructed moralists are corrupt. Rose-Ackerman's typology appears to be heavily influenced by the need to explain the Russian experience where the bribers are most typified by organised crime, a circumstance that makes it less applicable to the Philippines.

One of the most involved elements in analysing Philippine corruption is its industrial organisation as this has changed with political regimes. The paper writers consider that except for the dictatorship period, corruption in the Philippines was

generally decentralised. Relatively routine corruption prevails in the tenured bureaucracy; this is more or less tolerated and often even utilised by politicians and political appointees and lamented but countenanced by the private sector.

The variable and novel element has always been *political* corruption. Under the dictatorship, political corruption was centralised and bureaucratic corruption suppressed to the extent it was autonomous and did not fall in line with the requirements of the cronies and the ruling families (for example, the Bureau of Customs gained a reputation for a degree of professionalism under the Marcos dictatorship).

In the pre- and post-dictatorship democratic regimes (apart from the Estrada administration), on the other hand, it is our hypothesis that political corruption has become more decentralised, given the obvious checks and balances and risk of exposure entailed by the separation of powers and media freedom. As a result, political corruption may be hypothesized as being more modest and selective relative to the years of dictatorship, even as the dilution of central power gives an opportunity for bureaucratic corruption at the local and lower levels to gain more autonomy. This, of course, has its own economic consequences. *Selectivity* nonetheless entails that the corrupt deals politicians do engage in will be larger in magnitude (to attain scale economies), novel in character (to avoid detection) or both. Under the Ramos administration, for example, asset privatisations (including the IPOs of government controlled corporations), BOTs, joint venture contracts and foreign loan syndications were new areas where potential rents could be obtained; the very novelty of these areas made rents difficult to detect.

A unique feature of the Estrada administration was its failure to conform to the trend towards corruption-selectivity imposed by a *nondictatorial* regime. The internal organization of the Estrada circle was effectively one of awarding bounty-hunting franchises to a number of individuals consisting of cronies, kin, wives and mistresses. (This arrangement was implemented partly by the formal requirement that all contracts in excess of P50 million be reviewed by Malacañang.) The pecu-

The internal organization of the Estrada circle was effectively one of awarding bounty-hunting franchises to a number of individuals

liarities of Estrada's personal circumstances meant a large number of persons, clearly indicating "excessive entry". Two empirical points and a theoretical one are to be noted. *First*, this arrangement was superimposed on pre-existing bureaucratic corruption. Anecdotal evidence suggests that on top of 10-15 percent bureaucratic markups on contracts, additional 10-15 percent "fees" were required for franchised political facilitators. Under the dictatorship, by contrast, it will be remembered that bureaucratic corruption was reduced by some measure, leaving some slack for cronies and family to take over. The Estrada system therefore put a strain on the system it had not been subjected to before.

Second, the carte blanche given to a large number of rent-hunters meant an open invitation to expand the sphere of extraction of "fees", which clearly went against the selectivity in political deals that were the accustomed trend in all previous post-dictatorship administrations. Apart from the amounts involved, the pervasiveness of sanctioned corruption deals in the government was an additional strain on the implementation of programmes.

The *third* point is a theoretical one. Shleifer and Vishny's typology suggests that a competitive arrangement for corruption is most conducive to welfare to the extent that rents are bid down to zero. This did not occur under the Estrada arrangement, however, first because entry was not free and second, since the competition among franchise holders was not with respect to price but one arranged as a race, with the first mover getting the prize. For this reason, rents to bounty-hunters did not fall to zero but were obtained at the expense of the markups of bureaucrats and private interests themselves. Indeed, one will note, Estrada's fall from power was caused by the very *failure* of the arrangement. Luis "Chavit" Singson turned his back on Estrada when his exclusive "franchise" was challenged by another franchise holder, Charlie "Atong" Ang. From the viewpoint of industrial organisation, therefore, Estrada's system of corruption carried the seeds of its own destruction: it was an oligopoly with overcapacity.

Précis

The taxonomy enumerated above has been extensive, and it is useful to make a brief summary by enumerating a number of important and abiding features that

characterise corruption in the Philippines. Corruption here occurs on virtually all levels of government, both on a petty and a grand scale. Petty or retail corruption tends to exist in closed and routine bureaucratic contexts such as in the internal revenue and customs collection agencies and among the police where bribery and extortion (various terms being *lagay*, *padulas*, *komisyon*, *kotong*, *tong*) are predominant forms. While not always involving large amounts, this form of corruption is often the kind that ordinary citizens must confront. These types of corruption have generally existed continuously and have been subordinated to changing political leaderships which have either tolerated or benefited from them in varying degrees. The Estrada administration was unique in that it involved itself directly as a major beneficiary from closed-form corruption.

Higher levels of government are associated with greater levels of discretion and thus with larger amounts, culminating in the grand corruption that only high elected officials can engage in. Typical of these are large one-of-a-kind procurement contracts and awards (e.g., the PEA-Amari and Centennial scams under Ramos or the IMPSA deal under Estrada), as well as the sale of policy. It should be noted that as the scale of corruption increases, acts assume a more distinctly *political* nature and the yardsticks for evaluation become more *amorphous* owing to the more limited information on such deals available to the public and the conflation of genuine exercise of discretion and corrupt practices. Hence, the Estrada administration's bias in favour of PAL was rationalised (to some, credibly) as a valid defence of national interest, rather than an instance of cronyism while the purchase of shares of speculative stocks by SSS and GSIS could not immediately be pinned down as a behest purchase rather than a valid risk taken by management. In addition, innovative practices in grand corruption have also been tried as permitted by external circumstances or large policy shifts. Recent examples have included the sale of government guarantees, stock-price manipulation and behest stock acquisitions, among others.

In terms of its industrial organisation, corruption in the Philippines presents a mixed picture. The existence of formal democratic institutions allows corruption to be generally more dispersed among different agents, as compared to that in other countries in the heyday of Asian authoritarianism. Yet this is not unmiti-

Philippine
corruption, then,
is characterised
by its ubiquity
and scale

gated, since the dominance of the executive branch — remarkable when measured against, say, a US yardstick — permits great discretion and initiative on the part of the president [de Dios 1999b]. One effect has been to concentrate grand corruption at the national level, reflecting resource and power distribution. Owing to changing fortunes and the results of checks and balances between branches of government, however, there is a tendency for corrupt officials with over-

lapping claims to “overbid” in bribes, discouraging investment. A third effect predicted by theory has been to increase uncertainty and unpredictability in policy-making and -implementation, as the other branches of government interpose obstacles to initiatives of the executive, whether corrupt or legitimate, in an attempt to share in the largesse. Philippine corruption, then, is characterised by its ubiquity and scale and the overlapping claims of the main actors, leading to high demands for rents, uncertainty and unpredictability.

Economic impact of corruption

One of the most contentious issues is the exact economic impact of corruption. The agnostic view of economists regarding corruption is somewhat startling for many who tend to take a more ethical view of it. Barro and Sala-i-Martin [1995:440, fn. 14] conclude, for example, that “the theoretical effect of corruption is unclear; in some cases, the economy would operate more efficiently if governmental rules can be readily overcome by cash payments”. Even much earlier, of course, Adam Smith gave the benefit of the doubt to the smuggler and presumably, would have excused the corrupt customs official.

A good deal of literature deals with the microeconomic analyses of various types of corrupt transaction according to one or more of the categories cited above. Hence, one may compare petty versus grand or predictable versus unpredictable corruption. Much of what follows is based on de Dios [1999] and enumerates the various types of micro-analytic arguments seeking to show how one or another type

of corruption has a positive or negative impact on efficiency. It seems fair to say, however, that a microeconomic analysis alone is usually insufficient to make an airtight conclusion regarding efficiency, without reference to an analysis of the larger institutional framework, including the rationale and optimality of the existing laws themselves.

Positive or near-neutral impact.

The idea that some types of corruption have positive, neutral or negligible effects on efficiency is based on the idea that the scarcity value of goods and services provided is not unduly raised even with corruption, or that corruption can provide incentives for performance, thus forming part of a supply price of bureaucratic effort.

Some corruption exists because, as Rose-Ackerman [1998] puts it, it “*equate(s) demand and supply*”. It may occur because some public programmes seek to provide goods and services at prices lower than competitive markets would. Then it is obvious that some nonprice rationing system must be formed, as in a queue for subsidised grain during a rice shortage. An obvious opening for corruption occurs when bureaucrats and other interests seek to capture the difference. A bribe in this situation is a means of reverting to a *disallowed* method of rationing which is price. In principle, however, the level of the bribe cannot exceed the difference between the market-clearing price and the subsidised price. Therefore, people under the bribe system cannot be worse off than under a competitive market outcome. But the project would not attain the social goal it was meant for and if there were a social determination that a deviation from a market outcome would be superior to adhering to it, then a net social loss would arise.

bribes may
serve as
incentives to
bureaucrats

At other times, bribes may serve as *incentives to bureaucrats*, which is the same as saying that they form part of the implicit wages of public officials. This has always been an influential line of thought [Leff 1964] and is an argument that continues to be made [Chang 1999]. Predictable and petty corruption at lower

levels for regular services or goods provided is the closest example of this, although nothing in theory prevents it from reaching higher levels.

Rose-Ackerman [1998] notes, on the other hand, that most arguments for corruption as implicit wages assume that officials have limited discretion and that they cannot expand the scope of corrupt transactions, neglect ways to avoid the costs of illegal payment systems and disregard the fact that tolerating such corruption could reduce the possibilities for reform in the long run.

A related instance of a supply-price argument is the notion that a bribe to evade a fine (or a tax) may work in the same direction as the rule itself, as when motorists who violate traffic rules bribe policemen to evade a larger fine. A bribe in this sense closely approaches the effects of a tax. The corruption-as-tax argument really implies that a bribe does not distort incentives (at least not significantly). A bribe is thought to differ from a tax primarily in that the proceeds accrue to the official as an individual rather than to the government.

A similar argument is involved in the contention that free competition in bribes is not overly distortive since the prize always goes to the most efficient firm. The principle invoked is corruption-as-tax or fee, since an *open auction* for a government contract or privilege (e.g., a quota) would have yielded the same result. Again, the only difference is that the proceeds accrue to private individuals rather than to the government. For the same reason, queue-jumping based on the highest bribe would give priority to the firm with highest valuation of the resource being dispensed.

If one proceeds from the *social optimality of the rules* themselves, it is still clear that the amount of regulation provided with bribes is less than without it. One may therefore go to the other extreme where the rules or laws are socially suboptimal or inefficient, as the burdensome restriction of trade in the time of Adam Smith. On this premise, bribes to evade such restrictions would be socially welfare-enhancing, although still inferior to a repeal of the oppressive laws themselves.⁴

Negative impact.

The most obvious negative impact of corruption is on the potential beneficiaries of public programmes or projects. By eating into the provisions for a project, corruption either *raises the cost* to project beneficiaries or *lowers the quality* (or both

simultaneously) of a project. Where entitlements for certain groups are intended, the high implicit cost could result in the deprivation or even exclusion of these groups. In a fixed-price contract, the only way to recoup a bribe is to reduce benefits or quality of service; where the quality of service is pre-specified, a bribe compels the supplier to raise the cost to the user or the government.

As already seen, corruption to evade liabilities (e.g., traffic rules, taxes or environmental rules) can result in a less than optimal regulation of behaviour, if one proceeds from the assumption that the level of the liability is optimally set. On the other hand, if liabilities are in fact oppressive, then a bribe would have superior economic effects: None of this is new. All it says is that unjust laws of an unjust regime carry no moral weight.

Losses from corruption in the form of *lower investment and economic growth* are easily understood and have been the most econometrically researched effects. Corruption, like a tax, discourages the affected activity, investment in this case. It is worse than a tax, however, to the extent it is prone to more uncertainty or unpredictability which can be decomposed into (a) the unpredictability in the magnitude of payoffs asked and (b) unreliability in the delivery of the contract. Industrial organisation contributes its part, as when overlapping mandates cause the corrupt agencies involved to bid up the bribe amounts, leading to less investment than either a competitive or a monopolistic situation.

Counterfactual estimates of the economic impact of corruption in the Philippines can be made using Mauro's [1995] data and equations for the period 1960-1985. By assuming the Philippines had Singapore's level of corruption, Tadoran [2000] finds this would have produced (a) an increase in the ratio of investment to GDP of 6.6 percentage points; (b) an increase in average annual per capita GDP growth of 1.65 percent, or what is the same thing (c) a 40 percent increase in per capita GDP of 1985, assuming the actual average growth was 2.5 percent.

Besides affecting the level of investment, corruption can also introduce unwanted *biases in the composition* of investments, particularly by the public sector. There will generally be a bias to demand more than is needed of goods and services provided by corruption insiders [Della Porta and Vannucci 1999], which will only imperfectly correspond to what society itself requires. In addi-

tion, the economic characteristics of the types of projects demanded may also be affected by the imperatives of corruption, such as a likely bias for projects of short gestation, to minimise the uncertainty of payoffs; for projects of large scale, to economise on transactions costs; and for projects where compliance is difficult to monitor, to avoid detection (some Philippine examples are discussed in de Dios [1999]).

Additional indirect effects on growth may arise from the fiscal impact of corruption such as the loss of revenue and the bloating of spending, both of which lead to fiscal deficits which have potentially disruptive effects of their own.

Finally, the costs from *rent-seeking* are distinct and refer to the diversion of productive resources away from directly productive activities towards those that seek to capture corruption rents instead. These include mainstream political activity as well as the formal profession of lobbying and parts of the profession of litigation, public relations and various types of consulting, including economic consulting. It should be obvious that rent-seeking costs are not uniquely corruption-related. Rent-seeking may exist even in a non-corrupt society in the form of mainstream political lobbying by cause-oriented groups and group interests which are considered part of the workings of democracy. It has also been pointed out [de Dios 1999] that corruption wastes not only the talent of the corrupt but also of those who would *prevent* corruption. A part of the costs of a corrupt and inefficient government consists of the time of morally outraged citizens provoked by venality and insensitivity. Public mobilisation — ranging from demonstrations to watchdog institutions to open revolt — also expend resources that might otherwise have been used for directly productive purposes.

Corruption generally results in underprovision of public goods and probably, an overprovision of public bads. Where government already plays a much-reduced role in the economy, public sector corruption becomes even more harmful, since the need for public goods is likely to be all the greater. By contrast, corruption's adverse effects are likely to be less in economies that are overregulated and overtaxed and where government is oppressive. Indeed, corruption may act as "grease" in cases where government regulations and impositions hinder private initiative. Under an oppressive dictatorship, one would *hope* that officials could be bribed.

It has also been argued [de Dios 1999] that such systems would be better *with* corruption than *without* it, although admittedly only as an n-th best compromise.

Institutional effects

The cost of corruption in terms of the erosion of institutions is the most difficult to measure. The previous section showed how corruption can have large or small, harmful, neutral or beneficial effects depending on whether the rules themselves are rational and just. Corruption, however, makes little distinction between “good” and “bad” rules, since rents vary with the difficulty of evasion and the private values associated with that possibility, not with the *character* of the rules themselves.

Corruption's principal impact on the legitimacy of a regime is to undermine it.

It is in this latter sense that the *ethical* or *moral* emphasis of an earlier literature cannot be entirely dispensed with. An inherent value attaches to adherence to norms or institutions⁵, quite apart from a question of their *ultima ratio*, because where these are questioned, the uniformity and reliability of rules themselves may come under threat. The more recent literature has elucidated the economic consequences of regimes where norms and institutions are widely disregarded as when contracts become unenforceable and property rights are only vaguely defined. The effect of corruption on development may possibly — though not always — extend beyond the taxonomy of its role in facilitating or hindering particular transactions and come to include its wider impact on the indispensable web of institutions that govern economy and society. The most vivid illustration of this was the result of the aborted impeachment trial of former president Estrada. The refusal of the senate majority allied with Estrada at the time to proceed in opening important evidence on corruption cast a pall of corruption on the entire senate itself, irreparably harming its credibility. The loss of faith in institutions led to the search for extra-parliamentary means to obtain justice, culminating in EDSA 2.

Corruption's principal impact on the legitimacy of a regime is straightforward, namely, to undermine it. The case of the Marcos kleptocracy is the most obvious that comes to mind. The unprecedented rapid erosion of the Estrada presidency's legitimation in the period 1998-2000 following revelations of corruption on the highest levels is another. Some authors, however, have pointed to a role of corruption in supporting state legitimation. Without denying that less noble considerations may be involved, Jomo [forthcoming] points out an important motivation behind Malaysia's corruption and rents in terms of redistributive and legitimation goals, particularly in relation to the participation of *bumipeteras* in the economy. South Korea's tolerance of bribery relationships between the conglomerates (*chaebol*) and bureaucrats has been similarly depicted as part of a system of redistribution to poorer constituents through politicians [Chang forthcoming].

If these experiences indeed deviate from what is customary, certain distinct characteristics should be explained. In Malaysia's case, the *bumiputera* policy was publicly announced and adopted, although it remained controversial. A good amount of the rents to the *bumipeteras* could therefore be understood as being *legal* transfers. To the extent corruption accompanied the process, this too would be tolerated as part of the policy, legitimate though not legal. In the case of South Korea, it is a significant observation that *tukkap* is non-specific but in the nature of a uniform payoff to most, if not all, influential politicians as part of general goodwill, perhaps akin to a system of pooled tips in a restaurant. Its predictable and nonspecific characteristic approaches the function of a tax.

Both cases are embedded in a *larger system of redistribution* and their association (justified or not) with *significant economic success* contributed to the legitimation of corruption's existence. By contrast, the demonstrably narrower focus of beneficiaries from "crony capitalism" under the Marcos regime in the Philippines, plus its failure to deliver economic growth undermined the legitimacy of the regime erected upon it. In the same manner, as political changes preceding and since the Asian crisis have put into question the ideological foundations for interventionist strategies, public tolerance of corruption itself — which drew its rationale from that same system — has become much reduced.

Economic strategy and the scope of government

A central argument is that less government intervention in the economy and a greater reliance on markets instead is a key ingredient in reducing corruption [World Bank 1997a], a contention that must be measured against the idea of an activist “developmental state” in the East Asian mode [Chang 1996]. How countries of the latter sort (e.g., South Korea or Japan) managed to temper the state interventions that mode called for with the need to restrain bureaucratic and political self-seeking is an indispensable part of a growth puzzle.

It has also often been noted [Chang forthcoming citing Okimoto 1989 and also Fabella] that corruption is typically less in tradables sectors where poor performance is more easily exposed than in the nontradables sector. Part of the reason is that the standards of performance are more easily determined in tradables, where world prices serve as nonmanipulable benchmarks and budget constraints are hard. A second reason is that “locational competition” (*Standortswettbewerb*) to attract transnational firms and mobile capital may exert pressure on developing countries to enforce stricter rules against corruption which discourage such investments. But it has also been maintained that the rush towards the market, as witness the wave of liberalisations and privatisations, have provided opportunities for new and large-scale forms of corruption (in the Philippines, the BW stock-market scam) as assets are revalued and large players such as transnational corporations enter the field. Nonetheless, these moves in favour of privatisation are in the nature of one-off opportunities for corruption rents and have the advantage that they do not lead to the recurring economic distortions associated with continuing government economic involvement.

So it would seem that if one would bring down the level of corruption, it is necessary, perhaps sufficient, to make the state less interventionist. To be sure, the number of objects of corrupt transactions would be reduced in a minimalist state, apparently bringing the level of corruption down with it. While it has its merits, however, such an argument is at best incomplete.

While less intervention would decrease the number of transactions that may be corrupted, less intervention may only result in the increase in proportion of such

transactions being corrupted, or a change from being petty to grand of each incidence of corruption if its root causes remain. Secondly, the reasons for government intervention in the economy as a rule proceed from the choice of developmental strategy so that the abandonment of such a strategy because of corruption would occur if corruption totally negates the benefits from such a strategy. A paradox might in fact arise here. Cross-country studies have shown, conclusively we believe, that less corruption correlates with more development. The development of latecomer countries, on the other hand, involved increased intervention by the state (e.g., Chang and Rowthorn [1994]), which was surely accompanied by an increase in the scope of corruptible transactions. This dilemma can only be tackled by gaining a deeper understanding of the problems of corruption and economic development.

The hypothesis we put forward here is somewhat more differentiated. Corruption may be ubiquitous (indeed, high-level scandals have recently arisen in venerable countries such as France and Germany), but its significance for development prospects will vary. More likely, certain socio-political and economic aspects have allowed some societies but not others to reduce both the scope of corruption *as well as* to foster development. Such factors as social cohesion brought about by more equal income- and wealth-distribution, improved education and human capital, real political participation of the masses — all these are likely to lead to reduced corruption and greater development, leading to the observed correlation between these two. Existing corruption is likely to be rendered less malignant in a context of rapid development. Corruption rents then diminish as a proportion of the total output (which is growing), and — even if such rents should be generated — their reinvestment is more likely to be channeled into more socially productive and beneficial sectors.

A corollary of this view, of course, is that it is misleading and simplistic to regard development as automatically following from reducing corruption, or to think that corruption will diminish as a matter of course as development proceeds. Neither is sufficient. Rather, it may be more accurate to state that many fundamental social reforms needed to eliminate the most pernicious forms of corruption will also spur development. From this follows the irrelevance of the debate over the optimal size of government. The optimal scale of government in a developing con-

text cannot be determined simply and finally by the objective of eliminating the scope for corruption potential. Rather, the scopes for governments and markets to perform efficaciously co-evolve as development proceeds, hence, their boundaries cannot be set once and for all.

Conclusions and recommendations

While corruption has always existed in the Philippines, it has changed in form and magnitude through time as economic strategies and political systems have also changed. Its significance is determined primarily by inadequacies in the nation's political life, especially those that weaken the bonds of control and monitoring between the principals (society at large) and those who serve them (politicians and bureaucrats). It must be understood primarily as a *political* phenomenon; bureaucratic corruption is often merely secondary and instrumental but is of subordinate importance because (a) it pales in comparison with the grand corruption involved in corruption among politicians, and (b) it is often abetted and controlled by politicians (e.g., through appointments and undue influence on bureaucrats). Thus, even as one may argue for better design in the incentive mechanisms for politicians and bureaucrats, one must return to more fundamental questions about why the political relationship is deeply flawed and fails to serve as an effective check to the behaviour of officials.

A fundamental reason must be the continuing perception among many Filipinos that the relationship between the government and themselves is at best an abstract one. Many years ago, Corpuz traced the historical roots of graft and corruption to the "negative image" of government among Filipinos. Especially during the Spanish period, positions were awarded or sold as a matter of course to undeserving and often abusive individuals, leading to a government that was unresponsive to the needs of the inhabitants:

The institutions of government were agents of abuse and oppression. At its best, government came to mean for the Filipino an institution that was burdensome; at its worst, it was predatory.... To the Filipino, government became an institution to be avoided, for its interests were contradic-

tory to his. People and government were estranged from each other and the bonds of community were dissolved. ... [Corpuz 1965:78]

This predatory nature of the state and the failure of formal government to become responsive meant that Filipinos had only non-government institutions to turn to, primarily the family or extended kinship ties, the more basic informal rules of behaviour that North [1990] acknowledges are the default mode in traditional societies. A long-festering issue that illustrates the continuing conflict between formal rules and informal constraints, for example, is the perception of rights over

the emergence of
"civil society" in
the *positive*
sense... have
been responsible
for raising the bar
for standards of
public service

land. Formal land-ownership rules were often imposed by the central government on pre-existing informal land rights, resulting in conflicts between formal claimants such as friar corporations and *inquilinos*, wealthy, educated individuals with access to the legal system and traditional farmers or indigenous groups. In many cases, therefore, from the viewpoint of natives, formal rules were typically disputed and to be obeyed only because of fear.⁶ In the matter of corruption, this observation becomes relevant since the strictures against corruption have always existed merely as formal internal rules within

the government which did not necessarily carry weight in the more private or family spheres whose main criterion is overwhelmingly pragmatic and individual.

In the PA framework used in this paper, it is not clear how the interests of the principal (either the government or the society at large) might be asserted since the "principals" themselves at times do not take their interests (qua principals) too seriously. The country's division into groups based on ethnicity, language, geography, religion, social class and so on, in short, its existence as "civil society" in Marx's original sense of an anarchy of interests and its refusal to take the business of formal government seriously and as something more than an arena for sectional spoils must be seen as an important hindrance to an improvement in the quality of public service. It is in this respect that the emergence of "civil society" in the *positive*

sense, especially among the upper to middle and politicised segments of the working classes — the same elements responsible for EDSA II — is a hopeful development for the long run. It is these groups that have been responsible for raising the bar for standards of public service in recent years, a nonexistent phenomenon in the premartial law period.

Another metavariable is the government's chosen economic role. Philippine postwar history has shown how opportunities for corruption have risen during times of heavy government intervention, such as during the period of protection (e.g., smuggling and illegal immigration) as well as during the period of dictatorship when government undertook major economic projects largely funded by borrowing. In the long-run, a more open economic regime oriented towards producing tradables, with a reduced core role for the state (infrastructure, basic social services, environment standards), and benchmarking itself against competing countries under locational competition is likely to provide less room for corruption if only because it is more transparent. From a governance viewpoint, much of these moves also reduce unnecessary discretion on the part of agents and lower monitoring costs.

Finally, the organisation of government itself certainly influences the incidence and significance of corruption. Among the elements to consider are the current system of electoral politics, particularly campaign finance and the tenured bureaucracy's low status and lack of autonomy. These factors account for a large part of the adverse-selection problem in government to which a number of misfits are attracted. Proposals to reduce discretion on the part of the executive branch and of central government (and corollarily strengthen local governments) should be seriously considered. Again, these follow readily from the PA literature since devolution reduces discretion and shifts the locus of responsibility to local levels where monitoring is less costly and principals' interests are more homogeneous and clearly defined.

The disproportionate role corruption plays in the Philippines must be traced to more ultimate factors in the structure of Philippine politics and economy. These include the system of patronage in politics at both local and national levels; the lack of information among the majority (originally due to poverty, ignorance and alienation); the manipulation of government by powerful outside vested interests (origi-

nally based on landownership and relations of dependency); the entrenchment of a stratum of political opportunists and big money politics; and a political system used as means of wealth accumulation based on manipulations of the electoral process (including media, skillful use of resources and contributions). It is these which ultimately explain the failure of the controls over the presumed relationship between the public and its would-be servants.

The characteristics of the problem determine the approach required to address it. The following are broad suggestions:

First, one must “take it from the top” and attack political corruption first, using the levers of accountability for the polity-politician relationship. This follows from the analysis that in the Philippines, closed-form bureaucratic corruption is subordinate to politicians (and has not reached the point where underworld elements instead dominate politics). In some ways, this diverges somewhat from the prescription to “go after low-hanging fruit” [World Bank 2000]. Electoral contests must be an effective tool for recruiting honest and accountable politicians of a sufficient number to break the monopoly of adversely selected *trapos*. For this to occur, however, what is needed is voter education and information; transparency in campaign finance; public transparency and a prominent role for media and communications. Mechanisms for intra-regime recall and accountability need to be instituted and real advances must be made in creating a stable and credible political party, beginning perhaps with opportunities provided by the party-list system.

Second, the credibility of the justice system must be restored, especially in the prosecution of corruption cases. A decisive resolution of the most prominent pending political cases is needed. To forestall any suspicion that the purposes of such moves are political, however, visible progress must be made on a broad front. Hence, not only plunder cases from the Estrada administration should be pursued but also those from the Ramos presidency as well. Similarly, not only political cases but those involving bureaucratic corruption, e.g., from the revenue collection agencies as well as the judiciary must be pursued and speedily resolved. The corollary of this is that the conditions and morale of the judiciary must themselves be raised.

A third general area is to reduce political discretion from the centre. Part of this may be accomplished through devolution of functions to local governments, thus

reducing the scope for discretion through greater accountability at the lower levels without sacrificing the provision of local public goods. The depoliticisation of bureaucratic appointments below a certain grade would work to reduce the political dependence of the bureaucracy. Where it is merited on its own grounds (not simply because it is an anticorruption measure), government should withdraw from sectors of the economy where its developmental role is unclear. There is great need, for example, for a resolute disposition within a fixed timetable of government-sequestered commercial and corporate assets that serve no obvious public interest or address an externality. Appointments to these parastatals and sequestered corporations have been a way for politicians to distort economic outcomes and conceal corrupt transactions.

Fourth, it is important to raise the morale and professionalism of the bureaucracy to render it less vulnerable to arbitrary political demands and more sensitive to the general public interest. The improved incentives must be comparable with those in the private sector, which can be done only with more selective recruitment and vigorous culling. Innovations in rules may be required in hiring and firing, especially for problem agencies like Customs and the BIR.

Finally, underlying all these reforms in incentive mechanisms, society must begin to address the network of *real* social relationships that envelope and shape the political pa relationship. In particular, the problem of low social cohesion, of low political education and civic apathy must be addressed. This means coming to grips with the basic sources of social inequality such as the unequal distribution of wealth and incomes, the unequal access to quality education and the inequitable incidence of government taxation and spending programmes.

A minimum activist constituency for governance reform will be required. Few if any of these things can be accomplished without the active role of civil society organizations who take the institutions of the state seriously enough to demand results and strict adherence to the larger set of rules for all of society.

These requirements may appear burdensome, but in the end, the problem of corruption cannot be solved apart from the problem of institutional and governance reform and the problem of development itself. Rather, the means for solving one problem will go a long way towards addressing the others.

Notes

- 1 In the literature, cases where the agent's imperfectly observed *action* causes the problem is called a problem of *moral hazard*, such as situations where the decisions of government officials cannot be observed. On the other hand, *adverse selection* is the term used when the PA problem is caused by the agent's imperfectly observed characteristic, such as when the electoral process is unable to distinguish deserving candidates.
- 2 Owing its origins to the 1986 People's Power Uprising, the 1987 constitution accords special status to direct people's initiatives, differentiating it from previous Philippine constitutions.
- 3 In the same way, we believe that the real-world usefulness of general-equilibrium theory is to highlight the importance of various assumptions that are violated.
- 4 On this basis, Adam Smith looked with sympathy on the smuggler who "though no doubt highly blamable for violating the laws of his country, is frequently incapable of violating those of natural justice, and would have been, in every respect, an excellent citizen, had not the laws of his country made that a crime which nature never meant to be so."
- 5 North defines institutions as "the rules of the game of a society" which "provide the framework of incentives that shape economic, political and social organisation". They are composed of formal laws, informal constraints and the effectiveness of their enforcement.
- 6 From a legal viewpoint, scholars such as Sereno have noted that unlike the US and the UK, the Philippine legal system adheres not to common law but to codal law, the latter being introduced from outside. This fact further illustrates the potential conflict between formal and informal constraints to behaviour. In the Anglo-Saxon countries, by contrast, there was a chance for common law to become part of jurisprudence as it became applied in the courts.

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