CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE

# The Role of Business in Sustaining Reform: Reports from Latin America and the Caribbean

*Economic Feature Service Special Report*

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**The Center for International Private Enterprise** is an affiliate of the U.S. Chamber of Commerce, established in 1983 to promote private enterprise and market-oriented reform worldwide. As a principal participant in the National Endowment for Democracy, CIPE supports strategies and techniques that address market-based democratic development. CIPE also receives support from the U.S. Agency for International Development (USAID), as well as private corporations and foundations. Since its inception, CIPE has funded more than 700 projects in 80 countries and has conducted business association management training programs in Africa, Asia, Central and Eastern Europe, Eurasia, Latin America, and the Middle East.


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# PREFACE

Fundamental changes have occurred in the governance of Latin America and the Caribbean since CIPE began working in the region 17 years ago. The region is no longer a bastion of autocratic, military regimes and state-managed economies. Today, most Latin American countries have democratically elected governments and are in various stages of dismantling economic statism and establishing market-based economies. The change of government in Mexico after seven decades of one party rule underscores the region's trend. Yet the political and economic transformation of Latin America and the Caribbean has yielded a world of both highly visible successes and failures. Political crisis in Argentina, Colombia, Guatemala, Haiti and Venezuela are showing some of the cracks in what previously seemed a steadily improving environment for democracy.

Latin America suffers from lower than expected growth, low levels of investment, income inequality, unsatisfactory access to justice, increasing levels of poverty and unemployment, low levels of public participation in policy making, weak political parties, and excessive government regulation of economic activity. Each of these issues is bound up in the need for institutional reform, that is reform of the underlying laws, regulations, and norms that create the framework of a democratic market oriented state. As the interview with John Williamson shows, many of these issues were not addressed in the economic and political reforms of the 1980s and 1990s. Such institutional changes constitute a second generation of reform efforts.

The business community, especially the network of business associations and think tanks active throughout Latin America, must take the lead in sustaining the reform effort in the face of severe strains. Partners and participants in various CIPE's programs throughout the region have been advocating for these second generation reforms over the last several years. This compendium of articles entitled "The Role of Business in Sustaining Reform: Reports from Latin America and the Caribbean" draws on several conferences and projects sponsored by CIPE with funding from the National Endowment for Democracy. Two conferences supported by the Endowment form the core group of papers. The first was a regional strategy session held in Mexico City in 2000 and the second was a special panel on the informal sector held in Sao Paulo later that year. In addition, special reports on CIPE's anti-corruption and corporate governance programs round out the publication.

We have designed this document to provoke dialogue on a reform strategy for the region. Your comments and suggestions will help CIPE shape its strategy in the region for the year 2002 and beyond. Please send your comments to John A. Zemko, Senior Program Officer for Latin America and the Caribbean by email at: jzemko@cipe.org, by fax at (202) 721-9250 or by mail at 1155 15th Street, N.W, Suite 700, Washington, DC, 20005.

# INTRODUCTION

Since the early 1980s the world has witnessed an unprecedented trend toward democracy and market-based economies. Nonetheless, much work remains to be done to reinforce this trend and to prepare nations for the political and economic realities of the twenty-first century, including globalization. Even long-established democracies such as Colombia, Peru, and Venezuela have seen their political and economic stabilities threatened. Other countries, including Argentina, Brazil, and the Central American republics, are under severe pressure as they attempt to consolidate a democratic rule-of-law society, now seen as the irreducible minimum for participation in the emerging business system of the Americas.

Contemporary history has shown that countries with democratic, market-based systems are best equipped to respond to the challenges of globalization. Specifically, there are three essential aspects of democracy that have proved to be crucial to long-term economic and social development.

1. A stable democratic system is the best guarantor of political stability, which is essential for long-term economic growth.

2. Democratic practices such as transparency and accountability are essential for effective and responsive government and for efficient and prosperous economic activity. (The financial crises Asia and Russia experienced in the late 1990s are cases in point.)

3. Sound legal and regulatory codes backed by the rule of law must exist if business is to thrive in a market economy.

**Strengthening democratic governance**

The experiences of the 1980s and 1990s demonstrate that failure to incorporate democratic governance as part and parcel of economic reforms seriously jeopardizes the entire reform agenda. For much of the last 20 years it was fashionable to speak of the Washington Consensus, a reform program based on macroeconomic stabilization, fiscal reform, and other adjustments to economic policy. Recent developments—especially in Eastern and Central Europe, as well as in Indonesia and Argentina—demonstrate the limits of this approach; John Williamson discusses these developments in his contribution to this volume. Equal attention must be paid to the key institutions in society and to the process through which government decisions are made. In short, the process of building a democracy and a market economy begins by ensuring that the rules of the system are open and fair to all.

The intellectual foundations of efforts to build a broader and more comprehensive democratic reform agenda stem from the field of new institutional economics developed by Ronald Coase and Douglass North, who won the Nobel Prize for their work. In its simplest formulation, the institutional approach says that, "Rules are important in conditioning outcomes." Put more elegantly, "The success or failure of any effort to achieve a long-lasting transition to democratic market-oriented systems depends on the design and functioning of the underlying institutional framework."

In order to highlight the importance of institutions, it is essential that we recognize the fallacy of three common myths about the relationship between the state and the market.

The first myth is the belief that, once private enterprise constitutes a substantial portion of an economy, that economy has become a market economy. History abounds with examples that disprove that myth. The Philippines under Ferdinand Marcos and Indonesia under Soeharto are classic examples of capitalist economies, based on private enterprise, that definitely were not open-market systems. Economists call behavior associated with these economies "rent seeking." Others call it "corruption" and "cronyism." Simply stated, the greater the degree of systemic corruption in a society, the less its economy functions on market principles.

It should be emphasized that many different types of market economies are possible, and there are real distinctions between the institutional structures in different countries. But all market economies share a common feature: a competitive system where the rules are the same for all participants. Furthermore, only a fully functioning democracy can sustain such a system over time.

The second myth is grounded in the common misconception that the business community, or the private sector in general, is a homogeneous monolith that either supports or opposes certain policies or leaders. This is not the case. In fact, most countries have several business communities, each with its own interests and objectives. In the economy of a single country there can be the state sector, the private sector, and the informal sector. Even within the private sector, there might be firms and entrepreneurs who work mostly in international trade while others work solely in the domestic market. Clearly, these groups will not always support the same policies—nor will they always favor market-oriented reform.

Firms created behind protectionist trade barriers—and with strong links to and benefits from government—tend to support the status quo. Often they also are quite antidemocratic. Conversely, firms that have been locked out of government favors, small entrepreneurs, and those engaged in international trade are quite often the leaders behind the demand for change. Because the business community is so diverse, it would be wiser to form partnerships with business associations, think tanks, foundations, and other business organizations that have a vested interest in an open economy and a democratic political system.

The third myth is the most dangerous, and is often called the market fundamentalists' view. It is the belief that markets will spontaneously emerge if government stops intervening in the economy. This is far from true. The government must establish consistent and fair rules and laws so that a strong market economy may emerge. Further, government institutions and self-regulating organizations have key roles to play in ensuring that the rules are enforced. Credible, fair bank supervision is but one of the most obvious of these roles.

Without binding rules and structures that govern all players anarchy can result. Business then becomes nothing but "casino capitalism," where investments are only bets: bets that people will keep their word and that companies will tell the truth; bets that workers will be paid; and bets that debts will be honored.

**Foreign assistance and development**

Getting the relationship right among government departments, business organizations, civil society, and market institutions is vital. Any foreign assistance programs run by the donor countries or the international financial institutions must seek to achieve some very concrete objectives. These objectives are to:

- Promote development of the rules, laws, and institutions necessary for open, market-oriented economies, including property rights, antitrust or competition laws, banking regulations, and sound accounting rules.

- Increase citizen participation in the democratic process by allowing business groups and other parts of civil society to participate in the day-to-day process of making decisions.

- Create open systems of feedback to government, including legislative hearings, regulatory review panels, citizen advisory panels, and other channels of communication between society and the state.

- Foster private voluntary organizations and freedom of association.

- Build support for—and understanding of—the rights, freedoms, and obligations essential to a democratic private enterprise system.

- Enhance the entrepreneurial culture of the society by providing incentives to innovate, save, invest, and launch new firms.

- Simplify compliance systems for micro- and small businesses to enable them to join the legal (that is, formal) economy and thus the mainstream of society.

- Expand access to business and economic information necessary for informed decisionmaking by all parts of civil society.

**Reports from the field**

How can these objectives be accomplished through actual projects? Below are some examples of how business associations, think tanks, and other civil society groups have implemented these goals. Many other examples and links to other groups can be found at the Center for International Private Enterprise's (CIPE) Web site (www.cipe.org) and at the Web site of the National Endowment for Democracy (www.ned.org).

Strengthening the role of business associations and creating a national business agenda. As advocates for the private sector, business associations play a vital role in encouraging good governance and sound policymaking in industrialized nations. In most emerging market economies, however, these business associations are only beginning to realize the importance of strength in numbers, and why it is in the business community's interest to promote the democratic process. Mobilizing small- and medium-size enterprises is especially important to create the critical mass that drives reform. Associations are one of the most effective groups to carry out this effort.

National business agendas. A national business agenda is a tool commonly used to affect public policy. This agenda identifies policy reforms of the highest priority for the business community in the near term, and specifies the reform in terms of laws and regulations and offers concrete suggestions for vital changes. The key to the national business agenda is the notion of participation based on these simple steps:

1. Meeting with members in open forums to identify barriers to business growth and job formation
2. Analyzing policies and forming recommendations
3. Publishing in the media to gain input from concerned parties
4. Formulating policy reform programs
5. Publicizing the agenda
6. Presenting the agenda to the president and key ministers in a national meeting
7. Directing ongoing advocacy to the government, including the executive and parliament branches of the government

A number of business associations in the Americas, including groups in Paraguay, Bolivia, and Peru, as well as the U.S. Chamber of Commerce, have used the national business agenda approach. Today the task of implementing this agenda assumes an even higher priority as the growing criticism of economic reforms creates added pressures on national legislatures and governments. Unless the business community participates in building reforms—reforms that address the essential issues and deliver new jobs, economic growth, and widespread benefits for the people—country after country could experience not just reform fatigue, but also reform reversal.

Reforming institutional structures that create barriers to participation in the formal economy and democratic decisionmaking. Members of the informal sector are entrepreneurs who produce legitimate products without proper permits or legal status because they lack the resources to comply with burdensome, excessive, rules and regulations that are required for participation to participate in the formal economy. In many countries the informal sector can account for up to 50% of the official economy. These entrepreneurs are locked out of the formal economy and the political process as they work in low-income, low-growth business activities. A large and growing informal sector results from fundamental flaws in government processes and is proof that a market system has not been created.

Hernando de Soto of the Institute for Liberty and Democracy (ILD) in Peru was one of the first persons to recognize the challenges that the informal sector presents to political and economic reform. Lack of secure property rights is central to his thesis that millions of people are condemned to poverty around the world, as well as sidelined from their countries' political discourse. De Soto's trail-blazing research has changed the nature of the debate about markets and democracy, as illustrated in his latest book, The Mystery of Capital. Further, the efforts of de Soto and his ILD team are building market institutions in such diverse settings as Egypt, Mexico, and the Philippines. He will shortly be turning his attention to Russia, following a lengthy meeting in July with President Vladimir Putin, who expressed considerable interest in his work.

Combating corruption to support democratic values. Business communities in developing countries are realizing that corruption is costing them money, and they must do something to eliminate it. Corruption not only economically hurts the business community and the citizens of developing countries, it also has a destabilizing effect on democracy and the general well being of a nation. Combating corruption can serve as a tool for bringing about broader reforms and improving the functioning of governance.

The National Association of Entrepreneurs (ANDE) in Ecuador created a research and advocacy program targeted at eliminating some of the main opportunities for corruption. ANDE's focus has been not to blame past corruption on any one particular group. Instead it champions the need for reforms that will change the direction of business and institute clean governance practices.

Its studies show that since the Republic of Ecuador was founded 167 years ago some 92,250 legal norms have been created—with 52,774 still in force in 1997. The sheer number of overlapping, unclear, and contradictory laws and regulations has created an environment of legal chaos, leaving the application and enforcement of laws to the discretion of bureaucrats. Since Ecuador is a civil code (as opposed to a common law) country, its courts cannot reconcile law or create precedents. To address this critical issue, ANDE recommended creating a seven-member judicial committee empowered to codify and reconcile existing law. ANDE's advocacy campaign succeeded so well that the judicial committee it recommended has been included in Ecuador's new constitution.

Another approach to combating corruption is to help build the watchdog role of the media in society. CIPE has launched a new network called Journalists against Corruption (known by its Spanish initials—PFC) made up of 500 journalists throughout Latin America. PFC supports journalists dedicated to investigating and exposing waste and unethical conduct in government and corruption in all sectors of society. PFC is a network, clearinghouse, and service provider for these journalists and the organizations that support them. It not only encourages enhanced investigations and reports about corruption, it also offers investigative assistance and advocates on behalf of journalists when they suffer reprisals. Last year, for example, protests from PFC journalists resulted in the prompt release from jail of two Mexican reporters who had been reporting on corrupt practices and drug trafficking by the police. PFC can be accessed from CIPE's Web site (www.cipe.org).

Promoting sound corporate governance measures. Another focal point in a comprehensive strategy is the promotion of sound corporate governance principles. This issue is obviously related to anticorruption issues, because it attacks the supply side of the corruption relationship. Further, since the high-profile scandals during the Russian and Asian financial crises, corporate governance issues have surfaced as key reform issues in the developing countries and transition economies. One of the lessons from these crises is that weak or ineffective corporate governance procedures can create huge potential liabilities for individual firms and, collectively, for society. In this sense, corporate governance failures can be potentially as devastating as any other large economic shock.

Even countries that have few large firms may want to begin looking at the question of corporate governance, since it is now being adapted to meet the needs of family-owned companies. Even more important are the privatized firms and those still in the public sector. Ensuring good standards of corporate governance in these areas greatly enhances the faith of the public in the integrity of the privatization process, and helps ensure that the country realizes the best return on the national investment

**Conclusions**

Issues such as combating corruption, fostering corporate governance, strengthening women's business associations, and reducing barriers to formality have created new opportunities. Each serves as a focal point to push forward with market reforms and adopt democratic practices. For example, sound corporate governance requires a framework of market institutions as well as sound business practices based on democratic principles. Similarly, ensuring that women and entrepreneurs of modest means have access to the business system as participants and leaders helps to guarantee that an open market economy exists for all firms, not just for a favored few.

As Roque Fernandez, a brilliant former Argentine Finance Minister, once said, "The Cold War is over and the University of Chicago won." He was referring to the market-oriented economic reform agendas being pushed throughout Latin America and much of the rest of the world. At the time he was right. Now, hopefully, it will be possible to add critical new dimensions to this view by bringing about a broader and profoundly democratic agenda. It must be based on transparency, accountability, property rights, and other fundamental rules that societies and economies can use to govern themselves. ❖

# BEYOND THE WASHINGTON CONSENSUS: INTERVIEW WITH JOHN WILLIAMSON

*Editor's Note:* During the 1990s a consensus emerged among reformers and economists in Latin America and in the international financial institutions about the essential ingredients of economic reform. John Williamson, one of the leading research scholars on Latin America, dubbed it the "Washington Consensus." Mr. Williamson used that term since it captured the thinking of the World Bank, International Monetary Fund, and Inter-American Development Bank—all of which are headquartered in Washington—and regional policymakers interacting with those institutions.

Recently, the Carnegie Endowment for International Peace and the Inter-American Dialogue sponsored a study titled, "Washington Contentious," which reviewed the original concepts behind the Washington Consensus and recommend that a new list of major second-generation reforms be added to the original list.

The following interview was conducted by John A. Zemko, CIPE's senior program officer for Latin America and the Caribbean. The text box that follows contains both the list of the original 10 points from the Washington Consensus and the added reforms. John Williamson was one of the contributors to the"Washington Contentious" study, and agreed with the new additions.

MR. JOHN ZEMKO: Recently, there has been much discussion on how the reform agenda for developing and transitional countries needs to be broadened beyond the Washington Consensus that you discussed in your book, Latin American Adjustment: How Much Has Happened?

With respect to Latin America, this new reform agenda is often referred to as "second-generation reform." Could you define for us these second-generation reforms, and explain their relation to the original Washington Consensus?

MR. WILLIAMSON: Well, I think it was Moisés Naím, the editor of Foreign Policy, who first used this phrase, "second-generation reforms." He quite clearly had in mind reforms to make institutions work better, to root out corruption, to bring in third-sector organizations—NGOs. As Naím has said, and he is absolutely right in this, the first-generation reforms were largely reforms that could be accomplished by passing laws, abolishing regulations, whereas building up institutions is more difficult, but is also essential.

One question I like to pose as an example is "What use is a tax reform?" If you don't have a tax collection agency that works, if it is thoroughly corrupt, and if people can buy their way out of paying taxes, then having a wonderful tax code doesn't do any good. So you need institutional reform to make it work.

MR. ZEMKO: During the 1980s and 1990s there were heated debates concerning the sequencing of first-generation reforms. Is there a recommended sequence that you would see for second-generation reforms, and how could you define the main path of the second-generation reforms?

MR. WILLIAMSON: I don't see that there is the same need for sequencing in the second-generation reforms.

In the first-generation reforms there was a very strong belief that it was a mistake to liberalize the capital account until you had a financial sector that was working properly with a good system of regulations and supervision of financial institutions. So there were strong, logical reasons why some of those reforms had to be done in a specific order, and although not all countries obeyed that, we saw some pretty sad results when countries disobeyed. For example, Indonesia opened its capital account very early in the reform process. For 20 years, it was said, "Look, you have to do it that way." In the end, Indonesia seemed to have its crisis intensified because it had gone so heavily into debt internationally without knowing what was happening.

I just haven't seen any of those sorts of arguments brought forward in relation to the second-generation reforms. I think these reforms should be done as quickly as possible. You can't hope to do everything at one time, and so you ask what is most urgent to go first in the particular national situation. I don't see any reason for saying that it has to be first to do the tax administration or the central bank or to do the social security system.

MR. ZEMKO: Stepping aside from the Washington Consensus framework for a moment, if you were to devise a new reform agenda for Latin America, what would be its key points?

MR. WILLIAMSON: I think that this business of reforming the state would have to be at the center—that is, making the state work effectively. It is not simply a matter of cutting down the size. That was essential 10 years ago, when the state in almost all countries had become bloated. I'm not sure that there is a need for further pruning down the size of the state, but I'm quite sure that there is a very widespread need to make the state function more effectively, and that includes not just the central government's, but also the local government's, work.

There has been a widespread move in Latin America toward decentralization, which I think most of us welcome, but it is not working particularly well everywhere yet. Clearly, making that work is important. Giving the local government units, the states, their own sources of revenue is a priority, and then helping the public sector to work in partnership with the nongovernment sector, as well as, of course, supporting the private sector. So that would be the first general sort of heading.

The second thing I'd focus on is education. There have been some significant improvements in some countries, but by and large, it is still not where East Asia is. And if you want to take advantage of the modern world, then you have to have an educated population. There is just no question about that. So that would be a priority, and that partly means spending more, but it is also shifting the pattern of expenditures. The universities have been much more self-supporting and make loans to students, which they can repay out of their higher earnings. The savings can be used to build up primary and secondary education.

Education is probably the most important single method that can be used to attack the very uneven income distribution in the region. Of course it is a long-term method. One thing we have learned is that short-term attempts to redistribute income have a pretty high price. It has to be a long-term agenda focused on redistributing the assets in the population, the human assets, particularly distributing education much more broadly.

And then, my other heading would be in terms of fiscal policy. Changing the pattern of public expenditure is something that I actually did have in the original Washington Consensus. None of the critics would believe it, that I actually talked about the need to redirect public expenditure toward things like health and education and away from some of the more grandiose projects and exorbitant pensions in some countries. And also, the taxation system in Latin America leaves a lot to be desired. It relies very heavily on indirect taxes; it

is very regressive; and there is very little property taxation. So I think that should be a part of the agenda as well.

MR. ZEMKO: There are two related topics that are increasingly being discussed in the Latin American context. One is the problem of corruption, and the other one is lack of corporate responsibility, or we would term it a lack of corporate governance. Where do you see those much-talked-about topics fitting into the agenda, and how are they resolved?

MR. WILLIAMSON: Yes, certainly I thought of corruption as part of the public sector reform. One of the great objectives of public sector reform is to try and change the incentives in a way that will, ideally, eliminate or at least diminish corruption.

For example, if you pay a public servant a pittance, and he has a job where, by saying yes or no, he can cost somebody else a lot of money, then he is going to expect some payment under the table. If, essentially, his job is not yielding him an income that is important to him to defend, then he is going to be very susceptible to corruption. You have to pay public servants something. So it is straightforward truths like that which need to be the center of any public sector reform.

The question of corporate governance, I agree, is also one that has emerged into the public debate quite recently, or at least since the Asian crisis, and people have realized it is a problem in Latin America. Brazil is planning a major reform on these lines.

My own hope would be that the reform of corporate governance doesn't take quite as narrow a view as the American business school view, in which the shareholders are the only people for whom the company is working. I actually think there are other stakeholders who have a legitimate stake in how the company is managed. One should be looking for a system of corporate governance that recognizes that and doesn't simply say, "The shareholders above all."

On the other hand, the shareholders certainly have a legitimate stake in that the managers should be their agents rather than letting them run the whole thing.

MR. ZEMKO: Critics of the Washington Consensus and of the whole reform process in Latin America have often pointed out that decisions that are in developing countries tend to run counter to the local decision-making process. Are there ways in which that criticism is being addressed?

MR. WILLIAMSON: Well, that's a fair criticism. I think there is some truth in it, and at least the appearance has been one of too much dictation of policy from Washington. I'm not sure that it works terribly well. That's what the whole discussion about ownership is really saying, that if you try dictating to a country, that's not the way to get genuine reforms put in place.

There ought to be scope for local initiative. How a general idea is implemented ought to vary from one country to another depending on local circumstances. In fact, an attempt to dictate from Washington would be a mistake. The opponents of reform exaggerate the extent to which that happens, but nevertheless they have the basis for a genuine complaint in that direction. Of course, the best way to avoid it is if you have strong local leaders who believe in the same sort of course, and then they take ownership, and they develop essentially their own program, and, hopefully, the international institutions essentially will sign on to their program.

There are one or two instances where that has happened in Latin America. One that I have always been impressed by is Bolivia in 1985, when no international institution would dare to have proposed a program so strong as that which the local team decided to implement.

MR. ZEMKO: One of the big issues in Latin America has been the burden of bureaucratic regulations on the cost of doing business that have pushed people out of the formal sector and into the informal sector. The informal sector seems to continue to grow despite all the reforms that have taken place. Do you see this as a crucial problem that needs to be addressed, and if so, how do policymakers provide the right incentives to turn that situation around and move the informal sector toward formality?

MR. WILLIAMSON: Yes, well, I think the essential reforms here are in terms of reforming the state to make it more effective and less bureaucratic and getting it out of asking unnecessary things. Hernando de Soto of course, is the great expert on this subject. It is not a field that I have ever gone into in detail, but it just fascinates me. Hernando has to be right, that if being informal caries with it an implicit tax and payments of bribes of 15 percent of turnover, then there would be benefits in going formal. Once they do that, of course, there are benefits for the rest of the people and the economy as well—most obviously if they pay taxes, but also if they, by coming into the formal sector, use the formal financial system and increase the efficiency of financial intermediation.

MR. ZEMKO: The topic of globalization is something you have just addressed in the recent issue of "Economic Reform Today." I think it's safe to say globalization increases the opportunities for investment, but it also makes countries more vulnerable to external shocks. I am wondering if you could give us an idea what institutions are necessary in Latin American countries to benefit from the global economy without suffering needlessly from it.

MR. WILLIAMSON: Yes. You can approach that on two levels and probably, the government ought to be doing both. One is to try and ask what sort of institutions could stabilize the macroeconomic shocks from the rest of the world. There, the stabilization fund that Chile started a decade or so ago, which takes in money when the copper price is high and then releases some of it when the copper price is low—that's a helpful type of innovation.

One of the real complaints about the international capital market is that it has always worked in the opposite direction. It has shoveled in more money, for example, than countries could usefully use when times are good, and then the monies turn around and run away as soon as things become difficult.

So I think that we really need an effort to stabilize those capital flows. If nothing else, then one ought to have the sort of measures that, again, Chile pioneered in the last decade on its short-term capital inflows.

But it would be even better if one could change the nature of the capital flows at the source so that they were less unstable. We've got to get away from these relatively short-term bank loans and do much more through equity investment and long-term bonds. Equity investment going in as closed-end investment funds is the ideal. Another possibility would be perhaps a separate market for this type of capital, a separate parallel foreign exchange market for equity flows, for mutual funds and pension funds. That's an idea that, again, came up at a conference in Chile back in the 1990s. At the time, I was not particularly impressed, but then, thinking about more recent history, I wonder if we shouldn't develop that idea.❖

## Original Washington Consensus and the Next Stage of Reform

The 10 items in the original Washington Consensus said more about equity and poverty reduction than most commentators realize-perhaps because those with influence at the time, in Washington and in Latin America, brought their prior beliefs to what they read and remembered.

**1. Fiscal discipline** was explained as an instrument for efficiency and growth. As it turns out, it is central to equity, too. The consensus formulation made no mention of a particularly important rationale for fiscal discipline: the need to be ready to finance (countercyclical) social programs when times are bad, both as a macroeconomic corrective and to provide unemployment and other insurance to the vulnerable.

**2. Public expenditure priorities.** The consensus said public money should go to activities "with high economic returns and the potential to improve income distribution." The emphasis was on shifting away from indiscriminate subsidies and toward education and health. Critics on the left have forgotten or overlooked this item-perhaps because it is so notably inconsistent with the image of the consensus as "neoliberal."

**3. Tax reform.** The consensus formulation said the "tax base should be broad and marginal tax rate should be moderate." In retrospect the objective ignored the issue of how to make tax regimes more progressive, especially how to minimize widespread evasion by the rich. The consensus did include the suggestion to tax flight capital-which we also include, as a good way to make systems visibly more fair and to increase revenue.

**4. Interest rates.** The consensus called for an end to directed credit (public programs to provide cheap loans, usually by arbitrary criteria) and controls on interest rates paid to depositors. The idea was to liberalize financial markets. Compared with a decade ago, the consensus has shifted-to gradual and cautious liberalization until regulatory and supervision capacity is strong. Today's usual argument for caution is to minimize the risk of financial crises. In fact an additional powerful rationale is that crises are particularly harmful to the poor and others in the bottom half of the income distribution. An equity objective of financial liberalization also implies more emphasis on steps to ensure access to credit for all (as opposed to ensuing cheaper credit, which turns out not to work anyway-either for equity or efficiency.)

**5. The exchange rate**. The original consensus formulation emphasized the need for competitive rates to increase nontraditional exports. There is still no consensus on the "right" exchange rate regime, though the weight given to reduced financial vulnerability is higher following the crises in the 1990s. The emphasis is still on competitiveness and stability, central objectives to enhance job creation and protect the highly vulnerable poor and the near-poor.

**6. Trade Policy.** Reducing protection of local producers through quotas and tariffs on imports is a step towards efficient and sustainable growth. The controversy is about its effects on equity-left unmentioned in the original formulation. The evidence for Latin America is that more trade is not the culprit in the growing gap between wages of the skilled and the unskilled, though the opening of capital markets may be (because cheaper capital encourages more use of skilled labor compared to unskilled labor). In addition, because the consensus was concerned with domestic policy, there was no mention of the crucial importance for equity in Latin America of the industrial countries reducing their protection of agriculture, textiles, and other labor-intensive products.

**7. Foreign direct investment** brings needed capital, skills, and know-how and so is good for growth—the objective in the original consensus. As it turns out, that means it is probably good for the poor—or at least does little harm. Although it may be a vehicle for increasing wage gaps—that would be mostly by raising wages and salaries of the highly skilled, not by lowering wages of the unskilled.

**8. Privatization**. There is no mention in the consensus of the risks of increasing the concentration of wealth with privatization—where institutional arrangements are weak or vulnerable to insider pressures. Nor is there mention of the positive oppor-tunities to distribute capital more broadly (as in Bolivia's capitalization program).

**9. Deregulation**. The original consensus emphasized the benefits for competition.
Though not mentioned, deregulation can be good only for small businesses and for job creation—and thus for creating jobs and generally enhancing equity.

**10. Property rights**. The consensus included property rights, but without referring to the potential benefits to low-income households from land reform in rural areas and aggressive titling of land in urban areas. The mention of property rights at least opened the window to something we have become increasingly convinced about: growth and equity require not only more room for market forces and private enterprise, but also the strengthening of the institutions that underpin markets, including the laws and judicial procedures that help secure property rights.

**10 + 1: A Policy Toolkit for Equity with Growth**

How can Latin America escape its vicious circle? Our 10 "equity tools" suggest what governments could do to reduce poverty and inequality, without materially sacrificing economic efficiency and growth, and indeed in most cases enhancing them. Our tools have to do not only with reducing poverty, but in a larger sense with building more visibly just societies—in which the poor and the middle class, not just the elite, have full access to economic, social, and political opportunities. Our focus is the domestic policy agenda. But responsibility also lies with the industrial countries—the source of much rhetoric about reducing poverty in the developing world. To emphasize this point we add an additional "plus" item, so that the advanced industrial countries can also turn from rhetoric to action.

**The 10 + 1 policy tools are:**
**1. Rule-based fiscal discipline.** Fiscal indiscipline—when governments
consistently spend more than they collect and more than they can easily finance through sustainable borrowing—has high costs for the poor and the emerging middle class. Commitment to fiscal discipline must go beyond idiosyncratic efforts to a healthy budget grounded in transparent rules and procedures.

**2. Smoothing booms and busts.** Booms are better for the rich, busts worse for the poor. Fiscal and monetary policies and tough banking and other financial standards to manage volatility and minimize crisis cannot be improvised. They should be locked in when times are good.

**3. Social safety nets that trigger automatically.** A modern system provides an income floor for working and middle class households as well as the poor. During slumps, spending should kick in automatically for emergency public works employment and subsidies to families to keep their children in school.

**4. Schools for the poor, too.** Today's centralized systems reinforce inequality. Critical reforms include more school autonomy, lower subsidies to the better-off for higher education, and more public spending on pre-school programs. Education policy must also embrace the Internet, with public subsidies to ensure that every school and every community benefit from this revolution in access to knowledge.

**5. Taxing the rich and spending more on the rest.** The region relies heavily on consumption taxes that are regressive. Closing income tax loopholes and reducing evasion would increase revenues without adding to the tax burden of working and middle-income households.

**6. Giving small business a chance.** Weak financial and judicial systems and onerous red tape block talented small entrepreneurs from expanding their businesses. Improved enforcement of credit contracts and shareholder rights, the end of insider credit from state-owned banks, and access to information and professional services would help create more small firms and more jobs.

**7. Protecting workers' rights.** The poor bear the cost of a job contracting environment that has too little worker protection and too many legal rules. Latin America needs more aggressive protection of workers' rights of association and collective bargaining, more independent and democratic unions, and more social protection to replace inflexible rules that discourage job mobility and growth.

**8. Dealing openly with discrimination.** A serious attack on poverty and inequality has to include a visible attack on discrimination. Political leadership can help break down the social and political barriers that hurt blacks and members of indigenous groups—and, in some arenas, women.

**9. Repairing land markets.** A new generation of land reform programs can make rural land markets truly competitive—finally giving the rural poor a fair chance. The new approach emphasizes credit and community involvement and relies less on centralized bureaucracy.

**10. Consumer-driven public services.** Shortcomings in infrastructure, public health, and such regulatory services as consumer protection have cost the poor and the near-poor dearly. Poor and other low-income consumers must now be at the heart of a new culture of service delivery.

**Plus 1. Reducing rich-country protectionism.** Rich countries' barriers to agriculture and textile imports aggravate poverty and reinforce inequality in Latin America. Lowering them will do the reverse.

This section was extracted from *Washington Contentious: Economic Policies for "Social Equity in Latin America*, nancy Birdsall and Augusto de la Torre (Carnegie Endowment for International Peace and Inter-A,merican Dialogue, 2001). Complete copies are available online at www.ceip.org.

# MEXICO: FIGHTING CAUSES OF PAST CRISES

*José Angel Gurría, Mexico's Secretary of Finance and Public Credit under President Ernesto Zedillo and head of the government's transition team, spoke at CIPE's March 2000 conference in Mexico City entitled "Ideas into Action: A Business Plan for Think Tanks and Business Associations." He brought the message that, for the first time in 30 years, Mexico enters a presidential election and national government transition unshadowed by economic crisis. That is because the country has taken steps to identify the causes of past crises and neutralize them to maintain what Gurría calls "the cruising speed" achieved by the Mexican economy in 1999. The following article is adapted and slightly updated from his oral remarks and text prepared for the conference.*

For the first time in 30 years, Mexico will not experience an economic crisis between governments. At last, we've learned the lessons of past crises and begun to take the measures necessary to forestall future problems. My country is significantly less vulnerable today because we have done so.

Of course, we're helped by having posted terrific economic results in 1999, overshooting our announced targets in several areas. Mexico enjoyed 3.7% overall growth of its economy last year, rather than the predicted 3%. We also did better than expected in fighting inflation, which stood at 27.7% just three years ago. For 1999 our target was 13%, and we achieved 12.3%. Our savings rate rose from 14% of GDP in 1994 to about 22% today, which of course means more money injected into productive investment that creates new jobs. We aimed to reduce the public deficit to 1.3% of GDP and ended up with less than 1.2%. This year has begun with a dynamic improvement in both growth rate and inflation, so we expect a continuation of good news for 2000.

Looking over the past five years, a better indicator of positive change than merely one year, we feel encouraged by Mexico's economic results:

- Real GDP growth will average 5% in real terms between 1996 and 2000-a rate surpassing that of our main trading partners, the US and Canada.
- The open unemployment rate fell from an average of 6.3% in 1995 to 2.5% last year-the lowest rate since this indicator was first published in 1985.
- Perhaps most important for our people's well-being, annual inflation has been drastically reduced from 52% in 1995 to 12.3% last year. We expect single-digit results in 2000.

These solid outcomes have boosted our credibility with analysts and investors alike. We know that steadiness and credibility are the touchstones of improved ratings with these crucial audiences.

Still, in a way we are fighting the ghosts of Christmases past: trying to dilute a rather recent memory, when people were told our economy would be okay, and it wasn't. This time, however, I believe Mexico has honestly searched the roots of past crises, and begun logically addressing the causes in order to neutralize them. We know the US represents 80% of our trade and that helps a lot, so we humbly recognize this advantage and continue addressing the long-term problems. Our aim is to realistically minimize the harmful effects of the inevitable ups and downs of any economy. What are the culprits of economic crisis, and how are we fighting to control them?

**Achieving fiscal discipline**

Lack of fiscal discipline represents one of a handful of reasons that usually pitch countries into crisis. In Mexico, our deficits rose to 10%, 12%, then 14% and more. Focused attention to the problem and the Banco de Mexico's monetary stance have contributed to lowering the ratio of total net public sector debt to GDP from 38.5% in December 1995 to 25.3% in the same month of 1999.

Fiscal discipline improves when everyone has the same information, and it is reliable. We've worked hard to improve our collection and dissemination of accurate, timely information. For example, if it's Tuesday, you can get current account data that day. The daily markets are better informed about the Mexican economy-how much credit is available, how much the central bank is tightening its monetary policy, and so forth.

The struggle for fiscal discipline becomes especially difficult in an election year, when pressures to roll out the pork barrel are heavy. Our administration is fighting with the congress, which says, "Why do you have to cut the deficit in the final year of your administration?" In policy matters, it's never one big deficit item; it's just giving a little more here and there.

This year we've said that cannot happen: Mexico is under the microscope precisely because it's the final year of our administration. This year we have to be like Avis-we have to try harder even if a 1.25% deficit would not raise any eyebrows. But the clear message that we will reduce the deficit from l.25% to l% in the last year of the administration sent a critical message of fiscal discipline to the markets. By improving capital flows and reducing interest rates through the exercise of discipline, we would save a multiple of 1.25%, which we are doing.

Nowadays political leaders really have few choices about discipline. Staying on the straight and narrow path is fine, but today there is less virtue in it because we have little choice in a global economy with many observers scrutinizing our singleness of purpose. You cannot be very wild in fiscal terms because the market immediately slaps back if you do.

**Strengthening the export sector**

Another culprit responsible for past crises was heavy dependence on a single commodity, oil. Today oil represents only 6–7% of Mexico's total exports. When the price of oil is high, however, like many economies traditionally dependent on one or a few commodities, Mexico is tempted to be too optimistic.

Export diversification is just as important as expansion. As a percentage of total exports, non oil products rose from 38% in 1983 to 93% last year. Today, with manufactured goods accounting for more than 90% of exports, our country has become the world's eighth largest exporter, selling $13 billion worth of goods each month to many countries around the world.

Critical to this diversification has been our expanding network of free trade agreements-not only the North American Free Trade Agreement (NAFTA), but agreements with Latin American neighbors, Israel and, this spring, with the European Union. Fast, far-reaching trade liberalization measures have paid off for Mexico since it joined the international trade regime (then known as GATT, now as WTO) in 1985. We are now the only nation in the world carrying out free trade agreements that are both trade and investment pacts with the US, Europe, Israel, and numerous Latin American nations. Today, Mexico is filling the streets of Santiago with Nissans made in Mexico.

While the WTO struggles to decide its next steps, we have cemented bilateral, subregional and regional agreements of many kinds. The only one missing is an agreement with Mercosur. The only country where lately we've made less than great progress is Brazil, though we serenade and send them flowers and smile their way in church on Sundays.

Overall trade results in recent years show we chose the right road. Since 1991 the value of Mexico's exports and imports has more than tripled, reaching $279 billion last year. Furthermore, the value of our trade as a percentage of GDP has doubled in the same eight-year period.

**Arranging manageable debt**

The third cause of past crises was plunging into deeper debt than Mexico could sustain. We have reason to believe we're in better shape today because we have created a healthier scenario.

Not only have we reduced the magnitude of our debt, but its maturities are now spread over very, very long periods. Mexico faces no payments of any importance in the next two years that we must refinance. For the past three years, we've been refinancing in order to provide breathing room for two years-the last year of the current administration and the first year of the next one-with no accumulation of important maturities.

The ratio of Mexico's total debt to GDP, including the bank rescue package, is about 40% of GDP-still the lowest in the Organization for Economic Cooperation and Development (OECD) and far below the 60% country average of other member countries.

**Floating the exchange rate**

Another reason for our confidence that we will avoid economic crisis in transitioning to the next administration is Mexico's flexible exchange rate regime. Shifting from a fixed to a floating rate allows orderly adjustments to external shocks and avoids accumulating external imbalances.

In the past, under a fixed-rate currency regime, many times we borrowed money to shore up the foreign exchange reserves in order to maintain the fixed rate. But the market beat us every time, forcing a devaluation and ensuring that recession and inflation would follow. Thus, the reserves were lost, and debt remained to be repaid. A floating rate encourages policy realism and forethought.

**Structural reforms**

Without healthy, reliable economic institutions, the policies that have brought progress to Mexico in the past decade cannot succeed in the long term. Aware of this, our government has also made structural improvements within the policy framework of economic liberalization and free trade. Our aim has been to transform Mexico from a closed, heavily regulated economy, with a high degree of government intervention, into an open, market-driven economy.

***A reliable banking system.*** Strong, healthy banks are essential to promote savings levels that meet Mexico's investment needs and to channel those savings more efficiently into all sectors of the economy, supporting job creation.

In response to the 1994–95 crisis, the government undertook programs to improve the banking system's solvency. Then congress passed significant banking-law reforms in December 1998. One law created the

Institute for the Protection of Bank Savings, which will manage deposit insurance and sell all assets acquired through the earlier banking support programs. By 2005 total deposit coverage will gradually be reduced-per person per institution-to about $115,000 at today's exchange rate. While protecting small investors' savings, these deposit insurance limits should foster market discipline and self-regulation by the banks.

The December 1998 reform legislation also removed all limits on foreign investment in any Mexican commercial bank, regardless of size. This measure will strengthen and diversify the banking system's capital base.

To reactivate sustained credit growth that will fuel the economy, we need (1) continued macroeconomic stability (resting on the crisis-anticipation measures I've already discussed); (2) high and sustainable growth rates; (3) a stronger, more consolidated banking sector; and (4) modernization of the regulatory framework governing credit.

The first two conditions are present, and we're working to sustain them. Consolidation of the banking sector is underway due to bank and debtor support programs and new capitalization rules that will help improve banks' quality and quantity of capital.

Congress is now working on the fourth factor-a better credit regulatory regime. One element is to reinforce the legal framework governing credit guarantees; the other is a law permitting new types of corporate reorganization.

***A stable revenue stream.*** Mexico needs broad fiscal reform in order to improve the fairness and efficiency of our tax system while ensuring stable sources of public revenue.

We're pursuing tax reform along four lines. First, loopholes such as zero rates and exemptions allowing tax avoidance must be closed at the same time as we increase the tax base by improving economic performance. Second, the tax system has to be simplified, stressing quality of service and promoting voluntary compliance by ensuring greater legal certainty of tax enforcement.

Third, Mexico's tax system needs to provide better incentives for saving and productive investment. It's important that we move from a tax system that relies heavily on income taxation to one that targets consumption taxation. Finally, we need to improve the level and stability of federal revenues, and simultaneously work to remove the distortions that hinder growth and promote an unfair distribution of the tax burden.

***Privatization.*** The Mexican government participated in virtually every sector of economic life in the early l980s. Since then, structural reforms have significantly expanded the role of the private sector. Privatization, we believe, promotes gains in efficiency and more competitive pricing. A large number of state-owned enterprises have been divested. In l982 there were 1,155 of them-today only 247 remain, and more than 50 of these are in the process of privatization. Private-sector participation now includes telecommunications, railroads, ports, airports, natural gas, and, most recently, electricity.

The administration has proposed to congress that the private sector should be permitted to invest in electrical generation, distribution and commercialization. The government, however, would maintain operational control of the national transmission network and such aspects as rural and neighborhood electrification and nuclear power plants.

***Social security.*** July 1997 saw a far-reaching reform in our social security system that will change the Mexican pension system from a pay-as-you-go system to a fully funded plan that will create long-term savings to finance long-term investments.

The new system offers important benefits to retirees, including a guaranteed minimum pension equivalent to the minimum wage, adjusted yearly for inflation. Workers also are allowed to make voluntary contributions to their own individual accounts, and there are new provisions that give low-income workers access to financial markets. So far, 15.7 million workers have entered the new system and the resources in individual accounts are expected to reach about 5.1% of GDP by the end of 2000.

***Decentralization.*** We believe that decentralization of administrative powers has boosted our economy's efficiency. State and local authorities can now obtain resources directly, channeling them to meet each state's priorities. For the first time in the history of Mexico, state and local governments directly control more resources than does federal government. For every peso the federal administration spends today, states and municipalities are spending 1.5-almost twice the resources they controlled in 1994.

**The challenge of the future**

In working to dispel the ghosts of Mexico's past crises and restore international confidence in our management of the economy, we are not wearing rose-tinted spectacles.

We know full well that our growth is intertwined with the progress of our major trading partners, the US and Canada. I'll share with you a bit of insider information that shows a certain realism on our part. In our models, as long as the US economy grows at 2.6%, Mexico will be fine. We have thought ahead to accommodate economic deceleration, although of course we hope for that oft-mentioned "soft landing." The one thing we are sure of is that we can do nothing about what happens in the US. So our policy is to better prepare for shocks-to have a lower current account, to manage our debt better; in short, to get as big an umbrella as we can in case it rains.

We know that Mexico faces challenges like relying less on its oil and more on the creation of wealth and opportunity, and the measures I've discussed move in that direction. Our economy today is much less vulnerable than in the past, which enhances the credibility of our programs. We have concrete evidence of this despite concern about election-year excess in public spending. For instance, in the first ten weeks of this year, we successfully placed debt on both domestic and international markets. In February, the World Bank issued a three-year bond in international capital markets for one billion pesos-the first time one of its bonds was issued in a Latin American currency. In March, Moody's Investors Service upgraded Mexico's rating category to investment grade, a strong signal to private and institutional investors alike.

Erasing a crisis of confidence and of credit takes time, but Mexico is making progress in banishing its ghosts while achieving sustainable growth that improves life and opens opportunity for all our people. ❖

# TAPPING HIDDEN FORTUNES

**By Catherine Kuchta-Helbling, Ph.D.**
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Billions of dollars in potential profits are lost each year in emerging democracies and economies threatening to derail political and economic transitions worldwide. These losses result from ill-designed, complex laws and regulations that exclude millions of citizens from the political and economic system and unnecessarily raise the cost of doing business in the formal sector. High business costs force entrepreneurs of modest means to survive by operating low-income, low-growth activities in the informal sector, squandering their economic potential. Moreover, costly business regulations encourage investors to flock to more hospitable business climates causing other countries the loss of millions of dollars in badly needed investment. These factors greatly hinder competitiveness, profit-making and overall economic growth. They also impede a country's ability to benefit from globalization. As a result, many citizens feel that they have not benefited enough from democratic and market-oriented reforms and oppose further reform initiatives. In some countries, widespread demands to reverse past reforms are mounting. Unless barriers to political and economic participation are removed in the near future, democratization and market-reform could unravel across the globe.

A key barrier is the cost of doing business in the formal economy. Entrepreneurs who want to become and remain formal must spend time and money to:

- obtain a business license
- acquire land titles or leases
- hire employees
- comply with government laws and regulations–pay taxes, for example
- obtain credit
- hook up and maintain electricity and telephone services
- enforce contracts, and so forth.

How expensive these procedures are fluctuates wildly from country to country. Exorbitant business costs are found in nations where business people must follow burdensome laws and regulations and deal with inefficient, corrupt government agencies which offer few benefits. High costs force entrepreneurs to make calculated decisions as to which rules they will respect or violate based on what they can afford without having to go out of business, what they expect to receive in return, and the cost of noncompliance. Many entrepreneurs producing legitimate products lower their business costs by operating informally without proper permits and legal status. Hence, they are called the informal sector or "informals."

Every economy–developed or emerging–has an informal sector. New York City sweatshops are notorious examples of informality in the US. What is alarming is that the already large informal sectors in many emerging democracies and economies continue to grow. A recent IMF study reveals that about nine trillion dollars–roughly a third of the GDP of emerging markets–was produced informally. Similarly, 1999 International Labor Organization figures indicate that 17% to 84% of the urban labor force in developing countries work informally.

**What's wrong with high business costs and large informal sectors?**

To begin with, a large informal sector weakens democracy, hinders necessary reforms and contributes to misguided policies. Informals, if given the opportunity, are likely to suggest useful policy changes that

would reduce the cost of doing business and level the playing field. Yet, their illegality prevents them from voicing their concerns to government officials and holding them accountable. As a result, reforms that would increase private sector activity and growth are not implemented. Moreover, because informal sector activity is unreported, policymakers don't have the necessary information to make good decisions. Unsound macroeconomic policies can seriously harm an economy.

High business costs also damage an economy because they lower productivity and competitiveness and encourage informality. This happens in several ways. One is through costly business licenses that grant rich, but not necessarily efficient, producers an unfair advantage over potentially productive start-ups with limited funds. Another is through stringent, costly labor codes. Formal businesses reduce labor expenses by overusing scarce capital and under-employing available labor; conversely, informal entrepreneurs rely too heavily on informal labor and not enough on cost-effective capital. Either way, resources are misallocated, productivity is stunted and workers suffer. Formals lose hard-won benefits whereas informals are forced to accept low wages, unstable jobs and poor working conditions.

More familiar causes of low productivity and informality are complex and costly taxation and regulatory schemes. Many entrepreneurs avoid the time, money and headaches of burdensome regulations through tax evasion and noncompliance. This lowers government revenue to finance essential business-related goods and services such as the court system, administrative agencies, roads, and health care. As a result, their quality declines as does entrepreneurs' productivity levels, unleashing a vicious circle. Poor quality services discourage even more entrepreneurs from paying taxes and business-related fees which, in turn, further decreases government revenues and quality of service levels encouraging informality and corruption.

Informality and corruption waste vital resources and weaken political and economic institutions. Because informals are illegal, they don't benefit from law enforcement services such as the courts and the police that could offer them protection and reduced business risks. Some informals survive without these services by signing short-term, small-scale agreements with known partners. Yet, this greatly lowers their productivity and flexibility. Other informals bribe government officials to obtain services or escape costly punishment for their illegality. Corruption pads the pockets of officials, robs the government of much-needed revenue for essential services and raises the price of goods and services. Moreover, routine violation of government laws and regulations erodes their credibility and scares investors.

Complicated, costly and insecure property rights systems are equally harmful to economic performance. Assets lacking secure property rights tend to remain in the informal sector because they can't be converted into "productive economic currency" such as collateral for reasonably priced loans to start or expand a business or shares in incorporated companies. Without legally protected property rights, entrepreneurs will have difficulty attracting investors and will have little incentive to train personnel or purchase capital (such as computers or high-tech machines) in order to undertake large-scale, long-term investment, specialize and be competitive. As a result, the economic potential of assets worth trillions of dollars is squandered in small-scale, short-term, low-surplus generating informal sector activities.

Costly, insecure property rights damage economic performance in other ways as well. Obtaining water, electrical and telephone services usually requires a property title. Entrepreneurs without property titles can gain access to these services only through illegal tapping. Widespread siphoning forces providers to charge regular subscribers more. Higher prices, in turn, harm the competitiveness of companies that use these services.

**Where do high business costs and large informal sectors come from?**

The answer is from badly designed laws and regulations and poor quality government services that stack the deck against the entrepreneur of modest means. This is particularly the case when entrepreneurs are locked out of the policymaking process and thus can't tell government representatives which policies help or hurt their business activities. As a result, laws and regulations are made by a handful of individuals for the benefit of themselves and/or their cronies, and may not encourage overall, long-term economic growth. The failed crony capitalist systems in Asia illustrate just how disastrous such arrangements can be. Such crises also show that those who created or have adapted to such as system stubbornly defend it because significant changes will be costly and risky for them. As a result, poorly designed institutions often enjoy extended life spans.

There are plenty of examples of ill-designed rules and regulations. Among the most common are taxation and labor policies. High tax rates and poorly administered taxation systems reduce profit margins encouraging tax evasion and informality. Similarly, restrictive labor regulations impose substantial, fixed burdens on firms (especially low income-earning ones) and make hiring informal workers attractive.

In some countries, setting up a business is akin to a multi-year marathon. One of the first hurdles is acquiring legal property titles for assets such as land or scientific discoveries. Complex and lengthy titling procedures can prevent even the most determined entrepreneurs from setting up shop. Examples from Hernando de Soto's recent book, The Mystery of Capitalism, illustrate just how burdensome obtaining legal real estate titles can be in some countries: in the Philippines it requires 168 bureaucratic steps, involves 53 public and private agencies and takes 13 to 25 years; in Egypt it requires 77 bureaucratic procedures, involves 31 public and private agencies, and takes five to 14 years; and in Haiti it requires 111 bureaucratic hurdles and takes approximately 12 years.

Even with property titles in hand, entrepreneurs are often confronted with ridiculously expensive and complicated license and permit requirements. The Harvard Institute of Economic Research recently published a survey of the official requirements to set up a business in 75 countries. The results indicate that the process entails, at best, two steps, two days, and US$280 in Canada; at worst, 20 steps, 82 days, and US$2,696 days in Bolivia; and, on average, 10.2 procedures and 63.1 days.

Entrepreneurs' headaches and high costs do not disappear once their business is finally registered. Now they must comply with a whole host of administrative and operative regulations ranging from paper filing requirements to price, interest rate, and import and export controls. In Peru, 73% of the cost of remaining formal came from following administrative rules. In Brazil, entrepreneurs must abide by over 50 sets of filing and payment requirements and must comply with endless record-keeping demands including filing four copy slips per sale.

Complying with numerous laws and regulations becomes even more overwhelming and costly if government agencies lack adequate financial, technical and human resources to administer and enforce them quickly and correctly. When it takes five months to get a business license or resolve a contract dispute, economic opportunities are lost. Paying bribes to speed up the process or avoiding the hassles altogether by operating informally become tempting solutions.

Remaining formal is exacerbated by unclear, unknown, conflicting, and frequently changing laws and regulations. This forces government officials and entrepreneurs to spend time and money figuring out which

laws and regulations apply or risk noncompliance fines. It also breeds corruption by enabling government personnel to use their power to control the pace and the outcome of administrative and enforcement processes in return for illicit payments. A startling example is the Brazilian state and local safety codes that indicate different heights for fire extinguishers. A clever businessman put two sets of brackets per extinguisher and switched the extinguisher according to inspector. His scheme was foiled by conspiring inspectors who arrived together so that they could cite a violation and extract a payment.

Poor quality and/or nonexistent infrastructure can also bleed entrepreneurs' pocketbooks dry. Business costs rise significantly if entrepreneurs must travel long distances on unpaved roads or wait years to get a telephone line or electricity. Similarly, insufficient technological infrastructure hinders the creation and maintenance of business-related databases that contain essential information such as credit reports. Without credit reports, creditworthy borrowers can't benefit from lower interest rates.

**How can business costs be lowered?**

Lower business costs and economic revitalization are within reach thanks to a handful of policy recommendations. These entail reforming specific laws and regulations and decision-making practices as well as government agencies' operating procedures.

Unsuitable laws and policies have a better chance of being reformed if entrepreneurs participate in and oversee policymaking. To this end, governments should make laws and regulations (draft and enacted), budgets and legislators' voting records available to the public by adopting and enforcing freedom of information laws. They should also ensure that decision-making procedures are transparent and inclusive so that citizens can easily comment on existing and draft laws or propose new ones.

Streamlining legal and regulatory codes can greatly reduce business costs. This can be done by eliminating duplicative, outdated, complex, and conflicting laws and regulations and replacing them with ones that clearly define rights, responsibilities and compliance procedures. Property rights laws, for example, need to establish straightforward standards to identify asset owners and to indicate how property can be combined, leased, or exchanged. Tax codes and fiscal report requirements need to be simplified, and overall tax rates lowered. Similarly, labor codes should be revamped to eliminate outdated laws and to allow for more flexible employment contracts. Equally important are simple and well-publicized business registration requirements. Having a one-stop registration process that can be completed in every region of the country is one way to greatly reduce start-up costs.

Instituting corporate governance measures can work wonders for a country's business climate. What is needed is legislation that protects investors, shareholders and other stakeholders, requires transparent shareholder registries, and upholds the Organization for Economic Cooperation and Development's (OECD) Convention on Corporate Government and the International Standards Organization's (ISO) accounting standards. (For more information, see: www.cipe.org/efn/governance.php3.)

The same is true for regulations affecting the financial sector and government procurement. Implementing prudential supervisory mechanisms within the banking and financial sector can significantly reduce the risk of resources being drained by an "Asian flu." Similarly, fewer funds will pad the pockets of government cronies and their private sector pals if conflict of interest laws are clarified, Transparency International's government procurement codes are adopted, and OECD anti-bribery principles are upheld.

Overhauling government agencies can lower entrepreneurs' costs and improve the commercial environment. To this end, agencies' internal operating procedures need to be simplified and their performance regularly evaluated according to well-defined standards. Staff should be hired and promoted based on verifiable professional standards, and they should receive appropriate salaries. Agencies, particularly the judiciary, should be provided with sufficient, yet well targeted, financial and technical resources to administer and enforce laws and regulations consistently, efficiently and fairly.

Maintaining adequate checks and balances between government branches helps minimize frequent, radical changes to the legal and regulatory framework. This reduces the burden on the judicial system and inhibits abuses of governmental power–especially in countries where commercial activities are governed by civil codes that can be overturned by decree.

Providing quality, efficient and cost-effective infrastructure substantially lowers business expenses. To this end, government should ensure a healthy degree of competition in these domains by privatizing inefficient state services or by subcontracting with private sector providers based on transparent guidelines. With cutting edge telecommunication systems and computer systems, the public and private sectors can maintain up-to-date, accessible databases of essential business-related information such as property title records, licensing and permit requirements and credit histories.

**Converting ideas into action**

Knowing the types of measures that will reduce business costs, strengthen democracy and establish a level playing field for all entrepreneurs is only half the battle. Victory requires a well-designed reform platform and advocacy strategy. Developing a national business agenda is one way to promote legal and regulatory change effectively. The agenda sets reform priorities by indicating which laws and regulations need to be modified in the near future and provides concrete suggestions for change.

Formulating a national business agenda requires the private sector to take action. Heads of private sector business associations should take the lead by asking their members to indicate which laws and regulations raise the cost of doing business. Association leaders should collaborate to compile these in a single list. They should then get together to review the list and select reform priorities. Next, private sector leaders, alone or in collaboration with pro-reform think tanks, should draft a national business agenda.

The agenda should clearly identify which laws and regulations are being targeted for reform. Each should be described in straightforward terms. Each description should be followed by a simple presentation using basic charts or graphs that shows how the policy in question raises business costs and how alternative laws or regulations can reduce these expenses. This will provide powerful evidence that certain business costs are unnecessarily high and that solutions are within reach.

Spokespersons for the business community, allied with others in their communities, must take up the cause of reform and liberalization. Armed with the national business agenda, business people must make common cause with political leaders, journalists, academics, civic organizations, and others concerned with the economic future of their country. Coalitions can be formed to advance reform based on a simple proposition: A country that denies its own citizens the right to entrepreneurship is jeopardizing the future of its children. It is the entrepreneurs who will create new technologies, new jobs and access to international markets. This message must become a national call to action, to reform.

**Reducing barriers to participation strengthens democracy and economic growth**

Emerging democracies and economies are struggling to provide their citizens with better lives marked by political participation and economic prosperity. Yet, excessively high transaction costs hinder such efforts. Making this aspiration a reality hinges on instituting democratic governance in the public and private sectors. Such a change will contribute to more responsive policies and will increase efficiency, transparency, accountability, and growth, as well as reduce corruption. Moreover, if citizens are granted a greater voice in the reform process, they will gain a sense of ownership over reform measures. This will strengthen democracy and help to build a broader pro-reform constituency essential to consolidate political and economic reforms.

* More information on the informal sector is available on CIPE's Web site at: http://www.cipe.org/efn/informalsector/papers/. ❖

## RED TAPE RANKING

### Compare countries' levels of red tape, corruption, informal sector employment and growth

| COUNTRY | Number of procedures | Time in number of business days | Cost relative to 1999 GDP | Cost in USD | Nominal cost + time in USD | Corruption Ranking | % of urban sector employment* | % GDP Growth 1999 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | |
| Argentina | 14 | 48 | 10.19% | $774 | $2,234 | 71 | | -3.40% |
| Bolivia | 20 | 88 | 265.58% | $2,682 | $3,038 | 81 | 57% -1996 | 0.60% |
| Brazil | 15 | 63 | 20.14% | $890 | $2,004 | 45 | | 0.80% |
| Canada | 2 | 2 | 1.45% | $280 | $435 | 5 | | 4.50% |
| Chile | 10 | 28 | 13.08% | $620 | $1,151 | 19 | 30% - 1997 | -1.10% |
| Colombia | 18 | 48 | 14.80% | $333 | $765 | 72 | 53% - 1996 | -4.30% |
| Dominican Republic | 21 | 80 | 463.09% | $885 | $946 | N/A | | 8.00% |
| Ecuador | 16 | 72 | 62.23% | $815 | $1,193 | 82 | 40% - 1997 | -7.30% |
| Jamaica | 6 | 24 | 18.79% | $438 | $662 | 50 | | 1.5% (2000) |
| Mexico | 15 | 67 | 56.64% | $2,492 | $3,671 | 61 | 35% - 1996 | 3.80% |
| Panama | 7 | 15 | 30.74% | $944 | $1,128 | N/A | | 4.10% |
| Peru | 8 | 83 | 19.86% | $475 | $1,268 | 40 | 51% - 1996 | 1.40% |
| U.S. | 4 | 4 | 0.49% | $150 | $517 | 18 | | 4.20% |
| Venezuela | 14 | 104 | 10.60% | $389 | $1,916 | 78 | | -6.10% |
| **Average of 85 countries** | 10.48 | 47.4 | 47.08% | $3,873 | $5,428 | | | |

Source for data in columns 2-6: Djankov, La Porter Lopez-Silanes, and Shleifer, June 2001 (third draft).

Source for data in column 7: Transparency International's Corruption Perception Index for 1999 (http://www.gwdg.de/~uwvw/).

Source for data in column 8: International Labour Organisation. Percentages shown are the percentages of urban informal sector employment as a percentage of urban employment.
*Additional data will be provided as it becomes available.
** Data taken from Du Jeu, 1998 found in the 1999 World Survey on the Role of Women in Development. New York: The United Nations. Figures represent the informal sector as a share of total employment.

Source for data in column 9: IMF, International Financial Statistics.

# BRAZIL COST: HOW TO DEVELOP AND PROMOTE A COMPETITIVENESS AGENDA

**Jose Augusto C. Fernandes**
**Executive Director, Brazilian National Confederation of Industry**

**What is the Brazil Cost Project?**

The Brazil Cost Project is designed to reform government policies, laws or regulations that result in economic inefficiency and distortions. In order to be most effective, the project focuses on a few key economic issues that affect companies' competitiveness and also are relevant to the general public. These are the tax system that penalizes the export sector; labor legislation and conditions that are dictated by the government rather than negotiated directly between workers and employers; poor infrastructure; high cost of capital; and inadequate educational and health services.

In order to explain the nature of the Brazilian Cost project, CNI's staff members did cost comparisons between Brazil and other countries. For example, port charges in Brazil were compared with those in other countries, as were the degree of education of the average worker in Brazil compared to that of workers in other Latin American countries and regions. The study results were published in a booklet replete with facts and figures.

CNI disseminated these findings to the general public, opinion makers, Brazilian companies, and universities in several formats. One was in the booklet described above. Another was in a video that filmed a runner jumping over a series of labeled obstacles such as education, taxes, infrastructure, and so on. The results were also presented in articles, media kits and conferences. The project was well received. In fact, the airline TAM distributed the CNI booklet onboard its flights. The Brazil Cost Project was also discussed on many radio and television shows.

**Raising legislators' awareness**

The next step was to use the study to raise legislators' awareness about the importance of reforms as evidenced by the Brazil Cost Project. To this end, a seminar with Brazilian legislators was organized where the concept of Brazil Cost was defined, the booklet containing the study results was distributed, and businesspersons discussed specific obstacles that erode competitiveness. CNI began the conference in a creative, interactive way that really drove home the point that action needed to be taken: meeting participants had to wend their way through a labyrinth in order to reach the main conference room. At every turn in the maze, they were confronted with illustrative examples of obstacles that hinder Brazilians' competitiveness including high financial costs and the poor quality of infrastructure. At one juncture in the maze, there was a powerful image of a person lost in a Brazil-wide labyrinth, which vividly captured what is happening to Brazilian competitiveness.

During the seminar CNI distributed a special publication that identified the most important measures related to competitiveness that were then on the congressional agenda. Each one was assessed as to whether it would increase or reduce Brazil's competitiveness. The results were presented in a simple, straightforward manner. First, the subject was conceptually defined; secondly, the proposed measure was described and where it was in the legislative process; and, finally, each measure's relevance to the Brazil Cost project was detailed.

**A call for reform proposals**

CNI solicited proposals to reform laws or policies hindering competitiveness from a wide range of sources. In addition to the general public, the federation sought out proposals from companies, business federations and even from foreign firms doing business in Brazil. They could submit their proposed reforms to CNI through the Internet.

More than 800 reform suggestions were received. A team of experts on law, information technology, communications, and trade sifted through them and selected 20 on which the project would concentrate. Each of them was presented on paper in a general format that included a clear indication of what law, policy or issue was being considered, a description of how it negatively affects business and a proposed solution—for example, rescinding all or some of the clauses of the law or policy in question.

In response to these efforts, the government created a deregulation task force comprised of all government ministers to discuss the Brazil Cost agenda. CNI and government representatives struck a compromise concerning how to evaluate the proposed reforms. The proposals were posted on the CNI Web site in the format described above, and government officials were given the Web site password so that they could post their responses to the proposals.

The general public can also offer feedback on the existing reform proposals and suggest new ones through this Web site. Recently, for example, a Mexican investor complained to CNI's Executive Director about Brazilian tax practices that were hampering doing business in Brazil. The director suggested that the investor write down his problem and submit it as reform proposal through the CNI Web site.

The first phase of the deregulation project was evaluated in a report indicating what had been accomplished and what remained to be done. The success rate was impressive by any standards: of the 59 reform proposals that were posted on the CNI Web site at that time, 20 had been fully or partially adopted, 12 were under government study, and no action had been taken on the other 27. The largest number dealt with tax, labor and government procurement. As a result, CNI set reform of the tax system and labor laws as top priorities for the second phase of Brazil Cost.

**The impact of economic stability**

Next, CNI wrote a paper entitled "Competitiveness and Growth," which addressed the main issues confronting Brazil's economy. This document served as a guideline to evaluate the soundness of future proposals. In the paper, the stability of the Brazilian economy, for example, was listed as a key condition for competitiveness and growth. Hence, incoming proposals were screened as to whether or not they would contribute to economic stability. Since then, CNI has broadened the scope of the project to incorporate factors other than specific laws and regulations that affect competitiveness and growth.

**An expanded agenda…**

To begin systematically addressing broader issues affecting competitiveness, CNI is hosting a competitiveness forum during the second half of this year. The issues to be addressed include the results of international trade negotiations, the functioning of Brazil's political and judicial systems, credit, the environment, technology, and e-commerce. These will be part of a new competitiveness agenda which, as mentioned earlier, will also focus on reforming Brazil's labor and taxation systems.

A new strategy will be employed to promote legislative action on the new competitiveness agenda. The agenda will be used to identify legislative proposals rather than react to those already presented by congress or the administration. CNI will designate a policy manager to shepherd each legislative proposal from the proposal phase to its submission to congress.

**…and new strategies**

In addition to broadening the project's scope, CNI has developed new mechanisms to enhance Brazilian competitiveness. The first is the business "check-up." Instead of asking businesses what problems they are having, the federation now sends a four-person survey team—comprised of lawyers, trade analysts and tax specialists—to companies to speak with their presidents and key managers for a day or half a day in order to get their views on particular issues. Targeted firms are drawn from a sample survey pool of small, medium and large companies.

The second is a new, systematic strategy to lobby congress. The policy managers at CNI keep tabs on priority reform issues on a daily basis. How effective and costly this strategy is depends on how the political parties and congress are organized. If, for example, political parties are well organized and have specific persons in charge of certain topics, tracking particular issues is straightforward. If not, this kind of issue monitoring is very costly. The quality of the staff of Brazil's congress has improved, but the political parties are not very organized and are weakened by factions.

**Assessment**

The Brazil Cost project has contributed to reforming government laws and policies hindering competition by using innovative techniques in a strategy that was structured yet flexible enough to respond to "windows of opportunity." New tactics, such as working with multi-disciplinary teams of experts and using the Internet as an interactive mechanism, proved highly successful on several counts.

First, the implementation of 40 pro-competitiveness proposals is a clear-cut success story. These reforms clearly improved Brazil's business climate as attested by a recent A.T. Kearney report stating that the Brazil Cost project responded to the major complaints of foreign investors.

Secondly, the interactive Web site, forums and press releases raised awareness among government officials, legislators and members of the private sector about the critical need to improve Brazilian competitiveness. Today, Brazil Cost is a well-known project. The press regularly reports on it, and it is well known within multilateral international organizations. The Brazilian Workers' Party has even published a book on the subject.

Finally, the project strengthened democracy in several ways. It fostered continuous communication between the public and government representatives, encouraging both sides to identify obstacles to competitiveness and, more importantly, to craft solutions in concert. In fact, many novel reform ideas were introduced through the CNI Web site. Because the project focused on solutions and actively sought government and public involvement, it catalyzed both sectors to participate more actively in policymaking.

The government created a task force to study the reform proposals presented by the public and the private sector. And private sector associations, including CNI and many others grouped under Acao Empresarial, joined forces and succeeded in getting taxation reform on congress's agenda. This is the first time that a constitution-

al reform is being discussed in Brazil's congress at the behest of the public, instead of being an initiative that came from the congress or the executive branch. The reform hasn't passed yet because the government fears it would reduce its tax receipts at a time when Brazil has an IMF agreement.

This project provides conclusive proof that civil society groups can shape a country's reform process if they mobilize effectively. Moreover, by routinely publicizing the Brazil Cost agenda and comparing it with the government's agenda, the project made policymaking more transparent and thus facilitated citizen oversight of government activities.

The project's latest initiatives will build upon these past successes and the lessons learned thus far. Throughout the project, successful reforms hinged on active citizen participation, systematic lobbying and tracking of issues. The business "check-up" will increase the private sector's role in setting the legislative agenda and in shaping policies. Having a manager for each new priority issue will greatly strengthen follow-up efforts.

There are still many obstacles hindering Brazil's competitiveness that are beyond the scope of the initial Brazil Cost agenda (e.g., political reform and international trade policies). Thus, a broader agenda that addresses these larger competitiveness issues is being developed.

The fact that Brazil's congress is deeply divided has slowed down the reform process. Privatization of the enormous Furnas electric utility, for example, has been postponed. No major improvements have happened on tax and labor issues because different economic crises (Asian, Russian and now Argentina's and the world economic slowdown) have helped reduce the impetus for some reforms. Now that we are facing national elections in 2002, we will need to go deeper and improve business strategies.

Projects such as Brazil Cost that raise the awareness of congress and the public about the need to enact reforms that are part of a consistent, overall reform package will benefit the entire population. Without them, Brazil will not get the full benefits from global economic integration and will have a hard time increasing production, employment and the welfare of its population.

# LATIN AMERICA'S CHALLENGE: CREATION OF QUALITY JOBS

*Popular discontent is growing in Latin America as the reform process that held out so much promise a decade ago has stalled. The macroeconomic changes many governments instituted then ignored structural issues that now are coming to haunt the region's elected leaders. Key among them is the failure to create new job opportunities in the formal sector for the region's rapidly growing labor force. In his presentation at a Latin American reform conference CIPE hosted, Virgilio Levaggi, senior analyst at the International Labor Organization, underscored how substantial labor legislation reforms failed to deal with this critical issue. A summary of his presentation follows.*

In the last decade, several Latin American countries have enacted major changes to their labor legislation in order to compete more aggressively in today's increasingly integrated global markets. It would be an exaggeration to claim that Latin America's labor legislation has changed from one where jobs were virtually guaranteed for life to a flexible system—*de garantismo a la flexibilicación*.

In the Mexican tradition of so-called social constitutionalism, the return of democracy in Brazil, Ecuador, Peru, Honduras, El Salvador, and Guatemala in the 1990s led to the passage of constitutions that enumerate in detail many civil, social and political guarantees. Many of the labor-related reforms that were made during that time continued the *"garantista*" tradition. This was the case, for example, of two labor laws Chile adopted in 1991.

However, several countries have been moving in the opposite direction. And as policymakers consider the reforms that must be undertaken to ensure that a larger number of people in their countries benefit from globalization, they must ensure that quality jobs or *trabajos decentes* become available.

**Where it all began**

Modifications building flexibility into labor and benefits provisions have been primarily aimed at lowering labor costs. By reducing such costs, the final price of goods can be lowered, enabling companies to become more competitive given that labor costs account for a large percentage of total production costs. Lower labor costs—together with greater flexibility in hiring and deploying of workers—are enabling Latin American companies to become more competitive because they can now offer better prices to international buyers.

The trend toward flexibility in labor contracting began in Brazil in 1966 when the "Guarantee Fund on Term of Employment" was instituted to replace the traditional system of protecting workers against dismissal. More recently, labor contracts with specific two-year terms were introduced. It is also significant that Brazilian entrepreneurs are providing worker training and promoting ties between companies and universities as a way of fostering small and medium enterprises.

Chile's Decree Law 2000 of 1978 also contains many provisions that grant companies more flexibility in hiring and dismissing workers. So do the labor reforms Colombia and Peru enacted at the beginning of the 1990s. Chile—which has registered significant growth gains during a long period of time and low unemployment—also was the first to create private pension funds.

The development of private employment and temp agencies in some countries of Latin America also is indicative of the new trend.

One of the major objectives of instituting more flexible labor legislation is to make individual and collective labor relationships more dynamic. The reforms also have reduced companies' labor costs by doing away with the former system of guaranteed employment stability and increasing the number of just causes under which employers can legally dismiss workers.

Thanks to the new reforms employers in Latin America now enjoy greater flexibility on many fronts. They can hire workers for a fixed term. They can reduce their employment rolls due to changes in economic, market, or technological conditions now that the number of just causes for dismissals has been increased. Finally, companies currently enjoy greater freedom in setting work schedules and assigning workers to different tasks. Reforms have also been enacted to promote hiring of specific types of workers such as those affected by strikes, inexperienced young workers, workers unemployed for a long time, and women heads of households.

**Labor still faces heavy odds**

We are living through a period of *economic recovery with high unemployment*. After a long recession caused by the implementation of adjustment policies in the majority of the countries, Latin American economies began to make a comeback in the late 1990s. Current estimates project that the region finished the year 2000 with a 4.3% GDP growth rate, as well as real wage gains (1.2% for industrial wages and 0.5% for minimum wages) as a result of a low and decreasing rate of inflation. However, the unemployment rate will remain at a level similar to last year's 9%.

The number of unemployed workers throughout the region is now estimated at 19 million. Youth and women will continue to be the ones who suffer most, particularly young workers whose present unemployment rate is double the regional average according to the International Labor Organization's *2000 Labor Overview*.

The creation of jobs without contracts has increased, as has the number of illegal jobs (*en negro).* This has occurred notwithstanding the fact that one of the stated objectives of the flexibilizing labor reforms was to reduce unregistered employment. In Bolivia, Colombia and Peru employment in the informal sector represents more than 50% of total employment.

One reason for the growth of informal employment is that the cost of hiring employees continues to be high especially for micro enterprises and small firms—which were the most dynamic sector in terms of job creation during the 1990s. For example, a study in Peru indicates that only 36% of micro enterprises surveyed have the economic and financial resources to comply with labor law requirements. Moreover, between 50% and 75% of these firms stated that their profits would be lower if they complied with all labor requirements.

The labor situation in Argentina mirrors regional trends. Last year, 13 out of every 100 persons in the labor force were totally unemployed; 12 worked only intermittently and didn't receive any benefits; and 20 had salaried employment "*en negro*," with no benefits or job security and their average earnings were half of what workers earned in the formal economy. Another 12 workers worked independently, without any type of

benefits; and only 40% of these had stable employment. With a high unemployment rate, it is not surprising that Argentina has been experiencing growing social unrest, especially in the provinces.

**What's needed: quality jobs**

While at the beginning of the economic stabilization and structural adjustment process in the 1990s the principal objective was to increase economic efficiency and equilibrium, today there is a growing conviction among Latin Americans that peace and social well being depend in large measure on the economy's ability to generate *trabajos decentes*. Already there are a number of corporate case studies of strategies that boosted productivity by creating jobs with stable, long-term contracts. By reducing labor turnover, these arrangements have enabled the companies to better train an increasing percentage of their workers and to reorganize their production in order to successfully confront increased competition.

The current debate about stable employment shouldn't be interpreted as an expression of the old *garantista* tendency. Rather, it represents the growing conviction that a modern, competitive and equitable society must provide quality jobs; that is, jobs that result not only in higher productivity but also offer good wages, working conditions and benefits. An ever-larger number of politicians in Latin America share this growing conviction.

It is thus not surprising to hear this question among any increasing number of persons in Latin America: "If the country is doing so well, why am I doing so poorly?" This theme was heard frequently during the most recent elections in various countries of the region.

Providing good jobs with better salaries and benefits will not hurt companies. Studies carried out in Argentina, Brazil, Chile, Mexico, and Peru indicate that higher labor costs have not been an obstacle to improving competitiveness because labor productivity has increased concurrently. Therefore, an increase in labor costs does not necessarily result in decreased competitiveness if there is a concurrent increase in productivity. On the other hand, these studies indicate that there is a high correlation between competitiveness and several macroeconomic variables, especially a country's exchange rate and relative prices.

**Labor in a global economy**

More than half of the world population has no social safety net. It is abandoned to its fate in the event of illness, injury, pregnancy, unemployment, old age, or widowhood. Last year 200 million more people lived in poverty than in 1987. Today one billion people live on $1 a day, and per capita income in 80 countries is now lower than it was a decade ago. Thus, it is not surprising that an increasing number of people are unhappy with growing globalization.

Unprecedented globalization has made life very difficult for countless people the world over. Given that globalization and accelerated change appear to be inexorable facts of life it is essential to take steps to reduce their tendency to generate social exclusion and growing inequality. As experts have said, if the global marketplace is to survive, it must benefit the masses, and the masses will benefit from globalization if they can obtain good jobs.

This places work at the center of the public agenda on globalization because "for the majority of people, the best way to participate in the marketplace is through employment since it provides them not only economic but also social and political power" according to the UN Development Program. Only quality work—*trabajo decente*—will enable the global village to be a space of civilization, not of brutality, of

progress and not of impoverishment, of hope and not frustration. As the Nobel laureate economist Amartya Sen wrote in his last book, Development and Freedom, it is essential to weigh considerations of economic efficiency against their social consequences within an ethical framework.

Globalization is not a demon. But it must be managed according to higher principles in order to channel its dynamism into positive ends. For Latin America, the task at hand is to create quality jobs without going back to the time when jobs were guaranteed forever regardless of a worker's performance. This new kind of employment can contribute effectively to the consolidation of political and economic democracy in the region. ❖

# CIPE EFFORTS TO COMBAT CORRUPTION

*John A. Zemko is Senior Program Officer for Latin America and the Caribbean at the Center for International Private Enterprise. This article was drawn from remarks made at the Anticorruption Summit 2000.*

I'm pleased to discuss the partnerships CIPE has formed to alleviate the problem of corruption. CIPE is proud to have been a cosponsor of the OECD Washington Conference on Corruption that was held February of 1999. Our chairman, John Bohn, and the chairman of the National Endowment for Democracy, John Brademas, both had the opportunity to address the conference participants in keynote speeches. A number of our partner organizations from Ukraine, Colombia, Ecuador, India and several other countries were able to attend the conference as well. They have reported back to us on how important this conference was to them as a venue for discussing their own experiences in combating corruption.

These partner organizations have long formed the framework of CIPE's ongoing program efforts around the world and certainly form an important network of partnerships we have built to effectively fight corruption in a host of ways. This article will describe three different partnerships CIPE has formed with different private sector groups since that OECD conference. There are many more that are described in information available in the anticorruption discussion on our Web site at: http://www.cipe.org/efn/corruption.php3 I must give credit to one of our partner organizations in Bulgaria for helping to conceptualize this article. The Center for the Study of Democracy has been an exceptional partner for us in the effort to develop training programs in corporate governance in Central and Eastern Europe. CIPe has since adapted their experience for conferences we have developed in Asia and elsewhere.

It's helpful to group CIPE's partnerships into two separate areas for discussion purposes. In the one group are those initiatives designed to address the demand side of corruption and in the other group are initiatives that work at controlling the supply side of corruption. As you probably know, in the lucrative world of public-private transactions, these initiatives must work to both steer private companies in the direction of sound and honest business practices and also reform government policies that allow corruption to breed in the marketplace.

**"Demand" Side of Corruption**

- Some policy initiatives that are important to address on the demand side of corruption include:
- Sound procurement codes, particularly for large government procurement processes;
- Third party monitoring on these large procurements;
- Independent audits;
- Rationalizing tax schedules and collection systems;
- Paying civil servants a living wage; and finally
- Simplifying systems of law by creating sound systems of recording them and eliminating duplicative regulations that provide opportunities for corruption.
- On this last theme—and as an illustration for you—we have formed a partnership with the National Association of Entrepreneurs in Ecuador—or ANDE as we call them—that will improve the system of law in that country.

ANDE has been the recipient of great praise in Ecuador for its all-encompassing approach to eradicating corruption. They have issued recommendations on new legal reforms through a series of sessions with government officials, leaders of the business and NGO communities, and even the Catholic Church. Their focus has not been to blame past corruption on any one particular group but rather to initiate reforms that will change the direction of business and institute clean practices. Their studies have found that since the Republic of Ecuador was founded 168 years ago some 92,250 legal norms have been created of which 52,774 were in force in 1997. The sheer number of overlapping, unclear, and contradictory laws has created an environment of legal chaos and leaves the application and enforcement of laws to the discretion of bureaucrats. Several recommendations to clarify the system put forward by ANDE have been included in Ecuador's new constitution that went into affect last year.

Specifically, ANDE targeted six priority areas where corruption was the most pervasive including the administration of justice, public procurement and contracting, customs practices, privatization, social security, and transparency in financial management of the public budget. For example, ANDE recommended several policy reforms within the administration of justice including:

- Eliminating the susceptibility of the judicial system to outside influences;
- Installing a commission of distinguished jurists to codify standards and laws; and
- Amending subsidiary and procedural codes to eliminate double standards being used by public officials.

These recommendations were included in the new constitution, which established an independent seven-member commission under the authority of the National Congress that is supposed to codify and publish laws. The committee will also compile and systematically organize Ecuador's 53,000 laws to eliminate duplication and contradictions and lessen the discretionary authority of public officials.

**"Supply" Side of Corruption**

Of course it is crucial to develop policies addressing the supply side of corruption. Some of the most important achievements in that area have been the following:

- The OECD Anti-Bribery Convention, which is surely one of the most important international efforts underway to curtail the pipeline of corrupt funds moving from international corporations into the hands of public officials;
- The building of Internationally Accepted Accounting Standards as a fundamental institutional reform effort.

Teaching the importance of sound corporate governance has been one of CIPE's cornerstone initiatives on the supply side of the equation and again we must acknowledge the fine work in this area of our partner in Bulgaria, the Center for the Study of Democracy. CSD introduced shareholder registries to the government of Bulgaria as a fundamental policy reform initiative and was responsible for the passing and implementation of legislation that required their use. These shareholder registries decipher the ownership of companies and protect minority shareholders by ensuring that their shares are registered as a matter of public record, thus eliminating one of the leading causes of corruption in Central and Eastern Europe.

CSD has also spearheaded a corporate governance education program aimed at the key players in the privatization process, as well as educating interested members of the general public. The program consists of

study visits to transition economies, workshops for key private sector representatives, town hall meetings for the general public, and public education campaigns through articles and radio and TV presentations.

**Journalists Against Corruption**

Finally, in another supply side initiative, CIPE has undertaken broad efforts to upgrade the role journalists play as independent watchdogs for corruption. One of our most recent efforts in this regard is our partnership with the Trust for the Americas to train journalists throughout Latin America on how to uncover and report on corrupt practices. In April 2000, we sponsored the first of three regional conferences on this topic in San José, Costa Rica. The second was held in Cartagena, Colombia in November 2000. The third is scheduled to take place in early 2002 for the Southern Cone countries. At each conference some 50 young journalists are brought to a training program that teaches them the fundamentals of investigative journalism.

A second key component of this training program is the electronic journalist network we have created in partnership with an El Salvador based nonprofit group that produces "Revista Probidad"—an electronic anticorruption bulletin for Central America. This network takes advantage of information technology's edge in breaking down barriers to freedom of information that in many countries allows corruption to continue unchecked. It has received an overwhelmingly enthusiastic level of participation from over 400 journalists throughout Latin America to what is essentially a community building effort among journalists to wage war against corruption.

Below you will find two case studies of CIPE anticorruption projects in Latin America. The first is a more detailed description of our Journalists Against Corruption network. The second is a project conducted jointly by the Corona Foundation and the Colombian Federation of Chambers of Commerce aimed at stemming corruption in public sector procurement of services. ❖

# JOURNALISTS AGAINST CORRUPTION

**Linda Hemby, PFC Coordinator**

**Why a journalist network?**

Studies have shown that Latin American corruption undermines economic growth and development efforts to combat poverty, reinforces economic disparities and injustices, and strengthens the economic power of a small elite and their influence and "ownership" of the government and the media. It reflects inequities in the justice system, the absence of rule of law and impunity. It corrodes confidence in public institutions and increases citizen frustration, and shapes cultural mindsets and conduct that are unethical and anti-democratic. In these and other ways, corruption has undermined the democratization processes in Latin America and continues to jeopardize them.

Since 1989, international development and financial institutions have promoted anti-corruption in Latin America vis-à-vis numerous public sector reforms that have resulted in a plethora of new legislation. But government will to fulfill the promises of their eloquent anti-corruption discourses, by rigorously implementing these transparency and anti-corruption plans and reforms, has been shallow or non-existent.

Consequently, public interest in corruption has dwindled because political parties and government institutions have demonstrated such little commitment to curbing it, and because many anti-corruption crusaders have used "the cause" in an effort to appease international pressure, cover up their own involvement in corruption, or to vilify a political opponent. Even civil society anti-corruption initiatives have lost credibility because of opportunists who have used them to develop a public image and eventually run for public office and because of their partisan ties and related corrupt activities. They have also suffered from inadequate funding, national economic conditions that are unfavorable to volunteerism, a dependence on foreign concepts and strategies, limited vision and creativity, a lack of interest and knowledge about databases and other sources to collect and generate information, failure to use Internet resources, and a lack of local and cross border networking and partnerships with other anti-corruption actors. Even those citizens who are interested in corruption doubt the sincerity or effectiveness of most anti-corruption initiatives.

The Latin American anti-corruption initiatives with the most impact have been media reports. However, they have frequently been selective, incomplete, tarnished with ideological slants, and sometimes even inaccurate because of the internal censorship of editors and media owners who are tied to or bow to pressures of governing parties and economic elites. Too, difficulties in accessing information from the government, business, financial institutions and civil society organizations, the lack of investigative and reporting skills and support, numerous potential reprisals, and other complications and hazards, have undermined the quality of most reports about corruption or explain why many have gone unpublished.

**Objectives and Goals**

Journalists Against Corruption or PFC (Spanish initials) was launched as a CIPE in-house project in partnership with Probidad, a Salvadoran anti-corruption civil society organization. PFC emerged in August 2000 to offer the region an anti-corruption project that promotes quality and ethical watchdog journalism and supports journalists and media dedicated to investigating and exposing corruption in government and other sectors of society.

PFC is grounded in the notion that investigative journalism is crucial for highlighting improper or questionable use of public funds, holding politicians accountable, deterring government officials and employees from engaging in corrupt practices, and pressuring government to implement transparency reforms and other anti-corruption plans and legislation. Similarly, it is an important tool for monitoring and reporting corruption in business and civil society organizations.

By promoting and facilitating journalistic investigations and reports of corruption and defending the freedom of information and expression, PFC contributes to an informed public debate and to public awareness about the costs of corruption. Media coverage of corruption, as well as PFC's advocacy on its behalf, is also an important catalyst for popular indignation about corruption and for stimulating new anti-corruption attitudes and actions to prevent and control it.

From its inception, the goal of PFC has been to become a regional initiative developed in partnership with Latin American organizations and strengthened by the local initiatives they administer. In May 2001, PFC opened up an Andes region office in Lima, Peru, coordinated by the Instituto de Prensa and Sociedad (IPYS or Media and Society Institute). The next objective will be to open an office in the Southern Cone that would be managed by a local group and later to establish office in Mexico. Each office will assume PFC tasks in their region and implement new local support efforts for journalists who report on corruption.

PFC is a network, clearinghouse, and service provider for Latin American journalists who cover corruption and for organizations that support them. It not only encourages enhanced investigations and reports about corruption, but also provides investigative assistance and defends journalists and media when they suffer reprisals for these activities. PFC also advocates on behalf of legislation and other mechanisms that insure access to information and freedom of expression that are so important to journalist investigations and reports of corruption.

**Investigative Assistance**

PFC provides contact information and conducts Internet searches for Latin American journalists that require specific data for their investigations or reports of corruption. When the topic is not too sensitive, PFC shares the requests and search results through the "PFC listserv." an interactive email network of more than 430 Latin American journalists.

The investigations of local corruption commonly disclose that actors have cross border networks or activities in other Latin American countries. This underscores the importance and utility of the PFC network where efforts are combined and integrated to investigate such cases.

For example, the Peruvian investigations of former spy-chief Vladimiro Montesinos have generated interest in his corrupt activities in other parts of Latin America. Responding to a request from a Colombian journalist, PFC members in Peru offered information about foreign companies that transferred funds to bank accounts owned by Montesinos. Internet searches conducted by PFC administrators and information provided by PFC members helped a Peruvian journalists who published a series of articles about Montesinos' ties to the Mexican Cartel de Tijuana and a Panamanian journalist who reported on Montesinos' money laundering activities in his country. A Salvadoran journalist inquired about a possible link between Montesinos and the airlines TACA, whose owners have been tied to corruption cases and international terrorists like Luis Posada Carriles (Cuban) and Ricardo Carvallo (Argentinean). PFC identified four articles about anomalies in the constitution of TACA Peru and the operation permits provided to the airlines by Alberto Fujimori's government. Peruvian

journalists offered contact information and one of them - who has already published several investigations on irregularities between the airlines Aéroperu and Aéromexico - volunteered to conduct a joint investigation on TACA.

Other examples of cross border networking include a television journalist from Buenos Aires who requested information for a report on the Argentinean activities of the Cartel de Juárez. This organized crime cartel in Mexico is well known throughout Latin America for its money laundering activities, business fronts, bribes and other corrupt practices resulting from drug trafficking. In response, PFC provided numerous references obtained from an Internet search and Mexican, Uruguayan and other Argentinean journalists provided additional information.

PFC also suggests topics for investigations of corruption and provides related references. For example, PFC highlighted the importance of investigating the use (or misuse) of large secret petty cash funds available to governments or the military, pointing out how these monies are frequently utilized for illegal enrichment, as bribe money, or to fund illegal activities or groups. It identified supportive online resources organized in its Virtual Library and contacts that can be interviewed via email, and presented a detailed article, describing the mishandling of such funds by former Mexican president Carlos Salinas, to generate ideas on how to develop such a story. PFC contributed to an avalanche of investigations and reports in Argentina on money laundering between Latin American and US banks, after circulating new reports from a Senate committee and related materials. In a similar way, it assisted investigations and a series of reports in Uruguay about the contraband and tax evasion activities of Phillip Morris and the British Tobacco Company.

PFC frequently receives allegations of corruption, which are carefully channeled to reputable journalists residing in the country involved once some initial exchanges of emails with the source indicate the charges may have some credibility. A recent example of this process was when a citizen's watchdog group in Bogotá, Colombia provided detailed information about bank accounts with money apparently obtained from drug trafficking, under the name of the president of the most important iron and steel company in Colombia, Acerías Paz del Río: Another example was a Mexican citizen reporting information on mismanagement of money and resources within the state electoral entity of Hidalgo, Mexico, and then offering to aid journalists with contacts and documents.

PFC offers contacts and information on topics indirectly related to investigations of corruption and to Latin American journalists outside of the region. For example, PFC collaborated with a former Business Editor for La Prensa in Panama on a study about corruption in Mexico, Central America and the Caribbean, that will be published by Transparency International (Germany) as part of a global report on corruption, offering her information and expertise on the subject, helping to design and circulate a survey instrument, and suggesting local anticorruption experts.

**Encouraging cooperation and contact between Latin American journalists**

It is common practice among journalists—especially those in Latin America—to monopolize the information or resources they possess or uncover so that they can publish the first scoop about a story. In some countries, like El Salvador, printed media journalists are actually prohibited by their job contracts to discuss stories or to even interact with journalists from other media who may be covering the same story.

The investigative assistance activities of PFC have encouraged greater sharing of information and contacts between Latin American journalists. PFC members frequently help each other, sharing contacts, resources

or even performing some research themselves in order to assist a fellow journalist. PFC facilitates this support system by providing a trustworthy environment and strict confidentiality when needed. Moreover, many investigations would remain too difficult or time consuming if performed by a single journalist or media organization with little or no access to Internet resources. The cooperation encouraged by PFC has resulted in more and better investigations of corruption and related topics.

**Defending Freedom of Information**

It is impossible to separate investigative journalism into corruption from the promotion of the freedom of expression. When governments or powerful interest groups impose regulations that inhibit or undermine access and disclosure of information, they provide unlimited conditions and opportunities for corruption to spread without control, and facilitate an environment of impunity for corruption's beneficiaries.

In Latin America, restrictions and violations to freedom of expression express themselves in diverse ways, among them: limited or no access to public documents or information; laws that overprotect the "honor and reputation" of public officials and employees, restrict journalistic investigations and stipulate who can/cannot work as a journalist; government's publicity budgets that reward or punish media companies according to how much they support or question the ruling party; and the monopolization of media ownership, often by economic or political groups that favor or are run by the ruling party.

Logically, those media companies that assume a watchdog role, and especially those that discover and expose unethical conduct and corruption, are the ones that suffer reprisals. Measures taken against these companies vary from direct or indirect pressure, threats, lawsuits, damage to their premises, attacks against journalists, and even murder.

Clearly, any effort that promotes enhanced media coverage of corruption must necessarily promote and support freedom of expression. Thus, PFC receives alerts about journalists or media that are suffering or have recently suffered reprisals due to their investigative reports on corruption, or becomes aware of them during its daily review of local major news sources. It collects data necessary to substantiate and report a case; when needed, alerts journalists of funding sources to cover their legal costs; and registers the case and relating documents in a section of the Clearinghouse (Persecuted Journalists or Periodistas Perseguidos). In many of these cases, apart from notifying international and local human rights organizations and asking them to intervene, PFC contacts the authorities of the country or province where the abuse is occurring to request an investigation, protection, or pardon. If the reprisals come from the authorities themselves, PFC makes public the reprisal in order to put an end to it.

PFC also promotes and disseminates information on: legislation, codes of ethics; the monopolization of the ownership of the media; and other norms or practices that impede or enhance the quality of journalistic investigations and reports about corruption. It provides congressmen, international organizations and others with information that facilitate their promotion of legislation in favor of access to public information, freedom of expression and the freedom of the press in Latin America. It also makes public judicial sentences, legislation and other norms that undermine these rights.

PFC also provides a daily newspaper clipping service to international organizations that investigate, register information on, or advocate on behalf of journalists and media organizations that have suffered reprisals for any unjustified reason. The clippings include the aforementioned topics and other articles related to journalism in Latin America.

**Cultivating the Network**

In September 2000, PFC developed and initiated the PFC-listserv, an email mechanism that facilitates the exchange of articles, opinions, announcements, contacts and resources between journalists who investigate or report on corruption. When they are not sensitive, the messages are registered on the PFC web page for reference by the general public. This PFC network now includes more than 430 Latin American journalists.

The PFC web page provides information that facilitates: media investigations of corruption and media reports about anti-corruption; understanding about the importance of investigative journalism as an effective anti-corruption tool as well as the problems confronting journalists and media institutions that wish to cover corruption; knowledge about what journalists are actually covering corruption and how corruption is being covered by the Latin American press; what resources, services and opportunities (grants, public activities, or training sessions) are available for journalists who cover corruption; and information on freedom of expression issues (slander and other legislation that repress or sanction media coverage of corruption; the status of freedom of expression in Latin America; and reprisals against Latin American journalists or media institutions that cover corruption). The Web page also highlights and promotes community radio and women as important anti-corruption actors.

PFC members have been invited as conference speakers or trainers at various international events and have been asked to provide advisory services to organizations interested in offering anti-corruption training activities to journalists. It also helps journalists network to organize smaller local support systems.

For additional information, consult the PFC Web page at: www.cipe.org/pfc or its English section at: www.cipe.org/pfc/english/index.html#8 or write to: contacto@probidad.org.sv ❖

# PROBIDAD

**A Private Sector Initiative to Fight Corruption in Colombia's Public Sector**

Corruption in Colombia's public sector is pervasive and costs the private sector substantial sums of money each year. Yet the private sector has traditionally been reluctant to challenge these practices for fear of retribution.

The PROBIDAD program was created in late 1999 to fight corruption in the public sector and to change the culture of business. Initial funding for the program came from CIPE and Colombia's Corona Foundation. The program was later joined by the Colombia Center for Social Responsibility and the Presidential Program for the Fight Against Corruption, Colombia's chapter of Transparency International.

Results from a recent PROBIDAD survey of business leaders who have public sector contracts suggest that the timing is right for reform initiated by the private sector. Although the majority of business leaders in the survey acknowledged that they have engaged in unethical practices to achieve their economic objectives, 62 percent said that they are ready to accept the costs of committing to higher ethical standards. (See below.)

By raising awareness of ethical codes of conduct and bolstering support for businesses through local chambers of commerce, PROBIDAD hopes to change traditional private sector thinking and to bring an end to the culture of corruption that pervades business dealings with the government.

PROBIDAD has developed an ethical code of conduct that sets a high standard for transactions with the government. Through Colombia's 57 local chambers of commerce, businesses are being asked to commit to this code and to uphold ethical practices within their companies and in their relationships with the public sector. By working through the local chambers, PROBIDAD also hopes to develop cohesion within Colombia's private sector and to provide support for businesses in the struggle against corruption.

The PROBIDAD program is generating a new culture in the relationship between Colombia's public and private sectors. Its code of conduct is regarded as the "dorsal spine" of a strategy to encourage business ethics and to strengthen a new class of business leaders committed to securing Colombia's place in the global economy.

**Highlights of the Probidad Survey**

To assess public sector corruption and the perceptions of business leaders, PROBIDAD developed a national survey that included 150 questions. Responses were received from 420 companies that had done business with the Government of Colombia. Some of these responses are highlighted below.

- Based on a hypothetical scenario, respondents were asked to estimate the amount paid to secure a contract. In Medellin, the bribe was approximately 11.9 percent of the total contract value. In Bogota, it was 12.4 percent, in Cali it was 13.6 percent, and in Barranquilla it was 18.3 percent.

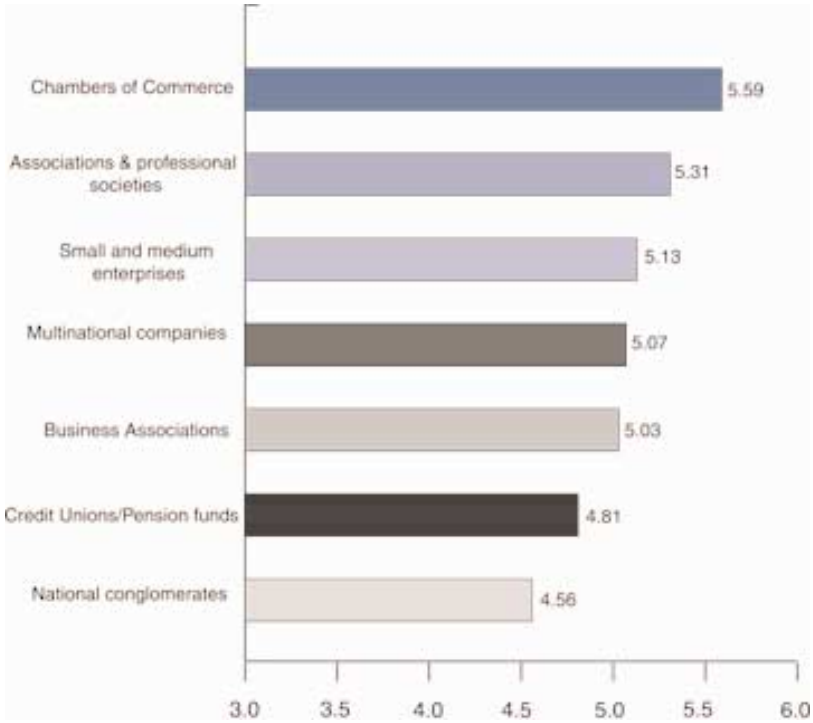
- When asked who takes the initiative in cases of bribery, 38 percent said that they knew in advance the amount of the bribe and the form the payments should take. (Nearly half of these respondents said they routinely include the costs of the bribe in their budgets.) Forty-four percent said the initiative comes from public employees, while only seven percent said that the initiative comes from the private sector.

- Less than half of all business leaders surveyed (47 percent) said they would blow the whistle on a bribe solicitation in an effort to secure a government contract. Another 28 percent said that they would limit themselves to working with other companies, including their competitors. Twenty-one percent did not respond to the question at all.

- The level of corruption within different government entities was also assesssed. Surprisingly, perhaps, the business community felt that the judiciary and regulatory agencies were least corrupt, compared to the National Congress and the Social Security Administration, which were at the top of the list.

Overall, the PROBIDAD survey highlighted the fact that there is little cooperation with anti-corruption organizations and little effort to collaborate with competitors to push for transparency in the bidding process.❖

## Perceptions of the Private Sector




*In the Probidad Survey, Chambers of Commerce were perceived as least corrupt while national conglomerates were perceived as most corrupt.*

# CORPORATE GOVERNANCE AND PUBLIC TRUST

**John D. Sullivan, Executive Director**
**Center for International Private Enterprise**

There are few topics that more central to the international business and development agendas than "corporate governance." A series of events over the last two decades have placed corporate governance as a top concern for both the international business community and the international financial institutions. Spectacular business failures such as the infamous BCCI scandal, the United States' savings and loan crisis, and the increasing gap between executive compensation and corporate performance drive the demand for change in developed countries. More recently, several high-profile scandals in Russia and the recent Asian crisis have brought corporate governance issues to the fore in the developing countries and transitional economies. Further, national business communities are learning and re-learning the lesson that there is no substitute for getting the basic business and management systems in place in order to be competitive internationally and to attract investment.

As a result, the World Bank, the Organisation of Economic Co-operation and Development, most of the regional development banks, and the various national development agencies have either launched or expanded programs in this area in the last several years. Similarly, business-related nongovernmental organizations such as the Center for International Private Enterprise, an affiliate of the U.S. Chamber of Commerce, have placed corporate governance at the top of their lists of concerns. Think tanks and business associations throughout the developing world and in the transitional economies are also focusing resources on these issues.

In developing countries the roots of what is now recognized as issues of corporate governance can be found in the drive for privatization that began in the late 1970s and grew throughout the 1980s. Clearly, creating a sound corporate structure should have been central to the success of privatization both from the point of view of the government seeking to sell the firm and from the point of view of the potential investors. In fact, some of the most telling failures in the early privatization experiences can be traced back to a lack of sound regulatory structures that allowed unwise business practices. Chile comes to mind in this respect. In the mid-1970s, Chilean business groups were able to purchase banks, often with only 20 percent initial payments. In 1982, Chile experienced an economic crisis generated by a combination of external shocks and an overvalued exchange rate. The business groups responded by using their banks to shore up failing firms, which led both into even more serious trouble. Finally, the government responded by re-nationalizing a host of firms and banks.[i]

It was the fall of the Berlin wall, however, and the drive to privatize rapidly the entire business structure of the transforming, or post-communist, economies that really increased interest in corporate governance as a development topic. In the first instance, state-owned firms had to be "corporatized," that is, converted from a governmental to a corporate form. Secondly, the overarching body of commercial law—including bankruptcy, laws on property, accounting systems, and a host of other rules of the game—had to be put into place. Most dauntingly, talent had to be nurtured. Few individuals had any experience as members of boards of directors. It is perhaps not surprising that the countries that rushed into large-scale privatization, especially the Czech Republic and Russia, have experienced large-scale corporate governance failures. Hungary, which chose to sell its firms to Westerners, and Poland, which chose not to delay privatization of large companies, have had better results. Today, think tanks and business organizations throughout Central and Eastern Europe, including much of the former Soviet Union, are working hard to press for adoption of key institutional reforms

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An earlier version of this paper was presented to the World Bank's Mediterranean Development Forum in Cairo.

and corporate governance practices.[ii] As noted, the Asian financial crisis has now driven the process even further. One of the lessons learned from the crisis is that weak or ineffective corporate governance procedures can create huge potential liabilities for both individual firms and, collectively, for society. In this sense, corporate governance failures can potentially be as devastating as any other large economic shock. As M. R. Chatu Mongol Sonakul, the Governor of the Bank of Thailand, has observed:

> There is no doubt in my mind that for the Asian economic crisis to be solved in a sustainable and long-lasting fashion, the government and the corporate sector have to work together better. By this, I don't mean that not working together was the cause of the recent economic crisis. Probably it was the other way around, working far too well together and in collusion with each other. … The Asian financial crisis showed that even strong economies lacking transparent control, responsible corporate boards, and shareholder rights can collapse quite quickly as investors' confidence erodes.[iii]

As seen from the above, Dr. Sonakul credits corporate governance as being at the very heart of the development of both a market economy and a democratic society. That view may be a bit of a surprise to those who think mainly of corporate governance issues as shareholder protection, management control, and principal-agent problems (of such concern to management and economic theorists). The focus of this paper is the concept of corporate governance as a key feature of the market system of competitive enterprise. In addition, the paper shows why corporate governance should also be of direct concern to those focusing on democratic development, especially rule-of-law issues. Corporate governance ultimately depends on public-private sector cooperation to achieve both goals—the creation of a competitive market system, and the development of law-based democratic society.

These concerns are not limited to developing countries; even in the advanced industrial societies there is a trend toward strengthening corporate governance. For example, in recent years, the Cadbury Commission in the United Kingdom, the Vienot Commission in France, and the Organisation of Economic Co-operation and Development (OECD) have all issued new guidelines. In the United States, there is mounting concern over the "independence" of independent audits, as witnessed in the recent publicity surrounding violations of rules prohibiting auditors to invest in the companies that they audit. In all of these cases, the underlying concerns center around ways to achieve the core values of corporate governance, including transparency, accountability, and building value.

**Definitions**

Corporate governance is typically perceived by academic literature as dealing with "problems that result from the separation of ownership and control."[iv] From this perspective, corporate governance would focus on how the internal structure and rules of the board of directors, the issue of audit committees, reporting to shareholders, and control of management. In fact, a recent academic survey began with the following quote: Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. How do the suppliers of finance get managers to return some of the profits to them? How do they make sure that managers do not steal the capital they supply or invest it in bad projects? How do suppliers of finance control managers?[v]

From this point of view, corporate governance tends to focus on a simple model:

1. Shareholders elect directors who represent them.

2. Directors vote on key matters and adopt the majority decision.
3. Decisions are made in a transparent manner so that shareholders and others can hold directors accountable.
4. The company adopts accounting standards to generate the information necessary for directors, investors, and other stakeholders to make decisions.
5. The company's policies and practices adhere to applicable national, state, and local laws.[vi]

Focusing on these types of internal control processes is quite natural when the subject is corporate governance within the advanced market economies. Point number five assumes that an external legal system is in place. Although there are considerable differences between the Anglo-American, German, French, and other national systems, they all share the luxury of defining the subject of corporate governance within the context of functioning market systems and highly developed legal institutions.

As noted earlier, when the subject of corporate governance is discussed in the context of transitional or developing countries, however, it tends to involve looking at a much wider range of issues. The Asian economic crisis in the 1990s, the continuing turmoil in Russia, and the recent experience of the Czech economy have combined to push the issue of corporate governance from the sidelines to center stage. In Asia, what began as a financial crisis is now viewed as a crisis of corporate transparency involving relationships between government and business, between holders of debt and equity, and the legal remedies for bankruptcy and cronyism. Further, as seen in the daily newspapers, the lack of adequate institutions in Russia has resulted in several highly publicized cases involving allegations of asset stripping, stock register manipulation, and fraud-[vii]. The Czech Republic privatization program has demonstrated the weakness of the voucher method in the absence of sound corporate governance mechanisms, since it resulted in a lack of corporate restructuring and a consequent decline in competitiveness.[viii]

What these examples have in common is that they all involve the basic rules of the economy and the relationship between these rules and the way companies are governed. The issues involved include some very familiar topics. In the interest of space, here are just a few core issues:

- Corporate transparency—or full disclosure of financial information
- Conflicts of interest involving boards of directors and managers
- Procedures for bankruptcy
- Property rights
- Contract enforcement
- Corruption and theft

Each of these issues poses grave challenges for both the functioning of a market economy and a democratic society. Solving corporate governance problems, such as those listed above, involves going beyond a narrow view of how owners and managers of capital interrelate. In this sense, a broader definition should be adopted:

> Corporate governance results from a set of institutions (laws, regulations, contracts, and norms) that create self-governing firms as the central element of a competitive market economy.

The key point in this definition is that the public and private sectors have to work together to develop a set of rules that are binding on all and which establish the ways in which companies have to govern themselves.

One interesting illustration of how transitional economies have had to come to grips with this issue stems from the first law on private enterprise passed in Poland in 1988. This law, the "Law on Economic Activity," stated that:

> Within the scope of their economic activity, economic subjects may perform operations and actions which are not forbidden by law.

Some might find that wording slightly odd. The clear expectation in the market-oriented (that is, non-statist) society is that all actions not forbidden by law are allowed. Indeed, that expectation is at the heart of private, individual initiative. The converse rule has been applied in command economies and in economies with a statist tradition. That is, only those actions specifically authorized by law, regulation, or written permission are allowed.

Building a market economy requires a complete overhaul of legal norms, to allow for innovation and initiative rather than predefining areas of allowable activity. That is why corporate governance should be thought of as a mechanism for creating self-governing organizations. However, it is equally important to emphasize that a market economy is not simply the absence of governmental intervention.

How often has it been said that, "The government should get out of the way and let the market function"? Of course, that idea is wrong. Government is absolutely essential to setting up the framework of a market economy. Without binding rules and structures that govern all players anarchy can result. Under such conditions business becomes nothing but "casino capitalism," where investments are simply bets: bets that people will keep their word, bets that firms are telling the truth, bets that employees will be paid, and bets that debts will be honored. What corporate governance is all about in larger terms is how a structure can be set up that allows for a considerable amount of freedom within the rule of law. Ultimately, these arrangements provide the basis for the establishment of trust, one of the most important ingredients in business.

**OECD Principles**

A useful first step in creating or reforming the corporate governance system is to look at the principles laid out by the OECD and adopted by the governments that are members of the OCED itself. These principles can be found on their Web site: www.oecd.gov. In summary, they include the following elements.

I. The Rights of Shareholders

These include a set of rights, including the right to secure share ownership, the right to full disclosure of information, voting rights, and the right to participate in decisions on sale or modification of corporate assets, including mergers and new share issues. The guidelines go on to specify a host of other issues connected to the basic concern of protecting the value of the corporation.

II. The Equitable Treatment of Shareholders

Here the OECD is concerned with protecting the rights of minority shareholders by setting up systems that keep insiders, including managers and directors, from taking advantage of their roles. Insider trading, for example, is explicitly prohibited, and directors should disclose any material interests regarding transactions.

III. The Role of Stakeholders in Corporate Governance

The OECD recognizes that there are other stakeholders in companies besides shareholders. Workers, for example, are important stakeholders in the way in which companies perform and make decisions. The OECD guidelines describe several general provisions for stakeholder interests.

IV. Disclosure and Transparency

The OECD also lays out a number of provisions for the disclosure and communication of key facts about the company, ranging from financial details to governance structures, including the boards of directors and their remuneration. The guidelines also specify that annual audits should be performed by independent auditors in accordance with high-quality standards.

V. The Responsibilities of the Board

The guidelines detail the functions of the board in protecting the company, its shareholders, and its stakeholders. These include concerns about corporate strategy, risk, executive compensation and performance, as well as accounting and reporting systems.

It should be noted that the OECD guidelines are somewhat general and that both the Anglo-American system and the Continental European (or German) systems would be quite consistent with them. However, there is growing pressure to put more enforcement mechanisms into those guidelines. The challenge will be to do this in a way consistent with market-oriented procedures by creating self-enforcing procedures that do not impose large new costs on firms.

The following are some ways to introduce more explicit standards:

- Countries should be required to establish independent share registries. All too often newly privatized or partially privatized firms dilute stock or simply fail to register shares purchased through foreign direct investments.
- Standards for transparency and reporting of the sales of underlying assets, along with enforcement mechanisms and procedures by which investors can seek to recover damages, need to be spelled out.
- The discussion of stakeholder participation in the OECD guidelines needs to be balanced by discussion of conflict-of-interest and insider-trading issues. Standards or guidelines are needed in both areas.

- Internationally accepted accounting standards should be explicitly recommended. (Also see above regarding developing such standards.)

- Internal company audit functions and the inclusion of outside directors on audit committees need to be made explicit.

A good example of model corporate governance procedures that builds on many of these points is the General Motors guidelines that are frequently used as a code of corporate governance by others.[ix] Interestingly, the pension funds have also become a major source of improved corporate governance along the same lines. Specifically, the California Public Employees' Retirement System (CalPers) has developed a very active program to promote good corporate governance and they, along with other pension funds, are using their investment clout to force change. As noted earlier, CalPers has taken this approach in order to increase the returns on their investments by ensuring that the firms are well run and that corporate strategies are well thought out. As more and more pension fund investments flow into developing countries, these funds can be expected to make similar demands in these countries.[x]

Some may think that these are exclusively American standards and are not really necessary in most countries. A recent study by the Center for European Policy Studies noted that the wider the distribution of shareholding, the greater is the role of the market in the exercise of corporate control. Hence there is more need for corporate governance procedures in this type of economy than in one where shareholding is relatively concentrated. The report went on to note, however, that financial market liberalization, increased privatization, and the growing use of funded systems to support pensions is driving European countries toward more explicit and more comprehensive rules on corporate governance.[xi]

The reason why it is important to take note of this trend is that, traditionally, many in developing countries have cited the European experience as proof that corporate governance issues only apply to countries that follow an Anglo-American tradition, such as India. Recent history would seem to show that, without sound corporate governance procedures, including the larger institutional features mentioned earlier, economic crises in developing countries are likely to increase in frequency. Many developing countries face rather stark choices: either create the type of governance procedures needed to participate in and take advantage of globalization—running the risk of severe (and frequent) economic crises—or seek to build defensive walls around the economy. It should be noted that the last option usually entails the risk of keeping out investors, blocking new technologies , and lowering growth rates dramatically.

Another consideration in the debate over corporate governance systems is the risk that individual firms face. Unless companies are able to build the kinds of governance mechanisms that attract capital and technology, they run the risk of simply becoming suppliers and vendors to multinationals.

In this respect, a recent Asian conference on corporate governance holds a number of lessons for other regions. During this conference, the participants debated quite extensively the need for outside directors and independent audit committees in particular. Several of those present—including representatives from Indonesia and South Korea—noted that there was some reluctance to adopt rules requiring audit committees to be made up of outside directors and requirements that audits should be public. In the end, however, there was general agreement that such reforms are essential to prevent a repeat of the Asian crisis.

**Key Issues for Latin America**

Several years ago, the International Finance Corporation (IFC) commissioned an analysis of the law and practice of corporate governance in Latin America. Then, the group of experts IFC brought together from every country involved identified five current issues "common to the four major markets in the region and probably also to many other [Latin American] countries." These issues, the panel thought, must be resolved by whatever form of corporate governance is chosen.

The issues they raise are quite technical, but each points to some of the fundamental matters that are also addressed in the OECD guidelines. The key corporate governance issues identified for Latin American companies follow.

- The status and treatment of non-voting shares is an important matter, especially given the temptation to issue these kinds of shares to maintain a closed form of investment. While non-voting shares may be successful in the short term in generating some additional investment, in the medium term it is likely that their existence will be harmful to attracting the necessary scale of investments. Most of the international specialist groups that have looked at this issue have recommended against non-voting shares, or even against classes of shares.

- Handling changes of control for publicly listed companies and the question of the family-controlled companies that may be sold to strategic investors or to the public is a relatively new development. However, as César Souza points out, "Companies have to face dramatic changes." This trend is likely to continue, and ways have to be worked out to protect investors and creditors during changes of ownership.

- The role of institutional investors, both foreign and domestic, may be a longer-term issue for Colombia. In some countries, such as Chile, pension funds are a major factor, and other countries will probably follow with variations of this model. At present, there is a temptation for institutional investors to "vote with their feet" by withdrawing, not standing firm against poor management practices. The question is, "Can these institutional investors begin to play the kind of role they do in the developed markets?"

- The problems of related party transactions are very obvious in Latin America, given the prevalence of industrial interlocking groups. An interesting related question is "What happens when one individual gains control of a public company and then begins to direct investments into areas that benefit private co-investors?" Some cases of this kind of practice have come to light recently in Mexico, for example.

- Finally, the IFC Latin American panel identified the role of special organs of corporate governance, which are variously known as *síndicos*, *comisarios* or, in Brazil, *conselhos fiscais*. Though the IFC concluded that these groups "have been historically ineffective" for the most part, there is renewed interest (especially in Brazil) in whether they hold any promise for keeping management honest. The growing interest in these and other mechanisms is basically a reflection of the need to increase transparency in business transactions.

**Benefits to Society**

As Latin America builds up a strong system of corporate governance, major benefits to society will be seen. Even in countries where most firms are not actively traded on stock markets, adopting standards for transparency in dealing with investors and creditors is a major benefit to all, in that it helps to prevent systemic banking crises. Taking the next step and adopting bankruptcy procedures also helps to ensure that there are methods that are fair to all stakeholders, including workers, owners, and creditors, for dealing with business failures. Without adequate bankruptcy procedures, especially enforcement systems, there is little to prevent insiders from stripping the remaining value out of an insolvent firm to benefit themselves.

Recent research has also shown that countries with stronger corporate governance protections for minority shareholders also have much larger and more liquid capital markets. Comparisons of countries that base their laws on different legal traditions show that those with weak systems tend to result in most companies being controlled by dominant investors rather than a widely dispersed ownership structure. Hence, for countries that are trying to attract small investors—whether domestic or foreign—corporate governance matters a great deal in getting the hard currency out of potential investors' mattresses and floorboards.[xii]

Many economists and management experts make the point that competition in product markets and competition for capital act as constraints on corporate behavior, in effect forcing good corporate governance. The fact that pension funds such as CalPers have had to take a very active role in improving corporate governance would seem to contradict this point. However, whether or not this is really the case in developed market economies, competition is surely a much smaller factor in transitional and developing countries. In many developing countries competition in product or goods markets is quite limited, especially where significant regulatory barriers exist. These realities further underscore the importance of adopting the best possible corporate governance systems in countries where the market system is underdeveloped.[xiii]

Corporate governance is also directly related to another topic that has emerged to a position of great prominence world wide—combating corruption. In most societies this is not an easy subject, both because of political sensitivities as well as potential legal action. Yet corruption has to be dealt with in order for a country to secure a position in the global economy and for it to secure the benefits of economic growth. The recent signing of the OECD anti-bribery convention is the beginning, not the end, of a concerted global anti-corruption campaign. Efforts to improve corporate governance, especially in the provision of transparency in corporate transactions, in accounting and auditing procedures, in purchasing, and in all the myriad individual business transactions, is a large-scale effort. Nevertheless, strengthening the corporate governance standards along lines suggested above would be one place to start.

The point has already been made that improving corporate governance procedures can also improve the management of the firm, especially in areas such as setting company strategy, ensuring that mergers and acquisitions are undertaken for sound business reasons, and that compensation systems reflect performance. However, it is also important to note that good corporate governance systems also have to include improvements in management systems. In many developing countries there has been a tradition of very centralized management, usually directly involving the owners of the firms. Throughout Latin America, for example, family business groups have tended to dominate the business landscape. This is now changing rapidly as a result of financial globalization, adherence to the World Trade Organization's liberalization rules, and the increasing integration of Latin America's regional markets.[xiv] As a result, Latin America's firms are adopting modern management techniques, financial accounting systems, and business strategies. All of this requires delegation of authority, paying increased attention to developing highly trained staff, and use of management information systems in lieu of the older centralized decisionmaking structures. Crafting sound corporate governance systems adds depth to these trends and can help to increase productivity, competitiveness, and profitability.

**Conclusion**

One way to sum up the concept of corporate governance is to look at it from the perspective of the corporate director. Increasingly, directors are being held liable for their actions (or inaction), at least in the developed countries. What, then, does a director need in order to function and have a balanced view of the firm? According to one seasoned corporate director, the following is the minimum essential information:

- Operating systems, balance sheets, and cash flow statements that compare current period and year-to-date performance to target performance and previous-year performance
- Management comments about current performance that focus on explaining the deviations from the target performance and revise performance targets for the remainder of the year
- Information on the company's market share
- Minutes of management committee meetings
- Financial analysts' reports for the company and its major competitors
- Employee attitude surveys
- Customer preference surveys
- Key media articles on the company, its major competitors, and industry trends[xv]

The list not only sums up the key responsibilities of a board, it also reinforces the argument that corporate governance reflects the underlying systems of law and regulation. Most importantly, without sound and accurate accounting systems, how could the director function? As seen in the OECD recently, maintaining these accounting standards—that all firms have to meet—is a considerable challenge. The list also points up that good corporate governance will bring with it modern management systems. For example, reviewing the minutes of the management committee meetings implies that a functioning management committee system is in place with delegation of authority and accountability.

Creating sound system of corporate governance is a high priority for both the public and the private sectors. However, there may be a temptation for the private sector to say, "Well, we'll let the government work this out and then we'll follow the results." In some cases, there may also be a temptation—especially for countries with protected markets and a large state sector —to put off corporate governance reform until after the privatization process and other types of reforms are fully completed. Experience would indicate that this would be a very unfortunate decision. Both the private and public sectors have much to gain by setting up clear and simple rules for all to follow. A sound corporate governance structure will be a great inducement to international trade and investment. In addition, sound corporate governance systems are a major advantage to those countries seeking to fight corruption. In this sense, good corporate governance is a way for the private sector to protect itself from outside demands and for the public sector to prevent undue influence in governmental decisionmaking.

However, it is vital to avoid simply copying other countries' systems or asking foreign experts to write model laws. Although the foreign donor community often pushes this type of approach, it should be resisted. Throughout the Americas a strong network of extremely capable policy research institutes and think thanks have been in the forefront of policy research and advocacy on market reforms. Many of these centers have been formed with the backing of the business leadership and are in a position to work with the corporate com-

munity to craft the right corporate governance mechanisms for their societies. In the process, not only will the resulting policy reforms advance better systems of corporate governance, they will point to the need for other reforms and, in the process, help build increased public support and trust. The need for adoption of modern management systems including areas such as knowledge management and strategic planning will become more apparent in the process. As more and more countries in the region further their participation in the global market, the demand for corporate governance will surely grow. Its up to the policy research centers, the national business associations, and others in civil society to work with governments to craft the best national systems.

The final point about the urgency of transforming corporate governance is that, if companies don't undertake it themselves, others will do it. There is high risk of inefficiency and misregulation when the iron fist of outside authority intervenes. Instead of cooperative work among companies, investors, stakeholders and government regulators, the alternative can prove troublesome. As César Souza points out, "Companies have to face dramatic changes." Highly centralized decisionmaking in a few hands doesn't work any more, especially in the hypercompetitive environment of globalization and privatization that's transforming many Latin American economies. Companies have to face the paradox that their decisionmaking must be simultaneously international and local.

What governments do best is provide the national fiscal discipline and infrastructure that can help businesses by assisting regional integration. What they do least well is to intervene in the details of business operations and management by over-regulation—or worse—by misregulation. CIPE has found that, in some cases in the former Soviet bloc nations, misregulation is caused by the government's failure to correctly identify the cause of business problems rather than sticking to the tasks that government performs well.

Over-regulation is indeed one of the major problems entrepreneurs face throughout Latin American, and a major objective is to improve and clarify the legal structures and rules under which business can exercise its creative muscle freely. Peruvian economist Hernando de Soto has written a new book called *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. This book has already attracted the attention of the international media and has been translated into a number of languages. In it, de Soto argues that the reason some nations have been unable to develop is not cultural, but legal. Tangled property rights, government over-regulation, and Byzantine legal systems have kept business-persons from turning their skills and property into capital.

But it is up to business-persons to take the leadership in creating these missing institutions. Again, if business groups wait for government to take the lead, they may well regret the result. While laws and rules are needed to set up the playing field that are developed through a democratic process, unless business-persons participate in that process, government officials will make the rules without consulting business.
In conclusion, investors in the global economy seek sound corporate governance backed by strong associations of businesses helping one another to shape their own destinies. These are essential democratic institutions. Growth economies are more likely to be democratic in the long run. Certainly they will be more flexible and capable of surviving crises. ❖

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[i] Galal, Ahmed, and Mary Shirley. Bureaucrats in Business. Oxford, England: Oxford University Press. 1995. Page 93.[[ Verify Oxford University Press is in Oxford (England). World Bank usually uses Oxford University Press in NY.]]

[ii] A number of programs can be reviewed at www.cipe.org under the corporate governance tab. The World Bank's corporate governance program contains a number of links as well—such as Governance and Public Sector Reform, at http://www.worldbank.org/publicsector. See also www.worldbank.org.

[iii] Sonakul, M. R. Chatu Mongol. "Corporate Governance and Globalization." Opening address at the "Asian Economic Crisis and Corporate Governance Reform" Conference, September 12–14, 1999, Bangkok, Thailand. Full text is available at www.cipe.org.

[iv] OECD (Organisation for Economic Co-operation and Development). "OECD Principles of Corporate Governance." [[YEAR?]] www.oecd.gov.

[v] Shleifer, Andrei, and Robert Vishny. "A Survey of Corporate Governance." The Journal of Finance LII (2): 737, June 1997.

[vi] This list is drawn from a course for new directors developed by the Central European University and CIPE. See CIPE's Web site for more information (www.cipe.org).

[vii] For example, see Andrew Jack, " Oil giant bogged down in Siberian intrigue: BP Amoco's stake in Sidanco has become a litmus test for foreign investment in Russia." *Financial Times*. October 20, 1999.

[viii] Joseph E. Stiglitz, "Quis Cutoiet Ipsos Custodes? (Who is to guard the guards themselves?)" ABCDE Conference-Europe, pages 11–12. Available on the World Bank web page (www.worldbank.org).

[ix] These guidelines can be found in the corporate governance section of CIPE's Web site (www.cipe.org).

[x] CalPers also has an excellent Web site that hosts their recommendations for improvements in corporate governance (www.calpers-governance.org).

[xi] "Corporate Governance in Europe: Report of a CEPS Working Party." Center for European Policy Studies, Chairman, Dr. Ulrich Bosh (Senior Vice President, Deutsch Bank), Rapporteur, Karel Lannoo (CEPS). June 1995. Available at www.ceps.be. See also the European Corporate Governance Network (www.ecgn.ulb.ac.be).

[xii] LaPorta, Rafael, Florencio Lopez De Silanes, Andrei Shleifer, and Robert Vishny. "Legal Determinants of External Finance." *Journal of Finance* 52 (July 1997): 1131–50.

[xiii] For a review of the available literature with special reference to Russia, see Erik Berglof and Ernst-Ludwig von Thadden, "The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries," presented at the World Bank's ABCDE conference and available on the World Bank's Web site (www.worldbank.org).

[xiv] For a very concise summary of these trends in Latin America and the response of Latin America's leading firms, see the interview with César Souza, "Latin America's Rapidly Changing Corporations," in *Economic Reform Today* 1 (1999). This interview is available at www.cipe.org. Souza is Senior Vice President of Odebrecht of America, a heavy construction firm operating in 14 countries.

[xv] Salmon, Walter. "Crisis Prevention: How to Gear Up Your Board." *Harvard Business Review* 7(1). 1993. Quoted in Marek Hessel (ed.), *In Search of Good Directors: Corporate Boards in Market and Transition Economies*. 1998 (second edition). Washington, D.C.: CIPE. Page 97.