

THE ECONOMICS AND POLITICS OF CORRUPTION: FIGHTING FOR A “CLEAN GOVERNMENT AND BUSINESS” IN TURKEY

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Let's make no mistake: Corruption is a global virus inflicting, in varying degrees, all countries, developing and developed alike. With their strict property rights, mature institutions and well-paid civil servants; developed countries are less likely to suffer from systemic corruption. Public scrutiny of government makes corruption very difficult to get away with. Hence, corruption occurs mostly in countries where the rule of law and institutions are weak or non-existent, where independent professional media and civil society agencies are absent, and where there is no independent judiciary or legal oversight.

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Introduction

Globalization offers many benefits for those who know how to surf its waves and take advantage of the changing tides, but there are a number of potential drawbacks if it is not managed in such a way as to take advantage of its positive aspects and minimize the negative ones.

In global markets, private capital managers, always on the prowl for the highest risk-adjusted returns possible, are investing greater amounts of money around the world. Global foreign direct investment flows reached US\$1.4 trillion in 2000 but have declined almost 66% during the past two years. Foreign portfolio investments are currently 200 times greater than they were in 1970 and worldwide mergers and acquisitions are expected to continue full steam ahead.

Approximately, US\$1.5 trillion changes hands in foreign exchange markets on a typical day in New York.

Such a large volume of trade, investment and public procurement transactions not only result in greater prosperity for us all, but also in unprecedented opportunities for international corruption, bribery and money-laundering for politicians, government officials and businesses.

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“Corrupt Practices” and Accountability

While much attention has been focused in recent years upon the twin threats of Islamic fundamentalism and separatist terrorism in Turkey, the endemic bribery and prevailing climate of corruption are at long last rightfully receiving due recognition as a clear and present danger to economic development and civil society. Despite years of wavering privatization and public governance reforms, the omnipresence of the state in the national economy still provides plenty of room for corrupt practices. Internal dynamics, triggered recently by media and civil society groups, and the drive to eliminate international corruption, have recently expanded the frontiers in Turkey for “clean government and business”.

Turkey's experience of the last two decades attests to the fact that corruption does not occur only between bureaucrats and businesses; many prominent political figures have also been involved. In recent years, several businessmen and bankers, who reportedly plundered the funds of public and private banks, were arrested and sent to jail. It also became clear that politicians and senior government officials have either aided or collaborated with them. Yet no politician has been brought to justice yet. Probably because either themselves or their close associates have been somehow implicated in similar charges. There are well-protected dossiers kept by each of these

politicians regarding the corrupt practices of their political rivals in case it is needed one day for blackmail purposes.

One of the first serious signs of the anti-corruption resolve began to emerge when the parliament passed, in November 1998, a motion of no confidence against the government, then led by Prime Minister Mr. Mesut Yılmaz, over allegations of corruption. Mr. Yılmaz was forced to resign. In a separate vote, the Parliament also voted for the dismissal of then Minister of State Mr. Güneş Taner. The last time a government lost a vote of confidence was twenty-one years ago and Mr. Yılmaz was only the second Turkish premier to be voted out of office. Revelations about his and some of his close associates' involvement in improper practices, though yet to be documented, undermined his efforts to project the image of a "clean" leader and as a consequence he was removed from the Turkish political scene in the last general election held in November 2002.

Susurluk, Çakıcı and Bank Rescues

The Susurluk car accident in November 1996 had an epoch-making impact on the country in that it aided in the unearthing of illegal links between corruption, organized crime, politics and bureaucracy in Turkey. Yet despite years of investigation and trials, the picture that has emerged is still fragmented and no one has yet been seriously charged or convicted. This episode was followed by the arrest in France, in August 1998, and subsequent hand-over to Turkey, of Alaattin Çakıcı, a prominent mafia figure. Leaks of taped conversations of Çakıcı and some leading businessmen and political figures rocked Turkey's business and political infrastructure and even delayed the privatization program, as proof emerged that sales had in fact been influenced by mafia leaders. Layer upon layer of corruption, murder and illegal deeds were uncovered as the Turkish media probed these relationships. However, investigations have not resulted in any indictments of the culprits. They are still in our midst.

The bank scandals have revealed even more disturbing dimensions of the corruption phenomenon in Turkey. These scandals have hit the banking sector hard since October 27th 2000, when the Banking Supervisory Board seized control of two ailing banks, Etibank and Bank Kapital, bringing to ten the number of banks under the supervision of the state. This move was welcomed as a sign that the new supervisory institution intends to fulfill its mission of bringing discipline and transparency to the financial sector.

In October earlier that year, the nephew of former president Mr. Süleyman Demirel and ex-owner of Egebank was arrested and accused of having siphoned off funds from his bank through 'front' companies and offshore accounts. As investigations into the bankruptcies continued, the scandal threatened to spread further. It became clear that bureaucrats and politicians allowed funds to be siphoned off without intervening. Newspapers revealed that a report on Egebank drawing attention to the fraud was submitted to the minister in charge of the economy as early as July 1999, six months before the state institutions took steps to stop the plunder.

Losses incurred by the ailing banks are placing a heavy burden on the Turkish economy, as are state banks weighed down by bad loans. Many economists believe that the state banks are in a worse situation. A clean-up of crime and corruption was a necessary part of a long-overdue restructuring of the 81-bank financial industry in Turkey, but ironically the alleged corruption – fuelled by a series of media leaks about the investigation – helped generate the liquidity crisis.

The arrests of bankers charged with siphoning money out of some of the banks seized by the state shed light on the sort of mismanagement and corruption that flourished under a regime of lax regulation and high inflation.

One of the World's Oldest and Best Established Vices

Agreeing on what exactly is meant by corruption is not easy. Even the most widely used definition, which is “the abuse of public office for private gain”, may be an over-simplification. A whole host of conditions can influence corruption, its different manifestations, its pervasiveness and, indeed, its perception by ordinary citizens. Understanding the multifaceted dimension of corruption is essential in order to identify appropriate ways of dealing with it. Corruption comes in many guises. Bribery, extortion, fraud, trafficking, embezzlement – but also nepotism and cronyism – all of which are different manifestations of the same sickness. Even the most straightforward acts of bribery need not always involve the exchange of money. Other gifts or advantages, such as membership in an exclusive club or promises of scholarships for children, have been used as “sweeteners” to cinch deals.

Corruption, whether it is in public service or private transactions, raises political and larger systemic questions with respect to the effect of corruption on economic development, governance, moral values, and the role of government in its cause and prevention. Higher levels of corruption, including illicit payments, could distort investment flows from areas identified by Governments as having development priority to those areas that would instead maximize private gain.

Additionally, the payment of bribes could ultimately increase the costs to host economies themselves in the form of inflated and excessive payments, either by the Government or consumers, for the purchase of goods, services or technology provided by the investor.

At the same time, such illicit transactions reduce commercial predictability and create an un-level playing field, both of which are important considerations for international business exploring foreign investment, especially where the latter involves substantial amounts in long-term projects. Corruption causes competitive disadvantages between market actors – including multinational corporations, but especially small and medium sized enterprises. It distorts the allocation of resources and undermines competition in the market place. Furthermore, corruption respects no borders, knows no economic distinctions and infects all forms of government. In the long run, no country can afford the social, political or economic costs that corruption entails. It erodes public confidence in political institutions and leads to contempt for the rule of law.

Another aspect of corruption is that it can occur in many different sectors of the economy. A commonly cited and morally reprehensible form is when government officials abuse public trust by accepting bribes from private businesses. However, the distinctions between the private and public sectors have been blurred by privatization, and corruption within the private sector is not without harmful consequences as well. While not as common, bribes happen between public officials too. And a recent bribery scandal involving government representatives and officials of the International Olympic Committee in a bid to influence the choice of the next venue for an Olympic Games is a reminder that propriety is something to be maintained between public officials and respected non-governmental organizations as well.

There are different degrees of corruption too. Some would distinguish between “petty” corruption and “grand” corruption. The former usually involves small sums paid to low level officials to

“grease the wheels” or cut through bureaucratic red tape. The headline-making cases of large multinational companies paying millions of dollars to government leaders or politicians to obtain lucrative business contracts are examples of corruption on a grander scale. The distinction should not imply that some forms of corruption are worse than others. Indeed, petty corruption, which can interfere with the delivery of basic education and healthcare programs, can have very serious consequences, one of which is the continuation of grinding poverty for the world’s economically disadvantaged.

Economics of Corruption

For most economists, the root cause of corruption lies in the delegation of power. It is the discretionary use of that power and the often-monopolistic position public agents enjoy when dealing with contracts, which make corruption possible. The incentives and opportunities for corruption depend on the size of the rents, or the personal profit, which public agents can derive from allocating those contracts. Corruption, therefore, occurs at those points where the political, bureaucratic and economic interests coincide. There is legislative corruption when politicians betray the electorate by selling their votes to pressure groups, and administrative corruption when public officials take payoffs to allow someone to secure a procurement contract or to gain immunity for tax evasion.

Like any other market, corruption is based on a contract between different interests. Firms, pressure groups and citizens try to maximize their gains by paying bribes, while public officials try to maximize their illegal earnings and politicians their power and wealth. Bribe-payers may seek to avoid or reduce costs, through illegal reductions in taxes, lax enforcement of regulations, underestimated rent for public housing or the dropping of criminal charges. Multinationals might pay bribes just to jump the queue in getting a house or a telephone line connected. Even obtaining a research grant often presupposes a bribe. Bribers may even be coerced to pay, which is called extortion.

The costs of corruption are difficult to calculate, partly because of the secrecy involved and also because the resulting distortions are hard to measure, but some effects seem to be beyond doubt. One result is lower overall investment. Studies indicate, for example, that moving from a relatively clean government environment, like that of Singapore, to one as corrupt as, say, Indonesia under Suharto, could entail costs for foreign direct investment equivalent to a 50 percent increase in the marginal corporate tax rate. More corrupt economies are also now seen as more prone to financial crises, because they are more likely to depend on short-term foreign loans—the type of capital most likely to flee a country in the event of a shock. Research suggests that portfolio investment is also negatively affected by corruption and that fund managers typically favor less corrupt countries.

Another effect of corruption is that it tilts public spending towards projects that make it easier to collect on bribes, at the expense of priority programs, hence the proliferation of so-called “white elephant” projects. Crucially, corruption can lower the quality of public goods and services and even threaten safety. The collapse of buildings in Seoul and Turkey during the earthquake was partially blamed on substandard contracts and shabby construction. Corruption also distorts the redistributive role of the state. It fuels the informal sector and acts as an incentive to evade taxes.

For instance, government statistics hint at the vast scale of tax evasion among business owners and self-employed people in Turkey. In the last 15 years, Turkey's population has grown 30 per cent and the number of taxpayers has risen only 1 per cent. Tax evasion is challenging the country's efforts to control inflation and pay civil servants a decent wage, two pre-requisites for Turkey's transformation into a developed nation. If a government cannot raise taxes, they cannot run a proper government or pay their civil servants enough to keep them honest.

Turkish businessmen are well known for their "creativity" and "craftsmanship" in offering well-disguised "sweeteners", not only at home but also in foreign markets, such as the Middle East, the former Soviet states and the Balkans. Whatever forms it takes, corruption is always a two-way transaction; it requires a supply side (the briber) and a demand side (the one who receives the bribe). That is why preventative measures must be designed to deal with both sides of the corruption equation. Incentive bribes, payoffs and extortion happen to be rare in developed countries, but frequent in developing and transition ones.

No Longer "Business as Usual"

Aware of its economic, social and political costs, many governments and international organizations are now making determined efforts to combat corruption and to achieve a stronger culture of accountability, including within their own administrations. The early 1990s witnessed a proliferation of initiatives aimed at fighting corruption – on the national, regional and international levels, primarily fanned by the US leadership. Fighting corruption has engendered an unusually high degree of international co-operation, leading to a series of international instruments, such as the OECD's "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions" (which has been in force since 15 February 1999), or the Council of Europe's "Criminal Law Convention on Corruption".

Until recently, offering bribes to foreign public officials as a way of obtaining contracts was a perfectly normal way of doing business in many OECD countries. Companies seeking contracts abroad often expected to have to pay a bribe to foreign officials, just to stay in the race. Several governments saw no reason to disagree, and offered favorable tax treatment for bribery payments, which could be written off as expenses. These governments argued that making bribes to foreign public officials non-deductible contradicted the principle that all expenses associated with earning taxable income should be taken into account for tax purposes.

The OECD has developed a simple argument: disallowing the tax deductibility of bribes serves as a strong and politically visible symbol of the common international commitment to combat bribery. And if combined with the criminalisation of bribery, non-deductibility becomes a potent force. Not all OECD countries treated bribery favorably for taxation purposes; in fact, about half of them disallowed the deductibility of bribes to foreign officials, though not all for the same reasons. In 1996 only 14 denied the deductibility of bribes to foreign public officials as a general rule. Canada, the United Kingdom and the United States denied it because of the illicit nature of the bribe in their own countries. Other countries adopted approaches that were perhaps a little less explicit.

In Turkey, bribes of foreign officials simply did not qualify as a deductible expense, and were thus not allowed, even if there were no explicit provisions against them in some of these

countries. It would be unfair to put all the blame for corruption on the lack of legislative controls. According to Turkish law, giving or accepting a bribe is illegal. Fines imposed in corruption cases focus on the amount of the bribe received, and the law attempts to recover as much of the losses incurred as possible from the financial assets of the person convicted. Turkey has enacted a wide variety of laws, regulations and penalties banning corruption, and recently approved the OECD anti-corruption convention, but enforcement is still uneven. The government has committed itself to amend applicable laws to explicitly provide that bribes of foreign officials, as well as domestic, are illegal and not tax deductible.

The Critical Role of Businesses in the Anti- Corruption Campaign

Businesses are often perceived to be largely responsible for corrupt practices, but they are also potentially powerful allies in the fight to change corrupt systems. Individual businesses may be afraid of speaking up on their own because it could undermine their business opportunities and because it is risky. Businessmen dare not complain against the corruption of ministers and civil servants if they know that there is no other way they can do their business. As businesses begin speaking out against corruption and refusing to participate in corrupt practices, some entrepreneurs will be tempted to remain passive while profiting from reforms actively supported by others.

At the same time, it is difficult for a company to try to change the rules of competition and refrain from participating in corruption when its competitors are free to continue to engage in it. So, it is critically important to achieve a level playing field - a world in which honest companies know that bribery does not pay and that dishonest competitors will be punished. This is the only thing, which will bring about a lasting change in the behavior of international business.

The Value of Integrity¹

The concept of business ethics is closely linked to the image of the modern corporation. In an increasingly competitive environment, immaterial values tend to play an increasingly important role in the profit and sustainability prospects of the corporation. Physical and financial capital is important but not sufficient for the success of the enterprise. It also needs human capital, including competent management and a skilled and motivated labor force, which in turn depends on proper incentive structures to motivate, upgrade and remunerate. The corporation's intellectual capital reflects its ability to adjust and innovate based on intellectual property rights, know-how research and development capacity. Finally the social capital of the enterprise is important: it is based on the company's image and reputation, the confidence it creates with suppliers, creditors and customers, its contribution to societal values and the quality of its stockholder relations.

Corporate balance sheets and financial accounts do not reflect all of these factors, which have become important with respect to how enterprises operate and communicate. Investors, in particular institutional investors, and consumers care about image, long-term strategies and responsible behavior. Aggressive, short-term strategies, which ignore societal values, can generate quick financial returns but can also entail high costs and risk perceptions. Companies are assessed today not just on their financial statements but their risk situation and long term

¹ This part has extensively used Mr. Rainer Geiger's remarks at Forum Istanbul, 5-6 May 2003.

prospects. Non-financial information, including social and environmental aspects of the company's activities is expected by market participants and may even be required by law. Rating agencies have started measuring performance in corporate social responsibility and developed indices for sustainable development.

The OECD Corporate Governance Principles clearly reflect this trend by recognizing the contribution of stakeholders in the process of value creation within the enterprise. "The competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of different resource providers including investors, employees, creditors and suppliers... It is, therefore, in the long term interest of corporations to foster wealth-creating co-operation among stakeholders."

Ethical behavior and good governance brings clear advantages to companies which are well advised to invest in transparent lines of command and effective internal control structures. Integrity and corporate social responsibility need to be integrated in management and become part of leadership functions at the highest level of the corporation.

Yet, these new trends entail costs, e.g. for training of staff, setting up internal control mechanisms and providing for transparency and communication within the corporation and with outside users. The costs can be relatively easily absorbed by large multinational enterprises but impose heavy burdens on smaller companies. Communications, controls and reports should not expand to the point where management is distracted from its primary goal of value creation and profitability.

One Day, a "Corruption-Free" Turkey?

Business surveys show that foreign firms have identified corruption as a significant barrier to foreign direct investment in Turkey. They often complain about contributions requested by municipal or local authorities on behalf of the local community, with varying degrees of pressure. The investors are requested to give "gifts" ranging from public playgrounds to garbage trucks, to hospital equipment. These can at best be termed as involuntary "corporate social responsibility" grants.

Corruption appears to be most problematic in Turkey's government procurement, although it is present in nearly all sectors. Allegations of favoritism in the awarding of public contracts, based on personal and financial ties between national businesses and politicians, are most common. At the urging of the European Commission, Turkey enacted and put in place new public procurement legislation as of January 2003, calling for greater transparency in tenders, which will hopefully reduce opportunities for improper deals between government, business and political party representatives.

The truth of the matter is that corruption and bribery cannot be totally eradicated: yet, it is possible to reduce it to a minimum by severe penalties and its condemnation as a morally reprehensible. Corruption can be tackled seriously only if the Turkish establishment decides that the most effective way to combat political Islam, ethnic separatism and to maintain secular democracy is by cleaning up the country's corrupt political system. As in other developing countries, the Turkish public tends to associate corruption with the existence of an "ultra" free-market system that has a poor regulation and supervision mechanism, and may, therefore, be

disposed to support opponents of globalization. Crimes committed by big businesses, politicians and bureaucrats need to be brought to justice speedily if we really want to see progress made in this area.

Politicians' noticeable reluctance to privatize state-owned banks and companies stems largely from a desire to maintain a political system based on nepotism and favors. Let it not be forgotten that wherever corruption occurs and at whatever level, the ultimate victims of corruption are ordinary citizens and society at large. That is why fighting corruption vigorously at all levels is so important. Finding effective, credible and enforceable measures to stamp out corruption and to hold the guilty accountable before an independent court is more than a noble objective: our economic, political and legal institutions depend on it.

Result-Oriented Actions Needed

The national strategy for “Enhancing Transparency and Good Governance in Turkey’s Public Sector”, which has been recently prepared by the Turkish Anti-corruption Steering Committee and is expected to be adopted soon, sets out a broad and coherent framework for action.

The strategy recognizes that, in Turkey as in many other countries, the fundamental roots of the problem lie in the structure of the public sector, its interactions with the private sector, and the way in which these factors shape incentives and the broader behavioral environment.

It presents a comprehensive approach to improving governance and transparency that reaches beyond the issue of enforcement to the more deep-rooted structural dimensions that give rise to corruption.

It complements on-going regulatory reforms in the energy, telecommunications and financial sectors, as well as the reforms to the public procurement system, and the Government’s broader public sector reform agenda.

The strategy concludes with an impressive action plan of priority objectives covering specific reforms to increase transparency and accountability in the political system, the judicial system, and public administration².

Political will is necessary to initiate and sustain anti-corruption reforms. This political will must exist within government circles, but also more broadly in society, which depends heavily on the necessary process of building alliances among the different groups that want to reduce corruption, including important segments of the private sector. The private sector is a key piece of the internal political coalition that is necessary to carry forward the required reforms. The participation of business is key to ensuring that the fight against corruption is rooted in the building of State and market institutions that will work together to create healthy price competition in the local economy and conditions favorable to the development of the private sector. Here, rhetoric alone is insufficient; the devil is in the details. This is an area where governments, multilateral institutions, the private sector, and NGOs must work together.

Some elements that are essential to strengthen awareness of the issues associated with an anti-corruption program include:

² Corruption in Turkey: The View from the Business World, Johannes Linn
Vice President, Europe and Central Asia Region, The World Bank, TESEV, February 15, 2002 - Istanbul

- Dove-tailing anti-corruption initiatives with good governance programs;
- Conducting reviews of public expenditures, financial accounting and auditing, and procurement, including that of the military;
- Enhancing human and institutional capacities (e.g. via ethics codes, transparency and accountability standards); and
- Strengthening efforts to raise awareness in partner countries, both with government employees and with the public more generally.

A vast educational effort is still needed to integrate ethics into politics and the management of public and corporate organizations. Such efforts should start in primary and secondary education and extend to university programs and vocational training. Transparency of the political process, public administration and corporate conduct is essential, with strict sanctions being applied to offenders.

Hopes are high that Turkey has embarked upon an irreversible path in the struggle against corruption. Public sentiment against corruption is very strong. Although arresting famous businessmen (and politicians condemned in the public arena) and displaying them in handcuffs on TV screens certainly has a deterring effect, over-using the PR side of this campaign could have a backlash if a clear distinction is difficult to make between the honest and the dishonest⁹, and if the process is turned into a political vendetta.

“The corrupt economy is the number one threat to Turkey’s economic and political stability. It lies at the root of many of our country’s problems and poses a future threat to our society and constitutional regime,” stressed the former Interior Minister (and now the leader of a small political party) Mr. Saadettin Tantan, promising that culprits, “at all levels”, would be brought to justice. “All those people or companies who swindle our people and wreak havoc with their honor will be met with the fierce determination of government forces. No one will be exempt from prosecution in our fight against corruption and the sources of corruption,” he remarked. This sentiment is exactly what is called for and must rigorously enforced.

It remains to be seen whether the new government, the parliament and the judiciary will be able to rise to the challenge of wiping out the root causes of corruption, disqualify from the nation’s political scene the prominent figures known to be nurturing most of the large-scale corrupt practices, and foster the culture of clean government and business. What is most needed is “openness in business, constant vigilance in government, strengthening of institutions and most importantly, encouragement of feelings of revulsion among ordinary people” against the corrupt practices.

Ultimately, it will be the Turks themselves who will have to put their house in order and unless their struggle against corruption is successful and Turkey achieves genuine transparency, no amount of external financial or political assistance will be sufficient. The current efforts at combating corruption have undoubtedly marked an encouraging start. But the government has yet to develop a “comprehensive” strategy to fight corruption. This means going beyond catching people who break the law, to reforming public procurement and enlisting the support of civil society. The government faces the delicate challenges of reinventing efficient government,

instituting the principles of corporate governance and ethical business, and boosting law enforcement while rooting out unlawful practices.

If Turkey fails to take advantage of the present window of opportunity, its long cherished goals of achieving rapid modernization, sustained economic growth, improved governance structures, political freedoms, human rights, and a world-class competitive economy will continue to be hollow dreams for another generation to fulfill.

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