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It's Not Always Nice to Play Nice: Collusion, Competition, and Development

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I. INTRODUCTION

Once upon a time, there was a wonderful country where politicians cooperated across the aisle. Under what was known as the Fixed Point Pact, the country's center-left party and center-right party worked seamlessly together for 40 years, alternating regularly between presidential power and loyal opposition. The center-right was friendlier with big business, and the center-left with big labor. Yet policymaking was rather stable no matter which side was in power, since the winner of each election was pledged to establish a national unity cabinet representing both parties and was bound to a set of shared policy principles. In 1995, two leading political scientists categorized countries in Latin America as having institutionalized, transitioning, or inchoate party systems. The political scientists lauded this country''s system as being the most institutionalized, marked by "stability in interparty competition, the existence of parties that have somewhat stable roots in society, acceptance of parties and elections as the legitimate institutions that determine who governs, and party organizations with reasonably stable rules and structures."[1] Three years later in 1998, Hugo Chávez became President of Venezuela, and those "reasonably stable rules and structures" came tumbling down. Venezuela's two traditional parties now have no representatives in the legislature, which recently granted Chávez the power to rule by decree for 18 months.[2]

The political stability of Venezuela's Fixed Point Pact was a mirage in the long term, because it was built on collusion rather than competition. George Stigler, who won the Nobel Prize in Economics in 1982 in large part for articulating the related concept of state capture, quipped that the plural of anecdote is data. With Stigler's implicit permission, I offer several anecdotes from Latin America to argue that collusion is the most harmful aspect of corruption, since its purpose is to defeat a fundamental prerequisite for development: competition. Competition drives economic growth, and economic growth drives economic development. So if we care about development, we must care about collusion. Part II of this paper defines collusion and explains why it can be combated effectively only with market-based mechanisms. Part III

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1. SCOTT MAINWARING & TIMOTHY R. SCULLY, BUILDING DEMOCRATIC INSTITUTIONS: PARTY SYSTEMS IN LATIN AMERICA (Stanford University Press: 1995).

2. BBC News, *Rule by Decree Passed for Chavez* (Jan. 19, 2007), http://news.bbc.co.uk/2/hi/americas/6277379.stm.

analyzes what this means for the three pillars of Gleneagles-style development policy: debt, aid, and trade.

II. COLLUSION AND COMPETITION

A. *Defining Collusion*

Collusion is cooperation between two parties that should instead be competing, or at least maintaining an arm's length. By cooperating, they seek to divvy up benefits between them, excluding other parties that might otherwise claim some of the benefits. In 1982, Robert Crandall, then-CEO of American Airlines, faced price-fixing charges by proposing to his counterpart at Braniff, "Raise your [expletive deleted] fares 20%. I'll raise mine the next morning . . . You'll make more money, and I will, too."[3] When two business competitors collude, their customers lose. The colluders may reap a higher profit margin and apparent market stability, but over time they do their jobs less efficiently and the economy as a whole will suffer.

A similar result can be seen with political collusion. In the case of Venezuela's Fixed Point Pact, the colluders were two political parties. By working out a long-term deal, they denied voters an authentic choice between competing ideologies and froze out other would-be leaders. Without truly competitive pressures, Venezuelan politics became a game of inside baseball, rather than representative democracy—and the stability brought by the pact became increasingly fragile. Chavez first tried to push his way in by attempting a military coup in 1992, and succeeded democratically in 1998 once the pact was sufficiently discredited.[4] Political collusion can also occur between politicians and private interests. In that case, collusion diverts political benefits from the public good to private pocketbooks or resumés.

Collusion is one of the two central aspects of corruption, the other being transfer of a bribe. In 2006, the International Financial Institutions Anti-Corruption Task Force proposed a harmonized approach to combating corrupt, fraudulent, coercive, and collusive practices in the operations of the World Bank, International Monetary Fund (IMF), and five regional development banks.[5] The task force defined corruption as "offering, giving, receiving or soliciting, directly or indirectly, anything of value to influence improperly the actions of another party" and defined collusion as "an arrangement between two or more parties designed to achieve an improper purpose, including influencing improperly the

3. John S. Demott, *Dirty Tricks in Dallas*, TIME (Mar. 7, 1983) *available at* http://www.time.com/time/magazine/article/0,9171,953755-1,00.html.

4. Damarys Canache, *From Bullets to Ballots: The Emergence of Popular Support for Hugo Chavez* in LATIN AMERICAN POLITICS AND SOCIETY (Spring 2002).

5. INTER-AMERICAN DEVELOPMENT BANK, OFFICE OF INSTITUTIONAL INTEGRITY: ANNUAL REPORT (2006), *available at* http://www.iadb.org/integrity/oii_ar06/leadership.cfm?language=en&parid=8.

actions of another party."[6] An act can be corrupt without involving collusion, if one party rejects the overture of the other, but all successful bribery involves collusion. In turn, collusion does not require a quantifiable bribe to change hands, though it always excludes another party from at least potential benefits.

B. The Importance of Collusion

Collusion is the most harmful aspect of corruption. Much public attention is paid to corruption's other major aspect: illicit value transfer. Fiscal losses from official fraud and public officials' solicitation of their "cut" impoverish government programs, some of which would otherwise make a greater contribution to development. The resulting loss is very real and can sometimes be in part dynamic.[7] For example, if the extra cost of a bribe cannot be passed on, a company may be dissuaded from even bidding on a privatization – robbing the economy of the additional investment and competition the company may have brought. However, the loss caused by the value-transfer aspect of corruption is in large part static.

In contrast, the loss from collusion is principally dynamic. Collusion between government officials and the winning bidder in a privatization may unnecessarily extend the term of the bidder's monopoly rights, for example, resulting in a less efficient privatized sector and less economic growth. In one way or another, collusion is the opposite of competition. Collusion is often between parties that should be competing directly. In other cases, a government official may limit the competition faced by the private interest with whom he colludes. Competition, by driving innovation and efficiency, is the principal source of dynamic economic gains. Thus, by undermining competition, collusion causes dynamic economic losses.

Development requires economic growth, and rapid economic growth rests on dynamic gains. For example, in the trade liberalization context, potential dynamic gains (e.g., local firms becoming more efficient in order to compete) far exceed potential static gains (e.g., a foreign firm offering a product at a lower price).[8] The same is true for losses. Thus, for development purposes, collusion is what hurts most about corruption.

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6. INTERNATIONAL FINANCIAL INSTITUTIONS ANTI-CORRUPTION TASK FORCE, UNIFORM FRAMEWORK FOR PREVENTING AND COMBATING FRAUD AND CORRUPTION (Sept. 2006) *available at* http://siteresources.worldbank.org/INTDOII/Resources/FinalIFITaskForceFramework&Gdlines.pdf.

7. Dynamic gains and losses are caused over time by a factor that changes the *rate of growth* of productivity, whereas static gains and losses are triggered by a factor that changes the *level* of productivity.

8. *See, e.g.*, Anderson et al, *infra* note 36 (estimating global gains from full liberalization of trade of goods by 2015 at $287 billion using static measurement and $461 billion using dynamic measurement).

C. (Collusive) Redistribution versus (Competitive) Production

Collusion between Venezuela's two traditional parties—the center-right Christian Democrats (COPEI) and the center-left Democratic Action (AD)—was encouraged by the so-called "curse"[9] of natural resources. American oil companies discovered heavy crude in Venezuela's Maracaibo Bay in the 1920s, giving birth to an off-and-on oil boom. In 1976, President Carlos Andrés Pérez of AD nationalized the Venezuelan oil industry. Chávez is using the state-owned oil company, Petróleos de Venezuela (PDVSA), to finance his social revolution both domestically and regionally, while cutting back on investment in the firm's operations. Part of PDVSA's ultimate purpose, according to its website, is to "provide a dignified and beneficial existence for the Venezuelan people, owners of the national subsoil riches. . ."[10] In a 2006 survey by Venezuela's leading pollster, 62% of Venezuelans categorized their country as "extremely rich," with very few saying it is "neither rich nor poor" (7%), "rather poor" (9%), or "very poor" (4%).[11]

This belief in natural abundance is mistaken: the first rule of economics is that resources are scarce. Thus, welfare ultimately depends not upon natural endowments, but upon ongoing production. The belief in natural abundance also encourages collusion. If there is a large enough national piggybank, then it is unnecessary to maximize production through competition (with all of its ugly disadvantages), and better to focus on how to share the riches among key players. For example, the scale of privatizations in Venezuela was less than in most other Latin countries,[12] even before Chávez increased the role of the state in the economy and reversed several privatizations.

In a fantasy world of abundance, the goal becomes a fair distribution of existing wealth—but the reality is that collusion is decisive in determining how the pot is divvied up. Before Chávez, the two traditional parties ensured a modest redistribution of populist goodies to the plebes, while traditional elites with powerful connections perpetuated the country's inequalities, typical of the entire region. Chávez gained power in reaction to this system, but rather than stopping the collusion, he has exacerbated it. Even without the constitutional amendments

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9. RICHARD M. AUTY, SUSTAINING DEVELOPMENT IN MINERAL ECONOMIES: THE RESOURCE CURSE THESIS (Routledge 1993) (coining the term "resource curse"); Jeffrey D. Sachs & Andrew M. Warner, *Natural Resource Abundance and Economic Growth*, National Bureau of Economic Research Working Paper 5398 (1995).

10. Petróleos de Venezuela, S.A., *available at* http://www.pdvsa.com/ (quoted under *Acerca de PDVSA*).

11. Alfredo Keller & Associates, http://www.alfredokeller.com (e-mail confirmation of poll results from Alfredo Keller on file with author).

12. *See* Energy Information Administration, U.S. Department of Energy, *Country Analysis Brief: Venezuela* (Oct. 2007) (stating that state-owned oil company, PDVSA, accounts for a third of Venezuelan GDP); *see also* EIA Report on Venezuela ("Although Venezuela's privatization efforts have lagged those of other Latin American countries, PDVSA has long been an internationally oriented petroleum company"), *available at* http://www.eia.doe.gov/emeu/pgem/ch3c.html.

narrowly voted down in December 2007, Chávez has unitary control over all national government authority in Venezuela, and government authority increasingly constrains Venezuelans' private economic and press freedoms. Subsidies, as well as currency and price controls, create massive distortions – and opportunities for arbitrage and corruption. Being "in" with the government is now more critical than ever to one's lot in life. For example, thousands of PDVSA employees who signed the petition supporting the 2004 recall vote against Chávez were fired soon afterward and replaced with loyal apparatchiks far less knowledgeable about the oil industry. In a speech to employees in 2006, PDVSA's president said, "Here, we are backing Chávez . . . Those who do not feel comfortable with that orientation should give their jobs to" a Chávez supporter."[13] Collusion sinks its roots deeper, market forces weaken, production suffers, and development opportunities escape.

D. (Collusive) Personal Relationships versus (Competitive) Rule of Law

Peru also has a history of shameless collusion between political leaders and entrenched private interests, as well as collusion within the business community. Society—including both politics and business—requires a modicum of trust in others' actions. In mature free markets and democracies, the rule of law allows for that requisite level of trust by enforcing basic rules which we can assume everyone will follow (or be adequately penalized for not following). Where rule of law is weak, the trust that derives from personal relationships replaces fair, arms-length dealings. This certainly describes traditional Peru, though there have been improvements in the rule of law in the last decade. People cooperate with those in their circle to maintain their reputation, honor, and mutually assured advantage within the circle. Thus, traditional "Peruvian society" was, in fact, not so much one society as groupings of separate, very small societies, held together by personal relationships. Among those very small societies, a very, very small elite society dominated both national politics and big business. From those elite came presidents whose entourages included advisors who made their livings from collusion with the private interests from which they had come and to whom they would return, as well as private-sector "friends of the President" who had license to engage in economic rent-seeking from inauguration to inauguration.

Then along came "El Chino"—Alberto Fujimori, who was surprisingly elected President of Peru in 1990. Fujimori was a true outsider: non-white, unpolished, middle-class; a second-generation Peruvian whose name elite society

13. *See* Strategic Forecasting, Inc. (STRATFOR), *Venezuela: Oil Workers Being Fired?* (Apr. 5, 2006) (subscription required); *Trade Union Reports Dismissals in Foreign Oil Firms Taken by PDVSA*, EL UNIVERSAL (Apr. 4, 2006) (suggesting that anyone who signed petition for recall referendum against Chavez in 2004 is now barred from PDVSA); BBC News, *Storm Over Venezuela Oil Speech* (Nov. 4, 2006) (stating that 18,000 PDVSA workers were fired in 2003 after PDVSA's strike to oppose Chavez policies, as well as that Chávez defended speech by PDVSA President Ramirez, saying it should be repeated "100 times a day").

barely recognized until weeks before his election. Fujimori initially appeared beholden to no one, with a maniacal, controlling, and scientific focus on governing the ungovernable. He fired top advisors at the drop of a hat, including his own brother, and eventually installed his daughter as First Lady after throwing his wife out of the presidential palace for opposing some of his policies.[14] He was a force of nature—and nature proved no match for him. For centuries, El Niño currents have caused deadly and economically devastating floods on Peru's coast. While previous presidents had done little but pound their chests for the dead, Fujimori, an engineer, planned ahead for the 1998 occurrence with $500 million in public works. Those El Niño weather patterns were the worst in 50 years, so his preparations proved inadequate. But Fujimori received credit from many voters for making a serious stand against the elements, as well as for his hands-on approach to crisis management once the floods came.[15] This only reinforced Fujimori's maniacal certainty that he alone knew how to govern Peru. He was a detail-oriented autocrat, not a get-along-come-along team player. The cozy, collusive relationships Peru was accustomed to were in danger.

Fujimori's reign unleashed a torrent of changes, many of which were unsettling to the traditional vested interests. Shock therapy threw open to market forces the prices of most goods. Mass privatizations attracted international capital that promptly began competing with local business in additional sectors. Fujimori's dissolution of the legislature and rule by decree for several months in 1992 deposed the entrenched, traditional political class and replaced many of their collusion-friendly laws with modern, market-friendly laws straight from the Washington Consensus.[16] Tax reform cut the number of taxes by over one hundred, reducing administration and compliance (previously, evasion) costs while increasing collections. Fujimori gave a large economic reform portfolio to Hernando de Soto, whose 1986 book *The Other Path* had brought international

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14. *See generally* RICHARD BAUER & SALLY BOWEN, THE FUJIMORI FILE: PERU AND ITS PRESIDENT 1990-2000 (Peru Monitor 2000).

15. *See Fujimori Against El Nino*, ECONOMIST (Sept. 27, 1997) *available at* http://www.highbeam.com/doc/1G1-19797234.html (subscription required) (crediting Fujimori for planning ahead with massive public works to detain weather disruptions forecasted to be far worse than the 1982-83 El Nino); *see also* Anthony Faiola, *In Peru It's President Fujimori vs. El Nino*, CHICAGO SUN-TIMES (Feb. 22, 1998) *available at* http://www.highbeam.com/doc/1P2-4434091.html (subscription required) (describing Fujimori shouting orders at work site, dressed in blue jeans and Caterpillar work boots); *but see El Dedo de la Falla*, CARETAS, *available at* http://www.caretas.com.pe/1998/1509/dedo/dedo.htm (tallying fatalities from El Nino at 296 and claiming that Fujimori's preparations were ill-designed).

16. *See* Augusto Alvarez Rodrich & Gabriel Ortiz de Zevallos, eds., IMPLEMENTACIÓN DE POLÍTICAS PÚBLICAS EN EL PERÚ [Implementation of Public Politics in Peru] (Apoyo Comunicaciones 1995) (surveying reforms in Fujimori's first term); JOHN CRABTREE & JIM THOMAS, FUJIMORI'S PERU: THE POLITICAL ECONOMY (Institute of Latin American Studies 1998) *see also* J. Welby Leaman, *Taxes and Transaction Costs: Peruvian Tax Reform as a Method of Microenterprise Development* (contrasting tax law before and after Fujimori's 1992-93 reforms), *in* Beatriz Boza, ed., PERU: BEYOND THE REFORMS (PromPerú and Universidad del Pacífico 1997), *at* 289, 294; *cf.* John Williamson, *What Washington Means by Policy Reform*, *in* LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED? (John Williamson, ed. 1990) (defining elements of Washington Consensus).

attention to Latin America's stultifying and collusion-inducing over-bureaucratization. With consultation and funding from the World Bank, Fujimori also established the Fund for Social Compensation and Development (FONCODES), presided over by a squeaky-clean development expert. FONCODES directed development assistance and awarded contracts using a scientific system to pinpoint poverty and microenterprise development needs, rather than the traditional system of walking-around money for loyal politicians and contracts for friendly businesses.[17]

Perhaps most importantly, Fujimori introduced Peru's first competition policy, including state-of-the-art anti-monopoly and consumer protection laws. The National Institute for Defense of Competition and Protection of Intellectual Property (INDECOPI), the independent regulatory agency charged with enforcing the new laws, shook the collusive foundations of Peru's business community and served as a model for free-market regulation throughout the region.[18] When bread prices spiked soon before the State of the Union speech in 1995, Fujimori's first instincts were to announce price controls. But INDECOPI's president, Beatriz Boza, demonstrated that bread prices were artificially high because of collusion among wheat producers. Fujimori held off announcing price controls, INDECOPI broke collusion in the market, and competition policy had a solid ally in the presidential palace from then on.[19]

That support held even when INDECOPI fined a leading Japanese-Peruvian over $1 million for collusion in the poultry industry. That businessman's line of defense showed how foreign the concept of competition was, and how reasonable collusion seemed: He made clear that he worked hard to remain first in the sector, but argued that INDECOPI was forcing him to be a bad Catholic. Why should he try to put his weaker "neighbors" out of business when, by cooperating on price, he could ensure that they, too, could afford to send their children to

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17. *A Valuable Experience: FONCODES 1995-98*, *in* FRANCISCO SAGASTI & AGENDA PERU, DEVELOPMENT STRATEGIES FOR THE 21ST CENTURY: THE CASE OF PERU (International Development Research Centre 2000), at 132 (highlighting Alejandro Afuso's tenure as rigorously focused on development results), *available at* http://www.agendaperu.org.pe/pdfs/inf-ing-02.pdf; *see also* Fondo de Compensación Social y Desarrollo, http://www.foncodes.gob.pe/ (describing FONCODES' stated objective of generating employment, alleviating poverty, and improving access to social services).

18. *See generally* THE ROLE OF THE STATE IN COMPETITION AND INTELLECTUAL PROPERTY POLICY IN LATIN AMERICA: TOWARDS AN ACADEMIC AUDIT OF INDECOPI (PromPerú, INDECOPI, Maxwell School of Citizenship and Public Affairs at Syracuse University, and Universidad del Pacífico 2000) *and* Beatriz Boza, ed., PERU'S EXPERIENCE IN MARKET REGULATORY REFORM: LESSONS FROM THE FIRST FIVE YEARS OF INDECOPI, 1993-1998 (Indecopi 1998) (providing internal descriptions of INDECOPI accomplishments and independent analysis of INDECOPI's leadership in international best practices, for example, "'Indecopi is a passionate concept, a new idea . . . that overcomes many traditional ways of doing things'—Douglass C. North, 1993 Nobel Laureate in Economics"); *and* Carlos A. Patrón, *Building Competitive Markets in Peru: The Case for Indecopi (unpublished University of Oxford thesis 2001).*

19. BEATRIZ BOZA AND INSTITUTO APOYO, TAILOR-MADE COMPETITION POLICY IN A STANDARDIZING WORLD: A STUDY FROM THE PERSPECTIVE OF DEVELOPING ECONOMIES 33 (International Development Research Centre 2005)(describing INDECOPI's wheat flour case), *available at* http://idrinfo.idrc.ca/archive/corpdocs/121364/121364.txt.

good schools?[20] Lost in that collusive logic were the businessman's other "neighbors"—consumers. Most of their children did not go to prep school with the businessman's children, so in Peru's traditional business culture, he did not recognize them as his "neighbors." But under Peru's new free-market rule of law, he owed them competitively set prices—and was now required to satisfy that obligation. Encouraged by an outsider President and new laws with international support, the free-market forces of competition were beginning to weaken the collusive power of personal relationships.

E. Conductivity of Collusion

Fujimori's background, personality, and some of his policy positions made him a good candidate to break collusion's back. Yet Fujimori's story did not end in anti-corruption bliss. Though he undoubtedly would have preferred to be an island unto himself, Fujimori turned out to need the cooperation of the military, the press, legislators, judges, and other key constituencies, in order to maintain his autocratic style in Peru's democratic system. This was particularly true during the several months that he ruled by decree after dissolving the legislature in 1992, as well as during his legally questionable campaign for a third term in 2000. Fujimori bought the cooperation he needed by spreading around millions in bribes from a slush fund maintained by his spy chief, Vladimiro Montesinos, and turning a blind eye to Montesinos' collusive relationship with certain businessmen and judges. During the 2000 election campaign, the owner of Peru's leading television station purportedly received $1.5 million per month for favorable coverage and Montesinos' right to veto certain shows and to terminate the employment of journalists he did not trust. Down-market yellow journalists got paid by the story.[21] When the election looked particularly difficult and the respected chief of FONCODES refused to revise his computer model to send some extra aid to parts of the country where the President needed votes, Fujimori forced him out.[22]

Fujimori may have stolen tens of millions of dollars in state funds for himself. Yet television crews that entered the Presidential Palace immediately after Fujimori faxed his resignation from Japan found slovenly living quarters in which the President did his own (hardly gourmet) cooking.[23] Fujimori's corruption appears not to have been so much about personal financial enrichment as about financing his way into prolonged power. Even this outsider, too self-

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20. *Id.* at 48 (describing INDECOPI's poultry case).

21. John McMillan & Pablo Zoido, *How to Subvert Democracy: Montestinos in Peru* (Apr. 21, 2004) at 6-8, 14-15, *available* at http://iis-db.stanford.edu/evnts/3823/Montesinos_0421.pdf

22. *See* Del Mazo Su Duro, CARETAS (July 14, 1998) (stating that Afuso resigned when Fujimori advisor Absalón Vásquez sought campaign assistance from FONCODES).

23. *Cf.*, Anthony Faiola, *A Wounded Samurai on the Run*, WASH. POST, Nov. 21, 2000, at A19 (describing allegations of illicit funds transfer; describing Fujimori's final image as desperate man on the run, with belongings being hauled away from Presidential palace after his resignation).

confident and impatient to cooperate with the old colluders, succumbed to collusion as the price for necessary cooperation from parties that Fujimori needed in order to govern "on his own." Even in a partial democracy, collusion cannot easily be defeated by giving significant powers to someone personally uninterested in corruption, unless he quickly develops authentic democratic support for his possession of those powers. Otherwise, the exigencies of governance will require even an anti-colluder to choose between colluding, and being shown the exit before he can complete his work.

Collusion is infectious. Personal, business, and official relationships—necessary for commerce and economic growth—spread the effects of collusion from one party to the next. Officials charged with combating collusion may be honest, but their actions are nonetheless often distorted by others' collusion. A recent Peruvian judicial reform project sponsored by a major international organization (*not* the one for which I worked) serves as an unfortunate example. Peru's judiciary is very corrupt and was especially so under Fujimori. In 2000 and 2004 surveys by the leading Peruvian polling firm, Peruvians ranked the judiciary dead last when asked which major national organizations they trusted.[24] As a result, several big donor organizations were keen to help reform Peru's judiciary during the Toledo administration. One, however, encountered significant reticence from its potential counterparts in the judiciary. A high official in the judiciary noted that he would be more likely to cooperate with the organization if its program in Peru were directed by an individual he felt especially comfortable with. Desperate to ensure that its program moved forward with good counterpart cooperation, the international organization promptly hired the "recommended" individual at a salary far above Peruvian private sector rates. Thereby, the management of a major anti-corruption program appears to have been indirectly controlled by the very same . . . corruption that was being targeted by the program.[25]

In contrast, the Inter-American Development Bank' (IDB)'s judicial reform project in Peru tried to cut off the conduction of collusion by tying its aid to unbending rules. IDB funding put judges, prosecutors, and public defenders together under one roof, in order to provide judicial services more seamlessly. The IDB realized, though, that the computer assigned to each of these one-stop judicial units was likely to "disappear," undermining the unit's efficiency. So the IDB required that each computer not be removed from the judge's desk. As a result, many computers sit unused or underused in front of judges who either refuse to, or do not know how, to use them.[26] In other words, one donor

24. Apoyo Comunicaciones 2004, *cited in* BOZA, *supra* note 19, at 36 (also citing Latinobarometer 2001 poll showing that 17 percent of Peruvians have faith in their country's judiciary, compared with 36 percent of Chileans).

25. Interview granted on condition of anonymity with one of the direct participants in the arrangement described, in Lima, Peru (July 2003).

26. Interview with Katherine Muller, Team Leader of IRIS Center Judicial Reform Project, in Lima,

organization paid collusion its due in hopes of winning the judiciary's cooperation, while another donor organization took a hard line against corruption but saw the effectiveness of its program suffer as a result. It is difficult to tackle collusion without it tackling you, one way or another.

F. The Search for a Prime Mover

To break the potentially infinite chain of collusive interactions, we must anchor our anti-collusion efforts in a "prime mover" that does not collude. In his *Metaphysics*, Aristotle posited that motion must have originated from a fixed point—the "prime mover"—from which the first moving object pushed off, starting the universe's endless chain of action and reaction.[27] There is only one potential prime mover free of collusion, and that is the free market—because the force that stabilizes it is competition, the opposite of collusion.

Our best opportunity to attack corruption is to promote a free market and to fashion market-based anti-corruption mechanisms, so that competitive forces bind the hands of would-be colluders. International trade liberalization provides a clear example of this binding effect. Local business leaders may prefer to collude among themselves and with captured government officials and agencies, but the entry of foreign businesses selling at competitive prices requires the locals to compete not only with the foreigners, but with each other—or risk losing their market.

The fact that we must tackle collusion by promoting competition should not be surprising—and may seem nothing more than circular—since collusion and competition are opposites. Yet few would instinctively have taken issue with the international development organization described above when it tried to gain the Peruvian judiciary's cooperation in order to tackle judicial corruption. Competition is the often-unnoticed alternative. INDECOPI, Peru's competition agency, competed with Peru's judiciary on resolution of competition and intellectual property disputes. Its administrative- judicial tribunals quickly demonstrated superior expertise and efficiency, and INDECOPI received more and more cases, since parties had few reasons to file in court. Doing so publicly signaled possible plans to bribe a judge or drag out a weak case to gain leverage. INDECOPI eventually began competing even with itself, creating a network of non-profit "franchisees" throughout Peru that competed to satisfy headquarters' ever-higher standards for processing of intellectual property registrations and

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Peru, (July 2003) (surveying history of judicial reform in Peru and describing her experience with, as well as her Peruvian judicial contacts' impressions of, IDB's "Basic Justice Modules" project); *cf.* Inter-American Development Bank, *IDB in Peru: Increasing Citizens' Access to the Courts* (providing post-project evaluation, including that modules' potential to increase productivity is only partially realized), *available at* http://www.iadb.org/exr/am/2004/index.cfm?language=English&Id=&PAM=&lang=E&pagePos=1&op=press&pg=25&preview=N.

27. ARISTOTLE, METAPHYSICS, *translated by* Hugh Lawson-Tancred (Penguin Classics 1999).

other, select INDECOPI responsibilities.[28] INDECOPI's demanding standards, 'combined with supervision of its brand name and the competition among franchisees for registrants left little room for corruption.

The free market is not synonymous with the private sector. As INDECOPI showed, free-market forces can be introduced even in the public sector, and, as the Peruvian poultry producer demonstrated, private business can be highly collusive—and will often choose to be if given the choice. In the United States, local politicians reputed to be pro-*business* rely heavily on targeted tax abatements and other policies that amount to little more than ensuring that business gets its share of public largesse, within an otherwise often anticompetitive environment. Pro-*market* policies, in contrast, require: (1) private property (including human capital) rights; (2) unfettered contract rights to negotiate the terms on which private property is traded at an arm's length; and (3) a reliable enforcement system for those property and contract rights.

A reliable free-market enforcement system begins, but does not end, with clear property, contract, and competition laws. In addition to bringing traditional enforcement actions, a competition regulatory agency must fashion market-based incentives to facilitate competition—through transparent information, prizes, and pro-competitive structures like INDECOPI's franchisee system, and the dual-track competition between INDECOPI and the Peruvian judiciary. For example, in the mid-1990s, INDECOPI published periodic rankings of banks and airlines based on waiting lines and delayed departures, respectively. Industry participants promptly began competing to improve their rankings, and their performance improved.[29] The exogenous power of simple rankings such as these will hold, even if the targeted industries capture their sectoral regulatory agencies through collusion, thereby defeating any effort to impose formal legal requirements.

A strong competition agency to regulate antitrust, consumer protection, and unfair business practices can thereby foster competition even in areas where the private sector has sheltered itself by colluding with its sectoral regulator. Anti-corruption czars, ombudsmen, and non-governmental organizations can wield many of these market-based mechanisms as well. Similar mechanisms can also target government agencies, forcing them through competition to improve their performance in areas lagging because of corruption. This requires refocusing incentives toward career promotion, reputation, budgets, and other public sector equivalents of the private sector's profit motive.

Still, the profit motive of the private sector remains the principal mechanism for generating competition. If government is rich and big enough to determine many of the winners and losers in life, then human nature will propel collusion with government officials. But if government is limited, principally providing the

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28. Beatriz Boza, *The Role of Indecopi in Peru: The First Five Years of Indecopi*, *in* BOZA, *supra* note 18, *at* 12-13 (providing statistics on INDECOPI's conflict resolution services).

29. *Id.* at 32-37 (reproducing public ranking published by INDECOPI for gasoline, banks, airlines, bus lines, and produce markets).

three components of a free market described above, then an adequately regulated private sector's ever-demanding competition for profit can work its magic. The comfortable inefficiency caused by industry-wide collusion with the government will be broken up by foreign or other new entrants' search for competitive advantage, and jealous competitors will help blow the whistle on any collusion that another firm uses to win an unfair advantage from the government.

III. MARKET-BASED ANTI-COLLUSION MECHANISMS IN DEVELOPMENT POLICY

The United Nations (U.N.) Millennium Declaration in 2000 called on developed countries to provide (1) "duty- and quote-free access for essentially all exports from the least developed countries," (2) "enhanced . . . debt relief for the heavily indebted poor countries . . . in return for their making demonstrable commitments to poverty reduction;" and (3) "more generous development assistance, especially to countries that are genuinely making an effort to apply their resources to poverty reduction."[30] The declaration also committed U.N. members to "special measures . . . [for] Africa, including debt cancellation, improved market access, enhanced Official Development Assistance and increased flows of Foreign Direct Investment . . . ."[31]

The Group of Eight (G8)—the United States, Japan, Germany, Great Britain, Canada, France, Italy, and Russia—promptly took up that agenda at their 2001 summit in Genoa, Italy, and subsequent summits.[32] By the time of the 2005 G8 summit at Gleneagles, in Scotland, those policy prescriptions from the Millennium Declaration had worked their way into public consciousness in the form of a popular refrain: *debt, aid, and trade.*[33] Below, we consider how market-based efforts to combat collusion would work in the context of each of these three pillars of Gleneagles-style development policy.

A. *International Trade*

Among debt (relief), (foreign) aid, and (international) trade, trade is the most important. Beginning in 2004, the Copenhagen Consensus, a Danish think-tank, has identified all major development priorities addressed by the U.N. and invited a panel of the world's leading economists to apply a rigorous cost-benefit analysis to answer the following question: "If we had an extra $75 billion to do good for the world over the coming four years, where could that money do the

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30. U.N. General Assembly Res. 55/2 (Sept. 18, 2000) at ¶ 15.

31. *Id.* at ¶ 28.

32. *E.g.*, G8 Communiqué, July 22, 2001 (Genoa, Italy) at ¶¶ 7, 10, 14.

33. *See, e.g.*, http://www.debtaidtrade.org (website of all-party caucus within House of Commons of the United Kingdom, which hosted 2005 G8 Summit at Gleneagles).

most good?"[34] Their analysis found that trade provides more bang for the buck than almost any other development priority.[35]

Fundamentally, foreign aid and debt relief are both transfer payments, generating an initial loss for the transferor and a gain for the transferee. If the transferred money is used well, then it creates ongoing gains for the transferee. This can also redound somewhat to the benefit of the transferor.

But trade is different-it requires no transfer payment. Negotiating trade liberalization costs little—negotiator salaries and plane tickets, versus the many billions in direct payments that foreign aid and debt relief cost donor countries. There are certainly individual winners and losers in both developed and developing economies, but the net economic effect is positive for all countries involved, since the resulting increase in trade creates major net economic gains, and since every country has comparative advantages. In other words, trade liberalization is a win-win proposition. Instead of developed countries paying a price to provide the benefits of trade liberalization to developing countries, developed countries receive a big benefit as well.

The World Bank estimates that developing countries alone would receive $86 billion in static gains if the Doha Development Round of trade negotiations is successful, lifting 65 million people out of poverty by 2015.[36] The total global gain is estimated at $287 billion. These gains result from comparative advantage and, more generally, the value-creating nature of trades: when two parties make a trade, they both end up with something that they value more than what they gave up in the trade. But the pixy dust that makes trade liberalization really magical is the dynamic improvement in economies' efficiency due to the increased competition that trade liberalization brings. With the inclusion of this dynamic effect, the World Bank estimates the total global gain of a successful Doha Round at $461 billion.[37]

Trade liberalization is the ultimate example of development policy that incorporates market-based anti-collusion mechanisms, because trade liberalization increases competition. In some circles, trade agreements are depicted as collusive plots by a global elite intent on undermining national sovereignty and ruling the world from the World Trade Organization's (WTO)'s Geneva headquarters. To the contrary, trade liberalization simply removes legal and regulatory detritus that accumulated during long periods of protectionist collusion at the national level. The role of the WTO, other supranational entities,

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34. SOLUTIONS FOR THE WORLD'S BIGGEST PROBLEMS: COSTS AND BENEFITS 6 (Bjorn Lomborg, ed., Cambridge University Press, 2007).

35. Copenhagen Consensus, http://www.copenhagenconsensus.com/Default.aspx?ID=158 (listing trade liberalization among the four "very good" projects, along with controlling HIV/AIDS, providing micronutrients, and control of malaria).

36. Kym Anderson, Will Martin, & Dominique von der Mensbrughe, *Global Impacts of the Doha Scenarios on Poverty*, World Bank Policy Working Paper No. 3735 (Oct. 2005) (noting that developing country gains increase to $142 billion if Korea, Taiwan, Hong Kong, and Singapore are added).

37. *Id.*

and international arbitration more generally, is not to force countries to institute certain policies, but rather to compensate those who would be harmed if countries reinstitute collusive policies that they have voluntarily committed not to reinstitute. In other words, rather than ratcheting up government to the international level, trade liberalization strips away government interference in free-market competition and, thereby, weakens collusion.[38] By shielding prudential and national security regulation, free trade agreements also encourage countries to provide the necessary regulatory support for a stable and well-functioning free market.

Trade liberalization encourages domestic businesses to become more efficient, as described previously. Protectionist rules allow businessmen to get rich through lunches at the country club with their "competitors" and local public officials. People tend to focus their efforts on whatever rewards them, so over time, businessmen in protectionist economies become good at country-clubbing—and not much else. But once faced with new entrants from abroad, businesses begin to get back into shape, which benefits customers and the broader economy.

However, pushing through trade liberalization over the traditional colluders' objections is the first trick, and requires a beachhead of competition. One step is to build and highlight support for a pro-trade coalition of new, competitive domestic businesses that resent the vested business interests' advantages. Another step is to engender a competitive popular spirit by showing that other countries are reaping the benefits of free trade and investment while your own country is losing out. Another critical step is to ensure genuine democratic, multi-party elections. Free elections and the right of voluntary association allow free-market parties to develop and to compete for votes by contrasting their ideas—freedom, competition, innovation, and industriousness—with socialist or otherwise protectionist alternatives.

On the back side, there is always danger that new international business entrants will simply "join the club" and begin colluding with local vested interests and public officials. But this is significantly less likely than is collusion prior to trade liberalization. First, newcomers from overseas have less incentive to share benefits with local, inefficient businesses that they believe they can beat outright through competition. Second, international entrants, as untrusted and untrusting outsiders from a different culture, do not initially have the ties to collude seamlessly. Third, public officials will often find it politically dangerous to collude with international business interests.

In *World on Fire*, Amy Chua argues that raw democracy and raw capitalism are combustible, since ethnic minorities often achieve disproportionate economic success, setting up a clash with a less economically accomplished ethnic

38. *See* Simeon Djankov, Rafael La Porta, Florenzio Lopez, & Andrei Schleifer, *The Regulation of Entry*, 117 Q. J. ECON. 1 (2002) (concluding that corruption is greater in economies that impede new entrants through protectionism or bureaucratic red tape).

majority. This effect may result in populists like Zimbabwe's Mugabe maintaining power by scapegoating white farmers or in the widespread riots that broke out against Chinese merchants in Indonesia once Suharto's authoritarian grasp began to slip in 1998 during the Asian financial crisis.[39] But Chua's examples lie at the extremes. Alternatively, the interplay between capitalism and democracy may encourage savvy public officials to resist state capture by international business interests—lest the government on which they rely for a job be voted out of office. In short, democratic competition can encourage economic competition once trade liberalization occurs. Collusion will not disappear, but it can be reduced.

The General Agreement on Trade in Services (GATS), which is enforced by the WTO, recognizes international investment as one of the four modes of international trade.[40] The U.N. Millennium Declaration explicitly mentions "increased flows of Foreign Direct Investment" (FDI) as one of the "special measures" developed countries should pursue to help Africa, along with debt, aid, and other forms of trade. The preceding discussion of trade applies to international investment, as well.[41] But one major vehicle for promoting FDI—privatization and concession contracts—is worth considering more closely, given allegations that have earned privatization the moniker "briberization" in some countries.[42]

Corruption within privatizations is flanked by, and must be analyzed together with, corruption both before and after privatizations. Prior to privatization, corruption plagues the day-to-day operations of state-owned enterprises, undermining their productivity. After privatization, corruption takes the form of state capture. The government agency created to regulate the newly private business may, instead, begin colluding with that business. Corruption during the privatization process can take many forms, including setting artificially low prices for state assets, in return for kickbacks. For example, in 1994 Banco Occidental de Descuento (then a small regional bank in Venezuela) was privatized. Only a few weeks later, the new owner sold a minority stake that valued the company at almost eight times the privatization price.[43] Corruption

39. AMY CHUA, WORLD ON FIRE: HOW EXPORTING FREE MARKET DEMOCRACY BREEDS ETHNIC HATRED AND GLOBAL INSTABILITY 16-17 (Anchor Books 2003).

40. General Agreement in Trade in Services, Art. I, §2(c), at http://www.wto.org/english/docs_e/legal_e/26-gats.pdf (defining "trade in services" to include "the supply of a service . . . by a service supplier of one Member, through commercial presence in the territory of any other Member"), *available at* http://www.wto.org/english/docs_e/legal_e/26-gats.pdf.

41. W. L. Meggison & J. M. Netter, *From State to Market: a Survey of Empirical Studies on Privati-zation* 39 J. ECON. LIT. 321 (2001) (concluding that privatizations generally produced positive economic effects).

42. JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 58 (Penguin Press 2002).

43. Luigi Manzetti & Charles Blake, *Market Reform and Corruption in Latin America*, 3 REV. INT'L POL. ECON. 662, 681-82 (1996) (citing prices per share of 320 and 2500 bolívars); *also* SUSAN ROSE-ACKERMAN, CORRUPTION AND GOVERNMENT: CASES, CONSEQUENCES AND REFORM (Press Syndicate Univ. of Cambridge 1999) (noting the subjectivity of business valuation, which gives public officials opportunities for kickbacks in return for setting low prices).

may also result in the state granting the winning bidder an unnecessarily long monopoly right. Thereby, privatizations meant to increase competition may instead result in greater market concentration.[44]

It should come as no surprise that privatizations are often the occasion for corruption. After all, they are massive transactions negotiated and implemented by the same governments whose corrupt ongoing management of state assets is one of the principal arguments for privatizations. But in *The Duchess of Malfi*, Antonio declares, "[B]etter fall once, than be ever falling."[45] In that sense, privatizations are an opportunity to fall once. Falling once, in the right circumstances, offers a tactical advantage over the ongoing corruption occasioned by state ownership of potentially productive assets. By concentrating the opportunity for corruption into one big transaction, even countries with a weak system of accountability should be able to assemble temporary vigilance. For example, the size of the transaction justifies the cost of hiring independent valuation consultants apart from the main investment bank A privatization is also far more newsworthy than the day-to-day operation of a state-owned enterprise, so it is easier to recruit journalistic vigilance. A respected international organization like Transparency International can also be recruited to monitor the deal. Every privatization and concession is different, but international organizations should also provide model contracts and identify procedural best practices to which countries should be encouraged to ascribe before beginning the process.[46] No fall is pleasant, but proper preparation makes it possible to guard against as much corruption as possible.

Post-privatization, the temptation toward state capture could be viewed as a continuation of the drip-by-drip corruption problem faced by the enterprise before privatization. But it is not. As previously discussed, regulators will find it politically dangerous to collude with an international business that has won a high-profile privatization contract. In addition, one of the reasons that it is important to grant monopoly rights for as short a transition period as possible (if at all) is because domestic competitors will raise a public stink if an a big multinational gets special breaks. Even if regulators and all players in the sector manage to collude, potential new entrants—including multinationals that have won similar privatizations in neighboring countries—still exert competitive pressures and make too much collusion economically dangerous.

44. LUIGI MANZETTI, PRIVATIZATION SOUTH AMERICAN STYLE (Oxford Univ. Press 1999) (arguing that many South American privatizations resulted in increased market concentration, not less, due to this effect).

45. JOHN WEBSTER, THE DUCHESS OF MALFI, Act V, Scene I (1623) (quoting Antonio, speaking with Delio).

46. *See* COLLIER, *infra* note 54, at 140-46, 153-156, 183 (proposing voluntary international charters on investment and on natural resource extraction contracts).

B. Foreign Aid

Much foreign aid is less concerned with development than with geopolitics and other donor country goals.[47] For example, the United States gives over $2 billion annually in foreign aid to Israel, which had GDP per capita of $26,800 in 2006.[48] In addition, the United States' largest foreign aid program in Latin America—Plan Colombia—funds not only development projects, but also significant coca eradication and anti-narcotraffic measures.[49] As defined by the Organization for Economic Cooperation and Development (OECD), official development assistance (ODA) is only that portion of foreign aid paid by developed countries' governments to poor countries for the purpose of development. ODA is most commonly what "debt, aid and trade" boosters mean when they invoke the second pillar of their mantra.[50]

> ... At Gleneagles, G8 countries agreed to increase ODA to Africa by over 100 percent between 2004 and 2010—an increase of $25 billion.[51] The European members in particular agreed to increase their ODA budgets to seven tenths of one percent of their gross domestic product (GDP) by 2015, following through on a pledge they made previously at the 1992 Earth Summit in Rio de Janeiro. The United States refused to link its ODA level to its GDP. The 0.7 percent benchmark—and countries' failure to reach it—goes all the way back to a U.N. resolution in 1970, which required members to exert their "best efforts" to reach that level of aid.[52]

One reason this long-term goal has yet to be reached may be that several demoralizing studies have shown ODA fails to improve recipient countries'

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47. *See* U.S. State Department, Congressional Budget Justification: Foreign Operations, Fiscal Year 2008, *available at* http://www.usaid.gov/policy/budget/cbj2008/fy2008cbj_full.pdf (Feb. 14, 2007), at 1, 3, and 12-14 (showing distribution of State Department's $20.3 billion FY 2008 foreign assistance request among low-, middle-, and upper-income countries and among peace/security, governance, investing in people, economic growth, and humanitarian assistance).

48. *Id*, at 492 (listing FY 2006 foreign aid to Israel of $2.5 billion and FY 2008 request of $2.4 billion) ; *also* Central Intelligence Agency, *The World Factbook* (2006) (listing Israel's GDP per capita).

49. U.S. STATE DEPARTMENT, FACT SHEET ON PLAN COLOMBIA, *available at* http://www.state.gov/p/wha/rls/fs/2001/1042.htm (March 14, 2001) (listing first-year appropriations of $129.4 million for increased interdiction, $122 million for human rights and judicial reform, $390.5 million for military aid against Colombian rebels, $81 million for alternative economic development, and $115.6 million for the Colombian police).

50. *E.g.*, http://www.netaid.org/global_poverty/aid-debt-trade/ (describing components of Mercy Corps' NetAid program).

51. Group of Eight, *Gleneagles Communiqué* ¶27-28 (2005).

52. U.N. General Assembly Res. No. 2626, ¶43 (Oct. 24, 1970) ("Each economically advanced country will... exert its best efforts to reach a minimum net amount [of ODA] of 0.7 percent of its gross national product by the middle of the Decade").

development.[53] In *The Bottom Billion*, Paul Collier, former director of research at the World Bank, argues that poverty is rapidly decreasing in most countries, but that the 50 poorest countries—home to "the bottom billion"—are so poorly run that the significant ODA they receive is often ineffective, misused, or stolen.[54] Other studies suggest that ODA encourages growth of the public sector vis-à-vis the private sector, thereby decreasing economic freedom and growth,[55] and that donor countries tend to cut back their aid when countries allow greater economic freedom.[56] In other words, aid tends to go to countries with autocratic rulers well-situated to steal it, and donor countries give them an extra incentive not to liberalize—nor to stop stealing. In the worst case, ODA is nothing more than a new stream of funds to be divvied up through collusion.

Notwithstanding this research, some studies suggest that ODA can be beneficial—but only if it is properly structured.[57] In particular, the aid allocation process should be structured to maximize competition and should target market-based reforms that improve governance. Several foreign aid trends are promising in this regard. One is the Millennium Challenge Corporation (MCC). In March 2002, President Bush joined other world leaders in agreeing to the so-called Monterrey Consensus at the U.N. Conference on Financing for Development. Consistent with that global consensus, President Bush announced that the United States would increase its ODA by $5 billion, distributed not through the U.S. Agency for International Development (USAID) but rather through a new entity, using a new approach.[58] In 2004, MCC was established to implement that new approach, which is based on the principle that "aid is most effective when it reinforces good governance, economic freedom and investments in people."[59] From those three broad categories, MCC has identified 17 indicators of commitment to development, on which a country's policies must receive a passing grade to be eligible for an aid compact from MCC.[60]

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53. *E.g.*, William Easterly, Ross Levine & David Roodman, *"New Data, New Doubts: A Comment on Burnside and Dollar's 'Aid, Policies, and Growth'*," National Bureau of Economic Research Working Paper No. 9846 (Cambridge 2003) (finding that aid generally fails to contribute to development even in countries with good policies).

54. PAUL COLLIER, THE BOTTOM BILLION: WHY THE POOREST COUNTRIES ARE FAILING AND WHAT CAN BE DONE ABOUT IT (Oxford University Press 2007).

55. *E.g.*, P.T. BAUER, THE DEVELOPMENT FRONTIER (Harvard University Press 1991).

56. Benjamin Powell & Matt Ryan, "Development Aid and Economic Freedom: Are They Related?" Independent Institute Working Paper No. 60 (May 9, 2005), *available at* http://www.independent.org/pdf/working_ papers/60_aid.pdf

57. *E.g.*, Craig Burnside & David Dollar, "Aid, Policies, and Growth: Revisiting the Evidence," *World Bank Policy Research*, Working Paper No. 3251 (Mar. 1, 2004), *available at* http://ideas.repec.org/p/wbk/wbrwps/3251.html (providing evidence that ODA's development impact depends on quality and relative corruption of public institutions and policy) *but see* Easterly et al, *supra* note 53 (providing evidence that contradicts the Burnside and Dollar article from 2000, which reached same finding as their 2004 article).

58. White House Fact Sheet on the Millennium Challenge Account, (Mar. 14, 2002), *available at* http://www.whitehouse.gov/infocus/developingnations/millennium.html.

59. Millennium Challenge Corporation, http://www.mcc.gov/about/index.php.

60. *Id.* at tp://www.mcc.gov/selection/ indicators/index.php.

Nearly four years later, MCC is now widely criticized for having dispensed only a small portion of its available funds, and Congress is likely to appropriate far less than the $3 billion President Bush requested for MCC in the 2008 budget.[61] This criticism reflects the failed mindset of traditional foreign aid, both nationally and at the international financial institutions. Aid officers' effectiveness should not be judged principally by how much money they can dispense, and how quickly. It is appropriate, not only in this initial phase, but indefinitely, for MCC to delay project funding until recipient countries have satisfied project prerequisites. Given the serious doubts about ODA's effectiveness in countries without proper policies in place, most of the aid game should be in creating incentives for better policy. One (but not the only) incentive should be withholding aid until potential recipients can show that they have laid adequate groundwork. So long as MCC continues to have significant available funds, it functions as a market-based incentive for policy reform even among countries that are not yet receiving aid. This effect can be seen in any contest: all competitors, not just the winner, improve their performance. Competition for ODA by and among developing countries can be a powerful development tool, if the indicators on which countries compete indeed correlate with development.

The incentive of MCC funding appears to be working; countries seeking aid compacts from MCC have improved 25 percent more than other countries on the 17 measures that determine MCC eligibility.[62] MCC provides Threshold Program Assistance grants to speed the reforms of countries that have reached the cusp of eligibility.[63] Unlike traditional aid,[64] however, countries have an incentive to ensure that these grants produce results. Otherwise, they fail to reach eligibility and thereby lose access to far greater funds.

In addition to generating its own accomplishments, MCC serves as a competitor for USAID, thereby encouraging improvements in that agency's more traditional methodology. MCC accounts for about ten percent of total U.S. foreign aid.[65] The broader State Department, Treasury Department, Commerce Department, U.S. Trade Representative, and other U.S. Government agencies also play a role in dispensing ODA. The role of the Defense Department, in particular, has increased significantly in the last few years due to reconstruction

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61. *See* Celia W. Dugger, *U.S. Agency's Slow Pace Endanger's Foreign Aid*, N.Y. TIMES, Dec. 7, 2007, at A14, *available at* http://www.nytimes.com/2007/12/07/world/africa/07millennium.html (citing Center for Global Development expert who believes it is justifiable that MCC has spent only $155 million of $4.8 billion approved for projects, since recipient countries need long time to accomplish prerequisites for project initiation); *compare with* Millennium Challenge Corporation, "Statement on FY 2008 Budget Request," (Feb. 5, 2007) (justifying FY 2008 $3 billion budget request).

62. Doug Johnson & Tristan Zajonc, *Can Foreign Aid Create an Incentive for Good Governance?—Evidence from the Millenium Challenge Corporation,* (April 11, 2006), *available at* http://papers.ssrn. com/sol3/papers.cfm?abstract_id=896293.

63. MILLENNIUM CHALLENGE CORPORATION, REPORT ON MCC THRESHOLD PROGRAM (2007), *available at* http://www.mcc.gov/about/reports/other/mcc_032706_threshold_report.pdf

64. *See* Powell & Ryan, *supra* note 56 (finding that ODA tends to fall as economic freedom increases).

65. Dugger, *supra* note 61.

efforts in Iraq and Afghanistan and the development-oriented mission of the armed services' Africa Command, which was established in 2007.[66]

In 2004, a few months before MCC began, Congress created the U.S. Commission on Helping to Enhance the Livelihood of People (the HELP Commission), to recommend reforms to the current structure of U.S. ODA.[67] Some members of the Commission considered recommending that all ODA responsibilities be consolidated into a "Super-State Department," but the Commission settled for less sweeping recommendations, including a reduction in the number of agencies responsible for development, as well as strengthening of USAID "in areas where [Department of Defense] has taken on their traditional development responsibilities in recent years so that [Department of Defense] can remain focused on its core functions."[68]

The HELP Commission makes a strong case that the current U.S. foreign aid system is ineffective and requires more intentional design, after over four decades of piecemeal changes and incidental evolution since passage of the Foreign Assistance Act of 1961. However, the Commission underestimates both the value of managed, intra-governmental competition and the danger of consolidating too much responsibility for ODA. The State/USAID culture has strengths and weaknesses, and only some of those weaknesses might be cured through greater authority and economies of scale.

Rather, the weaknesses of the traditional foreign aid model can be minimized by more carefully apportioning ODA responsibilities among several agencies that have different sets of strengths and weaknesses. One agency may minimize corruption through rigid DC-centric rules, as USAID does, with "encouragement" from Congressional mandates.[69] Another may increase productivity through greater decentralization and untied grants, but at the cost of more corruption. Yet another, like MCC, may set high governance standards for aid recipients, thereby encouraging competitive improvements, but also limiting the total aid dispensed. By supporting several aid agencies, the nation may generate a greater net development after corruption than any one agency can generate on its own. This structure is analogous to a well-managed investment portfolio, in which risk is diversified by combining numerous stocks with low correlations.

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66. *See* U.S. Africa Command, http://www.africom.mil/AboutAFRICOM.asp (last visited Jan. 16, 2008); *see also* http://www.africom.mil/africomFAQs.asp ("Designers of U.S. Africa Command clearly understand the relationships between security, development, diplomacy and prosperity in Africa"); *see also* http://www.africom.mil/africomFAQs.asp.

67. HELP Commission Act, 22 U.S.C. §2394b (July 23, 2004).

68. HELP Commission, *Recommendations for Legislative Action*, Recommendations 2.2-2 & 6.1-1, *available at* http://www.helpcommission.gov/portals/0/recommendations_final.pdf.

69. *See e.g.*, Editorial, *Food for the World*, WASH. POST, Apr. 26, 2007, at A8 (arguing that some Congressional mandates on contracting diminish USAID effectiveness); *compare with* Randall Wood, Program Officer, Millennium Challenge Corporation, *Incentives and Capacity at the Millennium Challenge Corporation*, *available at* http://www.therandymon.com/papers/incentives-capacity.pdf ("MCA was designed to be free from the constraints of contradictory, and sometimes self-defeating, Congressional earmarks that have historically reduced or crippled other organizations' ability to react efficiently").

High-level coordination, through the Deputy National Security Advisor for International Economics rather than the State Department, which is too closely tied to the traditional model and to geopolitical concerns, would help ensure that competition is constructive and structural, rather than behavioral. As in the investment arena, agencies' share of funding should be re-weighted periodically based on medium-term net development results—but not so often that agencies are unable to do medium-term planning.

Even this market-based structure for ODA would not come close to the level of organic complexity that the private and non-profit sectors bring to development assistance. U.S. public charities hold over $1 trillion in assets, and approximately 50,000 private foundations in the United States hold another $500 billion.[70] Both are expected to expand logarithmically as the wealthy baby boomer generation hits prime age for charitable giving. A large portion of this private giving is for domestic causes, but private money certainly plays a major role in the financing of international development. The largest U.S. private foundation alone—the Gates Foundation, with nearly $40 billion and a claim on over $100 billion more[71]—focuses on development issues, especially global health, and has the heft to walk shoulder-to-shoulder, or go toe-to-toe, with U.S. government programs.[72]

Thus, private philanthropy has the scale to put "best practices" competitive pressure on U.S. ODA programs,[73] as well as allowing government officials to choose among a wide array of approaches by a wide array of charities through which government can channel ODA. The proliferation of private actors would generally increase competition and reduce corruption, but private foundations are often insulated from competitive forces because they operate under their endowments, and state attorneys general are unable to provide more than cursory ex-ante supervision. Thus, it is especially promising that a new generation of business-minded philanthropists is insisting on rigorous results-based project

70. *See* U.S. Internal Revenue Service, *Form 990 Returns of 501(c)(3) Organizations: Balance Sheet and Income Statement Items, by Asset Size* (2004) *available at* http://www.irs.gov/pub/irs-soi/04eo01as.xls (providing most recent asset data reported by IRS for public charities: $1.2 billion); Thomas J. Tierney, *Higher-Impact Philanthropy: Applying Business Principles to Philanthropic Strategies*, PHILANTHROPY, (Feb. 14, 2007), http://www.philanthropyroundtable.org/article.asp?article=1453&cat=147 (quantifying private foundation assets).

71. Bill & Melinda Gates Foundation, *Foundation Fact Sheet*, *available at* http://www.Gates foundation.org/MediaCenter/FactSheet/default.htm (listing endowment of $37.6 billion as of Sept. 30, 2007); Matthew Miller, *The Forbes 400*, FORBES (Sept. 20, 2007), http://www.forbes.com/2007/09/19/richest-americans-forbes-lists-richlist07-cx_mm_0920rich_land.html (listing net worth of Bill Gates and Warren Buffet at $59 billion and $52 billion, respectively).

72. *Compare* U.S. State Department, *supra* note 47 (listing $20.3 billion FY 2008 budget request for foreign assistance, including $3 billion for MCC) *with* I.R.C. §4942 (requiring private foundations to make annual minimum distributions of five percent of assets, i.e., $2 billion annually, given Gates Foundation's current asset size).

73. *Cf.* Tierney, *supra* note 70 (citing 2002 self-evaluation by $500 million Annenberg Challenge, which found mixed results, given financial mismatch between Annenberg budget and $11.4 billion New York City school system it sought to reform).

management, through their own private foundations or by actively earmarking contributions to public charities.[74] Otherwise, government anti-corruption efforts will only succeed in shifting more corruption to the non-profit sector, which can collude with government funders or aid recipients. (Both private foundations and public charities are tax-exempt organizations and owe to taxpayers a duty of faithfulness to their charitable purpose, and not personal enrichment.) Independent public charities are more responsive to competitive pressures than are captive charities established and funded by one private foundation, because they must compete for private and/or public monies.

Ironically, one of the most cutting-edge models for market competition in the private and non-profit sectors is a new form of cooperation, which is changing the way business and, increasingly, government are done.[75] Social production, also known as peer production, uses virtual networks to bring together hundreds, thousands, or even millions, of people with similar interests, for the purpose of creating a shared information product. The magic of this popular collaboration is that, even though it sacrifices the quality control that a closed, expert-led process could provide, it can exceed expert-level quality and output because of the sheer number of participants, who are surprisingly reliable in the aggregate. The user-edited encyclopedia *Wikipedia.com*, may be one of the most famous examples, but social production can just as easily be used to solve development problems through mass collaboration, as the Development Gateway Foundation is already demonstrating.[76] Foreign aid should promote social production in the developing world, since one of the keys to growth is tapping new sources of productivity gains.

At first glance, however, social production's wild decentralization and lack of formalized quality control suggests greater opportunity for corruption and abuse. Indeed, intellectual property laws must respect the shared nature of the product (unless a sponsor discloses to participants that product ownership will be restricted). But corruption is less likely than it may seem. Collusion is difficult because a network's expansion is uncontrolled, which allows new entrants to shift activity away from any purposes that have been skewed by illicit collusion. There is an inverse relationship between the number of participants in a plot and the probability of detection, so participants also cannot co-opt new entrants without quickly exceeding the optimum number. Furthermore, because social

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74. John A. Byrne, *The New Face of Philanthropy*, BUSINESSWEEK, Dec. 2, 2002, at 5.

75. *See generally* YOCHAI BENKLER, THE WEALTH OF NETWORKS: HOW SOCIAL PRODUCTION TRANSFORMS MARKETS AND FREEDOM (Yale University Press 2006) (describing numerous examples of social production, including technical mapping work "outsourced" by NASA through open social network); *see also* DON TAPSCOTT & ANTHONY D. WILLIAMS, WIKINOMICS: HOW MASS COLLABORATION CHANGES EVERYTHING 9 (Penguin 2006) (describing cash-prize internet competition to help gold mining company locate gold reserves).

76. Development Gateway, http://topics.developmentgateway.org/ (describing *DG Communities* as "knowledge sharing and collaboration . . .for professionals working to . . . promote sustainable development worldwide").

production elevates the value of a shared network, reputation within that network becomes the undisputed coin of the new realm. Ever-improved mechanisms to calibrate reputation within social networks are indispensable. Even the elementary buyer and seller ratings on *Ebay.com* influence transactions, for example. Low-quality contributors quickly lose their ability to attract network relationships, which are also important for traditional projects in the relevant sector, not just whatever shared product the network is producing. In short, foreign aid can enthusiastically promote social production in developing countries without too much concern about whether it will increase corruption or, for that matter, terrorist plots and other invidious collusion.

Thus far, we have primarily discussed foreign aid structure and methodology, but project prioritization is equally important. The Copenhagen Consensus' analysis of the bang for the buck generated by potential development projects puts HIV/AIDS and malaria at the top of the list, along with a few other health-related projects and trade liberalization.[77] HIV/AIDS prevention and treatment are so critical to the productive capacity of Africa that DATA, the organization co-founded by Bono to promote debt, aid, and trade in Africa now notes that the first "A" in its name stands for AIDS, not aid in general.[78] But another top priority for foreign aid should be trade capacity building. This is a corollary to the previous section's argument that trade liberalization is essential to corruption-minimized development.

A corollary to the arguments above in favor of MCC is that traditional foreign aid should also give significant priority to governance reforms. One of the weaknesses of the Washington policy community is that every interest group tends to argue as if its priority could be pursued without sacrificing other priorities. In that tradition, a paper focusing on corruption would be expected to argue in favor of targeting foreign aid to governance reforms. But this is the correct answer even if our only concern is development, not corruption and governance per se. As discussed above, research and practical experience suggest that foreign aid is ineffective without good governance.[79] Collier's *The Bottom Billion* accepts this reality while constructively making the case for a narrow foreign aid agenda in the poorest countries, with governance reform front and center.[80] Notwithstanding many important priorities, ODA should focus first on building the good governance and free market structures that are necessary to channel subsequent ODA into satisfactory development results. Within narrow parameters, this ODA is essential to development, since the poorest countries are in such bad shape that even higher-than-average growth rates are failing to generate improvements in human welfare.[81]

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77. Copenhagen Consensus, *supra* note 35.
78. Debt AIDS Trade Africa (DATA), http://www.data.org.
79. *See supra* notes 53-56 and accompanying text.
80. *See* COLLIER, *supra* note 54, at 99-123 and 175-192.
81. *Id.* at 8-9.

An appropriately narrow agenda for ODA should include trade capacity building, competition policy, free and fair elections, public budget transparency, and other mechanisms to ensure public access to relevant, reliable, and timely information. Because many of the world's poorest countries have abundant natural resources, transparency is particularly important in setting and accounting for royalties. Collier argues convincingly for auctions to minimize the opportunity for corruption.[82]

Benchmarks are another important tool, which foreign aid should support. Ciudadanos al Día (CAD), a praxis-oriented think tank in Peru that focuses on good governance and citizenship empowerment,[83] was founded by Beatriz Boza after she left her post as President of INDECOPI before the end of Fujimori's tenure, only to see the institution's stellar reputation quickly subverted by corruption. In *The Other Path*,[84] Hernando de Soto highlighted the mind-numbing red tape of Peruvian local government, which is inextricably entwined with corruption. CAD follows up on that research by measuring the speed, cost, and transparency of business licensing in municipalities throughout Peru and in all the districts of Lima.[85] This benchmarking has created a basis for competition among local governments—and a basis for citizens' electoral punishment of public officials whose corruption-laden performance lags.

But benchmarking is just the first of four steps; the second is to create rewards for those who perform well against the benchmarks. CAD awards annual prizes for good governance in numerous categories, at the national, regional, and local levels of government.[86] Even those applicants who do not win still improve their performance and, in the process of preparing an application, develop a deeper understanding of their own efforts. As a result, they become better able to articulate their plans and principles to others, particularly within their organizations.

The third step is to offer training in good governance to capitalize on the demand benchmarks and prizes create. CAD publishes numerous manuals, including a review of the governance "best practices" created by annual prize winners. It also organizes in-depth courses throughout Peru for local government officials, as well as numerous seminars and an annual conference on good governance.[87]

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82. *Id.* at 38-52, 135-156, 180.

83. Ciudadanos al Día, http://www.ciudadanosaldia.org (full disclosure: the author was previously employed Beatriz Boza, both during her tenure in the Peruvian government and at CAD).

84. HERNANDO DE SOTO, THE OTHER PATH (Harper & Row 1989), first published in Spanish as EL OTRO SENDERO: LA REVOLUCIÓN INFORMAL (Editorial Barranco 1986).

85. Ciudadanos al Día, Reports Nos. 12 and 28, *available at* http://www.ciudadanosaldia.org/informes/default.htm (listing many additional CAD reports, measuring other performance indicators for both local and national government).

86. *Id.* at http://www.ciudadanosaldia.org/premiobpg/ (listing rules for 2008 prize, as well as past prize winners).

87. *Id.* at http://www.ciudadanosaldia.org/congresobpg/07/ (describing the annual Congress on Good

The fourth step is to create a network for the new class of good governance practitioners that the first three steps will identify, encourage, and train. The Peruvian judiciary and most of Peru's traditional ministries were never well-developed and respected institutions, but Fujimori's corruption undermined them further. In contrast, Fujimori allowed INDECOPI, FONCODES, and several other agencies to operate as largely independent "islands of excellence" during most of his administration. In the end, he undermined even these pillars when his difficult bid for reelection in 2000 required all the instruments of governance. But from 1990 to 1998, a new class of modern, effective leaders blossomed in these agencies—a class that now increasingly holds important posts throughout the Peruvian government and represents the country's promising future. In short, the only way to truly institutionalize good governance is to invest in people—individuals whose career prospects are based on their branding as good governance practitioners. Collier argues that one of foreign aid's principal aims should be to empower these local reformers.[88] CAD's programs are doing exactly that, adding to Peru's critical mass of good governance practitioners, including the many former INDECOPI officials who served under CAD's president when she headed INDECOPI.

The hard, long-term process of building a network for people who represent a good governance "brand" cannot be replaced by the purely short-term strategy of centralizing power in a white knight, as the Palestinian Authority has done in choosing Dr. Salam Fayyad as finance minister and now prime minister.[89] Institutionalization has a human face—but it is the face of a group, holding power diffused across numerous institutions and positions. No matter how authentic and unshakeable one individual's branding for honesty, the right person can easily be removed in an instant—at which point excessive centralization becomes a problem, rather than the solution.

The Peruvian case demonstrates one additional tool that is essential in forming a market for good governance, and which foreign aid should support: a free press. The debate over Fujimori's legacy is largely over whether his corruption or his governing effectiveness ultimately predominated.[90] But those two sides of Fujimori are fused: his administration's effectiveness extended to the art of corruption. As it became clear that Fujimori might not win the 2000 elections, Montesinos bribed far and wide. He claims to have 30,000 videos of his collusive pacts, and he kept meticulous record of every transaction, even

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Governance in Lima) and http://www.ciudadanosaldia.org/tallerescad/2007/default.htm (identifying cities throughout Peru to which CAD's workshop "roadshow" traveled).

88. COLLIER, *supra* note 54, at 175-192.

89. Barak Ravid, *Everyone's Favorite Palestinian*, HAARETZ (Apr. 1, 2007) (describing Fayyad's selection as prime minister and noting his well-deserved reputation as effective crusader against corruption).

90. *E.g.*, Simeon Djankov, Edward Glaeser, Rafael La Porta, Florencio Lopez de Silanes, & Andrei Shleifer, *The New Comparative Economics*, 31 J. COMP. ECON. 595, 614 (Dec. 2003) (arguing that results Fujimori accomplished required stability purchased through corruption and outweighed his corruption).

requiring many bribe recipients to sign receipts and contracts.[91] Montesinos' meticulous, effective corruption gives us insight into how best to buy—or avoid someone's buying—control of the levers of democratic power. Montesinos' records show bribes to local and national politicians, cabinet ministers, voters, judges, businessmen—but most of all, to the press.

Bribes of $10,000 to $35,000 per person, per month were sufficient to buy the cooperation of the majority of Peru's five-judge Supreme Court. For between $5000 and $20,000 per person, per month, enough opposition legislators switched parties to give Fujimori's Change 90/New Majority coalition a majority. But it was for news media that Montesinos dug deep; television stations were bought off for $500,000 to $1.5 million per month, and just one of many cheap tabloids received over $1.5 million in total.[92] In short, the most effective bulwark against—or instrument of—corruption is the press, because the press informs voters' decisions in the political marketplace. Thus, if we must minimize corruption in order for ODA to be effective, some portion of ODA must support free press, whether traditional or electronic. Otherwise, the first dollar of ODA is just an incentive to silence the press, so that it becomes easier to steal the second dollar of ODA, not to mention countless other acts of corruption.

In sum, foreign aid may be largely ineffective unless it is carefully structured and targeted. In particular, we must structure the aid allocation process to maximize competition. We must direct funds toward the creation of free markets, including a market for good governance, which in turn undergirds a free market for goods and services. Within these parameters, there is ample room for foreign aid. Yet a market-based approach to aid must not be afraid to cut off project funds in response to poor performance, no matter how perfect the project may be in theory. This may seem to add insult to the bottom billion's injury, but it is not so much insult as incentive.

C. Debt Relief

At Gleneagles, G-8 countries agreed to the Multilateral Debt Relief Initiative (MDRI), which is designed to cancel all debts owed to the World Bank's International Development Association, the IMF, and the African Development Fund by the world's most unsustainably indebted countries. The MDRI complements the Highly Indebted Poor Countries Initiative (HIPC), which was established by the World Bank and the IMF in 1996 and enhanced in 1999, with the encouragement of the Jubilee 2000 movement. Between the two programs, 40 countries—most of them Sub-Saharan African—are eligible for significant debt relief, explicitly for the purpose of poverty reduction and development. The net present value of this debt relief, as of 2005 when MDRI was announced, was $63

91. McMillan & Zoido, *supra* note 21, at 6-8, 14-15.

92. *Id.*

billion. Like grant-based foreign aid, this debt relief provides a major new revenue stream available for development—and for corruption.

Debt relief puts money back into the hands of the same governments—sometimes even the same officials—that wracked up the unsustainable debts now being forgiven. To discourage corrupt transfer of funds to non-development purposes, HIPC requires each recipient country to prepare and demonstrate compliance with a Poverty Reduction Strategy Paper (PRSP), prepared by the government in cooperation with civil society. The PRSP is the debt relief equivalent of a foreign aid program: a centralized plan for employing a new stream of funds at least officially destined for development. Thus, the discussion in the previous section about market-based anti-collusion efforts in the foreign aid context applies with equal force in the debt relief context.

But debt relief initiatives should also embrace a unique opportunity to fight corruption. They should require production of reliable information on how the debt crisis occurred, which will help create more of a market for good governance. On the day the World Bank announced that Uganda had qualified for HIPC debt relief, Uganda bought a $35 million Gulfstream jet for its President—on credit. The loan was encouraged by a guarantee provided by the U.S. government's Export-Import Bank. The World Bank delayed Uganda's debt relief for a few months, but even HIPC's requirement of a PRSP was unable to stop this potent symbol of collusive cycles unbroken. Over a quarter of the countries that have qualified for HIPC hold only sham elections, if that, and only a third audit their own budgets.[93] In short, there is insufficient information about collusion, and, even additional information will not immediately resolve the problem, since many countries' leaders go to great lengths to ensure voters cannot easily hold them accountable.

More information and accountability is needed even in democratic countries with stronger economies. During Alan Garcia's first tenure as President of Peru, from 1985 to 1990, Peru's foreign debt ballooned, Garcia's attempt to cap debt payments unleashed economic disaster, and corruption was so rampant that Garcia spent the 1990s in self-imposed European exile. Even now, Lima sports miles of tracks to nowhere, from an internationally financed elevated train system that somehow ran out of funds and was never completed. Yet Garcia is now President again, elected in 2006. So far, he appears to be pursuing responsible debt policy, so voters' forgiveness, or failure to learn from Garcia's corrupt first term, may turn out to be a good gamble. It is not so much that Peruvians learned nothing from the debt crisis, but that some of the lessons they learned may cause problems again in the future. Peru did not qualify for debt relief under HIPC. Yet soon after news of HIPC reached Latin America, villagers in Ollantaytambo, an

93. M.A. Thomas, *Getting Debt Relief Right*, FOREIGN AFFAIRS (Sept./Oct. 2001).

ancient Inca town between Cuzco and Machu Picchu, discussed taking out a loan because "they have to forgive us the debt because we are poor."[94]

Truth commissions should be required under all PRSPs. South African apartheid, Pinochet's oppression of political opponents in Chile, and the civil war fought between the Shining Path and Peru's military all left deep societal scars, nagging questions, and recriminations. In all three cases, blue-ribbon commissions led comprehensive, transparent, and newsworthy investigations that inculcated in the public psyche a reliable understanding of what happened and who was to blame. As a result, the public is now better equipped to spot any trend toward the bad old days. The Third World debt crisis involved a lot of parties acting badly: corrupt politicians and private contractors, aggressive commercial banks and developed countries too willing to bail them out, conflict-ridden international financial institutions and export credit banks, bad economic theorists, and who-knows-who-else. The collusion within and among these groups should have been meticulously chronicled in country-specific detail by truth commissions in every HIPC country. In a cauldron that hot, a true market for economic accountability might just have risen to the surface. We appear to have lost that opportunity for now, since the urgency created by the debt crisis has dissipated. We may have a future opportunity, however—thanks to our failure the last time.

IV. CONCLUSION

Collusion is the most costly aspect of corruption because it undermines competition, which is the lifeblood of economic growth and development. Collusion is infectious, so a collaborative approach is bound to fail. On the flip side, too heavy a hand will chill the countless transactions and interactions that generate economic growth. Rather, we must use market-based incentives to fight corruption, seeking to engender en environment of such demanding competition that anyone who engages in collusion will not survive the ever-greater demands for efficiency—or will be tattled on by jealous competitors. International competition is particularly helpful in this regard. Trade and investment liberalization, which clears the way for international competition, is the most important of the three pillars of Gleneagles-style development policy. The other two—foreign aid and debt relief—are not, by their nature competition-inducing. They can be structured, however, to build competition, market-based incentives, and a more informed market for good policymaking.

94. Kwang Wook Kim & J. Welby Leaman, *The Debt of Nations: Rethinking Jubilee 2000*, REGENERATION QUARTERLY (Spring 2000).