
The role and size of the state and incentives for corruption in the context of globalization

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"Only limited government can be decent government"
Friedrich A. Hayek**

I. - STATING THE PROBLEM

This article explains the role that a modern state should perform, within the framework of possible stimuli for corruption resulting either from the different ways this state operates or because of its size relative to national production. The environment in which relatively underdeveloped economies exist influences suggestions about possible roles for the state. This environment is known as globalization.

This paper also examines the issue of corruption in Costa Rica, which is no doubt similar to that of other nations in the area. The perception of an increase in corruption could be linked to the absence of appropriate institutions, in an uncompleted process of economic reform. This incomplete process of economic reform has consisted of moving from a model of economic development based on import substitution, to a paradigm characterized by more neutral trade regimes.

II.-BASIC CONCEPTS AND DEFINITIONS USED IN THIS ARTICLE

(1) Corruption:

A frequently employed definition is one used in different papers related to the World Bank, as "the abuse

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** Friedrich A. Hayek, *Law, Legislation and Liberty, Volume III: The Political Order of a Free People*, Chicago: The University of Chicago Press, 1979, p. 11.

of public power for private gain."¹ Specialists like Vito Tanzi are aware of the difficulties associated with this definition. One is that sometimes the abuse is not carried out for the actor's own benefit, but for groups with which the actor is possibly sympathetic. The other is that corruption exists in the private sector; it is not unique to the public sector. Nonetheless, Tanzi uses this "practica⁷ definition in his article *Corruption Around the World: Causes, Consequences, Scope, and Cures*.²

Using the World Bank's definition implies, on one hand, that no reference is made to the problems of corruption within the private sector; but, on the other hand, it considers corruption that results from the interaction between an agent from the private sector and another from the public sector.

It is important to mention that this definition of corruption considers private actions framed within state policies, when they turn into an undue damage to public funds.

The exclusion of corrupt transactions within the private sector could be justified, by the belief that incentives for its control exist. It is either reflected in losses to a firm or, alternatively, in a reduction of profits. Based on neoclassical models, sooner or later, those results are corrected in a competitive framework.

This analysis of corruption does not consider the process by which individuals or private groups obtain the approval of legislation that grants them special privileges. The issue of rent-seeking is taken into

1. The World Bank, *World Development Report, 1997: The state in a changing world*, New York: Oxford University Press, 1997, p. 102.

2. Vito Tanzi, "Corruption Around the World: Causes, Consequences, Scope, and Cures," *International Monetary Fund Staff Papers*, XLV, 4, December 1998, p. p. 564-565. Another re-searcher of the economic impact of corruption, uses the same definition in his analyses: Paolo Mauro, "Corruption: Causes, Consequences and Agenda for Future Research," *Finance & Development*, XXXV, 1, March 1988, p. 11. Other possible definitions can be found in Robin Thecbald, *Corruption, Development, and Underdevelopment*, Durham, North Carolina: Duke University Press, 1990.

account because it has implications on the proper management of public resources. But the process itself for obtaining rents is not relevant to this essay. The issue of corruption in financing political parties is not discussed.

2) Globalization:

What for Latin-Americans seems to be a unique phenomenon, has been questioned as being a peculiar process that has new features that imply a challenge for good economic performance. For instance, Friedman says: "I don't see any new process at work"; then he adds:

There's absolutely nothing new about so-called globalization, except the word and the existence of a more efficient system of Communications and of the transmission of funds.³

In the Latin American thinking, globalization has distinctive characteristics that have interesting implications. For this analysis, globalization is characterized by the pursuit of certain economic policies that differ from those followed by our nations since the middle of the last century. Then, under the auspices of the United Nations Economic Commission for Latin America (ECLA), an economic development model based on import substitution was set in practice.⁴

In certain sectors of the academic community, the opening to an international trade system was considered a main factor that enabled economic growth and were characterized by moving away from the international trade engine of growth. On the contrary, it was regarded that the take-off of our economies would spring from an import substitution through domestic production triggered by the protection that the prohibitive tariffs granted.

Although globalization is not really a new

3. Milton Friedman, "Confirmed Convictions," World Economic Affairs, interviewed by Christopher Ragan, ed., II, 3, winter 1999, p. 51.

4. On these topics, see Claudio González-Vega, *El Proteccionismo en la Estrategia de Desarrollo de Costa Rica durante las Últimas Décadas*, San José, Costa Rica: mimeo, no date; Claudio González-Vega, *Temor al Ajuste: Los costos sociales de las políticas económicas en Costa Rica durante la década de los 70*, Serie Estudios No. 2, San José, Costa Rica: Academia de Centroamérica, 1984 and Jorge Corrales Quesada, "El proceso de ajuste estructural en Centro América," in Miguel Ángel Rodríguez Echeverría, ed., *Ajuste Estructural y Progreso Social: La experiencia centroamericana*, San José, Costa Rica: Libro Libre, 1992.

phenomenon in history, it should be interpreted as a new form of economic order with very different characteristics from those prevailing during the fifties. Globalization is not only perceived as a more efficient system of Communications and a better international transmission of funds. But, also, as a substantial reduction of tariff and non-tariff barriers to international trade. A diminution of state activism, especially in the economic area, is also part of that global event.

It can be said that this opening to trade is nothing more than a restitution of previous world tendencies for a global exchange. However, now participation in world trade seems to be more extended than that existing early in this century. Gross capital flows are reaching real magnitudes that are larger than before and, above all, the flows are easier, due to deep technological changes in Communications that have taken place since the end of the eighties.

Globalization constitutes a unique and new phenomenon for our economies. If it is also considered as the adoption of certain types of economic policies, it is the first time in our countries' recent history, that government authorities have had the opportunity of putting them into effect. This has important implications regarding the institutional frameworks in which our different economies are embedded.

(3) Institution:

The concepts of "institution" or "institutional" in this essay mean

the rules of the game in a society. In other words the restrictions invented by human beings to structure an interaction among individuals. Such institutions are composed of formal rules (legislation, common laws, regulations), informal restrictions (conventions, norms of behavior and self-imposed conduct codes) and their compliance characteristics.⁵

5. Douglass C. North, *La Nueva Economía Institucional y el Desarrollo*, Serie Diálogo No. 6, Bogotá, Colombia: FUNDES, 1994, p. 19. Somewhere else, North points out that "*Institutions provide the framework within which human beings interact. They establish the cooperative and competitive relationships that constitute a society and more specifically an economic order... [Institutions are a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals.*" Douglass C. North, *Structure and Change in Economic History*, New York: Norton, 1981, p. p. 201-202.

(4) The size of the state and how it operates as causes of corruption:

Some authors have considered that both, the size of the state and the way it operates, have to do with the degree of corruption in a country. For instance, in the previously mentioned article by Tanzi, he states that

the solution to the problem of corruption may not be as simple as just reducing the level of taxation or public expenditure. Rather, the way the state operates and carries out its functions is much more important than the size of public sector activity measured in the traditional way.⁶

It is then assured that more than the size of government it is the way in which it operates that has an incidence in the levels of corruption.

Other authors have pointed the size of government as the cause of corruption (something different from the way it carries its functions). This position has not been as clearly stated as the one related to how governments operate. For instance, it has been expressed that

Foremost among the structural factors that encourage corruption in new states is the tremendous relative importance of government in these nations as a source of goods, services, and employment.⁷

It is possible that both, the size of government and the way it operates, encourage the presence of corrupt practices. An econometric analysis was made, to know the possible incidence on corruption of these two variables. It is conjectured that the larger the size of government is and the more distorted the economy is ("worse" forms of how the state operates), the more corruption will show up.

Factor analysis, in its versión of main components, is a frequently used technique for exploratory research in social sciences. It is considered to have inquiry purposes, not because of possible weaknesses of the hypotheses, but because of measurement difficulties with the involved variables. Data limitations have to do with the ordinal character of the information and with the possible measurement biases derived from the fact that

7. James C. Scott, *Comparative Political Corruption*, New Jersey: Prentice-Hall, 1971, p. 12, quoted in Kenneth U. Surjadinata, *Revisiting Corrupt Practices from a Market Perspective*, mimeo, Spring 1998, p. 20.

there is no measure that indicates the magnitude of corruption. There is only a perception about its level.

The following exhibit shows how the variable named "Factor 1" explains 51.2% of the total data variance. The variable "government intervention in the economy", that incorporates the government consumption as a percentage of GDP, the extent of enterprises owned by government and the value it adds, has a high correlation with Factor 1 (that is, 0.72). Indicative variables of distortions (trade policy, taxation, monetary policy, restrictions on foreign investment, banking, wage and price controls, property rights and regulations) which involve considerations on how government carries out its functions also show high correlation with Factor 1. The exhibit shows the results for a sample that does not include several developed industrial countries (DICs).

Appendix 1 offers a broader discussion of this topic. A main component analysis is presented there for the total sample available that includes the DICs.

Analysis of Principal Components'

Excludes some developed industrial countries

	Factor 1 (51.2%)	Factor 2 (12.4%)
Corruption"	-0.756	0.315
Development	0.670	0.315
Trade policy""	0.715	-0.270
Taxation	0.468	0.474
Government intervention in the economy	0.720	0.337
Monetary policy	0.609	0.568
Restrictions on foreign investment	0.680	-0.561
Banking	0.576	-0.244
Wage and price controls	0.788	-0.282
Property Rights""	0.855	0.129
Regulation""	0.871	-0.166

SOURCES: For corruption, International Transparency, 1997 *Corruption Perception Index*, Göttingen University and International Transparency: Internet Center for Corruption Research, 1997 and, for the remaining variables, Bryan T. Johnson, Kim R. Holmes and Melanie Kirkpatrick, 1999 *Index of Economic Freedom*, Washington D.C.: The Heritage Foundation and The Wall Street Journal, 1999.

* The parentheses indicate the explained percentage of the variance.

** Ordinal scale from 1 to 5.

*** This dimension includes indicators of corruption within that area.

Except for corruption, the measurement scales go from 1 to 5 (from "better" to "worse"). Corruption's goes from 1 to 10 (from "worse" to "better").

In comparing both analyses (sample that excludes DICs and sample that includes all nations) some interesting results show up. First, a possible influence of state's size on corruption is found when the analysis is made only to countries where DICs are excluded. In such a case, there is a correlation between corruption and both the size and forms of operating of the government.

Second, different results are found when the analysis includes the DICs. State's size (the variable "government intervention in the economy") no longer seems to have an important influence in explaining corruption (the correlation with Factor 1 is only 0.27. See exhibit in Appendix 1).

The difference between these results may indicate that, when the sample includes the DICs, there must exist a set of factors that eliminates the possible importance of the state's size on corruption.

These results lend support to Douglass North's emphasis on the importance of institutions.⁸ It could be hypothesized that since institutions in non-DICs are different from those in DICs, government size is a more important explanatory variable for corruption in the non-DICs. As a corollary, it could be suggested that, if it is not possible to achieve an institutional transformation, an appropriate policy to reduce corruption in the non-DICs could be to diminish the size of government.

8. Excluding institutions "means giving up on analyzing what I have come to believe are the most fundamental source of economic performance." Douglass North, *Economic Performance Through Time: The Limits to Knowledge*, mimeo, 1996, p. 4.

III. - AN ECONOMY IN TRANSITION: THE CASE OF COSTA RICA⁹

The term "economies in transition" is usually employed to name former socialist economies previously organized under a system of centralized decision-making. Latin-American economies are also experiencing an important transition, because of the change on how they envision their development possibilities. They are moving from one model based on import substitution to another based on opening their economies to international trade. This last model could better be characterized as one of "extended neutrality" in reference to the incentives granted¹⁰, where there is no discrimination between production directed to domestic consumers and that to international markets.

Since the beginning of the middle 80's, Latin America has implemented significant reforms. Concretely, in the fiscal field, an important opening of their trade sector, changes in the financial area such as abandoning fixed exchange rates schemes, a deregulation of labor markets and a wide process of privatization, among other policies. These reforms may be considered as part of opening, liberalizing or reforming their economies or, more generally, as policies to adapt their economies suit to the requirements of globalization.¹¹

For a better understanding, it is useful to describe the reforms that Costa Rica has implemented since the middle 80's and after what has been considered the deepest economic crisis of its history, experienced at the end of the 70's.

Costa Rica decided to abandon the pillars of the

9. See Appendix 2 for a presentation of some basic facts about Costa Rica.

10. Rhee, Yung Whee, *La Política de Exportaciones y su Administración: Lecciones derivadas del Asia Oriental*, Serie Industrias y Finanzas, 20, Washington D.C.: The World Bank, 1986. An extended neutrality regime "consists of the homogenization of the level of export incentives with that granted to import substitution. The purpose is that the diverse activities of the economy have the same level of effective protection, where the destiny of the output or the degree of elaboration does not matter." Jorge Corrales Quesada y Ricardo Monge González, *Exportaciones no Tradicionales en Costa Rica*, San José, Costa Rica: Econofin, 1990, p. 44.

11. Brief descriptions of the main reforms carried out in Latin America in the period 1965-1992, may be found in Sebastián Edwards. *Latin America and the Caribbean: A decade after the debt crisis*. Washington, D. C: The World Bank, September 1993, p. p. 32-33. Also Shahid Javed Burki and Sebastián Edwards, *Dismantling the Populist State: The unfinished revolution in Latin America and the Caribbean*, Washington D. C: The World Bank, 1996, p. p. 14-22.

social and economic policies associated with the import substitution model. The reforms have meant, in a sense, a change or substitution of previous policies by modifying their degree or by eliminating them. In another sense, by incorporating some new government interventionist policies.

I will refer to those reforms of the interventionist economic policies followed by Costa Rica, which, in my opinion, could have created incentives for corruption.

Some of these reforms could be classified within more than one category. But the main activities object of a substantial change during the period of reference, are: (1) public finance, (2) monetary-financial sector, (3) price control policies, (4) labor policies, (5) trade (6) bureaucratic procedures, (7) pension systems, (8) subsidies, and (9) government monopolies.

(1) Public finance:

The main changes have been, first, a tax reform in 1987 that lowered international trade taxes, not only on imports but on exports, as well as those applied to businesses' income. Also the coverage and the rate of the value added (sales) tax were increased. Second, a reduction of the public sector déficit: it diminished from 7.2% of the GDP in 1985 to 2.4% of the GDP in 1998. This result was basically derived from revenue increases, more than a reduction of public expenditure. Third, in 1992 many tax deductions were eliminated; however, the effect was rather limited, because exemptions previously obtained through contractual agreements with the government (those most significant) could not be disposed of. In 1995, another important reform was taken by the approval of the so-called Tax Justice Act.

(2) Monetary-financial sector:

The main variations were, first of all, in the exchange rate regime, since the multiple as well as the fixed exchange rate systems were eliminated and the exchange rate was unified. A mini devaluation system was introduced. Second, commercial banks were allowed to freely determine their asset and debt structures, as well as the interest rates and fees they could charge. The active interest rates would always be above the passive rates and, exceptionally, the commercial banks were permitted to temporarily grant a

subsidy in the loans given to small and medium-sized farmers. In 1992, capital movements were liberalized.

(3) Price controls:

Almost all regulations were eliminated, since now only the prices of three goods are controlled. These are milk, bread and lard. Price control is also applied to public transport charges, such as buses, taxis, air and water transportation, as well as for Utilities monopolized by the state, like electricity, telephone, gasoline and fuel, water, sewage drain-age, and also municipal fees and similar charges. The past practice of minimum or guaranteed prices, applied mainly to certain agricultural products, was abandoned.

(4) Labor policies:

In general, the labor market is considered as not too distorted, and hence has not required deep reforms. However, from 90 labor categories subject to minimum wage, this number was reduced to 25 in 1999. The absence of a distortion caused by nominal wages above market-clearing prices, probably has its origins in the way those minimums were established. They were set in such a way that they would not be too far from those determined by the market: this has been reflected in historically low unemployment and an underemployment rates.

(5) Trade:

The reform has been characterized by a substantial reduction of tariffs and by the elimination of a wide range of non-tariff restrictions to international trade. The level of trade distortion in the period of protectionism is clearly determined in a 1986 study. It states that the protection granted for production directed to the domestic market was 510%, while that for production for export was 24%, confirming the existence of a high anti-export bias at that time.¹²

At the present, the maximum tariff is 15%, although a higher tariff persists for certain products, like milk and its derivatives, chicken parts, textiles, shoes, jute bags, rice, sugar molasses and potatoes. In addition, there are almost complete tariff exemptions for the import of raw

12. Ricardo Monge González y Jorge Corrales Quesada, *Políticas de Protección e Incentivos a la Manufactura, Agroindustria y Algunos Sectores Agrícolas en Costa Rica*, San José, Costa Rica: Econofin S. A., 1988, p. 219.

materials, capital and intermediate goods. This practice raises the effective protection in the economy. Hence, it maintains an anti-export bias in the economy. However, this bias has been reduced substantially compared to the one prevailing up to the middle 80's.

As part of the trade reform, exchange rate surcharges, prior deposits required to obtain foreign exchange for imports, as well as many import permits, were eliminated.

(6) Bureaucratic procedures:

Reforms have been made in the procedures required by government to carry out foreign trade. In 1990 a one-stop electronically operated export window was created. All necessary administrative processes were centralized through this window. Something similar was done in 1995 for imports. In 1998 a government office in charge of eliminating multiple procedural requisites enforced by the public sector started its operations. In spite of successful initial results, a legal mess has pre-vented this deregulatory process from advancing even further.

(7) Pension systems:

The resolutions granting the pensions given by the Caja Costarricense del Seguro Social-the most important pension system- used to take between 120 to 180 days in 1990 and 117 in 1997. In 1998, it was estimated that only 41 days were required. In the same line, based on legislation passed in 1992 and 1995, there has been a simplification and a reduction of the several pension regimes, characterized each one of them for giving substantially different treatment to the various contributors.

(8) Subsidies:

Certain circles opposed to the liberalization process have incorrectly stated that, as part of the trade reform, a subsidy was granted to non-traditional exports that had a domestic added value of at least 35%. This subsidy, named Certificado de Abono Tributario (CAT) may be used for all types of tax payments by any taxpayer. Eduardo Lizano, on the other hand, states that the CAT "was not conceived as an export subsidy." He mentions that "it was rather a concession to the exporter for the additional costs that he should incur due to price increases of certain public services." Its purpose was to

compensate for the anti-export bias. The CATs were an essential part of the so-called "export contract", which is explained in detail below.

The thesis that the CAT was an integral part of the new export promotion model does not seem to hold historically. It was not originally established as an integral part of the new open-economy order, since it was created in 1972, when the import substitution model was in full applicability. It was not but a decade later when the first steps were taken to apply open trade policies or to follow an economic development model based on exports.

Although the CAT may have been considered the most important instrument for the export promotion when created in 1972, it did not achieve its objective. That is so because

the tariff levels were so high, that they made it more attractive to produce for the internal market, creating a very strong anti-export bias in favor of national production.¹⁴

Under the criteria that the CAT is a compensation for that anti-export bias, the percentage granted (a gross value of 15% and a net one of 13%) in certain moment exceeded in a 10.8% what was required to be given in order to guarantee a so-called neutral regime.¹⁵ That is, where

there exist internal distortions, the exports should be given the necessary compensation, in such a way that they may be competitive in world markets.¹⁶

However, the CAT granted was not enough as to guarantee an extended neutrality regime, de-fined in footnote 10 above. Therefore, the thesis of the CAT as a counterbalance for high internal costs seems to be only partially true. It helped to compensate a certain bias, but

14. Jorge Corrales Quesada, "Marco Legal, Institucional y Económico de las Exportaciones No Tradicionales en Costa Rica," in Pedro Arriagada Stuenkel, ed., *Marco Legal e Institucional para el Desarrollo de las Exportaciones No Tradicionales*, San Francisco, California: CINDE y FUSADES, 1992, p. 69.

15. Jorge Corrales Quesada y Ricardo Monge González, "Política Comercial Reciente y Subsidios a la Exportación en Costa Rica," in Claudio González Vega y Edna Camacho Mejía, eds., *Políticas Económicas en Costa Rica*, Tomo II, San José, Costa Rica: Academia de Centroamérica, 1990, p. 211.

Jorge Corrales Quesada y Ricardo Monge González, *Exportaciones no Tradicionales en Costa Rica*, Op. Cit., p. 44.

was not enough to guarantee extended neutrality to all activities.¹⁷

During those years of reform, new versions of incentives or subsidy schemes were created, such as those for investment in the tourism sector. Initially, the main tariff exemption granted was that applied to inputs. Afterwards, the most important was the one that enabled individuals and firms who had to pay income tax, to deduct up to a 50% of their investments in tourism projects.

Similarly, a favorable treatment was given to investments in the so-called free zones or those under the temporary import or drawback systems. The tax exemptions applied differed from those on businesses operating in the rest of the nation. Actually, these policies fulfilled the criteria of extended neutrality already mentioned. That is, businesses established under those tax regimens could operate under the same conditions as any firm in world markets. Under this point of view, these schemes may be considered as the total absence of distortions caused by the country's trade system (except if they use certain services provided by the state, such as telephony or electricity, that presumably have a monopoly element reflected in higher prices).

(9) Government monopolies:

Important changes happened in the sector of government activities, some of which were constituted as monopolies. For instance, in 1988 an aluminum plant was privatized, a fertilizer and a cement plant in 1994 and 1995, as well as an important sugar mill. The state's banking system lost its monopoly on the issuance of current accounts, and in 1991, private generation of electricity was allowed, although as a small percentage of total production (it was recently increased from 15% to 30%). In contrast, in 1993 a monopoly was granted to the state's oil refinery.

IV. - THE INSTITUTIONS WITHIN THE CHANGE OF A MODEL

Some considerations should be made about the

17. Monge mentions that the new export incentives program "has guaranteed a neutral regime for most of Costa Rica's nontraditional exports, as well as extended neutrality to a significant amount of them." Ricardo Monge González. "La experiencia de Costa Rica en la Promoción de Exportaciones," in Integración & Comercio, Year 2, 4/5, January-August 1998, p. 178.

relationship between the economy and the institutional framework. Especially because it has been said that to accomplish the proposed reforms, it is enough with letting prices reflect the market conditions. Forces that would attain efficiency and, hence, maximize the potential development of a country could then emerge.¹⁸ An elimination of tariffs and non-tariff barriers was thought to be enough to cause a removal of other cost increasing internal distortions. Just letting prices operate freely would tie the domestic entrepreneurs to international competition and they would then ask that the rest of distortions that hinder their world competitiveness be eliminated.¹⁹

Those expected reactions from entrepreneurs who now face international competition have not been fully observed. What has been seen is political pressure so that, in one hand, distorting characteristics associated with the import substitution model do remain. And, on the other hand, those entrepreneurs also call for their elimination, so they can play according to the new rules of international trade.

For instance, non traditional agriculture ex-ports and industrialists that only supply the local market or export mainly to the Central American Common Market, seek to have their exports supported not by tariff reduction and, hence, a diminished anti-export bias, but rather by subsidies for exports to third markets.

They want to enjoy the profitable possibility of

18. In changing socialist economies, Rey Koslowski indicates that since the neoclassical analysis assumes as given the functioning of institutions "it cannot consider adequately the support of the legal structure provided by the state for the establishment of the property rights." Rey Koslowski, "Instituciones de Mercado, Reforma en Europa del Este y Teoría Económica", mimeo, p.17 and reproduced in *Journal of Economic Issues*, XXVI, 3, September 1992. Also, "the policy prescriptions of the 'Washington Consensus' ignored the potential role that changes in institutions could play in accelerating the economic and social development of the (Latin American) region. It focused instead on the issues of fiscal discipline, liberalization of trade and investment regimes, deregulation of domestic markets, and privatization of public enterprises." Shahid Javed Burki and Guillermo Perry, *Beyond the Washington Consensus: Institutions Matter*, Washington D.C.: The World Bank, 1998, p. 1. The parenthesis is mine.

19. That may be the reason why Lizano points out that "the first stage does not simply consist in liberalizing the economy and assure the functioning of markets and prices (getting prices right). It is required to put into practice a certain degree of social engineering, in order to facilitate establishing the needed sociopolitical conditions and then go on with the process of changing the model." Eduardo Lizano Faith, "Estado y Economía en América Central," in Manfred Mols y Joseph Thesi^o, eds., *El Estado en América Latina*, Buenos Aires: Konrad Adenauer Stiftung y CIEDLA, 1995, p. 100.

exporting to global markets, but, at the same time, they want to retain tariff protection, so that production addressed to domestic markets continues to be profitable, although in a free trade regime, they would probably disappear because of their relative inefficiency.²⁰ Especially if they do not adapt to the new rules that probably require an increase in their efficiency.

These perceptions explain why the group of non-traditional exporters sometimes lobbies for a reduction in internal distortions. This group is expected to be deeply engaged in the process of opening the economy, and considered by some to have emerged as a result of a "social engineering" to get support for the change in the economic model.

But, at the same time this group insists on maintaining the export subsidy. Implicitly it assumes that an overvaluation of the domestic ex-change rate exists and that the subsidy act as compensation. Or, alternatively, it supposes that the subsidy can counterbalance an anti-export bias still present in the economy. But, the anti-export bias is derived from the fact that tariff protection still exists. Yet they do not call for further reductions in the external tariff.

These demands for state activism should not be expected to emerge from this part of the export sector, but it is just an example of what seems to be an extended phenomenon in the Costa Rican environment.

This ambivalence may be explained by Eduardo Lizano's observation that

Latin America lives a transitory stage between the GPP model²¹ and the introduction of the economic liberalization model. Actual times are characterized because it is hard for the old order to finally die, and it is

20. As an instance, recently, the Federation of Central American Chamber of Industry (FECAICA) indicated that "the process of tariff reduction should be frozen" in order not to reduce the maximum 15% rate, "because otherwise would affect their competitiveness." "Industria pide congelar aranceles," Periódico La República, Saturday, June 6th, 1999, p. 17A.

21. Lizano names his model GPP. It stands for Groupism or Guildism, Paternalism and Populism. Represents the set of economic policies of the import substitution model, with widespread and diversified possibilities for rent-seeking (Groupism). And where government becomes the main determinant of the economic policies that pretend to protect very diverse social groups from market forces (Paternalism). But gradually all degenerate to pursuing public policies that lead to an unlimited state (Populism). Eduardo Lizano Faith, *Ajuste y Crecimiento en la Economía de Costa Rica, 1982-1994*, Op. Cit., *passim*.

hard for the new one to finally have its complete birth. At the present time, a superposition of models is found in Latin American countries. Reality shows elements of both models simultaneously. This is the origin of many contradictions, lack of harmony and deficiencies of economic policies.²²

The true question that seems to come forward regarding the reform process of the Costa Rican economy is the role that the state should perform. The problem arises when there is a desire to maintain many of the functions that characterized the participation of the state under the import substitution model. In the meantime, other groups consider them as alien to the new circumstances and look for the necessary institutional transformation. Those functions are now incompatible with the new model of trade neutrality. When it is said that certain institutions do not seem to have been fully adapted to the new circumstances, this refers mainly to the results of the vision that society, and especially certain groups, have about that role the modern state should perform.

Lizano states that "in order to carry out the change of model, state action has been of enormous transcendence." He also cites that "without its active participation, it would not have been possible to initiate the process in the second half of the eighties."²³ Even if these conditions are accepted, requests for state activism do not only come from those who consider essential for success the provision of new or better public services, like an adequate infrastructure for exports or a reduction in government's expenditure in order to lower high real interest rates.²⁴

Also, some feel that for years there have been valid reasons to expand government's functions. For example, to attain adequate supervision of the financial sector. In their opinion, the absence of government's functions or their bad application created serious problems for the economy.²⁵

22. Eduardo Lizano Faith, *ibidem*, p. 303. The parenthesis is mine.

23. Eduardo Lizano Faith, "Estado y Economía en América Central," Op. Cit., p. 97.

24. This fits into what Burki and Edwards consider one of the objectives of state institutional reform, which is, among others, to maintain macroeconomic stability. Shahid Javed Burki and Sebastián Edwards, *Dismantling the Populist State: The unfinished revolution in Latin America and the Caribbean*, Op. Cit., p. 15 y p. 24.

On the other hand, there is a group that wants to maintain the status quo, and to increase government's participation in the most diverse areas. This group is made up of two main sub groups: one is constituted by those affected by the change of the economic model. It includes certain industrial groups, and some agricultural producers (small and medium-sized). It also includes a part of a bureaucracy whose existence under the new model has been questioned. All the rent-seeking process came as a result of an alliance between those who sought to obtain them, certain political groups and the state's bureaucracy, whereas the cost of the policy was diluted among consumers.

The second sub group has a more political-ideological twist and two strains. One stems from an administration at the end of the 1970's and starting the 1980's, when the Costa Rican economy experienced its recent history's greatest fall. Some authorities of that government attributed the results to the oil crisis, but mostly to policies applied by the International Monetary Fund. In fact, IMF policies were never put into effect during that administration.

From an ideological point of view, this first strain represents a conservative mentality. It proposes to retain a state intervention that is more appropriate for the import substitution model. This reaction to change may represent a justification for what, in general, has been considered a very bad economic and political performance, the cause of enormous social problems.²⁵ Other ideological groups traditionally unfriendly to liberal thought (or neo-liberal, as has been called lately) constitute the second variant.

In the Costa Rican economy, there are strong pressures from different sectors, to keep and to increase government intervention in different areas. Ironically, there is also a constant request for "reform of the state".

25. "... [I]n some areas the State should even be expanded..." ; for instance, in its roles of "regulating the financial sector... the promotion of competition and consumer protection." Eduardo Lizano Faith, *Ajuste y Crecimiento en la Economía de Costa Rica, 1982-1994*, Op. Cit., p. 180.

26. "In May, 1982, with a change of government (the Carazo-Odio administration is substituted by the Monge Alvarez), the country is in full economic crisis. The great majority of available indicators say so: inflation, exchange rate, public finances deficit, unemployment, and foreign financial relations. Besides, lack of confidence and anguish are generalized." Víctor Hugo Céspedes Solano, Ronulfo Jiménez Rodríguez y Eduardo Lizano Faith, *Costa Rica: Crisis y empobrecimiento*, San José, Costa Rica: Editorial Studivm, 1983, p. 140. The parenthesis is mine.

It could be that society favors change in the way the state works, but, at the same time, demands that it continues to carry out traditional functions of the rent-seeking model.

Reality is plagued with uncertainty for two reasons: the transition from a protectionist to a liberalized economy model and the enormous difficulties coming from the international sphere. Regarding this issue, Eduardo Lizano provides some arguments. He writes that besides "the need to deeply modify the sociopolitical structure" of the old order, it is necessary to modernize the state, which is a "task that cannot be left aside." He adds that, "the problems are, in a great sense, political. The difficulty is not what to do, but rather how to do it."²⁷

In certain circles, there is a presumption that the state should not intervene in the transformation process. According to Michael Storper, a vision exists in certain societies, where

each person expects the state to be *absent from* situations of economic action, and for individuals to work out coordination between themselves -this convention of the 'absent state' is particularly marked in the United States.²⁸

In the Costa Rican transition, the request for an absent state has almost never been heard. It could be out of a feeling that, in general, the state ought to perform a role in the new order. As a matter of fact, it has been an active participant in the process of change. The problem that Costa Rican society now must solve concerns the form this participation might take, during the transition and in the future.

There is a great desire to modernize the actual state. The question urging a reply is how to do it in order to have an efficient institution. Simultaneously, that lack of an answer constitutes the main obstacle to achieving the change from the old model of an interventionist state, to an economy where the state is not an instrument for rent-seeking, is not an inefficient and oversized institution.

In the process of transforming the Costa Rican economy, the conjecture that the economy is embedded

27. Eduardo Lizano Faith, *Ajuste y Crecimiento en la Economía de Costa Rica, 1982-1994*, Op. Cit., p. 308.

28. Michael Storper, *Conventions and the Génesis of Institutions*, mimeo, June 1995, p. 12.

in a structure of governance and can function because of this fact, seems for the most part to be accepted. These years' experiences show that almost no one has asked for a state that does not perform any role in the new order. On the contrary, there have been many different opinions about how much and what those roles should be.

More than the single fact of the economy being embedded within a governance structure,

...the Nation-State is itself embedded within a set of underlying cultural beliefs... The contrast is really not between the State vs. the Market, but rather the State vs. Civil Society, in which market activity and non-market voluntary association co-exist.²⁹

The formal rules of governance and the informal rules found in a culture restrict the actions of individuals. In Costa Rica, there is a presumption that the state has a wide variety of roles to perform. Many of these are inconsistent with those that should be performed in an open and liberalized economy within a framework of globalization. In the nation there is enormous uncertainty about what roles should be performed by the state in the actual economic life.³⁰ This is the main problem that the different society members should solve. If they do not, there is a risk that the Costa Rican economic reform process will remain stagnant, just as it has in recent years.

Evolution and institutional design should be taken into account in this building process of an economy in transition, such as Costa Rica. The institutional construction should allow the free operation of the market forces. This would enable the country to increase the possibilities of being a successful economy within the globalization framework, although there is no guarantee of that success. This is the way we have proceeded in our country, but we are now experiencing an enormous

obstacle to achieve that purpose. We need to define what role the state should perform. The role that the state should have is not yet clear.

The problem referred to above is not exclusive of Costa Rica. Sebastián Edwards states that,

Despite the progress in implementing reforms, it is important to avoid premature exuberance and enthusiasm. There is still much to be done, with numerous incomplete reforms and unresolved issues... in the rest of the region (he excludes Chile and México), the reform process is at different stages of implementation -with different degrees of political popularity. The state's economic role needs to be redefined and modern institutions need to be built.³¹

Similarly, Lizano mentions that

The task to accomplish is difficult in view of the great transformation that the State should suffer in these countries. Some of the transformations involve the following: to mark out the limits between the Public Sector and the Private Sector, to establish the functions and duties of the State, to determine the size of the Public Sector. In Central America, there are still no satisfactory answers to these questions.³²

Even in México's case,

Ending the state's role as the central player in the economy has devastated the melange of social, political, and economic relationships that comprised the bargain. The moral economy of many has thus been violated; individuals from many different social niches have lost a sense of security.

That leads the author to think about the need for "reconfiguring the secure relationships of the bargain".³¹ Again, the need to define a new role for the state is mentioned.

To accept that the state should play an important role in the process of transforming the economy and in the

29. Peter Boettke, *Is the Transition to the Market Too Important to Be Left to the Market?* mimeo, 1998, p. p. 5-6.

30. "An effective state is vital for the provision of the goods and services -and the rules and institutions- that allow markets to flourish and people to lead healthier, happier lives. Without it, sustainable development, both economic and social, is impossible." The World Bank, *World Development Report, 1997: The state in changing world*, Op. Cit., p.l. However, one should be aware of Douglass C. North's call for caution: "The existence of a state is essential for economic growth; the state, however, is the source of man-made economic decline." Douglass C. North, *Structure and Change in Economic History*, Op. Cit., p. 20.

31. Sebastián Edwards, *Latin America and the Caribbean: A decade after the debt crisis*, Op. Cit., p. p. 138-139. The parenthesis is mine.

32. Eduardo Lizano Faith, "Estado y Economía en América Central," Op. Cit., p. 104.

33. Tom Lewis, *Breaking the State-Society Bargain: Neoliberal market reforms and resistance in México*, mimeo, no date, p. 10.

new orders attuned to globalization does not mean that a non-liberal concept of the state should be approved inevitably. Neither does emphasis on relevance of institutions in all these processes imply that the presence of a wide range activist state should necessarily be recommended. That kind of state was an essential characteristic of the protectionist and paternalist ancient regime. It is the type of state that is in the process of being changed.

V.- CORRUPTION AND TRANSITION IN THE CHANGE OF THE ECONOMIC MODEL

As described in section III supra, the Costa Rican economy is immersed in a process of changing its economic model from one based on import substitution to another founded on extended neutrality. Compared to other economies, the country is lagging in its economic transformation process.

There is an "efficiency" index developed by Eduardo Lora, of the inter-American Development Bank. It compares the 1985-86 situation with that in 1995, where the time and speed of economic reforms are taken into account. According to this, Costa Rica is classified as a slow reforming nation. That is due to the fact that, at the beginning and at the end of the period analyzed, Costa Rica implemented reform policies which, on average, were inferior in terms of quality or intensity to those of the rest of the countries.³⁴ Costa Rica is a "slow reformer", just like Brazil, Ecuador, Guatemala, Honduras, México, Dominican Republic and Venezuela. In fact, it means that a series of distorted policies inherited from the ancient regime persist, while, at the same time, measures that cause some other new distortions are applied.

A summary is presented of those policies from the old regime and those recently implemented that could stimulate corrupt acts. The analysis refers to new or old forms, in which the state carries on its functions. These constitute what Tanzi calls "particular aspects of government activities that create a fertile ground for corruption."³⁵ But it refers also to those problems of

34. Eduardo Lora, "Una Década de Reformas Estructurales en América Latina: Qué se ha Reformado y Cómo Medirlo," *Pensamiento Iberoamericano: Revista de Economía Política*, Volumen Extraordinario, 1998, p. p. 48-49.

35. Vito Tanzi, "Corruption Around the World: Causes, Consequences, Scope, and Cures," Op. Cit., p. 566. The parenthesis is mine.

corruption de-rived, not so much from the way the state acts, but by its size.

Based on the perception index of corruption, Costa Rica is relatively high, which means that is not considered a corrupt country. According to International Transparency, Costa Rica occupies position number 22 out of 52 countries mentioned. It had a 6.45 grade with respect to a maximum of 10 (10 is for a country perceived as totally clean; none gets that grade). It has the highest ranking of all Latin American countries. However, it has not only recently been affected by possible important acts of corruption, but it also has had widespread press coverage. That could reflect an increase in the problem or the fact that affairs related to corruption are now more important in the eyes of the citizens, or both.

(1) Tariffs:

In 1776, Adam Smith exposed one of the effects derived from the presence of tariffs. This effect increases, the higher the tariff. He wrote,

The high tariffs which have been imposed upon the import of many different sorts of foreign goods, in order to discourage their consumption in Great Britain, have in many cases served only to encourage smuggling.³⁷

Although Costa Rica has reduced its tariffs and other non-tariff barriers when it abandoned its import substitution model, the tariffs persist.³⁸ In particular, differential tax treatments remain according to the type of imports. Now, some final goods have higher import taxes compared to others, while, in general, raw materials, capital goods and inputs imported are all totally exempt from any tariff.

Tariffs facilitate corruption. Although in the Treasury

36. International Transparency, 1997 Corruption Perception Index, Op. Cit., mimeo, no page. In International Transparency, 1998 Corruption Perception Index, Göttingen University and International Transparency: Internet Center for Corruption Research, 1998, mimeo, no page, Costa Rica occupies position 27 out of 85 countries, with a 5.6 grade. That means, compared to 1987 results, an increase in the perception of corruption in Costa Rica.

37. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Vol. II, Oxford: Clarendon Press, 1979, p. p. 881-882.

38. At the moment the top tariff is 15% for final goods (with notorious exclusions). Costa Rica, when it became a member of GATT in 1990, agreed to bind its tariffs to a maximum of 52%, with the exception of certain agricultural products. It means that the country could eventually rise its tariffs up to that rate without violating its international trade agreements under the World Trade Organization.

there are no details about the quantity and amount captured, nor of the number of cases presented to courts, it is well known that smuggling persists in spite of tariff reductions. Its persistence is due to the fact that high tariffs were part of the old protectionist model and they've not been fully eliminated, so the potential impact on corruption remains.³⁹

(2) Tax system:

The national tax system has also been an object of important reforms. Some of them tend to reduce corruption. Examples are the decrease in the maximum tax rates on business profits and the reduction in income tax brackets to which different tax rates were applied. Higher penalties for tax evasion were introduced too.

However, some important procedural reforms that may discourage corruption are still awaiting legal approval. These include the possibility of closing businesses that evade taxes, a better definition of certain terms used in laws for tax purposes and other measures directed to diminish tax evasion.⁴⁰ Likewise, there are sales tax revenue control problems. For example, many firms collect it, but do not fully enter the amount perceived. The actual mechanisms of tax review and control provide ample discretion to different tax administrators. That widens the possibility of corrupt acts.

These incentives for corruption are not the result of a recent legislation or of the reform process. It is an old "disease" of the Costa Rican economy. Although the Tax Justice Act approved in 1995 created the possibility of applying penalties to corrupt tax administrators, no one has gone to prison on this basis. The Act too foresaw the creation of specialized courts in charge of applying the new legislation, but they do not yet exist.

(3) Export subsidies:

Keeping in mind the objective of exporting under the protectionist model -in which policies were naturally opposed to achieving that purpose-an export subsidy (CAT) was created. So far, it has been kept as part of the new development paradigm, albeit it was granted only on a temporary basis. New CATs ceased to be granted in 1996 with the idea of eliminating them afterwards, possibly because of the country's fiscal difficulties.⁴¹

This subsidy has facilitated corrupt acts. For instance, the case where the good is actually different from the one specified on the export documents and with a value larger than the real one. Also, when the quantities exported are simply falsely increased. All of this is done in order to obtain a larger CAT.⁴²

Recently, those responsible for a case of corruption related to CATs⁴³ were condemned to prison by the court. An additional case is also pending in court. Not long ago two entrepreneurs were detained for investigation about a possible fraud with CATs around an amount of U.S. \$6 millions. It has been indicated that about 60 of the 500 firms allowed to receive CATs are under investigation. Meanwhile, their CAT permits have been suspended.⁴⁴

While the import substitution model existed, there were various incentives that lead to possible corruption. One of them is known as the "industrial contract", which was designed to force industrial development in the framework of the import substitution paradigm. It granted tariff exemptions for inputs used in the production of goods sold in domestic markets (or to the Central American Common Market), and to third markets. Among other favors given to protected firms, it also provided a preferential tax treatment for reinvestment of profits.

These benefits were offered by other nations of Central America, in part as a way of attracting foreign investment. Initially, the industry's preferential treatment varied between countries. But an equal treatment was eventually granted to similar enterprises in all the countries, especially to the firms already established. This action was done under the pretext that no firm should be in disadvantage.

39. The excise tax that varies between 5% and 75% depending on the taxed good, if it is imposed on a good with no domestic production and it is only imported becomes equivalent to a tariff. It encourages smuggling and, besides, increases the problem of an ample dispersion of tax rates. That duty falls on more or less half of the Costa Rican imports.

40. Recent comments by the president of the union of private producer organizations point out that, in the country, of about 81.000 enterprises, only 40.000 pay taxes. For this reason, \$270 million a year in additional revenues are not perceived from unregistered or informal sector enterprises. "Mitad de las empresas no tributan/" Periódico El Herald, Wednesday, June 9th, 1999, p. 4. These figures signal a serious tax collection problem due to possible evasion or avoidance. Those missing revenues amount to 2.7% of the country's actual GDP. If they were ever fully collected would almost solve the central government deficit.

That required a "scaling up" of all benefits to all firms in the region. This scheme of subsidies disappeared, but was replaced by some-thing similar, named "export contract". Its main export incentive instrument was the CAT. The export contract allowed tariff free imports of inputs used for producing exports.⁴⁵ It also granted an exemption for all taxes except payroll taxes.

(4) Incentives for tourism:

Incentives -or "carrots" as they have been called- for specific groups were required to form a coalition that supported the changes. But this created other distortions that may have induced corruption. For instance, in 1985 legislation was approved to grant some incentives to the tourism activity. In the past, it received a preferential deal compared to other service activities. The purpose was to have capital flowing to that sector by a preferential tax treatment. The new law purported to solve a problem of the previous legislation, that exempted taxes but by a relatively low fixed amount when resources were addressed to investment. That fixed quantity had been eroded by inflation.⁴⁶

Right now (1999-2000), the Congress is debating whether or not that legislation was properly used. The fact is that some tourism enterprises presumably increased the real value of their investment, and third parties could deduct a larger amount of the due tax. The public sector ended with less income tax revenues than what should have been collected according to tourism legislation. The possibility of an improper use of the deductions may be suitably valued in courts. Once again,

41. It is estimated that any CATs on exports will end in 1999; however, since they can be used in lieu of tax payments 18 months after its issuance, the positive effect of its elimination will not be felt in the public finances but until year 2001.

42. A recent study mentions the following as possible anomalies by CAT beneficiaries. They will be eventually confirmed or resolved by the judiciary: "fictitious exports in order to receive the incentive. Real exports but with changed goods. Artificial increases in prices and quantities. Imports of products that are re-exported but as if of a national origin. CATs received by now inactive enterprises that used to have the subsidy. Enterprises that did not fill the required domestic value added. Required guarantees of a lesser value (but enabled perceiving the subsidy); duplicated CATs (on collection)/ among others. The parenthesis are mine. José Merino del Río, *El Fraude con los CAT: Un asalto multimillonario a los dineros del Estado* (Propuesta de Informe de la Comisión Especial que investiga los Cat), San José, Costa Rica: Editorial Juricentro, 1999, p. p. 13, 16, 17, 20, and 22 - 25.

43. In 1991, the third most important non-traditional exporter was accused of falsifying exports in order to obtain a larger CAT. What was considered the first case of possible corruption linked to the CAT is still immersed in a delayed process of judicial decision.

this reflects the fact that subsidies somehow increase the possibilities of corruption.

The tourism incentive scheme, just like the CATs, was not a novelty tied to the substitution of the protectionist model by the open trade model. On the contrary, the new scheme was simply an adaptation to new circumstances, through an update of the tax-deductible amounts. It also provided a separate legal framework to deal specifically with incentives for tourism.

(5) Bureaucratic transactions and regulations:

A public office was recently created, to review and eliminate unnecessary bureaucratic transactions that citizens had to follow when dealing with the public sector. In many occasions, public officials have a high degree of discretion so these requirements could become a potential field for corruption. Some legal obstacles to reform have arisen. The opposition of various professional groups to some of the changes has also turned out to be a difficulty, given the fears of these groups of having their employment possibilities reduced. However, the most important obstacle is a paternalist vision about the role of the state. That has obstructed an adequate reform of the relevant legislation.

Those bureaucratic transactions are not necessarily the result of the protectionist development model. In fact, many procedures then required have disappeared. For instance those to obtain an industrial contract. Some existing transactions still reflect a protection bias in favor of domestic activities. This purpose, however, is, more or less, concealed.

Some of the actual procedures were imposed long before the import substitution model existed. For instance, the need to present import permits and registry papers at the Health Ministry for all pharmaceuticals,

44. "Dos presos por fraude con CAT," *Periódico Al Día*, Thursday, June 3d, 1999, p. 9.

45. Lizano mentions that, different from the stimuli given during the stage of import substitution, now the "promotion of exports" was pretended. That required a training process, when the direction of the production changed from the Central American Common Market, to the global economy. Besides, these subsidies were "not permanent, but temporary" and that the "interest groups, born under the umbrella of the new distortions, did not result as powerful as it had happened under the GPP." Eduardo Lizano Faith, *Ajuste y Crecimiento en la Economía de Costa Rica, 1982-1994*, Op. Cit., p. 106.

46. Before the 1985 reform already mentioned, tourism enterprises obtained several benefits under the industrial incentives legislation, by means of a variation of the industrial contracts.

medicines, cosmetics and some chemical products. Those requirements were not intended exclusively to protect human health. To import any kind of agricultural good or of an animal origin, it is necessary to present plant or animal health certificates at the Ministry of Agriculture. It is also a requisite to present permits for importing weapons and ammunitions. Even if it is only for the first time (recently so reformed, because it used to be required more often) it is necessary to register any imported food products.

Regulations to export certain types of goods exist under the pretense that they are very important in the consumption of low-income groups. These are sugar, rice and black beans. Similar export regulations apply in the Ministry of Agriculture for wood, ornamental plants and cattle, and, in the Ministry of the Economy, for those of scrap metal. If export quotas are applied to Costa Rica in international markets, for example for coffee, the Coffee Institute allocates them. In the case of textiles and clothing, the Office of Textile Quotas distributes quotas and, for sugar, the Agricultural and Industrial Sugar Cañe League does it. Something similar happens to bananas. Private associations allocate all quotas.

There are other examples, of regulations or restrictions that generate high rents to beneficiaries and hence could potentially constitute sources of corruption. For instance, training requirements in a government institution are necessary to obtain a driver's license. Radio and TV frequency concessions are granted not by some type of auction and with a certain periodicity, but depend on administrative decisions. The canon to be paid for this naturally restricted supply of frequencies is ridiculous.⁴⁸

(6) Subsidized interest rates:

Interest rate subsidy policies gained force after the nationalization of bank and credit in 1948. They were consistent with the import substitution model not by an apparent purpose to redistribute, but to encourage the use of modern technologies coming from countries where capital was relatively abundant. Those "modern" technologies were necessary for import substitution enterprises to compete in international markets.

With the change of model, almost all subsidies in banking were abolished. However, given the public

interest criteria defined by the Executive or the Legislative powers, sometimes state banks have been compelled, to grant preferential treatment to small and medium-sized industrialists and farmers, and to the housing sector. In the past almost all of the economy's total credit came from state banks. Those subsidies induced possible corrupt actions. They are in process of being totally abolished. Whereas in the bank and credit area the possibility of negative impacts during the last years has been substantially reduced, it has not happened in the housing sector. In it there is difficulty in achieving the required controls to avoid misuses of funds. But also the political decision to eliminate those subsidies has not been taken.

(7) Government monopolies:

The existence of certain state monopolies reflects the presence of the old order in the midst of one that emerges. As part of the economic reform, some production of goods has been transferred to the private sector. Examples of this, are the cases of a cement factory, a sugar mill, and a fertilizer plant. The same has not happened to public services like telephone, distribution and transmission of electricity (there has been some opening for its private production), drinking water, commercial insurance, airport operation (it is now changing) and seaports. State monopolies remain for some goods, such as oil refining and the still of liquor.

The privatization of public enterprises has not yet been subject to deep questioning regarding its correctness. It cannot be assured if improper practices have been present, so there is a presumption of their rectitude. However, the persistence of public monopolies could remain an incentive for un-due practices. At least privatized firms do not enjoy monopolistic privileges, because they are now subject to competition or, at least,

47. Besides the CAT, during part of the import substitution model's life existed another export subsidy, the CIEC (Export Increase Certificate). It oscillated between 1% to 10% of the export value, and varied according to export increase during the year, compared to the one of a year before.

48. The annual fee paid by the use of a radio station frequency is a maximum of \$3,10, while there is no similar payment for a TV station.

49. They do not have special protection beyond that granted to the rest of the economy. Also the tariffs applied to privatized enterprises are usually lower than that of the average (except for a sugar mill, but there are several similar firms in the country). Besides, there is free entry into the privatized activities. It could even be considered a contestable market. William J. Baumol, John C. Panzer y Robert D. Willig, *Contestable Markets and the Theory of Industrial Structure*, San Diego, California: Harcourt Brace Jovanovich, 1982.

to an eventual entry of possible competitors in the market.⁴⁹

The problem is the permanence of state monopolies that have not yet been privatized. Given their power to restrict the supply and, hence, to charge a higher price, it causes an increase in profits that could be partially eroded as a result of corruption, without any need to change their pricing policies.⁵⁰ The hope is that if Costa Rica continues its privatization program, it will not be in exchange of a monopoly guarantee to the eventual buyer. From the point of view exposed, this would maintain an incentive for generating acts of corruption.

A monopoly for a firm means getting extraordinary profits, so it is possible that through government actions such status can be guaranteed. A tariff that avoids foreign competition or free entry restrained by that same state assures the monopolista extraordinary profits. The incentive for corruption then exists. Historically, those limitations characterized the Central American economies during the life of the import substitution model, with the so-called "integration industries".

Certain monopoly concessions of the state to private firms (different from those resulting from high tariffs) still exist. That happens with all bus route operations. Similarly, by restricting free entry, the state promotes the emergence of cartels, as is the case with the professional exercise of certain activities (the so-called "professional bars") or with taxicab services.

The potential negative impact of monopolies on corruption may also spring from a practice implemented by some public entities during the last years. Former employees created workers or union owned corporations to provide certain services to those government companies. However, they were contracted as providers under a monopoly *status* for several years. Where

50. In a general sense, the formula developed by Klitgaard is well known: "corruption may be represented as following a formula: $C = M + D - A$. Corruption equals monopoly plus discretion minus accountability." Robert Klitgaard, "International Cooperation Against Corruption," Finance & Development, XXXV, 1, March 1998, p. 4.

51. As examples, see David Lindauer and Barbara Nunberg, eds., *Rehabilitating Government: Pay and employment reform in África*, Washington D. C: The World Bank, 1994; Caroline Van Rijckeghem and Beatrice Weder, *Corruption and the Rate of Temptation: Do low wages in the civil service cause corruption?*, International Monetary Fund Working Paper 97/73, Washington D. C: IMF, 1997, and Vito Tanzi, "Corruption Around the World: Causes, Consequences, Scope, and Cures," Op. Cit.

monopolies exist, extraordinary rents are created and corrupt practices may possibly appear.

(8) Agricultural sector subsidies:

Subsidies were contained in a law named FODEA approved in April of 1987. Among other measures, it granted a preferential treatment to debt restructuring by small and medium-sized farmers, due mainly to state banks. It gave an interest rate subsidy on loans used for transforming the agricultural sector to exports and non-traditional production, and also provided certain tax preferences.

This legislation created problems, like when a number of farmers, larger than expected, tried to benefit from the preferential treatment. It was not possible to separate those who surely classified as beneficiaries, from the too many applicants, neither to control debt recovery. There were also pressures to include a wider range of agricultural products than those initially included in the preferential treatment program. The farmers never cleared many of the due debt operations to the state. In summary, it was a subsidy scheme that went corrupt: public funds ended up paying for irrecoverable debts through FODEA, instrument through which the state guaranteed the farmer's unpaid balances.

Although Lizano does not incorporate it as a policy to stimulate the creation of alliances in favor of change in the economic model, in 1986 another subsidy was established. The Certificado de Abono Forestal (CAF) became an incentive for private planting of forestry species. The government provided entrepreneurs with financial support to pay for the long-run costs of wood-tree production. The subsidy consisted of a certain amount of money per planted area. So far, it has not implied large disbursements given the difficulties with the country's budget. However, this subsidy scheme could potentially cause corruption.

From 1999 on, the only export incentives system that will remain in effect is that of free zones. The CAT, the export contracts and the temporary import or the drawback systems will have ceased to exist. A potential problem leading to corrupt acts has been mentioned. It arises from the possibility that firms established in the free zones sell some percentage of their total production to the domestic market. In a free zone area no tariffs are

paid on raw materials, capital goods and other imports. This with the purpose that the firms established there are able to face similar costs to those found in world markets.

If free zone firms sell to the domestic market, the tariff on the final good would have to be paid in the same circumstances as if it was directly imported from international markets. As the preferences stand, this does not cause a problem. Obviously, a tariff on the final good is what constitutes a stimulus for smuggling, as it may happen with any other similarly treated import. The problem is not the free zone system by itself, but the existence of tariffs.

Other factors may indirectly have an incidence in the emergence of corrupt acts in Costa Rica that I will mention briefly.

(10) Public sector wages:

Studies have been made on how low wages in the public sector stimulate the surge of corruption.⁵¹ One of the paradoxes actually observed in Costa Rica is the tenacious and widespread opposition to wage increases in the public sector. Especially to those of officials in high posts, who happen to possess wide discretionary powers. These offices are the most vulnerable to possible undue actions.⁵² According to some estimates, the salary of a high official in the Costa Rican government is about 40 to 50% of that of a similar in the private sector. The paradox is that, while there is deep opposition to wage increases for high officials in the public sector, who are paid relatively poorly, it is expected, at the same time, that public corruption be stopped or even reduced.

(11) Government purchases:

The size of government and the administration's purchase of goods and services may have a substantial effect on corruption. In Costa Rica, 66% of the disputes presented for resolution to the Administrative Contracting Direction of the Office of the Comptroller General, are objections to the contents of the tenders prepared by the different public entities.

52. "In many countries the wages of higher-level civil servants are allowed, of ten for political reasons, to erode by more than those of the lower echelons; this wage compression makes it even harder to attract and retain high-quality staff at the vital senior levels." The World Bank, World Development Report, 1997: The state in a changing world, Op. Cit., p. 95.

The other 33% are appeals on who were the beneficiaries of the adjudication.⁵³

This indicates that most "problems" that come to the knowledge of the General Comptroller's Office, on these issues, refer to how tender contents are prepared. Those who dispute them may consider them "incorrect". That impropriety may be the result of ignorance in its preparation or of a deliberate attempt to favor a potential participant. It is difficult to know which applies.⁵⁴

(12) Other cases of possible corruption:

Some possible corruption cases related to the use of public funds in social assistance programs have recently arisen (1999). One of these has already been presented to the courts' decision. It relates to possible undue investments of public funds in a non-authorized private financial entity. A loss of about U.S. \$5 millions is estimated. The Attorney General Office is analyzing the other case to eventually present it to the court's knowledge. Preliminary estimates on this possible undue use of public funds amounts to U.S. \$30 millions.

The court is also handling the possible corruption case carried out in 1996 in the General Aviation Agency. The cause is a potentially improper use of public resources of about U.S. \$3.5 millions. Also pending in a penal court, is the case of a bankruptcy resolution of the Costa Rican Anglo Bank. According to some estimates, it caused total losses of about U.S. \$112 millions. Part of that amount has been alleged to be a misuse of public funds during 1993-1994 and the rest is the result of the bank's closing at the end of 1994.

(13) Crime and punishment:

53. What are usually presented to the resolution by that Office are those considered "big" cases, meaning that they involve large quantities of money. In this sense, the above mentioned phenomena may be significant, in spite that, for instance, of the total tenders published in a year, approximately only 10% is appealed and, of that, just 30% is declared nil.

54. The introduction of more open (electronic) systems that stimulate competition and provide abundant information, actual and past, about public acquisition tenders, where, for instance, the results of similar acquisitions of previous years are clearly indicated, could stimulate lower corruption. As an example, the introduction of better buying systems allowed a reduction of about 33% of the 1997 total annual expenditures on goods and services carried on by the City of Buenos Aires. Adalberto Rodríguez G., "Un Modelo de Transparencia y Eficiencia en los Procesos de Compras y Licitaciones: El caso del gobierno de la Ciudad de Buenos Aires," conference pronounced in the Seminar *Efficiency and Transparency in Public Sector Acquisitions*, Washington D.C.: Interamerican Development Bank de Desarrollo, February 26-27, 1997, *passim*.

Finally, I want to comment on some problems concerning the perception of crime and punishment in Costa Rica. There is a general feeling that there is little probability that those who commit corrupt acts will be prosecuted. In any event, the penalties imposed are relatively low. Procedural difficulties in some of these cases of possible corruption make for lengthy processes. There also exists the perception that the benefits derived from these types of crimes linked to corruption exceed their penalty costs.⁵⁵

I am afraid that these statements induce a sad perspective about the possibilities for success in the battle against corruption. But, the extent to which this view can be confirmed depends on the resolutions taken by the courts in the above mentioned cases.

VI.- THE STATE'S PENDING REFORM

With reference to proposals regarding the functions that a modern state should perform within the frame of globalization, different positions emerge according to diverse criteria. They vary from those based on religious beliefs to others based on the theoretical position of an economist, a social scientist or a philosopher. In the final instance, views on what functions the state should perform depend on the self-interest or benefit that an individual derives from actions performed by the state. My basic objective is to present some arguments in support of the position that corruption will be reduced with the minimization of the state and by changing the ways in which it actually operates.⁵⁶

The experience with the transition in Costa Rica, and because of the impasse in its reform process, reveals the need to define a role for the state. Not only during that process, but also in the type of society that people expect or hope to achieve. From what I have been able to infer, similar experiences are present in other nations of the area.

I share Popper's statement: "Personally, I believe

55. Gary S. Becker, "Crime and Punishment: An Economic Approach," *Journal of Political Economy*, LXXVI, 169, March-April 1968.

56. Minimization of the state is the process of reducing the size and transforming the ways in which it operates. Those lead towards a minimal state. The functions performed by a mini-mal state are the administration of justice and the defense of the nation against foreign enemies. Those functions should be considered protective of the rights of man: to protect the person and property from the aggression of the powerful. In addition, see note 63.

that a free-market economy is more efficient than a planned economy."⁵⁷ That does not mean that I judge desirable the state's non-existence. In fact, I consider that any free society, based on western traditions, requires a state. After all,

if there is an absence of a legal system, you cannot have a free market... And that can only be established by a state and by the legal system of the state.⁵⁸

I have no knowledge of any liberal (whig) thinker⁵⁹ that does not provide a place for the state in a society of free men. Their differences arise mainly about the degree of the state's intervention. Some consider that the functions performed by the state should be the least. They even judge that the third public function proposed by Adam Smith -that the state assure the provision of certain goods that otherwise would not be brought by private individuals- should not be carried on by the state in a liberal society.⁶⁰ But others propose different state functions from those suggested by Smith. Just as an example, there is Friedman's proposal for a negative income tax. He proposes this mechanism as a way to alleviate poverty, substituting other instruments that have created serious distortions that affect the functioning of markets.⁶¹

My opinion is that what we are talking about, consists of shades in a continuum, where some consider appropriate the existence of a state with very few functions⁶² while others find convenient its existence with more functions.

57. Karl R. Popper, "¿En qué cree Occidente", in Karl R. Popper, *En busca de un Mundo Mejor*, Barcelona: España: Ediciones Paidós Ibérica, S.A., 1992, p. 276

58. Karl R. Popper, "Entrevista I (1991)," in Karl R. Popper, *La Lección de este Siglo*, interviewed by Giancarlo Bosetti, Buenos Aires, Argentina: Temas Grupo Editorial SRL, 1998, p. 59.

59. I use the term liberal in the European (and Costa Rican) sense, not as employed in the United States. See Friedrich A. Hayek, *The Constitution of Liberty*, Chicago: The University of Chicago Press, 1959. See particularly its post scriptum *Why I am not a conservative*.

60. Briefly, Smith proposes a state that carries out the following functions: (1) to provide for the defense of the nation against foreign enemies, (2) to have a judicial system and (3) as described in the main text. See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Op. Cit., p. p. 687-688.

61. Milton Friedman, *Capitalism & Freedom*, Chicago: The University of Chicago Press, 1962, p. 191.

62. For instance, Hans-Hermann Hoppe, "F. A. Hayek on Government and Social Evolution: A critique," *The Review of Austrian Economics*, VII, 1, 1994. He criticizes Hayek as a "modern social-democrat" because of the government intervention he proposes in *The Constitution of Liberty* (Friedrich

The problem is how far one can move within a liberal conception of the state. For instance, Friedrich Hayek criticizes Mancur Olson for advocating a "minimal state" restricted to defense against an external enemy and to apply the law. Hayek states that

we find it unquestionable that in an advanced society government ought to use its power of raising funds by taxation to provide a number of services which for various reasons cannot be provided, or cannot be provided adequately, by the market.⁶⁴

It does not mean that, by the use of this taxing power, the state is in charge of fulfilling that lack or excess of production. Hayek, Olson and Fried-man are considered liberals ("whigs"), so there must be a way to decide when some are on this side or the other of the line.

Two criteria may be useful for this delimitation. First, that the proposal comes close to what I consider as essential for a good performance of the state. It is that

the prime public concern must be directed not towards particular known needs but towards the conditions for the preservation of a spontaneous order which enables the individuals to provide for their needs in manners not known to authority.⁶⁶

A. Hayek, *The Constitution of Liberty*, Op. Cit., especially in the third part of this book).

63. Herbert Spencer remarks that "... [Between the two extremes of its possible power, the everything and the nothing with which a government may be entrusted, there must be some point which both principle and policy indicate as its proper limitation. This point, this boundary, it behoves every man to fix for himself..." Herbert Spencer, "The Proper Sphere of Government/" in Herbert Spencer, *The Man versus the State*, Indianapolis: Liberty Classics, 1981, p. 263. It means that the persons have to define what roles should be performed by the state. However, since besides the administration of justice, "others may be added, did it seem desirable," Spencer cautions against a simple acceptance of a different role. That addition should be only after a serious examination. But this suggestion does not solve the problem of how to constraint factions from ruling. (Herbert Spencer, *Ibidem*, p. p. 262-263).

64. Friedrich A. Hayek, *Law, Legislation and Liberty: Volume III: The Political Order of a Free People*, Op. Cit., p. 41.

65. Friedrich A. Hayek, *Ibidem*, p. 42.

66. Friedrich A. Hayek, *Law, Legislation and Liberty: Volume II: The Mirage of Social Justice*, Chicago: The University of Chicago Press, 1976, p. 2.

67. Peter Boettke states that "the dilemma in the constraining of Leviathan is that a government strong enough to establish effective restrains on its own power, is often strong enough to break those binds when desired." Stiglitz does not solve this dilemma when he proposes a partnership between government and the private sector "an appropriate balance between markets and government." (Joseph E. Stiglitz, *Whither Socialism?*, Cambridge, Mass.: The MIT Press, 1994, p. 267). He cites his concern in curbing the influence of special interests (Joseph E. Stiglitz, *Redefining the Role of the State*,

Second, it is the limitation of the state. The state should be organized from and according to law. That law resulting from abstract and general rules that assures liberty to all and not that coming from the decision of a particular and external authority. Most of the rules of conduct exist without being explicit to acting persons. They come to be observed and acted in accord by the people, because they produce certain unintended results that make possible man's adaptation to the environment. Rules necessary for the maintenance of the spontaneous order are different and should not be confused with those governing an organization. To avoid policy measures that aim to obtain particular effects, - that benefit some discernible group rather than the enforcement of rules of just conduct- government must be limited. Then the tendencies of factions to rule can be restrained.⁶⁷

Hayek mentions that,

What is generally described as the public sector, ought thus not be interpreted as a set of functions or services reserved to the government. It should rather be regarded as a circumscribed amount of material means placed at the disposal of government for the rendering of services it has been asked to perform.

State's limits are given by the constitution, whose purpose is to configure and order a government. It assures government's limitation through the classical division of powers and establishes the necessary mechanisms to guarantee the citizen's fundamental rights. The state should be constitutionally limited to assure that its power be effectively restricted. The alternative to this limitation is having a despotic government, based on arbitrary rules and, hence, not decent.

The two Hayekian criteria already referred may help to delimit the size and the forms under which a government operates. Hence, they contribute to

Washington D.C.: The World Bank, March 17, 1998, mimeo, p. 10), and propose some strategies that may improve governance. But he does not address the problem of how to effectively curb the impulse of factions to rule using the state to promote their own interests. As stated, the functions assigned to government, "depend on the self-interest or benefit that an individual derives from these actions performed by the state." (P. 27 supra). This is the crucial reason for trying to establish limits to the state.

68. Friedrich A. Hayek, *Law, Legislation and Liberty, Volume III: The Political Order of a Free People*, Op. Cit., and p. 47.

avoidance of corruption, as it has been analyzed in this paper. It is so, because, on one side, they do not stimulate the emergence of a "large" state and, on the other hand, they avoid having rules for specific and not universal purposes.

In my opinion the state has a role to perform during the previously discussed process of change. The Costa Rican experience shows an active state in that sense. But, according to the information here provided and from the point of view of potential stimuli for corruption, the "temporary" measures taken may have facilitated the emergence of serious problems of corruption. Those measures could have probably been avoided, not only in the way they were designed, but also if it was really needed to put them into effect.

The different incentives created as part of the economic reform, and those partially maintained inherited from the old regime, have a lot to do with the national lack of definition about the role that the state should perform now and in coming years. That has created a situation that is incompatible with the desirable state restructuring under the new global rules. In a great deal, the actual system of incentives has induced the above-mentioned possible corruption.

It may be argued that those transitory measures were of convenience. One way or another, they took into account other factors different from the technological-economical prescriptions usually offered ("getting prices right"). The fact is that the paralysis, uncertainty and indecision about the role the new state should perform, means an enormous cost on society in the process of carrying out the required transformation. That is, if "the ability to establish institutions of governance which reduce political uncertainty by restricting the opportunities for public and private predator actions"⁶⁹ is not available, the effort to have an economic order that may give a chance for people to progress, will hardly come by.

In essence, what should be sought is, as Hayek proposed referring to Adam Smith, "a system under which bad men can do least harm". A social system that

does not depend for its functioning on perfect men for running it, or on all men becoming better than they are now. But on the contrary makes use of men in all their given variety and complexity, sometimes good and sometimes bad, sometimes intelligent and more often stupid.

This does not mean that we are referring to a perfect system and hence incapable of improvement. On the contrary, the great individualists

were more than aware of the conflicts of individual interests. They then stressed the necessity of 'well-constructed institutions' where the 'rules and principles of contending interests and compromised advantages' would reconcile conflicting interests without giving any one group power to make their views and interests prevail over those of all others.⁷⁰

APPENDIX 1

PRINCIPAL COMPONENTS ANALYSIS⁷¹

The main problem found with the available information is that of measuring variables. Particularly, there are "perception" indexes and not actual magnitudes. The corruption index by International Transparency (IT) used in this paper is construed on consultations to information media. Hence, it indicates how facts are perceived and not the magnitudes of corruption. If we assume a strong correlation between that perception of facts with the degree of corruption, then the use of this index may be helpful.

For measurements on the ways in which the state operates (distortions), indexes from Heritage Foundation (HF) are employed. The technique known as factor analysis in its variation of principal components was used for our estimations. It is widely used in the social science fields. Ordinal limitations and possible biases were the reasons for employing it. The data are perceptions about magnitudes and not measurements themselves, so it is not clear whether the variables

69. Peter J. Boettke, *The Russian Crisis: Perils and Prospects of Post-Soviet Transition*, mimeo, 1999, p. 6, forthcoming in *The American Journal of Economics & Sociology*, July 1999.

70. Friedrich A. Hayek, "Individualism: True and false," in Friedrich A. Hayek, *Individualism and Economic Order*, Chicago: The University of Chicago Press, 1969, p. p. 11-13.

71. This technique is exposed, for instance, in Donald F. Morrison, *Multivariate Statistical Methods*, New York: McGraw-Kill Book Company, 1990.

correspond to those appropriate for validating the hypotheses. The technique employed is considered exploratory, given the measurement difficulties.

Factor analysis constructs linear combinations of the variables analyzed. They indicate possible dimensions that underlie or are common to the group of the original variables. Mathematically, a linear dimension that groups the maximum number of the original variables is found. It bunches the largest percentage of the total data variance (Factor 1 explains most of the total variance). A second linear dimension would assemble the largest percentage of the remaining variance (Factor 2) and so on. The correlation of a variable with each factor indicates the variable's association with those that correlate with the factor. For instance, in the main text's exhibit, the 0.72 correlation between the variable "government intervention in the economy" and Factor 1, indicates the relatively high degree of association between this variable and all those that are also correlated with the factor. Also, it shows the relatively high lack of association with those that are not correlated with the factor.

Given the relatively limited size of the IT sample and a possible over representation of "developed" countries, evaluations were made for the total sample where data was available and also for a reduced sample that excluded some industrial developed nations. A variable named "development" was included to control the inexplicit systematic differences in factor analysis. The degree of development is the strongest of those systematic differences. For instance, the presence of industrial countries in the sample (mainly OECD nations), which simultaneously have the two characteristics: a relatively "big" government and "little" corruption. The reduced sample served as the basis for the table presented in the main text. It includes the following countries:

Singapore	Israel	Hong Kong
Portugal	Costa Rica	Chile
Greece	Czech Republic	Hungary
Poland	Taiwan	Malaysia
South África	South Korea	Uruguay
Brazil	Romania	Turkey

Thailand	Philippines	China
Argentina	Vietnam	Venezuela
India	Indonesia	México
Pakistan	Russia	Colombia
Bolivia	Nigeria	

A similar exhibit to that presented in the main text follows. It incorporates all countries for which data were available. Concretely, besides the countries already mentioned, it includes the following:

Denmark	Finland	Sweden
New Zealand	Canadá	Netherlands
Norway	Australia	Switzerland
Ireland	Germany	United Kingdom
United States	Austria	France
Japan	Spain	Belgium
Italy		

	Factor 1 (47.5%)	Factor 2 (14.7%)
Corruption	-0.870	0.278
Development**	0.826	-0.379
Trade policy***	0.789	0.056
Taxation	-0.146	0.787
Government intervention in the economy	0.274	0.541
Monetary policy	0.632	-0.384
Restrictions on foreign investment	0.569	0.409
Banking	0.687	0.088
Wage and price controls	0.648	0.308
Property rights***	0.890	0.031
Regulation***	0.809	0.245

Sources: For corruption, International Transparency, 1997 Corruption Perception Index, Göttingen University and International Transparency: Internet Center for Corruption Research, 1997 and, for the remaining variables, Bryan T. Johnson, Kim R. Holmes and Melanie Kirkpatrick, 1999 Index of Economic Freedom, Washington D.C.: The Heritage Foundation and The Wall Street Journal, 1999.

* The percentages of the variance explained are indicated in parentheses.

** Ordinal scale from 1 to 5.

*** This dimension includes indications of corruption within that specific area. Except for corruption, the measurement scales go from 1 to 5 (from "better" to "worse"). Corruption's goes from 1 to 10 (from "worse" to "better").

To conclude, the results presented in the main text are consistent with the hypotheses set in this paper: that the state's size as well as the way it operates in the economic system (distortions) are positively related to a country's corruption. The conclusion is different when developed industrial countries (mainly those of the OECD) are included. In these countries, there is a relatively large state with less perceived corruption. Now Factor 2 appears stronger, associated with indicators of the volume of fiscal resources ("Government intervention in the economy" and "Taxation").

The difference on the results of both samples could indicate the existence of factors different from government's size as an explanation of corruption. Those of an institutional nature, allow us to explain the problem of corruption. This could be an object of further research.

APPENDIX 2

SOME BASIC FACTS ABOUT COSTA RICA

Costa Rica is located in Central America and has a surface of 19.730 square miles. It possesses a long-standing democratic government. Its actual population is around 3.75 million, of which about 12 to 15 percent are mainly recently immigrated Nicaraguans.

During the 1987-97 period, its GDP grew at an average rate slightly over 4%, while its population did it at a rate of about 2.2%. Half of its population is considered urban. The actual (1998) per capita GNP is close to \$2.700.

Over the past 20 years, Costa Rica dedicated between 15 to 18% of its GDP to social expenditures. After a substantial increase during the 1980's crisis, poverty has now declined to 20.5% of households and those considered "extremely poor" amount to 5.5%.

According to the 1999 United Nations Human Development Report, Costa Rica is classified as a country with "high human development" and it occupies position 45 among the 174 countries listed. Among developing nations, Costa Rica is ranked number 4 in the Human Poverty Index.

Life expectancy for women is 77.3 years, the highest in the developing world, and life expectancy at birth is around 75 years, a figure considered high even for industrialized countries. 92% of its population has access to safe water and its illiteracy rate is about 5%.

Its economy is very open, especially after recent reforms. The 1997 ratio of exports and imports of goods and services to GDP is 96.1. The equivalent index for exports of goods and services is 46.8 and for imports, 49.3. The average growth rate of exports in goods and services in the period 1987-97 (after it started to reform its trade regime) is 9.5%. This growth is almost four times that of the period 1976-86.

In 1997, General Government Consumption was 17.5% of its GDP and the overall deficit of the public sector was 1.6%. However, in the past years, Costa Rica has had important fiscal problems, including a relatively high internal debt. In 1997 the inflation rate was 13.3%.

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