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The Economy of Seepage and Leakage in Asia¹: the most dangerous issue

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Pakistan, India, Bangladesh, Vietnam, Indonesia, China and other Asian countries already face very serious challenges in infrastructure, agriculture, State owned enterprises and environment. In spite of the increase in private investments, local or from outside, the situation could get worse in the next decade or so for lack of public finance. Such a shortage is bound to slow down future growth, particularly in China, Indonesia and Vietnam, and prevent an acceleration of growth in South Asia. One major remedy would be to reduce seepage and leakage of public money which has taken on such enormous proportions, that it looks like being the most critical issue for the coming decades.

The leakages so often referred to in Pakistan are, in fact, far from confined to that country, as shown below. However, such leakages have worse effects in Pakistan than in India and China, because of the much more precarious financial situation of Pakistan.

There is, at last, a **healthy reaction against corruption**. The World Bank, the IMF, the OECD, several governments of rich and poor countries are now striving to curb this rising disease. However, what I call *the economy of seepage and leakage* goes beyond corruption. I see the problem as having three tiers: *misallocation of resources in general*, the result of government policies or weak administration: excessive subsidies, real estate speculation, wasteful expenditure, neglect of most urgent investments in infrastructure and lack of public operations and maintenance expenditures. Then come **losses of revenue**: tax fraud, smuggling, poor enforcement or collection of fees and taxes; finally *corruption* including a variety of malpractices. All these factors severely curtail public investment and recurrent expenditure devoted to productive tasks, at the time when public funds are badly needed and in short supply.

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In spite of sound trends aimed at a reduction of the scale of government activities in industry and services, the **State** has still a major role to play as an agent of development, even though the rightist dogmas have replaced, since the 1980's, the leftist dogmas.

While this paper is confined to Asia, it seems likely that some of the following observations apply to Latin America and Africa. According to the OECD estimates: "Every year some eighty billion \$ are paid out world-wide in the form of bribes" and it may be the "tip of the iceberg". Besides, these data are confined to corruption only (*OECD Observer*, No. 216, March 1999).

The estimates given below are of course very rough, yet they underline the magnitude of the problems and the diversity of losses for governments. Most of them come from local reports and surveys.*

China: smuggling 12 billion in 1998;
tax evasion 30 billion \$ in 1993: unpaid taxes in construction projects 2 billion dollars in 1997;
illegal electrical connections 804 million \$ in 1993;
expenditures on official banquets, nearly 15 billion \$ in 1993;
real estate speculation, 50 million sq. m empty in 1993, costing 24 billion \$;
illegal taxes raised by local authorities, 800 million to 1.4 billion per year, part of them ending in private pockets;
bad debts of State owned enterprises, around 200 billion \$ in 1998;
diversion of State budget funds to set up private luxury flats 2 billion \$ in 1997;
diversion of funds from grain departments for "illegal actions"
6.7 billion \$ between 1992 and 1998.

President Jiang Zemin has often condemned "illegal operations of banks and frauds by enterprises". Zhu Rongji, the Prime Minister is particularly active, going round to local offices in order to curb malpractices.

India: non recovery of telephone bills, 750 million \$ in 1995;
tax evasion, about 30 billion \$ per year;
overinvoicing of exports and underinvoicing of imports to and from USA, 2 to 4 billion \$ in 1994;

subsidies, often of questionable value, equivalent to 15% of GDP in 1997;
illegal assets abroad 40 billion \$;
default loans mostly from public sector enterprises, 11 billion \$ in 1996;
free or very cheap electricity supply to farmers for opportunistic reasons:
diversion of funds allocated for electric networks maintenance or for irrigation works to private pockets;
losses in electric power supply, 40 to 50% of total output, half of it in pilfering and other malpractices estimated at 1.2 billion \$ per year.
Cumulative financial losses of State Electricity Boards 2.8 billion \$ 1998.

In India too, some political leaders and many representatives of public opinion have taken a strong stand against such leakages, and the judicial system has become more active in fighting corruption. Yet a lot remains to be done.

Pakistan: smuggling 3 billion \$ per year;
tax evasion 3 billion \$;
losses due to corruption 2.5 to 5 billion \$ per year;
default loans to the banks 3 billion \$;
size of the black economy: 30 to 40 billion \$;
power thefts from Karachi Electric Supply Corporation: 35% of power generated. 450,000 illegal connections in Karachi and 46,000 defective meters.

In addition, as a consequence of the continuing Afghan wars, narcotics and arms trafficking increase the already large flows of black money. Efforts are being made to fight such malpractices, but there is a long way to go².

We do not have comparative data on other Asian countries but seepage and leakage are considerable. According to the *Asian Development Bank, Annual Report 1998*, "corruption (alone) has added 20 - 100 % to the cost of procuring governments goods and services in several countries". Following the 1998 Report of Transparency International, Bangladesh, Vietnam and Indonesia seem to suffer from more corruption than the three above quoted countries, Thailand and the Philippines are at a rather similar level.

² After writing this paper the military coup in Pakistan occurred and it will be interesting to see the results of the fight against leakage and corruption.

Some of the most glaring cases of seepage and leakage are found in infrastructure. It is not uncommon to find that corruption, wrong allocations of public money, high subsidies, lack of maintenance expenditures, weak management and poor tax collection, pilfering (in the case of electricity) are interconnected.

The need for more **public expenditure** run into hundreds of billion \$ for the next five years or so, particularly in infrastructure. A few years ago, several Asian governments had put much hope on private, foreign or local investments in line with formulas such as BOT (build-operate-transfer) or BOO (build-operate-own) for electricity and transport. Experience has shown that FDI (foreign direct investments) are reluctant to enter such costly and risky projects, so that only a few of them are being implemented. That reluctance is greater now, following the East Asian crisis and the difficulties of China, Vietnam, India and Pakistan.

As a result, most Asian countries cannot escape massive new public domestically financed investments and considerable increases in their current public expenditures for maintenance and operations- wholly insufficient since many years – of transport systems and electricity networks.

The gaps between supply and demand of electricity have already led to billions of dollars of losses for the economies concerned. It is continuing in India and Bangladesh, while in China the gap has been reduced with the slowdown of the economy.

The continuous losses of **industries and services in the public sector** is another large source of leakage and of default loans affecting the banks. These shortcomings are the most serious in China because the public sector is more important than in India and Pakistan. However, reforms are slow in all three countries.

Other topics, much less openly discussed, concern **agriculture** which still plays a major role in Asia, except in Japan, South Korea and the province of Taiwan. It contributes to 20-30 per cent of GDP, and employs 50 to 60-70 per cent of the active population, except in China where it seems to have fallen below 50 per cent. Basic research, extension services, hydraulic works have suffered for the past fifteen years from acute shortage of public money, from Pakistan to China, including several countries in South-East Asia. These defects explain, to a large extent, why the production increase of major crops has slowed down, and is aggravated when the weather is unkind (drought and/or floods). One cannot put excessive hopes on the market and private initiative. A clever farmer can by himself invest in a drip system to irrigate his few hectares of orchards, make

much money and create employment. On the other hand, it is beyond the farmers' ability to maintain or improve irrigation canal systems covering 100 – 300,000 ha or build large size reservoirs, dykes and major drains.

One should also mention the enormous needs for more public funds (in addition to private ones) in order to curb the deterioration of the **environment**. In China, “the economic cost of air and water pollution has been estimated at 3-8 per cent of G.D.P. a year” (World Bank Report, *China 2020*, 1997). The situation is quite comparable in India and Pakistan with costs of 4 to 6 per cent of G.D.P.

Where can public money be found? Foreign aid and FDI cannot cope with such challenges, hence the need to improve local finance, banking and taxation. Curbing seepages and leakages could help replenish the exchequer. At the moment the Chinese are the most active, but even there, a lot more remains to be done. Pakistan, Bangladesh, Indonesia, Vietnam are in a particularly tight financial situation. In India, the 1999-2000 budget aims at more investments in agriculture and infrastructure, but it is not sure that they will materialise.

Part of the leakages (corruption, smuggling, tax evasion) is not the sole responsibility of Asian ruling elites. Questions must be asked from their **foreign partners**. Here also, there is a move in rich countries – it started earlier in USA with the *Foreign Corrupt Practices Act* (1977)- to fight against such malpractices. In a way, one sometimes wonders whether in the long run, the image of a foreign company refusing to engage in *bakshish* might not have some commercial value. Besides, is it not in the general interest of foreign firms to deal with countries which are in a better financial situation?

Finally come **political factors**. Neither in Western countries and Japan, nor in most Asian countries is the political leadership particularly impressive. At the moment, personalities like Zhu Rongji who has thoroughly understood the implications of leakages – and not only corruption – are not so common in either rich or poor countries.

When tackling these issues, Westerners must avoid the frequent **pitfall of sermonising** and emphasising “good governance”. Corruption and leakages are not lacking in rich countries, even if they are less widespread. The question is a practical one. We are in a much less tighter financial situation, with much less acute poverty and less population pressure than Asian countries. That is why we can afford a certain amount of loss and waste. See for instance the case of France. The economy is doing reasonably well while 30 ex ministers, over 100 former or present parliamentarians and

mayors and a quarter of present or ex heads of the 40 biggest corporations are “under formal investigation over various corruption scandals” (*The Economist*, 5-6-99).

In spite of the considerable economic and social achievements obtained in Asia, especially in the last twenty years, future progress may be in jeopardy, unless the economy of seepage and leakage is at least reduced. The present situation has reached, in many countries, such a critical point, that fast economic growth does not seem likely for the next five to ten years, if not more.

* Sources: All the data come from official reports or statements quoted in the following newspapers or journals from the countries concerned:

China : *Beijing Information*, 9-11-98; *China Business Review*, May-June 1994; *China Daily*, 3-5-94, 23-3-98, 7-5-98, 22-12-98, 6-4-99, 28-6-99.

India : *Times of India*, 30-1-97; *The Hindu*, 13-2-97; Ministry of Finance Report on Subsidies, 1997; *Economic Survey*, 1996/97; World Bank Report on Power, March 1998, quoted by Joel Ruet, Paris, CERNA, 1999. *Economic Times*, 6-9-99.

Pakistan : *Dawn*, 29-8-96, 10-10-96, 8-4-99, 26-5-99. *Human Development Report in South Asia*, 1999.