

CORRUPTION AND ETHICAL ISSUES REGARDING PUBLIC-PRIVATE PARTNERSHIP

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The paper raises general questions about ethical problems that taint public-private partnership. Everybody talks about the economical benefits of encouraging firms to invest in the community using different incentives offered by the public institutions. In the same time, every day, newspapers bring to our attention cases of misuse of public resources for private gain or cases of private investors who give bribes in order to get a contract with a public institution. The purpose of this paper is to synthesize our understanding of the entrepreneurial movement and analyze its implications for potential problems of corruption that can arise in the relation between the public and the private sector.

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Recent years have witnessed a revolution in the way governments work. The world has moved away from centralized governments and controlled economies, toward decentralized governments and market-driven economies, and those decentralized governments have been pushed to be more entrepreneurial (Hamlin and Lyons 1993). Some have termed this a movement from bureaucracy to entrepreneurship (Farrell 1986). As the "public vs. private" paradigm diminishes, the walls between the traditionally defined sectors are falling within countries and within communities. A pragmatic, approach to mixed governmental/economic systems is becoming the order of the day.

Some examples of this trend include the privatization of government owned properties and government services, governmental use of incentives to promote public goals through the success of privately owned business, and public choice in the consumption of government services through fees instead of taxation.

This trend has proven to have many positive results for the achievement of public goals, but also puts strains on some of the most basic values of any public system, fairness, equity, transparency and ethical behavior. Discussion of the ethical consequences of this pervasive international entrepreneurial tendency

is a subject for interdisciplinary analysis and synthesis. We need to understand the effects of the trend described above on governmental systems and the concept of a public. The purpose of this paper is to synthesize our understanding of the entrepreneurial movement and distill its implications for systems of ethics and issues of corruption in government.

The first section provides a definition of public-private partnerships, a term often applied to this movement. The second section offers background to the concept and outlines the benefits of the use of mixed venture arrangements. The third section provides examples of public-private partnerships. The fourth section describes some dangers of public private partnerships in terms of ethical problems and corrupt practices. The fifth section offers some solutions. The final section provides a summary and draws preliminary conclusions. It attempts to outline an action and research agenda for improving ethics and avoiding corruption in public administration in the new era.

Definitions

To discuss this complex subject we must define terms precisely so as to proceed with a common vocabulary. Numerous popular terms refer to aspects of this entrepreneurial movement. Several labels are confusing and some are already tainted with controversy and carry emotional baggage. The term “privatization,” is one example. The term describes activities ranging from selling state-owned factories in Poland to contracting out municipal garbage collection in Peoria. While nearly all forms of privatization belong to the entrepreneurial trend, they only represent a portion of the issue. “Public choice theory,” implies that the population should have greater choice in using and paying for governmental services. Often residents pay a fee for a service rather than have it financed out of general taxation. Sometimes public agencies “compete” for “customers” and raise their own revenues. While also a part of the entrepreneurial movement, “public choice” is very different from privatization (Lyons and Hamlin, 2001).

“Reinventing government,” uses and expands not only on public choice and fee-for-service theory but also on the privatization of local services approach (Osborne and Gaebler 1992). “Reinventing” advocates see governmental agencies competing with private firms and other agencies for service contracts that provide limited monopolies or franchises for certain areas of local services. “Reinventing government,” is clearly part of the world entrepreneurial movement.

During the 1980’s, the phrase “public-private partnerships” became popular. The label originally described governmental use of incentives to leverage private investment, particularly with respect to economic development projects. The goal was almost always to promote private physical and economic development in places needing economic rejuvenation (Hamlin and Lyons 1996).

In every case, the terminology mentioned above starts with a public sector and a private sector and talks about how the two sectors relate to one another. This is a false dichotomy. The new movement requires a new paradigm. The last twenty years have seen an explosion in the number and importance of intermediate sector organizations and activities. These promote the public interest, but must also be sensitive to the need to reward investors for taking risks. While “pure public” and “pure private” represent theoretical ends of a spectrum of entities, intermediate sector behavior is increasingly becoming the accepted practice (Hamlin and Lyons 1996).

The phrase, “public-private partnerships”, is now used more broadly than the original project-orientation mentioned above. It refers to a variety of activities in which the public sector, the private sector and an array of intermediate entities, influence one another by becoming partners. “Partnership” connotes relationships much broader than its legal definition, and, “public” and “private” refer to goals (pursuit of the public interest vs. the need to reward investors for taking risks) rather than pure organizational forms. This article uses public-private partnerships broadly to refer to all aspects of the public entrepreneurial movement discussed above.

One long-standing definition of public-private partnership comes from the Committee for Economic Development in the United States (CED): “Public-private partnership means cooperation among individuals and organizations in the public and private sectors for mutual benefit. Such cooperation has two dimensions: the policy dimension, in which the goals of the community are articulated, and the operational dimension, in which those goals are pursued. The purpose of public-private partnership is to link these dimensions in such a way that the participants contribute to the benefit of the broader community while promoting their own individual or organizational interests.” (Holland 1984)

Collaborations are not just organizational arrangements, but processes. The partnership process involves both establishing structures and using those structures to achieve mutual benefit. When referring to this broader definition of public-private partnership, only the imagination limits the methods for carrying out such alliances. The goal and the result of promoting interaction between sectors have, in many cases, been nothing short of the dynamic transformation of an entire social and governmental system (Hamlin and Lyons 1996).

To summarize the definition, by public-private partnerships the authors mean a society in which a high percentage of its formal and informal organizations are not identifiable with either the public sector or the private sector. While the public interest is identified and sought, and while investor risk is respected and rewarded, public and private goals are often pursued simultaneously within organizations and through alliances of organizations.

Benefits of public-private partnership

A primary benefit of public-private partnerships is that each sector contributes what it most has to offer, and the combination of these skills abilities and powers has the potential to produce the best results.

The public sector is best at defining public goals by creating a consensus of citizen’s diverse attitudes. Government should be good at serving a broad spectrum of society in an equitable fashion with respect for the rights of various minorities. The public sector is given greater power in certain areas such as condemning property with due compensation when land and asset assembly is in the public interest, and using police powers. The public is best at providing large-scale infrastructure such as a city street system or storm drainage system.

The private sector is generally better at managing factors of production for greatest efficiency in a competitive environment. This means getting maximum use of land, labor, technology, energy and other resources. The private sector is also expert at attracting investment capital. Because necessity is the mother of invention, the private sector, responding to competitive pressures is often thought to be more innovative in creating and using new technology.

The combination of these two ends of the spectrum often means that public goals can be accomplished more efficiently and effectively through a public-private partnership. Government can operate at lower cost by using private contractor. It can use the private partner to raise financing for projects, and the private sector can offer innovation in the pursuit of public goals, to name a few. If the private sector can increase profits because of governmental assistance, it is better able to raise investment capital by offering a greater return on investment. Generally greater quantity and quality of goods and services can be provided to all of society.

Examples of how public-private partnership works

One area of public-private partnership is the privatization of government services. An example of such privatization is contracting out of garbage and refuse collection. In its simplest form, this means that the municipality chooses a private company to collect garbage and refuse and pays the company a fee for the service.

On the surface, this seems straightforward. If the fee that the city pays the private company for this service is less than what it would cost for city employees to do the job, then municipal taxpayers save money that can be used on other activities or to reduce taxes.

And, good reasons exist for why a private company might be able to do the job for less. Possible reasons include lower labor costs, better management, greater experience from doing the same service in other communities, better equipment, and better technology. A private company that is in competition with other companies might have more incentive to be innovative, seek lower cost labor, and develop better technology.

A second example of public-private partnerships is where the two form a formal partnership on a development project. A city, for example, might decide that it does not have an international quality, executive hotel. It might be particularly lacking in high quality rooms in key locations such as in the business center or near a university. The lack of such a hotel might be holding the city back economically by making it difficult for the city to attract international investors and business people.

Private hotel developers might conclude however that the high cost of assembling land, redeveloping it and sufficiently improving infrastructure would make the project so expensive that it would be unprofitable. As a result a stalemate exists in which the city is held back because of the lack of an amenity, but the private sector will not step forward on its own to supply the amenity.

The municipality does not want to get into the hotel business because it does not have the expertise to build or run a hotel. But, it could form a partnership with a hotel developer. The municipality could use its powers to assemble land, clear land where necessary, and improve the infrastructure. It could do this using low interest municipal bonds. It could then lease the land on a long-term basis to a private developer who knows how to raise private financial capital, design hotels to satisfy the international market, and manage hotels effectively.

Because of the beneficial public involvement in preparing the site, the hotel developer has lower development costs and is able to make a profit. The developer is therefore attracted to the project that it did not want to pursue on its own. The general public gains from the project through the creation of a necessary city amenity. The project provides increased employment to citizens both directly and because of the general increase in business activity. The government also receives greater tax revenues that can be used to improve other city services. The private sector gains profits and repayment on investment capital.

Potential problems regarding public-private partnership

Looking at the example of garbage collection described above this simple process of contracting out government services raises a multitude of issues. First, how is the company chosen? Is the selection process objective or are there non-objective forces such as: companies giving campaign contributions to decision-makers, companies paying bribes or kickbacks to decision-makers.

Second, what is the quality of the work done? Is the company short-changing the city by using poor quality supplies and equipment, reducing the level of service? How does the municipality oversee quality and performance? Is the oversight process objective or tainted with the same conflict of interest or corruption concerns of the selection process? What happens if low quality or non-compliance, or corruption is detected? How does the municipality implement controls? Is the company provided incentives for good quality or penalties for bad? Are quality controls truly enforced? Is the quality control process objective or tainted with political pressure, conflicts of interest or corruption?

These are general questions that can be asked about many other activities related to public-private partnerships. As long as there is no understanding of the needs of both partners and of the importance of collaboration, it is more difficult to achieve the public interest of the community. The main goal of the private investors is to gain profit, and investing in public services is not always very profitable.

The private companies seek to reduce costs imposed on them by government. For example, time is important for firms. We often say that time is money. So private investors will want to avoid delays in getting authorizations (like construction authorizations), because the officials may delay issuing these decisions for months, even if the firm is qualified to receive them. In this case, the public officials can demand a bribe in order to issue the authorization. As long as there is no competition in granting of these authorizations and there is no other option to private firms to get them, the firms will be forced to give bribes. In the same time, the firms could simply want to reduce the time of getting an authorization through the payment of bribes.

Another important asset in the investments projects developed through public-private partnerships is the land. There are different cases of corruption related to reducing the costs of using the land in a development project. For example, a private company can be interested in redeveloping a certain lot, but it cannot afford to buy the land at the selling price or to invest money in developing the infrastructure. But it can bribe the local councilors to write down the selling price of the land or to decide to concentrate infrastructure improvements in the area targeted for redevelopment. Also, the decisions that are related to particular use of private land (zoning laws) can be subject to corrupt practices. The local councilor can decide whether the same piece of land can be used only for agriculture, or as residential or commercial area.

Beside the costs related to time and land improvements, private investors seek to reduce the costs imposed on them by government in the forms of taxes, fees, and regulations. The government holds the discretion to give different incentives to firms that are willing to invest in the community, like subsidies, tax incentives, and free lease. For example, the government can give a private company a space or the use of something for free. Also, the government can provide access to credits with interest rates below market. In all these cases, firms may use different forms of corruption to obtain incentives in order to have access to all these fiscal incentives and to reduce the investment costs.

The main cause of corruption in government is the discretionary power that the public officials hold, which refers especially to public officials who are in “positions where they have discretion over important decisions” that affects the business of the others (Vito Tanzi 1998, Susan Rose-Ackerman 1999). The level of corruption is directly related to the level of discretionary power that the officials hold, meaning that “greater the discretion of officials and the fewer the options open to private firms, the higher the costs of a system that condoms corruption” (Susan Rose-Ackerman 1999).

There are certain areas, related to public-private partnerships, whereby the public officials have a great discretionary power and which are more vulnerable to different forms of corruption. The procurements are the most vulnerable (ICAC 2001) because the government transfers large financial benefits to private firms through procurement contracts and the award of concession. In these cases, the private companies often make false statements to the government regarding the price, which means overcharging the government in connection with products or services delivered. Also, the firms can deliver inferior products to the government. These involve substitution of inferior materials or fraudulent testing.

Conflict of interest was reported as another problem that raised ethical issues regarding procurement and contracting out process (ICAC 1997). It refers to the pecuniary or non-pecuniary interests that civil servants and local councilors hold in any contract or proposed contract with the Council. There are many activities related to development projects that can create conflict of interest for public officials, like planning approvals or licensing. For example, a councilor may be tempted to influence an application to set up a new business in the town if his own business could lose custom as a result. This situation occurs often due to business and professional interests in the local government area that many councilors have. Conflicts of interests arise if public officials have access to information and opportunities that could be used to advance their personal and business interests. Another very common conflict of interest can occur in the contracting-out process. For example, a council has advertised for

a firm to supply office equipment. A councilor, who is a member of the commission assessing the bid, has a relative who is an executive director of a firm that submitted a bid. This may affect, or may be suspected to affect, the councilor's ability to make an unbiased decision.

The private companies have several reasons to pay off officials in order to get procurement or a concession contract. Very often the firms pay for inside information or to be included in the list of pre-qualified bidders. Also, the public officials are induced through bribe to "structure the bidding specifications so that the corrupt firm is the only qualified supplier". The firm pays bribes to be selected as the winning contractor, or once the firm wins the contract, "it may pay to get inflated prices or to skip on quality" (Susan Rose-Ackerman, 1999). It is cheaper to pay off the officials than to invest in the improvements required respecting the standards imposed through the contract.

The "services" which the corrupt official provides in order to achieve the result for which they were bribed consist in some cases in influencing the outcome of public procedures or the influencing decisions assigning benefits. In other cases, the corrupt official may provide confidential information, thus increasing the corrupter's chances of obtaining a benefit (Della Porta and Vannucci 1997). In the case of public contracts, information may relate to aspects of contracting procedure, which are intended to remain secret in order to ensure fair competition. For example, public officials may provide information about the minimum and maximum price for inclusion in competitive tenders, about the average-offer price, or about particular criteria to be taken into account in evaluating projects. At different times, investment projects have been carried out to provide opportunities to some individuals or some political groups to get "commissions" from those who are chosen to execute the projects.

The privatization process mentioned above as one form of public-private partnership was designed, especially in former communist countries, as a measure of reducing corruption "by removing certain assets from state control and converting discretionary official actions into private, market-driven choices" (Susan Rose-Ackerman 1999). However, the process of transferring assets to private ownership is seen in the same time as a source of many abuses. The privatization process creates situations "whereby some individuals (ministers, high political officials) have the discretion to make some decisions" (Vito Tanzi 1998) in favor of the clientele of particular political groups. In the same time, other persons (like managers or civil servants) have access to information not available to outsiders, so they can use the process for their private gain. Conflicts of interest may give opportunities for other corruption cases and refers to public officials who design and manage privatization-bidding process and who are on the staff of those companies that received the contract.

Another important issue regarding the ethics of public-private partnerships that we want to analyze briefly is the impact of perception at the individual, institutional and community level. "The perceptions are more important than reality" (Hamlin and Lyons 1996) and "it can substitute for both the law and trusting personal relationships" (Susan Rose-Ackerman 1999).

At the individual level, the reputation is very important because it can affect one's objectivity. For example, a public official may be offered by a group of private investor a free plane ticket to participate to a business convention (Richter, Burke and Doig 1990). But there are several ethical issues that could affect the reputation of the public official, and which could appear to the others to be unethical. The first issue relates to the possibility that the free plane ride will incline the public official to view their interests more favorably than he or she should do. So, the gift may tend to create a public impression that the free travel was made to influence the public official's actions or to obtain preferential treatment. The other issue relates to the possibility that the gift will affect in the future the reputation of objectivity and effectiveness, if the free ride is reported by the media. Other similar examples refer to cases of conflict of interest based upon a family relationship, close friendship, which induce the reputation of favoritism and lack of impartiality. These cases appear when people are involved in making decisions from which they or relatives might benefit.

At the institutional level, there are other ethical issues that can affect the institution's reputation. The perception of corruption may generate a loss of public trust and confidence in the corrupt professional person and. Also, the institutional processes and their roles are undermined (Miller, Roberts and Spence 2005). For example, close-working relationships between government and corporate officials may be essential in development projects, but these relationships may affect the objective evaluation of the performance of the projects.

If private investors view the situation as being unstable, some of them will not have the incentive to invest and some of the investments will flow in other communities. But other investors will choose to pay bribes to obtain certainty, which is risky because they can not enforce corrupt deals. In both situations, the community will lose. In the first case the investments will flow elsewhere. In the second case the investors that have benefited from payoffs "will resist efforts to increase the clarity of rules and laws" (Susan Rose-Ackerman, 1999) and, in general, the improvement of the services delivered to the citizens.

Solutions for corruption problems

After we analyzed some ethical issues related to the public-private partnership, the first question that comes in our minds regards the solutions to all the identified problems. For example, how does a government of the people, engaged in various forms of private negotiations and interactions with private businesses and citizens, ensure that the views of the general public are properly included, and that objectivity in selection, oversight and mutual compensation is maintained?

Having anticorruption strategies shows local council commitment in encouraging ethical behavior and helps increase transparency. And related to what we discussed before regarding the perception of the citizens, it is important to keep the community informed about the existence of strategies. The citizens have the right to know that the council is aware of and takes seriously its obligation to perform its functions impartially and in the public interest. Informing the citizens that the council has a detailed policy and procedures on combating corruption, that complaints concerning corruption are taken seriously into consideration, and how the policy and procedures have taken effect, is a useful accountability mechanism.

In the following paragraphs we will analyze some solutions related to the corruption problems presented before. We will refer especially to those problems that were mentioned as being more often encountered in the relation with the private investors. We will analyze the solutions related to the problems occurred in the procurement and contracting out processes, privatization, and to quality and standard inspections.

The most corrupt activities encountered by the city hall are those related to procurement of goods and contracting-out services. The most common measure to combat these problems is by establishing codes of conduct, which let everybody know what is considered to be acceptable and ethical as well as what is unacceptable or unethical. The codes of conduct should be sent to the private contractors in order to keep them informed about ethical expectations.

Because one of the most important problems related to the procurements and contracting-out regards the conflict of interests, other measures should address this problem. The easiest way to deal problems regarding conflicts of interest is to avoid them through a strict division of duties and responsibilities (Miller, Roberts and Spence 2005). But it is not always possible to avoid conflicts of interest. The next best solution is to disclose them. The members of a council or a committee should be required to disclose any direct or indirect pecuniary interest in any contract or proposed contract with council (ICAC 1997). Additionally, they should be required to refrain from discussing or voting on any matter to which it relates.

Keeping the process simple and transparent is extremely important. The more obscure and uncertain are the procedures by which a decision is arrived at, the more valuable to the corrupter

is the information relating to them (Della Porta and Vannucci 1997). Also, if the rules for taking the decisions are technically complex and even more, having a “reliable” interpretation, they create many opportunities for using the information for corrupt deals. In this respect, accountability established through institutional mechanisms is necessary for the control of corruption. The establishment of clear instructions for building inspections, for internal audit, and internal reporting procedures is important. Related to the management system, it is important for the city hall to keep records of contracts that the council issued. These contracts should be reported annually. Also, it is important to make the reporting procedures transparent in order to reduce the temptation for corrupt practices and to make the officials more accountable to the citizens. In this way, the citizens should have opportunities to report procedures. A committee should be set up to foreshadow possible problems and to decide how to deal with the corrupt issues.

Even if the privatization is seen as means of reducing corruption, the process is tainted with many corrupt activities. In this respect, it is necessary to establish a credible privatization by respecting several principles (Susan Rose-Ackerman 1999). The process should not favor different consortia with strong ties to the local elite, but should assure a wide participation of the private investors. Also, it has to be transparent and well publicized, especially in the evaluation of the assets. The way the privatization process is organized is also extremely important. The regulatory framework should be set up in a credible way before the tendering begins. Also, the regulators must be protected from improper influence, through a transparent appointment process, and cases of possible conflicts of interests should be limited as much as possible. The consumers and the citizens in general should have the possibility to report contractors’ failure in meeting the defined performance obligations.

Related to the performance obligations, it is important for the city hall to have specific measures that can be used in preventing low quality and fraud cases related to supervising the quality of goods and services delivered by the private contractors. The management system (ICAC 1998) is one of these measures, and it is used especially in health and building inspections. It refers to the use of computerized inspection bookings. By recording all requests for inspections, councils are able to randomly allocate work among surveyors and monitor work in progress. Also, the supervisors are expected to keep official diaries of their inspections appointments. Besides these, performance audits are necessary, which means that the city hall employs a form of “staff appraisal to measure an employee’s performance against a council’s goals” (ICAC 1998). Another way of ensuring the quality of the services delivered by the private contractors is through the “buddy system” (ICAC 1998) or “competitive bureaucracy” (Susan Rose-Ackerman). Both terms refer to reducing the discretionary power of any single bureaucrats by having more civil servants that can perform the same job. For example, a council can divide their area into regions for building regulations. When a supervisor responsible for a region is unavailable on one day to work, another surveyors designated as a “buddy” can take responsibility for that region. For example, the private companies that reported corrupt demands can reapply to a new official in the case the first official asked for a bribe. In this way, the discretionary power of a bureaucrat over a certain regulation is limited, as well as the bribe potential.

Summary and Conclusions

One of the most important trends in governance and economics is the increasing collaboration between the public and private sectors for mutual benefit. Innovative thinkers in both sectors have created mechanisms for promoting the accomplishment of public policy while at the same time compensating investors and entrepreneurs for taking financial risks. This process has brought greater innovation to government and a greater sense of enlightened self-interest to business. But this trend has significant implications for democratic oversight of the public policy process. Governmental policy that utilizes complex relationships between the public and private companies challenges the moral and

ethical fiber of both the legal and cultural system. Greater levels of trust are required and new forms of oversight must be developed.

Definitely, corruption implies financial losses for the community, even if the purpose of the public-private partnership is to bring wealth in the community. Private investors may deliver private goods and services to the public institutions at a higher price than their value to the seller (Della Porta and Vannucci 1997). A part of the difference in the value is sometimes given as a kickback to the public official whose influence resulted in the favorable decision. Also, the public institution may accept less for the right of the resources than the private purchaser would be willing to pay. In the case of an urban planning program, which increases the value of a certain plot of land – the presumption is that the decision might be inspired by a bribe paid to the public official. The landowner thus receives the profit equal to the entire increase in value of the land.

Beside financial losses, corruption may impose future costs on public institutions and on community in general. The inspector, who overlooks irregularities, allows the corrupter to avoid paying the fine provided by the law. The future costs are represented by the possible problems that can occur due to not respecting the standards required by law. People eating in a restaurant that does not respect the hygiene standards may get sick, so they need health care services. Buildings that do not respect construction standards or were built using low quality materials may fall apart and causes damages for the people that live in or may even hurt them.

In this context, a public-private partnership brings many benefits for the community, but in the same time it can generate harm at individual, institutional and social level, if it is not managed properly. It destroys the trust of the citizens in public officials' objectivity and in public institutions. Also, it destroys the citizens' trust in their representatives and raises questions whether or not they are motivated in their actions by the concern with the broad interests of the community or with private gains. At the same time, corruption deters investment and undermines competition (World Bank 2000) and therefore affects productivity.

This paper is just an outline of different issues regarding corruption in public-private partnerships and their implications for the community. The first part of the paper regarded definition of public-private partnership, its importance for the community and some examples of how this partnership works. The second part of the paper analyzed very specific corrupt practices that can occur in this partnership, their implications for the community and solutions for combating them.

Further research related to this topic is important. Some areas of interest include the implications of corruption on the economy at the community level, the mechanisms that sustain the corrupt practices, and the role played by cultural in fostering corruption. More case studies should be analyzed for each type of problem in order to have a complete imagine of the phenomenon. We should pay special attention to the post-communist countries that are privatizing the state enterprises and are in the process of developing new forms of public-private partnerships in order to promote economic development.

Past experimentation with mixed governmental systems illustrates what while ethical problems do arise, the challenge can also have the effect of strengthening professional ethics. Public-private partnerships can have the effect of opening up each sector to the scrutiny of the other and induce the actors, and the public at large, to think more clearly about issues of ethics and corruption.

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