

Corruption: A Theoretical Perspective and Relevance for Economic Growth

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The history of corruption goes back to ancient times. Its nature can be extremely diverse and thus the context and relevance of the problem varied widely between countries and time periods. The problem has become more focussed in recent decades with increase in global cooperation for achieving economic and social growth in all countries since 1960s. The paper argues that theoretically it is impossible to have a corruption-free society or economy. Corruption has its roots in market imperfection of any form. As perfectly competitive market doesn't exist in reality every market in every country has the potentiality to generate corruption. Although it is possible to have a strong prudential system to keep the situation under control, it doesn't work in most of the economies due to conflicts of interests. In developing economies, once policy-initiated corruption starts it often generates its own force and becomes a dominant factor over political, economic and social interests.

Field of research: Economics of corruption

1. Introduction

The problem of corruption is neither new nor it is restricted to developing countries only. Its nature can be extremely diverse and thus the context and relevance of the problem varied widely between countries and time periods. The problem has become more focussed in recent decades with increase in global cooperation for achieving economic and social growth in all countries since 1960s. Due to complex political and economic forces that have been shaping the global development agenda, the reasons for the phenomenal growth of corruption are also complex.

Roots of corruption go back to the history of human civilisation. Corruption, in some form or the other, existed since human lives became institutionalised and leader-follower relationship started in an organised manner. References of corruption were found in the writings of the fourth century B.C. in India (Bardhan, 1997) and also in the writings of Greek philosophers like Aristotle and Plato (Gong, 1994).

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Although corruption exists in all societies and all times, the problem seems to be more prominent in the context of developing countries. It is not difficult to visualise a strong relationship between scarcity and corruption. When resources are limited and competition among the participants in the production process is strong, the situation seems to be ideal for growth of corrupt practices. Everybody would be interested in maximising their own benefits through ethical or unethical means. The situation can be kept under control only if good prudential regulations are in practice within the country. But very few resource scarce developing countries can practically afford to maintain such a prudential system. Moreover, gradually corruption is becoming more and more institutionalised involving policy-making authorities and making the situation worse. Colonial and neo-colonial backgrounds of a large number of present day developing countries had also contributed in flourishing corrupt practices.

This paper attempted to provide a theoretical background of corruption and to explain to what extent it is possible or practicable to have a corruption free society in the modern world. The paper argues that theoretically it may be impossible to have a corruption-free society or economy. Corruption has its roots in market imperfection of any form. As perfectly competitive market doesn't exist in reality every market in every country has the potentiality to generate corruption. Although it is possible to have a strong prudential system to keep the situation under control, it doesn't work in most of the economies due to conflicts of interests. It has also been argued that the social welfare theory is based on value-free positive economics and thus immoral (or corrupt) activities can play an important role in enhancing efficiency.

It may be impossible to have a corruption-free society, but it is possible to restrict it to a minimum level. Strong policy cooperation at international level with sufficient resources may improve the balance between different levels of corruption. Corruption necessarily creates lack of accountability in public (and corporate) practices. It is very difficult to expect that such accountability would develop on its own in developing countries most of which are affected by high level of corruption. Very high sincere and concerted participation is needed from the developed nations and of international agencies to achieve a global balance. It is difficult to expect much within a short period of time if we go by the past experiences.

2. Defining Corruption

The term 'corruption' is widely used in a rather loose manner in literature as well as in day-to-day context. There is no consensus on definition of corruption, either in literature or in practice. In recent years, concepts of corruption are broadly viewed from the perspectives of the western economies although such economies themselves have not positively recognised the issue. Basically the concept has been derived from the ethical perspectives and thus normative values are associated. Certain practices can always be viewed as corrupt under any situation, but there exist a wide range of borderline issues that can be debated. Cultural variations should be considered while interpreting such practices.

Traditionally corruption was associated with public sector activities only. Black's Law Dictionary, one of the premier legal resources, defines corruption as "The act of an official or fiduciary person who unlawfully or wrongfully uses his station or character to procure some benefit for himself or for another person, contrary to duty and the rights of others." (Balck & Garner, 2000) Braguinsky (1996) defined it as 'misappropriation of government property or revenues made possible through government regulations' (pp. 14). Gradually, over the periods, the concept has expanded to include all areas of life such as private business, religion, culture and so on.

In early literature, the concept of acquiring unlawful incomes was referred as 'rent seeking'. According to Buchanan (1967), "rent is that part of the payment to an owner of resources over and above that which those resources could command in any alternative use. Rent is receipt in excess of opportunity cost." (pp. 46)

Roth (2002) referred corruption as an unintended consequence of social welfare theory. Although the market concept was originally based on moral standards, the neoclassical economists brought the idea that value judgements and normative issues were not the concern of positive economics. He argued that the neoclassical literature regarded corruption as efficiency enhancing. Government intervention was justified to reconcile competitive and ethical equilibria and that was how the corruption could be introduced. Government interventions in any form motivated by perceived market failures may lead to political rent seeking and may spread to other areas.

While reviewing the New Zealand state sector reforms, Gregory (1995) observed that treating all public sector activities as 'production' may lead to corruption. Many of the tasks undertaken by the public sector in any country are not like traditional products, they are not distinctly observable. More discretionary powers in the hands of public sector employees could be corruptive. He predicted increase in instances of corruption in New Zealand in years to come at both official and personal levels.

As evident from the literature, in early days corruption was primarily associated with politics and bureaucracy. As Gong (1994) viewed, 'the fundamental difference between the classical notion of corruption and the modern one is that the former focuses on institutions whereas the latter is behaviourally oriented' (pp. 4). With passage of time the concept has widened significantly. In modern world, corruption is evident in every sphere of life. Political corruption (involving governments or the policy-making bodies of a country) seems to be the major concern of developing countries whereas corporate corruption is increasingly becoming a problem in industrialised rich nations.

Corruption is a wide concept and closely associated with ethical norms. Cross-cultural issues play very important roles in defining corruption as ethical concepts are often different. Thus it is extremely difficult to provide a universally acceptable definition of corruption. It may be easier to describe corrupt practices in the context of a specific society, although that too can not avoid controversies. Gong (1994) provided a long list of activities that include taking bribes, neglect of duties, profiteering activities, lavish living, gambling and visiting prostitutes, smuggling and so on (Table 1, pp.9). There

could be difference of opinions on viewing several such activities as corrupt practices. Again, much depends on the circumstances where a particular activity is undertaken.

Economic benefits are the root of most forms of corruption in the modern society. Economic benefits directly or indirectly, are the root of most forms of corruption in the modern society. It is the strong motivation of controlling economic resources or power that motivates corruption. Again, the problem becomes much more serious when the policy makers of a nation involves in corrupt practices. This political corruption can become the driving force in such a society. At the same time, it prevents the system from initiating or successful implementation of anti-corruption measures of any kind. This is the situation in most of the developing countries in the world at present.

Hodess (2003, pp. 11) defined political corruption as 'the abuse of entrusted power by political leaders for private gain, with the objective of increasing power or wealth'. Political corruption leads to lack of transparency in public life and that leads to lack of faith in the system by the general population. It also creates and maintains business corruption through an institutionalised system of bribery and other illegal payments. The political corruption has become so widespread that certain practices are no longer considered as illegal or unethical. Political donation at election times with expectations of favour in future is one of the most common practices in all democratic systems in the world.

3. Theoretical Roots

It is commonly accepted that corruption is impossible in an economy where all markets are perfectly competitive. Perfect competition, at least in its theoretical form, ensures most efficient utilisation of resources and thus the possibility of having abnormal gains doesn't exist. From this perspective, corruption is a result of imperfections in the market. However, it is argued that 'limited' corruption is good to induce the market back to perfection and 'unlimited' corruption leads to further distortion of market features (Braguinsky, 1996). There is no evidence to suggest that limited corruption leads to unlimited level at some stage and it is difficult to maintain the distinction between the two. Braguinsky (1996) further argued that corruption is inevitably unlimited in a social state (e.g. former USSR) where economic growth tends to be lower. Such system is unsustainable in the long run.

In reality the concept of perfect competition doesn't exist and all markets are imperfect to some extent. Moreover, national policy makers in the modern world do not depend on market forces only to ensure the best operation of its economic system. Different types of interventions are common to improve the efficiency of the system. Governments in all economies tax certain groups of people and subsidise others. Such government interventions obviously create an important role for bureaucrats ('agents' of the government). These bureaucrats collect information, make decisions and implement policies. Since they have more knowledge about the system and mostly self-interested they can be potentially corrupt (Acemoglu & Verdier, 2000). This possibility of corruption can certainly lead to further misallocation of

resources and spreads corruption to other areas. However, it doesn't undermine the case for government intervention but the major problem would be to maintain a balance between 'equilibrium' and 'optimal' levels of corruption, particularly in developing economies. 'Government intervention with partial corruption is likely to be optimal only when corruption is relatively rare and the market failure it is trying to correct is relatively important' (ibid, pp. 209). However, it is very difficult to judge the situation in a value-free manner and without involving self-interests of the policy-makers.

The problem of corruption (or more clearly, of potential corruption) is practically unavoidable. It is directly connected with the rent seeking behaviour of people with administrative or market power. Commonly corruption is considered bad on moral grounds ignoring its economic, social and political origins and impacts. Tullock (1996) observed (with reference to China in the 19th century) that government official can write laws intentionally with provisions of unlawful payments. Thus, corruption indicates that the salary levels of government officials are over and above than what should have been. Under the principal-agent problem in the public sectors, the bureaucrats hold the real power and corruption starts from that point (ibid).

There are two structures of corruption exists in practice in governments – top-down and bottom-up (Waller et al, 2002). Under the top-down structure, decisions are made at the highest level of the hierarchy and lower-level officials get whatever is given to them. The other structure is decentralised. Lower-level officials collect corruption rents (e.g. bribes) and the highest ranking official is just one of the recipients. The first structure was mostly prevalent in former socialist economies, whereas a freer economy tends to have a decentralised system. However, it is difficult to argue in favour of either structure. Both can be equally harmful. According to Bardhan (1997), the structure of corruption has changed from top-down level (in former USSR) to bottom-up level in present Russia, and the problem has become much more acute.

India and Indonesia had high levels of corruption, but with different structures. Indonesian corruption was more centralised and controlled than that of India. In terms of economic performance, Indonesia achieved much better results than India (ibid). Waller et al (2002) attempted to identify the conditions under which centralised corruption is better for economic growth than the decentralised one. Based on a theoretical model, they observed that it largely depends on how corruption is measured. If it is measured as 'the amount of bribes paid per investment project' by the entrepreneurs than the centralised could lead to more efficient allocation of resources and thus, more effective for economic growth. But if it is measured as 'the total volume of bribes paid in the economy' then the centralised system leads to more corruption (ibid).

It is generally accepted that the economic costs of corruption are high. The economies operate within a vicious circle of corruption and economic growth. In the process, level of corruption consistently increases and economic growth suffers more and more. Understandably, it is virtually impossible for individuals to remove or even to reduce the level of corruption when it is widespread in the economy (Mauro, 2004). In fact, individuals do not have any incentive to remove corruption. Individually they seem to

be better off if corruption continues. Thus multiple equilibria exist in corruption, political instability and economic growth involving individuals, politicians and at the economy level respectively (ibid). Developing economies with large public sectors have more possibility of falling into this vicious circle of high corruption and low economic growth. Mouro (2004) suggested that the only way out from such a situation could be strong outside intervention by nongovernmental or similar organisations.

Most of the researchers agree on the fact that corruption occurs in all countries, irrespective of whether they are rich or poor, socialist or capitalist, dictatorship or democracies etc. (Lui, 1996). Only the form of corruption and its extent might be different. Again, within a country, corruption is generally more common in government sector (ibid). It may not be just a coincidence that the governments play vital decision-making roles in most of the developing economies and corruption levels are generally high in all such countries.

4. Corruption and economic growth

Apparently there is a 'chicken and hen paradox' in the relationships between corruption and economic growth and poverty. Corruption level is very high in most of the poverty-stricken developing countries. Again, due to significant leakage of scarce resources from the production system for corruption the level of economic growth and development remains low. There is sufficient literature to support that existence of high corruption reduces the availability of investment funds. Even foreign aids channelled through public sector can be misused and become a source of further corruption.

Mo (2001) explained the relationship between corruption and economic growth with ordinary least squares estimations. He observed that a 1% increase in the corruption level reduces the growth rate by about 0.72%. Expressed in a different way, a one-unit increase in the corruption index reduces the growth rate by 0.545 percentage points.

Pellegrini and Gerlaugh (2004) have estimated the direct and indirect effects of corruption on economic growth using regression analysis. They found that 'one standard deviation increase in the corruption index is associated with a decrease in investments of 2.46 percentage points, which in turn decreases economic growth by 0.34 per cent per year'. Again, 'a standard deviation increase in the corruption index is associated with a decrease of the openness index by 0.19, resulting in a decrease in economic growth by 0.30 percent per year. Jointly, the transmission channels explain 81 per cent of the effect of corruption on growth'. Lambsdorff (2003) identified clear impacts of corruption on net capital inflows. His analysis revealed that a country's law and order tradition is a crucial sub-component for attracting capital.

However, there are exceptions. Rock and Bonnett (2004) observed that, although corruption adversely affects growth through reduction of investments in small developing countries in general, it did increased growth in the large East Asian industrializing economies. With empirical supports they explained the paradox of high

corruption and high growth that generated from stable and mutually beneficial exchanges of government promotional privileges for bribes and kickbacks.

The most widely known relative indicator of national level corruption is the 'Corruption Perception Index' (CPI) prepared by the Transparency International (TI). Although it doesn't measure the actual extent of corruption (that may be impossible as well) the CPI provides comparative picture of corruption levels in a wide range of countries in the world annually. This Index indicates the 'perceptions of corruption among public officials and politicians as seen by business people, academics and risk analysts' (TI 2004, pp. 3). A close look at the CPI of 133 countries for 2003 reveals that the smaller nations from the wealthier parts of the world occupied most of the top rankings indicating lowest levels of corruption.

Use of CPI as a measure of corruption is subjected to several limitations. It is not based on quantitative estimates such as number of court cases and prosecutions etc. It also doesn't consider the anti-corruption measures initiated by a particular country. It is primarily based on survey of perceptions only. So it can at best be considered as a 'snapshot' (Williamson, 2004). However, CPI is the only measure that provides a comparative global picture.

5. Conclusions

Corruption is a major problem with long history. Strong link exists between corruption and economic growth. It is inappropriate to relate it with third world absolute poverty only. Relative poverty also generates corruption to a significant extent. So it is not a problem exists in developing countries only. There could always be interested parties in all countries who are the direct beneficiaries to maintain the system with high element of corruption.

Corruption primarily emerges from market imperfections that are fairly common in all societies. Very often such market imperfections generate lack of accountability in public (and corporate) practices. Poverty-stricken third world economies are most vulnerable and it is very difficult to expect that such accountability would develop on its own.

The corruption issue assumed a very serious dimension with technological development in early 1980s and with globalisation of production factors. With advancement of communication technology, intellectual property rights etc. have become important issues of concern. Again, production bases of MNCs in less developed economies are getting affected by practices in host countries (although they often took advantages of the same). And, as a result, for the first time the developed world started getting affected adversely by corruption issues in the developing world. From late 1980s it has become a very serious global issue. Differences in practices in first & third world economies have become prominent and international agencies started serious discussions and initiating measures. It may be for the first time now that the developed countries have direct economic interest to control corruption in developing countries.

Moreover, the developed world is also now very seriously concerned about growing degree of different types of corrupt practices. Corporate frauds, particularly in relation to accounting practices, are not very uncommon in developing and semi-industrialised countries where corporate governance practices are far from satisfactory. As per common belief, industrialised and developed countries have been so far relatively free from such practices. However, there has been a recent surge, particularly in the US market. Corporations have social responsibility. They do not exist merely for profit. When corporations inflate and fraudulently report inflated revenues just to attract investors, they should be penalised in order not to place the public in jeopardy. Fraudulent acts by the corporations jeopardise small-time investors, pensioners and the general public, and have prejudicial effects on the labour sector and the entire economy.

Although it may be impossible to have a corruption-free society it is possible to restrict it to a minimum level. Strong policy cooperation at international level with sufficient resources may improve the balance between different levels of corruption. Very high sincere and concerted participation is needed from the developed nations and of international agencies to achieve a global balance. It is difficult to expect much within a short period of time if we go by the past experiences. However, a beginning has to be made before it becomes too late. If anything positive emerges that would be good for South Asia, for the world and for the humanity as a whole.

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