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The Political Economy of Controlling Corruption

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Corruption — always and everywhere

The topic of our conference here today and tomorrow is a dark one. Corruption is an evergreen. It has been practiced probably since the very emergence of human civilization. It is something that happens everywhere. There is no society on Earth that is free of corruption, though the amount certainly differs by a large margin in different places or institutions.

Even though corruption is such a widespread form of behavior, it is generally despised. Corrupt public servants are considered to be parasites who misuse their position of trust for personal benefit in a villainous fashion. And yet, despite the stigma that it carries, it is a widespread phenomenon. Cases of corruption have been detected in all spheres of public activity, such as procurement, judiciary processes, provision of licenses or permits (especially for construction), and others. It also involves semi-public spheres, for instance, political party finance, or the sport industry, such as the recent scandals in the Italian and German football industries. In fact, corruption is also common in purely private interactions, where one agent is in a position of trust or power with respect to his employer, and then uses this position for personal benefit in his interaction with other private agents.

The World Bank has estimated the total sum of bribes paid just in the area of public procurement to be around 200 billion dollars per year worldwide.¹

¹ D. Kaufmann (2005), "Six Questions on the Cost of Corruption," The World Bank News, Washington, DC.

Two types of corruption

First, we need to distinguish two types of corruption that have to be treated quite differently:

- The first kind is bribes that are paid in exchange for permits that are required for legitimate activities.
- The second kind is bribes in exchange for preferential treatment, for instance, to get the contract in a public procurement process even though one is not the best bidder.

This second form of corruption is something else entirely, because it imposes a cost on society as a whole in the sense that it is not the most economical supplier who gets to build the new bridge or airport or whatever is being procured. This form of corruption is really just like stealing from the tax payer and should be repressed as much as possible. One can, however, prevent it to a large extent by a diligent design of the procurement mechanism.

In the following, I will talk only about the first kind of corruption. It is much less clear that this kind of corruption is bad for society as a whole.

Corruption is the solution ...

Homer Simpson — the well-known American cartoon character — once said that alcohol was the cause and the solution to all problems of this world. I don't know about that, but corruption certainly does have these two sides to it. It is the solution when one has to deal with an uncooperative bureaucracy, but it may well be the reason why the bureaucracy is uncooperative in the first place.

The incentive to perform corruption emerges whenever one has to deal with an unhelpful, harassing administration. What should you do if the

government official keeps harassing you instead of providing the service he out to provide so that you can go about your legitimate business. Of course, you may have the legal right to receive the permit or license or whatever you need, but to actually receive it, you still need the bureaucrat to cooperate. What should you do if also the judicial system won't help you, maybe because it does not function in a reliable way or is much too slow?

As an example, suppose you want to create a new firm. In some countries, this is very simple; in other countries, it is almost impossible. The team of Hernando de Soto has compiled a list of the steps that are necessary to create a new legal business in Peru. This list is 31 meters long! Well, when faced with a 31 meter hurdle, one might realize that a little Bakshish here and there could simplify matters considerably. Maybe you can shorten the list to maybe 5 meters or so, because bribes are sometimes able to make a corrupt or lethargic administration work in ways not seen before.

So bribes are not only bad. They give you predictability. You can have what you want — a license, a permit, whatever — it just has a price.

Given a dysfunctional state apparatus, corruption is the better of two evils. It is only the second worst, so to speak. The worst is a dysfunctional, uncooperative state that cannot be made to move even with bribes. Bribes make it expensive to start a new business, but if bribes don't even work, it is impossible to start a new business, which is clearly even worse.

... and the cause

Corruption is like many other things: one needs two to tango. One party has to be willing to pay the bribe and one has to be willing to take it. Now both parties receive a benefit from this transaction: the paying side receives the license he needs from the bureaucrat, and the receiving side receives — well — the money. Whenever a mutually beneficial trade like this presents itself, we should expect rational people to perform it.

The first impulse of the economist is that such a mutually beneficial trade cannot be bad. Nobody is forced into anything and both sides make a gain, so why call it bad or even evil?

The problem is this: from the point of view of the individual citizen who faces a Kafkaesque bureaucracy, corruption appears as an elegant and comparatively cheap solution. From the point of view of the corrupt official, the bribe just appears as an additional opportunity to make some money. The source of this extra income is of course the excessive regulation that is formulated in the law, and the fact that the judicial system is unable to help the citizen to claim his right. The extra money that the bureaucrat extracts for himself would quickly vanish in an environment with more straightforward, transparent regulation that could then also be enforced through the judicial system.

This is the reason why bureaucrats have no interest in simpler regulation. Anything that reduces the predictability of an administrative process creates an opportunity to collect bribes for them, because more decisions are left at their discretion.

So we conclude that from an individual point of view, corruption is beneficial in the short run for both directly involved parties. The person who pays the bribe avoids the harassment and receives the permit he needs, and the bureaucrat receives some extra income. And yet, the fact that corruption is possible is the major reason why the bureaucracy makes life difficult for everyone. The quality of public service and of institutions in general is endogenous. Corruption is a symptom of a dysfunctional administration, as well as a major obstacle on a way to a functioning and efficient government apparatus.

Bribes are a form of taxation

Corrupt bureaucrats are really like highwaymen who make legitimate private activities very expensive. They avoid killing their prey altogether, but they do try to extract as much as possible from them. From an economist's point of view, corruption — or bribes — is really just a form of taxation. But because the tax "authority" in this case is very dispersed — every corrupt official who is in a position to extract bribes levies his own little tax — it is a taxation system that leads to excessive taxation. It comes as no surprise that a system with nearly prohibitive taxation does not create much wealth. This is why a functioning, lean state with transparent regulation is better than a corrupt system: it imposes less heavy taxation on the citizens and thus more private initiative will flourish.

What to do?

So if we have a problem with corruption, how should we address it? There are two ways, which I would like to call the incentives strategy and the opportunities strategy. Let me explain.

One can give bureaucrats incentives not to let themselves be bribed, for instance with abrasive punishments for offenders if they are caught. Part of this strategy would also to be lenient towards whistle blowers, in order to catch the offenders. One can also try to give incentives to citizens not to pay the bribes, for instance by punishing them if they are caught. What is the result of this incentive strategy? Here's an example: suppose the the permits one needs to open a new legal business are many, and the forms one has to fill out are plenty, and the rules are unclear so that they are subject to discretionary interpretation, and yet, bribes are ruled out or made more difficult, the result will simply be to move from the second worst — the corrupt state which does accept bribery — to the very worst — the dysfunctional, non-corrupt state.

A better way, I think, is the opportunities strategy. It is the intransparency of the regulation that gives bureaucrats the possibility to levy their own little tax by asking people for bribes. It is also the fact that the judicial system does not help citizens to claim their legal rights vis-à-vis the bureaucracy. An ombudsman can go a long way towards making the administration less of a pest. More fundamentally, by making regulation light, easy to understand, not subject to discretionary interpretations, in short, by making the outcome predictable, one robs the bureaucrat of his leverage to raise bribes. This way, one can move from the second best — a dysfunctional but corrupt state — to the first best — a transparent and simple set of rules that regulate private activity in a sensible and predictable fashion.

In practice, one will probably need some of both strategies, but I believe that the focus should be on the opportunities strategy rather than the incentives strategy.

In this process, one might have to pay bureaucrats better salaries than before, to make up for the lost bribes, but the overall effect is clearly positive, because the effective level of taxation is significantly reduced and predictability of the administrative process is enhanced. This allows people to actually plan and perform an economic activity, make innovative ideas become a reality, and will thus help to make society as a whole prosperous and free.