
Development Economics

Lecture 14: Corruption

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ECON 2273

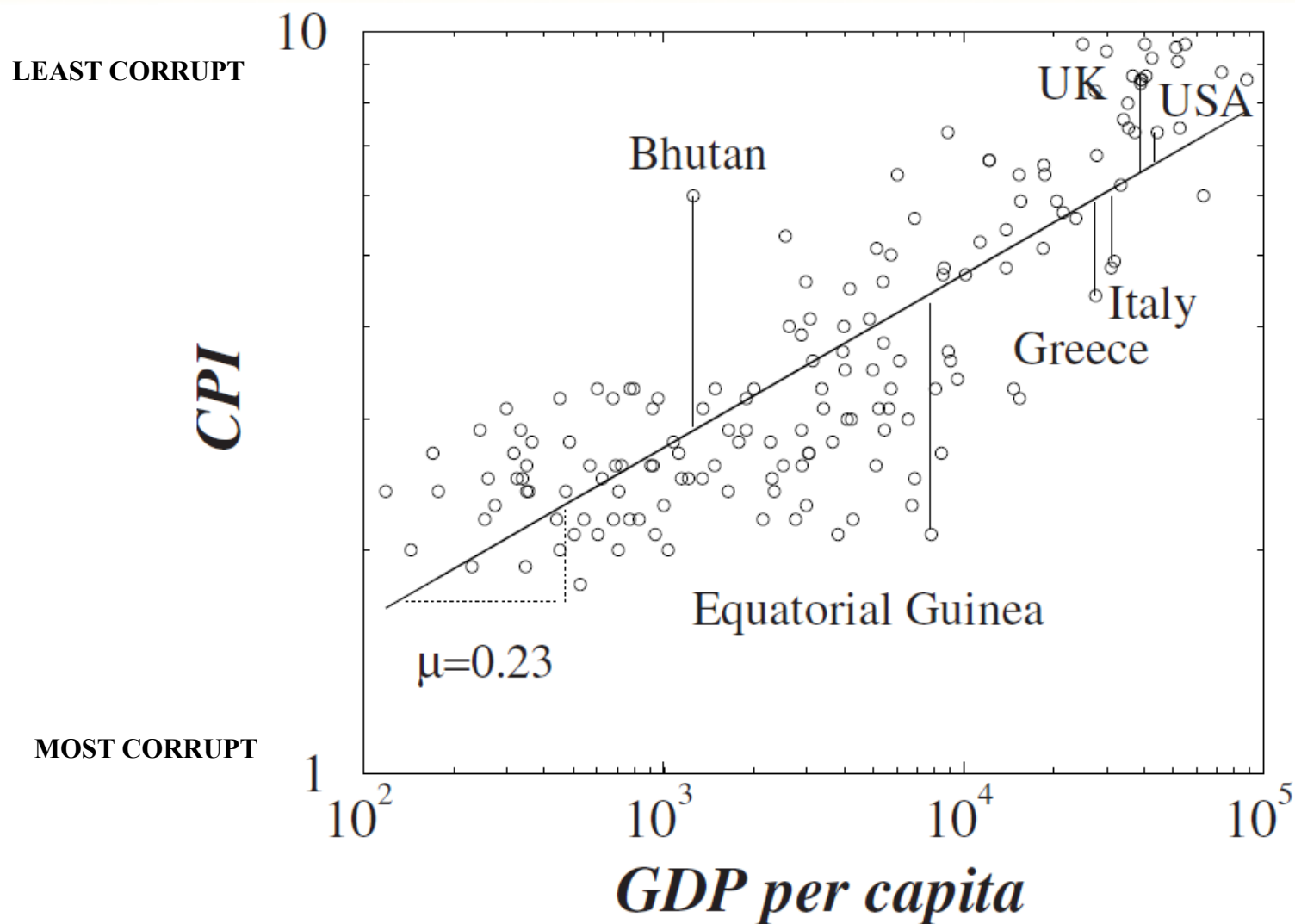
Corruption

- Many different forms of corruption
 - Not all illegal
 - bribing the bouncer at a club, campaign donations
 - Some just unfair
 - speed money to move along an application
- What is corruption and unfair depends on context
 - Bribing to get to the head of line at a nightclub is similar to bribing official at city hall to process your application faster
 - Many services institutionalize this speed money (passport application, TSA at airports)

Basic definition of corruption

- The use of public office for private gains
- Put in economic terms:
 - An agent (corrupt official) acts for the principal (the public) in some matter.
 - The principal cannot monitor the agent effectively.
 - So the agent can engage in activities that may be counter to the interests of the principal such as taking bribes, selling licenses . . .

Corruption perception and GDP



CPI is the Corruption Perceptions Index by Transparency International which ranks countries from most corrupt (0) to least corrupt (10).
Source: Boris Podobnik, Jia Shao, Djuro Njavro, Plamen Ch. Ivanov, and H.E. Stanley. (2008) "Influence of corruption on economic growth rate and foreign Investment" *The European Physical Journal B*, 63, pp. 547-550.

Is corruption bad for efficiency?

- Not necessarily!
- Suppose there are many bad regulations already in place
 - True in many developing countries, where it may take many licenses and a long time to start a business
- Then corruption—the ability to buy your way around restrictions—may help solve the problem created by inefficient regulations

Is corruption bad for efficiency?

■ Example:

- India for many years had very restrictive trade policy.
- Restricted imports, in order to foster industry in India
- Might make sense: “infant industries” may be unable to compete with established firms in the rest of the world initially
- But many firms in India could not get the goods they needed, since the local firms not very good, or did not have the ability to make some products (*e.g., IBM and Foreign Exchange Regulation Act in 1970s*)
- Corruption at the ports may have allowed them to get products into the country, helping growth

Is corruption bad for efficiency?

- Samuel Huntington:
 - “In terms of economic growth, the only thing worse than a society with a rigid, over-centralized, dishonest bureaucracy is one with a rigid, over-centralized, honest bureaucracy.”
- But to help growth, the existing regime must be inefficient such that corruption helps
- Corruption often gets around good restrictions, imposing a high cost on society, in return for a small bribe

Is corruption bad for efficiency?

- Example: environmental regulations
 - Suppose the cost to society of dumping is very large (so against the law, or regulated)
 - Costs of disposing of waste properly may be much smaller (although still large to the dumper)
 - So a small bribe to a corrupt official allows dumper to save some money, but at the expense of large costs to the rest of society
 - No efficiency gain unless cost to society small (in which case the regulation is inefficient)

Is corruption bad for efficiency?

- Overly restrictive regulations are often caused by the opportunity of corruption
 - Regulators give themselves power in order to extract bribes
 - In our institution framework those with political power (officials) create economic institutions (lots of regulations) which allow them to benefit (through corruption)
- Thus while corruption may be an efficient way to get around the restrictions, the system is inefficient because the restrictions exist in order to make corruption valuable

When is corruption likely to be worse?

- Suppose it is necessary to get a permit from multiple departments in order to start a business
- Then each department can require a bribe
 - If the departments do not cooperate then each may charge so much that it is better to not start the business
 - A single department has an incentive to keep the bribe low enough so that it is still worth starting a business

When is corruption likely to be worse?

- In economic jargon: a single department is a monopolist which takes into account that raising the price (cost of a bribe) reduces demand for business licenses.
- If many departments have monopoly power, they may not consider the effect of a high price (large bribe) on the other departments (externality, need coordination)
- Then multiple departments may “overfish” the common pool by charging high bribes, thus reducing the catch (of bribes)

When is corruption likely to be worse?

- Example:
 - Russia under communism
 - Corruption extensive
 - But centralized, and bribers were effectively monitored.
 - Russia after fall of communism
 - Many ministries, agencies and levels of government had power to demand bribes.
 - Much greater problem since it could stifle all action.

Corruption is most important for growth

- Growth involves creating something new, or using new innovations, and so involves changes
- Corruption is often used by the currently powerful to hold back (or tax demand for) change
- Highly damaging for growth
- Lots of corruption tends to mean bad institutions:
 - General lawlessness (high degree of expropriation)
 - Those with political power have chosen bad economic institutions (*favor personal benefit*), which harm growth (*at the expense of common good*)