

Causes and consequences of corruption

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Abstract

Corruption has been an important priority to gain the better and more efficient economical governmental and private systems.

Corruption remains serious problems in the countries.

It impedes economic growth, distorts competitions, inhibits development and productivity, and undermines the rule of law and good governance understanding and conclusions seeing corruption as an interdisciplinary problem and should be handling in holistic perspective. These paper discusses about causes and consequences of corruption and culture of bribery.

Keywords: corruption, definitions of corruption, causes and consequences of corruption, bribery.

Introduction

There is currently a wave of empirical investigations on the causes and consequences of corruption. These investigations by and large relate to cross-country analyses, based on comparative assessments of the extent of corruption in various countries.

Corruption is often cited as one of the key hurdles to improving democratic governance in countries.

Arab Human Development Report revealed that more than 90 percent of those surveyed ranked combating corruption as crucial to their concept of freedom (2004). Most of literatures on corruption referring corruption to many phenomena i.e.: bribery, collusion, nepotism, and so on. According to Berg (2001), corruption is the abuse of public power for private benefit, and that private benefit is most often in the form of illicit money or in-kind from a client to the agent; we call this as bribery. Conclusively, the evaluation of the definition on corruption from many literatures brings us to realize that the terminology of corruption is a floated signifier whose many terminologies should have point in.

In advance, we can say that corruption is a symptom of the weakness in political, social, legal and economic systems. Even where corruption is widespread, the actor will strive to keep it hidden from public view. Corruption is not new, nor is it confined to any particular part of the world. On the contrary, corruption is a global phenomenon, although its severity varies from country to country.

Some definition about corruption

“Corruption is one of the greatest challenges of the contemporary world. It undermines good government, fundamentally distorts public policy, leads to the misallocation of resources, harms the private sector and private sector development and particularly hurts the poor”.

Corruption is in itself a many-faceted phenomenon and the concept of corruption contains too many connotations to be analytically functional without a closer definition. The forms of corruption are diverse in terms of who are the actors, initiators and profiteers, how it is done, and to what extent it is practiced. Also the causes and the consequences of corruption are complex and diverse, and have been sought in both individual ethics and civic cultures, in history and tradition, in the economic system, in the institutional arrangements, and in the political system.

Can we identify a specific social practice that we can justifiably call ‘corruption’, and, if so, what are its distinct analytical properties? Given the multiplicity of definitions found in the literature and the considerable confusion over what exactly we should understand corruption to mean, this question, which forms the object of this essay, does neither have a straightforward or a formalistic answer (Gambetta ,۲۰۰۰)

The corruption is defined as the abuse of authority and or power trusted to someone to gain self-benefit offered by the third side finding benefits from the abusing of the trust game.

Many plausible theories on corruption have been derived from moral and cultural characteristics of individual societies. It has for instance been argued that the salience of corruption is the carry-over into present-day political behavior of cultural values inherited from a patrimonial past, like negotiations, gift-giving and unconditional solidarity with extended families, clans and other communal groups (de Sardan 1999:20).

Corruption and bribery

Corruption is a broad term encompassing various aspects of abusing entrusted power for personal gain. It can take many forms, ranging from hiring relatives giving contracts to supporters, or abusing privileged information to buy or sell stock the most familiar and pervasive form of corruption, however, is bribery. On a grand scale, bribery typically involves government officials, top executives, and huge sums of money.

The culture of bribery

Adam Smith noted that “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public.” Every day private firms spend vast amounts of money attempting to convince legislators to

grant monopolies or otherwise restrict competition so that some industry or individual can realize a rent.

The culture of bribery frequently exists throughout entire societies simply because average citizens cannot otherwise obtain basic public services. Even if bribery is pervasive in all segments of society, the private sector, in particular, becomes a source of bribes. Even small businesses tend to have more resources than non-entrepreneurs and those resources are tempting to corrupt officials. Businesses are also subject to many more laws and regulations than individual citizens, and complex legal requirements unavoidably create potential for abuse.

There are payments needed or required to make things pass swifter, smoother or more favorably through a bureaucracy, or to avoid some burden. Therefore " many business ans people interests are for example able to buy political favors and escape the full burden of taxation and environmental regulations, others are able to buy protected markets and monopolies, special advantage, special information , import/export licenses, etc.

Bribery also carries less obvious but no less costly negative externalities. By weakening the rule of law, bribery worsens governance and decreases efficiency and productivity in the economy. The costs of corruption are a catastrophe because reducing productivity physical and manual and cause to losing innovation and achievement motivation.

The Application of the Business Principles for Countering Bribery

The Business Principles were developed in 2002 as a joint effort of diverse stakeholders ranging from companies and academia to trade unions and non-governmental bodies.

Five years after their publication, the Business Principles for Countering Bribery (BPCB) have attained recognition as a leading corporate anti-bribery standard and have influenced various other anti-corruption and corporate social responsibility initiatives:

The BPCB have provided a new basis for corporate transparency and reporting in the area of anti-bribery.

A considerable number of companies around the world adopted the BPCB.

The BPCB were recognized by the World Bank and the U.S. Government's Overseas Private Investment Corporation as a model for anti-bribery programs.

The FTSE Good index for socially responsible investment introduced anti-bribery criteria based on the BPCB.

The World Economic Forum Partnering against Corruption Initiative (PACI) has largely based its principles on the BPCB.

The Dow Jones Sustainability Index refers to the BPCB, as does the UK's Business in the Community Index.

The BPCB are incorporated into the United Nations Global Compact, a collective initiative of business leaders to advance responsible corporate citizenship.

With the recent publication of the Small and Medium Enterprise Edition of the Business Principles, the initiative is bringing anti-bribery tools to an even broader range of companies.

Corruption and its causes and consequences

We can say, corruption discourages investment, limits economic growth, and alters the composition of government spending, often to the detriment of future economic growth. The following sources have been known.

- Discussion to definition theories of corruption

Corruption is in large parts of the literature understood as one of the evils caused by economic underdevelopment. In particular in the so-called dependency theories, that see Third World underdevelopment as caused by capitalist exploitation, corruption is considered to be only one of the socio-political consequences of this exploitation, along with political authoritarianism and economic underdevelopment. Also liberal economic theory will usually explain the prevalence of corruption in terms of economic underdevelopment, and understand economic decline and

economic crises as common explanations to increases in corruption

- Political explanation

The level of corruption and the form it takes is also varying rather systematically with the political setting. Corruption levels and forms vary with the regime type within which it occurs. One widely held general assumption is that the level of corruption corresponds negatively with democratizations that the level of corruption is decreasing with increasing levels of democracy. There has been formulated a “law” Or general regularity that says that the degree of corruption varies inversely to the degree that power is consensual (Friedrich 1993:16).

- Trade restriction

Trade restrictions are the prime example of a government induced source of rents. If importing a certain good is subject to quantitative restriction, the necessary import licenses become very valuable and importers will consider bribing the officials who control their issue.

Studies have shown that a very open economy is significantly associated with lower corruption. In other words, countries tend to be less corrupt when their trade is relatively free of government restrictions that corrupt officials can abuse. Studies have shown that a very open economy is significantly associated with lower corruption. In other words, countries tend to be less corrupt when their trade is relatively free of government restrictions that corrupt officials can abuse.

- Political Explanations

The level of corruption and the form it takes is also varying rather systematically with the political setting. Corruption levels and forms vary with the regime type within which it occurs. One widely held general assumption is that the level of corruption corresponds negatively with democratization. In other words, level of corruption is decreasing with increasing levels of democracy. Democratization also provides new incentives for corruption, in particular in the mounting of electoral campaigns, in the struggle for senior political and civil service offices. On the other hand in many case dictatorship cause to looting and banditry as well as the non-payment of taxes and customs into their new liberty.

- Economic Consequences

The economic effects of corruption are nevertheless dependent on the type of corruption in each country, on the way corruption is organized or disorganized. In general terms, the difference is between *controlled* and *uncontrolled* corruption, and thus between calculable and unforeseeable corruption. In general terms, the difference is between *controlled* and *uncontrolled* corruption, and thus between calculable and unforeseeable corruption.

- Government building regulation

It is not always clear whether the existence of government building regulations causes bureaucrats to ask for bribes in return for helping construction firms circumvent them, or whether these

regulations were created by corrupt bureaucrats seeking a means of realizing economic rents. Although some attempt has been made to establish the correct direction of causal links, the issue of causality remains unresolved, and it is possible that variables may occasionally act simultaneously as both cause and effect.

- **Multiple exchange rate practices and foreign exchange allocation schemes**

Having several exchange rates—one for importers, one for tourists, one for customs, and one for investors, for example, differentials among these rates can lead to attempts to obtain the most advantageous rate, although this rate might not apply to the intended use of the exchange. Multiple exchange rate systems are often associated with anti-competitive banking systems in which a key bank with government ties can make huge profits by arbitraging between markets.

- **Natural resource endowments**

(Oil, gas, gold) Constitute a textbook example of a source of rents, since they can typically be sold at a price that far exceeds their cost or is with a especially condition without necessary transparencies.

- **Low wages**

Low wages in the civil service relative to wages in the private sector are a source of low-level corruption. When civil service

pay is too low, civil servants may be obliged to use their positions to collect bribes as a way of making ends meet, particularly when the expected cost of being caught is low.

- **Sociological factors**

Sociological factors may contribute to rent-seeking behavior. An index of ethno linguistic fractionalization (societal divisions along ethnic and linguistic lines) has been found to be correlated with corruption. Also, public officials are more likely to do favors for their relatives in societies where family ties are strong.

In the presence of corruption, businessmen are often made aware that an up-front bribe is required before an enterprise can be started and that afterwards corrupt officials may lay claim to part of the proceeds from the investment.

Empirical evidence suggests that corruption lowers investment and retards economic growth to a significant extent.

Regression analysis indicates that the amount of corruption is negatively linked to the level of investment and economic growth, that is to say, the more corruption, the less investment and the less economic growth. Analysis further shows that if the corruption index improves by one standard deviation (equal to 2.38 in this case—a standard deviation measures variation from the “normal” index), the investment rate increases by more than 4 percentage points and the annual growth rate of per capita GDP increases by over a half percentage point. In effect, a country that improves its standing on the corruption index from, say, 6 to 8 (recall that 6 is most corrupt, 10 least), will enjoy the benefits of an increase of 4

percentage points of investment, with consequent improvement in employment and economic growth.(Paolo mauro, 1997)

Corruption may bring about loss of tax revenue when it takes the form of tax evasion or claiming improper tax exemptions.

The allocation of public procurement contracts through a corrupt system may lead to lower quality of infrastructure and public services.

By reducing tax collection or raising the level of public expenditure, corruption may lead to adverse budgetary consequences. It may also cause monetary problems if it takes the form of improper lending by public financial institutions at below-market interest rates. Inflation and recession and inter industry imperfect competition increase amount corruption. Corruption may distort the composition of government expenditure. Corruption may tempt government officials to choose government expenditures less on the basis of public welfare than on **the** opportunity they provide for extorting bribes. Large projects whose exact value is difficult to monitor may present lucrative opportunities for corruption.

While evidence is fairly robust that corruption lowers in public and private department total investment, no clear relationship has been found between corruption and public Investment. (Paolo mauro, 1997).

- Total Investment

The first investigation on the impact of corruption on investment in a cross-section of countries was undertaken by Mauro [1990]. He makes use of an older corruption index provided by Business International (BI), a private firm that sold this and related indicators

of country risks to banks, multinational companies, and other investors. The author finds that in a sample of 67 countries, corruption impacts negatively on the ratio of investment to GDP. He claims that if Bangladesh were to improve its level of integrity to that of Uruguay, its investment rate would increase by almost five per cent of GDP.

- **Gross Domestic Product and Inequality**

There is a strong correlation between GDP per head and corruption reported in many empirical studies. But there is equal agreement that no unambiguous causality can be derived from this. While corruption is likely to lower GDP per head, poorer countries lack the resources to effectively fight corruption (Husted 1999). The issue of whether corruption should affect levels of GDP or its growth has not been addressed extensively in the literature. In line with Paldam [2002; Lambsdorff 2003a] argues that lack of corruption is a factor for the production of GDP.

- **Government Expenditure, Revenues and Services**

One approach is presented by Kaufmann and Wei (1999). Making use of data by WEF and WB/UB, the authors compare respondents' assessments of the level of corruption with the time manager's waste with bureaucrats. The resulting regressions do not relate to a cross-section of countries but compare firm-specific responses, resulting in thousands of observations to enter into the regressions. The authors produced a highly significant positive association for various specifications of the regressions. Also an

indicator of the predictability of corruption from the survey by WB/UB has been introduced into the regressions. Higher levels of predictability were found to lower the time managers waste with bureaucrats.

Tanzi and Davoodi [1997] examine the impact of corruption on the quality of public investments. Referring to panel data on corruption from PRS for 1980-90, the authors suggest that corruption lowers the quality of the infrastructure as measured by the condition of paved roads and power outages. They support their hypothesis by reporting a high significance in their statistical results. However, based on own regressions for a cross-section of countries using the TI index for 1998 it was not possible to reproduce the significant results. This sheds some doubt on the robustness of the findings to different methodologies.

Gupta, Davoodi and Tiongson [2001] show that countries with high levels of corruption are associated with inefficient government services and a low quality of public health care provision, as subjectively assessed by respondents.

- **Foreign Direct Investments and Capital Inflows**

Henisz (2000), who uses the Conference Board Manufacturers database, provides a similar result. This database is a collection of data on foreign market entry for more than 1000 US corporations. Henisz finds that a variable on “unexpected” corruption deters market entry.

The variable on “unexpected” corruption is the difference between “actual” corruption as measured by PRS/ICRG and expected corruption as determined by data on the political system. Given the

problems with the PRS data on corruption, the results must be taken with some skepticism.

Habib and Zurawicki (2001; 2000) also provide evidence in the line of corruption deterring foreign direct investments. They find the impact of corruption on FDI to be larger than that on local investment. They conclude that foreign investors are more sensitive to corruption than their local counterparts. In sum, the evidence of an impact of corruption on FDI now appears sufficiently well established to argue in favor of a significant negative effect.

- **International Investors and Exporters**

Lambsdorff (1998) examined bilateral trade data between 1992 and 1996 for the leading 18 exporting and 27 importing countries. While controlling for common languages, geographic distance, export composition and trade blocks, he concludes that Belgium, France, Italy, the Netherlands and South Korea have competitive advantages in countries perceived to be corrupt. Disadvantages exist for Australia, Sweden and Malaysia. The USA also has significantly less market share in corrupt countries than the first group of countries. It is concluded that these differences should be explained by differences in exporters' willingness to offer bribes and that the results indicate that exporting countries must share part of the responsibility for the level of bribery in international trade. An update of this study, including more countries and trade data, is presented by Lambsdorff (2000).

Alesina and Weder (2002) investigate whether corrupt governments attract or deter aid from OECD countries. The

authors make use of a variety of different measures of corruption and investigate different samples of countries. Testing for various specifications of the regressions, they do not find evidence that foreign donors discriminate against corrupt countries. Quite to the contrary, some results suggest that corrupt countries are even more apt to attract foreign aid from OECD countries. Alesina and Weder (2002) also investigate bilateral aid flows. Scandinavian countries and Australia have a significant tendency to avoid providing aid to corrupt countries.

- **Further Variables**

The adverse environmental effects of corruption are investigated by Welsch (2004) for a cross-section of more than 100 countries. The author argues that corruption increases pollution. This is attributed to both a direct impact of corruption, reducing the effectiveness of environmental regulation, and an indirect impact, through which corruption lowers income.

Esty and Porter (2000) also provide evidence that highly corrupt countries tend to have lower levels of environmental quality. Smith et al. (2003) investigate the impact of corruption on biodiversity, arguing that corruption limits the success of conservation projects. They show that countries with high levels of corruption tend to experience decreases in the population of elephants and black rhinoceroses, a lower variety of species and a reduced total coverage of forest.

Corruption has been shown to increase theft (Azfar and Gurgur 2004), the amount of homicides (Azfar 2004) and human trafficking (Azfar and Lee 2003). All these studies claim that this result holds

the use of instrumental variables for corruption, hence making sure that it is not only the reverse causality (crime increasing corruption) that accounts for the findings.

The relationship among corruption and government expenditure

Most economists think that the level and type of spending undertaken by governments do matter for economic performance. Fairly robust evidence suggests, for example, that high rates of enrollment in schools are related to superior economic growth. Is there evidence that corrupt governments may display predatory behavior in choosing the composition of government expenditure? Specifically, is government spending on education negatively affected by corruption?

Statistical analysis of the data sources identified in this paper in fact shows that government spending on education as a ratio to GDP is negatively and significantly correlated with corruption (the more corruption, the less spent on education). Analysis also shows that if a country moves up the corruption index from, say, τ to \wedge (it improves its respectability by one standard deviation), government spending on education increases by around a half a percent of GDP (Paolo Mauro, 1997).

Conclusions

Corruption may cause these variables but is at the same time likely to be their consequence as well. This suggests that countries can be trapped in a vicious circle where corruption lowers income, increases inequality, inflation, crime, policy distortions and helps monopolies at the expense of competition. Democracy obtained the expected positive impact on absence of corruption, this impact was more complex. Only countries with high levels of democracy, or electoral systems with high rates of participation, are able to reduce corruption. There is strong evidence that corruption lowers a country's attractiveness to international and domestic investors. This reduces capital accumulation and lowers capital inflows. Also the productivity of capital suffers from corruption. There is equally strong evidence that corruption distorts government expenditure and reduces the quality of a wide variety of government services, such as public investment, health care, tax revenue and environmental control. This corroborates that large welfare losses result from corruption.

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