Economic Research of Corruption: Its Consequences

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Abstract

In current age, corruption has become a major socio-economic problem. It is one of the most prominent barriers in the way to economic development. The major focus of this paper is on the economic research of corruption. The first part of this paper brings various definitions by renowned authors and typologies like intellectual, political, economic, and bureaucratic corruption. In the second part, this paper presents different impacts of corruption through economy. It contains research on the effect of corruption on the Gross domestic product (GDP), the level of investment in public and private projects, governmental expenditure, capital flows and Foreign Direct investment, bureaucracy, resource allocation, and foreign aid.

1.   Introduction

In current age, corruption has become a major socio-economic problem. It is one of the most barriers in the way to the development. Huge corruption has made the administration a difficult task. It remained a great hurdle in the smooth functioning of state institutions. Administrative work is deliberately made complex by the officials just to grease their palm. Red-tapism is observed in every department. Meritocracy has become a thing of the past. The technical and professional posts are filled by the non – technical and non-professional. Common people have to face a lot of difficulties to get their basic rights as access to information and security of their rights and property. A school boy avoids from taking pains into study, a teacher runs away from giving guidance, a policeman considers corruption as the sole aim of his service; a layman tries his best to steal a few minutes without any work and so on. No doubt, individuals at every level are there who do not go into the bad practice of corruption whatever the circumstances are but as a whole, corruption is present everywhere. According to Glynn, et al. (1997), as cited by Shabbir G. and Anwar M. (2007), there is no region which has been protected from corruption. Like a cancer, it destroys all sphere of the society and effected the functioning of the main organs of the society (Amundsen, 1999). According to the Global Corruption Barometer (2010) "corruption has increased over the last three years say six out of 10 people around the world, and one in four people report paying bribes in the last year" [1]

According to the World Bank, corruption has been penetrated in socio-economic development projects. The major obstruction in the way of economic and social development is not other than corruption. Corruption weakens the rule of law and also distorts the functional capacity of state institutions which are directly responsible for economic growth.[2] According to the Transparency International, corruption is a big challenge of the world now a day. It destabilizes smooth governmental functioning, primarily garbles public policy, leads to the misallocation of resources, damage the development of public and private sector, and predominantly hurts the poor people'[3]

2.   Definitions, and Typologies of Corruption:

2.1 Definitions

There are many definitions in literature of corruption but, there is no to the point, exact and extensively accepted definition. Transparency International itself came up with a very short, but precise definition: Corruption is the "misuse of entrusted power for private gain"(Transparency 2008). The main component of this definition is the misusage of entrusted power; the power provided him for public responsibility on different principles, for personal gains. Corruption is a "bilateral, a voluntary and deliberate illicit deal between two actors involving the exchange of official decisions for some payment, or promise of payment"(Offe 2004, 78). Offe explained corruption as an unlawful deal between two parties. One party influences other party for sake of personal gains by providing bribe in return of unlawful deed.

"Corruption is basically done for personal motives, it covers mishandling of personal authority for personal gains through violating the laws, (Bayley, 1966).

The World Bank refers to it as: "the abuse of public office for private gain. It involves the seeking or extracting of promise or receipt of a gift or any other advantage by a public servant in consideration of the performance or omission of an act, in violation of the duties required of the office".

According to Oxford Advanced Learner's Dictionary, (2000) corruption is illegal sort of behavior which is based on authority. Through authority one can replace morality to immoral behavior. Therefore, According to

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[1] http://www.transparency.org/policy_research/surveys_indices/gcb/2010
[2] www.worldbank.org/publicsector/anticorrupt/index.cfm.
[3] www.transparency.org/speeches/pe carter address.html

this definition corruption contains three major components; authority, behavior, and morality (Seldadyo and Haan, 2006)

Moreover, Gould (1991) describes that, the corruption is deviation from the standards, from norms and values of the society. Nye, portrays corruption as "a behavior that deviates from the formal duties of a public role (elective or appointive) because of private-regarding (personal, close family, private clique) wealth or status gains, or violates rules against the exercise of certain types of private-regarding influence" (Nye, 1997:417).

As cited by (Muhammad Tariq Khan, 2012) "U-Myint (2000) by elaborating corruption, gives a new concept of 'Economic Rent' Economic rent means monopoly profit. Monopoly occupies with corruption because through monopoly or eager of earning more and more profit, one can suppressed the rights of other. In monopoly, when a person owns different assets can charge more due to its scarcity and only control on those resources. Due to control of single owner, accountability will be shattered and profit will be increased on owner's will. The Indian law commission (2001) with collaboration of U-Myint (2000) derived a concept of Economic rent through a corruption equation which was introduced by Klitgaard, 1998) which is as under:

Corruption = (Monopoly) + (Discretion) – Accountability or in abbreviated form as:

$$C = R + D - A$$

Where C is denoted by Corruption, whereas R is for Economic rent or Monopoly, D stands for authority or power, and A is denoting Accountability. The equation elaborate that if there is more monopoly exists than corruption will be increased. Similarly, if there is more power or authority than the corruption will be elevated. Moreover, if Accountability persists in the administrations and in government functioning than there will be less corruption in the society.

2.2 Typologies of Corruption

There are various forms of corruption due to fewer consensuses on internationally accepted description of corruption. So, like definition, commonly accepted typology of corruption is also missing. Investigators on corruption have explained their own typologies of corruption. Researchers classify corruption as, bureaucratic corruption, economic corruption, intellectual corruption, and political corruption.

Political corruption

People elect their representatives to incorporate their wishes into reality, if they are not doing so then it is political corruption. Selling of influence over the decision processes by involving third party, electoral rigging, nepotism and favoritism, embezzling funds from the treasury, and involvement in organized crime are included in political corruption. In political corruption, power is almost used for personal or private gains.

Economic Corruption

Economic corruption may include payment given personally to the official of the government in exchange of use of his authorized influence, outright theft of entrusted funds, misappropriation of property and entrusted government resources, when contracts are given to preferred one due to some reasons.

Intellectual corruption

Intellectual corruption involves violation of Intellectual property rights, plagiarism, and misuse of one's pen for personal gains, and misinterpretation of religion.

Bureaucratic corruption

Bureaucratic corruption means demanding extra payments from outs parties to move their files, back channel approaches with private firm for tenders and their help in succession in contracts, bribes for acceleration of works within stipulated time. Beurucratic corruption also contains kickback, nepotism and favoritism, promotions of official to nest grade, oppointments to the lucrative sites to promote their loves one.

3.   Consequences of Corruption
3.1   Impact on Investment Ratio

The first study was conducted to see the impact of corruption on investment by Mauro (1995). He used the Index of corruption, provided by Business International (BI). In study the author finds from the sample of 67 countries that there is negative impact of corruption on the ratio of investment. He also concludes that if Bangladesh improves the structure of bureaucracy upto the level of Uruguay, its Investment ratio to GDP would be increased upto 5 %. Further study was conducted by Keefer and Knack (1995) on 41 countries. Data source was PRS. In that study the result was same as Mauro concluded. Brunetti, Kisunko and Weder (1997:23 and 25) also endorses the Mauro results referring to a corruption index by WB/UB for a sample of 41 countries. This finds that corruption significantly slow down the investment ratio to GDP. In another study by Mauro (1997), data of larger sample of 94 countries was investigated and the findings were same.

3.2   Gross Domestic Products

In many studies, there is shown a strong correlation between GDP and corruption. According to (Husted 1999:

341-2) and (Paldam 1999), there are poorer countries those cannot tackle with the corruption due to non-availability of resources.

By the cross sectional study of 15 countries in Lambsdorff (1999), said that GDP increase due to decrease in corruption. In his investigation he used WEF data based upon answers to the question of whether corruption has decreased or not in the past 5 Years. In his investigation this variable is seen to better explanation to growth of GDP as opposed to absolute level of corruption. Tanzi and Davoodi, (1997) also investigate the relation between GDP and Corruption and their impact on each other. Referring to panel data on corruption from RRS for 1980 to 1995, the researcher explored that the corruption lowers the investment which ultimately down the GDP growth and another investigation of Lambsdorff (1999) by the cross sectional of 69 countries he found the negative relation between corruption and capital productivity.

Government Spending

It is considered that those government official or politicians who allocate the resources in budget for future projects, they use to allocate more expenditure for pilot project rather than to start small one. This provides more opportunities for them to make illegal money. Not only that leads to corruption but also increase burden on government expenditures. In 1997 Mauro, by investigation suggested that as corruption increase the public investment increases. But they found no evidences of this suggestion but they found some evidence that how corruption affects government expenditures on education and he gave suggestion those corruption lower this expenditures on education. Tanzi and Davoodi (1997) investigated through panel data on corruption which was provided by PRS for 1980 to 1995. The investigation shows that corruption significantly increase public investment but it was contradictory by Mouro (1999) because on the basis of mixed evidence there didn't appear to be cleared support the corruption increases public investment.

3.3 Capital Inflows and Foreign Direct Investments (FDI)

Corruption largely effects the country's foreign direct investment. In this context, Fons (1999) finds a relation between the Transparency Index (TI) and Mood's bank financial strength ratings (BFSRs). The former index by Moody purposes to provide information about the safety and excellent financial background of the bank to the stockholders and foreigner interbank lenders without telling other factors like country's political and economic condition. Fons investigated that country's poor political situation as well as weak transparency system and high level of corruption raises the sensitivity of foreign investors. Similarly, Fons argues that due to increase in risk factors, investors quit their current and future engagements with that country or bank. In results, impact of corruption in capital inflows is visible.

In another study, Hines (1995) shows that there is differences in attitude of US investors regarding foreign direct investment (FDI). After 1977, they prefer to invest in less corrupt countries.

Another investigation regarding the impact of corruption on Capital inflows is more concerned about its relationship. Wheeler and Mody (1992) finds the significant relation between the volume of foreign direct investment and the country's risk factors due to political and economic instability. Wei (1997) who investigates the capital flows of 45 different countries from 14 different sources. He argues after interpretations that increase in corruption is equivalent to increase the tax ratio over 25% points.

3.4 Corruption and Bureaucracy

Corruption has its impacts on bureaucracy in two ways. First, the corrupt bureaucracy becomes reluctant to give services to those contractors who complete their contract effectively and efficiently (Rose-Ackerman 1997, p 42). Even the efficient contractor has largest surplus so the ability to offer largest bribe. But on the other side the corrupt contractor, who use poor material and inefficient, might be able to offer more bribe. So in this scenario the corrupt producer are awarded a contract to get largest commission. Second, the corrupt existing contractors hamper the way of new contractors by using their corrupt relationship with bureaucracy. In a result, the new entrants feel indecision to get conversation with bureaucracy for offering some bribes. Similarly, corrupt bureaucrats deliberately use delaying tactics in extract payment from the contractors

3.5 Corruption and Resource Distribution

Corruption has its impact on allocation of resources in two ways. First, it can change private investors. This change follows from corruption in the shape of changes in the value of goods and services, and of resources and aspects of manufacture including entrepreneur capacity. Second, corruption can results in misallocation when the consent on investment of public finance and private investment are taken by a corrupt organizations of the government

Corruption effects investment level and pattern directly and indirectly through affecting tax collection and bulk of funds accessible to the government for distribution. (Tanzi and Davoodi 1997) Corruption also affects the allocation of human capital because it affects the return on productive activity. (Bhagwatti 1984)

3.6 Cost-enhancing impact of corruption

Industrial policies become less effective in the presence of cost enhancing corruption. Government encourages investments in preferred sectors of economy by creating large rents for investors through industrial policies. In the presence of corruption total impact of industrial policies on investment ranges between 84 and 54% of direct impact. (Ades and Ditell, 1997)

Rise in tax rate on multinational companies and corruption level in the host government would reduce foreign direct investment. (Wei, 1997)

Fons (1998) in his study finds that funding cost is high where county has weak transparency system. He also finds that poor transparency often exists in those societies having corrupt business practices.

3.7 Foreign Aid

Alesina and Weder (1999) explored whether the corrupt governments encourage or discourage foreign aid from OECD countries. The authors investigated the relationship between corruption and the level of foreign aid through samples of different countries. In findings, authors concluded that there was no evidence that the foreign donors had discrimination against the corrupt government. Interestingly, some results suggest that foreign aid is more attractive and it is encouraged in corrupt countries.

Bilateral aid flows are also explored in different studies. It is investigated that Scandinavian countries and Australian avoid providing foreign aid to the corrupt countries but in contrast, USA tends to provide aid to those countries where corruption is its peak.

4. Conclusion

In this paper, my intention was to show what is corruption, what are its typologies, and how corruption transmits its effects through an economy and other factors. In a recent wave of empirical studies the effects are sometimes ambiguous and inconsistent like the effects of corruption on foreign direct investment as well as on foreign aid. In some empirical evidences it is shown that corrupt countries attract foreign aid and FDI, but on the other way some results are contrary to these evidences. Similarly, it is proved that corruption has lasted its effects on investment ratio in corruption prone countries. The incentives provided to investors are high in these corrupt countries. But, there is strong evidence that corruption slow down the attraction of investors to invest. It is concluded that there is negative impact of corruption on investment. Similarly, corruption increases the expenditures of the government. Corruption effects tax collection and bulk of funds accessible to the government for distribution. In a nutshell, corruption hampers the socio-economic growth of the country where the democratic system and market based economies are prevailed.

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