

The Anatomy of Corruption

Bureaucracies are designed to perform public business. But as soon as a bureaucracy is established, it develops an autonomous spiritual life and comes to regard the public as the enemy.

Brooks Atkinson, "September 9", Once Around the Sun (1951)

While corruption is defined as "the misuse of entrusted power for private benefit", it can also be described as representing non-compliance with the "arm's-length" principle, under which no personal or family relationship should play any role in economic decision-making, be it by private economic agents or by government officials.

Once the arm's-length principle has been breached and a distinction made based on relationships, corruption will often follow. Conflict of interest situations and nepotism are examples. The arm's-length principle is seen as fundamental to the efficient functioning of any organisation.¹

A core, but unstated assumption underlying theoretical work on the role of the public sector is that public sector officials (both policy-makers and civil servants) are knowledgeable, neutral and impersonal in their pursuit of the social welfare.² But are they? What do officials see as the pursuit of the social welfare and what do they, themselves, consider to be "corruption"? And what of their willingness – or otherwise – to take action against it? These questions are all too seldom asked.

In 1994, a major research project in New South Wales, Australia, by the state's Independent Commission Against Corruption, sought to determine the kinds of conduct public sector employees would judge as corrupt and identify those factors which might hinder employees from taking action against it. A survey was conducted, in which public servant respondents were asked to assess twelve scenarios, in terms of –

- the desirability of the behaviour,
- how harmful it was,
- how justified they considered it to be, and
- what they would do about it.

In addition, respondents were asked to state whether, and how strongly, they agreed or disagreed with twelve attitude statements.³

Individual respondents differed sharply in their views as to what was – or was not – "corrupt". As the report notes, "it is important for all who are interested in minimising corruption to

¹ Vito Tanzi in *Corruption, Governmental Activities, and Markets*, IMF Working Paper, August 1994.

² Ibid.

³ The statements and other details appear in the Best Practice section of the web site version of this Source Book: www.transparency.org.

realise that what any one public sector employee understands as “corrupt” may not be shared by his or her colleagues”. This lack of commonality of understanding adds to the difficulty of combating corruption.

The survey showed that a willingness to take action would depend on a number of factors, including the relationship between taking action and how harmful, undesirable or unjustified each scenario was considered to be. Factors which reduced the willingness to take action included -

- the belief that the behaviour was justified in the circumstances;
- the attitude that reporting corruption was futile, as nothing useful would be done about it;
- the belief that the behaviour was not corrupt;
- a fear of both personal and professional retaliation;
- the low relative position within the organisation;
- employees’ perception of their relationships with the perpetrator and the supervisor; and
- concerns about insufficient evidence.⁴

Clearly, therefore, the starting point for any serious work on containing corruption has to be the personal perspectives of those in positions of trust or authority. As the Australian study demonstrated, this must begin by raising awareness of what constitutes the threshold of acceptable behaviour and the creation of a more informed understanding of the costs of corruption.

A very different survey of the experience of Transparency International chapters, in 1995, suggested that corruption in the public sector takes much the same form and affects the same areas whether one is dealing with a developed country or a developing one. The areas of government activity most vulnerable to corruption were -

- public procurement;
- rezoning of land;
- revenue collection;
- government appointments; and
- local government.

The methodologies, too, were remarkably similar, including -

- cronyism, connections, family members and relatives;
- political corruption through donations to political campaigns, etc.;
- kickbacks on government contracts (and subcontracting consultancies); and
- fraud of all kinds.

Within the public service (including politicians, as well as elected and appointed officials), the following kinds of activities often take place:

- Ministers “sell” their discretionary powers. For example, in New South Wales, Australia, the Minister for Corrective Services was convicted and jailed for selling early releases from prison to drug traffickers;
- officials take percentages on government contracts, which are often paid into foreign bank accounts;⁵
- officials receive excessive “hospitality” from government contractors and benefits in

4 *Unravelling Corruption: A Public Sector Perspective: Survey of NSW Public Sector Employees’ Understanding of Corruption and their Willingness to Take Action*, ICAC Research Report Number 1, Independent Commission Against Corruption (NSW), April 1994

5 The various ways in which this may be done, including circumventing the public procurement rules laid down by interna-

tional lending institutions, are described in the *Grand Corruption: How Business Bribes Damage Developing Countries* by George Moody-Stuart (WorldView Publishing, Oxford; 1997). Mr. Moody-Stuart is Chair of the UK chapter of Transparency International. His original manuscript was circulated privately in 1993 and did much to break the taboo in business circles of discussing the problem.

- kind, such as scholarships for the education of children at foreign universities;
- officials contract government business to themselves, either through front companies and “partners” or even openly to themselves as “consultants”;
 - officials deliberately travel abroad so that they can claim per diem allowances which they set themselves at extravagant levels;
 - political parties use the prospect of power, or of its continuation, to levy large rents on international businesses in particular, in return for government contracts (which may be dressed up as a “donation” to a designated “charity” or a “hospital”). For example, in Kenya during the Kenyatta years, the vehicle was the Gatundu Armed Forces Hospital, which was the enforced “beneficiary” of “charitable donations” by all who wished to do business with the regime. Had this hospital really been the ultimate destination for the money, it could have been a major teaching hospital, instead of being a comparatively modest hospital in the former President’s tribal area;⁶
 - revenue officials practice extortion by threatening to surcharge tax payers or importers unless bribes are paid, in which case unjustifiably low assessments are made, or goods are passed for importation without payment of any duty at all. For example, revenue collection in Tanzania slumped dramatically in 1994-95. In Italy, where the practice is also said to be widespread, taxpayers, particularly large companies, accuse the ‘financial police’ of extorting money from them, although the degree of their unwillingness to pay for illicit reductions in their tax bills remains to be tested in criminal prosecutions;
 - law enforcement officials extort money for their own benefit by threatening to impose traffic penalties unless bribes are paid (which are frequently somewhat less than the penalty the offence would attract if it went to court);
 - providers of public services (e.g., drivers’ licenses, market stall permits, passport control) insist on payments for the services in order to speed up the process or to prevent delays. In Latin America, this practice has become so institutionalised that a whole profession has grown up to “assist” those who wish to transact business with a government department⁷;
 - superiors in the public service charge “rents” from their subordinates, requiring them to raise set sums each week or month and to pass these on upwards. In Mexico City, a practice developed whereby a policeman on street duty would be charged rents on his patrol car, his gun and his job, with separate rents going to the different officers responsible for transport, firearms and supervision; and,
 - “ghosts” are created to pad payrolls and lists of pensioners, or to create fictitious institutions which, if they existed, would be entitled to state funds. In Uganda complete “ghost schools” were identified in a surprise audit undertaken in the context of a public sector reform project. The Warioba Commission found many instances of this in neighbouring Tanzania. Even France has not been immune. An army paymaster was found to have created fictitious units within the French Army in order to generate private payments.

Corruption, in all its forms, is not unique to any one country. Corruption in China, where bureaucrats have “commercialised their administrative power”,⁸ is really no different from that

6 Contemporary events in Europe have revealed how widespread this practice is in most Western European democracies (e.g. Italy, Austria, France, Spain, Belgium – see most issues of the TI Newsletter).

7 These “professionals” have been so co-opted into the system that they can take papers to the head of a queue and either process them themselves or have them processed immediately. Some city halls even provide office space for these individuals. However, reforming politicians have had them thrown out (e.g. Ronald McLean Abaroa as the first elected mayor of La Paz,

Bolivia). It can be argued that the familiarity of these individuals with the bureaucratic system is a positive aid to public administration, and that they provide a genuine service. This argument might be tenable were it not for the fact that the systems themselves appear to depend on, and be sustained by, the revenue that these individuals extract from the public and pass on to the officials. Ref. conversations with Ronald McLean Abaroa and Valeria Merino Dirani.

8 See Yufan Hao and Michael Johnston, *Reform at the Crossroads: An Analysis of Chinese Corruption*, Department of Political Science, Colgate University, Hamilton NY, USA, January 1995.

in Europe, where political parties have taken huge kickbacks for public works projects. (In Italy, the cost of road construction has reportedly dropped by more than twenty percent since the “Clean Hands” assault on corruption.) Slush funds have been established in Swiss bank accounts for illicit political party financing, and suspicions are that these funds have been “leaked” into private pockets. Kickbacks, too, have been paid to political parties for defence procurement. Companies have wined, dined, entertained and bribed officials, especially across international borders, to obtain business illegally and unfairly and, not infrequently, with disastrous consequences.

The Consequences of accepting bribes

Gordon Foxley, a civil servant at Britain’s Ministry of Defence, was imprisoned for four years for taking at least US\$2.25 million in bribes. But in an analysis carried out for TI-UK, he is said to have caused up to US\$200 million in financial damage. This included the cost of job losses at the factory in Britain which failed to gain the orders (they went abroad), loss of profits leading to lower values for privatisation exercises, the loss of highly-developed skills, the higher price paid than was necessary, and the purchase, in at least one instance, of a fuse which was useless as it was “ineffective in practice and battle conditions”.

*“MoD arms chief’s greed cost £130 million”
Observer (UK), 16 October 1994.*

In Britain, conflict of interest scandals implicated Members of Parliament to the point where public faith in government ministers being “generally trusted to tell the truth” was ranked at a mere 11 percent (with both doctors and teachers rating 84 percent, and television news-readers 72 percent). While most occupational groups had improved their standing over the previous ten year period, the standing of Ministers and politicians generally, already very low, fell even further. Press reaction suggests that public cynicism in Britain has, if anything, grown substantially since 1993, when the poll was taken.⁹

British politicians have generally fallen from misjudgement rather than criminal deeds¹⁰; however, in continental Europe, including Belgium, Italy, Austria, France and Spain, political figures are being actively investigated and prosecuted for criminal breaches of trust. At any given time, numerous political figures are under investigation in the United States. In Australia, ministers have been jailed, and in New Zealand, an Auditor-General, while in office, was alleged to have misappropriated public funds and was imprisoned¹¹. Nevertheless, in a 1995 TI poll, New Zealand still was rated as the least corrupt of the 41 countries included in opinion surveys of business people doing business internationally.

The myth of culture

One lesson is clear: very few are in any position to criticise anyone else on the issue of corruption. Even in Singapore, arguably one of the countries with the least corrupt government, corruption exists, albeit to a very small degree. Hence, the second lesson: corruption affects even the cleanest governments and must be guarded against constantly.

Types of bribery

There is widespread agreement on the situations that are especially amenable to corruption. However, an effective effort to deal with corruption must begin with its root causes. We need to understand the incentives for potential bribers and those injured by the corruption of others. Four broad categories can be distinguished:

Category (1): Bribes may be paid for (a) access to a scarce benefit, or (b) avoidance of a cost.

Category (2): Bribes can be paid for receipt of a benefit (or avoidance of a cost) that is not scarce, but where discretion must be exercised by state officials.

9 The poll was undertaken by MORI. Journalists fared even worse, halving their standing from 19 percent to 10 percent, illustrating the crisis, too, in the British public media. See *Standards in Public Life: First Report of the Committee on Standards in Public Life* Vol. 1: Report (HMSO, London, 1995) p. 107. The poll is contained in the Best Practice section of the web site version of this Source Book: www.transparency.org.

10 A former Minister, Jonathan Aitken, was jailed for perjury after he had tried to fabricate evidence to win a defamation case against *The Guardian* newspaper, which had documented secret meetings with Middle East arms dealers while he was a defence minister. Just what was taking place, and whether the conduct was appropriate, has not been disclosed.

11 TI Newsletter, June 1997.

Category (3): Bribes can be paid, not for a specific public benefit itself, but for services connected with obtaining a benefit (or avoiding a cost), such as speedy service or inside information.

Category (4): Bribes can be paid (a) to prevent others from sharing in a benefit or (b) to impose a cost on someone else.

Category (1) includes any bureaucratic decision where the briber's gain is someone else's loss: for example, access to import or export permits; foreign exchange; a government contract or franchise; concessions to develop oil or other minerals; public land allocation; the purchase of a newly privatised firm; access to scarce capital funds under state control; a license to operate a business when the total number of licenses is fixed; access to public services such as public housing; subsidised inputs; or heightened police protection for a business. In all these examples, there may be competition between bribers which can be manipulated or even created by bureaucrats or politicians. If public servants have the discretion to design programmes, they may be able to create scarcity for their own pecuniary benefit or over-allocate resources (a phenomenon known as 'supply stretching').¹²

Examples of Category (2) include: reducing tax bills or extorting higher payments when no fixed revenue constraint exists; waiving of customs duties and regulations; avoidance of price controls; awarding a license or permit only to those who are deemed to "qualify"; access to open-ended public services (entitlements); receipt of a civil service job; exemption from enforcement of the law (especially for victimless and white collar crime); board approval for a building project; and lax enforcement of safety or environmental standards. Bureaucratic discretion can often lead to the extortion of bribes. Police can pay gangs to threaten businesses, while at the same time accepting bribes from these same businesses for their protection.¹³ Similarly, politicians can threaten to support laws that will impose costs or promise to provide specialised benefits in return for payoffs.

Category (3) are services related to the first two categories, rather than a benefit per se. For example, inside information on contract specifications (as was the case in Singapore, where a consortium of corporations from exporting countries bribed to obtain privileged information in connection with government contracts - the corporations were subsequently blacklisted by the Government of Singapore). Other aspects include faster service; reduced paperwork; advance notice of police raids; reduced uncertainty; or a favourable audit report that would keep taxes low. Bureaucrats can often generate the conditions that produce such bribes. Officials can introduce delays and impose rigid application requirements. For example, despite tough environmental protection laws in Russia, the condition of the environment suggests that the legal regime is focused more on providing opportunities for officials to extract bribes for non-compliance, than on actually protecting the environment.¹⁴

Category (4), like (1), also includes winners and losers. Examples include cases where one operator of an illegal business might pay law enforcement agencies to raid his competitors. Owners of legal businesses might seek the imposition of excessive regulatory constraints on competitors, or attempt to induce officials to refuse to license a potential competitor. A Queensland Police Commissioner was bribed by illegal gaming interests to furnish a report to his government arguing strongly that the gaming industry should not be legalised.

In Categories (1) and (4), where there are direct losers, the organisation of the potential bribers

¹² Alam, M. Shahid, *Some Economic Costs of Corruption in LDCs*, Journal of Development Studies 27:89-97, p.91, 1991.

¹³ Ibid.

¹⁴ Discussion with private sector corporation active in that country.

may be important in determining the size and prevalence of corruption. If there is only a small number of potential beneficiaries, they may simply share the market monopolistically among themselves, rather than resort to bribery, and then present a united front to public officials. These cases demonstrate that the elimination of corruption is not an end in itself. A policy encouraging the monopolisation of an industry could reduce corruption, but would have few social gains. Instead of flowing in part to public officials, the benefits would flow into the pockets of monopolistic firms. In addition, if these companies are foreign-owned and repatriating profits, or international criminal concerns, the benefits will mostly flow out of the country. Examples like these illustrate how the problem might not be corruption per se, but the monopoly rents that give rise to payoffs.

The extraction of payments from people who are entitled to services but unable to get them (e.g. for the issuing of a driver's licence) is properly classified as "extortion" (and a crime in most countries), rather than a bribe. The test would be whether both payer and recipient were acting illegally, or whether the payer was an innocent victim of an offence by an official who would otherwise deny the payer his lawful entitlement.¹⁵

Corruption and market inefficiency

Some commentators argue that bribery simply represents the operation of market forces within state programmes, and that, given the efficiency of the market, payoffs should be tolerated. Such cases might exist; however, this benign assessment must be treated with scepticism.

First, public programmes may be undermined when public servants allocate scarce resources to the highest bidder. Public housing, for instance, is designed for the poorest families, not those who can pay the most. In addition, the prospect of payoffs can lead officials to create artificial scarcity and red tape. Moreover, where bribes are paid to induce public officials to favour a firm at the expense of competitors, the highest bidder is often not the most efficient organisation in the marketplace; instead, it can be the organisation with the highest monopoly profits resulting from the elimination of competitors.

The illegality of corruption itself introduces costs that will limit the efficiency of bribery. First, because its perpetrators try to keep their illicit dealings secret, the price information that is essential for a well-operating market is not easily available, and may result in price inflexibility. Once an acceptable bribe rate (10% of the contract price) or fee (US\$100 to get a driving license) has been set and is known in the relevant community, the price may remain constant, even in the face of changing market conditions over time. Corruption markets may be more influenced by habit and tradition than ordinary private markets. Large shocks may be needed, such as the fall of a corrupt government, to re-adjust bribe payments.

Second, to reduce the risk of detection, entry into the bribery market for both payers and receivers is limited to people who are known and trusted - relatives, close friends, members of the village or tribe. Third, the benefits of corruption are not widely distributed if some refuse to participate. Honest public servants may simply refuse to enter the corrupt marketplace. Fourth, given the illegality of bribes, contracts between beneficiaries and public officials cannot be enforced. Thus, the risk that one side or the other will not perform, will limit the number and type of deals and make it more likely that such transactions will only occur among people who are well known to one another. As a general rule, then, one can reject the claim that corruption allocates resources efficiently.

¹⁵ This distinction features in the work on corruption undertaken by the International Chamber of Commerce (ICC).

Transitions to democracy and to a market economy

Corruption thrives in rigid systems with multiple bottlenecks and sources of monopoly power within government. A planned economy, where many prices are below market-clearing levels, provides incentives for payoffs as a way to allocate scarce goods and services. Transactions that would be legal trades in market economies are illegal payoffs in such systems. In addition to selling goods and services to the highest bribe bidders, public servants have incentives to create even more bottlenecks as a way of extracting higher payoffs. Officials might, for example, create delays or introduce costly conditions. The fundamental problem is not simply the existence of controlled prices set below the market-clearing level, but also the monopoly power of state officials who are not threatened with entry by more efficient and lower-priced competitors.¹⁶

Throughout the former Soviet bloc, the state of the economy gave officials an incentive to exploit their positions for private gain and gave their customers and clients an incentive to make payoffs. Corruption was common because the formal rigidity of the system was not backed up by an impartial legal system capable of enforcing the rules. Instead, ultimate authority was exercised by superiors in the hierarchy who often had their own reasons for bending or changing the rules on their own authority. Subordinates could not appeal to “the law” as a reason for resisting the demands of their superiors. The system was not only rigid, but also arbitrary. Its requirements and irrationalities turned almost everyone into a law breaker. The widespread complicity of the citizenry in corrupt transactions, became a method of social control. Corruption cases were often used to punish dissidents, not to improve the functioning of the state bureaucracy.

It should be noted, however, that the situation differed from one Eastern country to another. There were complaint mechanisms, both communal and state, as well as mechanisms in trade unions, and certainly in some countries these worked reasonably well, at least when political questions were not involved. Omnipresent state security also covered economic matters and had a deterrent effect. However, one widely prevailing view is to the effect that “the State was stealing from us, and we were taking our own property back again”.¹⁷

These observations might suggest that the decline of authoritarian governments and centrally planned economies will reduce the incidence of corruption as competitive market forces come to the fore. According to this scenario, illegal payoffs will be converted into legal market prices, and the level of monopoly rents will fall. But such has not been the case. Corruption and lawlessness has been rampant in the emerging market economies of Russia and Eastern Europe and in the new democracies of Latin America.

Stories of America’s 1920 robber barons are invoked to argue that “cowboy capitalism” is just a transitional stage that must be endured on the way to a more stable capitalist stage. The danger, however, is that corruption can become so widespread that it can undermine and destroy the transitional stage itself. Even if corruption is consistent with economic growth under some conditions, this does not imply that it facilitates growth or that it does not have other negative political and social consequences. Moreover, the links between corrupt business and organised crime, and the cross-border arrangements they have made, add entirely new dimensions to the problem and are further reasons to suspect that history is not simply repeating itself.

16 Andrei Shleifer and Robert Vishney, 1992, *Pervasive Shortages under Socialism*, *Rand Journal of Economics* 23:237–246. Montias, J.M., and Susan Rose-Ackerman, 1981, *Corruption in a Soviet-type Economy: Theoretical Considerations*, in Steven Rosefielde, ed., *Economic Welfare and the Economics of Soviet*

Socialism: Essays in Honour of Abram Bergson. Cambridge: Cambridge Univ. Press.

17 See, for example, Mikhail Stern, *Defendant, The USSR vs. Dr. Mikhail Stern* (New York: Urizen Books, 1977).

During the transitional period, if prices are permitted to reach market-clearing levels, no one need pay a bribe to get supplies. If, however, pockets of state control remain, they may become the loci of payoffs. Thus, the privatisation process itself, although ultimately reducing corruption by lowering state involvement in the economy, may initially be a source of corrupt activities as investors jockey for position.¹⁸

The basic source of corruption is no longer the rigidity of the system, but the uncertainty surrounding it. The transitional stage lacks both legal legitimacy and institutional strength as a result of fragile and poorly developed administrative and political structures. People operating within these transitional state structures seek certainty, and they may try to achieve it by paying off officials.¹⁹ In the worst case, citizens and business people simply opt out of the legal economy and rely on organised crime to provide protection both from the state and any competitive threat.²⁰ Corruption may then be merely a device for inducing public officials to look the other way. The state becomes not just weak, but irrelevant as well. The end result of the destructive cycle could be public pressure to limit the role of the market and return the state to a planned economy.²¹

If stability facilitated corruption in the past and instability encourages it in the present, what is to be done? In spite of the dramatic changes in institutional structure that have occurred in transitional societies, an important obstacle remains: the lack of a credible state commitment to the Rule of Law. The response of transitional states to corruption must be both substantive law reform and institutional restructuring. Countries in transition should liberalise their economies by reducing incentives for bribery and eliminating subsidies, trade restrictions, and preferential treatment in government purchasing.

Nevertheless, as transitional states deregulate and decontrol in some areas, they will need to introduce regulations in others. For instance, they may need new laws regulating environmental pollution, worker and consumer health and safety, and financial and securities markets. They may also need new subsidy programmes for needy people unable to survive in a market economy. These new programmes, however, should be designed to keep corruption incentives low. Thus, pollution might be regulated through tradable emissions permits and welfare provided through direct cash payments or voucher systems. Yet, even these programmes can be open to abuse. Simplification and market-based schemes cannot solve all problems; structural and moral reforms must also be part of the solution.

18 Luigi Manzetti, *Economic Reform and Corruption in Latin America, North-South Issues*, North-South Center, University of Miami, 3: 1-6 (1994).
 19 Andrei Shleifer and Robert Vishney, 1993, Corruption, *Quarterly Journal of Economics* 108: 599-617
 20 Susan Rose-Ackerman, 1994, *Reducing Bribery in the Public Sector*, in Trang, Duc V. ed., *Corruption and Democracy*, Budapest, Institute for Constitutional and Legislative Policy, pp.21 - 28.; Daniel Kaufman, 1994, *Diminishing Returns to*

Administrative Controls and the Emergence of the Unofficial Economy: A Framework of Analysis and Applications to Ukraine, *Economic Policy* (December) pp. 51-69. 23. Timothy Frye, 1993, *Caveat Emptor: Institutions, Credible Commitment and Commodity Exchanges in Russia*, in David Weimer, ed., *Institutional Design*, Kluwer.
 21 Timothy Frye, 1993, *Caveat Emptor: Institutions, Credible Commitment and Commodity Exchanges in Russia*, in David Weimer, ed., *Institutional Design*. Kluwer.