The Political Economy of Corruption Indexes

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Declaration of Originality

This work contains no material which has been accepted for the award of another degree or diploma in any university, and to the best of my knowledge and belief, this thesis contains no material previously published or written by another person except where due references is made in the text of the thesis.

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ABSTRACT

Corruption indexes, such as the Transparency International’s Corruption Perceptions Index and the World Bank’s Control of Corruption indicator, have played a pivotal role in focusing global attention on corruption. Since they came into existence, these indexes have been influential on research and investigations into corruption. Aid donors have also relied extensively on these indexes to determine the allocation of aid to developing countries. Despite the intense anti-corruption initiatives over the past decade, corruption still remains one of the greatest stumbling blocks for sustainable development. The lack of success of these anti-corruption initiatives has cast significant doubts on the contemporary mainstream perspective on corruption. In this thesis, I examine the underlying concepts and theoretical assumptions of the mainstream approach to corruption which has its roots in neoclassical economics. It defines corruption as bribery and views it as a rent-seeking behaviour. I argue that this understanding of corruption is too narrow and does not reflect the realities of corruption. A more appropriate framework draws on the insights of institutionalism. Focusing on the institutional structures and its violation in its analysis, this alternative defines corruption as the subversion of institutions and rules of an organisation or society which results in the corrosion of the institutional and social fabric. This alternative approach provides a broader and more realistic understanding of the realities of corruption. In theory, it may be possible to construct a corruption index based on this alternative framework. In order to give the developing countries a real chance at tackling corruption, it is necessary that the international community, in particular the World Bank and IMF, alter the way they understand corruption.
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CHAPTER ONE
INTRODUCTION

1.1 General Overview

Corruption is widely regarded as one of the biggest challenges of the 21st century. The common conception of corruption is that it hampers economic growth, brings about political instability, disproportionately burdens the poor and undermines the effectiveness of foreign investments and aid. Former World Bank president, James Wolfensohn’s groundbreaking ‘cancer of corruption’ speech in 1996 has won plaudits for bringing international attention to the issue of corruption. The World Bank and the International Monetary Fund (IMF) share a similar understanding of corruption. Both institutions view corruption as ‘one of the structures of economic sin’ and assert that the social, political and economic backwardness of poor developing countries can ill-afford the menace of corruption (Krastev 2004, p. 10). The World Bank (2009) has identified corruption as the ‘greatest obstacle to economic and social development’ because it ‘undermines development by distorting the rule of law and weakening the institutional foundation on which economic growth depends’. Similarly, the IMF (2011) states that the ‘causes of corruption are economic in nature, and so are its consequences – poor governance clearly is detrimental to economic activity and welfare’. Therefore, combating corruption is seen as a necessary step towards achieving development.

Today, people in most parts of the world are no longer willing to tolerate corrupt behaviour. The shift in global attention and attitudes cannot be solely attributed to Wolfensohn’s speech. The formation of the corruption indexes has also played an influential role in bringing the issue of corruption to the centre of the international stage. Despite the difficulties associated with measuring corruption, the number of corruption indicators has grown exponentially over the past decade. Some of these measures of corruption include the Corruption Perceptions Index (CPI) formulated by Transparency International (TI), the World Bank’s Control of Corruption Indicator (WBCC) and the International Country Risk Guide (ICRG) of the Political Risks Services (PRS). These corruption indexes are widely recognised and used by policy-makers, businesses, international organisations, non-governmental
organisations and academics around the world. More importantly, these indexes revived the research into empirically and normatively important questions about corruption that scholars had previously abandoned due to the lack of data on corruption (Golden & Lucio 2005, p. 39). Without these indexes, it is doubtful as to whether research into the causes and consequences of corruption would have been undertaken. These researchers have played a huge role in shaping the anti-corruption strategies we have today.

With the 2015 deadline for the United Nation’s (UN) Millennium Development Goals (MDG) fast approaching, the issue of corruption and how to curb it has assumed increasing importance. Not only has there been a surge in academic research relating to corruption, the media has devoted a significant amount of attention to the corruption scandals that occur within governments, financial institutions and businesses. The emergence of various global governance structures that specialise in tackling issues of corruption is therefore unsurprising. The Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Public Officials in International Business Transactions (1997), the United Nations Convention against Corruption (2003) and the African Union Convention on Preventing and Combating Corruption (2006) are few examples of the legal instruments that have been implemented in the fight against corruption. Furthermore, non-governmental organisations (NGOs), such as TI, Global Witness and the International Association of Anti-Corruption Authorities (IAACA), continue to play an active role in raising the awareness of corruption worldwide through the dissemination of relevant information. These NGOs also monitor and recommend useful strategies to combat corruption. Despite these anti-corruption initiatives, many argue that corruption still remains widespread in many developing countries. This dismal result cast doubt on the effectiveness of the corruption indexes as a tool for analysing the scope and role of corruption.

Many who utilise the corruption indexes have employed them unquestionably. However, corruption has proven to be a difficult concept to measure and assess. The corruption indexes have drawn increasing criticism over the past decade. Scholars continue to debate on the ability of these indicators to produce reliable and valid results. Given the extensive literature dedicated to assessing the corruption indexes, it
is somewhat surprising that the theoretical underpinnings of the indexes have not received more systematic attention. Hence, the goal of this thesis is to examine the theoretical underpinnings of corruption, and by extension, the contemporary mainstream perspective on corruption, to highlight the dangers of utilising the corruption indexes without question. The two corruption indexes focused on in this thesis are TI’s CPI and the WBCC formulated by the World Bank. Both the TI and the World Bank have been at the forefront of the fight against corruption. The CPI and WBCC have been the leading measures of corruption since they came into existence in 1995 and 1996 respectively. These two corruption indexes have fundamentally altered the way in which we understand and study corruption. In particular, the formulation of the CPI provided a platform for the international comparisons of perceptions of corruption for the first time. Credit must therefore be given to these indexes for shattering the taboo surrounding corruption and putting the issue of corruption on the international development agenda. However, these virtues should not blind us to the deficiencies present within these corruption indexes. Leaving its methodological limitations aside, it is imperative that we examine the theoretical premise and assumptions on which the corruption indexes were built and how they affect the way we understand corruption.

1.2 Defining ‘corruption’

Definitions of corruption are essential and important for two reasons. First, definitions determine the scope of our analysis and the essential concepts that we are trying to capture when assessing corruption. As Toke Aidt (2003, p. F623) states, ‘the definition of the concept determines what gets modelled and what empiricists look for in the data’. Second, it influences our perception on the nature of corruption, which in turn, affects our understanding of the strategies needed to combat corruption. Therefore, any research relating to corruption is necessarily dependent on the manner in which corruption is defined.

Definitions are essentially incomplete descriptions, made up of a selection of elements that describe the character of a particular concept. Lenin stated in his writings that definitions ‘can never embrace all the concatenations of a phenomenon in its complete development’ (1917, p. 105-106). The question that springs into mind then is: what is a good definition? A good definition is one that is unambiguous.
Hence, elements selected for a definition have to be clearly defined. It has to set the limits, boundaries and features that contribute to the existence of the concept in question. A second criterion is more controversial. Many would argue that a good definition ought to be objective and should not be a reflection of public opinion. However, scholars have argued that the definition of corruption should reflect or accord with public opinion as corruption is intricately linked to public disapproval (Kurer 2005, p. 223). The role of public opinion is thus important as it can contribute to a definition of corruption and, at the same time, assess the quality of competing definitions of corruption (Kurer 2005, p. 224).

The term corruption is readily used and applied by many. However, difficulties present themselves when trying to define it. Over the years, both academic scholars and researchers in international organisations have redefined and developed numerous definitions of corruption. These attempts to define corruption have not culminated in a consensus. The vast amount of competing definitions within the corruption literature is a reflection of the diverse perceptions of corruption. However, one particular definition has been adopted by most scholars in their research and endorsed by international organisations, including the World Bank and TI.

The World Bank (1997) defines corruption as *the abuse of public office for private gain*. This is similar to the definition of corruption formulated by TI. According to TI:

> Corruption is operationally defined as the misuse of entrusted power for private gain. TI further differentiates between ‘according to rule’ corruption and ‘against the rule’ corruption. Facilitation payments, where a bribe is paid to receive preferential treatment for something that the bribe receiver is required to do by law, constitute the former. The latter, on the other hand, is a bribe paid to obtain services the bribe receiver is prohibited from providing.

These definitions dominate in the international understanding of corruption. At first glance, the definitions appear to be satisfactory as they are straightforward and objective. The employment of an objective stance is what enables these international organisations to compare the perceptions of corruption across different countries.
However, a closer examination suggests that there are some significant problems with these definitions. These definitions fail to take into consideration private sector corruption. Corruption exists in the private sector as much as it does in the public sector. Leaving it out of the definition can therefore be misleading and present an incomplete view of corruption. Moreover, it is questionable what terms like ‘entrusted power’ or private gain’ refer to. Although the World Bank argues that its definition was constructed broadly in order to cover most forms of corruption that the Bank encounters, it is important to note that there are serious limitations to such broad and ambiguous definitions of corruption (See Brown 2006, pp. 69-75). However, even if we were to disregard these limitations, an even more striking problem appears.

The formulated definitions refer explicitly to bribery. The reason why a definition that focuses explicitly on one form of corruption continues to dominate public policy may be because bribery has remained ‘one of the most persistent, pervasive and widespread examples of corruption across many societies over many centuries’ (Brown 2006, p. 62). However, to define corruption purely in terms of bribery is problematic as it neglects other forms of corruption that are not centred on the facilitation of financial payments or consideration. Corruption takes many forms and they vary according to the parties involved, the sector in which it occurs, the extent of their impact and the degree to which they are formalised (Andersson & Heywood 2009, p. 749). These definitions do not take into account corrupt practices such as extortion, nepotism or the misappropriation of funds. Although these practices fall under the rubric of corruption, they are not considered to be so by the common definition. A definition that focuses solely on one form of corruption is of little practical use if we are interested in capturing the ‘essence’ of corruption.

Furthermore, the adoption of an objective approach has its disadvantages. By not incorporating the public’s view of corruption, the World Bank’s and TI’s definition of corruption have been criticised as being culture-specific (Kurer 2005). These definitions seem to reflect a Westernised perception of corruption. What the World Bank and TI view as corruption may not be condemned everywhere else in the world. The person from a non-Western society may be accused of being corrupt according to these definitions, but may not be condemned by his society. For instance,
it is perfectly normal in most Asian countries for gratuities to be given to public officials who simply performed their job. However, when judged by these definitions, gratuities are seen as a form of corruption. Adhering to these definitions of corruption is necessarily imposing certain western standards on non-Western societies. This raises significant doubts about the international comparisons made based on these supposedly objective definitions of corruption.

Despite these serious drawbacks, the World Bank and TI have built their corruption indexes on these definitions. The significance of examining these definitions is to highlight its limitations and shed light on World Bank’s and TI’s inadequate understanding of the breadth and complexities of corruption. Any corruption index based on such narrow terms will inevitably result in the construction of biased and flawed corruption measurements. More importantly, the examination of these definitions suggests that the dominant conception of corruption has underlying neoliberal premises. These definitions derive from the principal-agent (PA) model. The PA model used to explain corruption focuses on the behaviour of utility-maximising individuals and their short-term incentive structures. This notion of the rational economic man stems from neoclassical economics. Thereafter, the anti-corruption strategies based on this model take a neoliberal stance against state involvement. Neoliberals, and neoclassicists, argue that state action in the economy may lead to the creation of rent and this opens up opportunities for corruption. Therefore, the neoliberals view corruption is a rent-seeking behaviour. However, this framework is misleading and misconceived. This might explain why, despite the intense research into corruption, the neoliberal prescribed anti-corruption strategies have not seen as much success to date. Instead of helping developing countries fight corruption, it seems that these anti-corruption initiatives are construed in such a way that serve the interests of the developed world.

This thesis will therefore examine the neoliberal understanding of corruption and identify the inefficiencies within this approach. An alternative political economy framework of corruption is proposed. This framework will draw on the insights of institutionalism which I argue provides a broader, more realistic conception of corruption. Instead of taking the individual as given, as neoclassical economics does, institutionalists focus on the broader institutional structures of society and their
violations. Based on this framework, corruption can be understood as the subversion of institutions and rules. It may be possible to build a corruption index based on this alternative framework but whether or not corruption indexes can ever adequately measure a phenomenon as complex as corruption is, in my view, quite unlikely. However, it is imperative that we rethink the current concept of corruption and look to alternatives so that future measures of corruption and anti-corruption strategies can adequately assess and tackle corruption.

This thesis proceeds as follows: Chapter 2 examines the contemporary mainstream perspective on corruption and discusses some of the theoretical and empirical literature within this perspective. Chapter 3 explores the neoliberal view of corruption as rent-seeking. Chapter 4 suggests a political economy alternative for understanding corruption. Chapter 5 reviews the extent of the failure of current-anti-corruption strategies and explores possible strategies based on the alternative framework discussed in the previous chapter. Chapter 6 concludes by giving an overview of the arguments in the thesis, its limitations and discusses briefly the implications of the alternative approach on the corruption indexes.
CHAPTER TWO

THE CONTEMPORARY MAINSTREAM PERSPECTIVE ON CORRUPTION

2.1 Introduction

‘Luke, you’re going to find that many of the truths we cling to depend greatly on our own point of view’, says a wise master to his apprentice in the movie Star Wars (1983). Theoretical discourses shape our perceptions and understandings of a particular phenomenon. What exactly is the contemporary mainstream perspective on corruption that has been adopted in the construction of TI’s CPI and World Bank’s WBCC as well as by scholars in their research on corruption? I argue that the dominant conception of corruption has its roots planted firmly in neoclassical economics.

This chapter starts off with an overview of the CPI and the WBCC and discusses some of the criticisms that have been made against it. The next section of the chapter examines the mainstream perspective on corruption and the theoretical and empirical literature within this perspective.

2.2 The Corruption Indexes

Early efforts to construct corruption indexes were inconsistent and fragmented (Urray 2007). Corruption indicators were derived from either pure objective measurements or subjective measurements. By the mid 1990s, a new generation of corruption indicators appeared. Due to the criticisms surrounding the previous indicators, the new generation of indicators were constructed by combining several primary measures together and are have therefore been termed ‘composite indicators’ (Arnt & Oman 2006) or ‘aggregate indicators’ (Kaufmann, Kraay & Zoido-Lobaton 1999).

Kaufmaan and Kraay (2007) identify four main advantages of aggregate indicators. First, aggregate indicators capture broader country coverage than individual ones. Second, they provide a functional summary of a large array of individual indicators. Third, by averaging out these indicators, measurement errors have been reduced and the influences of bias individual sources eliminated. Lastly, aggregate indicators take into account explicit margins of error. This ensures that
readers do not over-interpret small differences in the data between countries that are usually insignificant. The two most popular indicators used among anti-corruption practitioners are the CPI and the WBCC.

2.2.1 Corruption Perceptions Index

TI released its first CPI in 1995. The CPI does not represent TI’s own assessment of corruption in different countries of the world. Instead, the index measures the general perception of corruption based on TI’s definition of corruption: the abuse of public office for private gain. Countries are then ranked and scored according to the level of corruption that is perceived to exist. Table 1 (See Appendix A) shows that the CPI uses a variety of sources to measure the general perception of corruption that exists within a given country. Sources that are more than two years old are considered outdated and these are dropped out of the index. Only countries whose data can be supported by at least three sources are included in the CPI. Most of the sources used by the CPI are related to business decision-making, and focus specifically on assessing country risk and competitiveness. However, with the exception of the World Economic Forum (WEF) and the International Institute for Management Development (IMD) which ask for the extent of bribery, most sources utilised by TI do not measure the specificities relating to corruption. The CPI ranges from 0 (totally corrupt) to 10 (absence of corruption).

There is no doubt that the CPI was a watershed in the mid-1990s. The CPI has been a formidable instrument in raising the awareness about the scope of corruption and also in levelling the playing field by allowing different countries to be compared on the same scale. The international shaming that followed the publication of the index encouraged countries to work towards lowering corruption levels. In an interview in Ottawa (14th September 2000), then senior advisor to the South Korean Prime Minister, Choi Byung-Rok, stated that his goal was to get South Korea to be among the top 15 least-corrupt countries in the world within the next five years. The CPI has therefore been influential in putting the issue of corruption on the top of much governments’ agenda.
2.2.2 World Bank’s Control of Corruption (WBCC)

The WBCC is the end result of the attempts of World Bank researchers to improve on the CPI. Adopting the fundamentals of the CPI, the WBCC was developed under the Worldwide Governance Indicators (WGI) project. In its earlier reports, the World Bank had first termed the indicator ‘graft’ which adopted the World Bank’s conventional definition of corruption: the exercise of public power for private gain. However, the indicator was later renamed ‘control of corruption’ and the definition of corruption was reformulated to ‘the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as the capture of the states by elites and private interests’ (Kaufmann, Kraay & Mastruzzi 2006, p. 8). The WBCC ranges from -2.5 (very corrupt) to 2.5 (least corrupt).

Although the WBCC shares a number of similar sources with the CPI, the WBCC also includes sources that measure specific aspects of corruption. For example, some sources assess corrupt practices by specific actors such as judges, the media and households amongst others while others look at the degree to which political leaders and civil servants engage in these practices and its impact on the basic functions of government. The WBCC also utilises sources that assess corruption alongside other phenomena, such as political instability or nationalism. The Business Environment Risk Intelligence (BRI) is one such example. The BRI measures the internal causes of political risks and groups corruption with xenophobia, nationalism, nepotism and willingness to compromise under an indicator termed ‘mentality’. The sources utilised in the WBCC can be found in Table 2 (See Appendix B).

2.3 Criticisms of the Corruption Perception Indexes

With the implementation of the UN Anti-Corruption Convention in 2003, international efforts towards combating corruption shifted from the short-term goals of raising awareness to longer-term goals of implementation and enforcement of anti-corruption initiatives (Galtung 2006, p. 108). Despite its valuable contributions, these indexes still contain several limitations. These limitations can be grouped under three headings: corruption perception problem, measurement error problem and the usability in policy formulation problem (See Appendix C).
2.3.1 The Corruption Perception Problem

There is a common misunderstanding that the CPI and WBCC measure the perceptions of the general public. However, a quick look at the sources utilised in the construction of both indexes reveal that the CPI and WBCC do not measure the perceptions of the community at large, but rather relies on the perceptions of businessmen and country analysts. Expert assessments may, however, be prone to bias. These experts, who are often non-residents, may answer the assessments with the answers they expect to see. Therefore, the narrow range of perceptions these indexes reflect calls into question the validity of the CPI and WBCC. Moreover, empirical studies have shown that the results produced by the corruption indexes are nowhere near close to actual levels corruption (Donchev & Ujhelyi 2007; Olken 2009). This is especially problematic given how reliant the international community is on these corruption perceptions in guiding their aid allocation decisions and in the development of anti-corruption strategies.

2.3.2 The Measurement Error Problem

The second problem relates to the reliability of the indexes. Although improvements were made to reduce the measurement errors, these errors were not completely eliminated. The magnitude of measurement errors still present in the CPI and WBCC affects the reliability of the results produced by the indexes. There are three major sources of measurement errors in both the indexes. These errors are due to the high level of variance between sources, or produced by defective weighting schemes or may be the result of the yearly variations of the corruption indexes. The high levels of measurement errors in the indexes make it difficult to derive any reliable conclusions.

2.3.3 The Usability in Policy Formulation Problem

The corruption indexes have also been criticised on the basis that the assessments they generate are too broad to be converted into any effective anti-corruption strategy. If the CPI and WBCC are unable to contribute to useful policymaking, what then is the use of these corruption indexes now that global attention is already focused on corruption?
The limitations of the CPI and WBCC prove how difficult it is to measure corruption. However, it also cast doubts on the validity and reliability of the indexes and their results. These failings call for the reassessment of the CPI and WBCC, and perhaps, even suggest that after sixteen years, the time has come for us to find new measurements of corruption.

2.4 Theoretical Literature: Principal-Agent Model of Corruption

When talking about corruption, the question that lingers in the back of our heads is: Why do political leaders, religious elites or businessmen engage in activities that fall under the rubric of corruption? The answer given by the mainstream approach to corruption would be that choosing corruption over honesty is the optimal choice for a rational utility-maximising individual, if the benefits of corruption outweigh the benefits gained from staying honest (Becker 1968). This understanding of corruption reflects the neoclassical notion of a reasonable economic man.

The theoretical model that forms the basis of much of the current economic analysis surrounding corruption is the principal-agent (PA) model. The PA model assumes that there is a divergence between the interests of the principal and those of the agent. Corruption takes place when an agent betrays the principal’s interest in pursuit of his or her own (Kurer 2005, p. 226). The standard PA model can and has been modified to include third parties. This model is known as the principal-agent-client (PAC) model. The client adds another dimension to the model as he or she provides another window of opportunity for the agent to engage in corrupt practices. An agent who is charged with the responsibility of providing a particular service according to the rules laid down by the principal is now faced with other incentives apart from getting paid for performing his or her job well (Klitgaard 1991). According to the PAC model, corruption occurs when an agent colludes with the client and obtains a bribe in return for dismissing the rules set up by the principal (Klitgaard 1991). In both models, the conditions for corruption present themselves when the agent has some amount of discretion in doing his or her job and there is a lack of transparency and accountability (Klitgaard 1988).

The assumptions of the PA/C model are summed up in a well-known formula: Corruption = Monopoly + Discretion – Accountability (C=M+D-A) (Klitgaard 1988,
p. 75). Therefore, a situation where an agent, working in the liquor licensing division, is given a monopoly of decision power over resources and full discretion over the decisions of how, when and to whom these licences can be given to, without any checks in place to monitor his or her decisions, lends itself easily to corruption. Both the PA and the PAC models view corruption as a ‘crime of calculation’ and assume that the agent is self-seeking and will make his or her decision as to whether or not to engage in a corrupt activity on a cost-benefit analysis (Klitgaard 1998, p. 46). Klitgaard (1988, p. 71) also introduces a new aspect into the model by incorporating the moral satisfaction an individual acquires from not being corrupt into their utility calculations. Given that moral benefits are subjective, corrupt proclivity is distributed across the spectrum from 0 (completely corrupt) to 1 (completely honest). This is an important addition as different individuals can behave differently in a given situation, thus acknowledging the existence of honest officials within corrupt organisations (Klitgaard 1988, pp. 52-55; Ostrom, Schroeder & Wynne 1993). However, so long as the bribes are large and the chances of being caught and punished relatively small, the PA/C model shows that the chances of agents succumbing to corrupt activities are relatively high.

2.4.1 An Extension of the PA Model?

Another interesting approach to explaining corruption is provided by Collier (2002). Terming it an institutional choice framework, Collier seeks to combine the Institutional Analysis and Development (IAD) framework devised by Ostrom, Gardner and Walker (1994) with Onuf’s constructivist approach (1989). The IAD framework examines the rules of the game that influence the incentives facing an individual and their subsequent behaviours (Ostrom, Gardner & Walker 1994). In addition to acknowledging the multiple levels of decision-making, the framework demonstrates how different institutional structures are affected and influenced by an individual’s actions and decisions and vice versa (Ostrom 2007). In line with the IAD framework, Onuf’s constructivist approach asserts that agents do not exist independently of the structures around them. Both agents and structures are mutually constitutive and he argues that neither should be privileged over the other in an analysis (Onuf 1989).
Following on from these works, Collier (2002, p. 4) develops a framework that consists of two worlds: an internal (agency) one and external (structural) one. The internal world consists of the agent’s decision-making process while the external world constitutes the institutional structures that influence and impact on the individual’s decision-making process. Collier demonstrates how it is a combination of the agent’s willingness to break the rules and the opportunities presented by the external world that leads to corrupt behaviour. On top of this, he also seeks to show how corrupt behaviours can influence the institutional structures and affect the internalised rules of individual agents.

While developing his approach to corruption, Collier seems to imply that the system of incentives and punishments used to deter agents from corrupt behaviour is of no use without commitment rules. Commitment rules ‘create roles for agents’ and define ‘what they have a right or duty to do’ (Collier 2002, p. 5). Formal commitment rules stipulate promises by agents to abide by them. Therefore, the decision-making processes in societies with a higher proportion of commitment rules are always influenced by broader societal values (Collier 2002, p. 6).

Another interesting point Collier highlights is that political culture influences how society understands corruption. Political cultures thus affect the behavioural patterns of both principals and agents. Taking individuals to be rational utility-maximising agents who wish to maximise their private benefit through acquiring the state’s resources, agents are therefore expected to weigh the costs (loss of employment) and benefits (access to state funds and resources) of engaging in corrupt practices (Collier 2002, p. 12). Within this cost-benefit analysis, Collier (2002, p. 13) takes into account the different political cultures that might influence the individual’s decisions and behaviours so as to better explain the behavioural patterns of agents. This purports to address both the structural and agency factors that explain corruption.

On the surface, it seems that Collier’s framework of corruption is closely associated with New Institutionalism. However, closer readings suggest that it is difficult to draw the links between his approach and the works of new institutionalists. On the other hand, Collier’s explanation of corruption can be seen as an extension of the PA model, in which he considers how structural factors influence the decision-
making process of an agent when they are faced with the opportunity of engaging in corrupt behaviour.

2.5 Empirical Literature: How have Scholars Adopted This in Their Studies?

The literature on corruption is vast and diverse. However, a common thread that runs through these studies is the adoption of the PA/C model in the analysis of corruption. Most scholars investigating into the causes and consequences of corruption or into the relationships that exist between corruption and other phenomena have defined corruption along neoliberal lines. Given the constraints of this thesis, I will only be examining the literature pertaining to the relationship between corruption and economic development and that between corruption and aid. These empirical studies have been influential in contributing to the current understandings of the causes and effects of corruption on development. Following the logic of the PA/C approach, all the studies examined below define corruption as an agent’s misuse of public office to attain private gains by colluding with a third party at the expense of the principle.

2.5.1 Corruption and Economic Development

Is economic development a cause or consequence of corruption? Scholars have long suspected that the level of corruption present within a country varies according to the level of its economic development. Measuring economic growth in terms of Gross Domestic Product (GDP) per capita, Paldam (2002), Treisman (2002) and Montinola and Jackman (2002) find evidence that corruption levels decline dramatically with increasing economic development. However, Kaufmann and Kraay (2003) assert that economic development stems from low corruption levels and thus refute the argument that causation runs from higher income per capita to lower levels of corruption. Many scholars have thus set out to ascertain the influence of corruption on economic growth. Analysing a cross-section of 97 countries, Tanzi and Davoodi (2001) obtain evidence showing that corruption lowers growth. Studies by Leite and Weidmann (1999) and Poirson (1998) also report similar findings. Focusing specifically on the impact of corruption on growth in African countries, Gymiah-Brempong (2002) found that a unit increase in corruption reduces the growth rates of GDP and per capita income.
However, the empirical literature on the effects of corruption on growth is mixed. The issue of whether corruption ‘sands’ or ‘greases’ the wheels of economic development has been widely debated. The ‘sands the wheels’ hypothesis states that corruption has an adverse effect on the economy. First, corruption acts as a tax on investment income and thus creates an inhospitable environment for investors (Bardhan 1997, p. 1328). Second, it reduces the quality of investment as resources are diverted from their intended projects into payoffs (Tanzi & Davoodi 1997). Corruption therefore hinders the economic development of a country. Despite this, some argue that its effects may not necessarily be entirely detrimental. The ‘grease the wheels’ hypothesis suggests that corruption may be beneficial for economic growth in a non-ideal world where distortions are caused by imperfect institutions (Leff 1964; Huntington 1968; Leys 1965). Huntington (1968, p. 69) once stated that ‘[i]n terms of economic growth, the only thing worse than a society with a rigid, overcentralised dishonest bureaucracy is one with a rigid, overcentralised, honest bureaucracy. Corruption can circumvent bureaucratic rules and act as a trouble-saving device that increases efficiency and enhances growth. Klitgaard (1988) argues that economic growth can coexist alongside a small but optimal level of corruption. This is because corruption becomes increasingly costly to eliminate as it decreases and therefore there comes a point where eliminating it will lead to more economic costs than reward. An empirical study by Colombatto (2003) shows that corruption does contribute to efficiency in both developed as well as totalitarian countries (Colombatto 2003).

2.5.2 Corruption and Aid

The demand for foreign aid programs remains high as many developing countries struggle to stay on track to achieve the MDGs by 2015. However, the effectiveness of foreign aid in promoting economic growth in developing countries has remained a controversial issue. Critics of foreign aid programs have long asserted that foreign aid fosters corruption and worsens governance. However, a recent study by Charron (2011) indicates that since 1997, multilateral aid has been associated with lower levels of corruption. His data also provided evidence that official development assistance had a positive impact on corruption levels from 1986 to 2006. Similarly, Taveres (2003) found that aid decreases corruption.
Regardless of whether foreign aid fosters or reduces corruption, evidence suggests that corruption is capable of reducing the effectiveness of foreign aid programs as corrupt officials often pocket the money for private purposes (Ranis & Mahmood 1992; Boone 1996). Burnside and Dollar (2000) find that foreign aid can only have a positive effect on economic growth when the recipient country has effective institutions that can implement good policies. Their argument rests on the fact that a corrupt government ‘is not going to use aid wisely and outside donors are not going to be able to force it to change its habits’ (Burnside & Dollar 2004). Several studies have found support for the Burnside and Dollar result (Collier & Dehn 2001; Collier & Dollar 2002). Kaufmann (2006) also finds evidence that the probability of project success, long-term sustainability of investment and economic growth is much lower in aid-recipient countries with high levels of corruption than in countries that are less corrupt. Therefore, in order for foreign aid to spur economic growth, a country must first have reasonably good governance and low levels of corruption. A country where corruption is rife and the economy poorly managed will not be able to reap the benefits of aid programs.

As such, bilateral as well as multilateral donors have agreed that the key solution to the aid problem is to allocate aid based on the quality of governance of potential recipient countries. Although many international donors argue that their foreign aid policies are selective and that they favour honest governments with good policies, past aid analyses have shown that these intentions have not translated into actions. Alesina and Weder (2002) reject the rhetoric of donors who argue that they reward more aid to countries with effective and honest governments. The authors found that corrupt governments were given more aid than countries that recorded higher levels of corruption. Svensson (2000) report similar findings. However, studies also found that donors do differ in their willingness to reward well-governed countries with more aid. Although most donor countries do not take into account the level of corruption in recipient countries (Neumayer 2003; Svensson 2000; Alesina & Weder 2002), Australia and Scandinavia were reported to have rewarded countries for their good governance (Alesina & Weder 2002). Dollar and Levin (2004) also found that most aid institutions show a positive relationship between measurements of sound governance and their aid allocations.
2.6 How useful are these Studies?

These empirical studies have certainly been influential, especially in the development of anti-corruption strategies and initiatives. However, the PA/C model is not without its limitations. The PA/C model has been criticised for being too narrow. The reasons behind this are plentiful but I will only identify two limitations I think are the most important. First, the PA/C model presents an ahistorical conception of corruption, ignoring the cultural and social aspects associated to the phenomenon (Christensen 2007; Bratsis 2003). The model views corruption as a phenomenon that is independent of place, time and cultural and social context even though what really constitutes corruption is heavily influenced by societal and cultural values. Cultural and historical factors often determine and influence the way in which different people understand how delegated power is to be used or whether or not it is being abused. A model that neglects to take these factors into account gives an incomplete view of corruption. Second, the PA/C model assumes that the principal is immune to corruption (Lambsdorff 2002). Corruption can exist at all levels of society and therefore it is wrong to assume that the principal is a benevolent individual who will not succumb to corruption. Focusing on the agent as the corrupt individual therefore appears to be too narrow. Given these limitations, the adoption of the PA/C model by scholars in their studies may not lead to results that reflect accurately the realities of corruption. Hence, I would be cautious in stating that researches adopting these models of corruption greatly enhance or deepen our understanding of corruption.

2.7 Strategies derived from the PA/C model to Corruption

The anti-corruption strategies following from the PA/C framework focus on changing the incentives structure that affects the agent’s motivation to engage in corrupt practices (Klitgaard 1991). Therefore, reforms should ensure that the cost of accepting a bribe is much higher than the cost of staying honest and following the rules (Bachmann & Prufer 2005). Such reforms can include raising an agent’s salary, while imposing severe punishments, such as the loss of employment, so that there will be less temptation to engage in corrupt behaviour. Other measures include limiting the level of discretion of the agent, improving transparency and accountability and reducing the monopoly power awarded to the agent. In particular, reforms targeted at circumscribing discretion can include privatisation and deregulation, while
accountability and transparency can be improved through democratisation and legal reforms such as judicial strengthening. The only way to reduce an agent’s monopoly power is to introduce competition in the provision of the good or service in question (Rose-Ackermann 1975, 1996; Kaufmann 1997). Therefore, the role of the state in both the economy and the political arena must be reduced. This will induce public-private competition in the economic sector as well as allow for competition among public agents.

The strategies derived from the PA/C model have been endorsed by international organisations, including the World Bank. A large part of these strategies focus on the deregulation and expansion of markets. A 2007 report by the World Bank reflects how committed the Bank is to this understanding of corruption. In describing the causes and effects of corruption, the report states (World Bank 2007, p. 2):

Excessive regulation, for instance, increases the cost of doing business and often provides opportunities for corruption. By contrast, reforms that clarify the role of the state, reduce excessive regulatory burden, and promote competition can result in stronger firms, more jobs, and better public services.

These anti-corruption reforms reflect a neoliberal stance against state intervention in the market. Any policy which arises from this approach is necessarily geared towards economic liberalisation, deregulation and privatisation (Ohnesorge 1999). According to neoclassical economics, state action in the economy may create rent, and this opens up opportunities for corruption. Neoclassicists, and neoliberals, therefore view corruption as rent-seeking behaviour. However, corruption remains rife in many poor developing countries despite the implementation of these neoliberal prescribed anti-corruption reforms. Hence, there is a need to stand back from the minutiae of the corruption indexes and instead examine the wider theoretical premise underlying the current conception of corruption. A more effective fight against corruption requires that we first understand the concepts and limitations of the current approach.

In the following chapter, I will examine the neoliberal framework of corruption and identify the key problems with utilising such an approach to understand corruption.
CHAPTER THREE

THE NEOLIBERAL VIEW OF CORRUPTION, RENTS AND RENT-SEEKING

3.1 Introduction

The theoretical premise and assumptions that underpin the anti-corruption campaign have been endorsed and promoted quite vehemently by the World Bank, the IMF and various NGOs, including TI. As discussed in the last chapter, the current dominant conception of corruption is heavily influenced by neoclassical economics and neoliberalism which view rent-seeking as a source of corruption. The neoclassicists and neoliberals argue that it is state regulation and involvement in the creation of rent that predominantly leads to the occasion of corruption. Therefore, there is no surprise that the construction of the CPI and WBCC reflect this mainstream approach to corruption. A particular market-centred view of economic development is implicit in this reasoning.

In this chapter, I will critically examine the neoliberal view of rent-seeking and corruption. There are two bases for the mainstream view: (a) the neoclassical economic approach to corruption and (b) a public choice theory approach to corruption. I identify some key problems associated with the neoclassical view and briefly discuss the similarities the public choice theory approach has with the neoclassical framework. However, the criticisms of the neoliberal view as the dominant conception of corruption need not imply a rejection of the activities of the World Bank and TI. Instead, it should be seen as a point of departure for further research into identifying important preconditions that should be taken into account in the development of an effective anti-corruption strategy without impairing economic development processes in which the state necessarily plays a steering role.

3.2 Neoliberals, Rent-creation and the State

The mainstream literature has a neoliberal cast not only in emphasising the individual, but also in identifying corruption with rent-seeking in the public sector, more specifically the rents created as a result of state regulation and involvement. For economists, rent refers to the additional income that an individual receives over and
above what would have been earned in a competitive market. A seemingly more precise definition of rent is put forward by Khan, who asserts that ‘a person gets a rent if he or she earns an income higher than the minimum that person would have accepted, the minimum being usually defined as the income in his or her next-best opportunity’ (Khan 2000, p. 21). However, the problem with this definition is that the basis from which the extra income is measured is quite unclear. In a competitive market, the basis is an arm’s length price, or the price which covers the cost of production and yields a profit margin sufficient to enable the investor to earn an average rate of profit on the investment concerned. Thus, the extra amounts of profits (rent) are not necessary and their absence in no way inhibits the individual from carrying out a specific activity or producing a good or service (Khan 2000, p. 22).

Rent-seeking is the effort to acquire access or control over opportunities for earning rent. Earning a rent requires the capacity to control prices, which in turn requires the would-be price controller to control a sufficiently large share of the market in order to face little competition.

Rents can either be natural or created. Natural rent accrues from the ownership of natural resources. A rent earned when the technology used by a particular supplier gives an advantage to the firm is called a technological rent. Some economists also talk of a learning rent accruing to the holders of scarce skills (Khan 2000; Aoki et al 1997). On the other hand, rents that are created are usually created by the state, or by private firms. A state might create rent by limiting the number of firms that are allowed into a particular market by issuing licences or enacting laws that give production rights to a few producers (Krueger 1974; Posner 1975; Buchanan 1980). In extreme cases, the state may create a monopoly. Often times, and perhaps typically, a state may create an opportunity for earning rent in a particular market as an incentive to attract private investors to invest in activities chosen by the state. This has been termed by Aoki et al (1997) as ‘contingent rent’. These rents are earned contingent on outcome or on performance. Therefore, a state can offer a contingent rent to a firm in return for full cooperation by way of the firm’s investment according to the state’s plan (Aoki, Kim & Okuni-Fujiwara 1997, p. 16). This was a central feature of the developmental state in many countries in East Asia. Here, it is the state, through its ‘interventions’ and its habit of regulating the market, that creates rent (Aoki, Kim &
Okuni-Fujiwara 1997). A firm can also create rent even without help from the state. The creation of such rents will be explored below.

The way in which rents are used is critical (Bhagwati 1982). These rents may be reinvested in the activity in which they were generated, or they may be invested in other profitable activities, or they may be consumed in some unproductive fashion for unproductive means. The state may monitor the private firms profiting from state-created rents to ensure that the rents they earn are being used as intended. Although certain rents may not be invested in a desired manner, their reinvestment may still contribute to growth and development albeit not to the extent achievable if they were invested as desired (Bhagwati 1982; Khan 2000). However, the public purpose of a state-created rent is corrupted if it is used to finance private consumption.

Mainstream economists argue that rent-creation is the source of corruption. Drawing on a definition construed by Nye (1967, p. 419), corruption is ‘the use and abuse of public office for private gain’. Such a definition tends to focus on corruption as merely bribery and graft. It regards opportunities for bribery and graft as arising where there are rents to be earned from the limited supply of some kind of service or good. A public official may thus seek to earn a rent by taking advantage of a situation where there are few other officials in the position to provide the services that he or she is providing. This is similar to the way a private firm may take advantage of the monopoly it holds in a market by raising the price of a good (Stilwell 2006, p. 182). Therefore, an official responsible for issuing a licence may demand payment from applicants for that licence. However, applicants may also bribe the official in order to procure the licence. By the same token, firms may be willing to bribe officials who administer laws that regulate businesses to exempt them from these laws. If such is the case, applicants or firms can get a slice of the market from the state as long as they are willing to pay a slightly higher price in exchange for being protected in the market. This is seen as corrupt behaviour because the rents earned are earned at the expense of the client or customer. This relationship between rents and corruption has led mainstream economists to condemn state creation of rents as the creation of opportunities for corruption.
3.3 Some Deficiencies Present in the Neoliberal View of Corruption

There is also an emphasis within the neoliberal view of corruption that corruption is confined to the public sector and that it always involves some kind of private gain. Such biases within the mainstream approach have skewed its analysis of corruption and the strategies derived from it.

Among neoclassical economists, there exists a ‘consensus that corruption refers to acts in which the power of public office is used for personal gain in a manner that contravenes the rules of the game’ (Jain 2001, p. 73). Corruption within the private sector tends to be set aside. Although many scholars have acknowledged the existence of private sector corruption in the corruption literature, these discussions remain limited and analysis continue to be restricted to the public sector (See Rose-Ackerman 1978; Kaufmann 1997; Tanzi 1998; Argandona 2003). Such bias present in the neoliberal approach to corruption ignores the reality of corruption in the private arena. Even in the last decade, there have been many well-known instances of corruption in the private sector. The corruption scandal that led to the bankruptcy of Enron in 2001 is an excellent example of private sector corruption. Corruption is also present within sporting associations. For several decades, corruption has been rampant in international cricket. Referees and players have been reported to rig matches or deliberately underperform in exchange for large sums of money. It seems that wherever there is “big money” at stake, the likelihood of corruption increases. Given that the scale and scope of corruption in the private sector can be rather large, it is absurd that the mainstream approach does not study it.

Restricting its definition of corruption to the public sphere is not the only defect of the neoliberal view of corruption. Mainstream commentators also view corruption as always involving some kind of private gain. This idea stems from the orthodox assumption of the instrumental rationality of the individual: the individual rationally bound to act in such a way that maximises his or her individual utility. Although the majority of cases of corruption in the real world possibly do involve personal gains and rewards, such a definition of corruption is also problematic because it excludes situations where the individual acts corruptly for moral outcomes. These cases are commonly referred to as ‘noble cause corruption’ (Miller 2005; Miller, Roberts & Spence 2005; Hodgson & Jiang 2007). ‘Noble cause corruption’ is
where the individual engaged in the corrupt activity believes that noble ends justify the means of achieving them. One significant example of ‘noble cause corruption’ is the bribing of officials in a repressive regime to achieve higher motives. For instance, during the Second World War, Oskar Schindler bribed many Nazi officials in order to prevent over a thousand Jews from being sent to concentration camps. By the end of the war, Schindler was bankrupt as he had spent most of his fortune on those bribes (Keneally 1983). Therefore, corrupt actions may not always involve personal material gain. These actions may not have necessarily stemmed from the drive for material gain, but instead, from a strong moral conviction to improve society. Thus, it is imperative to be aware that there are other motives behind corrupt behaviour that may not have anything to do with material gains. All the same, ‘noble cause corruption’, however noble, is still corrupt and therefore should not be ignored in any analysis of corruption. To only focus on corrupt acts that involve private gain inevitably leads to an inaccurate analysis of corruption.

3.4 Neoliberal View of Private Monopoly and its Rents

The most commonly used assumptions about rents are derived from the analysis of monopoly in contemporary neoclassical economics, where it is argued that monopolistic market structures only lead to inefficiencies while a competitive rent-free market paves the way towards achieving economic growth and efficiency. Within the neoclassical analysis of the market, competition is undermined by the presence of barriers to entry and exit. In the absence of barriers to entry, no rent can be earned because as soon as a producer starts earning rent, other firms will enter the market and drive the price of the product down. Monopoly rents can only be attained if there exist high levels of barriers to entry which protect firms from competition and thus allow them to charge higher prices for their goods or services at a higher price. Competition eradicates any opportunity for rent; but the barriers in the way of competition may be tough.

Barriers to entry can be created in various ways. First, a firm can tie up supplies of raw material. This way scarcity of supply can be created by denying access to raw material to potential rivals. Second, a firm may develop and then patent a superior technology. Patenting procedures at every stage of production amplifies the effect. Unless a competing firm can obtain rights to all the steps of the procedure, the
first producer will continue to be the sole producer. This secures its monopoly power in the market, allowing a firm’s to capture monopoly profits from its business. There are also other barriers such as the creation of brand loyalty, which can be a very powerful tool for capturing higher market share. Just as state-created rents are to be avoided as they sow the seeds of corruption, in the view of neoclassical economists, private monopoly rents are similarly reprehensible, and the opportunities to create monopoly rent must be undermined by ensuring that there is competition over the supply of goods or services, or at least by ensuring the contestability of all markets. Friedman (1980) takes an interesting viewpoint regarding this issue. He argues that monopolies should be stopped wherever possible but that we should not be too preoccupied with monopolies as long as their position in the local market is always contested by foreign suppliers, that is, as long as imports are unrestricted. Thus, the idealisation of perfectly competitive market structures subtly shifts to a more pragmatic focus on market contestability (Baran & Sweezy 1966; Bellamy 1986).

Neoclassical economists find the creation of monopolies and monopoly rents reprehensible because they believe that they lead to economic inefficiencies (Stilwell 2006, p. 182). A situation that allows an agent or firm to accumulate rents by protecting their market power may create inefficiencies in two ways. First, the raising of prices to create rents disconnects allocative decisions from real costs. Second, when accrued rents are invested, they may not be invested where social returns are greatest: firms may not always use rent in a way that may be most beneficial for the economy. For example, rents earned may be reinvested in order to preserve or protect the agent or firm’s monopoly power. According to the neoclassicists, reinvestments can only be efficient if there are no market restrictions, or if the economy is not affected by distortions, i.e. where the conditions required for a competitive equilibrium are satisfied. Therefore, the presence of rents not only results in opportunities for corruption, but also denotes inefficiencies within the economy.

As much as they are opposed to the private creation of monopoly power and monopoly rents, neoclassical economists do allow for exceptions and argue that at times there needs to be a limit on the number of firms in particular market because ‘cutthroat’ competition can be destabilising. Excessive competition within a market is undesirable particularly because it affects the ability of producers to supply a good or
service at a constant rate. Such competition is especially destabilising when the good or service is an essential commodity that cannot be consistently supplied to society. Furthermore, such ‘cutthroat’ competition can lead to a wastage of scarce resources as when it forces businesses into bankruptcy and assets that are not yet worn out or obsolescent to be scraped. As such, it is acknowledged, within the neoclassical school of thought, that under certain circumstances, it is necessary to limit the number of suppliers in the industry to avoid destabilising the economy. (Aoki, Kim & Okuno-Fukiwara 1997, p.3)

To the neoclassicists, an ideal economic world should be free from all government interventions. However, the abstract nature of the theory allows neoclassical economists to widely accept certain exceptions that seemingly contradict the theory they believe in. Such exceptions fall under what is widely known and accepted as the theory of the second best. According to neoclassical economics, all optimum conditions need to be fulfilled simultaneously in order to achieve a Paretian optimum. The theory of second best states that if one of the Paretian optimum conditions cannot be fulfilled there is no single second-best outcome. Thus, any state of affairs in which there continue to be some market restrictions is not necessarily an improvement on the initial situation (Lipsey & Lancaster 1956-1957, p. 11). In a non-neoclassical world, it is difficult to distinguish between sub-optimal situations. Removing some but not all restrictions may not produce any improvement. Therefore, when perfect competition cannot exist, say, because of the existence of a natural monopoly, it is then questionable what the second-best alternative is. Would a second-best position be one where the state establishes a process of ‘competitive bidding’ for firms seeking to run a particular monopoly? Or would this lead to a worse alternative because any involvement by the state will only open up more opportunities for state officials to engage in bribery or graft in exchange for the contract? Such questions remain unanswered.

3.5 Corruption in the Public Sector via a Public Choice Theory

Although Public Choice theorists see themselves as being quite different from mainstream economics, public choice theory is in fact methodologically very similar to the neoclassical school of thought. This theory should therefore not be seen as a new discipline but rather should be understood as a research programme (Buchanan
Public choice theorists utilise orthodox economics’ model of the economically rational individual and apply this to analyse the behaviour of governments and their officials. The main assumption within this model is that although individuals in governmental positions have some concern for the interests and needs of others in society, their main motive is to further their self-interests (Buchanan & Tullock 1962; Riker and Ordeshook, 1973). While neoclassical economists view corruption as the abuse of the power of public office for personal gain, public choice theorists understand corruption fundamentally as the corruption of public interests through the pursuit of private (individuals’) interests.

Public Choice theorists argue that the political market is like any other. There is a supply of protective regulations and politicians sell these regulations to private interests in order to achieve some kind of benefit. Facing this supply is the demand of individuals for protection of their private interests. Public decisions made by parliamentarians in a duly elected parliament are thus made to benefit private individuals (Mueller 1989, p. 2). Regulation yields rents and to capture these, private individuals are willing to pay large sums of money to ensure that their chosen politicians get into the government. No politician acting alone, however, is likely to be able to supply protective regulations; on the other hand, politicians can form alliances, bundling legislative provisions together to create ‘pork’ barrels (Buchanan 2003). According to public choice theorists, the only way to stop such rent-seeking behaviour is to cease the supply of regulation (Gwartney & Wagner 1988). Putting an end to such activities will no doubt also lessen the opportunities for individuals to engage in bribery and graft.

Understanding corruption through a public choice framework is therefore to view regulations as dysfunctional to proper government. In other words, public choice theory demonstrates that looking to government to achieve public purposes, such as to create more employment in particular regions, results in general in more harm than good (Buchanan 2003). In this way, the public choice theory and neoclassical economics are very similar as they regard any sort of government intervention or involvement to be harmful as it increases the chances of corruption. Therefore, public choice theorists support the neoliberal policies that advocate the rolling back of the state.
3.6 Principal Strategy: Rolling Back the State

The focus on state-created rent within the mainstream economic school of thought and the public choice theory view that regulations inhibit good governance has led both neoliberals and public choice theorists to believe that the best solution to prevent the creation of rents and thus the opportunities for bribery and graft is to diminish the size and role of the state in the economy. The principal neoliberal policies include liberalisation, deregulation and privatisation. Rolling back the regulatory powers of the state and letting the market dictate will mean that firms and agents will no longer be protected by state-created barriers and will thus have to compete for their share of the market. These neoliberal policies are ostensibly opening up the public sector and the state-regulated sector of the private economy to competition (Lane 2001, p. 43). However this is only half the picture: firms can continue to rely on other barriers to protect their market power to enable them to earn monopoly profits. Competition can only work when all barriers are destroyed.

Furthermore, while neoclassicists advocate for a reduction in state involvement in the economy, they do admit a need for state intervention, not only in preventing ‘cutthroat’ competition in given sectors, but also in providing ‘public goods’ and internalising externalities (Stilwell 2006, p. 201). Therein lies a more complex paradox: the need for state action to ensure the smooth running of the system inevitably opens up greater possibilities for corruption.

The following chapter examines the political economy response to the neoliberal view of corruption as rent creation, and explores the possibility of utilising the insights drawn from institutional economics to gain a broader, more realistic understanding of corruption.
CHAPTER FOUR

A POLITICAL ECONOMY RESPONSE TO THE NEOLIBERAL VIEW OF RENT CREATION AND CORRUPTION AS BRIBERY

4.1 Introduction

Mainstream economists focus on the merits of the market system in contributing to overall economic progress while stating quite clearly that any sort of interference, whether through rent-seeking activities or otherwise, would only lead to economic inefficiencies and, most importantly, create opportunities for bribery and graft. Although many scholars recognise that there are serious limitations and defects of the market system, these have been ignored or deemed unimportant and claims of the virtues of the market system remain pervasive. As Sen (1999, p. 111) states, ‘any pointer to the defects of the market mechanism appears to be, in the present mood, strangely old-fashioned and contrary to contemporary culture (like playing an old 78 rpm record with music from the 1920s)’. The bias in favour of the mainstream preconceptions needs to be critically scrutinised and carefully investigated.

This chapter will develop a political economy response to the neoliberal view of the developmental state and rent creation and its attitude towards corruption. The political economy approach to corruption examined in this chapter relies heavily upon insights drawn from institutional economics. Within this school of thought, corruption is not simply taken to be bribery or graft but instead is seen as a wider undermining of rules and institutions. The institutional approach to corruption overcomes the limitations of the narrow conception presented by the neoliberal approach and paints a fuller picture of the realities of corruption.

4.2 In Defence of Rent Creation: The Developmental State and Rent Creation

If the conditions of the real world did correspond to the assumptions of the neoclassical world, then it would be logical to share the view that in general the involvement or intervention by the state in the economy only inhibits economic progress and lead to economic inefficiencies. However, given that economic reality differs quite drastically from the assumptions on which neoclassical economics is based, the strong involvement of the state in economic growth is not at all illogical.
Quite contrary to the mainstream’s perspective on the developmental state, the state can be an active promoter of economic growth by devising strategies to increase national wealth. It may govern the market and steer it in the direction of economic prosperity. This can be done in a number of ways. A state can recognise and identify the appropriate market opportunities and investments (Reinert 1999, p. 281). Japan would never have become the second largest economy in the world between 1968 to 2010 if the state had not made the decision to focus on making inexpensive cars and electronics (Reinert 1999, p. 281). In order for an economy to progress up the development ladder, it is necessary for the state to make a judgement call on what economic activities are appropriate and feasible and what others are not (Reinert 1995). After identifying the right investments, it is then not uncommon for the state to create a competitive advantage for the national firms that undertake the investments (Reinert 1999, p. 281). The success of the developmental state is best portrayed by the economic success of the East Asian nations and China between the 1960s and 1990s. Instead of abiding by the neoliberal policies of free trade, liberalisation and privatisation, these countries achieved substantial growth and development by adopting unorthodox policies which included export subsidies, high levels of tariff and nontariff barriers, patent and copyright infringements as well as restrictions on inward capital flows (Rodrik 2001, p. 58). The East Asian experience is testimony that the developmental state can help steer a country towards economic development and prosperity.

State involvement in the economy is also necessary to avoid bottlenecks that may arise out of coordination problems and to initiate projects with returns in a longer term than private investors can contemplate (Todaro & Smith 2009). In order to avoid bottlenecks, there needs to be some kind of coordination of the expansion of capacity in associated industries. According to mainstream economists, market forces can generally accomplish this coordination. They argue that so long as market prices are flexible and there are no distortions or market failures, the changes in one price relative to the others will signal changes in demand for and supply of all goods. Agents will respond to this signalling by a free market to ensure coordination. However, there is an extensive literature on the problems associated with coordination by market forces (See Spence 1978; Bell & Romer 1987; Hausmann, Klinger & Wagner 2008). First, problems arise when prices are sticky, when there is imperfect
information in the markets, or when decisions of firms are irrational or non-rational. This means that market signals will be wrong. Second, there are certain inputs and outputs that are not priced because there is no market for them. Examples include clean air and, conversely, wastes emitted into the air. Unpriced goods and ‘bads’ are externalities of production. The coordinating capacity of market forces is clearly undermined as a market does not exist. Lastly, there are limits to the capacity of the market mechanism to make necessarily concerted and collaborative decisions (Murphy, Shleifer & Vishny 1989; Nurske 1953). Take for example two industries, X and Y. X might potentially be supplying a particular good to Y, but due to a low scale of production, industry X is not profitable. However, if another industry Z is added to the picture, as a second customer of X, all three industries may be able to work at a scale allowing maximum technically efficiency and thus lowering cost. All three industries can profit from the coordination of their investments. However, there is no market signal coordination and cooperation to achieve this. Therefore, firms have to look beyond market signals to ensure this coordination. Associations of enterprises can form and discuss common plans and settle on an agreement to coordinate their investments without destroying their ability to negotiate over the prices of transactions between them. Alternatively, the state can ensure such coordination as it has a bird’s eye view of the economy and can cajole or coerce firms to enter discussions (Polidano 2001; Evans 1979). The state may then offer incentives, such as subsidies, to these industries in order to steer them towards desired investments. The inability of the market mechanism to coordinate between industries indicates the need for the state to be involved in the economy in order to rectify these coordination failures, especially if firms are hesitant to enter into associations (Wade 2003). Economic reality therefore requires a developmental state to direct, plan and create incentives for the private sector in order to promote economic development and growth. The involvement of the state and its rent-creating activities should thus not be condemned as being economically inefficient or destabilising.

A developmental state may have other ambitions too. Just as the state can create opportunities for certain firms to earn rent, rent-creation in order to privilege a particular ethnic or social group is a legitimate goal a developmental state may pursue. Malaysia’s New Economic Policy (NEP) is an example of state created rents aimed at improving the situation of Malays in Malaysia. The NEP was implemented
after the race riots of 1969 to placate the Malays who were unhappy with their economic and social positions in society and felt that they should be granted special status and privileges because of their indigenous status (Lee 2011, p. 5). The economic, social and cultural policies implemented under the NEP favour the 65% of Malaysians who are Malays, otherwise known as Bumiputra-Malaysians and discriminate against the 25% of Chinese-Malaysians and 10% of Indian-Malaysians (Lee 2011, p. 1). The programs under the NEP were state interventions considered by the (pro-Malay) government as necessary to correct the imbalance between Malays and non-Malays. The state started to play a greater role in the allocation of fiscal resources while also increasing its involvement in business enterprises and public sector ownership so as to establish affirmative actions that would benefit Malays (Heng 1997). The creation of opportunities for rents was ostensibly to create significant advances for the Malays, both in income and asset distributions. There was also a significant increase in the number of Malay professionals (Lee, 2011, p. 8). By giving Malays certain special rights, the NEP’s aim was to facilitate social mobility for the majority of the Malaysian people (Lee 2011). The privileging of Malays was in accord with the plan devised by a developmental state to create the socio-economic conditions needed for national unity in Malaysia. The creation of rents to pursue national goals and unity should not be seen as corrupt.

However, it would be a mistake to assume that corruption does not exist. Here, corruption can be seen as the misappropriation of rents by an individual or a group, i.e. where rents are used inappropriately or misappropriated. In the case of Malaysia, many members of the Malay elite abused programs under the NEP for political patronage and personal wealth aggrandisement. The ruling elite had the lion’s share of the economic cake in the guise of special Bumiputra contracts which were channelled to well-connected Malay patrons or parties (Heng 1997, p. 274). These policies ended up rewarding incompetent firms or individuals (Heng 1997, p. 283). Such misuse of the rents is a clear-cut case of corruption. It is therefore important to distinguish how the rents earned are used and by whom. Of course, not all misappropriated rents are inefficient and retard growth. Rents that are reinvested into productive sectors of the economy can contribute to development and lead to socially beneficial outcomes (Bhagwati 1982). In principle, however, the misappropriation of rents by the powerful
members of a group for which they were intended has to be seen as corruption, irregardless of how the funds are used.

4.3 A Political Economy Approach to Corruption: Institutional Economics

The current concept of corruption has itself been corrupted by the ‘rational agent’ underpinnings of mainstream economics and its prejudice against state intervention and the creation of rents. As a result, the modern day understanding of corruption is narrow, unrealistic and unhelpful in the fight against corruption. An alternative and more appropriate approach to corruption is to use the insights of institutional economics. The analysis surrounding the traditional institutional approach focuses heavily on the formal rules found in organisations as well the broader institutional structures of government (Lowndes 2010). Institutionalists do not take individuals as given and recognise that institutions influence an individual’s habits, conceptions and preferences. However, this social order is not an exclusively ‘top down’ process and individuals can create and change various institutions, just as the institutions mould and constrain individuals (Commons 1965). Therefore, institutionalists pay much more attention to institutional rules and their violations. Unlike the neoclassicists, corruption is not simply viewed by institutionalists as bribery or graft that stems from rent-seeking; but instead, a corrupt act is one that undermines the formal rules of an organisation or of society which in turn results in the corrosion of the institutional and social fabric.

Traditional institutional economists understand corruption as the subversion and moral violation of organisational rules, with the effect of undermining their capability to function effectively (Hamilton-Hart 2001; Jain 2001). Social rules are the key elements of social being and are given meaning and sustained throughout generations because of habits (Veblen 1919; Outllette & Wood 1998; Hodgson & Knudsen 2004). Societal habits reflect the culturally based social norms and rules that exist and are peculiar within each society. These social customs are bases to the way an institution is organised and structured. Therefore, if these social rules and institutions are ignored, the social order and any plan for increasing social prosperity will also fall apart. In other words, the undermining of institutions and social rules, rather than the ‘inefficiencies’ resulting from state involvement as projected by
neoclassical economists, may be what threatens economic growth, stability and distributional justice.

Although corruption in this instance is taken to be the subversion of rules and norms of any society or an organisation, it would be naïve to assume that all institutions are worthy of respect. Institutions can be unjust as individuals who are in powerful positions can influence the creation of institutions in a manner which protect their own interests. One then needs to be careful to distinguish between opposition to and the subversion of institutions. It is not uncommon for individuals or groups of individuals to oppose particular institutions by means of civil disobedience. Although civil disobedience is a form of civil resistance and opposition to the social order, it should not always be considered a corrupt act. For example, environmentalists may choose tree-sitting as their act of civil disobedience. Julia Butterfly Hill is an American activist and environmentalist who lived in a California Redwood tree for 738 days to prevent loggers from cutting it down (Oldenburg 2004, p. CO1). It would be absurd to view such acts of civil disobedience as being corrupt. However, there might, in some situations, be good reason to adopt practices that bring institutions into ill repute as a form of opposition and to bring about change. For instance, tax resistance is a form of civil resistance that undermines the government and makes it difficult for it to function. Henry David Thoreau had refused to pay his taxes in a bid to end the injustices related to slavery and the war in Mexico, both of which were actively facilitated by the government (Broderick 1956, p. 612). The subversion of these rules may be another way for us to look at the idea of ‘noble cause corruption’, as examined in the previous chapter. ‘Noble cause corruption’ can thus also be seen as the subversion of anti-democratic, and sometimes unjust, rules and institutions. This distinction is important and therefore it is imperative that corruption be broadened to include the breach and violation of both democratic and anti-democratic rules that have the effect of eroding the organisational capacities of the institution.

It must to be acknowledged that some members of the traditional institutionalist school do – like the mainstream economists – narrow their view of corruption to bribery and graft. Hodgson and Jiang (2007, p. 1053) construct quite neatly such an institutionalist model of corruption. This institutionalist perspective as depicted by Hodgson involves two individuals, A and B. A has a designated role in an
organisation and is obliged to abide by certain rules and regulations during his term of employment. These rules and regulations are in accordance with the goals and aims of the said organisation. B, on the other hand, is an individual who seeks to persuade A to breach one or more of these rules, knowing very well that breaching these rules would undermine the organisation. At all times, A has the freedom to choose between being honest or breaking the rules. A corrupt act occurs when A violates and undermines these rules according to B’s wishes. By breaking the set of rules that A was asked to abide by given his or her position within the organisation, A has also undermined the capacity and ability of the organisation to fulfil and achieve its own goals and objectives.

Unlike the PA model of corruption, there is no need for a principal or agent within Hodgson’s model. Without confining A and B to being either principal or agent, the model thus includes situations where A and B collaborate to violate an organisational rule (Hodgson & Jiang 2007, p. 1053).

When analysing corruption as the subversion of rules, it is necessary that we determine whether corruption is responsible for the widespread breach of the rules (Hodgson & Jiang 2007, p. 1054). A longstanding rule or practice within the organisation may fall into neglect or may be undermined simply by being deemed irrelevant or inappropriate. However, if corruption is necessary to maintain the neglect of this rule, then corruption is said to exist (Hodgson & Jiang, p. 1054).

4.4 New Institutionalism

In the discussion of institutional economics, it is necessary to also acknowledge New Institutional Economics (NIE) as a separate branch of institutionalism. The new institutionalists too recognise that the mainstream understanding of corruption is narrow and unrealistic. However, despite its refreshing perspective on corruption, the NIE does not divert very far from the mainstream’s view of corruption and the anti-corruption strategies it proposes remain similar to those advocated by the neoliberals. This makes it an unsuitable alternative for understanding corruption.

NIE builds on the basic principles of neoclassical economics. While accepting that an individual’s preferences, beliefs and actions can be influenced and constrained
by both informal and formal institutional settings, the creation of institutions are also seen as the direct consequence of the maximising behaviour of individuals (Menard 1995). Institutions are established to economise transaction costs; that is, they are set up with the purpose of reducing and minimising the costs of transaction between individuals, as well as to safeguard transactions against opportunistic behaviour (Lambsdorff, Taube & Schramm 2005, p. 6). Corruption thus stems from the opportunistic behaviour of public officials as citizens are often unable to hold these corrupt officials accountable either because they are not empowered to do so or because of the high transaction costs they face in the process (Shah 2006, p. 11).

The NIE approach adapts on the mainstream’s PA model. Here, the citizens are the principals and the public officials are agents. The principals act rationally based on the incomplete information that they have. In order to reduce this asymmetrical information bias, the principals face high transaction costs for the acquisition of information on public sector operations. Agents, on the other hand, are more well-informed. It is this informational asymmetry that gives the agents the upper hand and allows them to indulge in corrupt activities that goes unchecked (Shah 2006, p. 11). Such opportunistic behaviour is further encouraged by the lack of or the inadequacy of the countervailing institutions to enforce transparent and accountable governance (Shah 2006, p. 12). Agents will always seek to create an environment where they can exchange their corrupt favours securely and discreetly. Therefore, corruption levels are often higher in societies where there are inadequate institutions and mechanisms to enforce contracts, provide public goods and lower transaction costs.

New institutionalists thus acknowledge that institutions matter in the fight against corruption. They argue that policy makers should ensure that anti-corruption initiatives ‘encourage betrayal among corrupt parties, destabilise corrupt agreements, disallow corrupt contracts to be legally enforced, hinder the operation of corrupt middlemen and find clearer ways of regulating conflicts of interest’ (Lambsdorff, Taube & Schramm 2005, p. 14). This has to be done with the help of the state. As North (1991, p. 98) states, it is only by allowing the state to act as an impartial third-party enforcer with coercive force that ensures all contracts can be implemented effectively. This way transaction costs can be reduced thus lowering the opportunities
for corruption (North 1991, p. 98). However, new institutionalists still harbour a deep mistrust of the state. Despite his acknowledgement of the need for state involvement, North states that ‘if the state has coercive force, then those who run the state will use that force in their own interest at the expense of the rest of society’ (North 1990, p. 59). This explains why new institutionalists strongly advocate for a ‘night watchmen’ state. According to them, corruption breeds when institutions go beyond the reach of the ‘night watchman’ state (Ohnesorge 1999, p. 469). In line with the neoclassicists, new institutionalists call for the reduction of the state in the involvement of the market through privatisation and deregulation; in the sectors that the government must have a role, this role should be limited and constrained by a tight system of rules so as to reduce the discretion that might otherwise be held by government officials (Shah 2006, p. 12).

4.5 The Problem in the Use of the CPI and WBCC

The mainstream discussions surrounding the current anti-corruption campaign take on connotations of both economic and political liberalisation while assuming that the reduction of state involvement will inevitably lead to lower levels of corruption. Furthermore, anti-corruption reforms derived from the mainstream approach target specifically bribery and graft. To make a strategy attacking bribery and graft as a condition for the receipt of official development assistance shows the ignorance of those involved in the anti-corruption movement of the realities of corruption.

As mentioned in previous chapters, there is no doubt that the creation of TI’s CPI and World Bank’s WBCC was a watershed, not only in research on corruption, but also in contributing indirectly to the development of strategies to combat and eradicate corruption. Since its creation, aid donors have relied extensively on these indexes to determine the amount of aid that should be allocated to developing countries. However, the political economy approach to corruption alerts people to the dangers of using the CPI and WBCC wholeheartedly and without question. It seems that these corruption perception indexes focus attention on Nero is fiddling while Rome burns. Poverty is widespread in many developing countries and aid is essential to help pull them out of poverty. When aid becomes conditional on the adoption of the neoliberal prescribed anti-corruption reforms, those countries with limited resources to implement these reforms may suffer from the withdrawal of aid and
resources that they need in order to stand a chance in the fight against corruption. Indeed, as poverty worsens, a blanket of corruption in a general sense may come to smoother all hope of creating a social order that allows a country to rise out of poverty.

The ineffectiveness of the current anti-corruption strategies further proves that the neoliberal understanding of corruption is inadequate and cannot support effective reform and eradicate corruption. Given the flaws and shortcomings in the neoliberal approach to corruption, it is reasonable to question its continuing influence on the decision of the international community with regards to the allocation of aid to developing countries.

The following chapter examines the failures of the current anti-corruption initiatives and examines alternative possibilities to combat corruption.
CHAPTER FIVE
NEOLIBERAL POLICIES, ITS FAILURES AND POSSIBLE POLITICAL ECONOMY ALTERNATIVES TO COMBAT CORRUPTION

5.1 Introduction

Undoubtedly, one step to curbing corruption is to limit severely the misappropriation of rents and bribery. The neoliberal approach to corruption advocates, to this end, the introduction of competition in access to all economic activities and less state involvement in determining access. However, these strategies are limited and misleading as real world experiences suggest that the neoliberal anti-corruption reforms are inadequate for dealing with the complexities of corruption.

The first half of this chapter examines the failures of the neoliberal anti-corruption initiatives to show how misleading and misconceived the contemporary mainstream perspective on corruption is. To get to the roots of corruption requires more than curbing graft and bribery. Building on earlier discussions of institutional economics, the second half of this chapter will examine possible anti-corruption strategies derived from an institutionalist approach to corruption.

5.2 The Failure of Neoliberal Policies: A Case of Nero Fiddling while Rome Burns

The global track record of the neoliberal prescribed anti-corruption strategies in eradicating corruption has been far from impressive. Despite the implementation of anti-corruption strategies in many countries, corruption levels remain consistently high (Persson, Rothstein and Teorell 2010, p. 2). Researchers have argued that the failure of these anti-corruption measures is a result of the unwillingness of principals, or the wider community, to enforce existing laws by reporting and holding corrupt individual agents accountable for their behaviour (Svensson 2005; Fjeldstad & Isakesen 2008; Lawson 2009; Kpundeh 2004). However, the ineffectiveness of these anti-corruption strategies cannot be entirely attributed to either the principals or society at large. Having examined the inadequacies of the neoliberal approach to corruption in earlier chapters, the failure of recent reforms in many developing
countries is further evidence that the neoliberal framework is deficient and therefore feasible anti-corruption strategies cannot be derived from it.

One of Africa’s gravest problems is corruption. Corruption in African countries is both widespread and rampant. The inability to curb corruption denies the continent of the opportunity to achieve sustainable development. Therefore, in the last decade, the anti-corruption movement has mostly been targeted at the African continent (Persson, Rothstein and Teorell 2010, p. 6). Many African nations have implemented the prescribed neoliberal policies aimed at reducing the opportunities and incentives for corruption (Szeftel 1998; Medard 2002; Kpundeh 2004; Lawson 2009). However, the success of this ‘one size fits all’ approach has been limited at best. Drawing on evidence posited by Persson, Rothstein and Teorell (2010, p. 7-9), Uganda and Kenya are two good examples demonstrating the failure of the neoliberal anti-corruption strategies.

The governments of Uganda and Kenya have both developed and implemented the anti-corruption reforms advocated by the neoliberals in the hope of reducing the levels of corruption in their countries. A number of institutional and legal reforms have been introduced to curb malfeasance in both countries. For example, both governments have decentralised decision-making processes, implemented radical privatisation programmes while ensuring steps are taken towards intense trade liberalisation and deregulation (Persson, Rothstein & Teorell 2010, p. 7).

Moreover, the two countries have implemented various legal instruments to combat corruption. For example, Kenya has ratified the 2003 UN Convention against Corruption and signed the African Convention on Preventing and Combating Corruption and the African Union Anti-Corruption Convention. The latter requires officials working in government to declare their assets, to abide by a set of ethical codes of conduct and to allow citizens to access information relating to the government budget. Kenya has also implemented a number of new laws such as the Anti-Corruption and Economic Crimes Act and the Public Officers Ethics Act aimed at preventing corruption. In addition, several agencies have been set up in an effort to ensure compliance with the anti-corruption laws. These agencies include the Kenya Anti-Corruption Commission (KACC), the Ministry of Justice and Constitutional Affairs, the Steering Committee on Corruption and the office of Permanent Secretary
for Governance and Ethics. The government has also cracked down on corruption within the judicial system dismissing corrupt judges, magistrates and lawyers.

Uganda has also developed similar legal and institutional frameworks to fight corruption. In 1995, the Inspectorate General of Government (IGG) was created. The IGG is the national ombudsman charged with the responsibility of eliminating corruption and the abuse of authority and public office. Several other anti-corruption agencies have also been established. For example, the Directorate of Ethics and Integrity (DEI), Public Accounts Committee of Parliament and the Auditor General, were set up to review particular sectors of the government to ensure accountability and transparency. An anti-corruption court has also been put in place to investigate issues of corruption within society. In recent years, the government has also enacted anti-corruption laws such as the Penal Code Act of Uganda Chapter X, the Prevention of Corruption Act, and the Leadership Act of Uganda.

Both Uganda and Kenya – as well as many other developing nations - have adopted the anti-corruption strategies that are strongly supported by the World Bank, IMF and TI in their fight against corruption. The 2009 Global Integrity Report commends the legal-institutional frameworks in both Uganda and Kenya, suggesting that the anti-corruption approaches in both countries are paving the way towards a successful fight against corruption. However, despite many years of anti-corruption efforts, corruption remains rampant in both countries (Persson, Rothstein & Teorell 2010). Scholars argue that this lack of success stems from the inability of both countries to translate their anti-corruption laws and reforms into practice (Brinkerhoff 2000; Svensson 2005; Lawson 2009). While the institutional and legal reforms are convincing on paper, actual implementation of these reforms has fallen short (Riley 1998; Szeftel 1998; Kpundeh 2004; Johnston 2005). Furthermore, instead of preventing the spread of corruption, Doig and Riley (1998) argue that the current anti-corruption strategies have only created new avenues and opportunities for corruption. Although these anti-corruption policies were designed to accelerate development and enhance governance, it has presented its own opportunities for corruption (Warigi 2001). Corruption takes on diverse forms, all of which are ‘dynamic and often intractable’ (Riley 2000). It is therefore not surprising that a ‘one-size-fits-all’ strategy has proven to be ineffective.
Recent studies have found that the most corrupt countries are those that are halfway between democracy and authoritarianism (Montinola & Jackman 2002; Sung 2004; Back & Hadenuis 2008). Most empirical studies on democracy use indexes that are based on the procedural aspect of democracy (i.e. free elections). Although Hill (2003) and Chowdhury (2004) found that democracy lowers corruption levels, these studies employed few control variables in their analysis. However, a more comprehensive study by Treisman (2000) did not find this correlation. Instead, Treisman (2000) finds that only a long period of exposure to democracy lowers corruption. Rose-Ackerman (1999) states that a democracy may increase the accountability of politicians and therefore acts as a check on corruption. However, she argues that it also leads to an environment that provides more opportunities and incentives for corruption as politicians try to finance their campaigns. The empirical results suggest that it is the developing countries that are slowly introducing democratic institutions and reforms that have now become one of the major breeding grounds for corrupt activities.

Furthermore, contrary to what the neoliberals posit, the level of corruption within a particular country has no relation to the size and the role of the state in the economy. In fact, countries that are ranked least corrupt by the CPI and WBCC, such as Denmark, Finland, Sweden, Netherlands and Norway, are those countries whose states have always played a large role in the economy (Hodgson & Jiang 2007; Nelson 2010). Although the state plays an active role in the economy in these countries, both the TI and World Bank rate them to be “very clean”. Moreover, scholars also find that the bigger the size of the government budget relative to GDP, the lower the levels of corruption (Elliot 1997; Adsera, Boiz & Payne 2000; Nelson 2010). These results show that the neoliberal policies to combating corruption fly in the face of reality. Government involvement in the markets does not necessarily lead to higher levels of corruption. Quite contrary to improving governance and curbing corruption, these neoliberal policies seem to have only contributed to higher levels of corruption. Instead, it is countries with a more comprehensive state-managed approach in the economy that are least corrupt.

Despite the dismal results, it is curious that World Bank and IMF continue to insist that developing countries implement neoliberal policies to counter corruption. It
seems that behind the adoption of these neoliberal policies lies an agenda to press and force developing nations to develop and integrate into the global economy in a manner that would be beneficial to the developed world. To continue imposing on the developing world reforms that fail to curb corruption and achieve development reflects poorly on both the World Bank and IMF. In other words, Nero, in the form of the large inter-governmental organisations, is fiddling while Rome burns.

The lack of success with the current anti-corruption reforms shows that the neoliberal notion of eradicating corruption by eliminating rent is greatly misconceived. To want to eradicate corruption, as defined by the neoliberal framework is honourable. However, to eliminate state-created rents in the name of reducing corruption would be foolish. It is all very good to portray state-created rents as ‘crony capitalism’. However, rents can be quite central to processes of development. One example is the chaebols of South Korea. The chaebols (essentially large business conglomerates consisting of many family-controlled firms), have firms in all industries, ranging from food production, automobile, electronics to finance, and are commonly international in scope (Kim 1995, p. 105). The expansion of these chaebols have been encouraged effectively by extensive governmental support and finance. It is this interaction between the state and the large private networks and conglomerates that provided the structural basis for the rapid industrialisation and growth in South Korea in the 1970s; and it continues to exert an enormous amount of influence on the country’s economy (Kim 1995). Therefore, it is quite unlikely that any government will be willing to sacrifice something that is essential for turning the wheels of capitalism. To eliminate possible corruption by eliminating rents would be to put development at risk.

This is not to say that state-created rents are not misappropriated by cronies. Governments may favour business owners who are of the same race, religion and ethnicity as themselves. One such example is Syria. The Alawites in Syria are favoured and given special privileges in the government and in the business sector because President Assad is an Alawite (Shadid 2011). The same can be said in Mubarak’s Egypt, where groups of rich businessmen aligned with the Mubarak family were given special favours and appointed as key government ministers and governing party members (Fahim, Slackman & Rohde 2011). Cronyism concentrates power and
wealth in the hands of a few. Noam Chomsky (2008) once stated in an interview that ‘crony is superfluous when describing capitalism’. Businesses and political power are interconnected. Rich businessmen provide money to the government in exchange for political and economic favours. However, this is not far from saying that governments provide otherwise-missing incentives to private companies to undertake investments necessary for the economy as a whole. Such actions are sometimes necessary as a government’s first priority is to eliminate deficiencies in the market incentives if possible. The problem here is who the government chooses to protect and endow favours upon and on what basis.

In order to effectively tackle the problem of corruption, it is imperative that the international community recognise that there are broader structures and complexities surrounding corruption that go beyond what the neoliberal framework acknowledges.

5.3 Possible Strategies to Combat Corruption

Neoliberal commentaries identify corruption with graft and bribery. However, as established in previous chapters, this approach is too narrow. A broader, more realistic understanding of corruption is to view corruption as the subversion of formal rules of a society regardless of whether or not these formal rules are democratic or otherwise. This concern for the development of rules that achieve social order leads to quite different directions from the current neoliberal conception, both in terms of the understanding of the broader complexities of corruption and also in the development of anti-corruption strategies. Based on the institutionalist framework, corruption levels can only be reduced if people within a given society abide by and adhere to the rules. However, people will only comply with the rules if they feel that they are responsible for and ‘own’ these institutions. Therefore, a central feature of possible anti-corruption strategies is to ensure that the people of a given community are involved systematically and extensively in the formation and adaptation of institutions and rules so that they will have a sense of ownership over the rules by which their social interactions are governed. This way people will be more likely to resist corruption in favour of well-deliberated reforms.
In the absence of checks and balances, rule makers will tend to implement rules that further their interests. Thus, rules that are not well-deliberated and do not reflect a wider spread of interests will always end up suiting those who are in power. Correspondingly, powerful rule makers will attempt to suppress and deny opposing interests in perpetuating and maintaining a particular set of institutions. By the same token, those in opposition will subvert and corrupt any rules that happen to be created. In order to ensure that people will respect the social institutions and defend them, the rule-making process within a parliament or congress needs to be open to all sectors of society. All forms of civil society, including those who are in opposition of the rule, should be allowed to participate in this process. Although their views may be contradictory, it is important that all parties who are most interested and concerned over a particular public good be allowed the opportunity to come together to deliberate and voice their opinions on the matter. Through these deliberations, it is hoped that a compromise can be achieved. Hence, these processes must be genuinely open so that the outcomes will be accepted and consented by the bulk of the people.

None of this is to say that (i) people who are not well-served by the rules that exist should not or do not oppose to them or (ii) that the effective subversion of a rule may not be an effective means of opposition.

The benefits of public debate and deliberation are well-known. Sen argues that public deliberation exposes people to differing beliefs and helps them to overcome their parochial biases (Sen 2009). This ensures that the decisions made are done so in the interests of everyone in society. As Rawls (1997, p. 770) states, ‘[c]itizens are reasonable when, viewing one another as free and equal in a system of cooperation over generations, they are prepared to offer one another fair terms of social cooperation’. Although public debate may not always lead to a unanimous agreement, it gives everyone a fair chance to voice their concerns, defend their interests, listen and consider the beliefs and opinions of others and ultimately contribute to the creation of a rule that they promise to abide by in the interests of justice, equality and fairness. Such an approach is in line with deliberative democracy (Sen 2009).

At the core of a deliberative democracy is the notion that there be reasoned discussion in the political arena. Prachett (1999, p. 616) once stated that ‘there is nothing particularly new about public participation as a supplement to representative
democracy’. It is not uncommon to hear a government holding public hearings or soliciting public opinions and comments on particular matters of importance. Deliberative democracy, however, goes beyond consulting citizens of a society. It also advocates that ordinary people should participate in actual decision-making. This way public decisions are determined by the citizens who will be affected by them. ‘Deliberative democrats’ believe that people who will be affected by or who are most interested in a particular public good should be given the opportunity to voice their opinions and play a role in creating and implanting the social rules necessary to achieve material prosperity and social justice. The most effective way of safeguarding society against corruption and attempts to undermine stability, growth and just distribution is then to get all sections of society involved in the rule-making process. The responsibility and ownership over these rules will ensure that the chances of subversion are slimmer and that rules will not be unjust or corrupted.

The possible anti-corruption strategies advocated in this thesis emphasise on the need to empower individuals in society to allow them to take ownership in the creation of the rules which they will live by. This proposed strategy would no doubt come under attack by neoliberals as being too idealistic and utopian. Experience has shown that public goals are often easily captured by private interests and rules are corrupted to promote private purposes. Therefore, the only way to curb corruption effectively is to actively sustain agreed public purposes. This means that the long-term anti-corruption reforms should take the form of pro-democratic reforms. Public choice theorists can be expected to support the above proposition. They have a deep distrust of government officials, viewing them like any other individuals who would put their own interests over that of society. Hence, some public choice theorists might be inclined to push for deliberative democracy as a tractable anti-corruption strategy in which civil society plays a large role in determining the rules and institutions of a society. On the other hand, they would simultaneously and more fundamentally promote the scope for private choices within free markets.

Historical experiences have shown that the current methods of curbing corruption are ineffective. However, trying to curb corruption should not be seen as unrealistic or impractical. It is important that the international community continues to support and aid developing countries in their fight against corruption. By changing
the way we understand corruption, we can devise new anti-corruption initiatives that are better suited to tackling corruption.
CHAPTER SIX

CONCLUDING REMARKS

6.1 Introduction

Over the past decade, scholars have tried to explain and predict both the causes and consequences of corruption and devise anti-corruption strategies to help developing countries combat corruption. High levels of corruption have inhibited economic growth and development in many developing nations. In order for developing countries to get back on track to achieve the MDGs by 2015, the fight against corruption has to be made a top priority. Many aid donors rely heavily on the corruption indexes to determine the amount of aid, if any, that should be given to developing nations. However, as developmental aid is made conditional on declining levels of corruption, the implementation of ineffective anti-corruption reforms means corruption remains widespread and aid is held back.

The lack of success of the neoliberal prescribed policies casts doubts on the ability of the neoliberal framework to analyse and devise strategies to combat corruption. However, the World Bank and IMF have continued to insist that developing countries implement these strategies. Rather than just fiddling as Nero did, the World Bank and IMF need to re-examine their current approach to corruption in order to develop more appropriate and comprehensive anti-corruption strategies. This chapter provides an overview of the arguments made in this thesis, considers its limitations and concludes with remarks on the implications for future measures of corruption and other possible frameworks for analysing corruption.

6.2 Overview and Contributions

The neoliberal framework that underlies the current anti-corruption rhetoric defines corruption as the misuse of public office for private gain. There are three major deficiencies that make the approach too narrow for any adequate analysis of corruption. First, its focus on corruption as either bribery or graft means that other types of corruption are left out of the analytical framework. Second, the neoliberals confine their analysis of corruption to the public sector. By disregarding private sector corruption, the neoliberal framework presents an incomplete view of corruption.
However, even if we were to set aside these limitations, there are still serious misgivings about the neoliberal methodology used in their analysis of corruption. The last limitation, and perhaps its biggest limitation, is the tendency to view rent-creation as a source of corruption. This notion is misconceived. As seen in the case of South Korea, rent-seeking has and can contribute extensively to the development process. To eliminate rents might therefore hamper economic development. A better understanding of corruption in this instance would be to view it as the misappropriation of rents. The anti-corruption strategies advocated by the neoliberals focus on limiting the role of the state. Neoliberals believe that state involvement may create rent and thus the occasion of corruption. This understanding of corruption is misleading and may explain the lack of success of the anti-corruption initiatives thus far.

I argue that a more effective analysis of corruption can be drawn from institutional economics. Here, a corrupt act is one that undermines the rules of an organisation or society which in turn results in the corrosion of the institutional and social fabric. Hence, a central feature of possible anti-corruption strategies based on this understanding of corruption is to ensure that all members of society are given a chance to participate in the formation and adaptation of institutions. Only when citizens feel responsible for the rules will they abide by it and avoid bringing them into disrepute. A comprehensive anti-corruption strategy will thus emphasise on the implementation of a deliberative democracy.

6.3 Limitations

The biggest limitation of this thesis concerns the proposal to establish deliberative democracy. The criticisms made against deliberative democracy are plentiful and proposing it as an alternative measure to combat corruption inevitably raises a lot of doubts and questions. This is, however, not the time and place to have an in-depth assessment on the undesirability of deliberative democracy or the ways in which we should limit or enhance it. However, I will point out three key contradictions within the deliberative theory.

One purpose of deliberative democracy is to ensure the legitimacy of outcomes. For ‘deliberative democrats’, ‘free deliberation among equals is the basis
of legitimacy’ (Cohen 2006, p. 162). In order to achieve any legitimate and just outcome, participants in the process need to be open and accept that one’s pre-formed preferences and beliefs may be transformed in the face of better ideas and arguments (Dryzek 2000 p. 2). However, can individuals always come together and deliberate freely and reasonably with one another as equals? And can they do so even though their individual preferences may be irrational and unreasonable to begin with? If the answers to these questions are ‘no’, then the process is necessarily biased and the outcomes will only perpetuate inequality and injustice. The implementation of these anti-democratic rules and institutions will only open up more opportunities for corruption as individuals whose interests are frustrated by these rules and institutions will undermine them.

The second contradiction within the deliberative theory is with regards to scale. In order for an outcome to be legitimate, it needs to have received ‘reflective assent through participation in authentic deliberation by all those subject to the decision in question’ (Dryzek 2001, p. 651). Therefore, everyone who is interested and concern over the outcome has to take part in the deliberative process in order for the outcome to be legitimate. However, while leaving out too many people will result in illegitimate outcomes, bringing in too many people may also undermine the deliberative process and turn it into a speech-making event instead of a deliberative one (Goodin 2000, p. 83n). Therefore, it is necessary for individuals who want to participate in the deliberative forum to fulfil a set of procedural requirements (Parkinson 2003, p. 181). The conditions participants must meet include the ability to communicate competently, inclusiveness (Cohen 1989; Gutmann & Thompson 1996) and a willingness to set aside personal strategic concerns to achieve an outcome that will be just for all (Dryzek 2000, p. 2). These procedural conditions ensure that the process is more than ‘mere talk’ (Parkinson 2003, p. 181). However, a paradox arises. An individual’s willingness to take part in deliberative forums is motivated by the need to express and stand up for their pre-formed beliefs and preferences (Rawls 1996, p. 82). Why would anyone then enter into a deliberative forum when to enter it they have to first abandon their beliefs? Having such a requirement means that many individuals who may be affected by or interested in a certain outcome will not be allowed to partake in the deliberative process. This undermines the principle of
openness. Such processes run the risk of producing anti-democratic and unjust outcomes and therefore will be counterproductive in the fight against corruption.

The last contradiction is closely related to the outcome of the deliberative process. Advocates of deliberation argue that it leads to reasoning and rationalisation, both of which enables individuals to overcome their bias and set aside their preferences in order to establish institutional rules and arrangements that will be beneficial for society (Sen 2009). However, how can we be sure that a deliberative process will lead us to the best outcome all the time? The next question that follows then is whether we should continue to deliberate if it is obvious that the best institutional rules and arrangements cannot be achieved through deliberation? If we do allow for exceptions that override the deliberative process, then are we not undermining and subverting the very process aimed at reducing corruption? Such an act is in itself a corrupt practice.

Despite these contradictions, there is no doubt that the implementation of a deliberative democracy can be beneficial for society. If implemented properly, deliberative democracy can reduce the opportunities for corruption. Therefore, there is no reason to set aside the idea of a deliberative system as an alternative to the current anti-corruption measures.

6.4 Implications for the Measures of Corruption

The rejection of the mainstream perspective on corruption then begs the question of whether or not measures of corruption can be built based on the institutional approach to corruption.

Essentially, corruption indexes reduce the different dimensions of corruption into a single number. Take for example, the CPI and WBCC. Adopting the neoliberal view that corruption is bribery, both indexes limited its measurement of corruption to the quantity of bribes (Zaman & Rahim 2009, p. 118). Therefore, a corruption index based on an institutionalist approach would only need to measure the number of times a rule is being subverted and brought into disrepute. However, reducing the different dimensions of corruption into a single number is done at the expense of a large amount of information and the results can never be wholly accurate (Zaman & Rahim 2009). Going back to the previous example, in order for the CPI and WBCC to
measure the quantity of bribes, both indexes need to calculate the number of bribes and the size or volume of the bribes. However, it is quite impossible for a corruption index to reconcile these two separate dimensions and arrive at an unambiguous and accurate ranking (Zaman & Rahim 2009, p. 119).

Similarly, it is not as straightforward to construct a corruption index based on the institutional framework. We revisit the case of ‘noble cause corruption’. As discussed in chapter four, ‘noble cause corruption’ is the breach and violation of anti-democratic rules and institutions. Given that corruption indexes produce a one number summary of corruption levels, no distinction will be made between corruption and ‘noble cause corruption’. However, it is extremely misleading to rank countries as ‘very corrupt’ when the rules that are being subverted are anti-democratic and unjust. It would be unreasonable for citizens to have to abide by such rules. Rankings that take into account ‘noble cause corruption’ might be to the disadvantage of a developing country where most institutions and rules are anti-democratic or unjust. It would be especially harsh on the citizens if aid were withheld on this basis. Often times, countries depend on aid, not only for development, but also to implement the anti-corruption initiatives necessary to remove these anti-democratic rules.

No matter how one may define corruption, the different dimensions of corruption make it difficult for any corruption index to meaningfully measure the phenomenon. This is not to say that corruption indexes are totally redundant. If complimented by other indicators, corruption indexes can shed light on vital aspects of corruption that a single measure would not be able to do (Galtung 2006, p. 124). As long as these indexes are not used as general measures of overall corruption, it can still be used purposefully in the fight against corruption.

6.5 Concluding Remarks: The Future of The ‘Corruption’ Debate

Corruption is a multidimensional phenomenon. Although the term corruption is often readily applied, its contents are not as easy to grasp. What is deemed to be corrupt is dependant on the prevailing norms of a society. This explains why there still remains considerable dispute when it comes to defining the boundary between a corrupt act and a non-corrupt act. However, in order to effectively combat corruption,
it is imperative that both the developed and developing world agree on what constitutes corruption.

Although the alternative I have proposed in this thesis is quite different from the neoliberal view of corruption, both understandings of corruption present a rather optimistic view of corruption as a phenomenon that can be curbed and potentially eradicated. However, the complex nature of corruption suggests that it may be necessary to fundamentally rethink the concept of corruption. Instead of viewing corruption merely as a defect of arrangements, corruption can also be seen as a phenomenon that is deeply embedded in the economic system. In this instance, the exploitation of workers can be seen as fundamentally corrupt. Within the capitalist system, workers are constantly exploited by their employers for want of more profits. Such exploitations can lead to widespread discontent and dampen the morale of workers. This in turn affects the economic performance of the workers and can disrupt the economy. However, such exploitation is necessary to drive capitalism’s engine and thus will never be entirely eradicated. This approach views corruption as a symptom of the broader problems related to the economic system. As such, the only way to eradicate corruption would be to eliminate the structural inequalities present in the economic system.

Fifteen years have passed since Wolfensohn’s speech. Today, corruption still threatens the foundation of many societies around the world. The deficiencies in the contemporary mainstream perspective on corruption severely limit its ability to adequately analyse corruption and design solutions to combat it. International aid donors should therefore be cautious when relying on the CPI and WBCC in determining aid allocations to developing countries.

The complex nature of corruption and the difficulties in measuring it should not be reasons to discard further research into corruption. Just because it is an increasingly complex problem does not mean that it cannot be solved. As Berlinksi (2009) states, ‘corruption is the cancer of economics’ and although we do not have nearly as much success of curing cancer as we have of curing syphilis, it does not mean that we should invest ten times more into syphilis research than in cancer research. In order to effectively tackle corruption, the international community, in
particular the World Bank and IMF, must alter the way they view corruption and adopt a broader framework that better reflects the realities of corruption.
## APPENDIX A

### SOURCES OF TRANSPARENCY INTERNATIONAL’S CORRUPTION PERCEPTION INDEX

<table>
<thead>
<tr>
<th>Sources</th>
<th>Abbreviations</th>
<th>Data Provider</th>
<th>Subject Asked</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB Country Performance Assessment Ratings</td>
<td>ADB</td>
<td>Asian Development Bank</td>
<td>Transparency, accountability, and corruption in the public sector</td>
</tr>
<tr>
<td>AFDB Country Policy and Institutional Assessments</td>
<td>AFDB</td>
<td>African Development Bank</td>
<td>Transparency, accountability, and corruption in the public sector</td>
</tr>
<tr>
<td>Bertelsmann Transformation Index</td>
<td>BTI</td>
<td>Bertelsmann Foundation</td>
<td>The government's capacity to punish and contain corruption</td>
</tr>
<tr>
<td>Country Policy and Institutional Assessment</td>
<td>CPIA</td>
<td>World Bank</td>
<td>Transparency, accountability and corruption in the public sector</td>
</tr>
<tr>
<td>Country Risk Service and Country Forecast</td>
<td>EIU</td>
<td>Economic Intelligence Unit</td>
<td>The misuse of public office for private (or political party) gain: including corruption in public procurement, misuse of public funds, corruption in public service, and prosecution of public office</td>
</tr>
<tr>
<td>Nations in Transit</td>
<td>FH</td>
<td>Freedom House</td>
<td>Extent of corruption as practiced in governments, as perceived by public and as reported in the implementation of anti-corruption initiatives</td>
</tr>
<tr>
<td>Global Insight Country Risk Data</td>
<td>GI</td>
<td>Global Insight</td>
<td>The likelihood of encountering corrupt officials, ranging from petty bureaucratic corruption to grand political corruption</td>
</tr>
</tbody>
</table>
| IMD World Competitiveness Yearbook | IMD International, Switzerland, World Competitive Center | Category Institutional Framework - State Efficiency: 'Bribing and Corruption exist/do not exist'

| Asian Intelligence Newsletter | PERC Political & Economic Risk Consultancy | How serious do you consider the problem of corruption to be in the public sector?

| Global Competitiveness Report | WEF World Economic Forum | Undocumented extra payment or bribes 1) exports and imports 2) public utilities 3) tax collection 4) public contracts and 5) judicial decisions are common/never occur

Source: Transparency International (2010)
## APPENDIX B

### SOURCES OF WBCC

<table>
<thead>
<tr>
<th>Sources</th>
<th>Abbreviation</th>
<th>Data Provider</th>
<th>Subject Asked</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Environment and Enterprise Performance Surveys</td>
<td>BPS</td>
<td>World Bank and European Bank for Reconstruction and Development</td>
<td>How common is it for firms to have to pay irregular additional payments to get things done</td>
</tr>
<tr>
<td>Business Environment Risk Intelligence</td>
<td>BRI</td>
<td>BERI S.A.</td>
<td>Internal causes of Political Risk: Mentality, including xenophobia, nationalism, corruption, nepotism, willingness to compromise, etc</td>
</tr>
<tr>
<td>Bertelsmann Transformation Index</td>
<td>BTI</td>
<td>Bertelsmann Foundation</td>
<td>Corruption</td>
</tr>
<tr>
<td>Countries at the Crossroads</td>
<td>CCR</td>
<td>Freedom House</td>
<td>Transparency/Corruption</td>
</tr>
<tr>
<td>Country Policy and Institutional Assessments</td>
<td>CPIA</td>
<td>The World Bank</td>
<td>Transparency/Corruption</td>
</tr>
<tr>
<td>Global Insight Global Risk Service</td>
<td>DRI</td>
<td>Global Insight</td>
<td>Risk Event Outcome non-price: Losses and Costs of Corruption</td>
</tr>
<tr>
<td>Country Risk Service and Country Forecast</td>
<td>EIU</td>
<td>Economist Intelligence Unit</td>
<td>Corruption</td>
</tr>
<tr>
<td>Name</td>
<td>Code</td>
<td>Description</td>
<td>Source</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>------</td>
<td>-----------------------------------------------------------------------------</td>
<td>------------------------------------------------</td>
</tr>
<tr>
<td>World Economic Forum Global Competitiveness Survey</td>
<td>GCS</td>
<td>World Economic Forum</td>
<td>Public trust in financial honesty of politicians</td>
</tr>
<tr>
<td>Global Integrity Index</td>
<td>GII</td>
<td>Global Integrity</td>
<td>Anti-Corruption Law</td>
</tr>
<tr>
<td>Gallup World Poll</td>
<td>GWP</td>
<td>The Gallup Organisation</td>
<td>Is corruption in government widespread?</td>
</tr>
<tr>
<td>IFAD Rural Sector Performance Assessments</td>
<td>IFD</td>
<td>International Fund for Agricultural Development</td>
<td>Accountability, transparency and corruption in rural areas</td>
</tr>
<tr>
<td>Institutional Profiles Database</td>
<td>IPD</td>
<td>French Ministry of the Economy, Finance and Industry, Agence Francais de Development</td>
<td>Corruption</td>
</tr>
<tr>
<td>Latinobarometro</td>
<td>LBO</td>
<td>Latinobarometro</td>
<td>Have you heard of acts of corruption?</td>
</tr>
<tr>
<td>Merchant International Group Gray Area Dynamics</td>
<td>MIG</td>
<td>Merchant International Group</td>
<td>Corruption. There is an immense variety of activities that may be construed as corrupt. Bribery is the most obvious. However, what is and is not a bribe is a matter of presentation and perception in much the same way as &quot;corruption&quot; itself. Some of the issues that executives should consider include: accounting standards; anti-corruption policy credibility and enforceability, cronyism, nepotism and vested interests; cultural differences; judicial independence; transparency of decision-making</td>
</tr>
</tbody>
</table>


Corruption. Measures corruption within the political system, which distorts the economic and financial environment; reduces the efficiency of government and business by enabling people to assume positions of power through patronage rather than ability, and introduces an inherently instability in the political system.

Corruption

Indirect Diversion of Funds

Frequency of corruption among government officials

Bribing and corruption exist in the economy

Corruption: This index assesses the intrusiveness of the country's bureaucracy. The amount of red tape likely to be countered is assessed, as is the likelihood of encouraging corrupt officials and other groups.

Source: Kaufmann, Kraay & Mastruzzi (2008)
APPENDIX C

CRITICISMS OF THE CORRUPTION PERCEPTION INDEX

Since the creation of the CPI and WBCC, major improvements have been made to these indexes in order to overcome its limitations. However, certain challenges have not yet been adequately tackled. This has led many to question the credibility, validity and usefulness of these indexes as measures of corruption. The improvements on the corruption indicators have also made them increasing complex. These complexities have only generated its own set of problems. This appendix examines the failings of the CPI and WBCC. These problems can be categorised under three broad headings: (1) the corruption perception problem; (2) the measurement error problem; (3) the usability in policy formulation problem.

The Corruption Perception Problem

Both the CPI and the WBCC measure the perceived degree of corruption within a country. However, exactly whose perceptions are measured?

The common misconception is that these corruption indexes measure the perception of the general public. However, most of the sources that the CPI and the WBCC rely upon are expert assessments. Among the CPI’s 10 sources, only 3 sources surveys the public at large, while the rest are polls of country-analysts (See Appendix A). Similarly, only 8 out of the 24 sources utilised by the World Bank surveys the general public (See Appendix B). Therefore, it would be incorrect to assume that the CPI and WBCC represent the perceptions of the general public.

Relying mainly on these expert assessments can be problematic as they can be prone to bias. In most cases, the experts who dominate these assessments are staff of the organisations that are sources of the CPI and WBCC. Thus, there exist the possibility that the perceived degree of corruption is already skewed in a pre-determined direction. Experts may answer the assessments with results that they expect to see. Moreover, these experts are usually non-residents of the countries they are assessing. This means that the results produced by the corruption indexes are the perceptions of a small pool of outsiders. This has led many critics to dismiss the CPI and WBCC as valid measures of corruption. John Lambsdorff (2007), the architect of
the CPI, has disputed these criticisms stating that non-resident experts usually have a
good grasp of the culture and traditions of the countries concerned while at the same
time are not influenced by certain parochial biases that residents may hold. He also
argues that the judgements of these experts are more impartial as they are made
according to universal ethical standards (Lambsdorff 2007, p. 6). A recent finding by
Ko and Samajdar (2010) supports Lambsdorff’s argument. The authors found that the
perception of the degree of corruption by international experts is a close reflection of
the domestic perception of corruption.

However, even if we were to set aside the above-mentioned problems, a much
greater problem exists. Many people have consistently misinterpreted the results of
the CPI and WBCC as actual levels of corruption. Although these corruption indexes
have gone through many changes, their sophisticated statistical construction does not
equip them with the ability to measure actual levels of corruption within countries.
Empirical studies have proven that perceptions of corruption have a weak association
with actual levels of corruption (Donchev & Ujhelyi 2007; Olken 2009). This may be
because an individual’s perception of corruption is often heavily dependant on social
culture, prejudice gossip, media sensationalism and whether or not the individual
themselves has been involved in corrupt activities (Williams 2006). The empirical
findings suggest that there are certain types of corrupt practices that surveyors and
experts are unaware of and thus go unreported. Therefore, ‘using corruption
perception indices as a measure of corruption experience may be more problematic
than suggested by the existing literature’ (Donchev & Ujhelyi 2007, p. 17). This is
especially so given that the international community relies heavily on these corruption
perceptions when designing anti-corruption strategies and also in guiding their aid
allocation decisions. Although relying on subjective perceptions to construct the
corruption indexes may currently be the best option\(^1\), it is imperative to remember that

\(^1\) There has been an increased effort towards obtaining objective data (See Duncan
2006; Golden and Picci 2005; Olken 2006). These objective data are still perception-
based but instead of asking for the surveyor’s opinions of corruption, these objective
perception-based indicators are based on questions about real experiences. Utilising
objective measurements in corruption assessments will get rid of the attitudinal bias
that may be present in subjective data (Bradburn 1983). However, Kraay (2006) has
pointed out that objective measurements ‘provide only imperfect proxies for real
these indicators are not flawless, and that the results produced may often be very different from actual levels of corruption.

The Measurement Error Problem

The second category relates to the measurement errors present in the CPI and WBCC. Reliability is inversely related to random error of measurement (Carmines & Zeller 1979, p. 15). Therefore, in order for the CPI and WBCC to be reliable measures, they can only contain a small measurement error. Despite the major improvements made on the corruption indexes to reduce measurement errors, the magnitude of measurement errors in the indexes remains quite high. There are three reasons for this. First, given that the CPI and WBCC are constructed based on a number of primary sources, the variation among sources becomes a major source of random error. Second, the weighting schemes devised by the TI and Bank are defective and thus produces measurement errors. Lastly, measurement errors can also arise from yearly variations of the corruption indexes.

The high level of variance between sources produces measurement errors. Referring to the CPI in particular, The Economist stated that ‘a combination of few sources and high variance between them makes it hard to read much into simple averages, and hence into the rankings’ (The Economist, 30th October 1999). Researchers at the TI and World Bank have attempted to reduce the measurement errors by increasing the number of sources used in the CPI and WBCC (Ko & Samajdar 2010). These efforts have shown some results as the standard error of estimated corruption indexes published together with the CPI and the WBCC have reported significant reductions since 2000. However, Ko and Samajdar (2010) find evidence showing that the standard error present in the corruption indexes are still relatively high. Therefore, doubts remain as to whether the results produced by the two indexes are credible.

The defective weighting schemes of both indexes are also a source of measurement errors. Researchers at the TI and World Bank use specific weighting conditions on the ground’ and therefore may not necessarily provide us with an accurate image of reality.
schemes in order to try and standardise the variety of sources utilised. The CPI standardisation procedure is based on the ‘matching percentiles technique’. This technique determines the ranks of countries from the common sub-samples of a new source and the previous year’s CPI. The largest value in the CPI is then taken as the standardised value for the country ranked best by the new source. The second largest value would then be given to the country ranked second-best, and so on. For instance, imagine that the new sources ranked only four countries: United States, Singapore, Chile and Zimbabwe from best to worst. The previous year’s CPI values were 8.1, 9.5, 2.2, 2.3 respectively. The ‘matching percentiles technique’ would give the United States the best score of 9.3, Singapore 8.1, Chile 2.3 and Zimbabwe 2.2. Even though certain information from the sources may be lost in this technique, the main benefit of it is that it keeps the standardised values between 0 (very corrupt) and 10 (highly clean) (Lambsdorff 2003, p. 7). However, this technique is not without its flaws. Although it may be necessary to have a baseline of comparison in order to rank countries according to their corruption levels, the ‘matching percentiles technique’ does not produce ranks that take into account the positive changes that might have been reported by some of the CPI’s sources (Gatlung 2006). Therefore, the rankings produced by the CPI may not be as credible as they are thought to be.

In terms of the WBCC, World Bank researchers use a weighting scheme that is based on the assumption that the errors of the sources used are uncorrelated across sources and countries (Kaufmann, Kraay & Mastruzzi 2007). This means that the sources which are highly correlated are assumed to be more informative and are given higher weights than the other sources which are less correlated with the majority. Sources with the higher weights will have a larger influence on the result. Therefore, if four sources are chosen and three of them are similar, the weights attributed to the majority will be overbalanced whereas the source that has a lower correlation will have nearly no weight in the constructed index (Arndt and Oman 2006 p. 59). However, such a scheme is deficient. The fact that different sources are uncorrelated with one another does not mean that the information they provide is any less accurate than the others. Instead, it only reflects their greater accuracy of the underlying reality of corruption they are designed to reflect (Arndt and Oman 2006). Sources used in the construction of the WBCC may be much more interdependent than expected and weights attributed to certain sources can sometimes be overestimated. Given the
defective nature of the weighting scheme, the rankings and scores produced by the WBCC are highly suspicious.

Lastly, measurement errors can also be due to variation between years. The standardisation procedure that is to place different sources on a common scale does not have the ability to detect and track changes and trends over time (Rohwer 2009, p. 50). As the estimates for corruption are based on different sources, it is hard, if not impossible, to measure yearly trends. Changes in a country’s ranking could be attributed to the addition or reduction of sources (Galtung 2006). The availability (or otherwise) of sources for a given country can explain why countries drop in and out of the indexes. For example, an addition and removal of data sources for certain countries in a particular year can result in six countries being dropped out of the index, and two countries being added into it. This has the effect of changing the rank order of certain countries on the index. Therefore, countries may move up or down the CPI and WBCC but this may not necessarily mean that corruption levels have increased or dropped. Instead, these changes may be a result of the measurement errors produced by the yearly variations. Although many donor countries continue to allocate aid based on yearly trends, it is quite apparent that these indexes are unsuitable for any time-based analysis.

The Usability in Policy Formulation Problem

Since coming into existence, the CPI and the WBCC have not been able to generate policy-focused data that can guide policymakers to develop anti-corruption strategies. However, now that global attention is focused on corruption, what is the use of the corruption indexes if they are unable to produce information that would help in the development of strategies to combat corruption.

In order for corruption measures to contribute to useful policy making, measures need to provide some clear and concise picture of what corruption is, in what context it is taking place and solutions that can combat this phenomena. The current corruption indexes have been criticised for not being able to achieve any of these. So far, assessments generated by these indexes are too broad to be converted into effective anti-corruption strategies (Urray 2007, p. 8).
The need for more ‘actionable’ indicators that can contribute to policy-oriented solutions has led to the creation of a new category of corruption indexes. These indexes focus on non-perception measures and measures specific aspects of corruption that are connected to policy outcomes (See Duncan 2006). Examples of these indicators include the Organisation for Economic Cooperation and Development – Development Assistance Committee (DAC) Procurement Indicators or the Public Expenditure and Financial Accountability (PEFA) indicators. Although doubts have been raised about these non-perception indicators (Duncan 2006), the construction of new indicators to replace the current ones only questions the validity, reliability and usefulness of the CPI and WBCC.

The limitations of the CPI and WBCC prove how difficult it is to measure and assess corruption. Therefore, the efforts of the researchers at the World Bank and TI must be commended. However, these failings also call for the reassessment of the CPI and WBCC. Perhaps, after fifteen years, it is now time to find new measurements of corruption.
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