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THE EFFECT OF CORRUPTION ON THE GROWTH OF THE ECONOMY

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Abstract: Economies that are afflicted by a high level of corruption—which involves the misuse of power in the form of money or authority to achieve certain goals in illegal, dishonest, or unfair ways—are not capable of prospering as fully as those with a low level of corruption.

Keywords: Development, Growth, Economy, Corruption, Monitory policy.

Introduction. Corruption has been around for a very long time and will be around in the future unless governments can figure out effective ways to combat it. This is not going to be easy. Although the study of the causes and consequences of corruption has a long history in economics, going back 30 years to seminal contributions on what economists call rent seeking, related empirical work on quantifying the extent of corruption and putting a dollar sign on its economic effects has been limited. This is hardly surprising since most corruption is clandestine. Also, determining just how efficient government institutions are is not what would be called an exact science. As a consequence, corruption is notoriously hard to measure and empirical economic research on the question is fairly meager. This paper focuses exclusively on corrupt public practices--illegal activities that reduce the economic efficiency of governments. It does not address private corruption, such as that practiced on individuals and private enterprises by organized crime.

Wide publicity surrounding the statements at the multinational financial institutions' 1996 Annual Meetings by the Managing Director of the International Monetary Fund that governments must demonstrate their intolerance for corruption in all its forms and by the President of the World Bank that the "cancer of corruption" must be dealt with have stimulated renewed interest in the topic. Researchers have begun to look at so-called corruption indices, which are produced by private rating agencies and are typically based on replies by consultants living in the countries to standardized questionnaires. Obviously the replies are subjective, but the correlation between indices produced by different rating agencies is very high, suggesting that most observers agree more or less on ranking countries according to how corrupt they seem to be. The high prices paid to the rating agencies by their customers (usually multinational companies and international banks) constitute indirect evidence that the information is useful and can have tangible economic effects. On the other hand, the judgment of the consultants who produce these indices may be skewed by the economic performance of the countries they monitor. Substandard economic performance by itself does not argue to pervasive corruption, nor is economic success an infallible sign of innocence of corruption. It is therefore important in analyzing the relationship between perceived corruption and economic variables to be cautious about interpreting correlations as cause-effect relationships. An additional drawback of these indices is their failure to distinguish among various types of corruption: high-level versus low-level corruption or well-organized versus poorly organized corruption. Despite these limitations, the indices provide a wealth of useful information.

Since much public corruption can be traced to government intervention in the economy, policies aimed at liberalization, stabilization, deregulation, and privatization can sharply reduce the opportunities for rent-seeking behavior and corruption. Where government regulations are pervasive, however, and government officials have discretion in applying them, individuals are often willing to offer bribes to officials to circumvent the rules and, sad to relate, officials are occasionally tempted to accept these bribes. Identifying such policy-related sources of corruption is obviously helpful in bringing it under control. The following sources have for some time been well known.

Trade restrictions are the prime example of a government-induced source of rents. If importing a certain good is subject to quantitative restriction (for example, only so many foreign automobiles can be imported each year), the necessary import licenses become very valuable and importers will consider bribing the officials who control their issue. More generally, protecting a home industry (such as plywood manufacturing) from foreign competition through tariffs creates a semi-monopoly for the local industry. Local manufacturers will lobby for the establishment and maintenance of these tariffs and some may be willing to corrupt influential politicians to keep the monopoly going. Studies have shown that a very open economy is significantly associated with lower corruption. In other words, countries tend to be less corrupt when their trade is relatively free of government restrictions that corrupt officials can abuse.

Government subsidies can constitute a source of rents. Studies show corruption can thrive under industrial policies that allow poorly targeted subsidies to be appropriated by firms for which they are not intended. The more such subsidies are available to industries, the higher the corruption index.

Price controls, whose purpose is to lower the price of some good below its market value (usually for social or political reasons), are also a source of rents and of ensuing rent-seeking behavior. Price controls create incentives for individuals or groups to bribe officials to maintain the flow of such goods or to acquire an unfair share at the below-market price.

Multiple exchange rate practices and foreign exchange allocation schemes lead to rents. Some countries have several exchange rates--one for importers, one for tourists, one for investors, for example. Differentials among these rates can lead to attempts to obtain the most advantageous rate, although this rate might not apply to the intended use of the exchange. Multiple exchange rate systems are often associated with anti-competitive banking systems in which a key bank with government ties can make huge profits by arbitraging between markets. Some countries have little foreign currency and distribute what they have through various schemes, with varying degrees of transparency. If, for example, state-owned commercial banks ration scarce foreign exchange by allocating it according to priorities established by government officials, interested parties may be willing to bribe these officials to obtain more than their fair share.

Low wages in the civil service relative to wages in the private sector are a source of low-level corruption. When civil service pay is too low, civil servants may be obliged to use their positions to collect bribes as a way of making ends meet, particularly when the expected cost of being caught is low. In addition to government regulations as an occasion for corruption, other reasons for corruption have been identified.

Natural resource endowments (oil, gold, exotic lumber) constitute a textbook example of a source of rents, since they can typically be sold at a price that far exceeds their cost of extraction and their sale is usually subject to stringent government regulation, to which corrupt officials can turn a blind eye.

Resource-rich economies may be more likely to be subject to extreme rent-seeking behavior than are resource-poor countries.

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

Conclusion. While there is a large consensus in the literature on the negative impact of corruption on economic growth, some researchers continue to argue that the effect of corruption on growth is context specific and associated with factors such as the country's legal and institutional framework, quality of governance and political regime. They conclude that, in some highly regulated countries that do not have effective government institutions and governance systems, corruption can compensate for red tape and institutional weaknesses and "grease the wheels" of the economy.

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