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What is corruption?

Corruption is a huge obstacle to sustainable economic, political and social development for all economies. **Catherine Youds** investigates how it occurs and what governments can do to curb it

In 1968, future Nobel prizewinning economist Gunnar Myrdal claimed that corruption is virtually a taboo subject among economists. Much has changed in economics since then and it is now widely accepted that corruption has a significant impact on economic performance. The Organisation for Economic Cooperation and Development (OECD) states that corruption is one of the main obstacles to sustainable economic, political and social development, for developing, emerging and developed economies alike.

Classifying corruption

According to Transparency International, corruption is defined as 'the abuse of entrusted power for private gain.' It also identifies three classifications of corruption — grand, petty and political, depending on

the amounts of money lost and the sector in which it occurs.

Grand corruption occurs at a high level of government and enables leaders to benefit at the expense of the public good. Petty corruption occurs in everyday abuse of entrusted power by low- and mid-level public officials affecting ordinary citizens' access to basic goods or services such as hospitals, schools and police departments. Finally, political corruption occurs where policies, institutions and rules of procedure in resource allocation are manipulated by political decisionmakers to sustain their power, wealth and status.

What constitutes corruption?

Corruption can include acts of bribery, embezzlement, nepotism or state capture. It is often associated with or reinforced by other illegal activity. The OECD give examples of how corruption can emerge:

- a multinational company that pays a bribe to win the public contract to build a local highway, despite proposing a substandard offer
- a politician redirecting public investments to his hometown rather than to the region most in need
- a public official embezzling funds for school renovations to build his private villa,

or a manager recruiting an ill-suited friend for a high-level position
- a local official demanding bribes from citizens to get access to a new water pipe

All of these examples suggest that those hurt most by corruption are the world's weakest and most vulnerable.

Corruption Perception Index

The scale of corruption is impossible to measure with complete accuracy due to its nature. Transparency International publishes a number of assessments, surveys and indices that measure corruption. The Corruption Perceptions Index (CPI), launched in 1995, is the most cited measure. It allows for corruption to be placed on the international political landscape.

The index, which ranks 180 countries and territories by their perceived levels of public-sector corruption according to experts and businesspeople, uses a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean. The 2017 index found that more than two-thirds of countries score below 50, with an average score of 43.

In 2017, New Zealand and Denmark ranked highest with scores of 89 and 88 respectively. Syria, South Sudan and Somalia ranked lowest with scores of 14, 12 and 9 respectively (see Tables 1 and 2).

The best-performing region is western Europe with an average score of 66. The worst-performing regions are sub-Saharan Africa (average score 32) and eastern Europe and Central Asia (average score 34). Further analysis of the results indicates that countries with the least protection for press and non-governmental organisations (NGOs) also tend to have the worst rates of corruption. Every week at least one journalist is killed in a country that is highly corrupt.

The costs of corruption

The cost of corruption is the negative impact it has on the global economy and human development. Research by PricewaterhouseCoopers found industries that businesses felt were most affected by corruption were those that were commodity intensive, i.e. mining, construction and coal/gas extraction.

Such extractive industries tend to require certain permits and need official interaction with the government. This interaction creates opportunities for bribery to take place and therefore corruption. These industries also tend to be in less-developed economies, which are known to have more problems with corruption.

Corruption reduces efficiency and increases inequality. Estimates show that the cost of corruption equals more than 5% of global GDP (US$2.6 trillion) with over US$1 trillion paid in bribes each year.

The overall cost can be broken down into four main areas.

Increased costs to businesses and relatively low tax collection

Corruption acts as an extra tax for businesses and increases their costs. Bribery can be expensive and the negotiations can be lengthy. This additional fee or increase in operational costs will only impede a firm's performance. These costs are passed to the consumer, which reduces consumer welfare. This will have the most impact on goods and services with inelastic demand.

The World Bank found that firms that pay bribes are likely to spend more time trying to deal with red tape and regulatory burden as corruption brings with it the risk of prosecution, important penalties,

The costs of corruption are eventually passed to the consumer

Table 1 The top-ranked (least corrupt) countries in the CPI

2017 rank	Country	2017 score	2016 score	2015 score	2014 score	2013 score	2012 score
1	New Zealand	89	90	91	91	91	90
2	Denmark	88	90	91	92	91	90
3	Finland	85	89	90	89	89	90
3	Norway	85	85	88	86	86	85
3	Switzerland	85	86	86	86	85	86
6	Singapore	84	84	85	84	86	87
6	Sweden	84	88	89	87	89	88
8	Canada	82	82	83	81	81	84
8	Luxembourg	82	81	85	82	80	80
8	Netherlands	82	83	84	83	83	84
8	UK	82	81	81	78	76	74
12	Germany	81	81	81	79	78	79

Source: Transparency International

Table 2 The bottom-ranked (most corrupt) countries in the CPI

2017 rank	Country	2017 score	2016 score	2015 score	2014 score	2013 score	2012 score
169	Iraq	18	17	16	16	16	18
169	Venezuela	18	17	17	19	20	19
171	Equatorial Guinea	17	N/A	N/A	N/A	N/A	N/A
171	Guinea-Bissau	17	16	17	19	19	25
171	Korea, North	17	12	8	8	8	8
171	Libya	17	14	16	18	15	21
175	Sudan	16	14	12	11	11	13
175	Yemen	16	14	18	19	18	23
177	Afghanistan	15	15	11	12	8	8
178	Syria	14	13	18	20	17	26
179	South Sudan	12	11	15	15	14	N/A
180	Somalia	9	10	8	8	8	8

Source: Transparency International

blacklisting and reputational damage. Bribery does not guarantee the firm will receive the business in return, which creates business uncertainty. It is likely that there will be other corrupt competitors willing to provide a higher bribe.

As corruption distorts fair competition and markets, it deters domestic and foreign direct investment. This suppresses future opportunities for businesses and reduces growth. Research from the International Monetary Fund shows that investment in corrupt countries is almost 5% less than in countries that are relatively corruption-free.

On average it is estimated that corruption increases the cost of doing business by up to 10%. Siemens, the German engineering giant, had to pay penalties of US$1.6 billion in 2008 to settle charges that it routinely engaged in bribery around the world.

Inefficient use of public resources

Several studies provide evidence of the negative correlation between corruption and the quality of government investments, services and regulations. There is allocative inefficiency with public resources that have been diverted for private gain. In theory, available investment should be allocated to sectors and programmes which present the best value for money or where needs are highest. However, where there is corruption, investment is allocated to projects that offer the best prospects for personal enrichment to corrupt politicians, e.g. infrastructure projects or military procurement where bribes are high, rather than education and healthcare.

Ideally, the most qualified and suitable company would win a public bid. However, if that company is not willing to bribe, they will lose the contract to the company willing to pay the highest bribe. This has a negative impact on the quality of the service or good provided. Where corruption is particularly high, public funds may simply be diverted from their intended use, embezzled and exploited for private enrichment.

The bureaucratic process is dramatically slowed down, which increases its inefficiency. However, the slower and more inefficient the bureaucratic process is, the more opportunity for officials to take bribes. For example, the longer the queue for a service, the higher the incentive for citizens to bribe to get what they want.

Exclusion of the poor from public services and perpetuating poverty

In a corrupt society, it is necessary to have access to those who make the decisions in order to buy certain goods and services. The poor will generally not have access to the decision makers. Only the rich or well-connected members of society will be able to access particular resources.

The reduction of extreme poverty and persistent income and wealth inequality is lessened. The poor bear the largest burden of higher tariffs in public services imposed by the costs of corruption, as they have no alternative to the public offers. They also cannot afford the bribes that other people can and are excluded from accessing basic services such as healthcare and education.

The embezzlement or diversion of public funds further reduces the government's resources for development and poverty-reduction spending. The significant impact of corruption on income inequality and the negative effect of corruption on income growth for the poorest 20% of a country have been proven empirically (Gupta

Somalia currently occupies the lowest rank in the Corruption Perception Index

et al. 2002). The World Bank estimates that each year US$20 to US$40 billion, corresponding to 20% to 40% of official development assistance, is stolen through high-level corruption from public budgets in developing countries and hidden overseas.

Uncertainty and decreasing public trust in government

A lack of trust in government and wider institutions leads to a breakdown of social capital. The existence of bribes enables government regulation to be circumvented. There can often be corruption in the political processes, i.e. elections or party financing, which undermines democracy. Any critics of the process are silenced by bribes, which worsens the situation.

If basic public services are not delivered to citizens due to corruption, the state eventually loses its credibility and legitimacy. As a result, disappointed citizens might turn away from the state, retreat from political processes, migrate or stand up against what they perceive to be the corrupt political and economic elites. Recent uprisings such as the 'Arab Spring' and the Occupy Wall Street movement are proving that business-as-usual can no longer be an option for a number of countries.

How can businesses and governments fight corruption?

The costs of corruption for economic, political and social development are becoming increasingly evident. However, evidence of these are little known to the public and are not always drawn upon in political debates. The fact that 68% of countries have a serious problem with corruption suggests that greater efforts must go into strengthening governance across the globe. It should be in governments' and businesses' interest to contribute to combating the problem.

Strategies to fight corruption require transparency, a clear legal framework,

stronger anti-corruption laws, a credible threat of prosecution and a strong drive to deregulate economies. Nepotism in private and public organisations brings incompetent people into power, weakening performance and governance, thus highlighting the need for strategies that allow true democracy.

Recommendations

Transparency International suggests that the global community needs to take the following actions to curb corruption:
1 Governments and businesses must do more to encourage free speech, independent media, political dissent and an open and engaged civil society.
2 Governments should minimise regulation on media, including traditional and new media, and ensure that journalists can work without fear of repression or violence. In addition, international donors should consider press freedom relevant to development aid or access to international organisations.
3 Civil society and governments should promote laws that focus on access to information. This access enhances transparency and accountability while reducing opportunities for corruption. It is important, however, for governments not only to invest in an appropriate legal framework for such laws, but also commit to their implementation.
4 Activists and governments should take advantage of the momentum generated by the UN Sustainable Development Goals (SDGs) to advocate and push for reforms at the national and global level. Specifically, governments must ensure access to information and the protection of fundamental freedoms, and align these to international agreements and best practices.
5 Governments and businesses should disclose relevant public-interest information. Proactive disclosure of relevant data, including government budgets, company ownership, public procurement and political party finances allows journalists, civil society and affected communities to identify patterns of corrupt conduct more efficiently.

Are there any benefits of corruption?

Despite the fact that corruption is considered detrimental to growth and development, some research suggests that it is an 'instrument to grease the wheels'.

Huntington, Lui and Lein suggest that corruption actually helps to overcome cumbersome bureaucratic constraints, inefficient provision of public services and rigid laws, particularly evident in countries where institutions are weak and function poorly. It is argued that reduced regulations can limit bribery opportunities and provide companies more opportunity to grow without them.

Conclusion

Public-sector corruption siphons $1.5 trillion to $2 trillion annually from the global economy in bribes and costs far more in stunted economic growth, lost tax revenues and sustained poverty, with the poor and vulnerable suffering most from corruption.

Despite improvements in economists' attitudes towards what once a taboo subject, there is clearly still a long way to go in order to eliminate corruption. It is not only a question of ethics — the global economy simply cannot afford such waste. Tackling corruption is critical for the achievement of macroeconomic stability. Trying to reduce corruption is very difficult and requires years of sustained effort. However, the opportunities are significant for governments and businesses, and therefore the global economy. Good governance is an essential part of the solution to the global policy challenges governments face today.

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