

The Costs of Corruption

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Why fight against corruption? In many economies, corruption is institutional and dealing with it on a daily basis seems more convenient than combating it. Looking at corruption as an economic issue means that corruption is more than simply a wrong behavior. It means that corruption, while benefiting a few individuals, is costly to society, the private sector, and governments in the long run. Corruption must be rooted out because it:

Misallocates resources

Resources that otherwise could be directed towards production of goods and services are often devoted to corruption. This includes direct resources involved in cash transfers and indirect ones, such as maintaining contacts with government officials or providing an operation or production license to a less efficient firm. Corruption also misallocates resources that could otherwise be used for provision of public services. Funds for licenses or tax income, instead of contributing to the budget, may simply end up in the pockets of corrupt government employees. Also, resources are not used most efficiently, as it is not the most efficient but, rather, the best-connected firm that gets a government contract.

Fosters misguided and unresponsive policies and regulations

In the systems that are corrupt, lawmakers will often generate policies and regulations that are not intended to improve overall economic or political environment. Rather, they benefit a few who are close to the decision makers or those who are bribing government officials to pass a favorable regulation.

Lowers investment levels

Corruption has negative effects on the levels of both foreign and domestic investment. Investors will ultimately avoid environments where corruption is rampant because it increases the cost of doing business and undermines the rule of law. Corruption is also often associated with a high degree of uncertainty, something that always drives investors away.

Reduces competition and efficiency

Government officials demanding bribes for providing or denying services like licenses or permits limit the number of firms able to enter the market, thereby creating a "rent-seeking" environment that forces companies that are unwilling or unable to pay

bribes into the informal economy. Rent seeking sometimes leads to trade protectionism, and also to the fact that bad quality or inefficiently produced inputs result, which in turn lowers effectiveness, productivity, and competitiveness. Overall, the lack of competition hurts consumers, who receive fewer technologically advanced goods and goods of otherwise lower quality and pay higher prices for these goods.

Lowers public revenue for essential goods and services

Tax evasion, one of the biggest threats to government revenue flow, is widespread in corrupt countries because firms that are informal do not report their profits and subsequently do not pay taxes. Also, firms that operate in the formal economy will pay bribes instead of taxes when tax administration is corrupt or opportunities for abuse of the tax code are widespread. Moreover, corrupt government agents take for themselves fees and payments they collect from firms for the state budget, thus depriving government of funds needed to provide essential goods and services.

Increases public spending

Public investment projects often offer opportunities for government officials to get bribes. Simply put, faced with the possibility to directly benefit from awarding contracts to cronies, government officials will promote as many public investment projects as possible. In fact, these scandals erupt not only in corrupt developing countries, but also in more developed nations where corruption is less rampant. In many countries, it is sometimes the case that projects awarded to cronies are never finished as funds simply get stolen. Corruption also causes mismanagement of public investment projects and thus contributes to larger fiscal deficits, jeopardizing sound fiscal policy.

Lowers productivity and discourages innovation

In corrupt systems, individuals and firms spend time and resources engaging in corruption (paying bribes, nurturing relationships with corrupt agents, etc.) rather than in growth-enhancing activities. Also, corruption discourages innovation, as corrupt systems lack rule of law institutions that protect property rights.

Increases costs of doing business (serves as a tax on business)

Time and money spent on bribing government officials and dealing with complex regulations increases the costs of doing business. These costs are either passed on to the consumers through increased prices or products of lower quality or serve as a barrier to market entry by firms. Also, corrupt judicial systems limit the ability of business to enforce contracts, hindering normal operation and blocking new opportunities.

Lowers growth levels

Corruption hurts small enterprises because the high costs of corruption (time and money) are harder to sustain for smaller firms than for larger firms. Generally, small firms have less power to avoid corruption, and they tend to operate in highly competitive environments and, thus, can't pass on the costs of corruption to customers. Thus, in corrupt environments, it is harder for small businesses to survive,

and this hurts an economy's growth rate because small firms are the engine of growth in most economies.

Lowers private sector employment levels

By forcing business into the informal sector, creating barriers to entry, and increasing the costs of doing business, corruption essentially reduces private sector employment because firms are less likely to grow and expand.

Reduces the number of quality public sector jobs

Corrupt governments often offer many low-paying jobs to patronize key constituents. Also, the quality of public jobs suffers in corrupt systems because government officials spend resources on extorting bribes rather than providing services. For example, in many cases, within licensing agencies, public officials will simply stall the licensing process if they don't receive additional payments or gifts.

Exacerbates poverty and inequality

Corruption lowers the income-earning potential of the poor because there are fewer private sector opportunities. Also, by limiting spending on public sector services, corruption facilitates inequality. It limits access to such essential resources as health care and education.

Undermines the rule of law

Corruption creates a culture where government officials are not held accountable for their actions. Also, in corrupt systems, laws and regulations on paper are not enforced consistently and fairly. Therefore, what matters is not the law but whom you know and how much you are willing to pay.

Hinders democratic, market-oriented reforms

In order to be successful in building market economies and democratic societies, countries have to build and develop institutions that provide the enforcement of laws and ensure a transparent and inclusive policy-making process. In corrupt systems, developing such sound and well-designed institutions is an arduous task. Corrupt government officials responsible for reforms are less likely to take measures that will directly limit their ability to personally benefit from bribes and kickbacks. Corruption also undermines the legitimacy of public office and hurts the democratic process by discouraging people from participation.

Increases political instability

Widespread corruption contributes to political instability because citizens are encouraged to oust leaders who are corrupt and who can't effectively represent the interests of people.

Contributes to high crime rates

Corruption fosters a system with a high disregard for the rule of law and creates a society where legal, judicial, and enforcement institutions are ineffective. In corrupt systems, it is easy for crooks to buy their way out of punishment. Corruption not only

leads to political and corporate crime, but it is also responsible for fostering organized crime.

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