

Brol M., *Institutional determinants of corruption*, „Ekonomia i Prawo. Economics and Law”, Polszakiewicz B., Boehlke J. (ed.), Vol. 15, No. 1/2016, pp. 21–32. DOI: <http://dx.doi.org/10.12775/EiP.2016.002>.

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INSTITUTIONAL DETERMINANTS OF CORRUPTION[◇]

SUMMARY

Corruption is a phenomena which regards every society in both, geographical and historical context. Information on the phenomena in question occurs in many sources in writing and in legends told from generation to generation. Contemporary observations prove there is no society without the corruption. Some differences regarding scale and intensity of the phenomena exist, however, it is present in every country irrespective of economic and legal systems.

Corruption is widely regarded as a negative phenomenon for the economy and unfair from the social point of view. Criminalization of this phenomenon has not, however, led to its disappearance. In some countries, contrary to the current regulations, it has become widespread, displacing other forms of exchange. This applies particularly to countries with weak institutions. Their weakness may result from changes in political or cultural factors.

Goal of the paper is to point out the institutional determinants of corruption. A tool used to complete a goal is examination of indexes picturing corruption level as well as a case study — including countries characterized by serious and little concentration of the phenomenon in question. Because of formal restrictions regarding volume of the paper, just the most crucial facts and relations are demonstrated.

Keywords: corruption; institutions; corruption perceptions index

JEL Classification: D02; D73

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[◇] The article was funded by Wrocław University of Economics.

INTRODUCTION

“Institutional sources of corruption” shall mean all sources related to functioning of legal standards, but also certain non-formal principles functioning in a society. It comes about both, ineffective regulations, non-observance of law, breaking of social norms and also about weak efficiency of official authorities. Some standards accepted in a society may arise from traditional forms of behavior but also from historical events. Moreover, also institutional background is important in form of accepted and functioning social & economic system.

1. SIGNIFICANCE OF CORRUPTION PHENOMENON

In the theory of economics the corruption is deemed, most of all, a source of undue profits. Contrary to sociological approach to the issue, economists usually do not examine the corruption as a hazard but they focus on its impact on the efficiency of an economy. Effect of the corruption is lower efficiency of a public sector, it changes form of the market, it reduces expenses, it promotes and enables functioning of a black market¹. Nevertheless, there are definitions which define corruption as a secret form of exchange of products and services or other benefits between partners of a corruption deal — a giver and a receiver, motivated by an intent to acquire personal profits². This definition is based on the *homo oeconomicus* concept, which was criticized recently and recognized to be insufficient to describe and explain human behavior. Contemporary economists consider corruption as a use of public resources to maximize private benefits, without focus on a wide context i.e. social political, market, interpersonal and institutional. It is also a mistake to limit bribery process to the public sector since it has been irrefutably proved it can also exist in a private sector³. Satisfactory attempts to explain this phenomenon took place by means of an agency theory⁴, which establishes formal relations among economic entities, including individual motivation, it points out rights

¹ S. Rose-Ackermann, *Korupcja i rzady*, Fundacja im. Stefana Batorego, Wydawnictwo Sic!, Warszawa 2001, p. 44.

² A. Kojder, *Korupcja*, [in:] W. Kuczyński (ed.), *Księga dziesięciolecia Polski niepodległej 1989–1999*, Warszawa 2001, p. 1019.

³ N. Iyer, M. Samociuk, *Fraud and Corruption: Prevention and Detection*, Gower Publishing, Ltd., Aldershot 2006, pp. 1–4.

⁴ Cf. A. Wojtyna (ed.), *Instytucjonalne problemy transformacji gospodarki w świetle teorii agencji*, Wydawnictwo Akademii Ekonomicznej w Krakowie, Kraków 2005.

and assigned competences as well as held information. Such an approach was also applied in this paper.

It is necessary to provide details of what a corruption is. The following definition of the examined phenomenon has been accepted. Corruption is a social & economic process, which is a non-market form of exchange of secret and illegal character.

Goods allocation process takes place in exchange for bribes and hence, it can be called a corruption mechanism. Basic goal of a person, who bribes, is purchase of goods or privileges in order to extend range of profits. In microeconomics scale it can be concluded that such behavior results in extended opportunities to satisfy needs, in other words, to reach higher level of usefulness of consumption. Similarly, this mechanism works in case of a company, however, instead of increase in total usefulness it comes about extended production capabilities arising from acquisition of factors of production by a company, which bribes.

In both cases the corruption mechanism results in many profits acquired by a bribing party and the receiver as well. Nevertheless, it should be emphasized that such a distribution means reduced availability of goods to all other persons/entities. It can also cause additional costs for persons / entities, which are not a party to the corruption (based) exchange. E.g. if a subject of corruption is an administrative decision concerning a building permit for an object, arduousness of which would cause it could not be erected in a legal way, an effect is reduction of total usefulness for all neighbors, whose life standard will be impaired. Hence, enhanced usefulness for a single person/entity takes place at the expense of all other persons/entities. Therefore, it is contrary to the Pareto optimality principle as well as Kaldor–Hicks efficiency criterion.

2. CORRUPTION VOLUME

In order to measure this phenomenon corruption perceptions index (CPI) is applied. Nevertheless, structure of this index is far from being perfect. It is based on anonymous questionnaires. Respondents determine the way they perceive the corruption and they describe their experiences related to this issue. Hence, methodology of the index is based on subjective observances since respondents may exaggerate the problem under influence of media and other factors, or, being afraid of legal consequences or political repressions, not to reveal their experiences. Although there are other indicators describing the level of corruption, nevertheless they are less useful from the point of view of economic theory. One of these is the Global Competitiveness Index, name-

ly one part of the index, which is the quality of the institutions. This notion, however, is much broader than the corruption, because it concerns the quality of the state administration, accounting and reporting rules. Therefore, this report was not taken into account.

Admittedly, alternative indexes exist (e.g. Rule of Law Index developed by organization: The World Justice Project and Eurobarometer survey conducted by the European Commission), however, apart from similar methodological problems, their additional disadvantage is lower number of examined countries.

The CPI index may take values from 0 to 100, where 0 means corruption in every aspect of life while 100 – means no corruption. In practice these extremities do not exist since, from one hand, corruption cannot replace market exchange totally and from the other hand, total elimination of the corruption is not possible. Ranking of certain countries, mainly the least and most corrupt, as well as selected European countries, based on the CPI in 2014 is demonstrated in the table 1.

Table 1. Value of the CPI in selected countries in 2014

Country Rank	Country	CPI Score
1	Denmark	92
2	New Zealand	91
3	Finland	89
4	Sweden	87
5	Switzerland, Norway	86
7	Singapore	84
8	Holland	83
9	Luxembourg	82
10	Canada	81
14	United Kingdom	78
17	USA	74
26	France	69
31	Portugal, Cyprus, Botswana	63
35	Poland	61
69	Italy, Greece, Bulgaria, Romania	43
119	Belarus	31
136	Russia	27
142	Ukraine	26
172	Afghanistan	12
173	Sudan	11
174	North Korea	8
174	Somalia	8

Source: Transparency International, *Corruption Perceptions Index 2014*, Berlin 2014.

Four groups of countries characterized by varied corruption phenomena concentration can be singled out. The least corrupted countries are developed ones with solid democratic political system: members of the European Union, Canada, USA, Australia, New Zealand and developed countries of Southern-East Asia: Japan, Taiwan, Singapore, Hong Kong and South Korea. Second group of middle level corruption index countries comprises: countries of Latin America, South Africa and other countries of South-East Asia. Among the countries characterized by high corruption index there are countries of Sub-Saharan Africa and former USSR (Union of Soviet Socialist Republics) republics. Countries affected by corruption to the greatest extent: Iraq, Afghanistan, Sudan, Somalia, Myanmar, North Korea, Haiti. Their common attribute is atrophy of the national institutions caused by social riots or a civil war.

3. COMPETENCES ASSIGNED TO AGENTS AND THE CORRUPTION

Sources of corruption — both, institutional and economical are related each other. It means that institutional circumstances may affect behavior of economic entities and reversely — basic tendencies of a human to maximize consumption and consequently, all available benefits, may affect the institutional sphere. It comes about officials — agents' power to establish regulations and to implement legal norms. Unquestionably, the situation takes place in case of bureaucratic organizational structures which are characteristic for the public sector. By individual goals, officials may strive for maximization of bureaucracy, which was described by J. Stiglitz⁵, or use their competences to acquire benefits arising from corruption.

Actions of officials based on a search for a surplus originating from illegal and secret corruption exchange is in contradiction with institutional order deemed to be system of fundamental political, social and legal norms which regulate political & economic activity of a society⁶. In an environment defined in such a way, institutions are restrictions developed by people, which determine political, economic and social interactions⁷. They were estab-

⁵ J. Stiglitz, *Ekonomia sektora publicznego*, PWN, Warszawa 2004, p. 238.

⁶ L. Davis, D. North, *Institutional Change and American Economic Growth: A First Step Towards a Theory of Institutional Innovation*, "The Journal of Economic History", Vol. 30, No. 01/1970, p. 133.

⁷ D. North, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge 1991, p. 97.

lished in order to regulate social sphere and ensure better conditions for market functioning. However, because of increased transactional expenses such as costs of contracts and expenses arising from inspections, insufficient inveteracy of institutions in a society may cause an intent to omit extensive (in opinion of a society) expenses and consequently, to bypass existing rules.

Moving considerations concerning institutions into the area of the agency theory it should be concluded that potential tendency of an agent to corruption is based on tendency to maximize private benefits and moreover, it is supported or weakened by institutional environment. Serious incentives of institutional nature, both, formal ones — such as binding norms, and informal, such as customs, traditions and behavior patterns may strengthen or weaken an intent to receive or to give a bribe. Examples of post-USSR countries, Balkan countries as well as experiences of Southern Italy picture how informal institutions can support corruption. Formal institutions — country of law and system of law (justice) were replaced by informal ones — mafia and other criminal organizations.

Nevertheless, great institutional incentives — formal and informal ones, can reduce the corruption as well. The first group comprises solutions accepted by Singapore and Hong Kong as well as those copied in Botswana and Poland — there were established structures specialized in anti-corruption operations provided with adjusted legal and operational instruments. The second group i.e. group of informal institutions, comprises behavior patterns accepted by Protestant societies of Western and Northern Europe.

The most serious supporter of corruption is lack of institutions or their insufficient capabilities. Such a situation is characteristic for Sub-Saharan Africa countries. Ineffective law and weak country provide officials — agents, with freedom in the field of maximization of private profits by means of bribes. In this particular case there occurs issue of a multiplied agency that is bribery between junior and senior officials. It generates a phenomenon called “corruption pyramid” for needs of this paper, where cash transfers flow from the society to officials by means of a bureaucracy system. Officials use competences they got from their principals and increase their incomes from bribes. Nevertheless, in order to be beneficiaries of the system they need to remunerate their principals for this capability. In turn, principals remunerate their principals etc. Final beneficiary of the corruption system is a person, who holds the highest position in the system and “victims” are persons, who belong to the bottom of the (social) ladder.

4. INSTITUTIONAL IMPERFECTIONS WHICH SUPPORT THE CORRUPTION

4.1. ATROPHY OF A COUNTRY

An extreme case of lack of the institutional environment is atrophy of (official) structures of a country. No structures (institutions) and deficiency of essential public goods such as public defense, system of justice, public safety, disable functioning of the market mechanism. In such a situation no protection of ownership rights causes atrophy of the market. Inability to conclude a transaction causes, in turn, replacement of the market mechanism with other forms of allocation. Usually, the exchange process is replaced by a takeover, which is a form of violence. It took place in Sudan and Somalia, partially also in Afghanistan and, in a certain period, in Iraq. In all of the aforementioned countries civil wars have been waged for several years and the public administration is not able to control most of the territory.

As it results from examination of the corruption perception index, in these countries the index in question gets the lowest values in the world. The most probably because acquisition of goods or just access to any goods is involved with a bribe given to a person, who previously seized the goods or resources. At the same time institutions of a country are not strong enough to counteract such a situation. The most meaningful example of this is seizure of humanitarian aid by persons who manage refugee camps in Somalia⁸ and theft, by Hamas, of aid intended for Palestinians in the Gaza Strip. Embezzled foodstuffs and clothes are delivered to those they were intended for, after they have paid a bribe or rendered particular service.

Softer, from total atrophy, sign of imperfection of a country are defects of legislation system. Neither ideal bureaucracy nor perfect legal system exist. Range of corruption in an economy depends, to the large extent, on quality of regulations, control (or self-control) of their functioning and efficiency of legal regulations enforcement. It is confirmed by observances conducted on the grounds of the CPI index. Among the least corrupted countries there dominate those of solid democracy or those, which imposed deep institutional reforms at certain stage of their functioning, which enhance operation of structures of a country. This group comprises countries of the Western Europe and those, which function acc. to a widely-recognized European pat-

⁸ M. Kula, *Znika jedzenie dla głodujących Somalijczyków. Trafia na targi przy obozach. ONZ bada sprawę*, http://wiadomosci.gazeta.pl/wiadomosci/1,114873,10124687,Znika_jedzenie_dla_glodujacych_Somalijczykow__Trafia.html (20.03.2014).

tern (USA, Australia, New Zealand) and reformed Asian republics (Hong Kong, Singapore, Taiwan and Japan).

Among the group of countries striving for improvement of regulations and thus, aspiring to the elite of the countries characterized the lowest index of corruption, are Central Europe countries such as: Poland, Czech Republic, Slovakia, Hungary, Lithuania, Latvia, Estonia, Slovenia, Croatia, Romania and Bulgaria. At the present stage of the transformation one may observe characteristic attributes of the countries in question. Namely, inconstancy of regulations concerning functioning of a country and cyclic fluctuations of corruption perception index arising from corruption scandals, which have been discovered from time to time. However, final balance of reforms, which have been implemented, is positive since the corruption index has been regularly falling down in a long-time. It is contrary to the other countries of the former Eastern block, which have not implemented such reforms. Mostly, it concerns former USSR republics such as Russia, Ukraine, Belarus and former Yugoslavia republics, in particular Bosnia & Herzegovina and Serbia.

A group of countries characterized by the most defective and the weakest institutions comprises Arab countries, in particular those situated in North Africa and the majority of Sub-Sahara Africa countries. Nevertheless, there are exceptions confirming the impact of the quality of regulations establishing institutions and the regulations themselves on the corruption index. Namely Botswana, Namibia, Rwanda in Africa and Qatar, U.A.E., Kuwait, Oman, Saudi Arabia and Jordan in the Middle East. In case of Botswana, effective, unambiguous and clear law, including anti-corruption law is similar to European laws, which positively distinguishes this country in the background of neighbors. Different situation takes place in Rwanda. After the civil war had been over it implemented legal solutions which are intended to prevent potential conflicts in the future. Nevertheless, they made it, de facto, a police country. Similar political and legal system formed in afore-enumerated Arab countries. Although it has disabled development of democracy, it prevented growth of crime including corruption.

In Saudi-Arabia, Oman, Qatar, U.A.E., Bahrain and, to the lesser extent, in Jordan and Kuwait, where basic source of legal regulations is Sharia, there function similar rules. Additionally, system of sever punishments is to discourage crimes, hence, relatively high level of social order is maintained and consequently, low corruption index. Although in many Arab and African countries similar solutions have been implemented, they are intended to keep power and maximize profits instead of keeping social order. Certain countries such as Iraq, Egypt, Libya, which based their legal norms on Islam, were not able or did not want to counteract the corruption. In most countries

of the Sub-Saharan Africa regulations are intended to strengthen dictators; their complexity and opacity promote corruption.

4.2 DICTATORSHIP AND AUTHORITARIANISM

There is low number of non-democratic countries in the world characterized by low corruption level. Their list generally is limited to the aforementioned few Arab countries. All remaining countries governed by dictators or in authoritarian way must face common phenomenon of corruption. It is evidenced by the following data – from among 90 countries rated by a Freedom House free ones⁹, just three: Argentina, Dominicana and Guyana are characterized by a low corruption perception index (not exceeding 35) and, in the ranking of corruption they take position above 100th place.

Among the most corrupted countries are those with the worse result of the freedom rate, at the 7.0 level: Somalia (CPI 8), North Korea (8), Sudan (11), Turkmenistan (17), Uzbekistan (18), Equatorial Guinea (19), Myanmar (21). There functions a corruption mechanism where a dictator and agents appointed by him/her administer all of public resources and distribute them into society in exchange for bribes. It makes flow of cash from inhabitants, through officials at the consecutive stages of the “bureaucracy ladder” directly to a dictator of a group, which holds the power. In turn it causes huge social inequalities. Functioning of this mechanism is possible because of seizure of the administration system including system of justice, police and army (by a dictator, who holds enforcement, legislative and judicial power).

4.3 SYSTEM OF RELATIONS

Around heads of countries, which are governed in a non-democratic way there usually occur people, who want to participate in share of profits. Additional maintenance of power requires support provided by supporters, who offer their services in exchange for remuneration. In this way a dictator, or an autocrat, erects a symbiotic relations with, as it was called during one of corruption scandals, “power holding group”. One of forms of accessing

⁹ Freedom House rates annually the democracy rate of all countries in the world, as well as range of human freedom and freedom of press. Values of the rate are displayed from 1 to 7, where 1 means the best result and 7 the worst. Final result enables assignation of country to one of three groups of countries: free ones (from 1.0 to 2.5), partially free (from 3.0 to 5.0), or characterized by lack of freedom (from 5.5 to 7.0). See: Freedom House, <http://www.freedomhouse.org> (11.04.2013).

such a group in order to demonstrate own claims, demands and requirements and to find support for them is a bribe.

However, systems of relations may function also in democratic countries, institutions of which are weak or have no sufficient impact on the informal relations system. An example of this can be mafia structures in Italy and oligarchs in Russia. In both cases we face a situation, where power of informal institutions exceeds power of formal institutions. In Italy, the country, although numerous attempts have taken place, cannot deal with the mafia problem. A few times it happened that mafia managed to enter its members into the official bodies of the country¹⁰. In turn, in Russia, authorities accepted power of existing networks of relations and they interfere into their structures in very exceptional cases only¹¹. An example can be a conflict of Kremlin with oligarchs and ones of the wealthiest persons in Russia: Michaił Chodorkowski and Borys Bierezowski.

Corruption level in Russia and other countries – former USSR republics, is very high and it results from informal relations between officials and business environment. Contemporary former USSR countries are usually governed in an opaque way. Although in most of them democratic system has been implemented, in fact elections are conducted acc. to a scheme which assures winning of previous authorities or persons appointed by the officials. Basic features of such a system are: opaque and unambiguous relations between politicians and oligarchs, limited freedom of media, weakened potential opposition by means of national safety official system and system of justice. Corruption heritage of the centralized economy in form of relations network was strengthened in such countries by means legal alterations made in final period of USSR functioning and occurrence of an oligarch class, which became privatization beneficiary (mainly raw materials and national enterprises). It is especially noticeable in Russia, Ukraine and Belarus where most of administrative activities depend on a bribe.

However, also in countries, which are considered to be institutionally effective, there can occur such networks. It is evidenced by approach of executives, who faced the financial crisis dated 2008. Informal relations in the business sphere are frequently based on mutual services rendered in exchange for minor favors. Also in Poland such networks exist which is confirmed by quite regular press information regarding illegally conducted public tenders, agree-

¹⁰ D. Gambetta, *Mafia sycylijska: prywatna ochrona jako biznes*, Oficyna Naukowa, Warszawa 2009, pp. 249–255.

¹¹ F. Varese, *Mafia rosyjska: prywatna ochrona w nowej gospodarce rynkowej*, Oficyna Naukowa, Warszawa 2009, pp. 273–279.

ments between companies erecting highways, pressure of gambling companies etc.

CONCLUSIONS

The most important conclusion concerns role of a country, or, public sector played in the field of corruption process and, at the same time, in the field of corruption prevention. In this case we face a specific dichotomy. From one hand, extension of the administration system increases risk of corruption, from the other hand, insufficiently developed national institutions cause that market rules are replaced by corruption mechanism. First of the problems is of organizational nature and depends on quality of legal standards and cultural circumstances. Methods of enhancement of the bureaucratic mechanism are commonly known, however, to implement them there is necessary a political will and consistency. This barrier is relatively easy to overcome which is evidenced by experiences of Singapore, Hong Kong and Botswana. Even if it is considered to be the most important element of battle against corruption, in fact, it not as significant as the system issues. Countries, where atrophy of the country structures took place (such as: Iraq, Afghanistan, Haiti, Myanmar, Sudan, South Sudan, Somalia), are affected by corruption to the largest extent. However, even little institutional weakness may cause increase in corruption level. It comes about inefficiency of national structures resulting in deficiency of respect for legal standards demonstrated by inhabitants and representatives of public administration, police, army and system of justice. Then, there takes place institutionalization of corruption i.e. bribery becomes part of general social norm and corruption approach becomes strengthened. Such a phenomena takes place in nearly all of the former USSR countries and Africa countries. Ideal situation would be establishing clear, common and most of all, respected legal norms within a country of law, and simultaneously, self-improvement of the bureaucracy system.

It needs to be stated clearly that the higher democracy rate is the less opportunities for corruption mechanism exist. Probability of corruption in an allocation process grows up as freedom of inhabitants goes down. Hence, the largest corruption rate is observed in totalitarian countries. A reason for this is, from one hand, no transparency and from the other hand, choice of private benefits instead of public wealth. In other words, striving of representatives of authorities to maximize individual profits and simultaneous negligence of public allocation. Experiences of Poland from the period of Polish People's Republic and contemporary experiences concerning Arab, African

and former USSR republics seem to confirm these observances. Under circumstances of deficiency of transparency and no rotations of persons, who make a share, those, who govern and their agents meet their individual needs using public resources. No possibility to verify their actions in form of free elections and lack of independent control institutions and media very frequently preserve such a situation.

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