

**Observed Differences in Corruption
between Asia and Africa:
The Industrial Organization of
Corruption and Its Cure**

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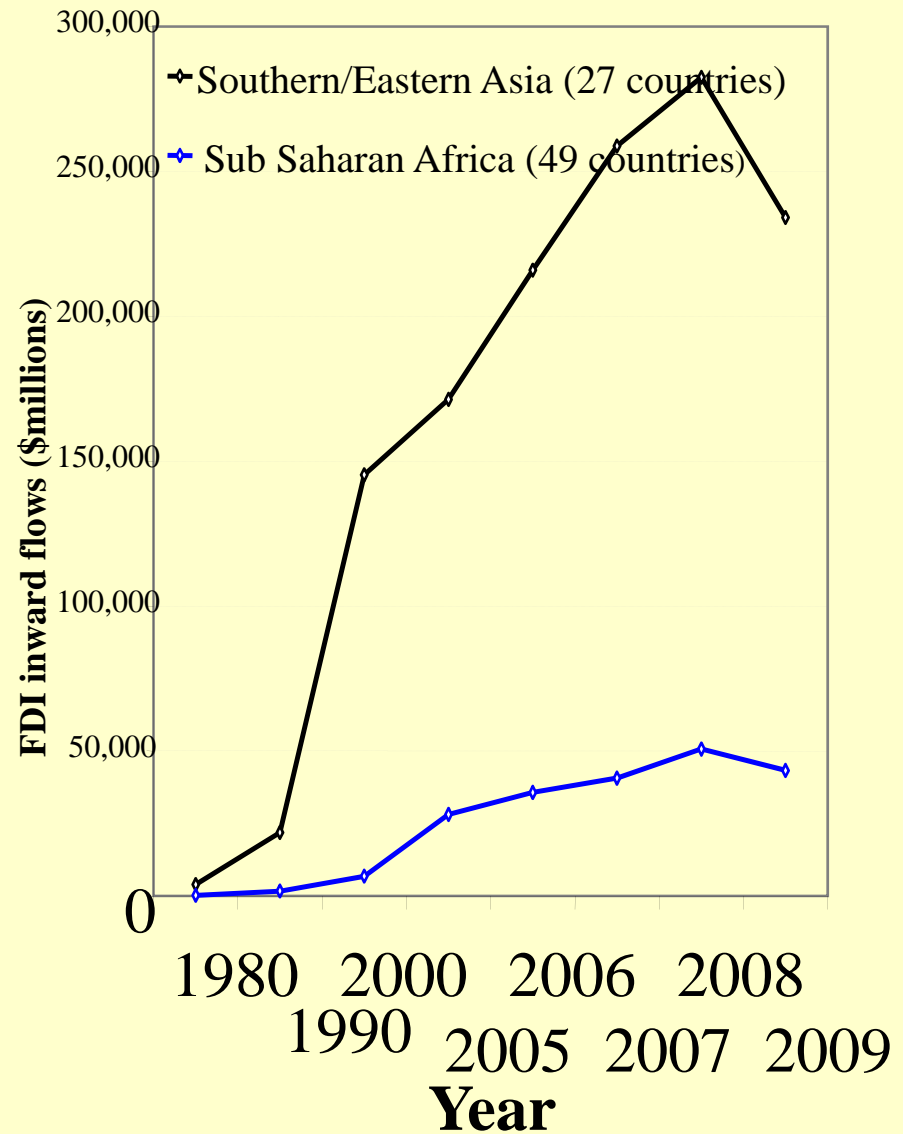
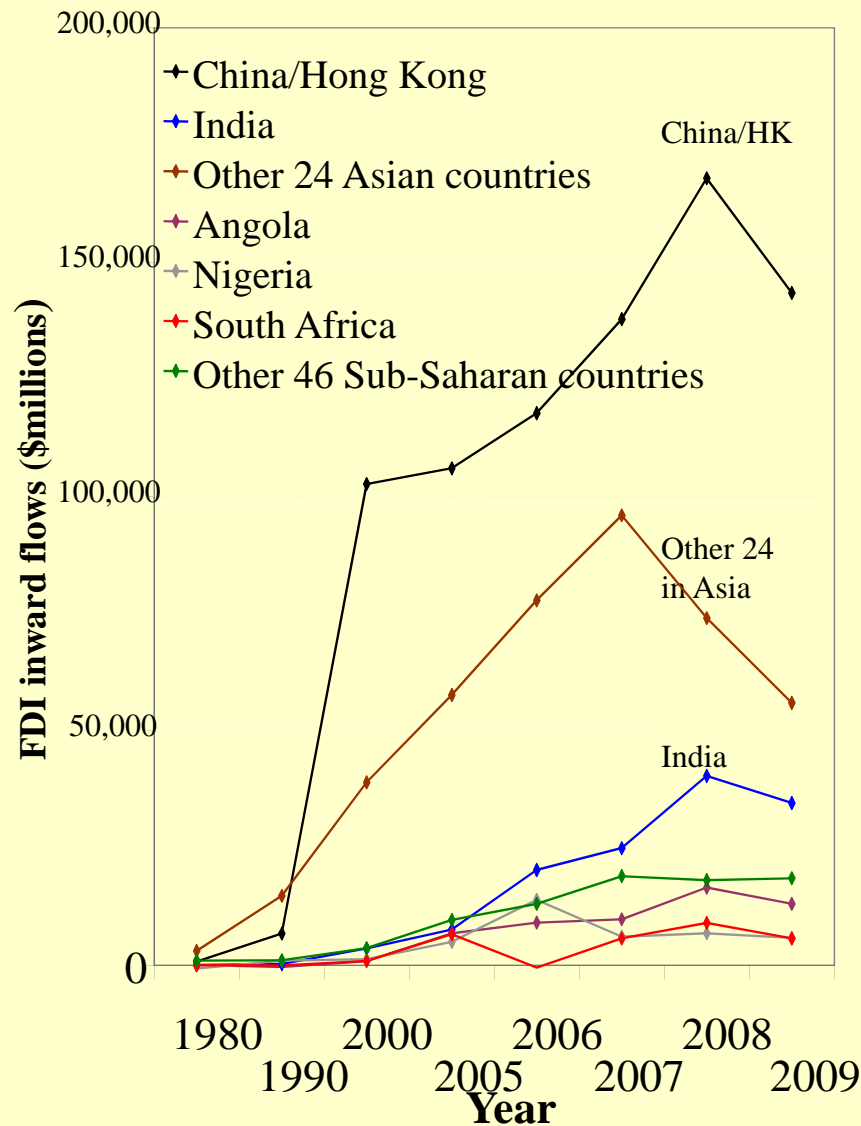
Received Definitions and Inferences

- *Corruption is the abuse of public power for private gains*
- *Corruption discourages investment and retards economic growth*
- *Corruption erodes private property rights*
- These definitions—given unrepressed greed of humans—imply existence of monopoly rents whose distribution is under the control of authorities that have discretionary power in non-transparent environment.

Empirical Evidence

- East Asian ‘miracle’ took place within inadequate institutional framework, systemic corruption and crony capitalism.
- The 90s crisis exposed what was known but not spoken: East Asian political economy was rigged with corruption and rent-seeking.
- Despite high levels of corruption, countries in East Asia attracted foreign investment, achieved remarkable economic growth and reduced absolute poverty

Foreign Direct Investment Inward Flows



Source: UNCTAD Handbook of Statistics (2010)

<http://www.unctad.org/templates/webflyer.asp?docid=14293&intItemID=2068&lang=1>

Recent Evidence: World Bank's GAC

- The “cancer of corruption” is a ‘moving target’ and context specific.
- Investment climate constrained by public sector bottlenecks and captured by politically influential persons.
- ‘Governance matters’ (also Kaufmann). Strong links between corruption and governance, and aid effectiveness.

Action plans from recent evidence

- Governance: decentralization, engagement civil society and communities, transparency in decision-making, curtailment of elite and state capture
- Procurement and fiscal management: from transaction-level risks to sector-level risks
- Detection tools: risk assessment, elaborate databases and monitoring systems, and “red flag” indicators.
- Punishment: zero tolerance of corrupt officials, persons and firms with coordinated punishment.

Summing up the evidence

- When corruption has significant negative effects it is endemic and part of leadership and governance ‘architecture’
- No shortage of studies about negative effects of corruption and of advice to ‘combat’ it.
- Recent literature on corruption has not presented codified theoretical or effective approaches to ‘cure’ corruption
- How can a country make significant economic progress in a short time in the presence of pervasive corruption?
- The 1997 WDR concluded that corruption in Asia is more predictable than in Africa. If so *why* is it more predictable?

Observations and revised definition

- *Corruption is a contractual relationship between economic agents for the misuse of entrusted power or position.*
- *There are four agents in corruption contract relationship: leader(s), private individuals, public officials and firms*
- *Corruption is part of the fixed cost in Asia but a variable cost in Africa. Result: in Asia corruption has not affected investment decisions at the margin, and its adverse effects on investments and economic growth are less.*

Two theoretical frameworks

- New Institutional Economics and (Modern) Psychoanalysis.
- The NIE gives a conceptual basis for analyzing corruption and governance structures.
- Modern psychoanalysis gives a theory of human motivation, and technique for individuals and groups.

Inferences from NIE

- Investments under a corrupt regime are riskier than under a non-corrupt regime because parties cannot safeguard themselves by writing contracts with *ex ante* obligations.
- Corrupted contract relationships are full of hazards and courts cannot be used to solve contractual ‘hold up’ disputes—most corruption is illegal .
- If one of the parties to the contract had invested in highly specific assets, he is vulnerable to later opportunistic behavior by the other party.

Corruption Contracts

- There are two types of contractual relationships in corruption
 - "Spot market" corruption contracts (e.g. paying a police officer to get away with a traffic violation)
 - Long-term corruption contracts: corruption that requires more than one interaction for transactions (e.g., winning a government contract).
- Corruption becomes part of the fixed cost of doing business when firms invest in a "relationship" — a governance structure — to organize and safeguard corrupt transactions and minimize ex post opportunism.

How is the fixed cost of corruption incurred?

- Businesses deploy resources to develop relationship grounded on trust, reputation and understanding
- Relationship-building as an *ex ante* safeguard is a means to create trust and to avoid 'hold-up'.
- Through repeated interactions
- Corruption in Asia is supported by fixed investment on governance structure
- Institutions in Asia foster trust and repeated interactions

Corruption in Africa is not supported by a specialized governance structure

- Corruption prevents businesses from appropriating their investment
- Business and government bureaucrats do not invest in developing relationships
- The institutions with which the society and governments are organized do not allow trust to develop

Why Corruption Is Not Part Of Fixed Cost in Africa?

- Short life span of government
- Poor leadership structure
- Unstable and poorly paid bureaucracy and civil service
- Ethnic differences prevent trust to develop among contracting parties
- Businesses find it difficult to consummate corruption contracts in Africa because of the deficient corruption infrastructure

Why change according to Cheung

When Cost of

[Operating the Current Institutions]

are greater than

[Adopting New Institutions + Operating Them]

- ***Current costs:*** Bribe (the smallest); Lack of property rights; Privileged groups face no competition; and, Exclusive rights and facilities at government expense
- ***Costs of change:*** Resistance by privileged groups; Critical role of the leader, Emotional contagion, Culture
- ***Costs of new regime:*** Prisoners dilemma; Private sector; Trade groups; OECD; Local participation; TA-processes and current initiatives.

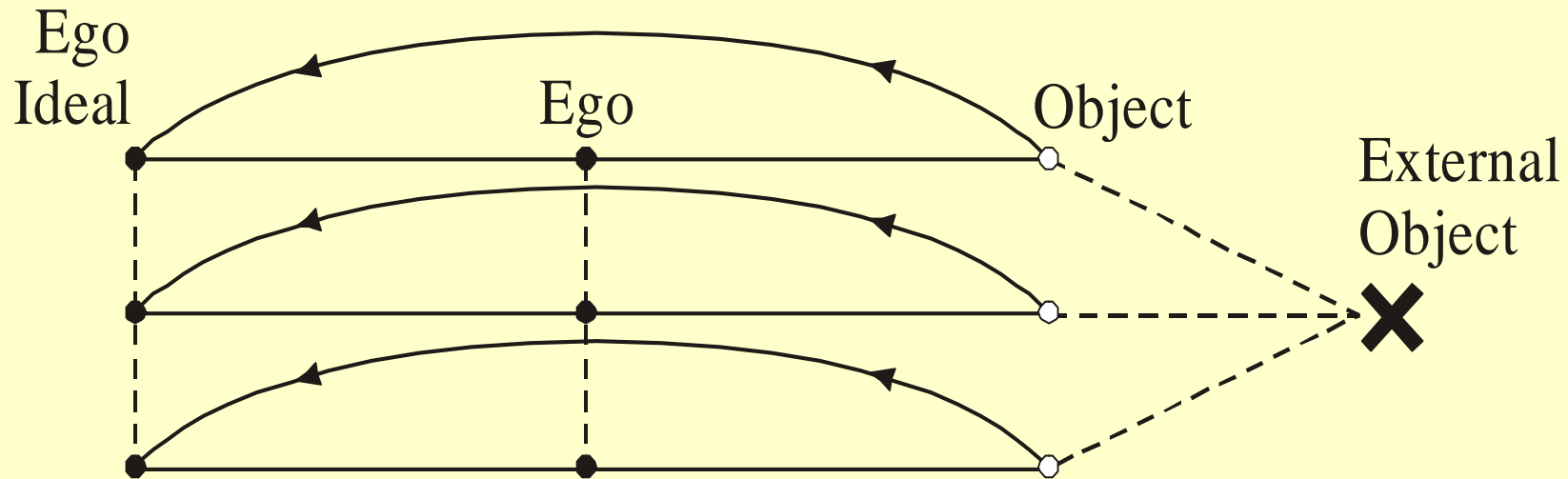
Corruption is a choice

- Corruption is a choice, even when it is endemic in a culture. Motivation is required to change dysfunctional behaviors.
- For plastic change, motivation for change must come from within. Members of privileged groups will resist change
- Citizens, NGOs, members of marginalized groups, and international organizations can militate to the other direction.
- Pressure and sanctions are necessary but not sufficient. Emotional and monetary costs of corruption need to be seen, known, and felt

Leadership in good and bad

- Freud conceptualized the role of the leader and the importance of identifications and emotional ties in groups.
- The leader and the members' emotional ties keep the group from dissolving.
- If the leader is corrupt and corruption is 'legal' emotional contagion spreads. Antisocial, destructive forces often fortify solidarity of a group.
- Openly violent leader can keep a group together by force. However, without emotional ties such group is unstable. Violence is part of corruption and should be studied.

Role of Leader in Group



- **Group cohesion related to leader (External Object).**
- **When leader falters group's emotional ties loosen, group may disintegrate, contagion sets in, and contracts are not protected because Leader was the sovereign guarantee.**
- **There may be a difference in groups if the dominant binding force is positive emotion or violence.**
- **Violence is an ever-present threat**

Institutional design (McDougall)

- There should be a degree of continuity in the group
- Group members need a clear idea of the group's functions to develop an emotional relationship to the group.
- The group should be brought into interaction with other groups
- The group should possess traditions and customs.
- The group should have a definite structure.
- *Transparency of decisions; an appeal process; and Rawlsian requirements for justice, equality and opportunity*

How to work with the ‘talking cure’: top-down and bottom-up

Principles:

- Contact function (follow the participants’ talk)
- Resistance to change
- Transferences within the group participants.
- Regular group meeting about “issues” in the country led by trained facilitators. Silent observers may be present.
- The participants are asked to talk about the concepts by which the decisions are made (NGOs admitted later)
- Everyone must talk; no particular topic or focus is prescribed. No results orientation.

Contact function

- The analyst team remains in sync with and listens to the group's verbalizations without introducing new ideas or interpretations.
- The facilitators pose questions fitting to the context: 'Why do people participate in corruption?'; 'Why are things you propose not done?'
- The 'talking cure' proceeds in small steps without a comprehensive reform plan. Plan and its implementation is the responsibility of the leaders and participants in their own work environment, not of the analyst team.

Resistance to change

- Two common disorderly paths for discharging resistance to change. Both are of serious concern; a gradual approach needed.
 - Economic hardships—for both of rich and poor. The majority vents anger against a minority, ethnic, political or religious, while sparing the privileged with whose (rich) members and leaders they (like to) identify.
 - Dissolution of emotional ties to the leader or among the people, or the fall of a violent leader, both resulting in violence and disorder

Resistance to change

- Current ‘combat against corruption’ is intellectual and tilted toward punishment. Paradoxically, “teachings” may simply lead to new ways to avoid detection
- Without forums where all things that participants bring up can be explored (without fear) over a sustained period, unraveling the web of corrupt relationships is impossible
- Dysfunctional relationships do also have positive attributes that will foster cooperation and rearrangement of personal and institutional functioning

Transferences among the participants

- Development of trust is necessary in order for the members of the group to feel confident enough to escape from the 'prisoner's dilemma'
- To break the trust of the corrupted group would lead to isolation, severe punishment and even death. Therefore, protection from harm must be provided.
- Gradual loosening of the resistances in itself is protection; changes that take place slowly and in many places make them observable only after passage of time.

Conclusions

- Experiential learning on how to live in truth and justice
- Sanctions and collective actions are necessary defenses; but punishments are unlikely to ‘cure’ corruption.
- Non-constructive and violent paths of discharging resistance to change are of grave concern in corruption.
- What about reconciliation? Amnesty or penalties, forgiveness or punishment for past corruption?
- The forces that safeguard and build good enough governments are the same that act as agents of corruption.

Contribution of paper

- A neoinstitutional analysis of corruption and its motivation with a process for “cure” that are distinctly different from those made at present.
- A behavioral theory about groups, anchored in psychoanalysis, that both describes and explains observable data about corruption.
- An incremental process of change that is based on the client's *contact* does not require a comprehensive plan or specific objectives, and respects indigenous culture.
- Presents a challenge to development professionals and IFIs of how to work with developing countries.