Introduction

> Crimes are only to be measured by the injury done to society
> (Cesare Beccaria, *Of Crimes and Punishments*, 1764)

1. CORRUPTION: DEFINITIONS AND CHARACTERISTICS

Corruption is a multi-faceted phenomenon, even more so when it is so deeply rooted as to be considered "normal". The problem related to defining it is strictly connected with the multiplicity of aspects that mark the phenomenon and with the difficulty of distinguishing it from other kinds of illegal acts or even from behaviors which are borderline but still legal. Here we address corruption in relationships between public and private sector, but make some reference to private sector corruption; the latter is analysed further in Part II where international treaties against corruption are addressed specifically.

From a very general legal perspective, corruption can be defined as "a deterioration in the decisional process that characterizes all cases where the decider (a private or a public agent) accepts to, or asks for, deviating from the criteria that should lead his (or her) decision for his (or her) private gain; however, the reasons that lead his action cannot justify his decision" (Huber 2002). This behavioral definition focuses on key aspects of the phenomenon: the concepts of exchange of favors and abuse of power. Since our analysis is based on data collected by Transparency International (TI), we follow its definition of corruption: an abuse of public office for private gain. While acknowledging that one of the two parties needs to be a public economic agent, there is no distinction between administrative and political corruption. However, in general the episodes of corruption can involve either one agent (or more) from the public sector and one private agent (or more); or two parties within the private sector.

This study concentrates on the dynamics involved in episodes of bribery between the private and public sector; in this case, corruption does not only affect economic development but distorts the policy-making process and its enforcement. Having said that, corruption within the private sector

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is a significant phenomenon and has recently been the subject of legal studies (Forti 2003b).

The World Bank (2002b) makes a distinction between the two main types of corruption: State capture and administrative corruption (we also mention so-called "grand corruption", which can be defined as abuse by public officials or the theft of public resources). The latter concerns all public employees' or public officials' actions for private gain that distort the application and enforcement of existing laws or rules; generally, these actions grant exemptions or tax allowances to specific agents. Alternatively, they are aimed at giving priority access to public services to an élite of agents.

The concept of State capture concerns all illegal actions aimed at influencing the decision-making process of policy making in the different spheres of the life of a country. Public opinion is an important input in policy making: it assures that the needs of citizens are taken into account by the authorities, while keeping the latter under scrutiny (and making them accountable to their voters). On the contrary, the concept of State capture concerns all actions exploiting illegal and secret channels that aim at favoring the interests of specific groups at the expense of everybody else. These channels are clearly accessible only to a limited group of "insiders" at the expense of those who are "outsiders" and do not participate in bribery.

The dynamics of corruption can be either organized centrally, by a single central group of agents inside the institutions, or decentralized throughout the system. Easterly (2002) shows that the number of episodes of bribery tends to increase when corruption is decentralized; however, when the dynamics of corruption are centrally organized, the average value of bribes tends to be larger.

We try to identify the peculiar features of corruption and the context in which it grows and spreads out. Bribery goes deep into the structures of public administration, limiting its ability to pursue economic and institutional goals; it interferes at the decision-making level by modifying general goals to the advantage of hidden parties; it compromises plans by thwarting the effective implementation of rules set by the authorities. It also interferes with the decision-making power of individuals by twisting the principles which guide their actions. The multi-faceted features that characterize the phenomenon confer on corruption a strong elusiveness. The elusiveness of corruption makes it difficult for politicians to fully understand the complexity of this phenomenon. If, on the one hand, aspects of bribery are clearly recognizable, on the other hand, their most dangerous effects are not directly measurable and lead to the destruction of the "intangible goods" of society. Corruption jeopardizes institutional

credibility, legitimacy, and image in the forum of public opinion; it encourages illegal acts and, therefore, speeds up its own diffusion and enhances a self-reinforcing process.

2.   PRECONDITIONS FOR CORRUPTION

The economic and legal literature describes a whole set of preconditions which constitute breeding grounds for episodes of corruption; it is concerned with those factors which, given agents with the same moral standards, encourage this kind of behavior.

The protection of its own citizens is the primeval function of the State, and also its origin (Pirenne 2010: 120). Citizens "delegate" powers to others, who voice their needs. These latter agents, however, also have personal private interests; thus, whenever their private interests are "compared" with the public welfare, a conflict of interest can arise. Indeed, thanks to the nature of their position, public officials are in a position that facilitates the fulfillment of their personal interests.

Not all aspects of the life of a State can be codified a priori. The residual aspects are thus left to the discretion of public agents. However, their action is limited by the supervision of the judiciary, by the control of citizens via the electoral process, and by public opinion. The degrees of freedom of public officials are at the root of possible conflict of interest: the more space is left to discretion, the more conflict of interest may arise. Therefore, if conflict of interest is not controlled and limited, a breeding ground exists for the spreading of episodes of corruption.

Corruption spreads in those areas of discretion characterized by strong concentration of political and economic power given to public officials.

For instance, too large areas of discretion are at the root of the episodes of bribery that affect the process of public spending. Indeed, if the process is characterized by conflicts of interest, decisions could be directed towards private gains instead of welfare considerations: tenders for public infrastructures involve large amounts of money; they represent an important source of profit for private agents; when systems are corrupt, tenders are often linked to the payment of bribes. In turn, wrong motivations lead to unproductive investments; to have an idea of the effect of decisions led by corruption instead of public welfare, one can think of investments with useless features (the so-called "white elephants") or infrastructure placed in non-strategic locations (the so-called "cathedrals in the desert"). Similarly, one dimension of public activity where discretion is most critical is tax collection; in particular, empirical evidence (Tanzi 2002) shows that the more complex the tax system, the more the episodes of bribery.

In addition, the more the collection of taxes allows for contact between citizens and tax collectors, the more bribery occurs. Indeed, the possibility to have contact with citizens gives tax collectors some bargaining power. It should be noted that fund-raising activities that are aimed at influencing policy making are not per se classifiable as bribery. Insider-outsider dynamics arise only whenever the tools to raise funds and the channels used to affect political decisions are secret and illegal, and thus only accessible to a group of insiders.

3.   GOVERNANCE

Corruption is mostly characterized by the difficulty of identifying the causal direction of the dynamics on which it is based; causes and effects are strongly interconnected with feedbacks that can hardly be isolated: the "effects" negatively influence their "causes".

The attempt to isolate cause from effect should be understood in the light of the strong limitations imposed by the presence of multi-directional causal chains. Cause and effect are recognized as such according to the predominance of the causal direction which empirical literature usually ascertains through econometric analysis.

The empirical literature recognizes governance variables as the main ones in the causal link to corruption. The actual spreading of corruptive episodes depends on the qualitative characteristics of governance. Good governance minimizes the conflict of interest and areas of discretion (necessary preconditions for the presence of corruption); sets effective rules, creates reliable institutions and also sets in place an effective system of prevention, control and punishment of deviant behavior. In this context, prevention of conflict of interest needs to be considered as a fundamental step towards prevention of corruption.

Keeping all other factors fixed, the level of domestic corruption is inversely related to the effectiveness of controls and punishment for episodes of bribery. Clearly, the larger the probability of being punished, the lower the number of episodes of corruption. Notice, however, that if on the one hand the number of illegal acts decreases, on the other hand, the amounts involved per bribery may increase (Rose-Ackerman 1997). Finally, the allocation of risks and benefits among agents depends also on their bargaining power: the more powerful the agent, the larger their benefit.

If governance is not strong enough to prevent episodes of public and private corruption, markets are dominated by distortions and inefficiencies; in turn, the mismanagement of markets generates advantages only

for privileged lobbies, these being the insiders of the corrupt structure. The incentive to join these lobbies weakens governance more and more.

Besides losing competitiveness, corrupt markets do not attract international capital flows and are marked by low growth (due to additional barriers to entry and the risk to investment caused by corruption). Corrupt countries are at a disadvantage compared with others: just consider that corruption not only reduces public revenues, but also has a negative impact on allocative decisions. A corrupt government does not allocate public revenues according to a project's qualitative features, but is heavily influenced by relationships based on patronage. Public investments are then characterized by low productivity which, in turn, compromises growth. Finally, in countries marked by pervasive corruption, governments tend to reduce public investment in education and health. It is consequently a truism that corruption impacts markets, and the dynamics of public bureaucracy jeopardize the fulfillment of the primary needs of the people. Corruption compromises the standard of health and human development of citizens, via the impact on investment in public health and education; cutting expenditure on education leads to a fall in the cultural standards of a country, and this has a devastating effect on the quality of governance: less educated citizens are inevitably less conscious voters, penalized by a weakened ability to influence the political course of the country. The negative feedback on the quality of governance is then evident.

Figure I.1 depicts the economic and social effects of corruption. The solid arrows indicate the main causal direction, from governance to
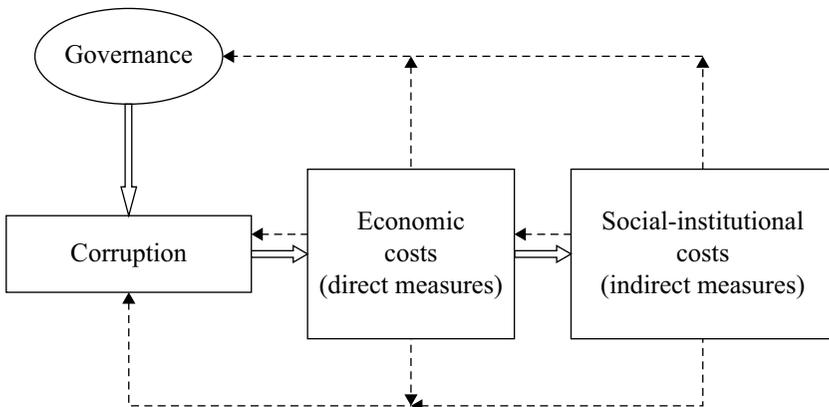

Figure I.1   Causal relationships (or interaction) between economic and social effects and governance

corruption, from corruption to economic costs (direct measures) and social-institutional costs (indirect measures). The broken lines reveal the feedback effects, which turn out to be weaker in comparison with the main causal relationships.