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**THE ECONOMIC AND FISCAL
COSTS OF CORRUPTION IN A
COUNTRY:
QUALIFIED AND QUANTIFIED.**

(2120 words)

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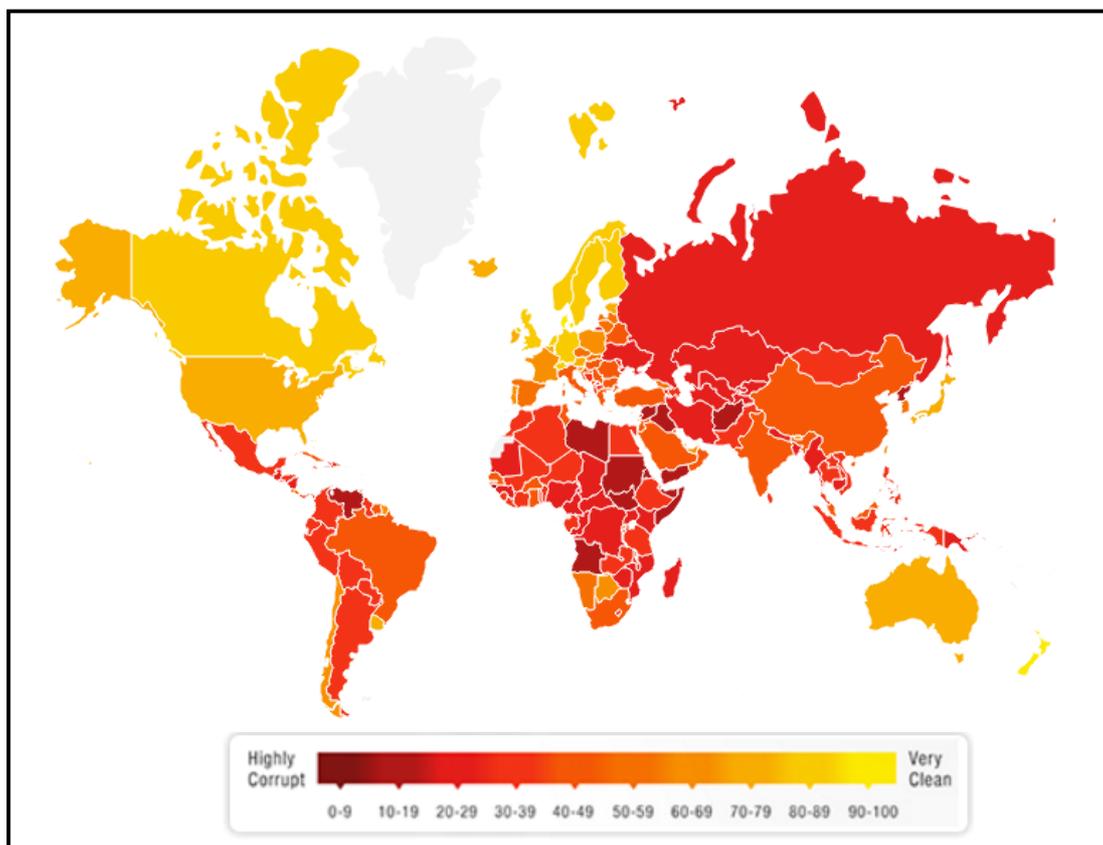
Figure 2: A basic supply and demand illustration of high transaction costs.

Introduction

Corruption as a phenomenon is endemic to societies and governments across the world. The level of corruption in South Africa has recently been alleged to have escalated to the point of state capture (eNCA, 2016); Nigeria's long history of corrupt administration has culminated in concerted efforts by the incumbent government not only to effectively and permanently root out corruption from within the Nigerian private and public sector but to also convict corruption related crimes and recover the ill-gotten gains and invest them into the growth of the Nigerian economy (Newsweek, 2017); Brazil's Supreme Courts have ordered that the country's President be questioned amidst allegations of corruption related to the alleged acceptance of bribes and embezzlement of state funds (eNCA, 2017); the former Statistics Bureau Chief in China, has been sentenced to life imprisonment for corruption (NDTV, 2017).

Figure 1 although limited in the scope of countries assessed, is a fair representation of the widespread prevalence of corruption across the world. Therefore, it comes as no surprise that the fight against corruption has increasingly gained universal traction in all countries and citizens, corporates and governments across the globe are calling for increased accountability and transparency in both the private and public sectors, in their respective countries as well as internationally, where applicable (Transparency International, 2016).

Figure 1: Patterns of corruption around the world based on Transparency International Corruption Index. (Transparency International, 2016)



Corruption gradually, even at the lowest level, erodes the governance structures in place and also poses a serious threat to the quality of life and livelihoods of the citizens in a country. The existence of corruption in any country not only undermines social justice but it also undermines the rule of law; therefore, the significance of efforts to address and ultimately eliminate corruption cannot be overstated.

In response to the growing rate of corruption, the member states of the United Nations convened and came up with the United Nations Convention against Corruption (UNCAC), which is a multilateral treaty promoted by the United Nations Office on Drugs and Crime (UNODC). The UNCAC is amongst the many international anti-corruption agreements which are legally binding (UNODC, 2004).

Defining Corruption

According to Zimmerman (2015) the importance of defining corruption is often taken for granted or in the most extreme cases, simply omitted, in most literature or publications (*inter alia*, Jones 2014, Bussel 2013, Runde and Hameed 2014). This 'error of omission' with regard to defining corruption is to a large extent informed by the fact that there is no universally adopted definition of corruption, which is aligned with its universal use.

A widely used definition, prescribed by the World Bank (1997) describes corruption as the "abuse of public office for private gain". This definition is simple however the benefit derived from simplifying the definition comes at the cost of not just ambiguity but it also becomes deficient in extensively and correctly capturing the essence of what corruption truly is. This definition simply focuses on corruption from a unilateral perspective that presupposes one key actor is predisposed to initiate, facilitate and benefit from corruption; *a priori* knowledge informs that corruption is not unique to and contained within the public sector and therefore for the purpose of this essay, which explores the costs of 'cross-sectoral' corruption, this definition will not suffice. The lion's share of corruption is no longer confined to the national institution (Liu, 2016).

The definition of corruption relevant to this investigation refers to corruption as the misuse of entrusted power (by heritage, education, marriage, election, appointment or whatever else) for private gain (Corruptie, 2017). The Organisation for Economic Cooperation and Development (OECD, 2008) defined corruption as the abuse of public or private office for personal gain. This definition is particularly relevant because it encompasses corrupt acts in both the public and the private sectors.

Costs of Corruption

Corruption bears with it costs, to the state, economy and citizen, whose parameters and reach cannot be accurately defined, because of the illegal nature of corrupt acts and transactions. The illicit enrichment of certain economic agents, stakeholders or factions in a country is hard to capture because of the covert nature of these transactions that operate in a similar nature to those in an underground economy. This following are the economic and fiscal costs of corruption as borne by different countries across the world (Herzfeld and Dreher, 2005).

Economic Costs of Corruption

The economic costs of corruption refer to the direct or indirect effects that the consequences of corruption have the on a country's economy. These vary greatly across different countries as they are influenced by the different characteristics or factors that inform the structure of a country's economy (Herzfeld and Dreher, 2005).

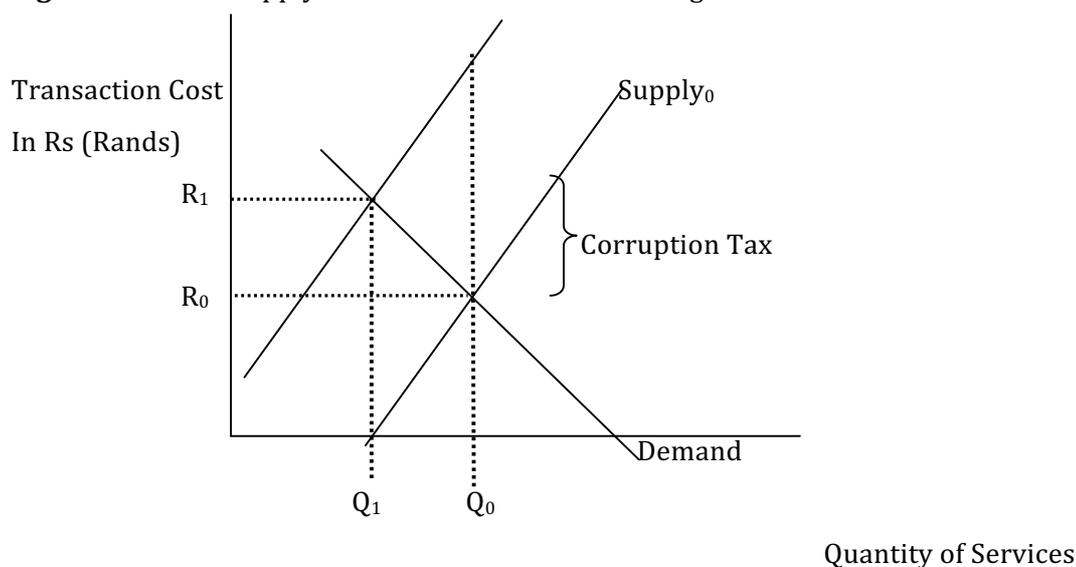
1. Higher Transaction Costs

A transaction cost is defined as the cost that facilitates the operation (s) within an economic system. It exists because of opportunism and bounded rationality, the former being the source of uncertainty in human behaviour. In an environment where there is asymmetric information, agents are susceptible to behaviour that prioritizes self-interests and self-enrichment. Bounded rationality refers to the limited human capabilities with regard to the ability to capture, process and store information. Therefore, the stability of economic activities is informed by the extent to which transaction costs are minimized (Nguyen and Pham, 2016).

In **Figure 2** below, R_0 represents the price of the 'legal' market-determined cost for an economic activity (the original transaction cost) and R_1 represents the inflated price transaction cost (inflated by the 'additional corruption tax' e.g. a bribe for the security or nurse etc.) imposed by the administrator of facilitator of the economic service.

The increase in the transaction cost from R_0 to R_1 distorts the equilibrium and creates and excess demand, which in a real life context would mean that people who cannot afford to pay the 'Corruption Tax' are systematically excluded from any meaningful participation in the economy (Jones, 2014).

Figure 2: A basic supply and demand illustration of high transaction costs.



In the public sector context, this would translate into the inefficient utilisation of public goods and in the private sector, it represents a disequilibrium in the markets, as a result of the misallocation of resources or the inefficient utilisation of existing resources (Nguyen and Pham, 2016). An example of this is one of the most corrupt Home Affairs departments in South Africa where security personnel collect a mandatory R100 from refugees who are seeking and applying for Asylum in South Africa in order to guarantee them a place inline before they even enter into the Home Affairs department building (eNCA, 2017).

2. Misallocation of Resources

The harsh realities of misallocated resources based on factional interests or the bidding of particular interest groups in the economy, mean that in the worst case scenario, funds are redirected to initiatives and projects where they are not needed as much as in other parts of the economy. This represents a distortion in the allocation of resources (Jones, 2014).

Jamaica is a prime example of how an economy bears the cost of misallocated resources. In 1966 Jamaica was selected by the World Bank to receive a special loan of \$9.5million to service the country's secondary education infrastructure projects expected to run for 3 years between 1966 and 1969; this would have doubled the countries secondary education capacity. However, the government of the day failed successfully regulate the award of contracts and the method of hiring contractors became a hotbed for looting of state resources by inadequately skilled or capacitated contractors awarded contracts via patronage, etc. The programme lasted 6 years and the overrun on costs was 125% (National Integrity Action. 2013).

However, arguments have emerged in recent years that argue that in certain contexts, corruption yields an efficient allocation of resources especially in countries bridled with inefficient bureaucratic structures and procedures; the proponents of this argument claim that corruption, in some cases often leads to increased efficiency and even an improvement in the economy's allocative efficiency. The popular Asian Tiger economies (Hong Kong, Singapore, South Korea and Taiwan) are used as a key point of reference where the country's record high rates of corruption and enjoy high rates of economic growth (U4, 2007).

3. **Distorted Competition in Markets**

The existence of cartels, price fixing and collusion in markets represents form of corruption that undermines the competition and undercuts the operations of similar businesses in the industry. This anti-competitive behaviour distorts the market because the profit motive in markets is fulfilled by fair competition (Nambuya, 2016).

Construction companies were found guilty of collusive tendering for the construction of stadiums in South Africa for the 2010 world cup and consequently fined R117 million; and more recently banks in the country have been exposed to have been colluding since at least 2007, on prices for bids, offers and bid-offer spreads for the spot trades in relation to currency trading involving US dollar / rand currency pair to intentionally manipulate the value of the rand (Business Tech, 2017).

Fiscal Costs of Corruption

It is important to take note of the fact that the fiscal costs of corruption can be classified into 3 grouping based on the effect that they have on a country's 'fiscus'. They are classified as follows:

- Revenue-side corruption which refers to corruption related to the collection of public resources.
- Expenditure-side corruption which refers to corruption related to the manner in which the collected resources are redistributed and channelled within the public sector.
- Quasi-fiscal corruption which refers to corruption characterized by imposing economic regulations or corruption effected using para-statal enterprises as vehicles (USAID, 2004)

The following are fiscal costs borne by corruption:

1. States reduced capacity to impose and collect Taxes

Corruption in the form of tax evasion has a negative correlation with revenue collected by the state in the form of taxes. “In its most elementary form, a corrupt act can be perpetrated by a single individual: unilateral corruption typically involves theft by a single tax collector of tax revenue collections, often even before the money reaches the treasury. On the other hand, multi-party corruption usually involves forms of coalitions, either between several tax administration officials or between tax collectors and taxpayers” (USAID, 2004).

2. Reduces effectiveness of public expenditure

Corruption can reduce the effectiveness of public expenditure through the channelling of state funds towards activities that serve the interests of minority groups that exert the most economic influence on public officials to do their bidding. In its simplest form, an example could be the diversion of funds within the fiscal budget from a basic service such as education (as in the Jamaican case) towards infrastructure development such as roads which are lobbied for by stakeholders with business interests in logistics (USAID, 2004).

Corruption alleviation or elimination?

Corruption is cited in both new and old literature as being a phenomenon that has been in existence since time immemorial and for that reason, people have become desensitized to the harsh realities accompanying this pernicious scourge (Harris, 2003).

The question then remains as to whether it is possible to completely rid society of this contagion; and if it is, what it is that can be done to effectively and successfully do so. Many propositions have been brought forth and each is as unique as the context in which corruption occurs, that it aims to address (Holmes, 2015).

It is therefore noteworthy that all efforts to eliminate corruption should be based on the premise that the choice to engage in an act of corruption is inspired to the perceived ratio between the benefits derived from the act of corruption to the penalties they are likely to suffer in the event that they are exposed (USAID, 2004).

Recommendations:

- There should be a concerted effort towards establishing and enforcing laws against corruption so as to inspire and consolidate a sense of trust in the country’s justice systems. This will also serve as a deterrent to any person from engaging in corruption (Liu, 2016).

- In addition to ensuring that the law punishes acts of corruption, there must be a practical aspect of this justice that recovers all ill-gotten gains obtained through acts of corruption and restores them to the rightful owners or to the state to use in advancing the interests of the whole country (Jones, 2014).
- Fiscal decentralization as a means to enact increased levels of accountability and transparency within the operations of the public sector would serve a great deal in addressing the incidences of corruption related to abuse of autonomy (USAID, 2004).

The most important thing to remember is that corruption affects all people and no one is exempt from its ravenous costs to the economic, political and social well-being of a country.

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