

## Globalization of the corruption phenomenon – human capital gone wild

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**Abstract.** *This research article tries to analyse the way corruption evolves and finds its fine tuning in developed countries around the world. Corruption represents a disease similar to a cancer that consumes organizations, entire societies, cultures or economic and political ideologies, all these being vital for the survival of the species in an almost normal social environment. Through this research the authors try to emphasize the true nature and relationship between corruption and social evolution and economic growth of a mature economy.*

**Keywords:** corruption, economic growth, globalization, politics.

**JEL Classification:** D72, D73, O47.

## 1. Introduction

Transparency International writes that, „Corruption is one of the biggest challenges of the contemporary world. It undermines effective governments, distorts fundamental public policies, leads to inefficient allocation of resources, harms public and private sector and especially hurts the poor.” (Amundsen, 1999, p. 1). In addition, Robert Klitgaard summarizes the „basic ingredients of corruption” in the following formula (Elliot, 1997, p. 181):

Corruption = Monopoly + Discretion – Accountability.

The main forms of corruption are: bribery, payment in cash or other assets; embezzlement – theft of public resources by public officials; fraud – an economic crime that involves deception and lie; extortion – obtaining money or other resources through the use of coercion, violence or threats; favoritism – abuse of power mechanism by which public resources are „privatized” or shared (Amundsen, 2000, pp. 2-4).

Yet not all the time corruption is defined as being „for private gain” but there is a form of it in which individual acts of corruption are performed with moral purposes. This is called „noble cause corruption”. A good example for this is bribery for moral reasons of officials of repressive and totalitarian regimes. Although his action violated the moral and legal standards, Oskar Schindler bribed Nazi officers to prevent more than a thousand Jews to be sent to extermination camps. Corruption is not always illegal: until 1977, US companies could legally offer bribes to secure contracts abroad and in many countries such incentives were legal until 1997. The rules can be violated inadvertently or ignorantly, but this is not always an act of corruption. Corruption is not simply a question of law; rather we can categorize this as a fundamental issue of morality (Hodgson and Jiang, 2007, pp. 1049-1052).

Anticorruption revolution is a revolution that not even Karl Marx could anticipate. A public revolt, simultaneous and largely peaceful across five continents against the oldest part –time profession: offering and accepting bribes (Glynn et al., 1997, p. 7).

## 2. Corruption – an economic approach

Most research is focused on indicators of economic prosperity such as: GDP per capita and its growth rate, quality of public infrastructure, the allocation of public expenses, total investment and foreign direct investment. The negative impact of corruption on economic growth has indirect effects on investment, education, trade policies and political stability (Dreher and Herzfeld, 2005, p. 3).

Corruption reduces the citizen’s level of confidence in their relations with the business community and the state. Consequently, corruption encourages confidence in relationships based on ethnicity, religion, family, where the application or enforcement

of certain contracts is based on reputation or sanctions in a defined group. Thus, the business environment is fractured between clans and mafia organizations, losing the benefits of extender market cooperation and even making market competition inexistent. At the same time undermines the effectiveness of legal norms, inclusive and non-discriminatory rules which are necessary for the functioning of a modern market economy (Hodgson and Jiang, 2007, p. 1057).

Corruption arises from the meeting of two systems: public and private. Whenever a public official has power over the distribution of a benefit or cost to the private sector, this creates incentives for bribery. In this case corruption depends on the magnitude of the benefits or costs. Private companies are generally open to pay to get these benefits at no cost. Each state should decide when to legalize such payments and when to label them as corruption (Ackerman, 2006). The private sector has a multiplier effect of corruption, discouraging reforms. The actions of corrupt governments that have committed to look for internally activities that bring income, supported by foreign investors who pay bribes to obtain facilities, have become a standard and are seen as part of the business. In such an environment there are not enough incentives or pressures for reforms. Bureaucracy changes very slowly and also the employees, so people who want to innovate and create transparency rarely have the opportunity to do this. Similar for business, „prisoner's dilemma” emphasizes corruption – businesses need assurances that other businesses will not continue fostering corruption, a vicious circle that must be broken for the reforms to be implemented in the business community (Hameed, 2014, p. 22).

### 3. Globalizing corruption around the world

Watergate political scandal of the mid-70s in America – where the media has exposed acts of corruption which led to the resignation of President Richard Nixon – the democratic revolutions that toppled the dictators of Latin Americans in the 80s, Gorbachev's decision to revitalize the Soviet economy through “glasnost” and the subsequent popular movements in eastern Europe – largely peaceful – which precipitated the fall of the Berlin wall and the collapse of the Soviet Union, they were all manifestations of globalization democratic trend. The end of Cold War accelerated the democratic process by fighting corruption especially in Italy where fear of communism has hidden the people the real level of corruption. Since 1992, a group of Milanese magistrates found that with the abolition of communism it was possible to bring to court politicians accused of corruption, especially politicians who were previously unattainable. The corruption was destructive on emergent markets attacking in two directions; first it was compromising the efficiency and productivity of economic activities making the transition to democracy and free markets more difficult and secondly it was distorting the public perceptions about how and in what way the market economy works. Under such circumstances it is increasingly easy to confuse economy

corruption with its democratization, creating fertile ground for authoritarian reactions and generating international hostile behaviour toward these countries (Glynn et al., 1997, pp. 9-11). Longevity of some regimes such as Ferdinand Marcos in the Philippines, Duvaliers in Haiti, Stroessner in Paraguay and all those tyrants in the African who abused citizens and stole the central banks have brought a minus in relations with the world powers. But the end of the Cold War also affected developed countries because foreign aid and military assistance continued to be directed towards those countries even though it was well known that most often the recipient country was just a stopover on route to Swiss private accounts of the ruling families and their cronies. On this topic during the last decade the Swiss government under pressure from major powers made a major breakthrough by repealing laws that were keeping under secret Swiss bank accounts (Glynn et al., 1997, pp. 9-11).

### **Corruption in America and Africa**

In late July 2008, the Ecuadorian government has led an operation in which took over 195 companies that belonged to the Isaias Group, one of the main actors responsible for the banking crisis in 1999. The President, Rafael Correa announced the government that all confiscated properties will be used to return the savings to those who were injured by the collapse of Filanbanco bank, one of the top business bank of group Isaias. In the middle of August another 300 companies were seized in the government's attempt to recover the 661.5 million dollars that Folanbanco lost in December 1998. During the ten years of operations, Agencia de Garantia de Depósitos – AGD, seized and „cleaned” over 18 financial companies who received loans from the Ecuadorian state still having to recover \$ 2.5 billion (Abbad, 2009, pp. 85-91).

A corruption scandal broke out in October 2004 in Costa Rica. Former President Miguel Angel Rodriguez was forced to resign from the post of Secretary General of the OAS (Organisation of American States), to face charges that he was involved in a scheme to defraud and bribery, scheme involving the telecommunications company French Alcatel. Investigations have unearthed evidence showing how the French company won a contract to improve mobile network of the country after company officials succeeded in bribing Jose Antonio Lobo, protégé of President Rodriguez and former director of the state electrical company, Instituto Costarricense Electricidad the (ICE), with a prize of 2.4 million dollars. Lobo said he was advised by Rodriguez to accept the amount, Rodriguez asking for 60% of the bribe. Thoroughly investigation on Alcatel revealed that the company officials tried to bribe influential current and former Costa Rican politicians. Authorities believe that Alcatel, which enjoys a situation where almost monopolizes the market of mobile services in Costa Rica, paid more than 4.4 million to Costa Rican politicians and officials (Amundsen, 2006, pp. 10-12).

Canada also provides examples of corruption where both parties, conservative and liberal, are involved. In 2005 the Liberal Party was involved in a corruption scandal uncovering that 143 million dollars were directed to marketing and advertising

companies, „friends” of the Liberal Party, sometimes without providing any services. At 2006 election it was the turn of the Conservative party to be involved in corruption scandals, for bribery and tax evasion (McGregor, 2009, pp. 55-62).

Expanding global economy increased the likelihood that effects of corruption extend to the world economy. For example, in 1991 the Bank of Credit and International Commerce went bankrupt leaving Gabon without full social security fund. Towards the end of the 90 s transnational corporations with worldwide sales of approximately 5.5 trillion dollars, incorporated a third of the production of world assets. Today, trade between the subsidiaries of these corporations represent between 30% and 40% of the world trade, transnational subsidiaries sales value being higher than the value of world exports (Glynn et al., 1997, pp. 12-14).

According to “African Peer Review Mechanism Report” agency, Uganda loses annually 258.6 million dollars due to corruption and abuse of public procurement. The violence that followed elections in Kenya in 2007, have made transportation of fuel and other goods to Uganda very difficult, leading to a severe shortage of fuel. In the attempt of stopping public outrage the government decided to avoid the procedures set by law and contracted an unknown company, Kenlloyd-Logistics, for 22.3 million dollars with the aim of restoring reserves. Authority for Public Procurement (The Public Procurement and Disposal of Public Assets Authority – PPDA), who was able to verify compliance with laws procurement has not stopped the contract, although it was questioned how Kenlloyd-Logistics won the auction against companies such as Caltex, Shell and Gapco. Later was discovered that Kenlloyd-Logistics was owned by the foreign minister Sam Kutesa son in law, also a close ally of the president (Biryetega, 2009, pp. 313-320).

### **Examples of corruption spreading in Europe and Asia**

British newspaper *The Guardian* described the ELF (Amundsen, 2006, pp. 12-17) scandal in France as the biggest financial scandal in a Western European democracy from the end of the Second World War. The scandal illustrates the corruption problems that have characterized the French oil industry for decades. In 2003, 37 people were accused of having accepted almost 400 million euros from former state oil firm Elf Aquitaine, for private use and to bribe politicians. Chief Executive confirmed that money was often used to finance political parties and presidential candidates. Ramifications of the case crossed the border, from France to Germany, where they destroyed the former chancellor Helmut Kohl's reputation. According to the charges, commissions were paid by Elf to facilitate the purchase of a refinery Leuna in eastern Germany, refinery that was on the verge of bankruptcy. According to statements of the ELF General Director, the company bought the refinery at the insistence of the President Francois Mitterrand to help his friend Helmut, whose "modus operandi" included buying regional office of the Christian Democratic Union (CDU) with „dirty” money.

The process has exposed several schemes and strategies of corruption: additional payment for goods generating hidden subsidies, payments made by a chain of offshore accounts, the "use" of Gabon as an account offshore financial generating hidden payments and using secret information as „key” to financial success (Amundsen, 2006, pp. 12-17).

Also in France, the „Ile de France” opened in March 2005 is one of the biggest lawsuits that found the implications of corruption in the procurement of public goods. There were necessary seven years of investigation to expose an extensive system of corruption in the procurement of contracts for the construction or renovation of 300 of the 470 high schools in Ile de France. Value of the contracts rise to 1.4 billion euros (Amundsen, 2006, pp. 12-17).

Russia is an example of a country that had to reform the entire government to be more transparent and to improve the investment climate to earn the right to be a member of the International Trade Organization (WTO). After 19 years of negotiations Russia joined the WTO in 2011, adopting a package of reforms to improve trade and taking a series of measures to protect the national and foreign investments. The effectiveness of anti-corruption laws adopted in 2013 suggested that corporate environment it is developing: identifies the company’s responsible agents, cooperates for strengthen laws, develops anti-corruption standards, adopts codes of ethics, avoids conflicts of interest and prevents the creation of false documents (Hameed, 2014, p. 20).

Audit Chamber of Russia with the help of Swiss authorities is about to settle a corruption case shrouded in mystery, where senior officials from former President Boris Nikolaevich Yeltsin staff or even himself were involved. Nearly \$ 4.8 billion dollars disappeared during the Russian financial market implosion in August 1998. It was assumed that this money ought to support the banking system and strengthen the ruble which was sharply depreciating. Instead of this, the money went into the bank accounts of some obscure corporations and then disappeared. The person in charge of these funds was Mikhail Mikhailovich Kasyanov none other than the Prime Minister of Russia at that time, the second man of the Ministry of Finance for foreign debt. It is assumed that he used a great part of the money to fund the fantastic salaries of Kasyanov and its officials. Kasyanov won 240,000 dollars in 1997, given that the average annual salary in Russia was less than 2000 dollars (Vaknin, 2009, pp. 70-79).

In Turkey, in April 2007 was discovered one of the largest public corruption cases. The investigation, began after a report of the Ministry of Intern Affairs, found that the city's public transportation authorities have made illegal transactions on acquisition and contracts between 2005 and 2007. Transportation Agency has systematically avoided tenders for contracts exceeding 100 million euro, which included procurement contracts for buses from Dutch or German companies and advertising contracts. An event of a greater magnitude held the headlines of all newspapers. It happened in 2008 when the group of companies Calik Group, led by Prime Minister Recep Tayyip Erdoğan's son in

law, was introduced as the unique bidder for the second largest national television station, ATV-Sabah. Unconfirmed sources reported that other companies were interested in participating in the auction but government officials warned them not to do so. Most of the sum of \$ 1.2 billion that Sabah\_ATV was taken by Calik Group, was financed by two banks belonging to the state. Officials of the two banks acknowledged that they have borrowed 750 million dollars to Calik group but declined to disclose terms of the loan, stating client confidentiality. Erdoğan said the whole affair, both buying the TV station and obtaining the loan, were in full „legality” (Bedkil, 2009, pp. 305-312).

One of the biggest cases of systematic corruption is related to market failures: through the Iraqi „Oil for food” program conducted between 1995 and 2003 it is only allowed to sell oil in exchange for humanitarian goods. People's desire to acquire these assets not only provided ample opportunities to raise their price but also gave the „possibility” to some UN senior officials to close their eyes to massive corruption. According to some estimates, Saddam Hussein was able to collect 1.8 billion dollars. Of the 4,500 private firms included in the project more than half were involved in corruption and bribery. Also, the bribes were paid in exchange for the sale of oil well below market price. The experience of this program warned the UN Security Council and it led him to seek solutions to control abuses of this kind (Lambsdorff, 2007, p. 3).

Use of technology in India has registered a success in the fight against corruption. An example is the „Bhoomi” project in Karnataka which have digitized land records of 20 million farmers. Thus, farmers who were not trustful could not use machinery and goods in the formal economy to take a loan or could not resolve property litigations. In the old system, the average bribe was more than 2 dollars and 75 cents; while in the new system this was reduced to six cents. By transforming the system farmers could avoid bureaucracy and bribery decreased significantly. 66% of those who still use manual system had to pay bribes, compared with 3% of users of the new system (Hameed, 2014, p. 23).

A study of corruption in Thailand, indicates the spread of bureaucratic corruption in infrastructure projects, construction and other fields, the losses being estimated between 20% and 40% of the total project costs. In Eastern Europe, Russia and other developed countries privatization provided many examples of purchases below market prices made by governments privileged. In Korea, bribing construction inspectors would have led to the construction of buildings below the imposed standards which could led to their collapse and loss of lives. Corruption leads to inefficiency, injustice and causes political legitimacy of a state. It can also how deep problems that exist in the relationship between the state and the public sector. Illicit gains are used by bureaucrats to open legal or illegal businesses in the country or abroad (Ackerman, 1997, pp. 32-55). Politics is a game with high stakes and its rules have little to do with who wins and who loses. There is no democracy without corruption, even some authoritarian

regimes (Singapore or Chile) have low levels of corruption. The balance between political and economic reforms strongly affects the balance between political and economic opportunities, making from this a critical problem (Johnston, 1997, pp. 68-79).

Where there is corruption, investors are aware that part of future investment income will be claimed by corrupt officials. Corruption also leads to loss of taxes when talking about tax evasion or abuse of tax exemptions. Affecting tax collection and public expenditure, corruption can have negative influences on the state budget or the composition of government expenses, politicians choosing to spend more on those components of public expenses that can more easily perceive bribes (Mauro, 1997, pp. 86-93).

Corruption has become a social problem in China after the Mao regime. Compared with Western people, Chinese are more tolerant on some forms of corruption. For example, the Chinese government employees can use public funds for personal interests for a limited time or receive bribes to not investigate the illegal activities that occur in their jurisdiction. The more expenses incurred by a company to negotiate with government officials are increasing, the government is more corrupt. All these affect China's economy by having a close relationship between corruption and inefficiency. Corruption has reduced economic growth, the most widespread form of corruption being fraudulent charges by falsification of export certificates. Before the freedom of movement reform, China had a low level of production and hence a low level of corruption. In 1951 there were 1,670 reported cases of corruption in 27 central government bodies. At that time the Chinese government had implemented extreme policies against corruption condemning to death anyone with gains of bribery more than ten thousand yuan (about 1,250 dollars). Hu Angang, an economist at Qinghua University, concluded that 90% of local government officials are corrupt (Zhou, 2006, pp. 1-21). Since 1978 three officials were executed for corruption. In 2000 Wang Huazong was executed for accepting bribes worth 4.8 million yuan and in the same year Chen Keji, the National People's Congress deputy was executed for embezzling five million yuan through corruption (Zhou, 2006, pp. 1-21).

In some countries, there are asymmetries in the perception of someone who pays bribe and someone who receives bribe. For example, in Taiwan bribing an official is a crime only when the payment is made to obtain illegal services. In other cases, the payment of bribes is a criminal offense and its acceptance is not always accompanied by other penalties (Chile, 1990). In American law, the penalties are proportionate both to those who give bribes and those who receive it. The accused can receive the maximum punishment provided "... three times the money equivalent to the amount or the asset received or promised to an official, or imprisonment for not more than 15 years, or both, and shall not be afford to hold any business in the US." (Ackerman, 2010, pp. 13-17).



United Nations Convention against Corruption reflects the consensus of necessary measures to be adopted including political models, anti-corruption institutions and an improved transparency in funding parties or campaigns. The Convention requires countries to establish laws to cover an area as wide as possible for corruption offenses (Saxer, 2014, p. 24).

#### 4. Economic effects of corruption

The literature describes a number of transmission mechanisms through which corruption can affect overall economic growth and private investment (Zelekha, 2013, pp. 21-23):

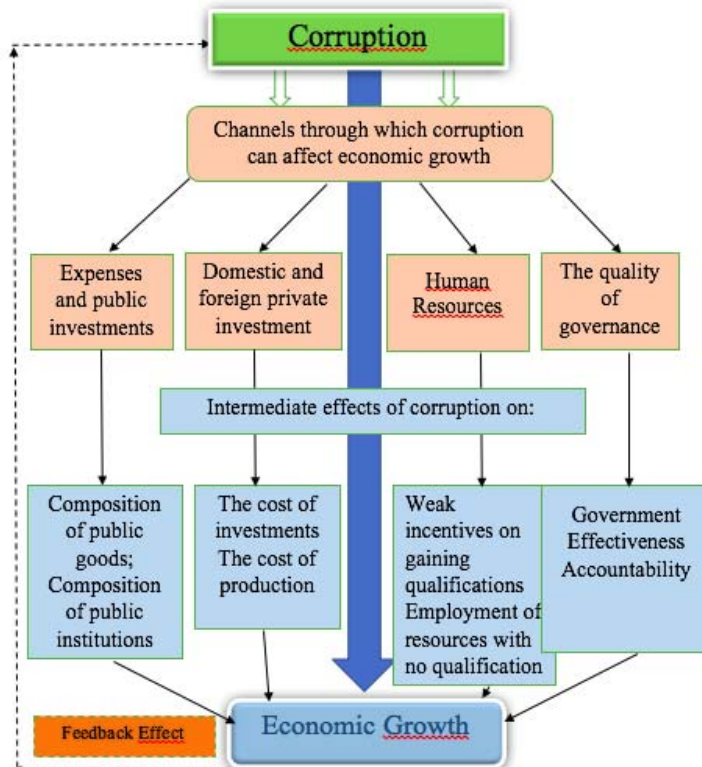
- a) Inefficient allocation of resources in the economy: firstly, illegal activities raise the cost of business respecting the law and distort the prices. Secondly, results in an inefficient allocation of investments in various sectors of the economy. In the third plan, part of the production factors (including labor, capital and economic activities) is used in illegal activities or to protect against them, instead of being allocated to legal economic activities.
- b) Increases uncertainty in taking economic decisions: uncertainty affects the investment environment in general, but particularly increases the fear of losing the invested capital.
- c) Degradation of mechanisms for resolving business disputes: in an environment where the government is suspected and implicated in corruption scandals, investors take into account that in everything they undertake (lawsuits, offers, licenses) will be exposed to decisions of corrupt officials. Moreover, Hernando de Soto and Alan Bennett Krueger argue that corrupt officials may favor or extend the term of such processes to make it easier to collect bribes in exchange for speeding up processes or change their results.
- d) Reduces the marginal productivity of capital is the result of allocating a large percentage of government resources to maintain security business (Zelekha, 2013, pp. 21-23).
- e) Increases the inequality of income distribution in the economy and stresses the loss of revenue from taxes, thereby reduces economic growth.
- f) It affects small and medium business sectors: large businesses are able to fight the effects of corruption, this distorts the relationship between large firms and small and medium ones, which still have a significant contribution to economic growth.

Theoretically, the payment of bribes by corrupt government officials who perceive these favors as a tax incentive, bring in addition to increasing investment costs and mistrust of doing business in such a country. It requires companies to allocate resources to pay favors, resources that could otherwise be invested profitably in any economic segment. Default corruption decreases expected profitability of investment projects, also reducing the total volume of investment (Zelekha, 2013, pp. 21-23).

In its first empirical analysis on the consequences of corruption on economic development, Paulo Mauro focuses on GDP growth per capita. To measure corruption, he used data from International Business. Of the 68 countries entered the study, independent estimation methods showed that the most corrupt countries are facing both a low rate of GDP growth and investment volume down. Studies have shown that corrupt countries experiencing significantly higher inflation rates also tend to depreciate the real exchange rate. Corruption destroying the infrastructure, focus and significantly increases state spending by the military, while reducing costs and health education (Dreher and Herzfeld, 2005, pp. 4-7).

In literature there are studies that analyze the impact of corruption on economic growth in an analytical framework where corruption is the main agent causing and aggravating the institutional weaknesses in a company. Mechanisms and transmission channels in corruption- economic growth relationship are shown in Figure 1 (Ugur and Dasgupta, 2011, pp. 20-22).

**Figure 1.** *The relation between economic growth and corruption*



Source: Ugur and Dasgupta, 2011.

Corruption affects economic growth through investment and public expenditure. Thus, projects that have high-level political support can be chosen against those that could bring economic and social benefits, which can cause inefficiency and effects of low or negative economic growth. In case of resources allocation, corruption can lead to low sustainability of public investment which are financed from public money at enormous costs.

The third channel through which corruption affects economic growth is represented by investment in human capital, measured in years of education or technical skills. These effects may materialize because meritocracy works not as effectively as an institution to balance the revenues of the qualifications and skills.

Corruption also affects the economy through adverse effects on the quality of governance in general. At this level corruption affects the decisions of economic actors, distorting information about the risks associated with investment decisions, transaction costs, the level of confidence or the ability of government institutions to manage economic crises or conflicts. Thus, it distorts the ability of a country to record economic growth by creating new market opportunities or strengthen existing ones (Ugur and Dasgupta, 2011, pp. 20-22).

## 5. Conclusion

An approach on corruption control based on economy suggests that increased competition can be a way to reduce revenue from illegal activities. The assumption is based on the fact that you cannot offer bribe on a perfect competitive market and so the illegal profit to be paying bribes is eliminated. Corruption affects expanding market competition, negatively affecting investor's revenue and also the balance of free entry on the market.

Corruption can convert competition into monopoly. A corrupt person may grant or withhold an operating license for any firm or company in any industry. Being a market with free entrance there are several companies with the same activity, thus there will be no surplus if the person is honest. But his right to grant operating licenses places him in a monopoly position (i.e. license for a hotel or beach club). Having all the necessary information he can easily calculate that the return on investment for hotels or clubs can be maximized to  $\pi$  if in this sector operates  $N$  hotels or clubs. Therefore, he requires a fee  $\pi / N$  from each hotel or club in exchange for the operating license. This lead to a monopolistic balance on the market and corrupt person receives a certain fee  $\pi$  for the license facility (Di Tella and Bliss, 1997, pp. 1001-1023).

Rafael di Tella and Christopher Bliss have developed several economic models one of which can be applied to a single item market characterized by perfect competition in the sense that all small producers are „price takers”. Thus, they took as the example a

network of farms, whose net profits are balanced and where the price of farm production is determined by supply and demand equality:

$A \cdot N^* \cdot \frac{dR(p)}{dp} = D(p)$ , where  $R(p)$  is the income function of a single farm (common to all farms without including fixed costs),  $N^*$  is the maximum number of farms,  $A$  is the proportion of producing farms and  $D(p)$  is the market demand curve. The balance has been defined for a given population of potential farms. If all are functional, it will be equal to one and if not all functional it will be less than one. Fixed costs are evenly distributed as:

$$F(C) = \frac{c}{c_{max}} \quad \text{and} \quad F_1(C) = \frac{1}{c_{max}}.$$

Where profit exceeds  $C_{max}$ , corrupt agents will take all surplus for themselves because the collection does not induce any risk relating to market exit. The extra earnings brought the surplus affects the decision of the agent. If the agent asks for a bribe much higher than the surplus, the company can be determined to exit the market (Di Tella and Bliss, 1997, pp. 1001-1023).

Alberto Ales with Rafael Di Tella examined assumptions and reached the conclusion that the level of annuities in general and the market structure in particular determines the level of corruption in the economy.

To sum up, we must understand that a low level of competition means that bureaucrats can collect more bribes from firms they control but may also mean that it is important for the public to bypass the corruption. Using data about corruption from various sources has been revealed that corruption is higher in countries where domestic firms are protected from foreign competition by natural barriers or political applied to trade, countries in which economic sectors are dominated by a small number of companies or countries where antitrust policies are not effective in preventing anti-competitive practices. For example, almost a third of corruption gap between Italy and Austria can be explained by reduced exposure to foreign competition. These results suggest that policies that aim to make markets more competitive could play a role in controlling corruption (Ales and Di Tella, 1999, pp. 982-993).

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