PRIVILEGE AND CORRUPTION: A MODEL FOR EVALUATING CHALLENGES AND DEVELOPING STRATEGIES FOR GLOBAL COMPETITIVENESS

Drew L. Harris, Central Connecticut State University
Teresa M. Twomey, Central Connecticut State University

EXECUTIVE SUMMARY

Building upon Lambsdorff's (2005) review of empirical studies on corruption leads to an integrative, casual model that presents corruption as a central node in a pathway from independent variables (free-press, independent judiciary and ease of market entry) through mediating variables (degrees of democracy, crime, and free markets) to outcomes (capital formation and social welfare). The elements of the model directly influence economic growth and competitiveness. Analysis shows that privileges act both directly and indirectly on the likely causes of corruption. This leads to policy proposals that might work to reduce corruption and facilitate developing stronger national economies and democracies.

Keywords: Corruption, Privilege, Economic Growth, Economic Development, Democracy, Free Markets

INTRODUCTION

Corruption is of great concern to multinational corporations as they decide where to locate facilities and do business; to nation-states as they consider how to make their economies and societies effective and efficient; to employees, citizens, migrants – everyone who interacts with government at any level. Corruption corrodes our institutions, stifles economic activity, and degrades the human experience.

According to Transparency International (2011), citizens of more than three quarters of the 178 countries in their surveys perceive their institutions as corrupt. Even in relatively "clean" countries, such as the United States, citizens perceive corruption on the rise. Corruption is pervasive. Therefore, it is important for organizations, citizens, political bodies to understand the sources of peoples' perceptions and experience of corruption.

Perhaps the perception of increased corruption in the West flows from governments' preferred recent response to financial crises: granting special payments, opportunities, rights, or advantages to specific firms or industries – that is, granting privileges. If the public perceives those privileges as a misuse of public power for private benefit, then those privileges fit the definition of corruption (Transparency International, 2011).

It is likely that the economic problems that led to this great recession came largely from corruption and privilege. For example, the Office of Comptroller of the Currency passed regulations that granted interstate banks the privilege of immunity from state laws regulating home mortgage lending (Bagley, 2008). As there were not sufficient resources at the federal level to monitor lending regulations, many firms engaged in corrupt behavior, breaking laws with regularity.

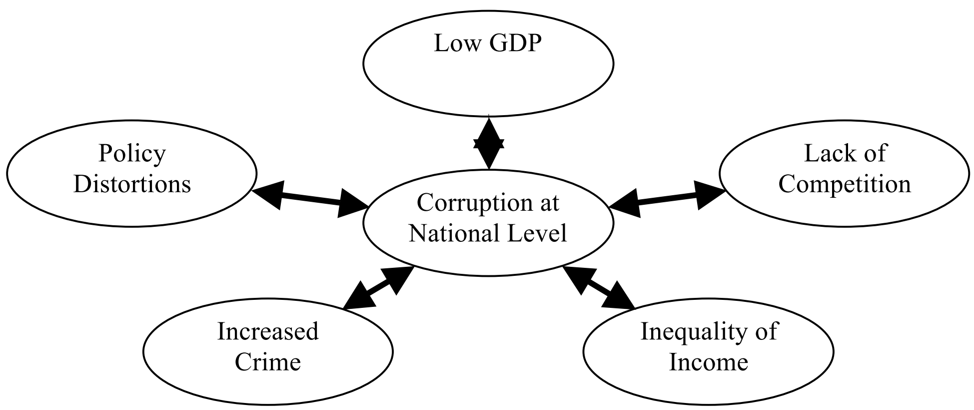
This paper proposes a model for mapping causes and consequences of corruption based on previous empirical research. We then explore relationships between specific privileges and corruption and propose methods for dealing with both privilege and corruption. With the general model explained, we suggest policies for dealing with state-granted privilege and the consequent corruption, unequal access to wealth and power, and impairment of global competitiveness.

CORRUPTION

Transparency International (2011) defines corruption as “the abuse of entrusted power for private gain.” This includes practices in both the public and private sectors. Surveys used to build the Transparency International indices ask about bribery, kickbacks, embezzlement and practices that reflect public sector anti-corruption efforts. The Corruption Perceptions Index (CPI) ranks countries according to the perception of corruption in the public sector. According to Transparency International (2011), between 2006 and 2009, 60 percent of the world population perceived an increase in corruption. North Americans and Europeans were above average in their pessimism: 67% and 73% of citizens in those respective areas perceived an increase in corruption. If these perceptions of increased corruption are grounded in reality, it does not bode well for the world as we struggle to recover from the “Great Recession” that began in 2007.

In an attempt to understand the consequences and causes of corruption at national levels, Lambsdorff (2005) surveyed empirical research on corruption. He concluded that although low GDP, inequality of income, inflation, increased crime, policy distortions and lack of competition have strong correlation with corruption, causality was inconclusive.

Figure 1: Mutual Causality with Corruption at National Level



Some well supported empirical findings had less ambiguous causal relationships (Lambsdorff, 2005). Complicated regulation of market entry and tariffs, abundance of natural resources, distance to the major trading centers and cultural acceptance of hierarchy (power distance) each were causally related to increased corruption. Freedom of the press and independent judiciary and prosecutors appeared to be important elements in reducing corruption. Democracies with transparent electoral systems and high participation rates reduced corruption, but medium or weak levels of democracy appeared to increase corruption. We show these in figures 2.1 and 2.2.

Figure 2.1 Factors Increasing Corruption

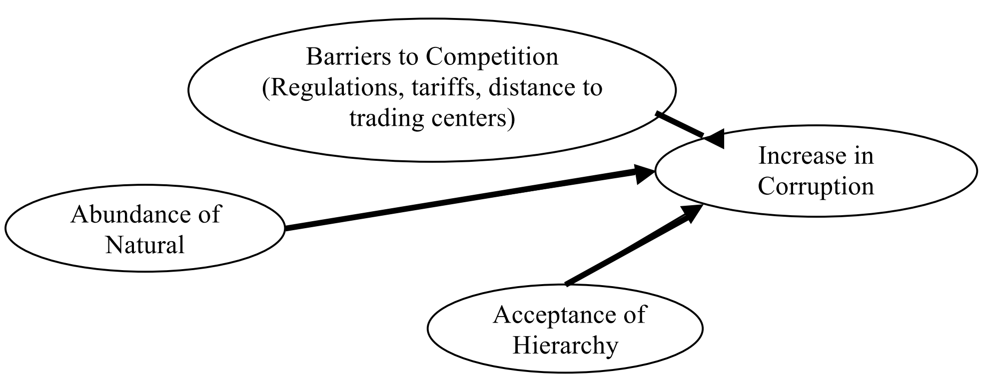
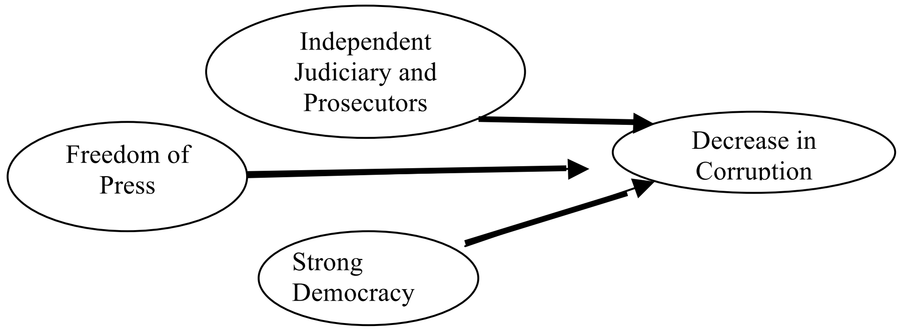
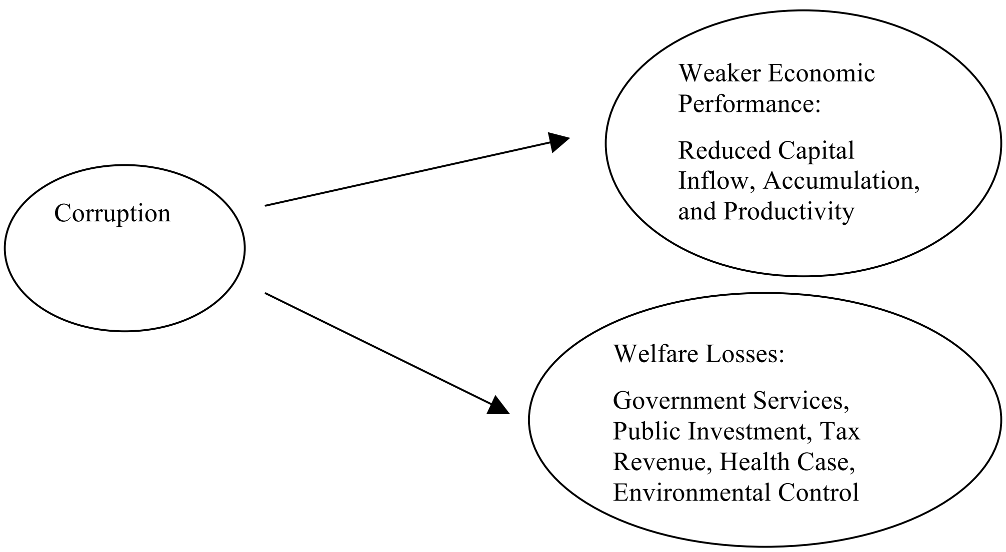


Figure 2.2 Factors Moderating Corruption



Consistent empiricism points to corruption lowering a country's attractiveness to international and domestic investors, reducing capital inflows and accumulation (Lambsdorff, 2005**).** Productivity of capital suffers from corruption. Evidence also suggests that corruption distorts government expenditures and reduces the quality of a wide variety of government services, such as public investment, health care, tax revenue and environmental control. In short, large welfare losses result from corruption. We summarize these in Figure 3.

Figure 3 Consequences of Corruption



In the traditional mode of thinking, these findings provide little in the way of guiding public policy. For example, creating strong democracies is a long-term program that requires cultural change as well as policy change. One cannot change natural resources, distance to markets, or cultural attitudes by decree. A nation may attack some of the variables of ambiguous cause-effect, but if corruption is already in place it may be difficult to work on any single variable.

PRIVILEGE

One of the more powerful variables that creates social context is privilege. Experimental studies in psychology (e.g., Zimbardo, Maslach & Haney, 2000) have shown that, once an individual or group has been granted a privilege they quickly come to believe they deserve the privilege, they are entitled to extend or seek new privileges, and that they may treat un-privileged groups in prejudicial ways. Other studies (e.g., Powell, Branscombe & Schmitt, 2005) have shown that once privileged, it is difficult for the privilege holder to observe their own advantages or to empathize with the disadvantaged. McIntosh (1989) asserted and demonstrated that many privileges are invisible to the privileged (and perhaps are designed to stay that way). These studies suggest there is a strong psychological impulse to leverage a privilege for more privilege and power and, therefore, to engage in corrupt behavior (using entrusted power to gain personal advantage).

Based on these studies it is tempting to say that we should simply outlaw all privilege, but that would be economically disastrous. A modern society needs a wide range of privileges to function efficiently. For example, few would make investments in buildings if they did not have the privilege of secure tenure in the land. However, not all privileges *are* economically efficient. For example, regulations to limit market entry and tariffs are clearly formal privileges (based in law). Tariffs are generally considered economically inefficient. Regulations that limit market entry aim to limit competition and therefore are likely to result in higher prices and deadweight losses – economic inefficiencies.

The Harris-Twomey typology of privilege (Harris & Twomey, 2008; Twomey & Harris, 2009) provides a system to distinguish these formal (state granted) privileges as "efficient" and "inefficient." They also make a distinction between formal (law/regulation/rule-defined) and informal (culturally or socially-defined) privileges. So, the state privilege that grants exclusive use of portions of the electromagnetic spectrum would be *formal* and *efficient* while subsidies to a particular oil exploration company would be *formal* and *inefficient*. (We will not further address informal privileges here, but it should be noted that many governments make formal responses to ameliorate the effects of informal privileges. These should be explored and assessed comparing for their efficacy in ameliorating negative effects of informal privileges against potential negative side-effects from granting formal privileges). Table 1 presents the Harris-Twomey typology with examples of the various categories of privilege they identified.

Table 1 – Harris-Twomey Typology of Privilege

	Economically Efficient	Economically Inefficient
Formal	- Property right in locations (land) and natural resources. - Incorporation - Use of electromagnetic spectrum - Airport landing and gate rights	- Current farm subsidies - Gifts to corporations for relocation - "Grandfathered" pollution rights. - Riparian rights in the western U.S. - Import quotas & Tarrifs
Informal (cultural)	- Contracting in trusted networks. - Manners - Cultural norms such as passing to the right when meeting head-on.	- Nepotism - Patronage appointments - Non work related bias in hiring and promotion

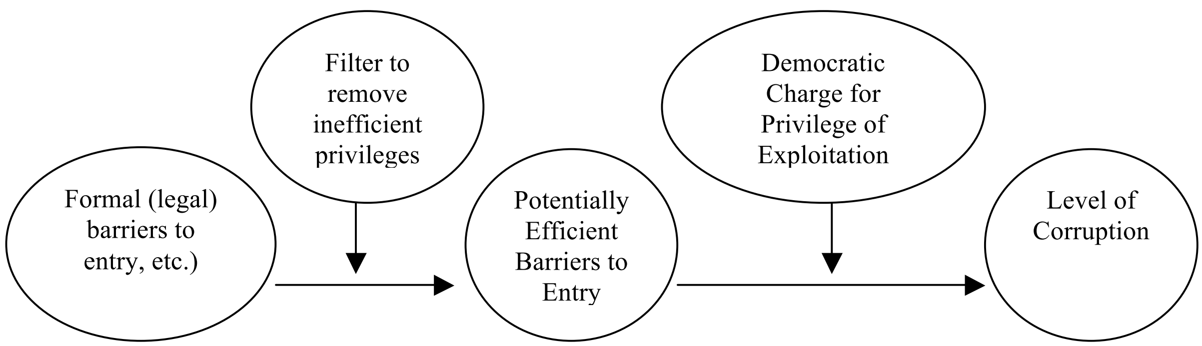
We will now illustrate how privilege can help us more deeply understand corruption's causes by exploring the relationship between privilege and two variables identified as causing corruption – ease of market entry and abundance of natural resources. This exploration will lead to suggestions for public policy.

Efficient exploitation of most natural resources requires formal privilege. There are two-fold problems with granting these privileges: 1.the psychological corruption mentioned earlier; 2. the privilege holder has the opportunity to gain extraordinary wealth which adds to the power and likelihood of manipulating political systems to gain further advantages. Incorporating privilege in the corruption model suggests that it is not the abundance of natural resources *per se* that creates corruption, but it is the privileges associated with the exploitation of natural resource that are the source of corruption.

This challenge can best be addressed by charging fees for the use of the privilege that are equivalent to the opportunity cost and/or transfer costs borne by all who do not hold the privilege. Ideally, those fees would be variable, episodically updated reflecting the general understanding of costs. The collection of use (exploitation, access) fees would have to be transparent and deployed for public welfare, otherwise the substantial wealth so concentrated would be too tempting a plum for corrupt officials. In the model below we call this "democratic charge for privilege." In countries where the other forces resisting corruption are weak, it may fall upon less corrupt trading partners to impose various taxes or tariffs and employing monitoring methods to ensure a less corrupt exploitation of the natural resources (as is being done with the monitoring of "blood diamonds").

Many legal constructs, such as tariffs and subsidies, are recognized as economically inefficient. The obvious public policy is to eliminate such privileges. Others, such as intellectual property, are subject to debate as to their economic efficiency. A test of this would be to charge a fee (on the same principle as fees on natural resources) and see what happens. If it is efficient for the economy to grant legal privileges, the state should collect the value of the efficiency for the benefit of all (or at least all who bear an opportunity cost of forgoing the privilege). Here the relationship between Barriers to Market Entry and privilege is two-fold – first a direct removal of barriers through removing economically inefficient barriers and then the moderating effect of democratically collected fees for barriers granted through formal privilege. Figure 4 illustrates this:

Figure 4: Barriers to entry, privilege and corruption.



We believe this form of analysis can be applied to several other variables affecting national levels of corruption. For example, the conditions that create a free press might include disallowing the privilege of concentrating broadcast media in a limited number of hands. Ironically, the argument made for allowing concentration of media is made as one of financial efficiency – a media conglomerate having a single news room for print, radio, television and internet. However, this is not the national economy level of efficiency we have in mind in this analysis. In any case, states would do well to charge for the right to use the electromagnetic spectrum as well as other "natural monopolies" such as stringing wires, fiber optic cables and such through neighborhoods. If states are interested in reducing corruption they would not allow for concentration of media.

There is considerable evidence that greater access to natural resources and fewer barriers to market entry create economic conditions that diminish gaps in wealth distribution (which would reduce corruption). Closing gaps in wealth distribution provides a context for reducing acceptance of power distance, another cause of corruption. It is also likely that making more of a population engaged in wealth products and sharing in that wealth will increase GDP, another factor that reduces the likelihood of corruption. So, we see a variety of ways that acting on privileges associated with natural resources, barriers to market entry, and free press may have secondary effects on other factors associated with corruption.

CONCLUSION

At the national level, there are multiple variables interacting with corruption. Some serve in feedback loops and others act in a more direct, one-way causal relationship. Corruption decreases public and private investment and the effectiveness of both types of investment; corruption is strongly and inversely correlated with economic growth and stability. Several variables that have been shown to cause corruption are related to forms of privilege. We propose treating the problem of corruption at the state level, by creating unique solutions for each category of privilege.

This analysis calls for public debate and action, but it also suggests opportunities for more in-depth research. We need to know more about the magnitude of the drag of corruption on developed economies, the ways various privileges motivate, and the limits (if any) to the interactions between privilege, corruption and economic activity. While there are many recommended methods for coming to an appropriate price for privileges (mostly variations on auctions), we need to study what has been effective and what might aid in better reaching prices so that acceptance of privilege-limiting policies is widespread. A catalogue of privileges of all kinds would also aid in more detailed analysis. For, example, sales taxes provide a form of privilege in most locales. Would we be better off eliminating all sales taxes or charging sales taxes on everything (in other papers we have suggested that all taxes on savings and production are inefficient, generally apply privileges in their application and therefore should be eliminated).

Our intent in the paper has been to provide a new set of variables that will enrich our understanding of corruption at the national level. Moreover, we intend these variables to be such that researchers and policy makers can take action upon them. There may not be much a policy maker or researcher can do with distance to trading partners, but there are many implications and places to action when looking at the roles privileges play in corruption.

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