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Active and passive corruption: Theory and evidence

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ABSTRACT

Focusing on the idea that a different allocation of bargaining power between the public official and the private agent can explain the emergence of two types of corruption, this paper develops a theoretical model which provides an account of different level of bribes and incentives when the bargaining power is in the hands of the official (active corruption) or in the hands of the private agent (passive corruption). By employing Italian data which explicitly differentiate between active and passive corruption, the paper empirically re-examines the determinants of the aggregate level corruption. The results show that the various categories of government expenditure, which proxy different allocations of bargaining power, differently affect active and passive corruption.

1. Introduction

Corruption affects the vast majority of poor and wealthy countries: by distorting resource allocations, it can decrease social welfare and impair capital accumulation, leading also to lower growth and poverty traps (Del Monte et al., 2001; Aidt et al., 2008; Angelopoulos et al., 2009). Though extensively analysed, many questions still puzzle economists: What is the real nature and what are the ultimate causes of corruption? The available evidence is inconclusive. Unsurprisingly, corruption cannot be easily defined or measured, given its complex nature and facets. Tanzi (1998) argued that corruption can be so ingrained in the social fabric that its very nature seldom becomes elusive, not to mention disentangling its determinants. Moreover, the causal direction between corruption and other relevant socio-economic dimensions cannot easily be established.

Since corruption mainly involves the public sector, economists hint at political institutions as its proximate cause: though electoral rules, the strength of parties competition, and the type of government do not directly cause corruption, these are the frameworks both shaping policy decisions and creating rent-seeking opportunities. Many empirical studies document that democratic regimes succeed in containing the spread of corruption.¹ Bhattacharyya and Hodler (2015) find that democratization and media freedom reduce corruption. Persson et al. (2003) find that the proportional voting system spurs corruption: unlike a majority voting system, poor direct accountability pushes politicians into more opportunistic behaviour. Nonetheless, Bardhan and Yang (2004) argue that excessive political competition that reduces the likelihood of re-election may promote rent-seeking.

The political framework is just one out of many causes of corruption, as countries with similar systems experience different levels of bribery. Social capital and norms, the level of public wages, the monitoring of bureaucrats and the degree of trust and compliance also play crucial roles in determining corruption (Hague and Sahay, 1996; Acemoglu and Verdier, 2000; Van Rijckeghem and Weder, 2001; Abbink, 2004; Blackburn et al., 2006; Baik et al., 2010). For example, Putnam et al. (1994) shows that regional

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governments are less effective in Italy where proxies of *civic virtues* score lower. Socio-economic factors are also relevant: Glaeser et al. (2004) suggests that higher per capita income, higher educational levels and higher civic engagement should lead to less corruption due to greater aversion to illegal behaviour and closer monitoring of public officials' activities.

Despite researchers' efforts, so far the literature has overlooked a key feature: corruption is an *agreement* through which a public official receives a payment in exchange for a favourable decision on a specific matter and, as with every agreement, the splitting of its gains depends on the allocation of bargaining power of the parties involved, with bribes being high when public officials have great power and private agents fall behind. The bargaining circumstances can lead to radically different terms of trade between the two parties. The corollary is that corruption itself depends on bargaining power and on its deep causes. Notably, Aidt (2003) identifies a bureaucrat's discretionary power as a necessary condition for corruption to arise. Given these premises, we distinguish between two types of corruption. In the first, *active corruption*, the bureaucrat has the bargaining power and can set the level of the bribe: we refer to this trade as *active* because it is the bureaucrat who "demands" and sets the bribe. In the second, *passive corruption*, the private agent has the bargaining power and sets the amount of the bribe. Significantly, in some legal systems, such as in Italy, the law distinguishes between *concussione* (active corruption) and *corruzione* (passive corruption). We believe that previous studies have missed a key feature of corruption and its determinants by not distinguishing between active and passive corruption, yielding to misleading policy recommendations.

On this premise, we build a theoretical model that rationalizes how the factors affecting active and passive corruption determine bribes in a bureaucrat–private agent relationship setting. We consider an economy where bureaucrats are in charge of procuring two different types of public good. The type of public good is a proxy for the allocation of bargaining power: "complex public goods" signal stronger bargaining power in the hands of the supplying firm (because few firms can supply these goods). This power structure implies that procuring this type of good involves more passive corruption because the firm can impose the terms of the exchange on the bureaucrat. The opposite scenario results in the procurement of "simple public goods", because active corruption predominates, i.e., the bureaucrat fixes the terms of the bribe. Hence, the total amount of the two public goods purchased and the corresponding procurement contracts determine the equilibrium level of active and passive corruption as well as the level of total corruption. Since the two types of corruption have different features, a change in exogenous parameters (such as the opportunity cost of corruption for bureaucrats or the amount of rent-seeking) differently affects active and passive corruption.

The model predicts that with a given allocation of bargaining power in the economy (i.e., a given amount of the two goods to be purchased), richer regions should exhibit lower levels of total corruption, both active and passive. As the economy grows richer and average wages increase, corruption starts falling only when a threshold level of income is crossed. Conversely, by increasing the possibility of rent-seeking, an increase in government expenditure raises both active and passive corruption. Nonetheless, in both cases, the rate of change in active corruption exceeds the rate of change in passive corruption.

While a precise correspondence between the nature of the public goods and the prevalence of one form of corruption cannot be easily established at the statistical level, some compelling anecdotal evidence supports the notion that passive corruption prevails whenever complex public goods are provided. Very recently, in a multi-million contract between Finmeccanica and the Indian Ministry of Defence for the supply of twelve Augusta Westland helicopters, the chief executive of Finmeccanica, a well-known monopolistic firm, was prosecuted for *corruzione* (passive corruption). In the same sector, defence, a case of *concussione* (active corruption), instead, regarded a number of Italian naval officers who demanded bribes from fourteen competitive firms that provided fuels and lubricants to the Italian Ministry of Defence. In a different sector, healthcare, the Italian firm Hermex, has been convicted for *corruzione* in relation to a bribe paid to public officials in order to secure a contract supplying sophisticated medical equipment to the Cancer Institute in Milan.

Using Italian data on active and passive corruption (*concussione* and *corruzione*, respectively), we re-investigate the determinants of corruption (public expenditure). We aim to show that the new interpretation and measurement of corruption may help explain certain empirical conundrums. As an alternative approach, we regress a measurement of active and passive corruption on government expenditure identified through its *components* (education, welfare, healthcare and defence) and its *categories* (current and capital). The notion is that goods in sectors such as education or welfare have a lower technological specificity and thus the supply of these goods involves a higher level of active corruption. On the contrary, one should observe a lower impact on active corruption following an increase in government expenditures when the increase concerns expenditures in healthcare and defence. The results confirm this prediction and more generally show the relevance of distinguishing between different types of corruption and moving beyond the analysis of aggregate corruption data.

The paper is organized as follows. Section 2 presents a simple benchmark model of active and passive corruption. Section 3 presents the empirical estimates. Section 4 concludes.

2. A simple model

Let us consider an economy in which public goods must be procured. The government assigns public officials (bureaucrats) the task of procuring these goods, which are produced in the market by a given number of firms. The interactions between bureaucrats and firms occur pursuant to contracts that might entail some form of corruption. Corruption, which can be viewed as a component of the agreement between the official and the firm,² results in a benefit accruing to the firm and a bribe accruing to the bureaucrat. The size of the benefit and bribe depends, among other factors, on the allocation of bargaining power among the parties. In other words,

² It might be considered as a shadow agreement in a formal contract of public procurement.

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