

Corruption and the New Institutional Economics

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Abstract

Corruption is common in poor and middle-income countries, but relatively infrequent in wealthy ones. How does corruption decline with modernization? In this essay, I consider two ways that analytical tools that derive from the New Institutional Economics may contribute to a better understanding of corruption and modernization. First, even where laws prohibit corruption, it often persists. How do cultures of corruption develop, and how can they be changed? Second, how do anti-corruption interests organize politically to change institutions that facilitate patronage and discretion, replacing them with meritocratic, formula-bound ones?

The Puzzle

What do we want to know about corruption? More precisely for the present context, how can we use the theoretical apparatus inherited from the New Institutional Economics (NIE) to make headway on important questions about corruption?

There is a lot we don't know about corruption. To my mind, the major intellectual challenge we face arises from a lack of serious understanding of how countries move from being plagued by corruption to a situation where corruption is, if not inconsequential, at least not one of the major obstacles facing citizens on a daily basis. The countries of the world that today are in the privileged latter position were, all evidence suggests, at one time as corrupt as those developing nations caught in the grip of endemic political wrongdoing. At one time, the United States experienced the kind of corruption that in the contemporary world afflicts countries as varied as Argentina and Nigeria (Glaeser and Goldin, 2006; Gingerich, 2013; Smith, 2007). In the nineteenth century, Sweden's squeaky-clean bureaucracy was rife with patronage appointments (Rothstein and Teorell, 2015). Germany once experienced chronic voter intimidation and electoral fraud (Mares, 2015). The

strong cross-sectional relationship that we observe today — the least corrupt countries are all wealthy, whereas the more corrupt are poor and middle-income — is merely one result of the poorly understood process by which improvements in government and governance accompany economic development.

Definitional Digression: What Is Corruption?

Some might pause at the outset at this characterization. Can it be true that the United States is a relatively uncorrupt country if less than a third of adult population considers elected politicians to be honest?¹ What do we mean by corruption, anyway?

The standard definition of corruption is that it entails the use and abuse of public office for personal or partisan gain. This is probably what many Americans have in mind when they condemn today's politicians for corruption: that at present, elected officials seem to be more interested in personal financial gain than in devoting themselves to improving the public weal. Yet few of those rent-seeking politicians that are so intensely disliked appear to be engaging in illegal behaviors. They rarely take kickbacks, orchestrate voter fraud, or steal from the public purse. Rather, they appear to be profiteering — mainly in legal ways — from their offices by using their access and influence to steer policy in ways that benefit themselves and their families. Does this mean that we systematically underestimate the frequency of corruption in the wealthy and supposedly clean countries of North America and Western Europe?

To answer this question, we have to distinguish the *illegal* use and abuse of public office that we observe with frequency in the countries that are generally considered highly corrupt from the perfectly *legal* influence peddling and cronyism that public opinion considers corrupt in the world's wealthy nations. The court of public opinion classes these latter behaviors

¹Pew Research Center, "Beyond Distrust: How Americans View Their Government," Nov. 23, 2015; <http://www.people-press.org/2015/11/23/beyond-distrust-how-americans-view-their-government/>, accessed March 30, 2018.

as corrupt, although they are (generally) not open to prosecution in a court of law. The data we use to think about corruption cross-nationally are based neither on an accurate count of public officials who engage in illegal behavior nor a count (accurate or not) of the susceptibility of these officials to engaging in influence-peddling. Rather, the indices that allow us to measure the relative frequency of corruption in countries around the world reflect *perceptions* of corruption — usually on the part of foreigners doing business in the specific country.² This means the indices are probably biased towards including perceptions of how likely it is that a foreign business will be asked for or could benefit from paying a bribe to receive a license, a permit, or other similar government authorization (Arndt and Oman, 2006). And this in turn could occur at quite different rates than the frequency with which ordinary people are asked by civil servants for a bribe in order for the latter to perform his official functions (Razafindrakoto and Roubaud, 2010).

What public opinion considers corrupt may be different than what is legally deemed corrupt, which is different again from what gets measured cross-nationally as corruption. As an illegal or publicly unapproved activity, corruption is something its perpetrators want to keep hidden, making it particularly difficult to measure with any real accuracy or consistency. Additional confusion arises when we consider corruption historically, since many activities that are today illegal — the selling of public offices, to take one example — were once entirely legitimate.

Rather than use the restricted space here to solve this definitional problem, I propose that we focus on *relative* corruption across time and space. The developed wealthy democracies were once relatively much more corrupt than they are now. The world's poor and middle-income nations are relatively more corrupt than today's developed wealthy democracies. Even if we believe that today's wealthy democracies exhibit a surprising amount of corrupt activities, the frequency and aggregate magnitude of those activities are simply much less

²The most well-known of these indices is Transparency International's Corruption Perception Index.

than in these other, more corrupt, contexts.

Two Questions

Let us now return to the main issue at hand. How can tools developed by the New Institutional Economics aid in understanding why the frequency with which politicians engage in illegal activities declines with economic development?

There are, I believe, two interesting avenues currently open that may prove fruitful to explore this question. The first focuses on norms and expectations, and how these do or do not come into alignment with formal legal rules. The second has to do with the role of intra-elite political conflicts in reshaping incentives, behaviors — and perhaps ultimately norms as well. In the remainder of this brief chapter, I will discuss each.

Formal Legal Institutions and Cultures of Corruption

One of the chief insights of NIE is that institutions can be decomposed into formal rules and informal patterns of behavior. In understanding persistent corruption, informal patterns of behavior are especially important. It is illegal almost everywhere for government officials to extort or accept bribes to do their jobs. Where they do so, this behavior is sustained by informal institutions — by a culture of corruption that makes it easy to participate in corrupt transactions and difficult to resist. When corruption is the norm, it can be difficult for individuals to remain immune to it. One important unknown in the study of corruption is how norms change, so that what was once inevitable and socially acceptable becomes unusual and disparaged.

There are vast differences in the frequency with which ordinary people become entangled in corruption. As *Our World in Data* reports, “In countries such as Kenya, Yemen, Liberia and Sierra Leone, more than two out of three survey respondents report having paid a bribe

within the past year. In Denmark, Japan, Finland and Australia, only one in a hundred reports having paid a bribe in the same window of time.”³ Where most people pay bribes, they become a routine part of daily life — part of the culture, in other words. There are certain interactions with government officials where paying a bribe is expected by both parties. Where almost no one pays bribes, there is no expectation that they are part of doing business with government (see ch. 6, Fisman and Golden, 2017). How norms — in the sense of expectations of behavior — become established and how they change comprise great unknowns (cf. Chwe 13).

The answer cannot be that corruption flourishes where legal prohibitions are lax. Almost every country in the world has legislation making vote-buying illegal: nowhere is it legal to offer an elector cash in exchange for the promise of a vote for a particular candidate, for instance. Likewise, almost every country in the world makes it illegal for public officials to take cash bribes in exchange for favors, such as overlooking a zoning regulation or allowing someone to queue jump to receive a government service. And, finally, almost everywhere, there are legal sanctions in place to prevent bid-rigging in the process of public contracting, as when public officials arrange for a particular firm to receive the bid to build an airport, a road, or a school. Despite legal prohibitions, these are three of the most common types of corruption that occur around the globe.

There are two implications of this worth highlighting. First, in many important ways, laws against corruption are relatively similar worldwide. Of course, there are many national and even subnational variations in these laws, and more generally in the criminal justice systems that we observe. Yet the broad parameters of legal prohibitions against the most common forms of corruption are simply not that different around the world. The reason there’s so much vote-buying reported in African countries does not stem from the fact that

³Esteban Ortiz-Ospina and Max Roser, <https://ourworldindata.org/corruption>, published October 10, 2016, accessed March 24, 2018.

vote-buying is legal there, because it's not. It is just as illegal to offer cash for a vote in Nigeria as it is in the United States or the United Kingdom. And second — and this implication follows naturally — the formal, legal prohibitions against corruption that are in place are often ineffective.

This raises an old conundrum that lies at the heart of the New Institutional Economics: namely, when do formal institutions bite? Relatedly, for formal institutions to operate as expected, do informal norms and expectations need to underpin them? When do people come to believe that government will actually behave as its legal structures proclaim, and that the *pays réel* will correspond to the *pays légal*?

These problems touch on issues of compliance (Levi, 1997), but are not identical, since typically corruption involves ongoing wrongdoing and law-breaking by some of the very people charged with upholding the law. In corrupt environments, where even law-makers are law-breakers, political elites charged with monitoring and enforcing the law have often gained power by using patronage and corruption to build clienteles that support them. As a result, they are usually not reliable proponents of reforms to improve governance (Geddes, 1994).

Observing persistent corrupt practices tells us that simply writing down a legal prohibition is inadequate for changing behavior. Not only must effective monitoring and enforcement mechanisms be put into place but society must also come to expect that corruption simply does not pay. We have little robust insight into where these expectations come from or what sustains them. Yet they appear crucially important to any permanent reduction in corrupt activities by government officials.

Intra-Elite Conflicts and Challenges to Corruption

The NIE approach is especially well known for its contribution to our understanding of limited government, especially the study of how institutions emerge historically that restrict the discretion of government (North and Weingast, 1989). In the canonical account provided by Douglas North and Barry Weingast, the British crown's promises only became credible when institutional arrangements were altered in the seventeenth century to include a second actor to check the crown — namely, Parliament. Gary Cox has pointed out that this story is incomplete, however (Cox, 2017). While it is true that after the Glorious Revolution, Parliament restrained the monarchy on fiscal and military matters, Cox argues that the civil component of government remained almost entirely under the discretion of the crown until passage of the Civil List Act of 1831. As a result, except in the military domain, the monarch continued to use patronage criteria for bureaucratic appointments, and corruption remained a noticeable political problem in Britain. Public offices were effectively personal property; office holders were appointed for life, and appointments were sinecures rather than merit-based. It took a hundred and fifty years after the Glorious Revolution for Parliament to develop the means to check government discretion and corruption in the civil domain.

These stories of the impact of institutional arrangements on the protection of property rights and the later curtailment of corruption are deliberately told as norm-free; aside from brief and analytically inconsequential references to religious conflict, North, Weingast, and Cox focus exclusively on incentives, interests, and institutions. As new elites gained economic power due to changes in the nature of production, they sought to use political institutions to protect their economic interests. In this perspective, institutional change occurs as an outgrowth of intra-elite conflicts.⁴

There are implications of this for our understanding of corruption. By this account,

⁴The story recounted by Alessandro Lizzeri and Nicola Persico (2004) of suffrage expansion in nineteenth century England is broadly consistent with this view.

permanent reductions in corruption result only when new economic elites gain an interest in preventing it. This in turn emerges from economic interests that align with well-operating government rather than the endemic unpredictability of discretion, personalism, and patronage. Over time, these elites learn to use political power to change the institutional arrangements that had previously permitted chronic government malfeasance.

We observe interesting analogies in some contemporary anti-corruption movements. India's Aam Aadmi Party (AAP), which governs New Delhi, arose to push an anti-corruption agenda and is propelled by an urban middle-class that urgently insists on improving the delivery of basic public services so it can go about its business. AAP party workers hence intervene in myriad ways, mainly to correct bureaucratic and political malfunctions: accounts of AAP successful on-the-ground interventions of this sort "essentially entailed acting 'as per rule,' a phrase referencing extant constitutional and legal architectures in the country . . ." (Roy, 2014, p. 48). Groups with new economic interests and socio-cultural resources organize politically to correct corrupt government activities by insisting on the neutral and equitable application of existing laws and regulations. The process of economic modernization promotes these groups, rendering them powerful.

This again raises a host of questions for which we have no clear answers. When and how do anti-corruption interests develop? When in particular do economic entrepreneurs favor the uniform, equitable, and dispassionate application of the law? How do technocrats come to exercise influence over the implementation of government policy, shifting it from discretionary to formula-based (Diaz-Cayeros et al., 2016)? Alternatively, when do political parties commit to anti-patronage, anti-discretionary policies and establish meritocratic regulations in their place (Kernell and McDonald, 1999)? How do efficient civil services develop? Most importantly, when do existing rulers who benefit from corruption step back and permit these changes, and acquiesce to institutional changes that lock them in? Research on the United States shows that political parties were able to use control over

patronage appointments at the state level to retain political control there (Folke et al., 2011), in some cases well into the twentieth century. Parties that benefit politically from patronage appointments have little reason to replace these appointment mechanisms with meritocratic appointment processes. How then do meritocratic criteria come to be used? Some of the few accounts of this process that exist stress the importance of political competition (Geddes 1994; Lizzeri and Persico 2004; Popa 2015), raising the question of how effective competition develops. The establishment of representative political institutions or of universal suffrage appear neither necessary nor sufficient to account for the development of genuine partisan competition.

Conclusions

In sum, there are two sets of questions well deserving of sustained research. First, how do cultures and expectations change to align them with legal-bureaucratic institutions? That is, how does the law come to be observed rather than disregarded? Second, how do new interests arise and organize politically to challenge and ultimately displace corrupt institutions? That is, how do laws change? These are big questions — much bigger than the topic at hand, of course. Corruption is but one instance of a great many legal/institutional and cultural practices that are gradually wiped out with modernization (cf. Stokes et al., 2013). Among the vast and profound cultural changes wrought by modernization, the gradual reduction in the resource to violence in daily life that has taken place in the west since the fourteenth century stands out as one of the most important (Elias 1939). Alongside this, the demarcation between public and private that is represented by the very concept of corruption is clearly of equal importance. Much research remains to be done understand how this demarcation comes to be internalized and lived with by most people in modern societies.

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