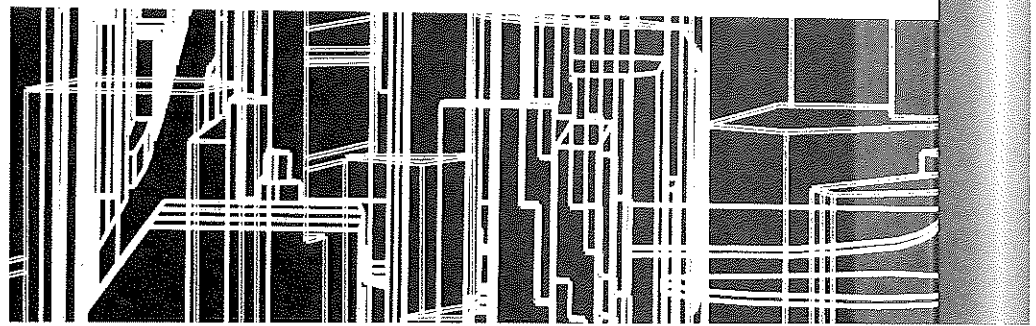


# THE POLITICAL ECONOMY OF CORRUPTION

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## 2 The Political Economy of Corruption

### On the Link between Corruption Control and Cronyism

*Kaushik Basu*

#### Corruption Control: Promise and Practice

History has many examples of individuals with mal-intent, who through persuasion, politics and guile manage to come to power and then do what they wanted to do—loot and plunder, allowing corruption to flourish. Interestingly, history is also replete with examples of leaders who come to power, concerned about the level of corruption in society and with the aim of controlling or even eradicating corruption but end up not just doing little but exacerbating the problem, with the nation getting mired in even more corruption and cronyism.

There is no way to be sure of the original intention of a leader. No one knows what led Vladimir Putin to seek power, but to Russians, Putin, in his early days, with his reputation for professionalism, from the time he was adviser to the democratically elected mayor of St. Petersburg, brought hope that he would end the erratic rule of Boris Yeltsin and the rampant corruption, such as the one in cahoots with the Swiss construction company, Mabetex, in which Yeltsin's family members were engaged in. Likewise, Daniel Ortega brought hope to Nicaraguans by his grit and determination to fight and overthrow the openly corrupt government run by Anastasio Somoza Debayle. The glimmer of hope however got blighted, in both these cases, as corruption became rampant, as did cronyism. Indonesia's Suharto came to power dislodging the old order, supported by students, and giving hope for a just and civilized society and "social justice for all." His thirty-one-year rule ended with Indonesia ranked as the most corrupt nation in the world by Transparency International. In all these cases, the nation is usually left with widespread corruption, disproportionate amount of business and work captured by a few cronies of the leader, and the nation mired in odious debt.

This is such a widespread phenomenon, of a leader coming to power full of good intention to end corruption and then ending up propagating more of the same, that we need to understand why this happens. As it turns out, there is good reason why this happens, and the aim of this chapter is to explain this.

Here are the basic premises of my argument. First, note that when corruption is widespread it is easy to get away being corrupt since there is only that much resource available with the government to detect corruption and then arrest the corrupt. Secondly, in countries with a lot of complex laws and rules, it is natural to see widespread violation of the law, including indulgence in corrupt activities. Some of this happens because people do not even know that they are violating the law, since so many of the laws are dormant, gathering dust, with neither citizen nor the enforcer of the law even being aware of them.

The ubiquity of corruption gives rise to unexpected political power in the hands of the oligarch at the top or the political leader, which the leader may not be fully aware of before coming to the seat of power. Once they become leader, they soon realize they can basically have anyone arrested for violating the law, since there is such an embarrassment of riches to choose from, since virtually everybody violates some law. It was not hard for Putin's government to find reasons to incarcerate Alexei Navalny, though the real reason for the arrest was transparently obvious to all observers.

Next note that, in this setting, it will be in the interest of the political leader to direct the limited capacity to stop violation of the law and corruption to those who oppose the government or criticize the leader. To do otherwise and arrest one's friends and supporters would be to erode one's own power base. On the other hand, to arrest the corrupt but confine this to those who oppose the government will show determination to curb corruption (you are arresting the number of corrupt people you had promised to arrest at the time of your election) and, at the same time, shore up your political strength, having more and more of the opposition behind bars.

Hence, corruption control and the enforcement of the law, even when it begins with a serious intention, can easily end up as an instrument for silencing the opposition, critical media and voices of dissent in society. Conversely, this provides comfort and shelter to the leader's friends and supporters. In short, corruption continues to flourish, and worse, may morph into cronyism since those who are close to the leader feel safe and can violate the law more egregiously.

An interesting by-product of this analysis is that even when leaders carry out their pre-election promise of incarcerating more corrupt people than may have been happening till then, the total amount of corruption in the nation may rise. This counterintuitive result needs a little formal analysis to demonstrate. This is done in the next section.

What I construct in the chapter is a theoretical model, but my aim is to contribute ideas for the design of policy to control corruption. I have argued elsewhere (Basu, 2016, chapter 8) that to control corruption we need determination and courage, but we also need analysis and theory. We have commonly neglected the latter and for that reason have failed widely in our effort to control corruption. I do not actually go into policy design in this chapter, but the chapter may be viewed as an effort to contribute ingredients for the design and control of corruption.

The argument in my chapter suggests the need for an autonomous body to control corruption, as has been tried in some countries such as Indonesia. But, of course, there are risks with autonomous bodies that can become loose cannons and go out of control. One of the reasons for constructing a formal model is that it can give us insights into starting up a discussion and analysis for designing more effective policy.

### How Corruption Control May Exacerbate Corruption: A Model

Consider a society with a set  $N = \{1, 2, \dots, n\}$  of individuals. I am making the standard neoclassical assumption that all individuals are potentially corrupt, that is, they will choose to indulge in corruption if the net return from this is positive. I want to, however, put on record my belief that in reality there are people—probably lots of them—who are innately not corrupt, that is, they reject corrupt behavior (or at least certain kinds of corrupt behavior) simply because their moral compass does not allow this, and not because by doing cost-benefit analysis they conclude that corruption does not pay.<sup>1</sup> This alerts us to the fact that nurturing a moral compass can play an important role in controlling corruption, though this is a topic neglected by mainstream economics. This is not a theme pursued in the present paper but should not be forgotten when devising policy. With this caveat in mind, let me focus on the set  $N$  of 'corruptible' people.

Since we are focusing on the set  $N$ , we can use Becker's (1968) logic in explaining human behavior. Let  $B(i)$  denote the benefit that person  $i \in N$  gets from an act of corruption. I shall follow the convention that if  $i > j$ , then  $B(i) < B(j)$ . Excepting for the fact that I am ruling out tie-breakers (purely for simplicity of analysis), this is not an assumption but simply a convention for naming individuals. The person who gets the highest benefit from the corrupt act is named person 1, the person who gets the least benefit from the corrupt act is named person  $n$ , and the names occur monotonically for those in between. A possible  $B(i)$  function is illustrated in Figure 2.1.

Let us suppose that currently there is a limit to the government's vigilance capacity and it can investigate at most  $m$  ( $< n$ ) individuals. Let  $F$  be the pain of being jailed. The absence of a subscript means everybody feels the pain of jail the same way. This is a harmless assumption. It follows that  $i \in N$  will choose to indulge in corruption if

$$B(i) \geq \frac{m}{n} F \quad (1)$$

I am making the assumption that in the absence of conscious policy concerning corruption control by the political leader, all corrupt people are equally liable to

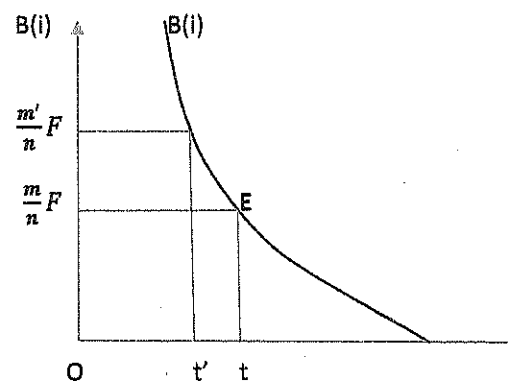


Figure 2.1 Relationship between number of corrupt individuals and benefits from corruption.

be caught and punished for being corrupt. In reality those close to government may be more safe, but this polar assumption makes the analysis easier.

Therefore, using  $f$  to denote the inverse of  $B$ , and given  $m$ ,  $n$  and  $F$ , the total amount of corruption in society will be given by  $t$ , where

$$t \equiv f\left(\frac{m}{n} F\right) \quad (2)$$

Given the values of  $m$ ,  $n$  and  $F$ , the amount of corruption (which is the same as the number of people choosing to be corrupt) is given by the point marked  $t$  in Figure 2.1.

Now consider an individual running for office, say to be president. The person is genuinely troubled by the high level of corruption in the country, that is, by the high value of equilibrium  $t$  in the country. She therefore runs for office by making a campaign promise of raising  $m$ . It is easy to see what

happens if  $m$  is raised to  $m'$ . Clearly, the value of  $\frac{m'}{n} F$  will rise, which means

the equilibrium amount of corruption, denoted by  $t'$ , will fall. This is illustrated in Figure 2.1.

History has many examples of genuinely concerned leaders running for office to cut down corruption and making promises like coming down hard on the corrupt. This can take the form of an election campaign commitment of raising the level of vigilance and investigating a larger number of people for corruption. Let us say the leader running for office promises to raise  $m$  to  $m'$ . Under normal circumstances this should cause corruption to fall as just shown.

Many such people, after winning an election and coming to office, however, confront a dilemma they may not have anticipated earlier. In countries with widespread corruption, they have an embarrassment of riches in terms of whom to investigate and whom to arrest. After all, there are limits to the capacity to monitor and investigate the behavior of individuals and corporations.

One thing politicians on taking office learn quickly is that if they investigate a random selection of people, they will soon have to punish many of their friends and supporters. This will of course damage their own political support base.

Under these circumstances, there is one easy way to keeping your promise of raising  $m$  to  $m'$ , without damaging your political base. Focus your attention on those who are your political opponents, reporters and journalists who may have criticized you, corporations who did not financially support your election campaign, and so on. Once you start out on this path, corruption begins to morph into cronyism. Some individuals and firms know they are in the comfort zone, by virtue of being friends or cronies of the leader, while others are persecuted. This ends up destroying democracy and creating a crony capitalist system or oligarchy. We have seen examples of this from Marcos' Philippines, through Somosa's Nicaragua and Ben Ali's Tunisia, to Putin's Russia. The propensity of corruption control to morph into cronyism is an important enough result to keep in mind. This is a problem that has plagued the world. But I want to now move on to a possible outcome of this kind of cronyism.

An interesting by-product of the above analysis is the following. It can be shown that, in some circumstances, this propensity of political leaders to shelter friends can not only nurture crony capitalism but also end up increasing the level of corruption. More formally, I am claiming that raising  $m$  to  $m'$  (i.e., investigating a larger number of people for possible corruption) can actually raise the total level of corruption in the country.

To see this, suppose that of the  $n$  ( $= \#N$ ) people, half are supporters of the political leader and the other half are opponents. Suppose that the two sets of people (the supporters and the opponents) are identical in terms of their propensity to being corrupt. It then follows that the aggregate  $B(t)$  function shown in Figure 2.1 is composed of two identical  $b(t)$  functions, as shown in the two panels of Figure 2.2. Thus the function shown in Figure 2.1 is simply a horizontal aggregation of the functions shown in the two panels of Figure 2.2. Let us assume that the left panel shows the preference of the supporters of the leader, and the right-hand panel depicts the preference of the opponents. We have assumed they have identical preferences. Hence, the two curves are the same. The original equilibrium in Figure 2.1, depicted by point  $E$ , is now shown by the equilibrium of the supporters,  $E_1$ , and the equilibrium of the opponents,  $E_2$ .

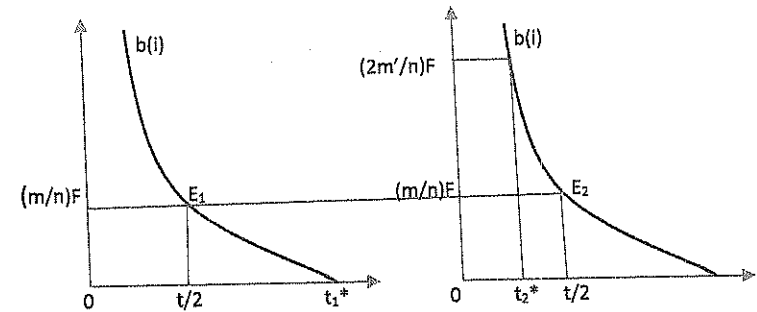


Figure 2.2 Corruption preferences of supporter (left) and opponents (right).

I am making the strong assumption here of there being no discrimination in investigating people for corruption depending on their political allegiance. Corruption control happens mechanically by an apolitical bureaucracy. And it becomes an active political matter only after a leader comes to power with a focus on corruption. The result derived below will have to be more qualified if we abandon this assumption.

Next suppose the new political leader says she will stick to her electoral promise of investigating  $m'$  ( $> m$ ) people, but she will do this by an unusual method. This will unlikely be made by a public order, but it will be made clear through nods and winks. She will not investigate any of her supporters and investigate only the opponents. Clearly then each of the opponents faces a probability  $\frac{2m'}{n}$  of being investigated for corruption.

It is obvious from Figure 2.2 that corruption among the opponents will fall to  $t_2^*$  and the corruption among the cronies will rise to  $t_1^*$ . Depending on the curvature of the  $b(t)$  function, it is entirely possible that

$$t_1^* + t_2^* > \frac{t}{2} + \frac{t}{2} = t \tag{3}$$

In brief, going for greater vigilance on corruption, but, at the same time, directing this entirely at those who oppose you, while, at the same time, protecting your friends and supporters, can make for a heady brew, giving you crony capitalism and overall higher corruption all at the same time.

Nations around the world have stumbled into this. The higher corruption and crony capitalism can be the outcome of a good leader, who comes to office with genuine interest in curbing corruption and drifts into this cronyism-corruption trap.

## Corruption and Policy

What does one do to control corruption? This is a big topic; this has concerned rich and poor countries, even though the nature and extent of corruption varies widely across nations. In a lot of emerging economies, corruption affects the everyday life of ordinary people in ways that one does not see in most advanced economies, where corruption takes the form of fewer but larger scams involving arms and other deals.

Among activists the end of corruption is often treated as purely a matter of grit and determination. If you are serious about rooting out corruption, you can. In reality, taking corruption out of the economy is difficult and an intricate matter of science, analysis and design. As the model above shows, there are situations where catching and punishing more corrupt people can exacerbate rather than limit corruption. Further, what I do not go into here but is important to note is the problem of collateral damage (Basu, 2016). Removing corruption from society is akin to the problem of taking a tumor out from the human body. One has to do this without damaging healthy tissues around the tumor, or else the cure can be worse than the disease. Likewise, corruption has to be taken out of the economy without damaging legitimate activities. Many nations have suffered by using blunt instruments like demonetizing the nation's currency, which can do a disproportionate amount of collateral damage to the economy.

Corruption is a big challenge for policymakers and researchers working in the area of law and economics. Not surprisingly, a lot has been written on this, from providing early conceptual foundations to analyze the problem of corruption and its control (Rose-Akerman, 1975; Bardhan 1997) to taking on contemporary concerns, using tools of game theory and controlled laboratory tests, which help us understand the challenges arising from increasing globalization and its attendant problems involving cross-country conflict and intercountry finance, and from the rise of digital technology and social media.<sup>2</sup>

One important regulatory idea that emerges from this chapter in the context of the problem illustrated in the previous section is the need for an autonomous body that is outside the control of politicians, like a nation's judiciary or the central bank in many countries, and can monitor, investigate and contain corruption. For a good leader, who comes to power with the genuine interest of weeding out corruption, the wise decision is to create such an autonomous body, empowered to control corruption and punish the guilty with the help of the nation's judiciary and beyond the reach of political leaders, including the good leader himself or herself. This is because, as the model above shows, if politicians have the power to decide who to investigate, they will not arrest their friends, and as a result, the shelter provided to friends and cronies can make the problem worse. So it is in the interest of the new leader keen to control corruption to take the power to control corruption out of his or her own hand and vest it in an autonomous authority.

A good example of what this can do comes from Indonesia. In 2002, Indonesia tried to implement the kind of policy I am suggesting here. Indonesia, bruised by a history of devastating corruption, set up a new entity to control corruption. The Corruption Eradication Commission, which has the acronym KPK, is an empowered, autonomous body with the responsibility of investigating and controlling corruption. After Suharto fell from power in 1998, having pilfered 35 billion dollars and leaving the nation ravaged by corruption, the country faced a challenge like few other nations had faced (Blank, 2019). It is arguable that the creation of KPK played a major role in cleansing quite a bit of this legacy. From being the world's most corrupt nation in 1995, it became 89th out of 180 nations ranked by Transparency International. As Blank (2019) argues, KPK played a major role in this improvement. It is arguable that this would not have been possible if KPK was kept under the control of the government. In that case, no matter what the original intention of the government's leaders, this would soon become an instrument for silencing opposition and lead to more cronyism and possibly even more corruption.

Let me close the chapter by returning to what was pointed out earlier, namely, the need to step beyond the model discussed here and pointing out what is anathema for mainstream economics, namely the need to educate individuals to carry their own moral compass in their heads and to desist from being corrupt. I began this chapter by recognizing that societies do have people who are not corrupt. These are people who have it in them hardwired not to indulge in certain kinds of activities. While mainstream economics does not recognize this, because of the axiom that individuals are uncompromisingly selfish, it is arguable that in reality the success of human society depends in large measure on us carrying certain kinds of norms in our head.

What Ken Arrow pointed out in his 1978 essay is right. If we did not have a basic commitment to fairness and trust, the "world of total self-interest would not survive for ten minutes." Just as the invisible hand of the market relies on these implicit assumptions about cultural norms, ignored by economists but critically important for the market to function effectively, the control of corruption does rely a lot on the norms we individuals carry in our heads. The time has come to study, understand and nurture the appropriate norms.

## Acknowledgment

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## Notes

- 1 The clear contrast is with Becker (1968), who assumes all human beings are rational in the sense of being amoral. In Basu (1983), I had argued that not only are many

human beings programmed not to be corrupt or at least not to be corrupt in certain ways but that economic life is made possible by this kind of hardwiring in human beings. Subsequently, it has been shown that there are ways of getting around the argument I had produced in that paper by demonstrating that pure rationality and self-interest can lead to similar behavior (Myerson, 2004; Larry Samuelson and Stacchetti, 2017), for instance, by allowing for the war of attrition to break out when people violate certain norms. While admitting that this is valid, I remain convinced that human beings do have moral hardwiring in their heads.

- 2 See, for instance, Basu, Bhattacharya and Mishra (1992), Mishra (2006), Choi and Posner (2007), Luddington, Gulati and Brophy (2010), Abbink et al. (2014), Oak (2015), Jha and Sarangi (2017).

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## 3 Corruption, Institutional Trust and Legitimacy

### A Vicious Circle

*Amadou Boly and Robert Gillanders*

## Introduction

Corruption remains endemic in much of the world with very few countries on course to meet the 2030 corruption target enshrined in the United Nations Sustainable Development Goals. In part, this is explicable by entrenched elite and their simultaneous responsibility and reluctance to monitor and punish corruption. In part, this is because 'anticorruption strategies are adopted and implemented in cooperation with the very predators who control the government and, in some cases, the anticorruption instruments themselves' (Mungiu Pippidi, 2006: 87).

Another reason for the persistence of corruption as a leading barrier to economic and social development is its self-reinforcing nature. Stephenson (2020) outlines several ways in which a corruption trap can arise. These include a fall in the chance of an individual being caught and punished as fixed law enforcement resources are stretched thin as corruption spreads; outright capture of the justice system; increased confidence in the complicity of others in corrupt acts; a collapse in both internal 'shame costs' and external stigma; selection into roles that offer opportunities for corruption; and a smaller tax and resource base.

Stephenson also points to a corruption-induced collapse in trust and an increase in cynicism as a fertile ground for increased corruption. By undermining expectations of fairness and efficiency, corruption can create a vicious circle of mistrust and bribery. As Cho and Kirwin (2007: 6) put it, 'people who have low expectations regarding the efficiency and impartiality of government try to look for an alternative to obtain access to public resources'. Cho and Kirwin test and confirm this bidirectional link using survey data from sub-Saharan Africa.

In this chapter we draw together results from several related literatures and argue that taken together they point to a related mechanism that can explain why corruption is so persistent in so many parts of the world. Even if elites and reformers are willing to put laws in place, the legacy of corruption and mistrust may render them ineffective. We begin by discussing the literature that has shown that corruption has a significant, in both economic and statistical terms, effect on citizens' trust in the institutions of the state. Predatory and