



## The Economics of Corruption - a university lecture on good governance and reform

All international organizations have started to emphasize the fight against corruption. Codes of conduct are gaining increasing importance in the eyes of multinational firms. Donor assistance is eagerly offered for effective reform programs. But training and qualifying students in anti-corruption, is still in its infancy. This is a requirement which universities face, making good governance and anti-corruption part of their programs. This document informs about a first course that has been created lately, filling this gap.

The course “the economics of corruption” was held four times already, in April 2001 and April 2002 in Göttingen, Germany; in November 2002 in Mozambique and in October 2003 in Passau, Germany. The latest presentation in October 2003 attracted 70 participants, 20 of them coming from foreign countries especially to attend this course. A documentation of these events is available at [www.gwdg.de/~uwvw](http://www.gwdg.de/~uwvw).

The course introduces into the economic analysis of corruption, defined as the misuse of public power for private benefit. Theoretical modelling focuses on the principal agent approach, an analysis of welfare effects, political economy, rent-seeking theory and models of kleptocracy. Institutional Economics is utilized to assess, how corrupt deals are contracted and enforced and how corruption impacts on policy credibility and investment decisions. Case studies and empirical research enrich the theoretical analysis. Emphasis is also given to corruption in international business transactions, to empirical analysis and to measurement techniques.

The course is directed towards graduate students that are in their third or fourth year of study. But the course is also open to a wider audience, including post-graduate students and those from other disciplines and countries. While these tend to be more advanced in some areas, they profit from the course bringing diverse theories and arguments into a coherent and overarching context. Practitioners from donor agencies, public servants or businesspeople have in the past widely attended the course. Their contribution is particularly valuable because they enrich the course with practical experience and are inspired by the open-minded atmosphere that universities can provide.

## Content

### I. About the Immeasurable

#### a. Why study Corruption?

What do we know about corruption? Is there an empirical approach to determining its adverse effects? What do empirical studies reveal about the causes and consequences of corruption?

#### b. Definitions and Opportunities

What are the various approaches to define the term "misuse" in a definition of corruption? How can bribery, fraud, embezzlement and extortion be described with the help of a Principal-Agent model. In how far may bribery go along with fraud or extortion? How can one distinguish corruption from related phenomena such as gift-giving and lobbying? Which sectors are vulnerable to corruption?

#### c. Quantitative Assessments

What are the problems with objective data on corruption? What does the term "degree of corruption" mean? What are the pros and cons of a composite index! What are the potential biases that arise with subjective assessments of corruption? How do individual sources assess the degree of corruption?

### II. Individual Calculus and Public Welfare

#### a. Corruption and Regulation

How does bureaucratic discretion affect the behavior of public servants? How does a regulated market compare to one where public servants maximize income from corruption? What are the pros and cons of speed money? Why can corruption be a cause of market distortions! In how far may corruption undermine the selection of the best qualified bidder? In how far may the decision which goods to buy in public procurement be distorted by corruption?

#### b. Incentives, Ethics, and Punishment

How can bureaucrats be induced to serve the public? What is the role obtained by monetary inducements that promote honesty? In how far can these be implemented? In how far can incentives reduce corruption? Why may penalties crowd out and intrinsic motivation?

#### c. The Business People's Dilemma

In the absence of ethical considerations, how would businesspeople and public officials determine whether to engage in bribery? How may "moral costs" enter into the calculus? What forces the bottom line of the moral code to win out? Why may ethics survive competition? What is rent-seeking as opposed to profit-seeking? Why is competition for rents not as bad as suggested by rent-seeking theory? What are the pros and cons of lobbies which strive for broader interests?

#### d. Supply of Corrupt Services

Does competition for political positions increase or decrease corruption? In how far may independent departments "overgraze the market" when requesting bribes? What type of corruption emerges when self-seeking is the actual object of government! Why does a perfect kleptocrat avoid welfare losses! Why is such a static analysis insufficient?

### III. Corruption and the New Institutional Economics

#### a. Making Corrupt Deals

Why are transaction costs in corrupt exchange particularly large? How does a public official advertise his corrupt service? What are the methods for concealing a corrupt payment? In how far does contract enforcement represent a problem to corrupt parties? How may middlemen lower transaction costs? How can repetitive exchange act as an instrument for securing corrupt deals? How do corrupt partners integrate vertically, when trying to safeguard against opportunism? In how far can "social embeddedness" act as a facilitator to corrupt transactions? How does denunciation contribute to an analysis of the transaction costs?

**Time requirements:**

The course requires 28 hours of lecture and another 14 hours for sessions devoted to discussion and training. The usual approach has been to provide participants upfront with reading material so that the whole course can be carried out within 8 days. A possible schedule would be Monday through Monday (without Sunday), lecture from 9.00-10.30 a.m. and 3.00-4.30 p.m., sessions 11.00-12.30 a.m. A final test forms part of the course.

**About the lecturer:**

Johann Graf Lambsdorff holds a chair in economic theory at the University of Passau and is director of statistical work for Transparency International. He annually compiles the Corruption Perceptions Index on behalf of Transparency International. He widely published on corruption. Recent examples of his publications are How Corruption Affects Persistent Capital Flows, *Economics of Governance*, 4(3), 2003, Making Corrupt Deals - Contracting in the Shadow of the Law. *Journal of Economic Behavior and Organization*, Vol. 48 (3), 2002, How Corruption Affects Productivity, *Kyklos* 56(4), 2003, Corruption and Rent-Seeking. *Public Choice*, Vol. 113 (1/2), 2002

**Contact address:**

University of Passau  
Prof. Dr. Johann Graf Lambsdorff  
Chair, Economic Theory  
Innstrasse 27  
D-94032 Passau, Germany  
T: +49 (851) 509-2550  
F: +49 (851) 509-2492  
jlambsd@uni-passau.de