



Göttingen, April 25, 2001, 3 p.m. - 5 p.m.

Final Exam: The Economics of Corruption

From the four exercises listed below exactly three must be answered. In a preceding statement it has to be made explicit which questions were chosen. Apart from a dictionary and writing equipment no further material is allowed. Answers can be provided in English or German.

- 1) "The gold trade in Pakistan was formerly unregulated and smuggling was common. Shortly after Ms Bhutto returned as Prime Minister in 1993, a Pakistani bullion trader in Dubai, Mr Abdul Razzak Yaqub, proposed a deal: In return for the exclusive right to import gold, he would help the government regularize trade — and make some further private payments. In 1994 the payment of US \$ 10 million on behalf of Ms Bhutto's husband was arranged. In November 1994, Pakistan's Commerce Ministry wrote to Mr Razzak informing him that he had been granted a license to be the country's sole authorized gold importer — a profitable monopoly position"
 - a) Sometimes economists argue that corruption can be the effect of market restrictions. Use a graphical illustration to describe this argument for the case of an effective quantity restriction imposed on a market.
 - b) Illustrate with the help of the above given case study that the causality between corruption and market restrictions can also be reverse!

- 2)
 - a) Four firms compete for a monopoly license for gambling. The total rent is US\$ 240 Mio. One firm assumes that its competitors will spend US \$ 20 Mio. for rent-seeking (bribes and lobbying) each. Determine its optimum probability to win the contest and the optimum level of rent-seeking expenses, assuming risk neutrality and that its probability to win the contest is proportional its own rent-seeking expenses, divided by the sum of all firms' expenses.
 - b) How much will each firm spend for rent-seeking when all firms expect their competitors to optimize their expenses (Cournot-Nash solution)?
 - c) Rent-Seeking theory concludes total rent-seeking expenses increase with the number of firms. What is the economic reason for this conclusion? Why may this relationship not arise in reality?

3) From Indonesia many cases are known where Suharto relatives, instead of taking a monetary payment, were given a stake in the operation, e.g. by letting the briber found a joint-venture and handing out free shares to the bribee.

a) Describe in detail the transactional advantages that can arise with the above mentioned type of arrangement!

b) Corrupt deals are often made with well-acquainted business partners. What are the transactional advantages that arise in this case?

4)

a) There is a variety of welfare losses that can arise in case of corruption. Provide a list and explain them briefly.

b) A kleptocrat is only concerned about his own (corrupt) income and not that of his citizens. Nonetheless, he has an incentive to avoid these welfare losses. Explain!

c) For a very powerful kleptocrat one type of welfare loss becomes particularly strong and unavoidable. Describe this type of welfare loss!