

Göttingen, April 17, 2002, 3 p.m. - 5 p.m.

Final Exam: The Economics of Corruption

Subsequently you will find three exercises of roughly equal weight. All three must be answered. Apart from a dictionary, a non-programmable calculator and writing equipment no further material is allowed. Answers can be provided in English or German.

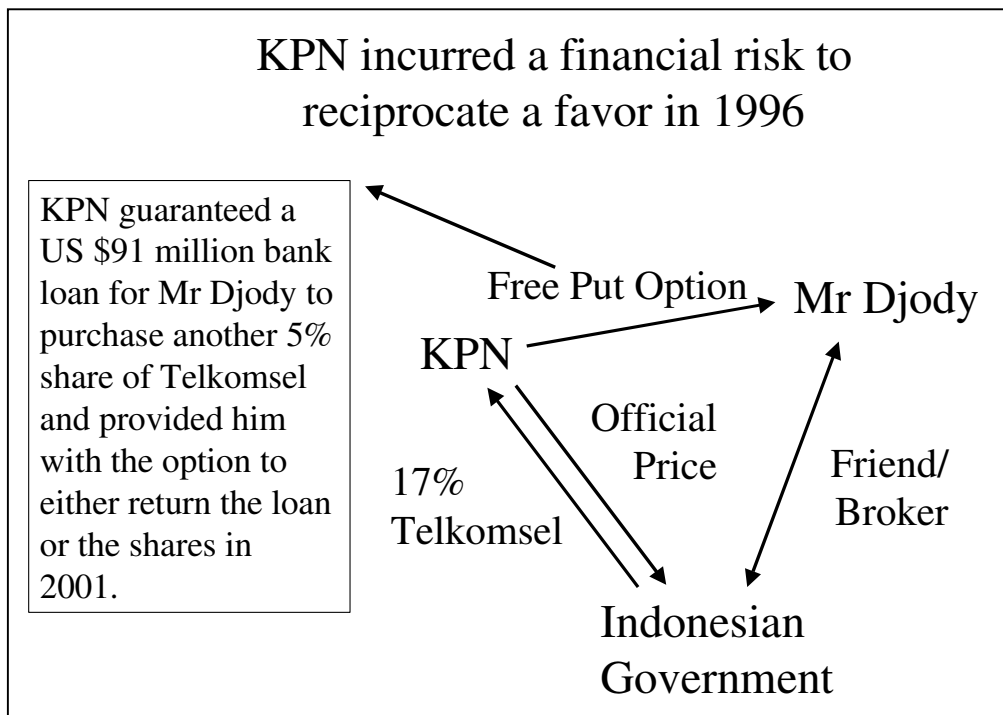
1. a) Explain the following four forms of corruption with the help of a principal-agent-client model: Bribery, Embezzlement, Extortion, and Fraud

b) Define what is meant by “clientelist”, “patrimonial”, “petty”, and “grand” types of corruption. In how far have these types of corruption an impact on the quantitative measurement of the “degree of corruption”?
2. The market for tobacco is characterized by customer’s willingness to pay (in €):
 $p=14-0,8x$ and the suppliers’ cost function $K=2x+0,2x^2$. Bureaucrats control this market and can request an entitlement from the producers for each quantity of tobacco sold.
 - a) Show that the outcome in case of perfect competition and when bureaucrats provide entitlements for free is $p=6$ €!
 - b) The government imposes an effective minimum price of 8 € per unit of tobacco so as support local tobacco producers. Determine graphically the welfare loss if i) producers with the lowest marginal costs are able to supply their product to the market, and ii) producers with the highest marginal costs will supply their product to the market.
 - c) Bureaucrats can now change the minimum price by making use of their influence on parliament or by having sufficient discretion in interpreting the law. Determine the optimal level of the minimum price they will set. Assume that they strive for maximizing their income from corruption and that they have no costs associated with providing their corrupt service. Hint: Any formula used should be explained and derived.

3. a) “Corrupt exchange does not commonly take the form of perfect competition but is rather restricted to a limited number of insiders”.

In how far can this be explained with the help of transaction costs?

- b) In the lecture a case was given with regard to the Dutch firm KPN guaranteeing a US \$91 million bank loan to a friend of the Suharto-Clan in Indonesia:



Explain why this type of arrangement may have minimized the transaction costs of the corrupt agreement. Might the arrangement also have helped to enforce the corrupt agreement?

