

CORRUPTION AND POVERTY

ABSTRACT The quantitative methods have been questioned, mostly because at certain points they served as tools to identify the poorest countries as being the most corrupt, and the most developed ones, such as Germany, as being the least corrupt. In the end, the criticism to the econometric models of the German school and, specially, the example of *International Transparency* turned out to become an ideological fight between two suspicious worlds.

This paper will enable to conclude that, in reality, corruption creates a death weight on the Economy, *i.e.*, it decreases the commerce acts and thus ends up by contributing to the countries' impoverishment.

I support the idea that corruption really contributes to the reduction of the economies' potential and it is therefore an impoverishment factor of the States.

KEYWORDS

Corruption

Poverty

International transparency



1. INTRODUCTION

In the various civilizations, we find reflections on the financial phenomenon – some times by turning it mostly into a political phenomenon or in an economic perspective. As a rule, the economic means of the exercise of political power and at its disposal, while providing useful things to the community's members, are the ones which constitute the object of more consideration.¹

What we see nowadays is that the public policies of fighting poverty have failed and that the replacement of the Social State or the Welfare State by the Guarantor State after the 2008 Big Crash has not yet produced results.

For example, in Portugal, the number of programmes and policies of fighting poverty address the problem's origin are few.

The number of poor people in Portugal has remained the same in the past ten years, as a result of the continuous distancing of the country regarding the economic growth averages of the European Union (with an average between 2000/2010 of 0.9% against the EU's 1.6%). In the Social Action area, there is reference work made, but in what concerns the fight against poverty we verify that the impact of that action is not very relevant.

In a first approach, the reasons for that difference appear to reside in some identifiable factors, the most important of which is the limitation of the programmes and policies of fighting poverty of not being able to affect privileges nor the inequality pattern that characterizes the Portuguese society, of which corruption is necessarily a conservative factor. That is why everything which is done in this domain is peripheral because the effects are addressed but the causes are not.

Another issue is related to the fact that the majority of the actions address "problems of privation and do not touch the lack of resources problem which exists behind the privation".²

Besides the "technical-scientific and political aspects interfering in the fight against poverty, there are ethical aspects which require deep changes and constitute a culture and personal problem".

Poverty "is not a peripheral problem" nor an "accidental phenomenon" but a "structural problem of society" and the real fight against poverty demands social changes which necessarily will touch situations of intolerable privileges that cohabit and contrast with situations of poverty and misery in a fertile field for corruption itself. One should not expect significant changes" in the actions of fight against poverty from the State and the State-dependent institutions due to issues related with the electoral and political party *clientele* and because those reformatations may cause the risk of violence.

Thus, we are left with the protagonism of society in general, of the individuals, of families, of ecclesiastic communities and of companies, in the Portuguese case with a special focus on *Misericórdias*.

"Poverty in Portugal remains at the same level or presents an irrelevant reduction". Poverty in Portugal, and in a general way in the entire Iberian Peninsula, is persistent. The number of poor people who freed themselves from these shackles is the same as the number of people who were trapped in the web and part of the answer to this fatality is the lack of economic growth and consequently the lack of employment creation.

As I have mentioned, the first issue is the economies competitiveness, in many cases, such as the Portuguese one, heavily indebted at their financial level aggravated by the fact that the national elites and the most skilled human resources have a sort of a "vertigo" by the companies producing non-transactionable goods or the Public Administrations, thus worsening our trade

¹ J. A. Schumpeter, *History of Economic Analysis*, Oxford, 1967, p.101; J.A.M. Amado Mendes, *História Económica e Social dos Séculos XV a XX*, 2ª edição, FCG, Lisboa, 1993.

² Bruto da Costa, *Jornal de Notícias*, Porto, 13 of September 2010

balance. The question is to know what the people and the private and public institutions who work in the fight against poverty really wish to do and really do.

First point: The redistributive policies are necessary. Yet, besides these ones, other policies which change the primary distribution of income resulting from the normal economic activity and that divides into work remuneration, capital remuneration and opportunity remuneration are also necessary. Even more so nowadays, with the economic recession that further enhances and potentiates the inequalities between the lowest and the highest work remunerations.

It is in the Public Economy plan that the corruption phenomenon works as a distortion, better said, as a conditioning factor of public decision.

Wicksell's, Mazzola's, Pantaleoni's, Sax's and Viti de Marco's analysis, at the end of the XIXth century³, presented deeply the problem of the Public Economy integration in a generalized system of exchanges. Wicksell was the first to rigourously integrate the spending with the income as parts of the same option and to study the criteria of a collective decision (unanimity and majority rules with their incidences and limitations).

Erik Lindahl (1919) generalised the study of the relations between the efficiency norms and the political negotiation processes. Based on these foundations, R. Musgrave created the "voluntary exchange" theory in public economy (1938), H. Bowen clarified the theory of the relations between the public goods and the vote, J. Buchanan criticized the Pigou's perspective and developed the integration between decision and well-being criteria within a Wickselian framework (1949).

Some developments have been registered in this field since that, such as the Samuelson's theory of public goods demand (1954) or the study of the votations as a way of collective choice in terms of well-being func-

tion (Black, 1948, and Arrow, 1950) or the theory of political decisions (Buchanan and Tullock, 1962), the justice theorized (Rawls, 1975) or the bureaucracy theories (Tullock, 1965, Niscane, 1971, Nozick, 1974), or one of the political parties (Downs, 1967), advancing some of them towards the limit of a new economic theory of policy, justice, law, and social institutions. In the 70s and the 80s the old ever-present debate on the State's role continues (Friedman, Von Hayek, Nozick, Rawls...)⁴.

In the conceptions of the Welfare State⁵, mainly with Rawls, one became aware of the principle of justice, considering the initial inequality of people and the need of organizing the inequalities so that they are a benefit for everybody (*Maximin Principle: the well-being only increases if the position of those who are worst off in the society improves*)⁶.

From this normative perspective, the analysis of the minimum State⁷ and mostly of the Welfare State suggests the *public interest* for the guidance of the State's role in the intervention in a mixed economy.

However, a positive analysis of the public entities actions cannot ignore the evidence that the public agents' behaviours are conditioned, both in the public sphere and in the private sphere, by their interests. These interests which are divided by those that must guide the search for the collective good and the efficient allocation of public resources, universal premises of the public service.

As we know, The State is imperfect such as Hobbes (1651) (Leviathan State) immediately recognized (and very well), and its spending grows continuously, due to reasons that are also beyond the public interest, like for example the needs for technology or simply the electoral cycle.⁸

In this Hobbesian approach, the modern State cannot but be understood as being at the disposal of interests,

³ Cf. Musgrave and Peacock, *Classics in the Theory of Public Finance*, New York, 1958; considerations on the public spending cf. www.usc.es/econo/RGVE/Vol%2012_1Castelan/notablc.pdf; R. Musgrave and P. Musgrave, *Public Finance in Theory and Practice*, MacGraw Hill, New York, 1989.

⁴ K. Arrow, *Social Choice and Individual Values*, John Wiley and Sons, New York, 1951.

⁵ Sousa Franco, op. Cit., p. 113; A. Atkinson and J. Stiglitz, *Lectures on Public Economics*, MacGraw-Hill, NY, 1980.

⁶ The Rawlsianism defines social well-being firstly in terms of access to basic freedoms and secondly in terms of the position of those who are worst off in the society;

⁷ J. Rawls, *A Theory of Justice*, Harvard Press University, Cambridge, Mass. 1971.

⁸ Neoliberal concept

and thus does not have any moral or ethical restraints and democracy itself, with the majoritarian vote, does not necessarily favours the public interest.

The modern State's imperfection is more visible when the State tries to take into account specific conditions leaving the discretionary power to the public agent. Decentralization and lack of supervision, lack of control of the public finances and of the growth of public spending, short political-electoral cycles and administrative intervention of proximity end up by enabling a less efficient allocation of resources to an economy.

At the centre of the issue lies the corruption phenomenon which has spread in the last decades into the formulation of national and international policies.

The key to success and the corruption enlargement, since the financial revolution of the first half of the 80s in the XXth century and the Spreading of the global crime in the 90s, is found on the flexibility and versatility of its procedures and organization. "The formation of networks and their *modus operandi*".⁹

On the other hand, and since the criminal system only makes sense if the profits can be reinvested on the legal economy, the corruption's key problem becomes the problem of money laundering and its procedures.

The chaotic move of the East Countries into the market economy enabled the ideal conditions for the penetration of the organized crime which participated in the looting thus accelerating the collapse of the institutions oriented to regulate and organize the market.¹⁰ But there was always the conviction that that was the price to be paid by the liberalization and for the mind's tranquillity of some the same old excuse was used: Despite the fact that the laundering and fostering of crime, there was initiative and economic growth.

Many times, the tolerance to corruption results from the fact that empirically one thinks that from an economic

point of view, the crime ends up by coming back to the market with its "commissions", by means of the consumption, investment or exported savings, what means that the global efficiency of the economic system would be kept – at least, in what concerns the corruption volume that we estimate is of about 1% of the GDP (the propensity to corruption determines its value), in Portugal, in a country where the parallel economy overcomes 22%, according to the OECD estimations (we estimate that due to the economic crisis, the informal economy is increasing in the Iberian Peninsula). There is to say, it is not only the economy that acts on the corruption, but the corruption that acts on the economy, and according to those terms, it is either a growth or an impoverishment agent.

The real problem is that, without an approach to the corruption phenomenon by the economic science, all these convictions hide a crucial issue: corruption is not only a moral problem or one of social justice, it is mostly, and that is so much more relevant to the Nation's Wealth, a problem of economic efficiency besides what is paid to the corrupt people.

That is to say, in an economy, the loss in commerce gains of the consumers and producers of a particular good is higher than the gain of the corrupt people.

In order to understand this, we elaborated what we are going to call the "*corruption diagram*", with which we intend to prove that the corruption creates a "dead weight" on the market, representing a reduction of the well-being, and therefore an economy impoverishment, what can explain why the most corrupt countries are precisely the poorest ones.¹¹

The question of measuring the corruption, mainly the one concerning the State is fundamental to understand the problem and to define a paradigm.

The marginal propensity for corruption (PMgCr) is a datum which may be the result of a survey and that

⁹ Manuel Castelles, O Fim do Milénio, A Era da Informação: Economia, Sociedade e Cultura, Volume III, Fundação Calouste Gulbenkian, Lisboa, 2003, p. 225.

¹⁰ Manuel Castelles, op. cit., pp. 232-235

¹¹ Corruption harms the policies of fighting poverty and their perception, in less sophisticated economies and that depend on the international aid, it makes those countries more vulnerable to the international blackmail and less attractive to capture foreign investment and thus, corruption is an additional element to the lack of competitiveness of the poorest countries' economies. This ways, the vicious cycle of "corruption-poverty", not being under analysis in this study, must however be mentioned, even when due to the effects of globalisation, the poor people of the poorest countries have enormous perspectives of becoming richer with the growth of the middle classes.

varies from country to country, having the perception that the development stages are not strange to the corruption levels, not even to the tolerance to laxism and informality.

Corruption, (Cr) in the public sector is related to the current investment and consumption levels, *i.e.*, to the State's (G) purchases. There is to say, in principle, G excludes the spending with staff, the social allowances, the subsidies, the transfers and the finance charges (interest), and the other capital expenses from the total amount of the public spending.

Thus, in a simplified way,

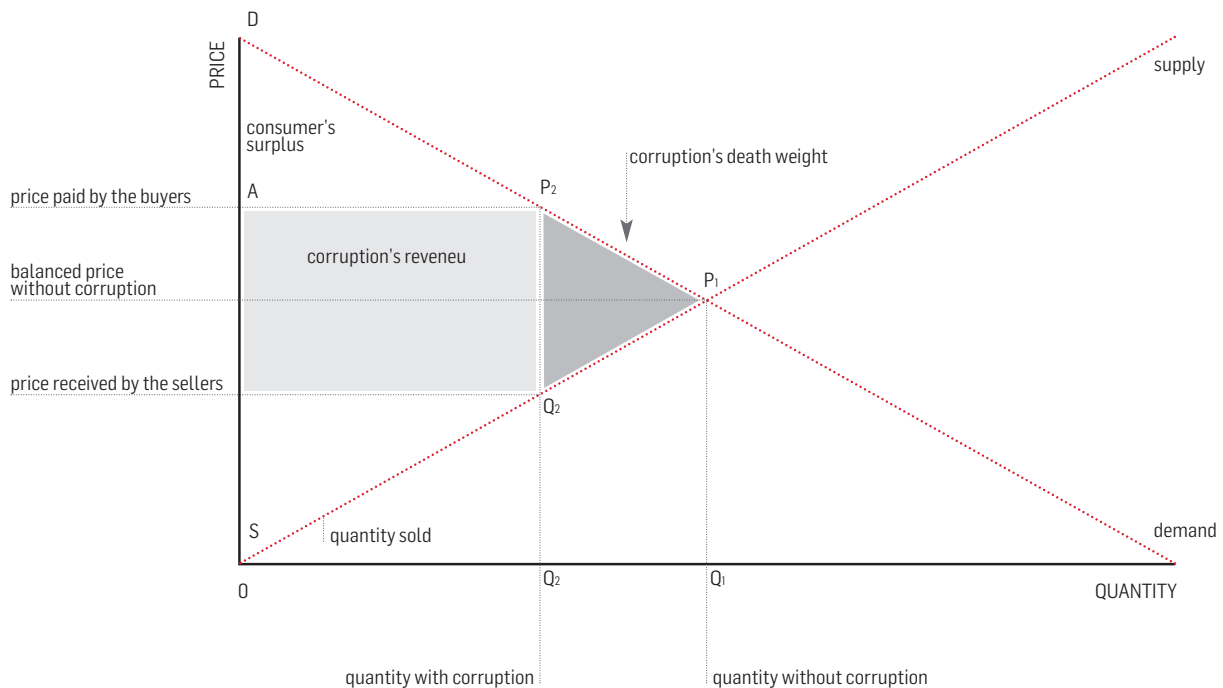
$$Cr = G \times PMgCr$$

Thus, if the marginal propensity to the corruption associated to the SB/2009, in Portugal, is of 1% and if the public investment represented 4.2% of the GDP in 2009 (about 271 billion dollars), we conclude that the amount involved in corruption, in 2009, in Portugal, was of about 113.82 million dollars, which reduces the corruption phenomenon in the State, in Portugal, (we exclude the investment on the remaining Public, corporate, regional, and local Administration) to 0.042% of the GDP.

I, therefore, present the formula to quantify the corruption.

However, it is important to be aware of its impact on the efficiency of an economy. I will use the graphic representation as a tool since it is easier to explain the impact of corruption on the countries' economy:

FIGURE 1. CORRUPTION DIAGRAM



One of the principles of economics is that the market is an efficient formula to decide the price and the quantity consumed and produced of a good in an economy. The diagram we built translates a demand curve and a supply curve. The demand will be less if the price is higher and the supply will inversely be higher if the price is higher, says the law of supply and demand. The balanced price (P_1), or graphically the point where the supply curve meets the demand curve translates the maximum efficiency of a competitive market, there is to say, the point at which more consumers and more producers of a good see their needs met. In other words, in a competitive market of a good, the balanced price would be P_1 , before the corruption.

2. THE WELL-BEING MEASURE

In the well-being economies¹², we call consumer's surplus to the amount the buyer is willing to pay for a good minus the amount he really pays for it.

There is to say, in the market of our diagram, the market consumer's surplus before corruption would be the triangle formed by D and the P_1 horizontal axis. For the sellers, the cost is the value of everything he must give up in order to produce a good and we call producer's surplus to the differential between the amount really received by the seller and his cost of production. It is the sum of those surpluses that enables us to understand the benefits of the existence of a market for an economy.

The well-being is exactly measured by the sum of the seller's and consumer's surpluses, the total surplus, which is equal to the amount for the buyers minus the cost for the sellers. The maximization of the surpluses translates exactly the market's efficiency. It is that surplus that is going to enable afterwards to search for other goods, to enjoy some holidays, to buy Christmas presents or which is decisive for a country's wealth and that of its companies and its citizens.

However, in Portugal, too many times the price paid is not the balanced price established in a public bid or in the market, but it is influenced by the commission to be paid to the corrupt. The effect of the corruption's commission on a good makes our diagram displace the supply curve to the left, if the commission is on the seller, for example, which naturally changes its price (from P_1 to P_2) and the quantity sold (which in our graph changes from the amount without corruption to the amount with corruption), being the corruption weight, regardless of the commission being paid by the seller or the buyer, divided into sellers and consumers, by the forces of supply and demand and depending on the resilience of one or the other curve (that is easy to understand since the new P_2 price is not necessarily equal to P_1 plus the corruption commission).

3. REPERCUS- SIONS OF CORRUPTION

Now, we are going to see how the corruption influences our well-being. We know that the corruption increases

¹² Well-being economics is the economic concept of the market economy

the prices and decreases the quantity of a specific good or service that is sold and that that cost is divided by all the market's players. In short, this means the commissions for the corrupt people are being paid by someone and all become in a worse situation because they are going to sell less or buy less.

We know the repercussions of the corruption on an economy. The corrupt people take the commissions and they either invest them or buy goods thus also contributing to the economic growth. But for us to understand the way the corrupt commissions influence the economic well-being, we need to compare the buyers' and the seller's reduction of well-being with the commissioned income by the corrupt people.

Corruption places a wedge between the price the producer receives and the price the consumer pays. Comparing the prices before and after the corrupt people commission, and according to the supply or demand resilience, we will conclude that the entrepreneurs or producers are not the only ones to pay the tax, but that its cost is divided by consumers and producers, overloading the ones who have a less resilient curve. In our corruption diagram, that wedge is represented by the vertical axis from P2 to Q2. The main result is that because of that corrupt wedge, the quantity which is sold drops below the level at which it would be sold if the commission wasn't paid. In brief, the corruption commission on a good or service reduces the dimension of the market of that good or service.

4. THE GAINS AND LOSSES OF CORRUPTION

With the economy tools, we can now measure the gains and the losses resulting from corruption. To do that, we must consider how the commission will affect the buyers, the sellers and the corrupt people.

As far as the corrupt people are concerned, their revenue translates the commission (j) times the quantity of the good, which is graphically represented in our diagram by the green square formed by A, B, Q2 and P2, between the supply and demand curves. Since this money can be used by the corrupt people in the economy, though it is withdrawn from the initial surplus of consumers and producers, the benefit ends up by coming back to the economy (admitting naturally that there are no irreversible capital flights).

As we mentioned, the benefits or the well-being obtained by the consumers are measured by the consumer's surplus and the benefit or the well-being of the producers is measured by the producer's surplus. In our figure, the consumers' benefit decreases with corruption since its surplus (the measure of their well-being) decreases from the area graphically represented by the triangle between D and the P1 horizontal axis, to the triangle between D, A and P2. Likewise, our diagram shows how the sellers' surplus also decreases since graphically it moves from the triangular area between S and the P1 horizontal axis, before the corruption, to the S, B, Q2 triangle after the corruption commission is applied. This means that after the corruption commission, the total surplus measured by the sum of the producer's and the consumer's surpluses drops comparing

to the well-being without the corrupter's commission. In brief, there are negative variations on the side of the consumer's and producer's surpluses and a positive variation on the side of the corrupt's revenue. But the sum of these three elements is not equal to the initial surplus of the producer and the consumer when there was no corruption in the market.

5. THE CORRUPTION'S "DEAD WEIGHT"

As we can graphically see in our figure, the consumers' and buyers' well-being does not fall only in the amount of the corruption commission, represented by the square between the supply and demand curves, but it is diminished by the blue corruption triangle in our diagram, formed by P1, P2 and Q2 angles. This total surplus reduction resulting from the corruption, *i.e.*, this loss of buyers and sellers higher than the corrupt people's revenue represents a "dead weight" on the economy that naturally does not stimulate the commerce and does not benefit the economy.

This dead weight turns the economy less efficient since the corruption ends up by not allowing obtaining all the potential gains resulting from the commercial operations of a certain economy.

It is the loss of these commerce gains, translated into our diagram by the blue triangle that explains the effect of the corruption on an economy. And the higher the percentage of the corruption and the resilience of the demand or the supply curve, obviously the higher is the corruption's dead weight on an economy. It is thus sci-

entifically shown that corruption decreases the market's efficiency and does not stimulate the producers and the consumers, by creating a "dead weight" that translates itself into a market that ceases to exist due to the influence of the corrupt people's commission on the well-being economy.

By relating the quantification formula of the corruption with this "*Corruption Diagram*", we conclude that the higher the marginal propension for corruption is, the higher the effect induced on the public investments and consumptions is and, therefore, the higher the *dead weight* created on the Economy is.

The Dead Weight (PM) is equal to the public investment and intermediate public consumption (G), minus the Well-Being lever or the consumers' and producers' surpluses (BE), being a value which is always inferior to the amount of the corruption.

6. CONCLUSION

The conclusion is obvious: even if the corruption is not the only factor explaining the States' poverty, it is undoubtedly an element present in the poorest countries for corruption itself is an impoverishment agent of the States. In a way, with the necessary reservations concerning the bad use of this analysis – for which the science is obviously not responsible – we must support the idea of the non invalidation of the econometric and survey methods that enable the elaboration of international rankings that really show that the poorest countries are probably the most corrupt countries.

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