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CONTEMPORARY ECONOMIC RESEARCH OF CORRUPTION

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Abstract

In this paper, we focus on the economic research of corruption. In the first part, we define corruption, types of corruption, its factors and ways to measure it. This section brings together various definitions by notable authors of this domain, such as Begovic, Tanzi, Mauro or Lambsdorff. Before moving to the second section, we are presenting definitions, typologies and factors already researched by acclaimed authors. In the second part, we focus on the channels by which corruption transmits its effects through the economy. This section consists of two major sub-parts, the first one in which we take part in a vivid scientific discussion with the ''apologists'' of corruption, i.e. with those economists who underline positive roles of corruption. In the second sub-part of the second section, as a logic continuation of the previous sub-part, we are listing three important consequences of rampant corruption in one economy: consequences to economic growth, foreign direct investments and economic efficiency. Major contribution of this paper is compilation of significant scientific discoveries in the area, as well as bringing new arguments in the discussion on the economic consequences of corruption. The paper uses traditional approach of the New institutional economics (NIE), by underlining the importance of governance, transaction costs and rent seeking.

Key words: *corruption, institutional capacities, new institutional economics, transaction costs, FDI*

1. Introduction

Corruption has become one of the major economic issues of our time, up to the point where we consider this phenomenon as one of the most important obstacles to the development. However, the economic research of corruption is relatively new. It is only in the Susan Rose Ackerman's article ''Economics of corruption'' that corruption has become a subject of one serious economic work. Ackerman's work cannot be fully comprehended out of the scientific framework set up by the school of public choice and Gary Becker. This economist has shed light on the problem in his famous 1968 article ''Crime and Punishment''. He has focused a special economic interest on one form of crime, i.e., on corruption; by modeling the costs of the crime and costs of the penal system for one society.

Corruption itself does not belong only to the economic domain. This problem can also be approached from the aspects of law, criminology, sociology, and other sciences. However, we research corruption on the grounds of the economic methodology. As an economic problem, corruption can be researched on two levels: macroeconomic (for instance what is the role of corruption within one economy) and microeconomic (for example, what are the incentives for one economic agent to take part in one corruptive activity). Our methodology has mostly a macroeconomic optic of this problem, because we want to see the concrete consequences of corruption for one economy.

For these reasons, we will ask the following questions: what is corruption? Can we approach this problem by using strictly the economic methodology? Which agents take part in a corruptive activity? What is the role of the state? Why and how is corruption embedded in one economic system? Which are the economic consequences of corruption?

In order to give an adequate answer to these questions, we are going to present a paper divided on two sections, which will be divided on several sub-sections further on. In the first section, we will present the definitions, factors, typology and different measures of corruption. In this part we wish to describe *what* corruption is *per se*, which factors contribute to its development, what kinds of corruption there are, and how are we able to measure this problem. In contrast with the first chapter, in the second section we try to answer how does corruption affect one economy, how does it transmit its effects, and does it have only negative, or maybe some positive aspects too? We believe that these two sections are deeply complementary, whereas the first one tries to describe corruption, and the second tries to situate it inside an economic context. In the both sections, we will heavily rely on the contemporary literature and econometric findings.

2. Definitions, factors, typology and measurement of corruption

2.1 Definition of corruption

What is corruption? Is it a cultural phenomenon or not? Can corruption be understood by every human being the same way? As Rose Ackerman (2004) puts it, corruption is a term whose meaning shifts with the speaker. So how can we use the economic methodology in a domain where not all of the economic agents are ready to cooperate, because of the fact that their activities are condemnable by the society?

Historically, it was considered that corruption is a phenomenon of *the corrosion of the social material.* This means that it was a question of morality. As moral is too vague of a concept, we have to search for another, more stable definition. For example, Begović (2007, p. 51) offers a very elegant solution. According to Begović, corruption can be defined as a behavior that spreads away from a certain norm; whereas the norm is defined as a set of legislative, public interest or public opinion criteria. This elegant solution has at least two major problems. First, there is an institutional problem: there are different judicial interpretations of corruption, which treats the notion of corruption the different way. A problem linked with this one is that the law system is a human – built, social system. This means that it is prone to promulgation of certain laws that are not favorable in diminishing corruption, but on the contrary, they aggravate it. Secondly, corruption can not be approached only from the judicial point of view. There has to be more sociological and economical explications.

A more comprehensive definition is proposed by Tanzi (1998). Corruption, according to Tanzi (1998, pp. 6-7), exists if *there is an intentional violation of the principle of impartiality in the process of the decision making in order to appropriate a benefice.* Tanzi also adds that corruption is an *abuse of the public power for private benefits.* We shall underline five important implications drawn from these definitions:

1. *Principle of impartiality – interpersonal relations should not have any importance in the decision making process. Any other behavior raises doubts of corruptive activities.*
2. *Differentiation of corruption from other forms of abuse – corruption is not extortion or fraud, stricto sensu. There has to be two sides in consent for a corruptive activity to take place.*
3. *Corruption is not only a public sector phenomenon – it exists also in private organizations*
4. *Not every corruptive activity is connected to bribe – the benefit does not always have to be material. Bribe is only a specific form of a corruptive ``tax``*
5. *Corruption is a transaction – between the corruptor and the corrupted*

2.2 Factors of corruption

As for the definition, there is a number of typologies of corruption. We are going in this section to present some of the most important.

Begović (2007, pp. 135) proposes the following factors:

1. *Rents*
2. *Size of the state*
3. *Incitation to the public functionaries*
4. *Pressure from the civic society*
5. *Extent of democracy*
6. *Culture and tradition*
7. *Economic (in) equality*

Johan Graf Lambsdorff (2005a, p.14) proposes a similar typology:

1. *Size of the state and decentralization*
2. *Institutional quality*
3. *Competition*
4. *Liberty of the medias*
5. *Extent of democracy*
6. *Culture and tradition*
7. *Other variables*

7.1 *Colonialism effect*
7.2 *Natural resources effect*
7.3 *Corruption in the neighboring countries*
7.4 *Percentage of the women in the public institutions*

Jean Cartier Bresson (2008, p. 63) proposes this typology:

1. *Economic causes*

1.1 *Information asymmetry*
1.2 *Extent of discretionary power*
1.3 *Rent seeking*

2. *Political causes*

2.1 *Transparency of the funding of the political parties*
2.2 *Low paid politicians*
2.3 *Clientelism*
2.4 *Neo-corporatism*
2.5 *Extent of the democracy*
2.6 *Extent of centralization*

3. *Administrative causes*

3.1 *Bureaucratic market*
3.2 *Poverty and inequality*
3.3 *Public approval of corruption*

Mauro (1997) focuses on the size of the state and those government politics that provoke rent seeking activities. For example, according to Mauro, if the regulations are omnipresent and if the functionaries have a large set of discretionary powers in hands, the economic agents will be incited to offer them bribes so they might obtain certain rents. If the regulations are too complicated, the absence of transparence and the rents coming out of government politics, represent a trigger factor of corruption. When it comes to the rent seeking, Mauro shows the origins of this phenomenon. The first origin is the commercial barriers. For instance, these barriers might take the form of the quantitative restrictions of the imports, under pretext of protection of domestic businesses. In his article (1997) Mauro shows a statistically significant relation between the level of openness and corruption. Some other sources of rents might be subventions, price control systems, even fixed exchange rates in some extremely corruption ridden economies. Mauro also stipulates that certain economies might suffer from corruption if they are rich in natural resources and poor in terms of institutional quality. Finally, Mauro underlines the importance of the sociological factors, such as the ethnic or linguistic fragmentation of a country. This might be an important source of clientelism, particularly in those countries that have weak democratic and regulatory institutions.

Finally, Tanzi proposes this typology:

1. *Regulations*
2. *Taxation*
3. *Public expenditures*
4. *Public procurement at prices different from market ones*
5. *Political parties financing (transparence and regulation)*
6. *Indirect factors*
6.1 *Quality of bureaucracy*
6.2 *Salary level*
6.3 *Penal system*
6.4 *Institutional controls*
6.5 *Transparence*
6.6 *Positive example from the leaders*

Our idea is that major factors of corruption are: level of economic openness, size of rents and level of complicatedness of regulations. The first factor, level of economic openness, is often approximated by share of the sum of exports and imports in the nation's GDP. It reflects the economic willingness to trade with the exterior, and it is normally correlated with importance of the trade barriers. Economies with high barriers (import or export ones) are often affected by high corruption, because of difficulties to enter such a market. In these situations, exporters might have to pay to obtain ''exporting subventions'' (even the exchange rate might be altered by discretionary decisions for some companies), and importers might have to pay very high prices due to importing restrictions provoked very often by lobbying of domestic producers (who tend to be monopolists themselves). Therefore, the level of economic openness is in the same time an indicator and a factor of corruption.

As mentioned by various authors, rents have an important role in causing corruption. It is because of the possibility of certain economic agents to attribute parts of the social wealth through a discretionary decision. Finally, complicated regulations sometimes seem to be meant to increase the costs of the legal operating within an economic system, as we are presenting on the figure 1.

2.3 Typology of corruption

As for the typology, we will present the typologies proposed by the following authors. Begović (2007, p. 75) proposes the following types of corruption:

1. *Corruption without collusion* – where there is no collusion (agreement) between the corruptor and the corrupted agent. This type of corruption exists mostly in the public institutions, where the employees ask certain material or immaterial benefits from the beneficiaries, in order to procure them with certain resources.

2. *Corruption with collusion* – where there is an agreement between the corruptive parties. Whilst the first type of corruption is effectively extortion, corruption with collusion represents a voluntary pact.
3. *Centralized vs. decentralized corruption* – where the difference between the two represents the hierarchical level of a corruptive person or a group. For example, a highly centralized corruption is where the president and clique, make ask for ``voluntary contributions`` from the economic agents of some particular country. The decentralized corruption is the most common one – for instance the one that appears in various government, health or education institutions.
4. *Administrative corruption vs. the state capture* – difference between the two is situated at the level of institutional regulations. According to Begović (2007, p. 99), the administrative corruption is linked to the execution of certain rules. Put simply – whilst the rules of the game rest intact, their application is altered. The state capture is where the rules of the game are changed in order to be more convenient for one or various economic agents that have influenced this particular change. Needless to say; the latter type is difficult to detect and to determine its particular scope, because it tends to embed into the economic and political system.

Tanzi (2000) proposes the following typology:

1. *Bureaucratic (administrative) vs. the political (state capture)*
2. *Materialized thru the cost reduction vs. materialized by the increase of benefits*
3. *Initiated by the corruptor or the corrupted*
4. *Centralized vs. decentralized*
5. *Financial vs. non financial bribing*

Lambsdorff (2005a) proposes the following typology:

1. *Market corruption* – This is essentially a competitive corruption, with the rules of the corruptive game known to the general public.
2. *Parochial corruption* – As opposed to the previous type, a corruption with a smaller degree of transparency, where the rules of the game are known to a limited number of economic agents.

1.4 Measuring corruption

The importance of measuring corruption is vast: what is not measurable is not understandable and thus solvable. But, by its nature, corruption is hardly quantifiable. The best known indices that we have at disposal are the World Governance Indicators, compiled by the World Bank, and the Corruption Perception Index, which is made by the Transparency International (TI). Some less known – and less direct – are the Opacity Index, made by the PricewaterhouseCoopers, Nations in Transit by Freedom House, Bribe Payers Index (TI), World Values Surveys, etc. The TI`s Corruption Perception Index is up today the most comprehensive and the most direct measurement of corruption available. The World Governance Indicators is an index on governance, which gives notes of most countries in the world in 6 different sectors, of which one is corruption. It is important to notice that these indicators are actually perceptions of economic agents working and/or living in selected countries. This is a serious limitation to the quality of these indices, which than raises doubts on its aptness to measure thoroughly corruption. There are generally four limitations of these two major indices:

1. Perceptions – whose perception, and of what? Did the economic agent that states a certain perception really encounter corruption? Is it engaged in corruption? The indices do not differ political from administrative (petty) corruption, which too blurs the precision of these instruments.
2. Standardization – whereas we use the indices to measure corruption in one country, we also use them to compare countries. But, as the business culture differs from country to country, so does the perception of corruption. This leads to the reduced precision of the indices.
3. Number of base indicators – most of these indicators is composite, which means that they are being compiled out of a number of certain base indicators, such as the World Values Surveys or the Opacity Index. However, most of the countries are not noted on the yearly basis, which alters the quality of the overall indices on the year – to – year basis.
4. Transparency – whilst the composite indices are compiled the transparent way, this is not always the case of the base indicators.

3. Inefficience of the institutions and corruption. Influence of corruption on the economy

3.1 Is corruption tonic or toxic?

Many authors like Cazurra (2008) claim that corruption may be positive for the economy. In the academic circles, especially in the 80's, some economists have been comparing corruption to a lubricant that makes the ''economic wheels'' turning around. In this paper we will present the main arguments of the apologists of corruption, and afterwards we will try to refute them.

The first apologist argument (A): if the regulations aren't optimal or are inefficient, corruption helps to escape from its application. In the post-socialist economies, corruption had the deregulation role. In this way, the barriers for market entry were neutralized, which allowed stronger competition. Nevertheless, we think that this argument does not hold, because of three reasons: 1) costs, 2) integrity of public policies, 3) incitation to the bureaucrats to complicate the regulations further on.

As for the costs, we make difference between two types of imposed costs. First of all, by *bribing* the bureaucrats, the economic agents are paying for obtaining a service for which these bureaucrats were already paid by their salary. This is why we think that the ‘’institution’’ of bribe is an irreparable economic loss of resources that could have been used in productive activities. Second type of cost that we refer to is the *transaction costs*. Escaping to respect the inefficient regulations can boost the economic efficiency in the short term. In the long term, it makes the regulation disappear, by creating a situation in which the economic agents are forced to ‘’muddle’’ through a non regulated institutional system. In this kind of situation, the transaction costs tend to elevate, which leads to a smaller number of transactions on the market, with further repercussions on the level of specialization and finally on the economic efficiency. So, basically, even if it looks as if corruption may be positive for efficiency in the short term, it is negative in the long run.

The integrity of the public policies is harmed when they are executed selectively. By the integrity of the public policies we think of: arbitrariness of the regulation application (where the integrity represents the application of all the regulations) and the quality of the state interventionism. As for the first point, the corruptive activities make the arbitrariness more important because a lower transparence, where the decision makers can choose freely which regulations to apply. As for the interventionism policies, the same reason, lack of transparence, makes public projects less reliable. The first cause is that the projects (especially in infrastructure) are more prone to higher costs and a less significant quality in presence of high corruption.

The third remark, cited by Habib and Zurawicki (2001, p. 4), stipulates that if one institutional system is ‘’sclerotic’’, it will generate corruption, because the economic agents will be incited to escape to apply the regulations. However, the response from the system will not be a simplification of the rules of the game; but on the contrary, it will complicate the regulations further on. It will do so to make possible to elevate the potential bribes. So, corruption generates corruption. We can illustrate our point by the following algorithm.

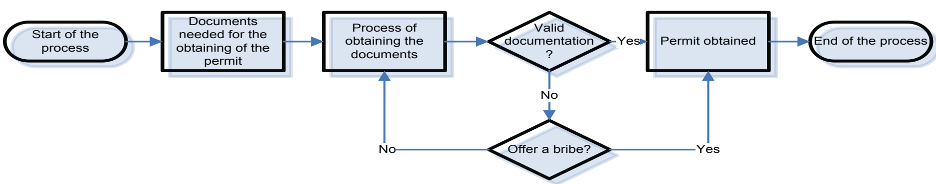

Figure 1: Algorithm of process of obtaining a permit

If the necessary documentation for obtaining a permit is valid, this permit will be issued. If the costs for obtaining the documentation are superior to potential bribes, the economic agents will be incited to offer them, and the bureaucrats will be incited to accept them. So, the only solution might be the simplification of the regulations, so that the process of obtaining the documentation becomes less expensive than the potential bribe. Habib and Zurawicki stipulate that the system will seldom simplify the regulations, because only through its complication it can always make the regular obtaining of the documentation more expensive than to bribe the bureaucrats.

The second apologist argument (B) is that corruption incites the bureaucrats to work on their tasks more efficiently. Highly qualified staff is attracted to work in the public administration because of the possibility to ask for the bribes. As the bureaucrats are already paid for their work efforts, the economic agents who are bribing them are forced to offer some sort of a ‘’voluntary tax’’. The main problem with this tax is that it raises the transaction costs, because the size and frequency of the tax are not normally known. The only type of corruption that allows the ‘’voluntary tax’’ and low transaction costs in the same time is the centralized corruption. This type of corruption centralizes the discretionary powers in the hands of a relatively small group. According to Blackburn and Forgues – Puccio (2007), in South Korea, for instance, corruption has proven to be somewhat beneficial for the development, because the ruling class obviously had the intention to centralize all the resources under the single command, and thus to channel the development into the promising industries (by using the ‘’voluntary taxes’’ as a macroeconomic tool). However, this is more of an exception than a rule. Except for the case of the ‘’enlightened absolutisms’’, the voluntary tax does not end in the public funds, which not only raises the transaction costs, but also lowers the quality of public services and infrastructure. In case of decentralized corruption, the position of a corruptive agent is substantially worse – if an economic agent decides to offer a bribe to a bribe solicitor (the bureaucrat for instance), it may end in being blackmailed by the same bribe solicitor, which raises the transaction costs over the acceptable level for most agents.

Another problem of this argument is that the bureaucrats may work more efficiently – but only for those agents who are ready to bribe them. It should not go unobserved that, even if the bureaucratic system is able to cut the waiting lines – and thus improve the resource allocation – the public resources are delivered not to those who merit, but to those who are specialized in corruptive activities (in terms of financial situation and the social capital).

Finally, the last good known argument (D) is that the superior levels of governance and low levels of corruption can be reached only in developed countries. Au contraire, according to Kaufman (2005, p. 86), the good governance and the low corruption are not a luxury, but a necessity for the development. There are many countries that still haven’t reached the high development, but they have already substantially lowered their levels of corruption. The best known cases are Botswana in Southern Africa, Chili in Latin America and Slovenia in Central Europe. The example of these three countries is flagrant, as they are, in terms of governance as measured by the WGI, far in advance comparing to their respective regions.

Corruption can substantially increase the efficiency, especially in terms of better resource allocation and cutting down the waiting lines. However, in the long term, the effect of a devastation of the rules of the game leads to a permanent dissolving of the system, which in turn increases the transaction costs.

3.2 The economic effects of corruption

In this section, we will show three economic domains, normally affected by corruption. These are: the efficiency, the growth and the foreign direct investments.

3.2.1 The efficiency and corruption

The efficiency drops as a consequence of four reasons: drop in specialization, barriers to competition, incapacity to protect the lender and the indirect costs.

As for the first reason, our argumentation is based upon a double presumption: that every exchange needs a contract, and that the decrease in level of exchange leads to a decrease in specialization. We stipulate that corruption reduces the quality of the judicial institutions (which is why the contracts are not solid anymore), which raises the business uncertainty, consequently the transaction costs lift, which makes the economic agents to abstain from all but only necessary market exchanges. In turn, the level of specialization drops, leading to a lesser efficiency.

The second reason is a rise in competition barriers. Corruption affects competition in two ways. The first way is that the institutional fragility makes the transaction costs higher. In corruption free countries, the economic agents, because of low transaction costs, have the ability to change partners very often. Contrary to this, in corruption ridden economies, the rational agents should be incited to form partnerships, in order to protect themselves from high transaction costs. As a consequence, these partnerships are difficult to join for the outsiders, and difficult to quit for the insiders. This results in the fact that the membership in these partnerships is often rewarded in a cut in a certain monopoly, but paid by long-standing loyalty to the alliance, and a prime paid to every transaction committed with a partner. From the outsider point of view, the fact that it is difficult to join a partnership, leads to the fact that the outsider enterprises, especially the foreign ones, have high un-institutionalized entry barriers to the market. It should not be forgotten that even to form a partnership it takes year of investing in seeking a right partner, which also constitutes a considerable economic loss of resources, otherwise usable in productive activities.

As for the third reason, it is not possible to keep the credit system, because the law and economic system is incapable of protecting a lender. In this kind of system, these are the borrowers who are protected, because they are not forced to return the resources they have borrowed, because the judicial system is unstable. This incites the creditors to raise the cost of the credit, which in turn raises the business risk, makes business ventures more expensive, raises the costs of investments, raises the general price level, and all in all, lessens the efficiency.

There are three indirect costs that affect the efficiency. The first are the costs of the corruptive transaction. As corruption is normally illegal, the partners in this activity are not protected by the court of justice. This is why they have to protect their ‘’contractual’’ interests themselves. In other words, they have to find a partner for their activity and to negotiate with him. As normally there is no ‘’beaten track’’ in finding a partner, nor in negotiation, this activity provokes a considerable loss in resources. Second type of indirect costs is the opportunity costs, the costs spent at rent seeking, that could have been used in productive activities. Third type of indirect costs, according to Begović (2007, p. 303), are the costs of property rights protection. In a country with a frail judiciary system, the economic agents are forced to protect their property themselves, which augments their costs (for instance, they have to hire the physical protection)

3.2.2 The growth and corruption

The second consequence is the growth. There are many authors who underline the significant connection between the economic growth and corruption. For instance, Pellegrini and Gerlagh (2004, p.7) show the significance of corruption on the growth. The regression they have obtained is the following:

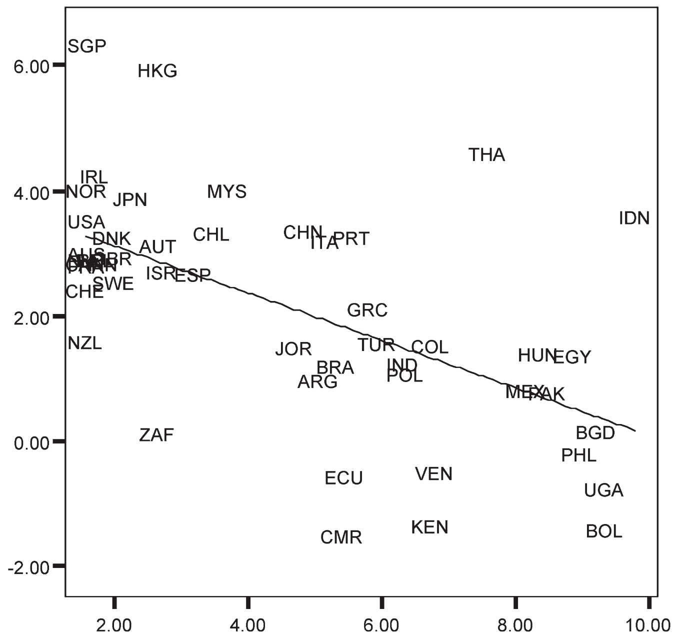

Figure 2: Corruption and growth

It seems that the rise in corruption leads to a drop in the growth rate levels. Begović (2007, p. 303) differs two factors of growth – the one that is the consequence of the growth of the engaged resources (population, investments) and the second which makes the factor productivity higher (institutional factors, investments in the human capital, etc). This author also makes difference between three channels by which corruption affects directly the level of corruption: the investments, the investments in the human capital and the political stability. Lambsdorff (2005b) shows the link between corruption and the productivity. He stipulates that corruption diminishes the factor productivity. Pellegrini and Gerlagh (2004) show the significance of the following factors for the growth: investments, education, commercial openness, political instability and corruption. We stipulate that corruption affects the growth on both direct and indirect way: apart from rending the institutional system instable, corruption lessens the quality of the other factors – education, investments in public infrastructure, political stability, commercial openness, etc. It is a veritable vicious circle –corruption lessens the government institutions quality, by which it widens the social gaps. These two affect the political stability, which creates more corruption. This is affirmed in the paper of Pellegrini and Gerlagh (2004), who quantify these relations. According to these authors, among several variables to affect the growth, corruption is not the most important: it is the investments (32%), followed by the commercial openness (28%), corruption (19%), political instability (16%) and education (5%). Although corruption is not the most directly influential, it most certainly affects the other variables. The quality of investments in public infrastructure is lower – the projects are more expensive and worse maintained than they could have been in absence of corruption[1]. The commercial openness is lower in corruption ridden countries than in corruption free countries for two reasons. Where there is significant corruption, the local producers might be interested in pushing for higher commercial barriers, in order to protect themselves from the international competition. Second, international competitors are reluctant to enter a corruption ridden economy, because they are not familiar with the local rules of the game, they have low social capital. Thus the transaction costs for them are too high to enter.

3.2.3 Foreign direct investments (FDI) and corruption

The FDI are especially vulnerable to corruption, but in the same time, they are invaluable for the development. If we apply the question of the usefulness of corruption on the FDI, we confirm that it has a slightly positive role in the short term and a negative role in the long term. Corruption, in the long term, provokes the arbitrariness that abolishes the regulations, and thus increases the transaction costs. Tanzi (1998, p. 586) says that the level of uncertainty is directly and negatively linked with the FDI. The uncertainty functions like a ‘’voluntary tax’’. The foreign companies know neither the size nor the frequency of the imposed ‘’supplementary’’ taxation.

Habib and Zurawicki (2001) distinguish two types of direct investments: the local (LDI) and the foreign direct investments (FDI). Their opinion is that, because of the fact that the local investors are better informed, the impact of corruption on their business will be less important. The two authors made a list of factors who contribute to the level of both kinds of investments, wishing to see if corruption is 1) important for investments, and if yes 2) does it hurt the LDI and the FDI the same way. The list constitutes the following factors: size of the economy (approximated by the GDP), GDP per capita, GDP growth, orientation towards exports (approximated by the percentage of exports in the GDP), political instability, the inflation rate and fiscal position of the country. Their paper confirms the two presumptions: it is true that corruption is negatively linked with both types of investments, and it is also confirmed that the FDI are more affected by the LDI.

Not only that corruption lowers the general level of the FDI, but its structure is less favorable for the development. Begović (2007, p. 332) stipulates that in a country where corruption is rampant, the international investors will look for the local partners, because they are better informed; for it is in this joint venture with the local partners that the international investors are seeking to lower the transaction costs. However, this solution may not be a durable one, because the foreign investors will not be incited to transfer their technology to the local partners. Because of this, if corruption is high, the FDI will arrive under form of the investments in production of low technology goods and services. This

1 According to Tanzi and Davoodi (1997) show that corruption elevates the investment expenditure, but it lessens the investment quality and that these investments do not have substantial effect on growth.

has been proven by the research of Smarzynska and Wei (2000). Effectively, these authors have shown that high corruption may raise the level of the joint ventures, but also that the investors disposing with high technology will avoid the country.

There is another important question linked with the FDI: which type of corruption affects the FDI more – the small (administrative) or grand (political) corruption? Lambsdorff (2005b) stipulates that the investors are particularly vulnerable to the impact of the small corruption, because this corruption provokes higher uncertainty. For instance, Lambsdorff gives empirical evidence that the impossibility to obtain some public services, such as the electricity, water or gas[2], have a strong negative impact on the investors. It is for that reason that Lambsdorff stipulates that the eradication of corruption in infrastructural companies will significantly ameliorate the business climate for the foreign investors. Finally, Lambsdorff remarks that the 1) high level of corruption lowers the FDI, and that 2) for a fixed level of corruption, the augmentation of the grand corruption compared to the small one, raises the general level of the FDI. One interpretation of this find might be that the grand corruption practically transfers the discretionary powers to the high rank bureaucrats, who can then personally step into a political trade with the foreign investors.

Al Sadig (2009) tries to explain the role of corruption in attracting the FDI. At the sample of 117 countries, he is trying to observe the different roles of corruption in different institutional systems. His conclusion is that the decline in corruption for 1% makes the FDI per capita increase for about 20%, in all the countries. However, in a model where Al Sadig includes the governance variable, corruption effect diminishes, which can be interpreted as the fact that the foreign investors prefer the institutional stability to corruption.

Finally, Robertson and Watson (2004) show the link between the FDI and corruption inversely. They are not looking to explain the influence of corruption on the FDI, but on the contrary, what kind of effect do the FDI have on corruption. The authors stipulate that the rapid afflux of the FDI might raise corruption, but that this effect might take place even if there comes to a drop in the FDI.

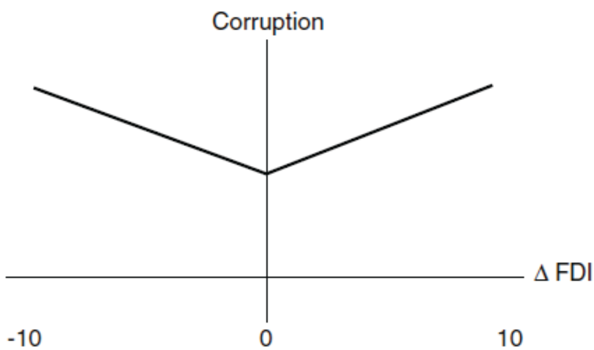

Figure 3 : Corruption and the FDI, source : Pellegrini and Gerlagh (2004)

2 These services, however, are being delivered by lower rank bureaucrats, and thus we believe that it is an example of how the small (petty, administrative) corruption scares off the foreign investors

For instance, the massive FDI in Ecuador in 2000 have been followed by growth of corruption of 13%. Au contraire, countries such as Estonia, who had a gradual increase in the FDI, also had a gradual drop in corruption. Our interpretation is the following. If the FDI grow without forming an institutional system[3] in order to welcome these investments, the local bureaucrats and politicians might have a possibility to deviate an important part of this afflux to their personal accounts. For instance, a country like Nigeria, rich in natural resources generally attracts the FDI, but those FDI rarely contribute to growth of development.

5. Concluding remarks

We have tried in this paper to focus the attention to the problems of corruption in modern economies. In the first part of this paper, our intention was to show *what* is corruption, how does it appear, what aggravates it, how can one measure it. In the second part, our intention was to show *how* corruption transmits its effects through an economy. The focal point is the transaction costs, whereas the rise in corruption makes those costs more important, and thus lowers the overall efficiency of one economy. The body of literature presented in the paper confirms our ideas. In spite of the growing body of corruption literature, there is still a live discussion on the question whether corruption is tonic or toxic for the economy, whereas we choose the latter answer.

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