

**THE GROWTH AND CORRUPTION CORRELATION:
ITS IMPACT ON THE ACHIEVEMENT OF
MIDDLE INCOME STATUS**

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I INTRODUCTION

That corruption adversely affects economic development has become commonplace knowledge. Corruption damages economic development and keeps people poor. As Vaclav Havel, former Czech President (October 2001) observed: Corruption may either deter investment or render it less productive through its adverse impact on the risk and cost of doing business.

There appears to be worrisome evidence of a perception of high levels of corruption as well as tolerance for corruption in Ghana. The recent four-urban cities in Southern Ghana survey of the Ghana Integrity Initiative (GII) reported as follows:

- A high – 70 per cent of respondents – said they had been involved in bribery and corruption either as victims or perpetrators.
- Almost 90 per cent of respondents who had witnessed incidents of bribery and corruption usually looked on unconcerned.

Clearly, this is an indication of an “unacceptably high level of tolerance for corruption among Ghanaians” [GII Alert of September 2005]. According to the Release of Findings, the survey captured the perceptions of respondents on institutions or organizations highly affected by corruption in the country today. The top ten institutions are shown in the Table below. They can be grouped into four categories with the Police Service alone in the top category. Perhaps a saving grace in the otherwise dismal picture is the Politician being in the fourth group together with the Internal Revenue Service.

i.	The Police Service	-	76.8%	I
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ii.	Ministry of Education	-	31.5%	II

iii.	Customs – CEPS	-	31.1%	
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iv.	The Judicial Service	-	16.4%	
v.	Civil/Public Service	-	16.4%	
vi.	Ministry of Health	-	15.6%	III
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vii.	Politicians (Ministers, MPs, etc)	-	8.7%	
viii.	Electricity Company	-	5.5%	
ix.	Internal Revenue	-	5.2%	
x.	Ghana Immigration Service	-	4.3%	IV

Political Corruption is defined by Transparency International (TI) – the world-wide anti-corruption advocacy organization as:

the abuse of entrusted power by political leaders for private gain, with the objective of increasing power or wealth.

Political corruption it may be noted, need not involve money changing hands; it may take the form of “trading influence” or granting favours that “poison politics and threaten democracy”. Corruption is essentially an issue of governance touching on law and bureaucratic quality, government stability and civil liberties.

Some professions also have their own Code of Ethics but this has not stopped some of their members appointed into positions of trust from misusing their positions to enrich themselves while consciously impoverishing the organization in their charge. Just like political corruption, these acts also “poison politics and threaten democracy”; they also raise the risk and cost of doing business.

Three key Fiduciary Acts all passed by Parliament in 2003 were designed to regulate, and bring order, control and sanity into the country's financial administration. They were the following:

- Financial Administration Act (Act 654)
- Internal Audit Agency Act (Act 658)
- Public Procurement Act (Act 663)

They “were promulgated to ensure transparency and accountability in public procurement, public business and also to promote fair competition among all interested parties “as our Concept Note puts it.

II THE CORRUPTION/GROWTH CORRELATION

In the context of aid, growth and poverty reduction, the question has been posed: Will cancellation of debt and the provision of more aid really better the conditions in Africa, or are the problems related to something other than money? The evidence, such as it is, suggests that many experts would put their money on the latter alternative. William Easterly, New York University Economics Professor and former World Bank Senior Advisor is quoted to have said:

You have to face reality. If debt cancellation and relief has not brought that much in the way of benefits over the last 20 years, why do we expect it today?
The G7 – which became the G8 in 1997 with the addition of Russia – has been canceling increasingly larger chunks of debt for almost 20 years. Yet that still leaves some \$260 billion owed by 40 countries – other than the 18 impoverished countries of which 14 are African, \$40 billion of whose debt has been cancelled.

The sad reality is that Africa has not had very good governments. There's been a lot of corruption, and they're just not very effective at getting good things to the people.

“The money didn't go to build clinics or schools or roads or hospitals. It went into Swiss bank accounts and to build homes on the Riviera for these rulers” to quote Salih Booker, Executive

Director of Africa Action, a non-profit US organization that promotes political and economic justice in Africa.

There is little doubt that progress has been made over the last few decades but Easterly says Western expectations are too high. “I think that slogan – ‘make poverty history’ - is kind of a symptom of what’s wrong with the whole foreign aid debate.What I’m afraid of is the expectations of the public and rich countries are being raised so high by this effort and the goals are so ambitious that when the goals are not reached, which I think is pretty much inevitablethere could be a big wave of disillusionment..... It would be much better if we could move away from those types of utopian goals of ending world poverty by tomorrow and just focus on the little things that can be done by lots of people”.

The Concept Note points out that corruption and fraud in public procurement – accounting for between 50 and 70 per cent of government expenditure-impact on governance, economic growth and development. An important channel for this relationship is through the effect of corruption on investment: corruption deters investment.

Corrupt politicians, all over the world tend to choose investment projects not on the basis of their intrinsic economic worth, but on the opportunity for bribes and kickbacks these projects present. It is important to note that, in corrupt environments, the enterprise that pays the commission may or may not suffer from the payment of the bribe. It is usually not difficult in corrupt environments to recover the cost. The taxpayers end up with either one or more of the following:

- a more costly project;
- a bigger or more complex project than necessary;
- a project of inferior quality that would require costly upkeep and repair.

Thus in general, corruption raises the cost and risk of doing business which in addition to deterring investment could also make investment and business less productive or profitable. Experience with public sector projects, especially in developing countries, is replete with stories about roads that are pocked with potholes soon after completion, power plants that experience regular blackouts and sewerage systems that simply to not work.

The result is that, rather paradoxically, increased public investment spending often ends up reducing the country's economic growth. This would happen when in spite of the higher spending, the average productivity of total public spending falls more than proportionately. Thus corruption could through this nexus decelerate the economy. But to achieve middle income status and the Millennium Development Goals, economic growth must accelerate not decelerate.

The possibility of increased capital spending resulting in economic slowdown runs counter to popular wisdom which asserts that countries need capital to grow. But popular wisdom assumes the existence of a direct relation between capital spending and economic growth (a fixed incremental output/capital ratio). Given this assumption, if a country engages in capital spending, growth would most likely follow. In recent years, economists like William Easterly (see the Elusive Quest for Growth) have pointed out that no such automatic linkage exists. Capital spending must be productive to have the required growth-enhancing effect.

The bias in favour of capital spending has been evoked as a good guide to policy even in the face of much evidence that some types of current expenditure – for example on operation and maintenance that keeps existing infrastructure in good condition or that contributes to the accumulation of human capital – could promote growth much more effectively than unproductive capital expenditure. What makes this happen is the limited room for discretionary authority and therefore for corruption in respect of the bulk of current expenditures in contrast to capital expenditure.

Around the world some politicians have been quick to internalize this bias and to have sensibly learnt to exploit it as (Vito Tanzi and Hamid Davoodi) summarized in the IMF paper: Roads to Nowhere: How Corruption in Public Investment Hurts Growth. To quote from it:

Ribbon-cutting ceremonies marking the opening of investment projects – such as roads, dams, irrigation canals, power plants, ports, airports, schools and hospitals – are every politician's dream. These occasions present splendid photo

opportunities, while the very act of cutting the ribbon seems to identify the shear-wielding politician as a contributor to the future growth of the economy.

The capital budget and its composition are highly discretionary. The formulation of the capital budget is done at the highest level of the Executive with senior political figures making basic decisions. It is these decisions that determine:

- the size of the total public investment budget;
- the general composition of that budget – the broad allocation among different categories of capital spending;
- the choice of specific projects and their geographic locations; and
- the design of each project.

The extent of discretion exercised by senior officials is higher when the country's controlling or auditing institutions are not well developed and institutional controls are weak. These observations underline the importance of the three Fiduciary Acts named above which were passed into law in 2003 and which are the core topics of our deliberations.

When corruption influences the approval of an investment project, the rate of return calculated by cost-benefit analysis ceases to be the criterion for project selection. When corruption plays a dominant role in the selection of projects and contractors, some projects may even be completed but never used. Others may be so poorly built that they could need continuous repair and their output capacity could prove disappointing. In such circumstances, there can be no mystery about the empirical finding that capital spending often fails to generate the growth expected by economists.

Moreover, higher spending on capital projects could reduce the resources available for other spending especially on operation and maintenance – the current public spending required to keep the existing physical infrastructure in good working order. All too often, in developing countries, new projects are undertaken even as existing infrastructure is left to deteriorate. In extreme cases, operation and maintenance spending on the already existing physical infrastructure has been known to be intentionally neglected to make or strengthen the case for

new infrastructure to be built – an opportunity for corrupt officials to extract additional commissions.

Yet, more output could be squeezed out of existing infrastructure that is maintained in good working condition. It is not too difficult to think of situations in which the deterioration of infrastructure retards growth more than new capital projects add to growth.

The Golden Rule

The bias in favour of capital and against current spending is also reflected in the so-called “golden rule” often advocated by economists. The rule states simply that, within limits, a country can safely run a budget deficit to be funded by domestic and foreign borrowing equal to the capital spending of government. In other words, the country could borrow whatever is possible for the capital budget. Going by this rule, it is all right for the country to borrow to finance the construction of new roads, but not borrow to finance the repair and maintenance of existing roads, to borrow for a new hospital but not for hiring nurses or doctors or for the purchase of drugs or medicines. But with some thinking, where generalized corruption adversely impacts on the domestic revenue mobilization effort, operation and maintenance spending – for which there can be no borrowing – will be reduced far more drastically than capital spending for which borrowing is allowed or even encouraged. In this regard, the perception reported by GII regarding the revenue-collecting agencies and particularly CEPS – placed third – cannot be taken lightly.

Empirical research (conducted at the IMF in the 1990s) produced the following summary:

1. Corruption can reduce growth by increasing public investment while reducing its productivity.
2. Corruption can reduce growth by increasing public investment that is not adequately supported by expenditure on operation and maintenance.
3. Corruption can reduce growth by reducing the quality of the existing infrastructure. A deteriorating infrastructure, not surprisingly would tend to increase the cost of doing business

for both government and the private sector – for example through congestion, power outages and accidents – and thus lead to lower output and growth.

4. Corruption can reduce growth by decreasing the efficiency of the revenue collecting agencies and consequently the domestic revenues needed to finance productive spending.

III DEVELOPMENT PARTNERS' CONCERN WITH CORRUPTION

Development Partners, in recent times, have shown increasing concern about corruption in recipient countries. Corruption in poor countries is now perceived as a direct threat to the security of richer countries who therefore have a stake in the fight in developing countries to stamp out corruption and alleviate poverty. Where millions are left in misery and poverty thus these are breeding grounds for hopelessness and for planting the seeds of terrorism. Fighting corruption is also fighting terrorism as without corruption the attacks of September 11 could not have taken place, argues Peter Eigan, Chairman of Transparency International (TI).

On December 17, 1997 ministers of 34 countries including 29 from member states of the Organisation for Economic Co-operation and Development (OECD) signed a landmark agreement aimed at eradicating bribery of foreign officials. The agreement sought to encourage its signatory countries to introduce legislation making payments of bribe to foreign officials no longer tax deductible and criminalizing the payment of bribes to foreign government officials.

Until then, it was commonly accepted that in some countries it was nearly impossible to win a government contract without first paying a bribe. In their bid to obtain advantages for their national enterprises in international competition for contracts, therefore very few countries made the payment of such a bribe illegal. The laws of some major industrial countries regarded commissions paid by domestic enterprises to foreign politicians legal expense and therefore tax deductible.

More recently, the communiqué of the Gleneagles Summit under the theme *Promoting Good and Responsive Governance (in Africa)* committed the G8 countries to:

- Work vigorously for early ratification of the UN Convention Against Corruption (UNCAC) and start discussions on mechanisms to ensure its effective implementation. Work to establish effective mechanisms, consistent with the provisions of UNCAC and previous G8 commitments, within our own administrations for the recovery of assets, including those stolen through corruption and to return assets to their legitimate owners. We encourage all countries to promulgate rules to deny entry and safe haven, when appropriate, to officials and individuals found guilty of public corruption, those who corrupt them, and their assets.
- To further protect the international financial system from illicit corruption proceeds, we encourage all countries to require enhanced due diligence for financial transactions involving politically exposed persons. In addition, we urge all countries to comply with UN Security Council resolution 1532 to identify and freeze the assets of designated persons.
- Reduce bribery by the private sector by rigorously enforcing laws against the bribery of foreign public officials, including prosecuting those engaged in bribery; encouraging companies to adopt anti-bribery compliance programmes and report solicitations of bribery; and by committing to co-operate with African governments to ensure the prosecution of those engaged in bribery and bribe solicitation.

IV CORRUPTION AND CAPITAL FLIGHT – ANY LINK?

For low-income Africa, capital flight is not a marginal issue. The continent has haemorrhaged private capital over the same period as it has received relatively large inflows of international public capital. On reasonable calculations, it is even more short of private capital than it is of public capital.

Especially in Africa, capital flight has been very substantial, so that potentially, movements in domestic wealth portfolios are very important. Aid will be scaled-up if it induces domestic

residents to retain a greater proportion of their wealth within the country, and it will be offset and potentially vitiated, if it induces a greater proportion of private wealth to be held outside the country. The latter is a distinct possibility through the effects of corruption. Many commentators have suggested that in the context of the high levels of corruption common in much of Africa, aid is likely to fuel capital flight. Some spectacular and disturbing examples of the abuse of aid by corrupt leaders adds credence to such concerns (Mobutu's Zaire). Africa is after all the region with both the highest levels of aid and the highest levels of capital flight.

The good, even if perhaps surprising news from empirical research carried out by Paul Collier and Jan Dehn at the World Bank in 2001 is that aid has significant and substantial effects on capital flight, but that these effects are benign. To summarise a particularly influential research finding:

Aid substantially reduces capital flight. As a consequence, aid is substantially 'scaled up' by the induced decisions of domestic wealth holders. In the short term, additional aid has substantial effects on their portfolios, being matched more than dollar-for-dollar by induced reductions in capital flight. In the longer term such changes in the portfolio are each maintained if aid itself is maintained for a substantial period, perhaps a decade

Capital flight is a major problem in Africa. To date, considerable emphasis has been placed on corruption as a driver of capital flight. However, our analysis suggests that corruption is not central to capital flight.capital flight is driven by the risk-corrected rates of return available on domestically held assets. In Africa risks have been high and returns have been low, so the risk-corrected returns have looked very unattractive relative to foreign assets

The massive amounts of flight capital held outside Africa now provide an important opportunity. If this capital could be attracted back it would make a major contribution to development. Increased aid, according to the study, can play a significant role in inducing such a repatriation. So too can improvements in domestic economic policies and political conduct. This provides a further basis for partnership between donors and recipient governments. The just concluded

Consultative Group Meeting sought to lay the basis for a new Ghana Partnership Strategy. In his Opening Statement, Mats Karlsson, World Bank Country Director noted the importance of Ghana's pacesetter role:

Not all your neighbours are as fortunate to be able to have that possibility. But that also means that we have a serious responsibility, for Ghana, but also for Africa as a whole.

The challenge is for Ghana to accept to be Aggrey's eagle and soar to middle income status in this decade. We should succeed for both Ghana and Africa.