

THE EFFICIENCY IMPLICATIONS OF CORRUPTION

Mushtaq H. Khan

published in the *Journal of International Development* 1996 Vol 8 (5): 683-96

ABSTRACT

Corruption has different efficiency effects across countries. Conventional economic models of corruption are shown to be deficient in explaining these differences. Instead the article suggests that the distribution of power within the patron-client networks in which corruption is taking place is an important variable explaining the differences in the efficiency effects of corruption. Where patrons are powerful the range of rights transacted is limited and the allocation is likely to be efficiency maximizing. In contrast where patrons are weak the range of rights transacted is likely to be much wider with the rights allocated according to political calculations with large efficiency costs.

In late 1995 and early 1996 two parallel corruption scandals rocked India and South Korea. What is interesting is that although the sums of money involved in the Indian scandal were relatively small (some \$20 million dollars spread over 30 or so politicians over two years) there was a general perception that poverty in India must have something to do with the corruption of its politicians. In contrast, in the South Korean scandal the sums of money involved were much larger. In late 1995 ex-president Roh Tae Woo admitted that he alone had accumulated a personal fortune of around \$650 million over a five year period in office. While Roh's behaviour had equally serious political repercussions in South Korea, it was difficult to argue that economic performance had been seriously undermined as a result.

Does corruption have any effect on economic performance? If so, why did the presence of widespread corruption not have more damaging effects in countries like South Korea? These are the sorts of questions which the economic analysis of corruption seeks to answer. In this article we review the routes which contemporary economic theory has followed in providing models of the effects of corruption. We argue that in general these models are unsatisfactory because they ignore the distribution of power in the patron-client networks in which corrupt transactions are conducted. This distribution has an important effect on the efficiency of corruption by determining which rights are subject to corrupt transactions and the terms under which they are allocated.

1 DEFINING CORRUPTION

Corruption has been defined in a number of ways in the literature. The basic distinction is between normative and positive definitions, summarized in figure 1. Two variants of normative definitions are provided in definitions 1 and 2 in figure 1. The first looks at acts and is clearly normative while the second looks at the consequences of acts. The second remains a normative definition because the definition of the public interest may differ across observers. It is also problematic to define corruption in terms of its consequences because this defines out of existence cases of beneficial corruption. Economic and sociological comparisons most often use the third, positive, definition using the standard of legal norms to identify deviations. Thus corruption is defined as deviations from the formal rules governing the allocative decisions of public officials in response to offers to them of financial gain or political support (based on Nye 1967).

Normative Definitions	Positive Definitions
1 Deviations from Ethical Norms 2 Actions that Harm the Public Interest	3 Deviations from Legal Norms

Figure 1 Definitions of Corruption

The stipulation that corrupt transactions should violate *formal* rules rather than simply ethical norms rules out any disagreements about the appropriate ethical standards. The additional stipulation that *public officials* are involved distinguishes corruption from *theft* which is illegal but which exclusively

involves decisions by private individuals. The definition is still open to the problem that formal rules can vary across countries. A strict application of the definition could lead to different sets of practices being identified as corrupt. Fortunately, the corrupt practices which economists have wished to analyse would in fact violate formal rules in *most* countries.

The extent of corruption is difficult to objectively measure but it is widespread in many developing countries. Empirical evidence on corruption comes from journalistic and sociological case studies as well as cross-country indices of corruption such as those provided by Business International, Transparency International and the World Competitiveness Report. A number of empirical estimates of the effects of corruption have been based on such indices (Ades and Di Tella 1996). These provide a step forward but the subjectivity of local respondents in reporting the degree of corruption has to be kept in mind. It is likely that respondents in poorly performing economies will find even petty corruption more oppressive and therefore rank the extent of corruption higher. The case study based approach must therefore complement the index based one wherever possible.

The recent revelations of corruption in South Korea are interesting from this perspective. A major case which came to the surface in the 1990s was the decision of the Chun administration to disband the Kukje business group (chaebol) when its chairman refused to make large transfers to President Chun's chosen funds. In 1993 a South Korean court found the Kukje breakup illegal opening the way for further cases to be brought and indicating a shift in the overwhelming power of the South Korean state. The Kukje case was only the tip of the iceberg. The revelations eventually led to the admission by ex-President Roh of his personal involvement in the \$650 million scandal.

The opposition leader Kim Dae Jung, one of the harshest critics of the corruption of the regime admitted to having received 2½ million dollars from Roh. But he pointed out that this was considerably less than his opponent, the conservative victor for the presidency, Kim Young Sam, had received (*Financial Times* October 28 1995). In November 1995 twenty four of the country's chaebol were implicated in the scandal including the big four: Hyundai, Samsung, Daewoo and Lucky Goldstar. The other chaebol named included a "roll-call of Korean industry" (*Financial Times* November 25 1995). It would be difficult to argue that corruption was either small-scale in South Korea or limited to a few sectors or politicians. The figures are likely to turn out to be the tip of a much larger set of redistributions which held the Korean industrial policy system together.

This kind of evidence challenges the conclusions of those who see a uniform negative relationship between corruption and economic performance. The usual response to the observation of corruption in dynamic countries has been to argue that the extent of corruption and the presence of countervailing factors varied across countries. According to this line of argument, the differential performance is explained by saying that the practices identified as corrupt were i) not equally present everywhere and/or ii) that in the successful countries corruption was offset by countervailing factors. It is important to establish why this response is not very satisfactory.

While it is virtually impossible to measure precisely the degree of corruption with any precision, when we compare *specific* cases of corruption, such as examples of collusion between government and business it appears that similar practices have had very different outcomes. Moreover, the countervailing factors often turn out to be precisely the details of the bargaining between government and business rather than variables elsewhere in the economy. Thus the evidence suggests that the

problem is not just the extent of corruption but also its type. We should therefore try and see whether there are differences in the types of corruption which can account for the differences in observed effects.

2 CONVENTIONAL MODELS OF CORRUPTION

Economic models of corruption attempt to identify the efficiency implications of changes in resource allocation brought about by corrupt transactions. The first step in this exercise is to identify the *ex ante* allocation with which the effects of corruption are to be compared. This is not as simple as it sounds and many of the controversies in the literature can be traced to ill-defined benchmarks with which the post-corruption allocation is being compared. Consider figure 2. Suppose we are at the stage shown in box 5. Do we compare the efficiency implications of this allocation with the allocations at stage 4, 3, 2 or 1?

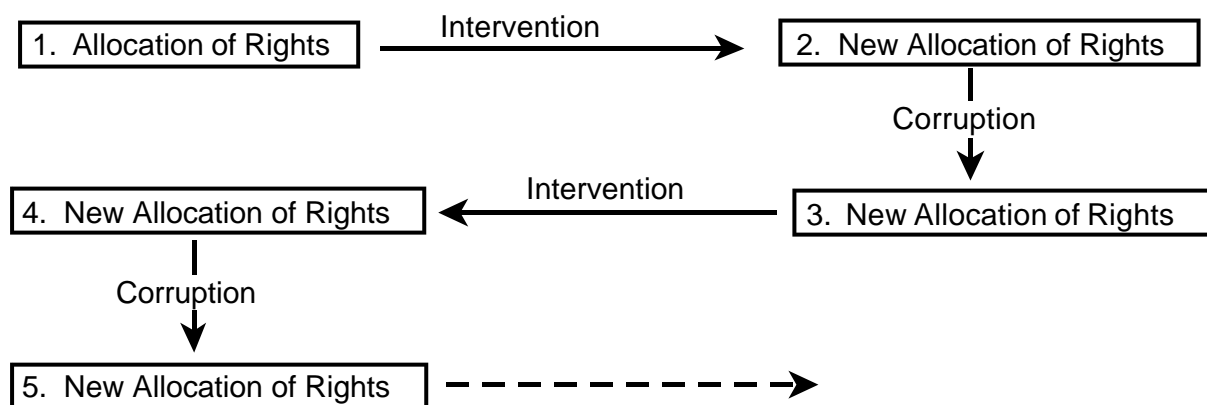


Figure 2 The Allocative Effects of Corruption: Choosing Benchmarks

The problem is solved in neoclassical models by choosing the perfectly competitive allocation as the benchmark. Suppose this is shown in box 1. Neoclassical theory tells us that welfare is optimized at this allocation and any intervention takes us away from this optimal level of welfare. Consequently the welfare at stage 2 is lower than at 1. The subsequent corruption which takes us to 3 can increase the welfare loss, as in most rent-seeking models. On the other hand, it can undo some of the misallocation by allowing resources to be bid back to higher valued uses, though the level of welfare will still be lower than at stage 1. Thus even with the neoclassical benchmark, our assessment of the effects of corruption will depend on whether we compare the efficiency in box 3 with that in box 1 or 2.

Leff's (1964) argument that corruption had beneficial effects in sub-Saharan Africa because it allowed some entrepreneurs to side-step restrictive monopolies was effectively comparing a situation such as 3 with the even worse allocation at 2. In contrast, Myrdal's (1968) argument took the opposite position, arguing that the possibility of corruption would encourage state officials to deliberately introduce restrictions which maximized their take. Here the comparison (anticipating subsequent rent-seeking arguments) is with a benchmark such as stage 1 which involves neither the corruption nor the interventions which led to it.

In real-world comparisons where intervention of particular types and corruption come as package deals, these problems are even more relevant. The perfectly competitive benchmark may not be useful in such comparisons. Suppose the only way to get efficiency-enhancing interventions which

take us from stage 3 to stage 5 is to accept some of the efficiency loss brought about by corruption at stage 4. We have to decide whether to choose 3 or 4 as our benchmark. If the corruption is part of a package deal with particular kinds of intervention, so that stage 4 is not a feasible benchmark, we should consider the corruption cost as a necessary cost for attaining the improvement in welfare between 3 and 5. Comparing 5 with 3, corruption appears as a necessary cost of increasing welfare in the same way as labour or input costs are necessary costs. If on the other hand it was feasible to attain the allocation at 4, the corruption which took us to 5 would be an avoidable cost. Consequently by comparing 5 with 4, we would conclude that corruption reduced welfare. The need to make this type of judgement about feasible benchmarks makes the analysis of corruption difficult.

The next step in the economic analysis is to model how corruption at different stages can explain the eventual allocation of rights. The aim is to explain the difference in welfare levels between the current level and that at some benchmark allocation. The analysis of corruption has drawn most heavily on rent-seeking models. These developed to answer the more general question of how the legal and illegal expenditures on persuading activities affected welfare. While not all rent-seeking is illegal and therefore corrupt, the general models can be amended to examine the effects of corruption. We argue that the models are indeterminate in terms of predicting both the *extent* of corruption as well as its likely *social cost*. In the next section we look at some of the factors which might make the analysis more determinate.

Rent-seeking theories have primarily looked at the determinants and effects of the *magnitude* of expenditures on rent-seeking. Rent-seeking describes the activities and expenditures of individuals who seek to change rights to earn the above normal profits described as rents. The theories of rent-seeking developed in response to the observation that measures of the deadweight losses associated with tariffs and other interventions were relatively small. Buchanan, Posner, Tullock, Krueger and others argued that the real efficiency cost of intervention was larger because the artificial rents would persuade other agents to spend resources trying to acquire rights to these rents till the rate of return had been equalized across activities (Buchanan, Tollison and Tullock 1980).

The first goal of the rent-seeking literature was to identify the magnitude of the rent-seeking expenditure. While some of this expenditure could be legal, in the form of lobbying, queueing and so on, much of it is likely to take the form of corruption in developing countries. The earliest models such as those of Krueger (1974) and Posner (1975) argued that the rent-seeking expenditure was going to be equal to the value of the rent being competed for. However, it was soon established that the aggregate expenditure is indeterminate in terms of conventional economic variables.

To some extent, the expenditure does depend on a number of conventional variables. These include the number of agents competing for rents and the number of state officials competing to supply the rights demanded. These factors can be modelled in a way familiar to economists. The structure of demand and supply in this "market" partially but not fully determine total expenditures. However, total expenditure also depends on a number of other factors including the determinants of each individual's *probability* of getting the rent in response to expenditures on rent-seeking (Mueller 1989: 231-5). This probability depends to some extent on the number of agents competing for the right but it also depends critically on other features of the political economy which determine the rules governing the allocation of rights in rent-seeking transactions.

For instance, if there are a small number of agents competing for the rents, they may end up spending far less than the total amount of the rent if some agents have a much higher probability of getting the rent. This could be the case if insiders have an advantage over outsiders (Rogerson 1982). The outcome here depends not only on the small number of players but also critically on the enforceability of the rule determining the probabilities of different agents getting the rent. With the same number of agents the rent-seeking expenditure could be very large if there was a reasonable probability for outsiders to become insiders by spending large amounts of resources on rent-seeking. The analysis is therefore indeterminate without a description of the political economy which determines the distribution of probabilities of winning across groups and individuals.

Similarly, attempts to relate the magnitude of rent-seeking expenditures to the number of state officials offering the rights also proves to be indeterminate. One of the earliest models of how the agency structure of the bureaucracy can affect the magnitude of corruption was provided by Rose-Ackerman. She considered a number of alternative bureaucratic structures: fragmented, sequential and hierarchical. In the fragmented structure each of a number of agencies provide part of the approval required, the sequential is similar except that approval is provided in sequence while the hierarchical corresponds to the command structure usually assumed in theories of bureaucracy. Rose-Ackerman's analysis established indeterminacy and showed that under particular conditions each of these structures may dominate in generating the greatest degree of corruption (1978: esp. 176-88).

A similar indeterminacy exists in subsequent rent-seeking models which have attempted to model how the number of competing officials affects the magnitude of rent-seeking expenditures. Thus in Congleton's (1980) model, the competition amongst officials in a democracy could push the total bribe take down if each official was prepared to accept a low bribe. But if the minimum effective bribe was high, democracy may end up with a higher total bribe take than a dictatorship. Once again the total rent-seeking expenditure depends on features of the political economy of the society, here on the determinants of the bargaining power of bribe-givers and state officials.

While progress was made in pinning down at least some of the determinants of the *magnitude* of rent-seeking expenditures, less progress was made in identifying what part of this total expenditure was likely to be a true *social cost*. The problem here includes the one we discussed earlier of agreeing on a benchmark for comparing *ex post* outcomes. In the early rent-seeking models, the entire expenditure was assumed to be a waste. The justification for this was provided by Bhagwati (1982) who defined all expenditures on rent-seeking activities as *directly unproductive*. The basis for this definition was the assertion that the resources used up in rent-seeking activities do not produce an output which enters anyone's utility function.

However, in terms of neoclassical theory, this definition has the status of an assertion. It is clearly possible for expenditures, particularly if they are on pet political causes, to enter into the utility functions of the spenders as well as being rent-seeking expenditures. Moreover, as Bhagwati himself recognized, if the rent-seeking expenditures resulted in society moving from a less efficient to a more efficient position, it would be difficult to say that the expenditures were a waste from society's point of view. Recall that a move from stage 2 to stage 3 in figure 2 as a result of corruption could result in an improvement in welfare by reallocating resources to higher valued uses.

Thus an important source of confusion in the literature is the assertion that the *entire* rent-seeking expenditure was a social cost. This implicitly assumes that no welfare improvement comes about as a result of the reallocations of rights brought about by the expenditure. To properly identify the social cost associated with any given magnitude of rent-seeking expenditures, we would have to know the *particular* rights which were being reallocated or changed as a result. This is once again outside the ambit of rational choice models. In no society is every rent-yielding right up for reallocation or change through rent-seeking. A description of the political economy which determines *which* rights are up for negotiation is a critical precondition for analysing the waste implications of any particular level of rent-seeking expenditure. If the rights being reallocated result in welfare improvements, the rent-seeking expenditure may be a necessary cost and therefore no more a waste for society than the expenditure on fuel. If the rights being created or destroyed result in welfare losses, *any* level of expenditure on rent-seeking is a social waste.

A further source of confusion in the literature is a debate about whether bribes are a social cost if they are simply transferring resources between members of the same society rather than changing the level of output (Tullock 1980, Browning 1980). In theory, if bribes are pure transfers which change the distribution of income without affecting incentives, they have zero social cost apart from the transaction cost of organizing the bribes (Varian 1989). In reality, bribes inevitably change incentives and therefore have effects on production. Like any other expenditures on rent-seeking, the efficiency losses due to acts of bribing have to be compared with the outcomes to assess their social cost.

The incentive effects of bribes have been modelled by Shleifer and Vishny (1993). Rose-Ackerman's early work had modelled the magnitude of bribes under different agency structures of the state. Shleifer and Vishny relate the agency structure to both the magnitude of bribes and their social cost in terms of lost output for society. Shleifer and Vishny's three-fold classification is quite similar to Rose-Ackerman's. Their first case is a centralized state where a *single* agency is the sole supplier of all relevant rights. The second case is a fragmented state where a *number* of agencies each provide one of a number of *complementary* rights. Each productive user requires a package of all these rights and therefore has to deal with all the agencies separately. The final case is one where there are a *number* of agencies but they can each supply *all* the relevant rights required by each productive user.

The outcome in terms of the effect on incentives for the productive sector is radically different between the three cases. The single agency case is equivalent to that of the monopoly case in industrial organization. State bureaucrats maximize their income from bribes by restricting the joint supply of the separate rights to their profit-maximizing level. Shleifer and Vishny argue that the total bribe collected will be the highest in this case as in a joint monopoly in industrial organization where the same firm supplies a number of complementary goods. Since the rights are over complementary inputs, the level of bribe demanded for *each* type of right will not necessarily be maximized.

The fragmented case is a version of the Cournot oligopoly case in industrial organization. Here a number of agencies each supply a right over a complementary input. One agency may supply the right to import raw materials, another may supply the right to set up the factory, and a third may supply access to credit. The different agencies face a prisoner's dilemma. In attempting to maximize rents for itself, each will raise the price of the particular right it supplies so high that overall activity

shrinks and the *total bribe* collected by all agencies falls. The total bribe take falls because high individual bribes cause a fall in the level of activity and therefore in the demand for the rights sold by the state. Output and efficiency are lower than in the monopoly case.

The final case is a special case of fragmentation where each agency can supply a package deal to purchasers with all the complementary rights necessary to set up the business. This corresponds to the competitive case in industrial organization where a large number of suppliers are supplying the product. In this case the product is the *package* of rights necessary for productive activity. Competition between agencies will in theory push the price of the package of rights to zero and therefore the total bribe take to zero as well. The total bribe falls to zero not because the demand for rights has collapsed but rather because the price of each right has become zero. The absence of the bribe tax means that output and efficiency are now at their highest level.

The Shleifer-Vishny policy conclusion is straightforward. Corruption is best dealt with by increasing the competition between bureaucrats and allowing more agencies to supply similar rights. The aim is to approximate the third case: the competitive supply of rights. Total bribes are zero and output is highest. The worst case is that of competing agencies supplying complementary rights. Total bribes are not maximized but output is lowest because individual bribes are highest. The absolute monopoly case with the highest total bribe is in between, with a higher social output than the fragmented case.

Despite its apparent ability to model the consequences of state fracturing, the model does not actually fit a casual assessment of the costs of corruption across countries. As Shleifer and Vishny admit, most successful countries do not resemble the competitive agency structure of their theory. Indeed countries like South Korea appear to be closer to the monopolistic supply case rather than the competitive supply one. Equally, the classic cases of corruption-led sclerosis do not exhibit unqualified state fracturing. As the authors point out, countries such as the Philippines under Marcos were closer to the monopolistic supply case. A characteristic feature of such dictatorships has been that the strongman had a finger in every pie and could in principle have ensured that the total bribe was maximized for important packages of rights. On the other hand, Shleifer and Vishny point out that India approximates the fragmented case but it would be difficult to argue that the social costs of corruption were greater in India than, say, in the Philippines.

The model may therefore explain a *part* of the difference in the effects of corruption across countries in terms of these agency structure differences. But some of the most successful countries have monopolistic rather than competitive supply (South Korea, Taiwan). In this they are quite similar to some of the countries where the social costs of corruption were perceived to be the highest (Philippines under Marcos, Bangladesh under Ershad). On the other hand, some moderately successful countries (India) approximate the oligopoly case without collapsing in the way the model predicts.

One obvious shortcoming of the model is that it is silent about the packages of rights which are at issue. There is no description of the political economy of the society which determines *which* rights are being contested and the rules governing the resolution of these contests through the mediation of the state. We argue in the next section that differences across societies in these respects can explain why the social costs of rent-seeking can differ across institutionally similar state structures.

In summary, conventional models have limitations in determining both the magnitude of the expenditure on rent-seeking activities as well as in determining the social cost of these expenditures. The magnitude of expenditures does depend on some of the variables identified in rent-seeking models such as the number of competitors for rents and the number of agencies or officials supplying the rights to these rents. But the magnitude of the expenditure also depends on features of the society which determines how the probability of each individual getting the rent varies with the amount of expenditure she is willing to make. In the extreme case, the probability may have nothing to do with expenditures but may instead be determined by other political or sociological variables. The models determining the social cost of these expenditures are even less determinate. To determine whether expenditures are a social cost or not we need to know *which* rights are being contested and the *rules determining success and failure* for individuals or organizations in these contests.

3 PATRON-CLIENT NETWORKS AND CORRUPTION

In this section we discuss what can be said in general terms about the factors which determine which rights are transacted between state and society and the terms of their exchange. Many of the determinants of these characteristics may be quite specific to societies but some relevant differences between societies can be identified at a general level. One of these determinants is the distribution of power between the state and the organizations in society which are demanding changes in rights.

Developing country states typically operate through patron-client relationships with key sections of society. State leaderships operate through these networks to *implement* their economic and political strategies and to *negotiate* changes in rights. A simple way of capturing the relevant differences in the balance of power across developing countries is to look at the power relationship between patrons and clients within such networks (Khan 1996 and forthcoming).

A comparison of two ideal-typical cases will establish the importance of these differences. At one extreme we define the *patrimonial* patron-client network. The term *patrimonial* refers to the ability of the state to protect existing rights at low cost. This is actually implicit in much of economic theory where the state is assumed to have the power to enforce property rights at low cost. Underlying this is a distribution of power in society which allows the state to do this. This distribution of power between the state, right-holders and contestants of rights is in fact characteristic of a relatively narrow range of social structures in developing countries.

Patrimonial patron-client networks, where the state is able to protect the existing property right structure at low cost, are likely to be unusual in developing countries. This is because in developing countries current allocations of rights typically do not have a long history and civic institutions supporting such allocations are typically underdeveloped. Consequently, patrimonial patron-client relationships are only likely to develop in a relatively narrow range of developing countries where the distribution of power between the state and the coalitions contesting rights is tilted in favour of the state.

At the other end of the spectrum we define the *clientelist* patron-client network. State officials as patrons within these networks lack the power to enforce rights. Property rights within these networks are weakly-defined. Variants of the social distribution of power which produces this result are the norm in developing countries. Property rights over valuable resources are newly emerging

and the groups or individuals getting access to these rights typically do not have a long history of possession. The degree of contestation over rights is consequently much higher.

In the clientelist case, state officials as patrons within patron-client networks are unable to monopolize the protection of rights. Mafia-like groups are likely to emerge engaged in private protection activities for patrons both in the private sector and in the state. In turn these "clientelist" groups organize their own challenges on rights. This difference in the distribution of power within patron-client networks has important implications for the efficiency of corruption. On the one hand, the range of rights being contested varies greatly between clientelist and patrimonial networks. In addition, the factors determining success also differ between these networks with important allocative implications.

3.1 THE RANGE OF CONTESTED RIGHTS

The standard assumption in rent-seeking models is that the rent-seeking expenditures are being targeted towards a limited range of rights. This is consistent with the existence of patrimonial patron-client networks. It is assumed that rent-seeking does not affect the entire range of rights collectively. If all rights were being contested, the social allocation of rights would collapse without protection mechanisms (such as clientelist coalitions or mafias). In addition, the implicit assumption in conventional rent-seeking models is that while the state can limit the range of rights being negotiated, it only wishes to create (and trade in the creation of) socially harmful rights. It is not clear why the state should have such an objective function. One reason could be that only harmful rights have rents as in the standard neoclassical model. But most contributors to the rent-seeking literature would admit that in reality socially beneficial rents frequently exist (as when scarce resources or innovations have to be protected from free access).

Indeed, in developing countries, where capital, entrepreneurial skills and technical knowledge are in scarce supply, we would expect positive rents pervading the modern sector. If the distribution of power within patron-client networks was of the patrimonial type, state officials would be secure in their ability to allocate or protect such rents. This ability would enable them to capitalize (by appropriation) a share of the streams of future rents. The net present value of their streams of future income are maximized if productive rights are created and protected since over time productive rights are likely to create larger streams of appropriable income than redistributive rights. Corruption in this case may not be socially harmful because state officials have an incentive to create and protect productive rights.

The combination of economic dynamism and high levels of corruption in some East Asian countries can be explained in terms of the emergence of a distribution of social power which sustained patrimonial patron-client networks. Such a distribution of power emerged in South Korea under Park and under the KMT in Taiwan (Amsden 1989, Wade 1990). During their high growth period, states in these societies could effectively enforce rights and could reallocate or change them at low cost. Long run profit maximization by state officials dictated that productive rights were protected and changes were in efficiency-enhancing directions.

Under a clientelist political settlement, neither top state officials nor any other single group has the ability to define which rights will be protected and which changed. The range of rights which are being created or reallocated depends on the objective functions of a large number of clientelist

groups and on their relative power. In a situation of instability no group is likely to have a long term view and rights which maximize long-run profits are not likely to be created. Instead the rights which are likely to be created and reallocated are rights which generate rents over short time horizons. This does not mean that powerful individuals and groups within the state will not be getting very large benefits in the form of bribes. They will, but only by virtue of belonging to one or more of the clientelist organizations competing over rights.

It has often appeared to observers that dictators such as Ershad of Bangladesh or Marcos in the Philippines had the power to create productive rights but chose to create short term rents instead. Their failure to create efficiency-enhancing rights is clear. The problem is to explain it. If we maintain the assumptions of the patrimonial system, we have to explain why a state which feels secure in its ability to selectively create rights will nevertheless choose to create and share socially damaging short run rents which do not maximize its profits. This can only be explained by persistent cognitive failure or a very short time horizon. It is interesting that new institutional economists have begun to stress differences in mental models and ideologies across countries (North 1995: 22-4). However, we would argue that it is possible to explain to a large extent the relative performance of states without recourse to cognitive problems by looking at differences in the distribution of power across countries (see also Khan 1995).

The time horizon explanation is weak because these and other dictators *wanted* to be in power for very long. The cognitive failure explanation is also not satisfactory because dictators in these countries have occasionally tried to limit the effects of clientelist competition and failed. Marcos, for example, made an unsuccessful attempt in 1975 to crack down on the decentralized appropriation which we have described as clientelist contestation (Klitgaard 1988: 13-97). A series of unsuccessful attempts by successive rulers in Pakistan and Bangladesh to combat clientelism is described in Khan (forthcoming). The problem lay not in the cognitive models of successive state leaderships but the social distribution of power which prevented them from defining *which* rights were to be created and protected.

Despite these occasional attempts at central control, a wide range of rights were being continuously contested by powerful clientelist groups with unplanned and unpredictable consequences. It was difficult in this context for the top state officials to create and allocate the rights which would maximize long-run rents. Given this constraint, the next best strategy was the one which was eventually followed. This was for the state leadership to organize the largest clientelist group, participate in the contestation of rights and use superior organizational power to grab most of what was available. This was a perfectly rational response and not the product of cognitive failure. The social consequences of such corruption were, however, large and negative.

3.2 THE ALLOCATION OF RIGHTS

Apart from the range of rights which are contested, the basis on which rights are *allocated* between agents is also likely to be different between these networks. The assumption in conventional rent-seeking models is that rights to rents are allocated in response to expenditures on rent-seeking. This assumption is more plausible in the patrimonial patron-client network. If the state officials acting as patrons can appropriate part of the rents, they are likely to allocate the right in response to bids being made by competing agents who wish to acquire the rent. This allocative procedure can be efficiency-enhancing because it favours the allocation of scarce resources to users who are most likely to maximize returns.

This is not necessarily the case in the clientelist patron-client network. Here the state officials who are patrons in particular transactions are themselves being challenged by state officials and private agents in competing clientelist coalitions. The allocative rule for patrons in this network is likely to be different. State officials are likely to look at a combination of economic and political rewards in making allocations. Rights will not be created or allocated to agents who are the highest bidders. Instead clients or clientelist groups with superior organizational power are likely to get payoffs for their support in the form of allocations of rights. This means that rights will not always (or indeed very rarely) go to individuals or groups who are the highest value adding users. This too contributes to the inefficiency generated by the clientelist system.

An important manifestation of a clientelist process is that while it may be relatively easy to create new rights, it is very difficult to change or transfer existing rights if this hurts powerful constituencies who already possess them. This means that even if some agents are higher value-adding users who are willing to bribe to change the structure of rights, the state may be *politically* unwilling to consider reallocations of rights. In contrast, in patrimonial networks or in the models considered in conventional economics, allocative decisions are based on calculations of economic gain by state officials.

If existing rights cannot be changed, competition results in the creation of new rights. One manifestation of this is excessive entry into new industries, excessive employment creation for powerful white collar workers and so on (Bhaskar and Khan 1995). The proliferation of new rights dissipates rents even when their preservation is socially valuable. The multiple sources of power in the case of clientelist competition may give the appearance of the fragmented state machinery discussed by Rose-Ackerman and Shleifer and Vishny. But the causes are quite different. The problem is not that the *institutional* structure of the state is fragmented, preventing potential coordination. In fact in many countries with corrupt leadership, the supreme leader is nominally in a monopolistic position. Instead the problem is due to the proliferation of competing *clientelist organizations* many of which may include as key players powerful individuals within the state. The apparent similarity of clientelist competition with the disarticulated supply side structure of state agencies is misleading. The solution here is not further competition between bureaucrats. Competition between clientelist organizations which include important state bureaucrats and political elites is already high and is the source of the problem.

Let us return to our examples of the corruption scandals in India and South Korea. In both countries the magnitude of the transfers themselves should only be a starting point in an enquiry into the

networks of patron-client exchanges. In South Korea our argument would be that the networks were patrimonial. The rights created and altered by the state were efficiency-enhancing. The profit maximizing strategy for state officials in patrimonial networks is usually to create the most productive rights and cream off as much of the rents created as possible. In the Indian case, the transfers were located within clientelist networks. Bribes paid by businessmen went into organizing political factions for their patrons who were clients of higher level patrons. What businessmen eventually get from their expenditures in clientelist networks depends very little on the rents they can potentially generate from productive enterprises created with state help. It depends rather more on the relative power which their chosen faction turns out to have relative to other clientelist factions. The cause of sclerosis is not the size of the expenditures on rent-seeking but rather the distribution of power between clientelist coalitions which prevents any group in society from pursuing long run profit maximization.

4 CONCLUSIONS

The efficiency effects associated with corruption depend on the way in which the rights to be transacted are selected and the terms under which the bargaining over their allocation happens. Conventional models analysing the efficiency implications of corruption are deficient because they ignore how rights are selected and the political constraints on their allocation process. We have argued that one of the important factors affecting these processes is the distribution of power between the state and the organizations competing over the creation or reallocation of rights. A number of mechanisms were suggested which would explain why corruption in countries with patrimonial patron-client networks may not be efficiency retarding. In contrast corruption in countries with clientelist patron-client networks may be associated with structural sclerosis, the proliferation of rights and slow growth. In each case performance is related not to the extent of corruption but rather to the political structures which sustain different processes through which rights are created and reallocated.

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