

# THE POLITICAL ECONOMY OF CORRUPTION IN BRAZIL

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## RESUMO

Este artigo é a primeira parte de uma pesquisa sobre corrupção no Brasil e é teórico. Apesar disso, ele fornece uma interpretação econômica da corrupção usando o Brasil como um estudo de caso. O objetivo principal desta pesquisa é aplicar algumas ferramentas microeconômicas para entender a "grande corrupção". Mostraremos que a corrupção não é simplesmente um tipo de crime. De fato, ela é uma atividade econômica ordinária que surge em alguns ambientes institucionais. Primeiramente, serão descritos alguns casos de corrupção no Brasil. Veremos que a democracia, por si só, não assegura o controle da corrupção. Em segundo lugar, será apresentada uma visão geral de alguns casos de mudanças institucionais que aumentaram o controle sobre a corrupção em algumas economias ocidentais. Argumentaremos que a corrupção, seu controle e sua ilegalidade dependem da evolução institucional. Em terceiro lugar, será explicado como alguns modelos econômicos poderiam ser adotados para um entendimento melhor da corrupção. Finalmente, será apresentado um modelo de múltiplo-ego aplicado ao agente público (político ou burocrata), cujo comportamento é restrito exogenamente pelas instituições e sistemas de *pay-off*.

## ABSTRACT

*This article is the first part of a research on corruption in Brazil and it is theoretical. Despite this, it provides an economic interpretation of corruption using Brazil as a case study. The main objective of this research is to apply some microeconomic tools to understand the "big corruption". However, I am going to show that corruption is not simply a kind of crime. Rather, it is an ordinary economic activity that arises in some institutional environments. Firstly, some corruption cases in Brazil will be described. This article is aimed at showing that democracy itself does not ensure control over corruption. Secondly, I am going to do a very brief survey of institutional changes and controls over corruption in some Western Societies in which I am going to argue that corruption, its control and its illegality depend on institutional evolution by streamlining the constitutional and institutional framework. Thirdly, I am going to explain how some economic models could be adopted for a better understanding of corruption. Finally, I will present a multiple-self model applied to the public agent (politician and bureaucrat) constrained by institutions and pay-off systems.*

## PALAVRAS-CHAVE

Corrupção, Brasil, caçador de renda, escolha social, economia política.

## KEY WORDS

*Corruption, Brazil, rent seeking, political economy, social choice.*

## INTRODUCTION

The democratic liberalisation in Brazil created optimism for the possibility of the country resolving its problems such as chronic inflation and corruption. There was panacea for democracy; from democracy would arise the solutions for all national misfortune. However, the recent history shows that democracy did not coincide with the elimination of chronic corruption. On the contrary, corruption has damaged some fundamental democratic institutions such as the Presidency and the Congress.

Unfortunately, corruption is very dangerous to democracy itself. As noted Tocqueville, with his natural perspicacity, people even tolerate corruption in a tyranny, because it is a natural fact in this kind of government. Nevertheless, under a democratic regime, corruption is unacceptable because common people are elected to represent citizens and not to work against them. The last corruption scandals in Brazil, as the Collor's Affair and mainly the "misuse" of the national budget were important since they showed that the society was not able to control this institutional risk factor. In Brazil, political corruption apparently arose in a period of structural crisis. Unfortunately, this fact has an undesirable outcome: the increasing pessimism of the common women and men for the future.

In spite of that, corruption can be studied scientifically, and positive analysis can supply some normative medicines to fight it. Corruption can be seen as a rational choice behaviour constrained by institutions and incentive schemes. Institutions and pay-off systems change along the time as well as the behaviour of public agents. Maybe some interesting results could arise from theoretical and historical speculation about corrupt behaviour. This is the main purpose here.

The objective of this paper is to discuss, in a critical way, the problem of corruption by using Brazil as an example. My main purpose is a theoretical speculation about the phenomena but I am going to use some examples from the recent history to show how dramatic is corruption in Brazil.

Firstly, I am going to point out some data and figures about corruption using the Budget Scandal and the Collor's Affair, which will be the scenario where some reflections on corruption will be made.

Secondly, I am going to investigate some historical examples of corruption and the notion of institutional evolution linked with the control of the rational public agents.

The next step will be setting up some relations between democracy and corruption. In this part of the

essay, I will be concerned with the dilemmas involved in a democracy that suffers from chronic corruption.

Finally, I am going to make an interplay between the theories and the facts about corruption and I will establish here a comprehensive vision about the role of institutional evolution in the control of public and private behaviour.

## THE PARADOX OF CORRUPTION IN BRAZIL

Whenever an external observer analyses the problem of corruption in Brazil, the first impression arising therefrom is the existence of at least two paradoxes.

Once questioned about values as honesty and probity, the common man or woman puts him/herself as an extreme follower of an ethical conduct in his private and public life. However, the average behaviour of the *homo brasiliensis* shows the opposite<sup>1</sup>. In the social and political life always comes forth an amazing set of honourable rationalisations for actions that involve short and large scale corruption: You have always a reason not to respect the traffic light (you are delayed to work) or you do not pay taxes because you are against the "excessive burden" imposed by the government. You bribe a civil servant because the municipal laws are unfair or you use public money for a political campaign and justify that "it is not for private use!" and finally recognises that "if everybody uses public money why wouldn't I?". However, at the same time, everybody is apparently concerned with corruption and its moral and social costs. This is the first paradox.

On the other hand, there are in Brazil many control units in order to monitor the civil servants' behaviour, and people spend a lot of public money to make the system work. This is the second paradox: There is a costly institutional machine to control corruption; however, it is widespread and uncontrolled, and impunity is the rule, not the exception<sup>2</sup>.

Let's see the figures behind this costly and ineffective control system<sup>3</sup>. The federal control system is comprised of six units: The Federal Bureau of Control, the Integrated System of Financial Management (Sistema Integrado de Administração Financeira - SIAFI), the Federal General Advocacy, the Federal Audit Court (Tribunal de Contas da União - TCU), the Public Prosecutor and the Federal Police.

The Federal Bureau of Control is comprised of 23 internal control secretaries which perform in every Ministry and are represented in all federal states. Around 3,000 people, comprising technical team and auditors, perform in the system. These agencies

are aimed at monitoring and supervising that budget is appropriated as determined by the Federal Budget.

The SIAFI is an on-line data information system, the purpose of which is to supply figures about the budget appropriation. The clients of the system are politicians and the Federal Bureau of Control itself (as from 1996 every citizen has the right to access the files).

## The recent history shows that democracy did not coincide with the elimination of chronic corruption.

The Federal General Advocacy has 200 civil servants whose function is to investigate suspicious cases of corruption and to defend the Federation against any corrupt operation.

The TCU performs a supervising function and has the power to sue and to punish people involved in corruption practices (even those eventually practised by the President). This unit employs 2,000 civil servants.

The function of the Public Prosecutor is to investigate and denounce to the Justice corruption cases inside the government. It employs 3,300 civil servants, among them 342 prosecutors. Finally, the Federal Police, represented here by the Federal Revenue Service, must investigate corruption cases and tax evasion and is comprised of 54 officers and 150 civil servants.

A brief examination of the Federal Budget shows that in 1995 Brazilians taxpayers spent US\$330 million for the payment of the civil servants involved in this big control system. This figure represents 10 times more than the estimated costs of the recent budget corruption case in Brazil.

On the other hand, there are units carrying out similar functions at state and municipal levels and performing similar internal and external control mechanisms. Consequently, one cannot say that there is a lack of control units (except in the case of the Federal Revenue Service). Some simple facts of the practical life show that with a minimum effort this big structure against corruption could work.

The Federal Bureau of Control identified recently three corruption affairs<sup>4</sup>. The first one occurred in the state of Rio Grande do Sul in December 1994 and consisted of an investigation into private warehouses that provided for crop stocks for the federal government. The investigation encountered 3,000 tons illegally appropriated (they had been simply stolen). Due to the action of the Federal Bureau of Control, the owners of private warehouses were obliged to provide again for the stocks.

In that year, another investigation carried out by the SIAFI revealed that there were 19,456 illegal government contracts for special budgetary credit release. However, these budgetary credits must be refunded to the Treasury. In fact, the figures arising from illegal contracts were even higher: 42,000 credits were being legalised in the beginning of 1995. Public

agents such as politicians and bureaucrats, at many levels of the Federation, had access to the credits but very often they did not follow the Treasury's requirements. Since the punishment was not granting them new credits, many politicians

were obliged to address their situation. The most recent event occurred in 1994 as well. The Federal Bureau of Control was informed, by the press, that security guards were being contracted at salaries of at least US\$1,000 by the National Institute of Industrial (Intellectual) Property (INPI). These salaries were by far above the market salary (for this function). In a timely intervention, the government suspended the contracts.

While the FBC was successful in such case, most of the corruption cases were not investigated. As a result of the investigations, offenders are usually not tried nor punished.

A famous case of corruption that occurred in the early 80's – during the last military dictatorship – and was known as the Manioc Scandal can be used as a dramatic example of impunity. In Floresta, a town in the poor northeastern state of Pernambuco, between 1981 and 1982, civil servants of Banco do Brasil, politicians and farmers (who were supposed to be manioc farmers) convinced illiterate and modest people to open bank current accounts which were used to finance the planting of manioc. However, the corrupts did not use the money for the planting, instead, they invested it in the financial market.

The 24 individuals involved in the scandal were condemned but never went to prison.

A study made by the TCU reveals that from 1990 to date only 10% of the prosecutions against offenders have implied the return of the embezzled funds. Around 1,030 prosecutions are being executed<sup>5</sup>. These facts lead the analysis towards an important question. If there is an expensive control system and if it is possible to inspect the public agents' behaviour why is corruption hard to control? Any speculation about a possible answer to this question depends on the concrete examination of the facts and of the analysis of the political economy of corruption in Brazil's contemporary history<sup>6</sup>.

## THE ENDEMIC NATURE OF CORRUPTION IN BRAZIL: IS IT A RESULT OF TOLERANCE OR JUST A CONSEQUENCE OF LACK OF CONTROL?

The two big corruption scandals recently occurred have something special in common (about the subject, see Krieger, Rodrigues & Bonassa, 1994). They did not occur due to investigations carried out by the Congress or by the federal system of control. On the contrary, they have appeared to the people accidentally. The Collor Scandal was a result of a family intrigue, and the corruption in the budget arises in the middle of a murder investigation not directly related to the affair. Let's see something about the second case since it is very illustrative and shows the absurd drama of the misuse of public money.

This case looks like a surprising detective short story. The economist José Carlos Alves dos Santos, an upgraded Senate's civil servant, was being investigated into the assassination of his spouse who was kidnapped in strange circumstances. During the investigation, the police found him as the main crime suspect and in a diligence in his house the police found thousands of dollars (many of them false). When he was inquired about the origin of the money, he said that it was provided by illegal activities linked with the Federal budgetary process.

The economist was a brilliant professional and had begun his public career as a Senate's technical assistant in 1965. In 1985 he was a budget assistant and in 1988 he was the main legislative civil servant dealing with the budgetary process in the Congress. Later he was appointed as a technical advisor in the Budget Committee. In 1991 he was appointed to the Federal Department of Budget (DOU), an Executive unit, but in 1992 he was seconded again to the Legislative.

This civil servant (an expert in labyrinths of the budgetary legislation) was one of the most important individuals in a corruption scheme that deeply impaired the credibility of the Congress. As a professional in budgetary affairs, the economist had articulated a large corruption scheme with politicians and private agents (lobbyists and construction companies). The budget corruption had a cost of US\$27 million to Brazilian society<sup>7</sup>.

The scandal was structured in two simultaneous corruption schemes<sup>8</sup>. The first one was known as the "Construction Companies Scheme" and the second one as the "Social Transfers Scheme". Both occurred in the Congress but they were structured inside the political machine in the Executive Power.

The common core of the corruption schemes was the Budget Committee. Many groups of politicians and rent seekers had influence power before the budgetary legal proceedings in the Congress. They used their influence to mould the allocation proposals in the budgetary units (Ministries) in order to satisfy the interests represented by them. Thereafter, they used their influence on the Budget Committee to sanction the allocation of revenues and expenditures. The politicians involved in these schemes were nicely known as the "seven dwarfs".

The main step of the schemes was the budgetary process in the Congress. A small group of MPs – the "seven dwarfs" – had appropriated the Budget Committee to guarantee the representation of the rent seeking and lobby interests supported by them during the budgetary process and the making of the Budgetary Law.

The principal corruption evidence was the high level of approval of Committee Members' amendments. Other evidences were: (i) the MP's districts were favoured with expenditures; (ii) some construction companies were specially benefited from the expenditures approved; (iii) the compliance in the resources execution approvals despite a strong fiscal execution control. These facts reveal the level of clientelism and patrimonial relations inside the Congress.

The first scheme was linked with construction companies. The companies made a kind of roundabout to win the public contracts. The cartel of the companies promoted the choice of enterprises without any public control.

Another way of action used was to do business with local governments (states and municipalities). Once accepted the deal, the politicians who represented the local government or the district tried to make influence on the budgetary process. After the approval, they made lobbies to force the execution of expenditures. The "payment" made by the companies to the politicians was an "incentive bonus" at an amount around 5%-20% of the total price of the investment. Directly speaking, these were the average value of the bribes.

Apparently all the stages involved bribes to the civil servants directly involved with the budgetary process in the Congress and to the politicians who were the "managers".

The second scheme favoured the politicians directly involved in budget corruption. This was a typical structure of clientelistic corruption. The politicians involved in it tried to create social service institutions and to register them with the National Council of Social Service. These institutions – that theoretically are ONGs (non-governmental organisations) – can receive

budgetary resources to render social services. However, the majority of these institutions were created and managed by the politicians themselves or by their relatives. Many politicians used the institutions to transfer their own properties to them as a way to allege the absence of personal assets<sup>9</sup>. Frauds as the emission of illegal receipts and the employment of dummy civil servants were used to privatise public resources.

## Corruption has damaged some fundamental democratic institutions such as the Presidency and the Congress.

There is another particularity of this scheme, which was characterised by political clientelism and involved only the politicians of the Budget Committee. On the contrary, the first one was more comprehensive.

What can one deduce from the analysis of these cases?

There was not any control over the budgetary process. There was not any legal control by the TCU and nor internal control performed by the Congress. Another deplorable fact: The “seven dwarfs” were recognised as corrupts years before the scandal. This unfortunately reveals strong evidence that the scheme was public domain in the Congress and that many lawmakers had a free rider behaviour and attained indirect benefits from the corruption structure.

The baseness of the rules of the political game and the lack of control in a democratic scenario highlight the fertile field for the clientelistic corruption and fraud to arise.

However, why did corruption appear so ingrained in the budgetary process?

Certainly, corruption is not entailed by the absence of a control system. There are various causes, including those particular and structural. The particular causes mainly relate to the budgetary process but the structural causes reflect the endemic character of corruption in Brazil.

The first factor that gives rise to budget corruption is the incapacity to follow up the expenditures in all budgetary units. The internal departments of control just evaluate the budgetary expenditures *a posteriori*.

Secondly, the chronic inflation had actually hampered the supervision of the budgetary expenditures. It was very hard to know whether a purchase price was correct for some goods or some services.

Another fact linked with chronic corruption is the specialisation and the technical advance in the

corruption market. The corrupt activities are carried out on a professional basis and involve all kind of business, specialisation and technical advance. The corruption in the budget is a case of crime specialisation.

Nevertheless, another cause of corruption is the institutional arrangement at the back of the budgetary process. The 1988 Constitution effectively settles the

Congress as the centre of the budgetary process. During the military dictatorship, the Executive Power elaborated the budget. The logrolling process and the negotiations of the project expenditures were obscure. Accordingly, in 1988 the motto “all the power for the Congress” was introduced and reflected as a naïve

desire for a democratic transparent budgetary process. However, this is not a sufficient condition to have an honest, democratic and fair budget. On the contrary, the absence of control over the Congress’s activities was the principal cause which gave rise to the pork-barrel politics<sup>10</sup>.

The establishment of democracy and further power granted to the Congress did not bring along the improvement of the controlling system. The institutional scenario existing prior to the 1988 Constitution did not take into account the necessity of an external control. This fact, associated with a clientelist Congress, created the ideal conditions to corruption growth.

The budgetary corruption is mainly characterised by structural issues which are linked with the inner nature of the phenomenon. They do not specifically relate to the budgetary process but to overall kinds of political and public corruption in Brazil.

The first structural cause is tolerance or cynical ignorance towards corruption: apparently, Brazilians ignore or tolerate corruption or just accept it as a cultural feature of the *homo brasiliensis*. Apparently, this is the drama of many Latin American countries wherein corruption is **the** system, the rule, and not the exception. However, on the other hand, Brazil suffers from institutional underdevelopment. The set of institutions and rules of the game that prevails in a country, nation or society is behaviour determinant, which gives rises to the pay-off structure that motivates the decision-making process of the agents. We are going to see that, despite “culture” or any kind of vague definitions, instead of the people’s tendency, a theoretical *homo brasiliensis*, the rules of the game are what really matters and also do institutions and their evolution and change. This is why I am going to

analyse briefly some historical examples of institutional evolution towards rules that effectively deterred corruption. Following, I am going to analyse some theoretical aspects of corruption and their relation with incentive and rational choice theory.

### INSTITUTIONAL EVOLUTION AND CORRUPTION IN HISTORY: SOME CASES

Corruption is a universal phenomenon that pervades the public and private life in developed and undeveloped countries. However, many countries that have been through periods of chronic and structural corruption overcame it at least partially and corruption was controlled by using the laws, the press and the public power.

In Britain and France, for example, corruption was endemic and chronic in the past, but institutional evolution, mainly in Britain, restricted and controlled the action of politicians and public officers. This institutional evolution was an effect of (i) the modernisation of the public service, and the (ii) Constitution of the modern democratic State. In these situations, institutions such as a democratic government and public opinion (the *vox populi*) play an important control function.

In these societies, the relationship with the public environment changed from clientelism and patrimonialism to the obedience through the administration of the public property (considering the existence of a crime and punishment system). In these countries, a modern democratic State gave rise to (i) a professional bureaucracy, (ii) a developed political market comprised of organised parties and knowledgeable voters and an **efficient** legal power.

The study of historical examples shows that the evolution of some rules and values which generated these modern institutions set establishes an illegal and illegitimate corruption environment.

In the case of Britain, since Middle Ages, the State was founded on patrimonial domination (see Theobald, 1990)<sup>11</sup>. The “State officials” were employed following personal judgement and their salaries were paid through the right to participate in collection of taxes and land apportionment. This personal relationship system prevailed up to the Modern Age and created a clientelistic network that involved all social hierarchies. In such system, the State officials need the King’s trust, who demands loyalty from them. The evaluation of the State officials did not depend on merit. The most important thing was: personal relationships were the main criterion to choose State officials and to form the power establishment<sup>12</sup>.

The patron-client structure prevails after the separation between the Church and the State, at the beginning of Tudor Age. During Restoration, the patrimonial domination was fundamental to guarantee the parliamentary control over the King. Despite this fact, vote trade and concessions of titles were common practices to obtain MP’s support.

The seventeenth century was particularly important to the reform of some structures of the patrimonial State. On the other hand, this was traumatic period pervaded by political and social crisis and with the violent rising of new relationships shaped on wage remunerated work.

The “Old Corruption” in Britain during the eighteenth century had proliferated inside the State, however with less violence if compared with the corruption in France and Spain (Brewer, 1989). As E. P. Thompson (1993, p. 29-30) asserts:

*Old Corruption is a more serious term of political analysis than often is supposed; for political power throughout most of the eighteenth century may best be understood, not as direct organ of any class or interest, but as a secondary political formation, a purchasing-point from which other kinds of economic and social power were gained or enhanced; in its primary functions it was costly, grossly inefficient, and it survived the century only because it did not seriously inhibit the actions of those with de facto economic or (local) political power. Its greatest source of strength lay of its paternal, bureaucratic and protectionism powers; in the license which it afforded to agrarian, mercantile and manufacturing capitalism to get on with their own self-reproduction; in the fertile soil which it afforded to laissez-faire.*

Nevertheless, in that century it is introduced in Britain, among many positive reforms that should be implemented, the separation between the government budget and the royal cash flow. It was a crucial reform. In 1782 an expenditure control system and a formal definition of public budget are established. This separation would be intensified till the formal differentiation between the Royal Family’s patrimony and the *res publica*<sup>13</sup>. For example, the necessity of Parliament’s authorisation for the Royal Family’s budget is introduced in the Victorian Age. By the way, many budgetary control actions and rules involving fiscal discipline were implemented at that time.

The budgetary control system was developed as a result of the application of accounting methods. The creation of an Auditor General was an important institutional innovation, combined with budgetary

transparency and the existence of the Comptroller.

In 1834 the sinecures were eliminated along with the vote trade and the public positions' market (Theobald, 1990, p. 26-7; Harling, 1996, p. 246-7). In 1846 a formal wage payment mechanism was introduced and in 1859 a social security system. Later, in 1870, the selection of government officers was established as well as the public examination requirement.

## Everybody is apparently concerned with corruption and its moral and social costs.

One could say that, mainly in the Victorian Age, the formal remains of patrimonialism and clientelism inside the British State machine were gradually eliminated. However, it is important to note that the rules of the game and the institutions created around the second half of eighteenth century gave rise to a behaviour restriction framework that controlled politicians and bureaucrats. Hence a quasi ideal type of administration was created not as a result of a change in people, but mainly because the rules which were implemented created a specific pay-off system.

These rules of the game would contemplate a legal and punitive system. In 1854 the Corrupt Practices Act was implemented and in 1883 another law limited the political campaign expenditures. Gradually the political market was regulated and the consolidation of democracy enabled a more efficient control over the public agent behaviour (the main consequence of this evolution was the elimination, partially at least, of clientelism). The inhibition of these forms of personal relationships established the legal or moral locus that differentiates a corrupt act from a legal one.

It is interesting to compare the British case with France to show how corruption was transformed into an illegal practice (Theobald, 1990, p. 27-45; Anderson, 1979, p. 33-5; Braudel, 1992, p. 542). The most important example of what is nowadays considered big corruption (although in the past it was not) is the public bureau market (the selling and buying of offices). This procedure, which was usual in some ancient Eastern empires (sultanism), was largely utilised in France during the Middle Ages and the Absolutism. The "owner" of a public office might resign in favour of a relative (nepotism) or simply sell the office. This practice was so usual during the sixteenth century that in 1604 a sales tax was

established (*paullete*). As a result of the demand for fiscal revenue during Mercantilism, the practice of selling offices was supported by the government.

Another kind of appropriation of the *res publica* was selling a right to tax collection. In France, this practice was extremely usual till the Revolution. As noted by Fernand Braudel, the absence of an administrative structure barred the adoption of a more efficient tax collection system<sup>14</sup>. On the other hand, Perry Anderson observes that the selling of public offices in Britain was an intermediate stage, a transition period from medieval patrimonial domination to a professional bureaucracy<sup>15</sup>.

John Brewer (1988, p. 1-88) develops an interesting argument to explain why the British State was less venal than that of France and Spain. The British Fiscal State existed since the XVII century in a very special context in which Britain had been kept away from the continental wars and the underlying premature political centralisation of the British State.

The British military powers decayed during the sixteenth and seventeenth centuries and became a marginal power. On the other hand, in the same period, Spain and France faced many conflicts and became highly militarised States. A common way to finance the military expenditures was to sell public positions, which caused consequently the hypertrophy of the State. Britain did not have the same necessity for expenditures financing and was overtaken by the exaggerated State growth. Moreover, the British monarchs were limited by Constitutional constraints to use these kinds of financial mechanisms (Brewer, 1988, p. 17).

However, the war was the most important factor which entailed the excessive growth of the venal State in both countries. The British State did not have to use venality to finance its expenditures. Probably, had the war been a frequent event, a parasite civil servant class would probably have privatised the British State as well.

Another important characteristic of the British State was the centralisation of governmental decisions. There was a strong pact involving the lords and the monarch and later, with him and the House of Commons. Since the seventeenth century, the fiscal system was institutionalised. Before the Revolution the State enforced the private property rights and the power to expropriate was eliminated (North & Weingast, 1989). This represented a kind of institutional constraint used to avoid structural fiscal crises. Spain and France suffered structural fiscal crises during the sixteenth and seventeenth centuries.

The consequences of the British institutional evolution over corruption were very important if compared with the other two examples. The British State was capable to raise money without the use of venality. However, there was corruption, mainly the “Old Corruption”. Despite this, the institution of a Fiscal State and the control over the monarch performed by the House of Commons assisted in restricting corruption in Britain.

Anyway, the clientelistic corruption was gradually suppressed along the nineteenth century, and the political and public corruption was declared a crime in many countries of Europe and in the United States. Mainly during the nineteenth and twentieth centuries, the professionalisation of public administration and the improvements of the control systems reduced clientelistic practice. The institutional evolution was fundamental to the control of corruption.

Why does institutional evolution have a central role in the control of corruption?

It is extremely difficult to establish an overall explanation to the process of institutional evolution and its relations with corruption. The historical experiences lead some social scientists to notice some elements in common (Moore, 1973).

These factors are as follows: (i) the necessity of a efficient public sector, (ii) the rise of capitalism and liberalism, (iii) the rise of a strong ethic of labour and efficiency, (iv) the development of a political market, of democracy and a free press, and (v) the development of an effective and active Justice<sup>16</sup>.

In many European countries, since the end of the eighteenth century, the bureaucratic systems were being modernised, mainly because the administration of colonial empires and colonial companies. For example, Caterina, in Russia, and Frederick, in Prussia (the “Illuminated Despots”), invested in the modernisation of public services and in education, which demanded an efficient public management<sup>17</sup>.

However, the main movements in Europe for bureaucratic modernisation occurred in the second half of the twentieth century. The necessity of supplying public services increased because the population grew. The European population totalled 187 million in 1800 and in 1900 accounted for 401 million. Many governments needed more efficient fiscal systems to supply security services (police) and public goods in general<sup>18</sup>.

The capitalism and the strong emergence of the market imposed a labour ethic and a kind of rationality that corroborated the “gain according to the capacity” motto<sup>19</sup>. This important moral constraint is a self-enforcement against the “easy money” strategy represented by corruption.

Nevertheless, democracy was the most important institutional evolution because it brings about an implicit and explicit control over the behaviour of civil servants and politicians. Additionally, there is a very clear formal distinction between the public and private thing.

In the political market, despite its failures, citizens can choose the politician. In such scenario, the individuals can vote for more efficiency, discipline and decorum in public life. Moreover, the essence of the democracy is the supervision of the political and bureaucratic behaviour.

The press (free press) has an important role in a democracy by limiting and controlling corruption. In the United States and Britain, the press has till today an important control function. At least in the United States, history shows that at the end of the last century the press was active in the fight against corruption<sup>20</sup>. At the end of the nineteenth century and at the beginning of the twentieth century, corruption was an everyday fact in the United States. It was clientelistic and reminds the corruption in many Brazilian cities and states. The mayor and the clientele represented by him (inspectors, comptrollers, judges, and businessmen) used the public power in their own interest and were bribed to overlook crimes (prostitution, for example).

The decline of clientelism in the United States is linked with the diminishing role of the political machines (Speed, 1978)<sup>21</sup>. These political machines represented typical clientelistic structures and resulted, in part, from the incorporation into the political market of a mass electorate which had no reasonable education and knowledge. This kind of electorate could be a fundamental input for clientelism. The decline of the political machines was linked with modernisation of the public administration and with the role of the press. The immersion of the democratic life and the increasing role of professional public administration restricted clientelistic relations. The State, which was formally represented by elected public agents, replaced the patronage system<sup>22</sup>.

The press plays in any democracy the determinant role of control and also underpins the supply of information to the voters who act in the political market as buyers of political services. Consequently, democracy (and a free press) is a kind of political organisation institutionally developed and facilitates the battle against corruption. While it is an important weapon to combat corruption, democracy is not a sufficient condition.

Even Brazil, where at least formal control institutions are in place and a democratic regime is adopted, can suffer from chronic and endemic

corruption (the budget affair is an unmistakable example that corroborates this affirmation). Maybe the answers for the corruption problem in Brazil reside in the role of institutions and incentive systems instead of in artificial assumptions such as the single existence of a formal democracy.

### IS THERE ANY RELATIONSHIP BETWEEN DEMOCRACY AND CORRUPTION? THE POLITICAL ECONOMY OF CORRUPTION

It can be dangerous to establish directly any kind of link between democracy and corruption. In some developed and democratic countries, democracy is not a sufficient factor in controlling corruption. Recent corruption affairs like Berlusconi's Affair and Clean Hands Operation in Italy apparently corroborate this point of view (for more details about the encroaching corruption in Italy, see Fiorentini & Peltzman, 1995, and Porta, 1997)<sup>23</sup>.

**Corruption takes place whenever there is a high incentive to bribe the referee.**

One can argue that the juvenile Brazilian democracy could not manage to control political and public sector corruption. Strictly speaking, in a democracy in which voters are mostly illiterate and not knowledgeable, a rapid evolution towards a stricter control of corruption can hardly be noted. Additionally, many corruption practices were inherited from the military dictatorship period, when the centralism and darkness in public administrations enabled the dissemination of corruption.

Nevertheless, one cannot say that corruption was intensified due to the democratic liberalisation process. During the military regime, many corruption cases arose such as the Manioc Scandal (Assis, 1984a, 1984b)<sup>24</sup>. In fact, in authoritarian regimes two factors can give rise to corruption: (i) the limitation of the press activities and the (ii) absence of transparency in governmental actions.

The facts arising from the last corruption scandals in Brazil show that democracy is an important element for controlling corruption, despite all political and justice shortcomings.

In spite of that, there is a fundamental question to be answered considering the recent affairs such as Collor's Affair and the Budget Scandal: Are democratic institutional advances sufficient to control political corruption inside the government?

Considering the facts, the answer is certainly no.

The fight against corruption demands a deeply civic engagement of citizens and Justice. The process to impeach ex-President Collor made clear that there is some possibility of civic engagement against corruption in the Brazilian society. However, there is no place to illusions here: the impeachment process was mainly underpinned by the political and economic scenario. The poor performance of the Brazilian economy, the violence of the assets and savings confiscation in the stabilisation program and the amateur behaviour of the economic policy team created the ideal environment for the prosecution against the ex-President. Practically at the same time the Argentinean President Carlos Menem was under an all-out attack for corruption accusations. Nevertheless, the economic performance justified the adoption of a *Realpolitik* by the politicians and the people. They apparently concluded that institutional and economic stability is better than stagflation and accepted passively the suspicions of corruption.

The Clean Hands Operation in Italy reveals that the constant action of organised groups in civil society and an efficient justice are important factors in the fight against corruption (for a theoretical analysis of the subject, see Karpoff & Lott Jr., 1997).

However, the society needs to be really willing to undergo deep modifications to the Constitution, but the unknown costs of an institutional change could obliterate the process, since there is a Rawlsian veil of ignorance prior to the modifications to the Constitution.

These experiences show that any strict long-term policy to combat corruption requires an effective engagement of the civil society and the action of justice and the law. However, breaking apathy and tolerance towards corruption can be called on together with norms, rules and structures of civic engagement.

Putnam (1992) tries to illustrate how the change of a large set of traditional relationships (clientelistic and patrimonialist) could appear by emerging co-operation structures inside the society. Let's see more details of the argument.

Putnam defines two concepts of co-operation, ie horizontal and vertical. Vertical co-operation depends more on the State action than spontaneous engagement. On the other hand, horizontal co-operation is based on the civil society and does not depend on the State. The horizontal co-operation between morally equal people is more fruitful than the vertical cooperation (the more authoritarian one) to solve collective choice problems. However, the horizontal relationships are grounded on the social capital.

Social capital is a stock of rules and civic engagement networks<sup>25</sup>. Putnam's core argument is grounded on the idea that this kind of capital leads a society to political and economic development. Societies with a low stock of social capital should be more resistant to the establishment of horizontal relationships and would degenerate in an authoritarian and centralist government.

In fact, Van Dijk (1997, p. 91-133) developed a growth model departing from Barro (1990) and using the social capital conception. The basic idea of the model is that social capital represents a kind of social infrastructure related to economic growth: high social capital means high willingness of the horizontally integrated community to provide public goods. The private provision of public goods would have a positive impact on growth.

Alongside the attempt to determine social capital and its related impacts on economic growth, there are some cross-section experiments aimed at deriving a measure and comparing cross countries social capital stocks. For example, Putnam (1995) emphasises that these measurements indicate that Brazil has one of the lowest social capital stock<sup>26</sup>.

The social capital is simply rules and norms founded on trust. The co-operation based on trust eases the solution of collective choice problems. Nevertheless, the special role of trust is to guarantee the collective respect and to encourage compliance with the rules of the game. Moreover, the co-operation networks diminish the uncertainty and the risks associated with the veil of ignorance behind the agents' behaviour.

The experience and theory show that the social capital stock tends to be self-reinforcing and cumulative (see Becker, 1996). However, two opposite trends can arise when defining path dependence in a society. Trust and increasing social capital stocks lead to virtuous circles which are socially balanced and enjoy high levels of co-operation, reciprocity, civic engagement, collective well-being and low levels of defection, and also free rider behaviour and incentives to cheat. On the other hand, the chronic absence of trust creates a fertile field to defection and social disintegration associated with a high incentive to cheat and corruption (which is here understood as the systematic and collective breaking of the law).

The configuration of rent seeking societies organised in factions that compete for legal and illegal rent transfers tends to bring about social disintegration and privatisation of the State. A "factionist" society, even if the transfers therein are "under the law", runs the risk of social disintegration.

The crystallisation of factions in society could be related to the interests of businessmen, bureaucrats and politicians who represent lobby interests. The economic problem related to rent-seeking behaviour is the waste of productive resources in unproductive activities: it is inefficient and obliterates, at least partially, economic growth. However, on the other hand, widely accepted or tolerated rent-seeking behaviour associated with law breaking leads the society – history and experience supports – to cumulative disintegration (see Mbaku, 1997).

Olson (1965) noticed that the State it is not neutral and private groups such as trade unions, businessmen, civil servants organise groups for collective bargain and to act upon the public machine. These organised actions have the main purpose of seeking rents owned by other groups. The fight for rent transfers generates a dangerous competition among the factions. Olson (1982) has an argument that links excessive rent seeking with stagnation: chronic and intense distributive conflict can create an unproductive rent transfer system and entail fiscal crisis and stagflation.

In this scenario, corruption is a natural output. The common men see the social cartelisation and the widespread rent-seeking activities as corruption usually involving bribe (Putnam, 1995, p. 8). The direct consequences of rent-seeking competition and corrupt competition in the society are the citizens' scepticism and distrust. Nobody trusts in the government and the politicians (about this subject, see Porta & Meny, 1997, p. 1-6). In such *status quo*, democracy will be the next victim because it is based on collective values and on the respect of the laws (the Peruvian case is just an example of how chronic fiscal crisis, inflation and corruption can damage democracy).

Without public control over the action of the government, and with high levels of rent-seeking and corrupt competition, people tend to think that the *status quo* is unchangeable and such perception leads to an apathetic collective *comportment*. The way towards to the vicious circle of chronic corruption is opened (see Porta, 1997). The apathetic tolerance can arise from the society together with rationalisations and "cultural values" that incorporate corruption in the society as a natural value and as the right system.

In case of Brazil, we can see, using Putnam (1995) estimates, that the social capital stock is very low. The easy way to an apathetic and passive acceptance of corruption is to consider it a natural item and to blame politicians or even to democracy.

But is this situation actually unchangeable?

What really matters when we consider the phenomenon of corruption and overall social phenomena

is the structure of incentives that makes people to become corrupt. Accordingly, corruption can be seen as a political economy problem. The agents acting on the market or in the government face rules of the economic and political game. The rules (or simply **institutions**) give rise to an incentive or pay-off system that constrains the decisions made by the agents.

Empirical and theoretical studies of management and organisation theory show that the trust in a group of individuals depends on “culture” or simply the institutions are naturally conceived and accepted by the agents (Casson, 1994, p. 55-81). If there is a strong incentive to cheat in the group, the result therefrom will be the disintegration and the systematic disrespect to the rules of the game. The incentives to bribe tend to be very right, and corruption will come into being.

The role of institutions in society can be explained using a very simple metaphor. The game of the agents on the market and in the State can be compared with a soccer match. The elements of the match comprise the players (the teams), a stadium and a referee. However, the match needs rules too. These are the most important production factors of the social game which can derive an incentive system that will be fundamental to the quality of a soccer match.

Consider a case in which the rules determine that the winning team will receive US\$2 million if it wins by a score of 3 goals. Even in the case the team is comprised of regular players, the probability of a great match is high. The collective product of human action depends on the quality of the institutions (or the rules of the social game) as well.

Following the soccer metaphor, corruption takes place whenever there is a high incentive to bribe the referee. In such case there is no respect to rules and the referee’s behaviour (the Justice) is unseemly or incompetent (inefficient Justice).

To better understanding this problem, consider de pay-off matrix in the example below. The matrix shows two agents (A and B), two possible strategies (to be or not to be a corrupt) and four pay-off sells. The symbol C represents the strategy “to be corrupt” and the symbol  $\neg C$  is the strategy “not to be corrupt”. A is vertically represented and B is horizontally represented.

Figure 1 – Corruption game

Agents A, B/strategies $\neg C, C$	$\neg C$	C
$\neg C$	10,10	-10,50
C	50,-10	30,30

The equilibrium strategy for both is C, C or to be corrupt. However, this equilibrium is stable because C, C represents a strong competitive strategy equilibrium: C, C is, at the same time, a Dominant Strategy Equilibrium and a Nash-Cournot equilibrium<sup>27</sup>.

This example shows what could happen in a society wherein everybody has no rational choice but “to be corrupt”. The dramatic face of such situation is related to the fact that this equilibrium is stable. Moreover, there is no possibility of change to a new *status quo* (obviously this very simple example does not consider evolutionary paths neither repetition games).

As a matter of fact, institutional evolution and revolution depend on exogenous factors, which replaces the pay-off values. It is important to notice that the pay-offs are exogenous because they are determined based on the institutional set. So changes in the pay-offs mean changes to the institutional and constitutional set. Accordingly, a society like that represented in the example implies a “collective incentive to cheat”.

Brazilian society seems to be a society where the incentive to cheat and to disrespect the rules is widespread. It is an incentive to corruption the fact that the Justice is inefficient as well. The problem here is how to break the vicious circle of an “unruly” society. When the rules are “not to be respected” it is very difficult, but not impossible, to recovery collective values.

Nevertheless, the chronic and endemic corruption creates a situation in which an individual agent considers unreasoning to behave honestly. Considering this kind of environment, what kind of medicine must we adopt to combat corruption in the State?

### THE RISKS OF BUREAUCRATIC AND POLITICAL AUTONOMY: THE RATIONAL CORRUPT AGENT

Przeworski (1996) proposes a “new” approach to the study of the bureaucratic behaviour: the theory of the agency or the principal-agent problem. Actually, among the economists and modern analysts of private and public administration, this theory does not presently stand for any novelty (see, for example, Silva 1996a, 1996b; Cartier-Bresson, 1997). However, in social sciences in general unfortunately such conception is not known very well, since the principal-agent problem helps to better understand the bureaucratic and political behaviour.

The agency theory or principal-agent conception can be summarised in a very simple way. The principal

is the individual who delegates responsibility to another individual named agent, who acts in accordance with its private objectives. The problem lays in the fact that, in business administration in general and in the public affairs in particular, it is extremely difficult to monitor the agent's behaviour, on the part of the principal. One could affirm that principal-agent is a question of supervision. The efficiency and the decorum in public administration depend on the agents' (bureaucrats') behaviour, which is not always controlled or supervised. In this case, the principal (the society, represented by the government) sees itself at the mercy to a chronic loss of control over the State machine.

Buchanan & Tullok (1965) built an overview of public agents that mainly complements the basic elements of the agency theory. According to them, the public agent is as rational as any ordinary economic agent, ie there is no reason for supposing that only the private man looks for his private ends: the public man is not a perfect agent, immune to his own interests and those of the lobbies of several private agents who can put pressure on him. The modern economic theories applied to the politics and the public administration take into consideration that the actions in the public environment are specifically political, ie the private interests in and out of the State are important to explain the actions carried out by the government itself (Horn, 1996). Therefore, whether this empirical fact is disregarded in the control models for the public agents, serious consequences can be brought about public administration.

Considerations for economy of the information are important for a best understanding, together with the principal-agent problem, of the public agent's legal or illegal behaviour. The economy of the information studies a wide object, associated with breaking down the present hypothesis in economic analyses based on the fact that individuals who act on the market, or in organisations, have access to the same stock of information. However, the discussion on public administration and the relationship between the principal (the society represented by the government) and the agents (bureaucrats and politicians) should be sufficiently realistic by incorporating the hypothesis that agents' action is not under total control by the principal. Moreover, considering that the agents have private ends, the problem of supervising their actions is very significant.

The economists consider the possibility that the agent's behaviour strays from that wished by the principal as moral hazard. Accordingly, a part involved in the organisation management can undertake certain actions of which the managers is not aware. Therefore,

we can now understand all the dimensions of the principal-agent problem applied to the public sector. The principal-agent problem is noticed when, in the case of the public administration, the contracting-principal (society) is not provided with accurate information that enables it to evaluate whether the action undertaken by the latter is suitable, which, in its turn, affects the well-being of the former.

We can conclude that, in a perfect world of perfect information and perfect control and with absolutely honest people working for the State, certainly there would not be corruption. However, in the everyday life, we notice that the world is unfortunately quite different. The agent can have - and she/he is generally provided with - more information than the principal and she/he can act - and she/he will act - in agreement with her/his own interest; the information provided to the principal is not suitable to the extent that the agent can be monitored. That is, the agent behaves strategically. For example, if a firm (principal) hires an employee (agent), the principal expects that the agent works hard, with the utmost effort. However, the agent can cheat if she/he has an opportunity for it. The incentive to frauds is directly proportional to the possibility of the agents' actions being off-record and of the principal being unable to control them.

One can imagine how outlines and control systems would supervise the bureaucrats' behaviour. Even so, supervision functions are mostly expensive or impossible (as the Brazilian case exposed above apparently shows). Perhaps, the solution lays on the introduction of incentives in the contracts: if a priori an agent has an incentive to act in his own interest, a system of incentives can drive his behaviour to a first best result from the point of view of the principal and of the agent. As regards corruption, the main problem is how to create a contractual architecture that limits the behaviour of the public agent.

For the reasons described above, this kind of analysis is perfectly applicable to the study of the corruption in the public sector, particularly in case of requesting public works and contracting processes.

This is a very important point. For example, during 1997, the Ministry of Administration and of Reform of the State in Brazil was trying to modify the Bidding Law (Law 8666) alleging that it only generated costs to the public administration. The referred to law would be a mistake since it limited the bureaucrats' discretionary power and generated purchasing price increase to the State.

The big fallacy of those arguments, which intend to ascribe more freedom to the bureaucrats, is to suppose that only the private agents tend to corruption.

It is a terrible mistake to suppose such a thing, principally considering the case of Brazil, where the social capital is extremely low and, therefore, the use of legal mechanisms is required, even those draconian, for controlling the misuse of the public machine.

**The corrupt activities are carried out on a professional basis and involve all kind of business, specialisation and technical advance.**

It is fundamental to understand that the basic rules guiding the agents in the State are the Constitution and the control laws. Firstly, the law is to restrict, to limit, and to guide the behaviour of the public agents. The law is aimed at achieving the social, collective interest. However, there is a problem that transcends the power of laws in controlling the public agents: they have their own interests, which can coincide with interests organised in the form of pressure groups of the society. In this sense, the public administration tends to be more imperfect than one can wonder *prima facie*. The Constitution, the institutions and the laws are fundamental in defining the rules of the game of the State and of the public administration, in order to minimise the deviations of the State *vis-à-vis* the interest of the society.

The State collects taxes (it subtracts income from the society) and passes them over, by means of, for example, purchase of public works of engineering from certain companies. In principle, this fact does not cause any problem. In connection with fair payment of public works, bribes can be offered and, therefore, given a group of inefficient laws, the corruption can occur very often. Moreover, flaccid rules can incentive the best talents of the bureaucracy to apply their competence in crime and corruption. It is important to bear in mind that corruption is an economic activity that demands on sophisticated technological “knowledge” (as highlighted at the time of the budgetary corruption in Brazil).

In the long term, there are costs associated with corruption. Firstly, corrupt activities reduce the efficiency of the private and public organisations. Baumol (1990) argues that the allocation of talents in activities as crime and corruption generates an opportunity cost, since these talents could be used in innovative and managerial-productive activities that create organisational-managerial improvement. From this point of view, the economic performance of an

organisation such as the State does not depend so much on the offering of talents, but on their relative allocation between productive and unproductive activities (it would be emphasised that the corruption is an unproductive activity *par excellence*).

Secondly, corruption could have costs to be incurred for economic growth, since it represents an unproductive activity and just illegal rent transfers. In pursuing rent, the rent seeker agent can obtain it in three basic ways: by innovation, ensuring special privileges, and resorting to crime and corruption. The basic difference between

the first activity and crime/corruption lays in the fact that it gives rise to economic growth. If we consider endogenous growth models, the costs of corruption to be incurred for growth could be higher than in the case of the neo-classic growth model<sup>28</sup>. The existence of positive externalities associated with capital accrual and innovation are lost if in an economy there are more incentives to assign talents to pure rent-seeking unproductive activities (Baumol, 1990; Murphy, Shleifer & Vishny, 1991; Klitgaard, 1991; Kurer, 1993; Shleifer & Vishny, 1993; Tanzi, 1995).

But what does determine the talents assignment between productive and unproductive activities?

The rules of the economic game and of public administration give rise to the incentive framework that addresses the individual choices and, therefore, determine talent assignment.

## CONCLUSIONS

Corruption is an institutional phenomenon, and the Brazilian case confirms this assertion. This is the main conclusion of this paper. Corruption depends on institutional evolution and must be studied as an economic phenomenon. More than this, the economic method can be applied to researches on bribery and corruption. In this sense, corruption is a typical rent-seeking problem.

Additionally, corruption itself is an economic fact, an economic activity as like as crime, and it has costs to society. I consider that all these facts are sufficient arguments to support the inclusion of corruption definitely in the economic research agenda.

The recent literature on economic growth and development confirms my main concern in analysing the phenomenon of corruption, because development cannot just be seen as related solely to economic variables *stricto sensu*. Corruption must be endogenised as an explanatory variable.

Although Economic Theory studies of corruption are relatively scarce, there is a significant evolution in discussion on the impacts of corruption in economic efficiency and performance. Even so, although this progress is real, the majority of the

economic academia does not consider corruption as a significant economic problem. Therefore, it was highlighted the potential contribution of the New Political Economy to studies of the State and the political market. ○

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## NOTES

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1. See Giannetti (1993, p. 11-2). The author refers here to a "Brazilian paradox".

2. There are in fact laws to control corruption, mainly in the public budget. See, for example, *The Constitution of Brazil (1988)*, Arts. 71, 74 and 166 and *Law 4320*, Arts. 70, 75, 77 and 82. Any citizen has the right to denounce any suspicion about corruption crime directly, using a Constitutional item (Art.72).

About some technical aspects of the Brazilian public administration and budgetary process, see Silva (1995), Afonso & Giomi (1992), Arvate (1993), Bacha (1994), Guardia & Biasoto Jr. (1992), Guardia (1992), Giacomoni (1985), Longo (1991) Machado Jr. & Reis (1980), Martins (1989), Piscitelli (1988), Santos (1993), Serra (1989, 1993, 1994), Constituição da República Federativa do Brasil de 4 de outubro de 1988 (1993), Lei 4.320 de 17 de março de 1964 (1993), Lei de Diretrizes Orçamentárias (1992,1993), Lei Orçamentária (1992,1993), Nota Técnica à Comissão Mista de Planos, Orçamentos Públicos e Fiscalização (1993), Parecer Preliminar: Comissão Mista de Planos, Orçamentos Públicos e Fiscalização (1993), Plano Plurianual de Investimentos (1993,1994), Relatório Final da Comissão Parlamentar Mista de Inquérito (CPI Orçamento)(1994).

3. I would like to thank José J. de Carvalho for the explanations about the structure and functioning of the Integrated System of Financial Management (SIAFI). The data supplied is for 1996.

4. See *Folha de S. Paulo* 29/01/95.

5. See *Folha de S. Paulo* 29/01/95.

6. For more references about corruption in Brazil, see Silva (1994, 1995, 1996a, 1996b, 1996c, 1996d, 1996e) and Bezerra (1995).

7. See "*Relatório Final da Comissão Parlamentar Mista de Inquérito*" (January 1994).

8. For more and detailed information about the scandal, see "*Relatório Final da Comissão Parlamentar Mista de Inquérito*" (January 1994).

9. See "*Relatório...*", V.III, 7.

10. In fact, rent seeking activities and pork-barrel politics are "natural" characteristics of a budgetary process. The question is how to control these types of behaviour as regards the budgetary process. About this problem, see Scully (1991).

11. The concept of patrimonial domination was introduced by Weber (1984, p. 184-5).

12. The referential works here are: Theobald (1993), Harling (1996), Elton (1977), Stone (1982,1973), Perkin (1969), Hill (1976) and Thompson (1993).

13. About the budgetary and fiscal history of the Western World, see Webber & Wilddovsky (1986).

14. For more details, see Braudel (1992, p. 538-542).

15. See Anderson (1979, p. 33-5) and Theobald (1990, p. 29).

16. See Theobald (1990, p. 33-9) for another typology.

17. See Krygier (1979, p. 6-8).

18. See Theobald (1990, p. 43).

19. See Perkin (1969, p. 315-6) and Buchanan (1994).

20. There is a classical study of this period: Weinberg & Weinberg (1961).

21. For more details, see Meyerson & Banfield (1969, p. 176-7).

22. Gottfried (1968) provides a comprehensive study of the subject.

23. One can argue that economic development is linked with institutional development. This is partially true. In some sense, good things came together. However, Italy and Japan represent important exceptions. They are rich countries with a considerable level of corruption when *per capita* GNP is under control. See *Transparency International Corruption Index (www.transparency.de)* and Woodall (1996). On the other hand, in the case of countries that have been through relatively recent economic and political liberalisation, corruption is endemic. In Russia and some former communist countries, corruption appears to be related to the lack of enforcement of property rights. About these cases, see Harris-White & White (1996).

24. From the late 60's up to the early 80's, there were 21 corruption cases related to public life.

25. This concept was firstly developed, in social choice theory, by Colleman (1984, 1990) and further developed, theoretically and empirically, by Putnam (1992, 1995). There are many definitions related to social capital and social choice which have been analytically developed by theorists. See, for example, Van Dijk (1997, p. 57-89).

26. In this reference, Putnam emphasises that these measurements indicate that Brazil has one of the lowest social capital stock in a sample of 50 developed and underdeveloped countries. Another reference is a study for Tanzania, in *World Development Report, 1997* (1997, p. 115). Finally, Putnam (1993) provides a theoretical and empirical application of social capital to regions of Italy.

27. It is easy to prove this proposition.

Proposition: C,C represents a Dominant Strategy Equilibrium (DSE)

Definition: A DSE implies that both players have (i) dominant strategies and (ii) the same dominant strategies.

Proof: Consider **A** - Regardless of the decision of **B**,  $50 > 10$  and  $30 > -10$ . Consider **B** - Regardless of the decision of **A**,  $50 > 10$  and  $30 > -10$ . **A** will opt for C, and **B** will opt for C.

On the other hand, C,C represents a Nash-Cournot Equilibrium (NCE).

Definition: In a NCE, the agent takes the best decision for herself/himself, taking into consideration what the other agent is doing.

Proof: Consider **A** - **A** will choose C if **B** chooses  $\neg C$ , and **A** will choose C if **B** chooses C ( $50 > 10$ , and  $30 > -10$ ). Consider **B** - **B** will choose C if **A** chooses  $\neg C$ , and **B** will choose C if **A** chooses C ( $50 > 10$ , and  $30 > -10$ ).

28. The neo-classical theory of growth is underpinned by a model that considers *coeteris paribus* the capital accrual as the main source of growth. Savings and productive investment continually increase the workers' capital stock in an economy and, therefore, income in the future. Actually, this model emphasises the close relationship between savings and growth. However, there are limits to savings in an economy. It is not possible to change *ad infinitum* the steady state capital stock, as the neo-classical model contemplates a traditional decreasing return economy. Nevertheless, in the absence of capital accrual which depends fundamentally on the formation of savings in an economy, other variables are called on to explain the phenomenon: the dynamic population and mainly the technical progress. These variables are characterised by the model as important factors for the economic growth. The technological changes are considered exogenous and defined empirically by the statistical residue. The fundamental characteristics of this model are (i) exogenous technical progress and *coeteris paribus* (ii) the absence of economic growth in steady state. Actually, even savings are exogenous in the model, because it cannot explain the changes to savings behaviour and to the private agents' savings trend. However, there is a limit to savings and in this sense, exogenous technical progress becomes the main explanation for continuous growth.

On the other hand, the endogenous growth models take for granted that the capital accrual (including the human resources) has an effect on growth that is more significant than that set forth in the neo-classical approach: the capital accrual would have considerable levels of positive externalities. The nucleus of the argument of the new growth models - as they are known - is microeconomic: the investment in new equipment and in human resources by an isolated firm enables that its growth capacity be overtaken. Other companies using similar equipment and labour force would be positively affected. Even the role of the economy could be affected.

Alongside this argument, there is an important assumption generally presented in the endogenous growth models: the capital is not just physical, but human. It means that capital accrual gains a new and different dimension: the creation of new ideas is plenty of positive externalities. New technologies are, in some sense, public goods. These assumptions are incompatible with the perfect completion assumption in the neo-classical model and with the hypothesis of diminishing capital returns. Endogenous models suggest the possibility of arising a growing return economy, in which technological change and increases in savings rate could generate a permanent increasing in growth rate.

For this reason, institutions could be seen as technologies - or social technologies. They can (or cannot) improve the economic output produced by the interaction of the agents who behave following the incentive structures created by them. The economic costs of a rent seeking and corrupt society could be considerable. Considering the endogenous growth vision, the allocation of talents in activities as crime and corruption generates a cost, since these talents could be being used in innovative and managerial-productive activities that otherwise would create organisational-managerial improvement, productivity gains, and positive externalities.