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## **A troubled relationship: corruption and reform of the public sector in development.**

**Vincent G. Fitzsimons**

### **Abstract: Purpose**

This paper presents an analysis of the nature and determinants of corruption, using recent data to clarify the nature of the corruption phenomenon and answer the question whether corruption can categorically be said to be a problem requiring public sector reform, or a consequence of it.

### **Design / methodology / approach**

The paper analyses data on corruption in relation to the timing of introduction of public sector reform in recent economic transitions, and examines the persistence of increased corruption following the introduction of reforms.

### **Findings**

The theoretical model suggests that events that negatively affect administrators in positions of trust create some reactive tendency towards corruption, and this is supported by the evidence from transition economies. There is a significant increase in corruption following transitional economies' public sector reform, and this demonstrates an unusual degree of persistence even after general institutional reforms have been completed.

### **Research limitations / implications**

Further research could try alternative measures of corruption, instead of 'perceptions' data analysed here, and examine the strength of persistence across a larger set of countries to test the confounding effect of other institutional reforms in transition countries examined.

### **Practical implications**

The costs of New Public Management reform programmes are broader than is currently suggested, and significant short- to medium- term deterioration might be expected in the aftermath of reform.

### **Originality / value**

The paper provides a new approach to corruption research examining the importance of the corruption 'tipping points' of individual administrators and how these are significant in modelling corruption.

**Keywords:** New Public Management; Corruption; Tipping points; Transition; Reform

**Article Type:** Research paper

## **A troubled relationship: corruption and reform of the public sector in development.**

### **Introduction**

Recent decades have seen 'managerialism' in public administration progress from a fad to a fundamental basis of government in many countries in the developed world. The 'managerialism' or 'New Public Management' (NPM) movement has a relatively specific and limited number of core principles and recommendations. Hood (1995) defines an 'NPM' approach according to two factors. The first is the belief that private sector management practice can be extensively and effectively transferred to public administration (or, conversely, the belief in the distinctive nature of public administration). The second is the extent to which rules (or explicit contracts of some form) determine the role of public bodies and officials in order to reduce the scope for managerial discretion.

Whilst the widespread recognition of the NPM might be thought to reflect its superiority to alternative approaches to public administration, it appears in fact to be relatively untested. As Pollitt and Bouckaert (2000) state, 'the international management movement has not needed results to fuel its onward march' (p.132). This was at least in part due to its relationship with the political and economic changes of the time. The 1980s saw the rise of a new type of government that aimed to shrink the systems of state support developed under the post-war consensus, and introduce more flexible ways of operating in a competitive environment. This coincidental rise of political neoliberal principles and free market economics led to the political desire to reduce the size of the state structure and reduce the taxation previously raised to finance 'extravagant' public services. In this sense the focus of governments of the time was as much on reduction in spending as it was on efficient use of spending. The change in policy-making, whilst claiming benefits to public sector efficiency, was also motivated by ideological dissatisfaction with the nature of the political systems of the time. In this sense, any poor performance in terms of economic benefits would still be potentially tolerable to those pushing through the reforms. In particular, the New Public Management appears to have produced only limited savings that are hard to quantify, and definite costs to the public administration of many developing countries (Andrews and Shah, 2003).

Given the points considered above, some distinct elements of reform can be identified for developing countries. Typical Public Administration Reform elements

for Commonwealth countries have been identified by Kaul (1997). Miller (2005) summarises these as:

1. redefinition of the political and administrative interface: clarify the roles between political policy makers and administrative policy implementers – ‘distinguish between strategic objectives and operational processes’ (p.22);
2. selection of appropriate reform options (from both private sector and international experience);
3. raising accountability (government or donor led initiative) – ‘performance measurement, devolution or resource control, improving monitoring and evaluation techniques, clarifying incentives and aligning functions with strategic objectives’ (p.22);
4. initiating public-private sector partnerships;
5. efficiency: ‘emphasis... placed on the public service to achieve developmental priorities.’ (p.22);
6. audit of staff cost and skills;
7. anti-corruption initiatives;
8. change, fundamentally, public sector values.

(adapted from Miller, 2005, p.22)

The UNDP Governance project (UNDP, 2004) has encouraged the reform of public sectors to pursue both political and economic/administrative aims for many years. In their review of best practice in the field of public sector administration, they come to two strong conclusions. Firstly, the nature of the developing economy makes a significant difference to the nature of appropriate policies, with a powerful and ‘over-large’ state being a necessity rather than a burden. In many cases it needs to substitute for the absent or under-developed private economy. Secondly, the nature of the state is not simple, and it appears unlikely that a clear separation of duties can be effective, with administrators performing specific goal-oriented processes and politicians setting strategy. This over-simplifies the role and character of both administrative and political actors in developing countries.

Overall, the situation is still unclear whether the New Public Management approach was effective or not in helping to achieve its goals. Moreover, it remains unclear what the wider impacts are on the operation of governments. As Peters and Pierre (2001b) state: ‘administrative reform has ... had a profound impact on the nature of politics within the public sector, and especially on the relationship between civil

servants and their nominal political masters' (pp.1-2). What that impact is, exactly, remains unclear.

This paper attempts to examine one particular aspect that constituted a weakness in the reforms, that of corruption and its control. The paper takes the approach of examining the connections between different sets of reform and corruption using corruption theory and criminology theory to analyse the likely outcomes of such programmes. In reviewing the evidence of 'completed' reform programmes executed in the former-socialist states in Central and Eastern Europe, in particular, it demonstrates the long-term changes in levels of corruption that follow economic and public-administrative reform programmes of the types referred to above. In practice, both sets of reforms were simultaneously introduced in the process of post-socialist transition, and the effects of 'standard reforms' can therefore be considered in a way, although the examination of particular elements is of course not possible due to the simultaneity of the effects on the economic system.

### **Theoretical approaches**

The theoretical underpinnings of the NPM approach are slim, perhaps based more on consensus view rather than the outcome of a long process of intellectual debate. The NPM approach is based on broad-stroke economic theory such as the theory of perfect competition and developments in public choice economics in the period immediately preceding its adoption. These types of economics vary enormously in their realism. They assume that competitive markets with large numbers of service providers and customers working together to produce bargains, are commonplace, which they are not, and that individuals will act rationally and selfishly to maximise their benefits from a given situation, which is unlikely. On the basis of this theory, and on 'principal agent' theory regarding the nature of delegated authority in organisations, the NPM approach believed that incentives could be created through processes of separation out of dedicated administrative units from general state administration, and contractual structures defining service provision and rewards if achieved. Whilst this appears logical, it fails to recognise the position that would result if oversight mechanisms failed, competition failed to operate for a range of reasons, or individuals acted contrary to the psychological assumptions of the model. In practice, these reforms are as likely to create problems as to solve them, and in particular the risk of disaffection and reactive failures of performance are high in the introduction of 'NPM' style initiatives. In particular, there exists a risk of increased

corruption, the reduction of which is in fact one of the central aims of NPM reforms in developing countries.

### *Corruption theory*

Some confusion exists between the different approaches to corruption, relating to the exact nature of corrupt administrators. The question is, are they 'bad', or 'mad'? The relationship between the administrator that 'chooses' to be corrupt and the state in which they operate is relevant to this problem, obviously, but this is often neglected from some theoretical approaches. Alternatively the relationship between the administrator and the 'clients' that they deal with may similarly be significant in the explanation of the corrupt act. Many of the deviations from expected behaviour in the 'principal-agent' relationship between the state and individual administrators may be interpreted as corruption.

On the basis of much traditional political, administrative and economic theory, models of the state from the early 20<sup>th</sup> century often held an implicit assumption of benevolent, public-service motivation amongst the civil service. Authors such as Weber (2003) asserted that the state's administration constituted a form of rational-legal system that was trusted and held authority over the public on that basis. The economist Pigou (1938) believed that the state could be trusted to effectively enforce regulation in the public's interest. Such public interest theories, however, were increasingly questioned in the light of real-world evidence, and new models of the state emerged from economics and political science that instead predicted deviant behaviour in the form of corruption.

Broadly speaking, the economic approach to corruption, which is possibly the dominant one, would discount relationship factors that might have encouraged individuals to act in a public-spirited way in favour of explanations based in the calculation of self-interested strategies, given the incentives which surrounded individual administrators. This is clearly assuming that the administrator is 'bad'. People are selfish unless incentives are created to keep them honest. Alternatively, it can be assumed that individual administrators are inherently good, but are turned by environmental factors or group decision making into someone 'bad' – this is an explanation of 'bad, but understandably so'. Gorta (1998) sees this tendency in some of the sociologically based criminology literature as of potential value in combating corruption, in the case of Australian public administration following its implementation of the New Public Management approach. Finally, they may be

categorised as 'mad'. This would either involve non-calculating behaviour that does not benefit the individual (the closest an economic approach may come to a definition of irrationality) such as public-interested behaviour of the sort described by Weber and Pigou, or it may be seen as 'annoyance' or loss of reason.

On the margins of corruption theory there lies the related field of white-collar crime. Whilst this has mainly been applied to private-sector workers, its lessons may equally apply in public administration. The literature on fraud uses the 'fraud triangle' (Figure 1) based on Cressey's (1953) research into the motivation of offenders to explain the decision to perpetrate a fraud, and this may be similarly applied to corrupt acts. In Cressey's model, the act of the crime depends on the existence of a motive, an opportunity (to commit crime and potentially get away with it), and 'rationalisation'. Individuals who are de-motivated or hold some grievance may be tipped over from being honest to dishonest by the existence of this third factor, which reduces the reluctance to harm one's victim. The strength of this model is that it incorporates calculating and self interested elements to the decision to commit crime, but also incorporates a realistic mechanism that enables us to consider the psychological or social environment of corruption.

*Figure 1: The Fraud Triangle*

[Figure 1 about here]

Cressey's work has highlighted how individuals are tipped over from normally honest behaviour (which enables them to achieve positions of trust) into dishonest behaviour given certain conditions. The problem of corruption then becomes one of identifying such factors, and to predict the 'tipping points' when individuals become somehow disenchanted or pressurised to the extent that corrupt or criminal acts will occur.

The implications of these models for public administration reform can be briefly sketched out if we consider the position of individual administrators and compare this to the 'decision factors' used in each of the approaches. Firstly, the economic approach is quite simple to apply to the case of administrative reform, and Stiglitz (2002) examines just such a case from a developing country. Faced with the changing administrative structures and, in particular, with the reduction in the scope of activity of an individual administrator in the process of 're-focussing', there exists a strong incentive for individuals to take some benefits while the opportunity still exists, for example in the cases of 'insider privatization' in transition countries. Stiglitz cites

examples of administrators used to taking small occasional bribes (minor corruption) from state service provision who, faced with their privatisation, decide to compensate themselves with one-off windfalls through acts of major corruption (p.58). Stiglitz concludes that standard economic reforms such as privatization (the ultimate in agencification) are very unlikely to cure corruption.

Similar conclusions can be reached using the Cressey model. The 'tipping factors' that might cause honest workers to become corrupt are such things as increased personal financial pressure, reduced individual prestige, stress and psychological problems and, as in the case of Enron, excessively target driven and pressured management that encourages concealment of any problems. These factors can all be easily found in transitional organisations, and on these grounds the NPM approach to restructuring is in fact likely to kick-start some corruption in otherwise honest officials.

In both of the above examples, there would be a severe deterioration in corruption in a country experiencing particular types of reform (specifically relating to economic reform, but more generally to any reform where public administrators could derive an income, if inclined to do so, pre-reform). These short-term effects would be severe, but shortlived on the face of it. Experience of corruption suggests, however, that the growth of crime such as corruption has a 'ratchet effect' in which it is easier to raise than to lower. The growth of corrupt practices has a range of knock-on effects in the economy that are likely to reinforce the tendency to corruption.

## **Data**

Both corruption and public sector efficiency are difficult concepts to measure, at least in part because they are difficult to clearly and thoroughly define. At first glance, governments that manage to reduce the size of state budgets may appear to be successful in increasing 'efficiency' in the sense that they reduce spending on services, but the search for efficiency should not be conflated with the desire to reduce the power or extent of the state. Often the NPM countries appeared to do just this. Data from Afonso et al. (2003) reveals how public sector performance actually declined in many of the key reform countries over the period between 1990 and 2000, using a measure of public sector performance across a range of government policy objectives. True efficiency, in provision of units of services for units of spending, similarly deteriorated in a number of countries over the same period. One strong result was that the connection between income levels and public sector performance



is not as significant as that between the size of the state and public sector performance – suggesting that it is a small state, rather than any particular organisational feature, that produces benefits for economies.

*Figure 2: Relationship between corruption control and income levels*

[Figure 2 about here]

Turning to the causes of corruption, a different set of factors appear to be dominant. Whilst many models of corruption exist, a strong and significant correlation exists between levels of income and corruption. Relating this to the fraud model, higher income is likely to reduce the dissatisfaction of individuals and so reduce the potential ‘rationalisation’ of the act. Accordingly, this can be seen as evidence consistent with the fraud approach. This may then account for the distinct and prolonged worsening of corruption scores for transition countries for whom historical data exists (Figure 3, below), as the process of economic reform entails inevitably deflationary policies. The idea of ‘reactive corruption’ therefore appears relatively appropriate, on general principles.

This correlation is a partial explanation, however, of the phenomenon of corruption. Whilst income is a strong determinant of corruption, the evidence from non-OECD countries is much less conclusive showing wide variation that is not explained by income levels. Is it the case, however, that a small state, such as pursued under the NPM, might improve corruption? Potentially the reduced opportunities for rent-seeking may reduce it. Unfortunately the statistical analysis of such phenomena is massively complicated by the confounding effect of related variables. We can argue that richer countries can afford better anti-corruption strategies; that richer individuals need not resort to corruption; or even that institutions such as social capital networks may both favour growth and discourage corruption (although this remains debatable on the basis of the existing literature on negative social capital). What we can do is examine the trends that actually occurred and related data for the transition countries.

*Figure 3: Impact of post-socialist reform on corruption scores (CPI)*

[Figure 3 about here]

Typically, transitional states experience a ‘corruption J-curve’ effect, with a sharp and prolonged decline in the control of corruption over the post-transition period. The persistence of the problem is particularly concerning, as it suggests that corruption is

resistant to the new institutions typically introduced in the process of reform. From the reasoning above, this may well be due to the increasing pressure to corruption created by the reforms. This characteristic behaviour, in terms of the corruption performance, of post-socialist reformers is potentially of significant concern for those considering the implementation of public administration reform. The evidence suggests that corruption both deteriorates and then stagnates for a significant period, with many of these countries experiencing a decline for the best part of the following decade.

*Figure 4: Control of corruption over time, ranked by size of economic decline*  
*[Figure 4 about here]*

In order to examine whether the prolonged persistence of corruption is due to the income fluctuations experienced in transition, a final comparison is made between various transitional countries using World Bank data on control of corruption (Figure 4). In this diagram, the transition countries are first ranked on the basis of the extent of their recession following the implementation of reforms. In this case it is clear that those suffering the smallest recessions, post transition, have a generally better control of corruption, although the relationship demonstrates only a relatively poor  $R^2$  score (0.316) suggesting a great deal of variation within the sample. Typically, two types of country suffered small recessions – those with already strong economies, and those that ‘pulled their punches’ and implemented only half-hearted reforms. The less enthusiastic reformers may, therefore, experience relatively better performance in the control of corruption. This relationship may also help explain recent work on transition economies that suggests that corruption is actually lower in countries with large governments, contrary to the suggestions of the NPM (see Goel & Budak, 2006).

## **Conclusion**

There exists a strong relationship between the theory of corruption and public sector reform. Whilst many areas of public policy proceed without necessary reference to corruption, the reform of the public sector appears inextricably linked to the problem of corruption. Economic bases for public sector reform now emphasise the need for transparent governance structure, and ‘checks and balances’ that may prevent abuse of any individual’s position. Reform packages will now typically recognise some issues of corruption - the nature of the relationship between the two concepts, however, is less straightforward than is normally suggested.

Overall, the outcome of a 'New Public Management' style reform programme is, on the basis of the evidence presented above, impossible to judge. This stems from differences in the nature of the economic or political system in which reform takes place; the differences in social and cultural institutions; and the varying levels of development of necessary supporting institutions that might support the effectiveness of the reform programme. It is however likely that reforms may actually create incentives to corruption that, unless checked, can cause significant and prolonged problems with corruption that may undermine the benefits of the administrative reform. Whilst New Public Management appears to demonstrate only limited benefits, the consequential corruption appears on the basis of statistical evidence likely to have significant negative economic impacts. The surprising conclusion can be reached that unenthusiastic reformers may in fact do just as well, or even better, in terms of the control of corruption as those who diligently pursue the recommended policies.

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Figure 1: *The Fraud Triangle*

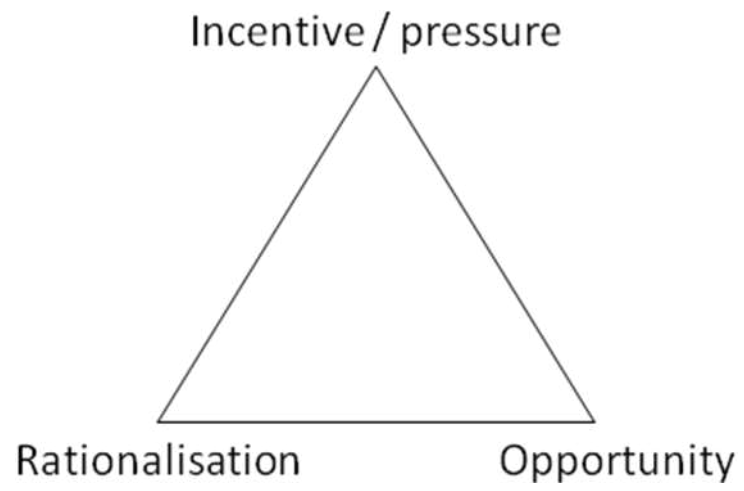
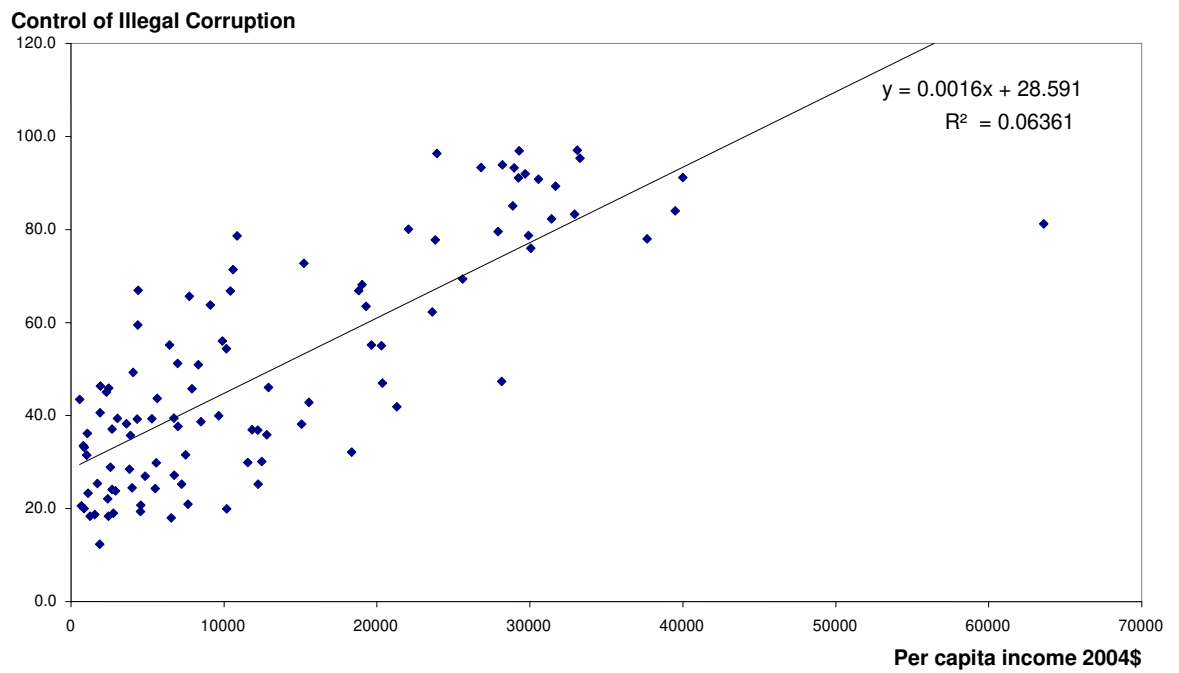
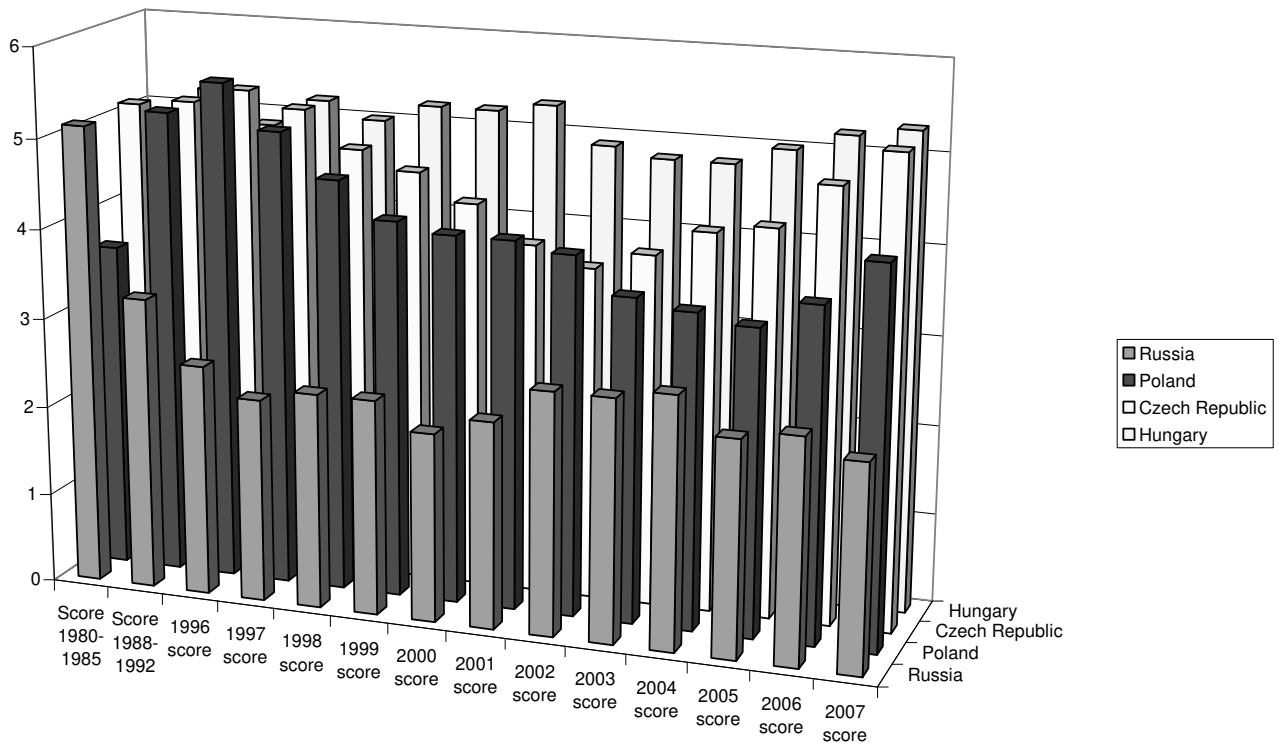


Figure 2: Relationship between corruption control and income levels



Data sources: Kaufmann (2004); IMF World Economic Outlook Database (2006)

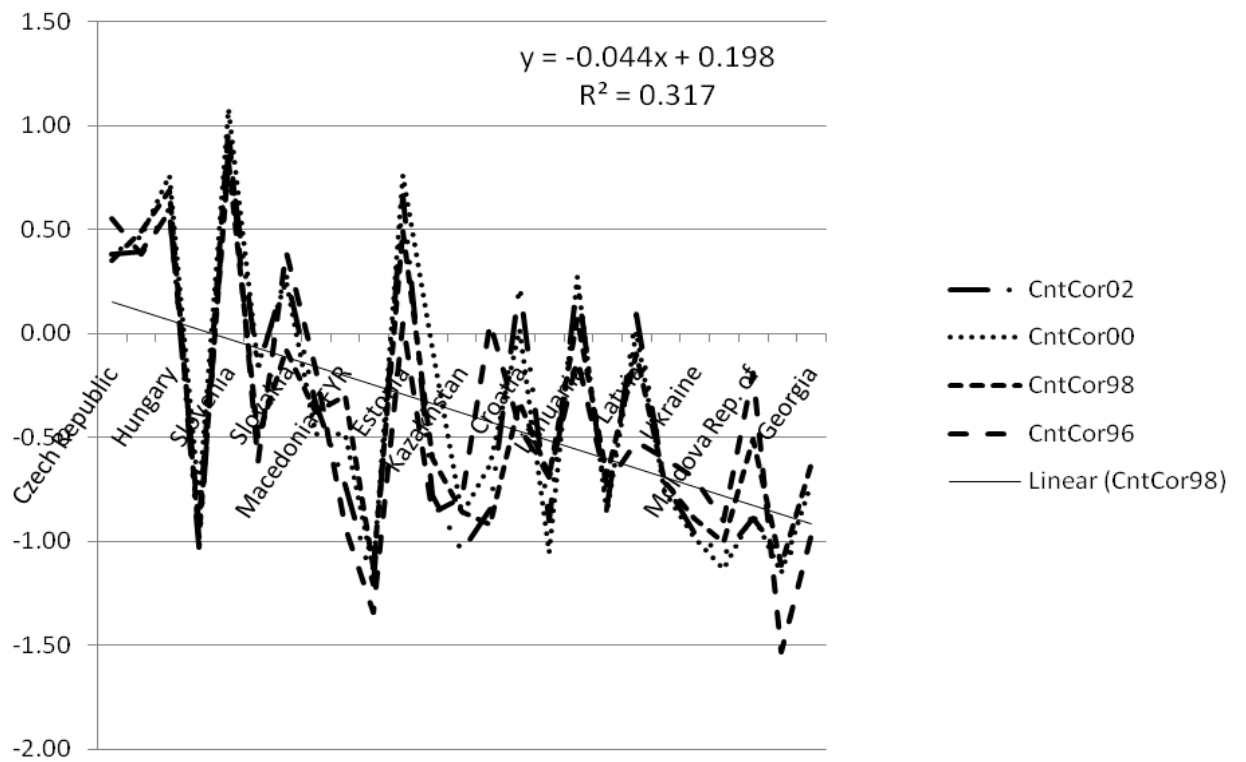
Figure 3: Impact of post-socialist reform on corruption scores (CPI)



Data source: Transparency International Corruption Perceptions Index



Figure 4: Control of corruption over time, ranked by size of economic decline



Data sources: Kaufmann, Kraay & Zoido-Lobaton (2002) Governance Matters dataset; UNECE dataset.