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Benefit sharing: An incentive mechanism for social control of government expenditure

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Abstract

The present paper analyzes the incentives individual members of society face to contribute to a nation's efforts in controlling corruption. A Principal-Agent model is constructed, leading to the following results. First, although individual agents do have an interest in devoting a portion of their resources to the nation's control effort, the opportunity cost of the effort and a free rider problem blocks the spontaneous provision of individual support to corruption control. Second, to cope with those incentives, a new welfare improving mechanism is proposed, which aligns individual incentives with those of society at no extra cost to the government.

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1. Introduction

The efficient use of public resources is one of the fundamental factors underlying the distinct development paths forged by nations that were initially at a comparable stage of technological development. To be sure, investments in unfinished projects, waste, and the diversion and mismanagement of public resources have a devastating effect not only on a country's public

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accounts but also on its GDP growth rate.[1] Mauro (1995), for example, presents a 67-country econometric analysis, in which "corruption is found to lower investment, thereby lowering economic growth". Similarly, Habib and Zurawicki (2002) provides an 89-country econometric analysis which concludes that corruption reduces foreign direct investment as well. A specific country study presented in Bugarin, Gomes and Ellery (2005) suggests that Brazil wasted approximately 20% of its gross capital accumulation in the last 5 decades of the 20th century.

The high social cost associated with the inefficient use of public resources has driven societies around the world to assume a far more active role in controlling public resources and in demanding punishment of those individuals involved in corruption and the diversion of resources. To cite a landmark example, the impeachment of former Brazilian President Fernando Collor de Mello in 1992,[2] which was only made possible by the significant pressure exerted by society,[3] represented a milestone in the effort to raise social awareness in that country.

Civil society's participation in detecting and monitoring the diversion of public resources is of great importance to a country. First, because it represents a form of civic action that fosters a spirit of national unity centered on the common good. Second, because it carries the potential of frightening corrupt individuals, who face the risk of punishment, and, in this way, deters them from engaging in illicit activities.

Social involvement by average citizens, however, requires dedication and resources, and, moreover, it also competes with their everyday activities such as work and leisure. Given the cost of devoting oneself to social control, citizens have a natural tendency to delegate to the government the responsibility for controlling the Public Administration. Therefore, in the current context, it may be the case that the Federal Government is not taking advantage of the effort civil society might well be willing to invest in controlling the public administration, were it not for the high cost of this activity.

The purpose of the present article is to study the incentives society faces with respect to its participation in the control of public expenditures, and to determine how this participation can be promoted. The second section sets forth the basic ideas of the proposed model. As a benchmark for future comparisons, Section 3 develops and solves the optimization problem of an agent who is unaware of his potential for participating in the collective control effort. The following section determines the optimal choice for an agent when he recognizes his role in the control process, although here he receives no government encouragement to become involved. This case

[1] There is no theoretical unanimity about the effects of corruption on economic development. One trend of the literature highlights the inefficiency-reduction role of corruption as it allows for a Coasian negotiation between the bureaucrat who owns the property rights of public resources and private agents that can benefit from those resources. In a society dominated by a rigid bureaucracy such negotiation may lead to a second best instead of a third best allocation. In Huntington's (1968) words: *"In terms of economic growth, the only thing worse than a society with a rigid, over-centralized, dishonest bureaucracy is one with a rigid, over-centralized, honest bureaucracy"*. A second trend of the literature notices the symbiotic relationship that may arise between corruption and the bureaucratic structure and concludes that instead of reducing the inefficiency of a rigid bureaucracy, corruption may in fact induce such rigidity, so that the bureaucrat can benefit from the resulting negotiation process. In that case corruption reduces economic growth by keeping an inefficient bureaucracy. Clearly, the authors of this article agree with this last analysis of the effects of corruption. For an excellent review of that literature see Bardhan (1997).

[2] "In May of 1992, Brazilian President Fernando Collor was accused by his own brother, Pedro, of leading a broad corruption network" (Hinojosa & Perez-Linan, 2002). This accusation led to his final impeachment in December of that year.

[3] "On September 29, 1992, the chamber of deputies voted 343-34 to impeach Fernando Collor, while more than 100,000 people demonstrated against the president in front of Congress" (Hinojosa & Perez-Linan, 2002). See also Ramalho (2004).