



Bureaucratic complexity and impacts of corruption in utilities[☆]

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ABSTRACT

This paper explores how the relationship between bureaucratic complexity and corruption affects the performance in utilities. We observe considerable variation in the performance of the utilities across countries, even across countries which appear to be relatively similar. Our hypothesis is that corruption plays an important role in explaining this observed difference in performance. In particular, corruption coupled with a complex regulatory structure can have negative effects on performance. The analysis points at the importance of considering the institutional framework and institutional quality when introducing new bureaucratic procedures, as the same set of policy advice will work differently in different countries. We measure bureaucratic complexity by the number of procedures needed for starting a business from the Doing Business Database provided by the World Bank.

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1. Introduction

The negative impacts of corruption and poor quality of institutions on economic development are well established. Institutional improvement is a slow process, and simply changing formal procedures will not necessarily have the desired effect. Institutional reform often imply that more concerns and political motivations are taken into consideration, and the demand on administrative procedures increases. The introduction of more administrative procedures to ensure consumer welfare may result in greater bureaucratic complexity. Greater complexity, in turn, can provide new opportunities to hide corruption, however. Thus, rather than protecting consumer interests, more procedures may result in higher levels of corruption and inferior sector performance.¹

Whether more complexity works to secure consumer welfare or is exploited as a tool for hiding corruption may depend upon the general quality of institutions and governance. The same set of procedures might result in different outcomes across countries depending on levels of income, credibility of legal systems, and

human capacity.² Bureaucratic procedures are particularly relevant for the utilities sectors, which are often natural monopolies, characterized by economies of scale and low marginal costs. There are often few firms, and the incentives and opportunities to benefit from market power are higher than in other sectors. Thus there is a stronger need for regulation through bureaucracy. The variation across countries in how complexity works might therefore be expressed more strongly in utilities compared to many other industries.

There is limited empirical information about how the establishment of comprehensive administrative procedures fulfils the goal of higher consumer welfare in terms of improved sector performance. Even if greater complexity increased welfare in higher-income countries with well functioning institutions and a credible legal system, it might raise the level of corruption where institutions are weaker. There are, however, a few studies that address the linkage between various forms of governance and infrastructural performance. Estache et al. (2006) find that regulatory reforms offset the effects of corruption on performance

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¹ Large parts of the literature on corruption relate to the various ways in which corruption can be caused by poor institutional quality (for an overview, see Aidt, 2003; Rose-Ackerman, 1999, 2004; Bardhan, 1997).

² For instance, the number of procedures behind the award of licenses to operate a business is the same in Bangladesh and Norway, which experience very different challenges with respect to corruption. On the basis of information about the number of procedures in dealing with the public as part of doing business in a country, Germany and Thailand are ranked very equally, while Italy is ranked worse than Colombia, and Spain is ranked worse than Puerto Rico. And yet, the higher number of procedures and greater bureaucracy are part of a system with higher levels of welfare in Germany, Italy and Spain, compared to Thailand, Colombia and Puerto Rico (Doing Business Database).

indicators only to a limited extent and that the effectiveness of reforms is reduced when there is a higher level of corruption. Gasmí et al. (2006) find the positive effect of political accountability on the performance of regulation to be stronger in developing countries.

This study explores how performance across the utility sectors, such as electricity, water and telecoms, is affected by the connection between the level of corruption and the level of bureaucratic complexity. We apply data from the Doing Business and Enterprise Surveys Database collected by the World Bank. In Section 2 of the paper we first look at whether performance in the electricity, water and telecom sectors in developing countries is systematically affected by the levels of corruption and complexity. We go on to test more thoroughly the relationship between bureaucratic complexity, corruption, and levels of income.

We find that in general, service delivery in the utilities functions significantly better in countries with few procedures and low levels of corruption. We also find that the pattern with respect to corruption, complexity and sector performance differs across income levels. In general, complexity (the number of procedures) is a significant determinant of corruption levels, but the effect depends on the income level. Higher confidence in the judiciary also tends to reduce corruption. For developing countries only, the effect of fewer procedures is smaller but still significant. Our findings support the notion that simple procedures, by lessening the problem of corruption, holds potential for improving performance.

2. Corruption and complexity in utilities

We know that regulatory decisions can be extremely important for firms in the utility sector and they will often have every incentive to influence their terms. A high level of technical complexity of provision and complex financial contracting provide many ways to hide corrupt transactions. Hence, despite the presence of advanced administrative procedures, the risk of corruption is perceived to be high in these sectors (Transparency International, 2002; Finger and Allouche, 2002; Hall and Lobina, 2002; Søreide, 2006a).

Bureaucratic procedures are not a clear-cut concept, however. First, there might be a number of formal procedures, yet informal solutions may prevail. Rules are not necessarily respected or they may be politically overruled. Second, bureaucratic procedures are usually established to improve welfare and smooth regulation, yet also these decisions can be influenced by corruption. “Greasing the wheels”-theories suggest that bribery speeds up bureaucratic procedures (Leff, 1964; Huntington, 1968: p. 386). Kaufmann and Wei (1999) tested this theory empirically, and found that higher levels of corruption implied more time spent dealing with the bureaucracy for the business community. Third, it is not obvious how to count procedures. The time it takes to comply with procedures might vary substantially. However, it is not unreasonable to assume that a higher number of procedures entail more bureaucratic complexity.

Bureaucratic complexity can facilitate corruption in several ways, and the problem is relevant for all stages of the regulatory process: (i) prior to operation, in some form of tender manipulation; (ii) during operation, for instance through opportunistic renegotiation of operational terms; or (iii) when the term of operation comes to an end, most relevantly to ensure a new term without competition.³ If many concerns are included in the decision-making processes, such as the protection of domestic industrial development, trade politics, employment issues, environmental concerns or district politics, these can be exploited to hide a biased decision. There is then often a legitimate argument

that will fit with the characteristics of a company that offers bribes or make significant party contributions. Complex award procedures may provide more opportunities to argue for a certain aspect, and to hide corruption. General monitoring and auditing systems may thus be comprehensive, yet still not able to detect corruption.⁴

A bureaucratic hierarchy, established to facilitate the functions of the state by delegating responsibilities, may contain structures that encourage principal–agent problems, instead of preventing collusion between agents and firms.⁵ An important distinction must be made between corruption initiated by *public officials* who make decisions that are against the will of the political levels, and corruption initiated by representatives of the *political* level, who influence bureaucratic procedures to fulfill a corrupt deal with a private firm.

The first category, corruption conducted by public officials, will represent a violation of procedures, either by making it look like as if all rules have been respected (through bid rigging or violation of communication rules, for instance), or by misusing legitimate deviations from the rules (for instance by referring to discretionary decisions, extraordinary circumstances or previous experience). The opportunities for such corruption depend on the number and/or nature of procedures. Such complexity can either enforce integrity or increase corruption (Fjeldstad, 2005; Moody-Stuart, 1997).⁶

The second category, political corruption, will in this setting refer to the many ways that political levels can influence bureaucratic procedures, for instance by giving instructions to regulatory bodies on how to prioritize between tender criteria or factors that appear to support a political goal. Even if the nature of corruption differs between these categories, depending on benevolent versus non-benevolent principal, it may under each circumstance be easier to hide or carry out the crime if the administrative rules are many or intricate.⁷

We have limited information about who initiates corruption, and we do not know the extent to which the problem tends to be caused by those who offer bribes or those who receive them. This will probably depend on relative bargaining powers and particular characteristics of institutions and markets.⁸ There is also limited information about the private sector’s influence on its own regulatory terms and how and why this varies across countries and sectors, although there is strong reason to believe that the problem escalates when legal institutions and monitoring systems are weak (Laffont, 2005). A combination of weak constitutional control over the government, limited contract enforcement, and sunk

⁴ See Della Porta and Vanucci (1999), who argue for more quality control in procurement procedures, because there are so many ways of manipulating the system.

⁵ The principal–agent relationship has therefore been much applied to the exploration of corruption, see for instance Mishra (2006), Acemoglu and Verdier (2000), Olsen and Torsvik (1998) and Laffont and Martimort (2001). This literature makes an important distinction between benevolent and non-benevolent principals (Aidt, 2003).

⁶ Fjeldstad (2005) explains connections between bureaucratic complexity and corruption in Tanzania’s tax administration. Moody-Stuart (1997) describes how complexity is used to hide corruption in public procurement. Della Porta and Vanucci (1999) point at how reduced discretionary authority will require more detailed rules – and hence greater complexity. The anti-corruption effect of reduced discretion depends on how much it adds to procedural complexity.

⁷ Similarly, the mechanisms to control corruption, such as control mechanisms, transparency and sanctions, will function differently in these different circumstances. Independent regulatory bodies will seldom be a solution, however. The underlying challenge is related to questions of political benevolence, a long-term horizon for political decisions, and the function of democracy. When these factors work there is little reason to make the regulatory bodies independent, and when they do not there is little reason to expect independence to work.

⁸ On bargaining powers and bribery, see Svensson (2003) and Clarke and Xu (2004), for instance.

³ See Guasch and Straub (2005) for empirical results on renegotiation in utilities, and discussion about opportunistic renegotiation.

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