



Bureaucracy intermediaries, corruption and red tape[☆]



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ABSTRACT

Intermediaries that assist individuals and firms with the government bureaucracy are common in developing countries. Although such bureaucracy intermediaries are, anecdotally, linked with corruption and welfare losses, few formal analyses exist.

We introduce a model in which a government license can benefit individuals. We study the net license gain when individuals get the license through the regular licensing procedure, through bribing or through intermediaries. For a given procedure, individuals using intermediaries are better off than if intermediaries and corruption had not existed. Then, we study the incentives of corrupt bureaucrats to create red tape. Bureaucrats implement more red tape and individuals are unambiguously worse off in a setting with intermediaries than with direct corruption only.

Intermediaries can thus improve access to the bureaucracy, but also strengthen the incentives to create red tape – a potential explanation why licensing procedures tend to be long in developing countries.

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1. Introduction

Intermediaries that assist individuals and firms with the government bureaucracy are present throughout the developing world. Yet, there is a limited understanding of what such bureaucracy intermediaries do. Although the prevalence of intermediaries is, anecdotally, linked with corruption and welfare losses, there are few formal analyses and an almost complete lack of empirical studies.

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This paper aims at filling a gap in the theoretical literature on bureaucracy intermediaries. In a model where individuals can get a benefit by going through a licensing procedure at the government bureaucracy, we study how the net gain from the license is affected when it can also be obtained through intermediaries. We study how the incentives of bureaucrats to create red tape are affected when there are intermediaries, and the effect of such “endogenous red tape” on the license gain. We also endogenize the existence of the intermediary sector itself.

The study focuses on one specific aspect of what intermediaries can offer individuals and firms – time saving. Individuals can get the license through the regular procedure, or by bribing corrupt bureaucrats to get a speedier treatment, or from an intermediary, which allows for even more time saving. From individuals' choice of how to get the license, we derive several interesting and novel results. We first show that, *ceteris paribus*, individuals that get the license through either corrupt bureaucrats or intermediaries are better off than if corruption and intermediaries had not existed. Second, and importantly, we show that the incentives to complicate licensing procedures and add red tape differ in a model with intermediaries. Bureaucrats find it optimal to create more red tape when there are intermediaries. Third, when corrupt bureaucrats can choose their “optimal” level of complication of the government bureaucracy, individuals' net gain is unambiguously lower in a model with intermediaries than with “direct” corruption only.

An additional contribution is that we endogenize the existence of the intermediary sector. Whether the sector arises or not, the degree of competition within the sector, the effect on the license gain, and

bureaucrats' "optimal" amount of red tape, are analyzed in a model with endogenous entry and oligopolistic competition between intermediaries. We show that as long as entry costs are not too high and bureaucrats are free to choose the level of red tape, the intermediary sector exists, licensing procedures are longer and individuals are unambiguously worse off, than without intermediaries.

For citizens to get a license from the government bureaucracy, a number of steps must typically be completed, involving visits to several offices, standing in lines, making different payments, etc. As long as the costs for getting the license are smaller than the benefit obtained, individuals will optimally choose to get it. The lower the costs, the better off individuals will be. Importantly, any reduction in the license costs will make available a surplus that would otherwise be lost, for instance in queuing, waiting, going between different offices, etc., as well as on the extensive margin where some individuals possibly switch from "informality" into getting the license.²

Consider bureaucrats that are interested in capturing the surplus associated with reducing license costs. Apart from legitimate license fees, individuals face other costs, such as monetary costs for transport, and time costs of queuing, waiting and going to the offices. It is bureaucrats' removal of such time costs, against payments from individuals, that is the focus in this paper. The model is inspired by the fact, especially true in developing countries, that individuals and firms typically spend considerable amounts of time in completing licensing procedures, including visiting multiple government offices at different locations and points in time.³ We refer to the reduction of such time costs as "speed money corruption" for which individuals pay "bribes" to bureaucrats. We take the principal–agent relation between bureaucrats and the government as given, assume that bureaucrats can pocket the bribes, and focus on the optimal choice of such bribes.

The time costs can be broadly categorized as either of the following types: those that bureaucrats directly control and can affect, such as waiting times in lines and processing times of applications within the office, and those that bureaucrats cannot directly control, such as the time that individuals spend in transporting themselves between different offices of the bureaucracy.

Paying a bribe to speed up the handling of the licensing procedure is a typical example of the first category. In a Brazilian survey of entrepreneurs' costs and experiences to register a firm in the garment industry, 40% of firms affirm that "speeding up" the registration is possible (Zylbersztajn et al., 2007). In a related paper, Zylbersztajn and Graça (2003, p. 14) find evidence of "exposure to bribes solicited to accelerate the process". Gancheva (1999) discusses similar practices at firm start-up in Bulgaria. Queuing times inside the office is another time cost that bureaucrats can affect, by accepting bribes to let individuals jump queues. Even when paying for such "services", the license applicant typically has to complete the same steps as a regular applicant. What the intermediary function does, however, is to also reduce costs that bureaucrats cannot directly control, further shorten the time individuals spend in licensing and eliminate steps that the individual has to undertake. This may include handing in/picking

up the application at the different bureaucracy offices, undertaking payments, assisting when the applicant fills in forms, taking care of paperwork, and delivering the completed license to the applicant. The applicant saves on transportation costs, both the monetary cost and the time involved, and economizes on time spent to find out how the procedure works.

An individual can thus bribe corrupt bureaucrats to avoid some time costs, or use an intermediary (that in turn pays bureaucrats), avoiding a larger fraction of time costs.

In Section 3, we introduce a model with three players: individuals, bureaucrats and intermediaries. Individuals can obtain a government license in three ways: through the regular procedure, by "direct" bribing, which eliminates some time costs, or through intermediaries, which eliminates all time costs. Intermediaries, which in turn pay "indirect" bribes to bureaucrats, maximize profits from license fees, and bureaucrats maximize profits from direct and indirect bribes.

We first study the effect of bribing and intermediaries on individuals' gain for an exogenously specified licensing procedure. As intermediary entry is endogenous, the paper provides new insights into when such services can be expected to exist.

Many authors, e.g. Myrdal (1968), Rosenn (1971), de Soto (1989), Tanzi (1998) and La Porta et al. (1999), have hypothesized that bureaucrats deliberately create extra bureaucratic hurdles, or red tape, to extract bribes and, in addition, some have argued that such proceeds are channeled through intermediaries (Bertrand et al., 2007). As expressed by Rosenn, citing a typical Brazilian complaint regarding civil servants and red tape; "eles criam dificuldades para vender facilidades (they create difficulties in order to sell facilities)" (Rosenn (1971, p. 535, translation from the original)). In actual licensing procedures, we often observe that a multitude of offices have to be visited, documents should be stamped and certified, individuals have to visit the same bureaucrat several times and deliver and pick up papers on different days with varying opening hours, etc.

Inspired by such evidence, we then let bureaucrats choose not only the level of the bribe but also the length/complexity of the licensing procedure. We thus have in mind corrupt bureaucrats that either have discretion over the actual implementation of the licensing procedure, or that lobby against legislators with such influence, or that channel corruption proceeds to supervisors in order to influence the complexity of the procedure. In doing this analysis, we assume "centralized corruption" (Shleifer and Vishny, 1993). All corrupt bureaucrats take one joint decision on bribe levels (and the procedure length). In our central result concerning red tape (Proposition 5, a special case of which is Corollary 2), we show that there is more red tape and that individuals are unambiguously worse off when the intermediary sector exists than when there is "direct corruption" only.

The paper proceeds as follows: Section 1.1 discusses related literature and Section 2 presents stylized facts about bureaucracy intermediaries. Section 3 presents the model. Section 4 discusses the results. The proofs are in the appendix.

1.1. Relation to the literature on corruption and intermediaries

In this paper, corruption means "speed money". The modeling choice is different from many papers in the corruption literature, where a typical question is how the existence of corruption affects the allocation of (scarce) government benefits/licenses/permits. The social benefit of allocating the permit to some (deserving) individuals is higher than allocating it to other (undeserving) individuals. Banerjee et al. (2012) model corruption and the emergence of red tape in such settings. Bertrand et al. (2007) document that in Delhi, India, using an intermediary/agent is the way to get a driving license without actually learning how to drive, and Drugov et al. (2014) study the role of intermediaries in lowering the moral costs of corruption. Hasker and Okten (2008) and Bose and Gangopadhyay (2009) provide a theoretical framework for the role of intermediaries as observed by Bertrand

² In Section 2, we document evidence on the prevalence of bureaucracy intermediaries. Both individuals and firms use such intermediaries. The model is one of individuals' demand for intermediaries, a demand derived from time saving aspects. However, it can be broadly interpreted to also concern firms.

³ de Soto (1989) reported that starting a firm in Peru involved 11 steps at seven different government authorities, and obtaining authorization to build a house on state-owned land involved 15 steps at six authorities, which in turn consisted of 207 sub-steps at approximately 50 (sub-) offices/counters/desks. Property formalization, or similar procedures, involved 168 steps in the Philippines, 77 in Egypt and 111 in Haiti (de Soto, 2000). Following this work, the World Bank Doing Business project has documented procedures for starting firms, registering property etc., in most countries. For the same procedure, the number of offices to be visited, monetary costs, as well as time spent, tend to be significantly higher in the developing world, as compared to developed countries (Djankov et al., 2002; World Bank, 2012b).

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