Symposium on Institutional Capacity, Corruption, and Development

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Why is corruption like a black hole?
(This is not a joke)
No, the answer is not that if you get too close it will suck you in and you will never be seen or heard from again.
Answer: We can’t see it but we know it’s there.

Next question: Then how do we know it’s there?
By its impact!
Therefore, in terms of measuring corruption, we should focus on measuring the consequences – that is, the impact – of corruption.
This presents 3 challenges

• What are the consequences of corruption?
• How can these consequences be measured?
• How can these consequences be attributed to corruption?
  – After all, these consequences are multi-causal
  – E.g. poverty rates, inequality, poor or non-existent service delivery, increased ethnic/racial conflict, capital flight, decreased FDI, etc.
Two Thought Experiments

- How would you measure the level of happiness in a society?
• How would you measure the extent of justice in a society?
And my point is ...

• It may be close to impossible to measure the degree to which a society is happy or delivers justice

• Part of this difficulty stems from the difficulty in defining these words, or in breaking them down into measurable (and agreed upon) components
And yet ....

We know that happiness and justice exist
Another analogy to physics

What is the relationship between trying to measure corruption -- or its impact -- and the Heisenburg uncertainty principle?
In trying to measure corruption (or its impact) we may be changing the behavior of what we are trying to measure.
World Bank grants to build roads in rural Indonesia

• Road building program in rural Indonesia
• Given same amount of money to build roads of equal length
• 900 Villages divided into three groups:
  – 1) 300 villages told their expenses would be audited
  – 2) 300 villages told they would be exclusively responsible for building the roads – no outside monitoring
  – 3) 300 control group villages
• All the roads were built
• Built to the distance mandated
• But, based on core samples, the vast majority of the roads built to spec were those built by the villages that were told their expenses would be audited
• So, can we conclude that knowledge of independent auditing is the best antidote?
• Perhaps
• But it is also possible that the villager’s knowledge and certainty of independent auditing changed the behavior of those (the villagers) being observed
• We do not know, absent that knowledge, how they might have behaved
A Clever Way to Measure Corruption

• Raymond Fisman and Edward Miguel ask (*Economic Gangsters*, 2008, pages 24 – 41): what is the value to a company of having political connections?

• Specifically, how much is it worth to a specific Indonesian company, Bimintara Citra, to have the President’s son (President Suharto) a major owner of the company?
How did they do this?

• July 4, 1996: Indonesian government announces that President Suharto is to travel to Germany for a “check-up.”

• Upon the release of this news, the Jakarta Composite Index fell 2.3%
• But Bimintara Citra’s shares fell by more than 10%

• Based upon simple calculations and comparisons of share values, they concluded that the company’s political connections accounted for 25% of its market value

• Two additional interesting facts:
1) Bimintara Citra’s share price began to decline 2 days before the public announcement of the President’s trip to Germany

2) While the shares of companies owned by Suharto’s inner circle dropped on average by 4.5% following the announcement, the share prices of a competitor’s companies – with no political connections – increased by over 1%

A 6% difference
• But note the rare combination of factors that have to occur simultaneously for this type of precise calculation to be made:
  – 1) able to find allegedly politically connected companies
  – 2) ability to measure the market value of the company
  – 3) able to find companies that are known NOT to have political connections
  – 4) an unexpected political shock or upheaval
  – 5) a benchmark to make value comparisons
Conclusion

• Despite all these caveats, cautions, uncertainties, challenges, obstacles, and (according to some) impossibilities in measuring corruption, it is vitally important.

• And this may be “unfair” because there is a real question whether corruption can be accurately measured.
Nonetheless, measuring corruption determines:

– how much money is allocated to fight corruption
– where that money is directed (in terms of both locations and sectors)
– Who receives the money
– whether the resources committed to the effort will continue to be committed
– the impact/effectiveness of these efforts