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JUDICIAL CORRUPTION IN DEVELOPING COUNTRIES: ITS CAUSES AND ECONOMIC CONSEQUENCES

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1. Introduction

Law and economics of development focuses its attention on the effects that well-functioning legal and judicial systems have on economic efficiency and development. Adam Smith states in his *Lectures on Jurisprudence* that a factor that "greatly retarded commerce was the imperfection of the law and the uncertainty in its application...." (Smith, p. 528). Entrenched corrupt practices within the public sector (i.e. official systemic corruption) hampers the clear definition and enforcement of laws and therefore, as Smith (1978) stated, commerce is impeded.

Systemic corruption within the public sector can be defined as the systematic use of public office for private benefit that results in the reduction in the quality or availability of public goods and services (Buscaglia,

1997). In these cases, corruption is systemic when a government agency only supplies a public good or service if an unwilling and uncompensated transfer of wealth takes place from an individual or firm to the public sector through bribery, extortion, fraud, or embezzlement.

Rose-Ackerman (1997, p. 5) states that "widespread corruption is a symptom that the state is functioning poorly." In fact, the entrenched characteristic of official corrupt practices is rooted in the abuse of market or organizational power by public sector officials (Buscaglia, 1997, p. 277). Many studies have already shown that the presence of perceived corruption retards economic growth, lowers investment, decreases private savings, and hampers political stability (Maoro, 1995; Schleifer and Vishny, 1993). Moreover, foreign direct investment has demonstrated a special negative reaction to the presence of corruption within the public sectors in developing countries (Leiken, 1996) while Lambsdorff (1998) also shows that the degree of corruption of importing developing countries affects the trade structure of exporting countries.

Many scholars have provided path-breaking contributions to the economic analysis of corruption. Studies focusing on describing corrupt practices and on analyzing the impact of corruption on economic development are abundant. Low compensation and weak monitoring systems are traditionally considered to be the main causes of corruption. In Becker-Stigler (1974), and Klitgaard (1991), official corruption through bribery of public officials reduces the expected punishment faced by potential criminals and thus hampers deterrence. In this context, increasing the salaries of public enforcers and/or paying private enforcement agencies for performance would tend to improve the quality of enforcement.

Rose-Ackerman (1978), Macrae (1982), Shleifer and Vishny (1993), and Maoro (1995) provide alternative approaches to the economic analysis of corruption. In these studies, corruption is considered to be a behavioral phenomena occurring between the state and the market domains. In all cases, they assume that people and firms respond to incentives by taking into account the probability of apprehension and conviction, and the severity of punishment (Becker, 1993). Of course, in all

these studies, ethical attitudes matter. However, the economic analysis of corruption stresses that, to a lesser or greater degree, people respond to incentives.

The existence of official corruption distorts market systems by introducing uncertainty in social and economic interactions (Andvig 1991). Moreover, official corruption is an essential input for the growth of organized criminal groups with the capacity to pose a significant international security threat through the illicit traffic of, among other things, narcotics, nuclear, chemical, and biological materials, alien smuggling, and international money laundering operations (Leiken, 1996).

The literature mentioned above has been providing an outstanding overview of the social situations associated with entrenched corruption within the public sectors. But an economic theory of corruption must contain more than just an account of the general situations enhancing corrupt practices. Therefore, in order to develop reliable anti-corruption policies, it is necessary to go beyond the simply descriptive and symptomatic studies of official corruption by focusing much more on the search for scientifically-tested causes

of corrupt practices in specific institutions within the public sector.. While all of the above studies have made path-breaking contributions to the economic analysis of corruption, the literature has not yet isolated and empirically tested the main legal, organizational, and economic causes of corruption within specific public sector institutions.

This piece advances a review of the causes of corruption within the judiciary in developing countries. Corruption within the judiciary (e.g. paying a bribe to win a case) has a profound impact on the average citizen's perception of social equity and on economic efficiency (Buscaglia 1997). The individuals' judgment of how equitable the social environment is must be incorporated into the long term impact of corruption on efficiency. Second, a scientific approach to the study of corruption must be empirically verifiable if we are to develop reliable public policy prescriptions in the fight against official corruption (a review of the latest findings in this area follows). Third, the economic theory of corruption should recognize that official corruption is a significant source of foot-dragging or institutional inertia in public sector and market reforms in developing

countries. An account of the private costs and benefits of state reforms as perceived by public officials must also be considered in these cases.

1. The Main Causes of Corruption within the Judiciaries in Developing Countries.

A scientific approach to the analysis of corruption is a necessary requirement in the fight against any social ill. Corruption is no exception. Systemic corruption deals with the use of public office for private benefit that is entrenched in such a way that, without it, an organization or institution cannot function as a supplier of a good or service. The probability of detecting corruption decreases as corruption becomes more systemic. Therefore, as corruption becomes more systemic, enforcement measures of the traditional kind affecting the expected punishment of committing illicit acts become less effective and other preventive measures such as organizational changes (e.g reducing procedural complexities in the provision of public services), salary increases, and other measures become much more effective. The growth and decline of systemic corruption

is also subject to laws of human behavior. We must better define those laws before implementing public policy. For this purpose we must:

- (i) formulate a policy claim (e.g. administrations with high concentrations of organizational power in the hands of fewer public officials with no external auditing systems are prone to corrupt behavior)
- (ii) formulate a logical explanation of why higher concentrations of organizational power and corrupt behavior go hand in hand
- (iii) gather information to support or disprove the claim
- (iv) and finally, design public policies based on the findings

In this context, in order to design public policies in the fight against corruption, it is necessary to build a data base with quantitative and qualitative information related to all the factors that are thought to be related to certain types of systemic corrupt behavior (embezzlement, bribery, extortion, fraud, and other types). For example, the World Bank is currently assembling a data base of judicial systems worldwide (Buscaglia and Dakolias, 1999). This data base covers those factors associated to relative successes in the fight for an efficient judiciary.

International experience shows that specific policy actions are associated with the reduction in the perceived corruption in countries ranging from Uganda to Singapore, to Hong Kong, to Chile. These actions include: lowering tariffs and other trade barriers; unifying market exchange and interest rates; eliminating enterprise subsidies; minimizing enterprise regulation, licensing requirements, and other barriers to market entry; privatizing while demonopolizing government assets; enhancing transparency in the enforcement of banking, auditing, and accounting standards; and improving tax and budget administration. Other Institutional reforms hampering corrupt practices include civil service reform, legal and judicial reforms, the strengthening and expansion of civil and political liberties. Finally, we can also mention organizational reforms such as improving administrative procedures based on avoiding discretionary decision making, duplication of functions, while introducing performance standards for all employees (time and production related); determining salaries based on performance standards; reducing the degree of organizational power of each individual in an organization; reducing

procedural complexity; and making norms, internal rules, and laws well known among officials and users.

Sequencing in the Design of Anti-Corruption Policies

The following steps are recommended in the design of anti-corruption policies:

- (i) we first need to perform a diagnostic analysis within a country identifying, within a priority list, the main institutional areas where systemic corruption arises. This identification must be conducted through surveys of users of government services , businesses, or tax payers. The survey should be applied to each government institution (e.g. customs, judiciary, tax agencies, and others).
- (ii) Once a priority list of areas subject to systemic corruption is derived, we next need to develop a data base for each of these institutions containing objective and subjective measures of corruption (e.g. reports of corruption, indictments related to fraud-embezzlement, extortion, or bribery in that agency, prices charged by the agency) and of other variables

that are thought to explain corruption. Among the factors explaining corruption we could gather information on procedural times in the provision of government services, users' perceptions of efficiency, effectiveness, corruption, and access related to that agency, procedural complexity in the provision of services, etc.;

- (iii) Given the above data base, it is also necessary to conduct statistical analysis with a clear identification of the factors causing corruption in a specific government agency. Here we would identify if any of the economic, institutional, and organizational factors mentioned above are related to corruption.
- (iv) Once this diagnostic and identification stages are complete, civil society should get involved in the implementation and monitoring of the anti-corruption policies. The action plan should be developed through consensus between civil society and government and contain problems, solutions, deadlines for

implementation of solutions, and expected results.

This approach has been applied at the judicial and municipal levels in many countries with significant results (Buscaglia and Dakolias, 1999). In these cases, the following steps were followed: first, a survey was conducted of those users applying for specific permits from their local government (county office) in Venezuela. These users were interviewed just after finishing the application procedure and were asked to rank the efficiency, effectiveness, level of access, quality of the information received, and corruption in the administrative procedure used to obtain construction and industrial license permits; next, numerical and qualitative data were gathered in order to identify those variables affecting the public's responses to the survey by applying statistical analysis. The results of this diagnostic study were then shared with representatives of civil society and local government at a workshop. In this workshop, representatives of civil society and local government could agree or disagree with the results.

Once civil society and government agree on the nature of the problems, a technical empirical study conducted by the interdisciplinary team focused on how to reduce corruption and increase efficiency in those areas (e.g. issue of permits) covered by the diagnostic study. This technical study identifying the mechanisms to reduce corruption and increase efficiency/effectiveness were later discussed, understood, and accepted by members of civil society and local government. Here, civil society is able to devise mechanisms for monitoring the implementation of reforms with implementation deadlines included. It is noteworthy that the results of implementing these reforms must be measured months after the implementation stage has been completed through another survey of users applying for those same type of permits. The actual results were then compared with the expected results previously defined as goals by civil society groups. These experiences show that it is clear that the implementation of any anti corruption campaign should be based on sound multidisciplinary scientific principles applied by researchers

practitioners and civil society. Only a multidisciplinary approach specifying methodology, data, a scientific analysis of what works and what does not work, and finally, a well specified sequencing of policy steps mentioned here would help to establish a solid policy consensus in the fight against systemic corruption.

Scholars have already recognized the advantages of going beyond the analysis of the impacts of corruption on economic growth and investment and some have stated the urgent need to isolate the structural features that create corrupt incentives (Rose-Ackerman, 1997). But, only general situations within which corruption may arise have been identified in the literature. These situations are neither overlapping nor exhaustive. A rigorous analysis, however, of the corruption-enhancing factors within the courts are all left unexplored in the literature. The need to develop an empirically-testable anti-corruption policy in the courts is a necessary if we are to incorporate the study of corruption into the mainstream of social science.

The empirical frameworks first introduced by Buscaglia (1997) to Ecuador and Venezuela and by Buscaglia and Dakolias (1999) to Ecuador and Chile explain the yearly changes in the reports of corruption within the first instance courts dealing with commercial cases. This work shows that specific organizational structures and behavioral patterns within the courts in developing countries make them prone to the uncontrollable spread of systemic corrupt practices. For example, their work finds that the typical Latin American court provides internal organizational incentives towards corruption. A legal and economic analysis of corruption should be able to detect why the use of public office for private benefit becomes the norm. In theory, most developing countries possess a criminal code punishing corrupt practices and external auditing systems within the courts for monitoring case and cash flows. However, even if they function properly, these two mechanisms would not be enough to counter the presence of systemic corruption in the application of the law. Other dimensions need to be addressed. Specific

and identifiable patterns in the administrative organization of the courts coupled with a tremendous degree of legal discretion and procedural complexities, allow judges and court personnel to extract additional illicit fees for services rendered. Buscaglia (1998) also finds that these characteristics fostering corrupt practices are compounded by the lack alternative mechanisms to resolve disputes thus giving the official court system a virtual monopoly. More specifically, according to Buscaglia (1998) and Buscaglia and Dakolias (1999), corrupt practices are enhanced by: **(i)** a higher concentration of internal organizational roles concentrated in the hands of fewer decision makers within the court (e.g. judges concentrating a larger number of administrative and jurisdictional roles within their domain); **(ii)** the added number and complexity of the procedural steps coupled with a lack of procedural transparency followed within the courts;

(iii) the greater uncertainty related to the prevailing doctrines, laws, and regulations (e.g. increasing inconsistencies found in the application of the

jurisprudence by the courts due to, among other factors, the lack of a legal data base and defective information systems within the courts); **(iv)** fewer alternative sources of dispute resolution; and, finally, **(v)** the presence of organized crime groups (e.g. drug cartels), that according to Gambetta (1993), demand corrupt practices from government officials. These four factors associated with corrupt practices provide a clear guideline for public policy making. Developing countries such as Chile and Uganda that have enacted a simpler procedural code while introducing alternative dispute resolutions have at the same time witnessed a reduction in the reports of court-related corruption. Moreover, the different success stories of Singapore and Costa Rica also show that corruption has been reduced by creating specialized administrative offices supporting the courts in matters related to court notifications, budget and personnel management, cash and case flows. These administrative support offices that were shared by many courts have decentralized administrative decision-making while reducing the previously high and unmonitored

concentration of organizational tasks in the hands of judges (Buscaglia, 1998).

3. Corruption and its Long Term Impact on Efficiency and Equity.

Some scholars have observed that official corruption generates immediate positive results for the individual citizen or organization who is *willing and able* to pay the bribe (Rosenn, 1984). For example, Rose-Ackerman (1997) accepts that "payoffs to those who manage queues can be efficient since they give officials incentives both to work quickly and favor those who value their time highly." She further states that in some restricted cases, widely accepted illegal payoffs need to be legalized (Rose Ackerman 1997). This statement, however, disregards the effects that present entrenched corruption has on people's perception of social equity and on long term efficiency. The widespread effects of corruption on the overall social system always have a pernicious effect on efficiency in the long run. In order to understand this effect, an economic theory of ethics urgently

needs to be applied to the understanding of the long term effects of corruption on efficiency.

The average individual's perception of how equitable a social system is has a pronounced effect on his incentives to engage in productive activities (Buscaglia 1997). The literature has delved into many of the negative impacts that corruption has on the efficient allocation of resources. Yet, previous work does not pay attention to the effects that corruption has on the individual's perception of how equitable a social system is.

First, in all developing countries, a vast majority of the population is not able to offer illicit payoffs to government officials, even when they are willing to do so (Buscaglia 1997) and, second, the hope to legalize illicit payoffs may have no impact on social behavior in societies where most social interactions are not ruled by modern laws but by multiple layers of customary and religious codes of behavior.

A significant impact of corruption on future efficiency is channeled through the effect that official corrupt practices have on the average

citizen's perception of social equity. Homans (1974) shows that in any human group, the relative status given to any member is determined by the "group's perception" of the member's contribution to the relevant social domain. Homans further states that changes in the relative wealth-related status of an individual member without a perceived change in his social contribution will face open hostility by the other members of society (e.g. envy may generate retaliation and destruction of social wealth). Therefore, within Homans' view, in cases of corrupt practices, a "socially unjustified" increase in the wealth-related status of those who offer and accept bribes represents a violation of the average citizen's notion of what constitutes an "equitable hierarchy" of statuses within society.

Homans' theory of ethics can be applied to the understanding of the effects of official systemic corruption on efficiency over time. Those members of society who are neither able nor willing to supply illicit incentives will be excluded from the provision of any "public good" (e.g., court services). In this case, even though corruption may

remove red tape for those who are able and willing to pay the bribe, the provision of public services becomes inequitable in the perception of all of those who are excluded from the system due to their inability or unwillingness to become part of a corrupt transaction. This sense of inequity has a long term effect on social interaction. Systemic official corruption promotes an inequitable social system where the allocation of resources is perceived to be weakly correlated to generally accepted rights and obligations. Buscaglia (1997) shows that a "perceived" inequitable allocation of resources hampers the incentives to generate wealth by those who are excluded from the provision of basic public goods. The average citizen, who cannot receive a public service due to his inability to pay the illegal fee, ceases to demand the public good from the official system (Buscaglia, 1997). In many occasions, the higher price imposed by corrupt activities within the public sector force citizens to seek alternative community-based mechanisms to obtain the public service (e.g. alternative dispute resolution mechanisms such as

neighborhood councils). These community-based alternative private mechanisms, however, do not have the capacity to generate precedents in certain legal disputes affecting all society (e.g. human rights violations or constitutional issues) as the state's court system does. Hernando de Soto's account of these community-based institutions in Peru attest to the loss in a country's production capabilities due to the high transaction costs of access to public services (de Soto 1989).

One may initially think that, by eliminating bureaucratic red-tape, the payment of a bribe can also enhance economic efficiency. However, this is a fallacy because corruption may benefit the individual who is *able and willing* to supply the bribe. However, as described above, the social environment is negatively affected by a diminishing economic productivity over time caused by the general perception that the allocation of resources is determined more by corrupt practices and less by productivity, and therefore, is inherently inequitable. This creates an environment where individuals, in order to obtain public

services, may need to start seeking illicit transfers of wealth to the increasing exclusion of productive activities. In this respect, present corruption decreases future productivity, thereby reducing efficiency over time.

4• Corruption and Institutional Inertia

Whenever designing anti-corruption policies within the legal and judicial domains, we must take into account not only the costs and benefits to society of eradicating corruption in general, but also the changes in present and future individual benefits and costs as perceived by public officials whose illicit rents will tend to diminish due to anticorruption public policies. Previous studies argue that institutional inertia in enacting reforms stems from the long term nature of the benefits of reform in the reformers' mind, such as enhanced job opportunities and professional prestige (Buscaglia, Dakolias, and Ratliff 1995). These benefits cannot be directly captured in the short term by potential reformers within the government. Contrast the long term nature of these benefits with the short term nature of the main costs of reform,

notably a perceived decrease in the state officials' illicit income. This asymmetry between short term costs and long term benefits tends to block policy initiatives related to public sector reforms. Reform sequencing, then, must ensure that short term benefits compensate for loss of rents faced by public officers responsible for implementing the changes. In turn, reform proposals generating longer term benefits to the members of the court systems need to be implemented in later stages of the reform process (Buscaglia, Ratliff, and Dakolias 1996).

For example, previous studies of judicial reforms in Latin America argue that the institutional inertia in enacting reform stems from the long term nature of the benefits of reform, such as increasing job stability, judicial independence, and professional prestige. Contrast the long term nature of these benefits with the short term nature of the main costs of judicial reform to reformers (e.g. explicit payoffs and other informal inducements provided to court officers). This contrast between short term costs and long term

benefits has proven to block judicial reforms and explains why court reforms, which eventually would benefit most segments of society, are often resisted and delayed (Buscaglia, Dakolias, and Ratliff 1995). In this context, court reforms promoting uniformity, transparency, and accountability in the process of enforcing laws, would necessarily diminish the court-personnel's capacity to seek extra-income through bribes. Reform sequencing, then, must ensure that short term benefits to reformers compensate for loss of illicit rents previously received by court officers responsible for implementing the changes. That is, initial reforms should focus on the public officials' short term benefits. In turn, court reform proposals generating longer term benefits need to be implemented in later stages of the reform process.

Additional forces also enhance the anti-corruption initiative. We usually observe that periods of institutional crisis come hand-in-hand with a general consensus among public officials to reform the public sector. For example, within the judiciary, a public sector crisis begins at the point

where backlogs, delays, and payoffs increase the public's cost of accessing the system. When costs become too high, people restrict their demand for court services to the point where the capacity of judges and court personnel to justify their positions and to extract illicit payments from the public will diminish. At that point court officials increasingly embrace reforms in order to keep their jobs in the midst of public outcry (Buscaglia, Dakolias, and Ratliff, p. 35). At this point, the public agency would more likely be willing to conduct deeper reforms during a crisis as long as reform proposals contain sources of short term benefits, such as higher salaries, institutional independence, and increased budgets. It comes as no surprise, then, that those developing countries undertaking judicial reforms have all experienced a deep crisis in their court system. For example, important judicial reforms implemented in Costa Rica, Chile, Ecuador, Hungary, and Singapore make our point (Buscaglia and Dakolias, 1999). In each of these five cases, additional short term benefits guaranteed the political support of key magistrates who were

willing to discuss judicial reform proposals only after a deep crisis threatened their jobs (Buscaglia and Ratliff, 1997). These benefits included generous early retirement packages, promotions for judges and support staff, new buildings, and expanded budgets.

Nevertheless, to ensure lasting anti-corruption reforms, short term benefits must be channeled through permanent institutional mechanisms capable of sustaining reform. The best institutional scenario is one in which public sector reforms are the by-product of a consensus involving the legislatures, the judiciary, bar associations, and civil society. We need to keep in mind, however, that legislatures are sometimes opposed to restructuring the organization of the courts in particular and other public institutions in general from which many of the members of the legislature also extract illicit rents.

This paper has provided a review of the most recent literature related to the economic causes of entrenched corruption within the public sector in general and particularly within the court systems in

developing countries. This study stresses the need to develop scientific explanations of corruption containing objective and well-defined indicators of corrupt activities. Along these lines, this paper proposes that the joint effects of organizational, procedural, legal, and economic variables are able to significantly explain the occurrence of corruption within the courts in developing countries.

Additionally, this paper describes how equity considerations by individuals have an impact on long term efficiency. Previous work of social psychologists could shed more light in future studies linking the impact of corruption on equity and efficiency.

Finally, in order to understand and neutralize institutional inertia during anti-corruption reforms, all future studies must incorporate the identification of those costs and benefits that are relevant to those who reform public sector institutions and are responsible for implementing new anti-corruption policies.

The main question then to be asked in the development of any anti-corruption public policy

approach is the following: how to generate public policies based on sound and scientific principles that at the same time can be accepted and adopted by civil society and the public sector alike?. The answer to this question is a necessary condition to develop a still absent international public policy consensus in the fight against corruption.

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