

Corruption, Collusion & Development

What we've learned from
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by

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Introduction

- Infrastructure has positive impact on Growth & Poverty Reduction. Though transmission channels not fully elucidated yet the marginal impact is greater in LDCs
- A higher access price, however, mitigates this effect
- The obvious inefficiency of infrastructure in LDCs, to which corruption purportedly highly participated led to a surge of privatization considered a “silver bullet”
- However, problems remain with corruption still on top. The need for regulation is fully recognized
- Transplantation of regulation models from developed countries “almost” doomed to fail
- Jean Jacques Laffont’s outstanding and pioneering contribution that recognizes the need to account for LDCs specificities is reviewed here with a focus on corruption

Regulating Perfect Vs. Real Worlds

- Perfect Information
- Benevolent Social Planners
- Benevolent Regulator
- Contractibility & Verifiability
- Costless Enforcement
- First-Best Welfare Achievement
- Asymmetric Information
- Government's Private Agenda
- Corruptible Regulator
- Incomplete Contracts
- Costly Enforcement
- Rent Extraction – Efficiency Trade-off
- Second-Best Welfare

Developing Economies World

- Exacerbated imperfections of others, and...
- Weak institutions, lack of checks and balances, weak commitment power, lead to reduced level of trust and a higher probability for ratchet effect
- High Marginal Cost of Public Funds that makes rents paid for by tax money very costly
- Low enforcement capabilities
- High corruption levels
- Higher infrastructure needs in poor rural areas

Regulation under Corruption

- Corruption can arise at all levels in the hierarchy
 - Government can pursue its private agenda
 - Regulator and independent auditor prone to capture may hide relevant information to the planner
- Outside the hierarchy lobby groups also may have an interest to capture the regulator
- Corruption takes different forms: bribery, theft, cost padding, political interference, etc...
- Impact on service quantity, quality, access prices and availability
- Impact also on optimal decentralization degree

Regulation under Corruption (cont...)

- General Result: Corruption is harmful for infrastructure development because increases costly rents to be paid for and induces new distortions
 - Reduces stock of infrastructure stock, area coverage, increases access price. Corruption thus tends to reduce social welfare
- Guiding Principle: Incentive mechanisms that prevent corruption (are collusion proof) are optimal
 - Preventing collusion is, however, costly to society
- Under some conditions a positive level of corruption may be superior to a collusion-proof mechanism
 - different types of regulators
 - Incomplete contracts

Regulation under Corruption (cont...)

- Instruments at government's disposal to maximize objective function
 - Power of the incentive scheme
 - Competition (information reporting (separation of power), market structure, auditing technology, supervisor)
- Instruments may be substitutes or complements for costly rent extraction
- Impact of high propensity to corruption on optimal regulation depends on the cost of observability
 - Low powered incentives if costs perfectly observable
 - High powered incentives if costs observed with auditing
- What if the government itself is corrupt?

Regulation, Corruption, and Poverty Reduction

- USO is a powerful redistributive tool and entails choosing “the right” pricing policy.
- Serving the Universe under the threat of Corruption
 - Regulator may collude with monopoly and/or interest groups
 - More costly rents to be paid for information revelation
 - Low powered incentives scheme is optimal
 - Impact on prices, quantities, and network size in rural areas
- The threat of collusion impacts differently the optimal regulation depending on the pricing policy (price discrimination, uniform pricing) imposed by the government.

Conclusion

- We cannot conclude without paying tribute to JJL
- JJL perceived very early the importance of adapting the regulation framework to developing economies context, where a surge of privatization started, to avoid the ‘Transplant Effect’
- He understood better than and ahead of many if not all the importance to involve LDC’s researchers to have an impact
- JJL launched a big research program working closely with individual economists in LDCs (e.g. Cote d’Ivoire)
- He could not have lost sight of the institutional aspect and helped to lift up entire research departments and provide them with international exposure

Conclusion (cont...)

- Though his focus was on economic infrastructure, JJJ left us with a set of important tools that can help answer regulation problems in the “social” infrastructure too
- Note the parallel between the issue in telecom or health
 - Universal service: difficulties providing rural areas with adequate health services because it is costly to serve these areas
 - Incentive payments are an often proposed solution
- How to protect consumers from being captured by the provider for instance informal payment can be considered as cost padding