# Corruption Corrosive Effects (Distorting Markets)

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**Definition of terms**

OECD: Organization for Economic Co-operation and Development
IMF: International Monetary Fund
GDP: Gross domestic product
FDI: foreign direct investment
TI: Transparency International

## 1. Introduction

There is enormous amount of literature available on the corrosive effects of corruption distorting the markets. However, some researchers argue that corruption has positive effect on markets and hence deems to be necessary to “grease the wheels”. The purpose of this essay is to establish a counterargument and validate the negative impact of corruption on markets and economic growth.

Corruption in the markets has increased in the past few decades due to several factors including - but not limited to - globalization, establishment of overseas companies, cultural differences, and lack of governance in some countries. “Global Cost of Corruption is projected to be at least 5 Per Cent of World Gross Domestic Product” Secretary-General Tells Security Council, (World Economic Forum Data | Meetings Coverage and Press Releases, 2020). The cost of corruption is estimated in trillions every year and although corruption has corrosive effects on markets globally, but its biggest impact is in developing countries. ($1.26 trillion every year is the corruption costs in developing countries). Transparency International assesses that one of every four individuals overall have offered a bribe in 2009. Apparently, the complete number of bribes is increasing annually. The World Economic Forum stated that the cost of corruption in 2011 is more than five percent of worldwide GDP (US$2.6 trillion) with over $1 trillion worth of bribes every year (Ethical Challenges in the Global Environment | Introduction to Business, 2020). Corruption is becoming more of a phenomenon than a one-off problem. International bodies took several measures to minimize the distorting effect of corruption on markets. Yet, numbers are increasing in some markets. Because of these worries, organizations such as the World Bank, the OECD and the IMF are becoming more engaged in designing and implementing systems of financial governance whose main purpose is introducing more control and strength to markets. Enhancing controls and having robust systems shall minimize the risk and vulnerability faced by global capital as it goes into external markets (WILLIAMS & BEARE, 1999).

There are various types of Corruptions. Bribery is the most common and one of the most destructive types of corruption specifically distorting markets and this is our focus area in this essay. Nevertheless, corruption might take different shapes - including but not limited to- favouritism and misuse of power. In addition to bribery, corruption is committed through different means like embezzlement and extortion (The Effects of Corruption on Business, 2020).

In this essay, we'll firstly talk about historical background of corruption emerging to markets and how factors like overseas companies and the absence of robust governance helped in the spread of corruption. Secondly, we'll talk about corruption corrosive effects on markets with some real examples and numbers. Thirdly, we'll address an ongoing argument on whether corruption always have negative impact on markets, or it sometimes helps to "grease the wheels".

## 2. Historical Background

Although corruption flourished in the past few decades, but it's an old problem that was mentioned in several old civilization. The leader of the early Lagash, the Babylonian state (c. 2400 B.C.) started a complete set of governmental and legislative reforms to reduce what can be nowadays called "official corruption" (Rose, 2017). As this essay mainly talks about the corrosive effect of corruption in distorting markets, it's believed that although corruption existed for thousands of years, but its big impact on markets increased after the expansion of overseas companies in the last few decades. The expanding number of overseas companies and international business exchanges has connected countries as well as societies with totally different perceptions and understandings for bribery. Overseas companies have regularly provided bribes to get business in unfair way to their competitors in the same market. Bribes paid by these companies to executive people also resulted in considerable reduction in taxes, importing custom duties and sometimes it went beyond that to favourable law interpretation in the targeted market countries (Baughn, Bodie, Buchanan and Bixby, 2020).

## 3. Reasons for Corruption Spread

Absence of good governance, transparency and anti-corruption practices are main factors for corruption spread in markets. Corporate governance and clear tables of financial authorities are essential in public as well as private sectors as there is a clear link between poor governance and the spread of corruption. Countries which have robust governance like Switzerland and Sweden are seen to be less tending to offer bribes in international business (Baughn, Bodie, Buchanan and Bixby, 2020). If countries want to develop and maintain confidence in their markets, then the authorities should adopt robust governance, avail spending plans to stakeholders equally and give equivalent opportunities to all players without preference to some players over the others. These measures are extremely important not only to maintain confidence in the markets but also to lay the foundation for economic growth (WILLIAMS & BEARE, 1999). History and social standards are also amongst factors that make bribe taking and or bribe giving acceptable in some countries while they are intolerable in others (Goel and Nelson, 2020).

### 4. Corruption Corrosive Effects on Markets

After discussing the historic background of corruption emerging to business and the reasons that helped in spreading corruption, we'll discuss how corruption distorts markets. Scholars show that corruption has negative impact on markets beyond overpricing and low value for public money. Corruption discourages investors from reaching out to markets. It also impacts economic growth by distorting markets. Research show that corruption prevent investments from accessing markets thus affect economic growth. They also suggest that corruption reduces private as well as corporate investments, this negatively impacts economic growth. Statistics show that corruption leads to ineffective investments especially in public projects (Huang, 2020). Corruption damaging effects on markets includes lower tax revenues, lower public spend on education and health and poor public infrastructure. Researchers found that corruption also reduces Foreign Direct Investment (FDI). Corruption is likewise seen to increase investment costs. Researchers suggested that corruption hinders sustainable development. Data show that corruption constantly associated with lower market growth, GDP and business equality. Scholars argue that corruption favors well-connected and wealthy people thus deters market growth. They also suggest that investment to GDP ratio reduces as a result of corruption. Economists found several ways through which corruption affect markets and economic growth. This includes increasing production cost, reducing investment profitability, fluctuating market incentives and reducing market efficiencies (Transparency International, 2020).

Corruption leads to unequal opportunities which shall result in favouring specific class of people over others. Unequal opportunities shall also result in frustration to the disadvantaged people and costs market considerable amount of investment and job opportunities. Corruption also hinders productivity. Scholars found that each corruption increment by 1% decreases the market growth by 0.7%. Research showed substantial negative impact of corruption to the market investments and GDP and in addition to the short-term effect of corruption in markets, it's apparent that corruption decreases investments in production and manufacturing activities. The assumption is that if the return of investment in production and manufacturing activities is less than the return of corrupted activities, then capital will turn to the bigger return which is corruption in this case (Mo, 2020).

To have a real-world examples of corruption effect on markets, we'll mention three of the biggest corruption scandals and their corrosive effects on markets. In the following scandals, market corruption sometimes overlapped with political corruption and misuse of power.

In 2006, Siemens was taking corporate corruption to another level. For more than 10 years, it offered bribery to governmental authorities and employees around the globe, adding up to roughly US$1.4 billion. While corrupted leaders benefitted, markets where they functioned in was distorted and people paid the expenses of overrated necessities, for example, streets and power plants. The organization's corrupted acts were caught in some countries like the United States and Germany, which at last made sure about a notable sanction of US $1.6 billion.

Tunisia suffered corruption that negatively affected its markets. This was during the presidency of the ex-president Ben Ali who gave unfair privilege to his family in the local market. During his presidency period, Ben Ali made laws that oblige companies to obtain permissions to enter Tunisian market in specific sectors. This was against the fair market competition and ended up letting his family benefit from more than 200 companies in a monopolized way. This included important sectors like transportation, real estate business and telecommunication. These companies formed 3% of Tunisia's GDP, however, took almost 21% of the private sector revenue. From the aforementioned numbers and percentages, we can envision the price paid by Tunisian local market and citizens in terms of lost opportunities.

In Malaysia in 2009, the government established a development fund, and the main aim of this fund was to develop the market and support economic growth. The fund was chaired by the previous Prime Minister (PM) of Malaysia Najeeb Razak. But unfortunately, this fund was used for the private benefit of the PM and other people inside and outside Malaysia. The lost opportunity to the Malaysian market was estimated at 700 million US dollars and this unfortunately went to the private pockets of some people in power including the PM himself (25 corruption scandals that shook the world - News, 2020).

### 5. Argument is Corruption Always Bad!

After discussing and giving real examples of corruption effect on markets and subsequently growth, it’s worth mentioning that some companies believe that bribes can secure considerable amount of business or at least retain their market share. Some scholars agree with this idea. Others debate this and suggest that companies committing bribery harm themselves and the markets that they work in on the long-term although it might have what they perceive as a short-term win. There is literature available on the positive impact of corruption in markets. This positive relationship was evidenced in countries like Bangladesh and South Korea. Researchers suggested that corruption in some cases enhances the efficiency in governmental ministries and agencies, thus allows for smooth business transactions in specific markets.

Researchers argue that under particular conditions, companies or individuals bribes to officials and decision makers protected them from unfavourable conditions mandated by local laws and legislation. This in turn supported markets to flourish and economy to grow (Huang, 2020).

## 6. Conclusion

A valuable conclusion that has arisen from this discussion and the ongoing debate and counter views about corruption effects on markets is that corruption is one of the biggest factors that distort markets. Figures and facts show the significant negative impact that corruption has on markets. Although some scholars argue that corruption and specifically bribes sometimes “grease the wheels” but there is a lack of accurate data and numbers of this positive impact or at least they are insignificant to the losses. On the other hand, trillions of dollars and considerable percentage up to 5% of the market value is lost due to corruption. Another fact is that companies committed corruption or persecuted in corruption scandals lost reputation which in many cases are more valuable than the business gained by committing corruption. It’s very difficult to recover and rebuild the brand name after such scandals. Literature showed that corruption clearly distorts markets and negatively impacts companies functioning in these markets. This subsequently effect the economic growth of markets and countries. Scholar finds negative correlation between bribes and markets growth. Scholars argue that the negative impact of corruption is greater than taxation on companies’ growth. Generally, there is an enormous amount of evidence showing that whereas corruption may assist to cut the cost associated with administrative requirements in certain settings temporarily, it has corrosive effects on the long run on both companies as well as markets. This ultimately disintegrate the proficiency and legitimacy of state foundations, and at last disrupt sustainable development. Researchers argue that corruption indicators failed to produce a powerful proof of the “greasing” impact of corruption in markets. Literature argues that tax to GDP ratio reduces because of corruption. Corruption also has a long-term negative impact on markets and economies through changing tax structure and encouraging underground economy. Corruption is likely weakened governance and legislation through incentivizing decision makers (Transparency International, 2020).

## 7. References


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