



FT WEEKEND MAGAZINE - The Undercover Economist

**If the price is right Theft and corruption can be thwarted, it's just a matter of appropriate incentives.**

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If you want to be rich, you can try to set up a brilliantly successful company. Or you can steal money. Transparency International, the corruption watchdog, has estimated that Mohamed Suharto embezzled up to Dollars 35bn when he was Indonesia's president, a figure that is in the same league as the entrepreneurial fortunes of Bill Gates and Warren Buffett. On a humbler scale, we all face the same choice. We can try to earn money by doing something useful, or we can try to steal or extort it from other people. A society where most people are doing something useful has a good chance of being rich; a society full of corruption will be poor.

That is a glib enough explanation of wealth and poverty, but what causes corruption? Many economists believe that corruption is a response to perverse incentives. For example, in Indonesia it takes an average of 151 days to legally establish a small business, according to the World Bank's "Doing Business" database. This is a large incentive to pay bribes or keep a business unregistered. It is not surprising that there is a strong correlation between red tape and corruption. In general, the harder it is to make money legally the more tempting it will be to do so illegally, and if people are not punished for stealing they will be more likely to steal.

The view that incentives are paramount suggests that if you take a person from a poor, corrupt economy and move him to a richer, less corrupt economy, he will live up to the new system. William Lewis, founding director of the McKinsey Global Institute, points out that illiterate Mexican workers on building sites in Houston are as productive as any construction worker. The Mexicans are perfectly capable of living up to the potential of the American system.

An alternative view, popular among the common-sense crowd, is that corruption is a problem in Indonesia because Indonesians are crooks by nature; poor countries are poor because they are full of people who are lazy or stupid or dishonest. I disagree out of faith, rather than because the evidence is compelling. But then, what evidence could there be? You would need to take people from every culture, put them somewhere where they could ignore the law with impunity, and see who cheated and who was honest.

That sounds like a tall order for any research strategy, but the economists Ray Fisman and Edward Miguel have realised that diplomats in New York city were, in fact, the perfect guinea pigs. Diplomatic immunity meant that parking tickets issued to diplomats could not be enforced, and so parking legally was essentially a matter of personal ethics.

Fisman and Miguel found support for the common-sense view. Countries with corrupt systems, as measured by Transparency International, also sent diplomats who parked illegally. From 1997- 2005, the Scandinavians committed only 12 unpaid parking violations, and most of them were by a single criminal mastermind from Finland. Chad and Bangladesh, regularly at the top of corruption tables, produced more than 2,500 violations between them. Perhaps poor countries are poor because they are full of corrupt people, after all.

It's a very clever piece of work, but I will not be abandoning my faith in economic incentives just yet. In 2002, New York city was given much greater power to punish deadbeat diplomats: cars were towed, permits suspended, and fines collected from the relevant foreign aid budget. Unpaid violations immediately fell 90 per cent. When it comes to parking violations, personal morality matters, but incentives matter more.

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