HOW CORRUPTION AFFECTS SOCIAL EXPENDITURES: EVIDENCE FROM RUSSIA

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ABSTRACT

This paper clarifies the main theoretical issues of corruption. An estimate and branch analysis of corruption in Russia is offered. The research concentrates on effects produced by corruption on social expenditures. The analysis demonstrates how corruption influences the poverty situation after social transfers and on the general efficiency of social payments. Using the European Commission method and a corrected method, indicators of efficiency of social spending are calculated for Russia. Also, the existence of correlation between efficiency of social spending and corruption perception index calculated by Transparency International Agency is estimated for European Union countries and Russia. A few policy recommendations aimed at controlling corruption in modern Russia and optimization of public expenditures are offered.

INTRODUCTION

Corruption has been an issue for humanity since ancient times and became a global problem in the beginning of 20th century. Bribes were, are, and will be taken. Research conducted by the Institute of the World Bank show that around $1US trillion is annually paid all over the world. This figure is constantly increasing and demonstrates that corruption is widespread. This paper focuses on the effects of corruption on social expenditures. It is hypothesized that corruption decreases the efficiency of government social expenditures aimed at poverty reduction and results in general economic inefficiency.

As social expenditures are aimed mainly at the poor, the question of how corruption affects the poor is of great interest. Corruption slows the rate of economic growth and increases the gap between the rich and poor. It also skews the incentive structure, with adverse consequences on the poor by depriving them of income-generation opportunities or favoring capital-intensive projects, as opposed to labor-intensive projects for which bribery is not so profitable. Finally, corruption can affect the targeting of social programs to the truly needy because funds are siphoned off from poverty programs by well-connected people in the public and private sectors.

With regard to social expenditures efficiency, research has shown that, for the same level of spending and for a given budgetary function, public spending is less efficient in countries with high levels of corruption: Corrupt public agents tend to favor investment projects that generate the highest bribes and not necessarily the most efficient (Shleifer & Vishny, 1993). Corruption diminishes the impact of public spending on social outcomes and alters the quality of public services.

The major impact of this paper is to expand knowledge about specific features of corruption in Russia. Even though reasons and consequences might appear similar to other countries, the scales and portions of corrupted spheres differ greatly. Previous analyses on this topic have identified that corruption introduces distortions into social expenditure levels and efficiency of measures aimed at poverty reduction. None of these previous studies, however, have taken Russia into consideration. Using research of Herrmann et. al. (2008), the recent Transparency International Agency's Report (2010), and Russian Federal Statistics Department data on national budgetary accounts, this article attempts to answer the following questions:

Does corruption affect efficiency of social expenditures in the European Union and in Russia. If yes, to what extent?

The paper consists of six sections: an introduction, followed by the literature review, which clarifies main theoretical issues of corruption study (e.g., definition, reasons, and consequences of corruption). Next, background on corruption in Russia is analyzed: Statistical methods are used to examine the correlation between corruption and social spending efficiency. Recommendations for improvement and concluding comments close the paper.

LITERATURE REVIEW

There is no conventional definition of corruption, mainly because of significant cultural differentiation. For instance, something that is called a bribe in one society, in other one may be allowed and expected. Corruption means actions that lead to infringement of rights and freedoms equity. Experts from the Europe Council have created a general definition of corruption: graft, bribery, and any other kind of behavior of a person, endowed responsibilities in public or private sector, who infringes his duties as a public person, employee, independent agent or other same status, aimed at obtaining incompetent advantages of any kind for themselves of another person" (Some Aspects, 2000).

Existence of public property presupposes that some people will realize their own interests from participation in a state organization by trying to maximize their use of opportunities. In modern research, this kind of behaviour is connected with opportunism and examined as a form of corruption. This phenomenon is common for states and has been known for some time. Public property in the form of state property sometimes is not used in the interests of society but in the interest of private persons. A contradiction between public and private interests is not decided in society's favor. Hence it is impossible to attain the full potential realization of state property as a basis for the realization of public interests. Russia traditionally has a strong state institution. State power, which dominates social life, is connected with a complex of historical, geopolitical, economical, national, and social factors (Ryazanov, 1998).

The literature describes several types of corruption, including local, business, and supreme (Yani et. al., 2002). Local corruption is triggered by interaction of common citizens and officials on duty. This type of corruption includes gifts and services for the officials and/or their families and is often associated with nepotism. Business corruption arises during interaction between state powers and business society. Supreme corruption relates to higher political officials in democratic systems. It supposes dishonest behavior of politicians who are not in favor with the electorate. Supreme corruption is a type of behavior strategy used by powerful social groups and directed at economic seizure of state and power for further establishment of shadow control under markets and finance. People who make such seizures are usually called oligarchic.

Several types of corruption can be defined according to the chosen criterion, for instance, bureaucratic and political; forced and consensual; centralized and decentralized (Ozhiganov, 1999), criminal and mainly of economic character (Katayev & Serdyuk, 1995). Executive power is usually corrupted more than others because it conducts operative management of economic resources (Chetvericov, 2008). To sum up, corruption appears in multiple forms and involves either obtaining or giving up some advantages.

Theories of corruption broadly fall under two categories: demand theories and supply theories. In general, demand theory models of corruption include two approaches: resource-allocation models, which assess the consequences of the allocation of resources to bribe-seeking activities, and principal-agent relationship models (Jain, 1998). Resource-allocation models are based on the premise that bribe-seeking is one aspect of any economic activity and thus part of a firm's resources are devoted to this pursuit (Krueger, 1974). In a competitive world, bribe-seeking opportunities are created either by agents through

government policy or by underlying societal characteristics (Mauro, 1995). Bribes are shared between agents and firms.

Principal-agent models of corruption concern the misuse of power by a ruling government, which is motivated either by the desire to be re-elected or by self-interest. Economic policies motivated by self-interest lead to the misallocation of resources to the highest bribe-yielding projects (Jain, 1998). The second aspect of this model explains that bureaucratic corruption arises from an agent's incentive to disregard a principal's interest because of information asymmetry and the principal's inability to monitor the agent's behavior. Demand models clearly indicate that agent behavior is the central determinant of corruption and thus demand-model theorists have argued that anticorruption efforts should be aimed at controlling agent behavior.

Supply theorists put the onus of the fight against corruption on the supplier side. People pay bribes by their own volition and primarily for three reasons: to counterbalance poor quality or high pricing, to create a market for redundant goods, or to stay in competition (Stuart, 1997). On the basis of an empirical examination of the 19 largest exporting countries during 1992-1995, Lambsdorff (1998) observed that highly corrupted exporting countries attract a larger market share in corrupt importing countries. He concluded that the inclination to offer bribes therefore emerges as the sovereign choice of exporters.

More recent theories support a middle-of-the-road approach and have observed that corrupt behavior is characterized by the decision calculus of both the payee and the payer based on value maximization. Also, an experimental game has been developed to analyze corrupt behavior at the micro level (Abbinik et al., 2002). According to these researchers, the essential characteristics of corruption are reciprocity relations, as no corrupt contract can be legally enforceable, negative welfare effects, and sanctions when corrupt practices are discovered. Based on the authors' experiments using game theory, they conclude that reciprocity alone establishes stable relations between the payee and the payer and negative externalities such as welfare effects have no impact on the level of cooperation. Additionally, the threat of drastic penalties significantly reduces the level of reciprocal cooperation. However, the payer-payee pair has a tendency to underestimate the overall probability of sanctions, which diminishes the deterrence to some extent.

The main reasons for the existence of corruption are low incomes of the majority; opportunism of officials on duty; weakness of civil society and democratic tradition; and illiteracy of the majority. Social and economics situations are influenced greatly by corruption. First, an illegal economy grows and leads to decreases in tax inflows. Social guarantees become difficult obtain. Second, market mechanisms are broken, which decreases economic efficiency and discredits the market system at large. Third, public budget resources are used sometimes in the interests of small, powerful groups. Fourth, prices increase because of additional costs of corruption. As a result, consumers suffer. Fifth, property inequality and poverty are maintained. More, corruption whips up injustice and unjust redistribution of facilities in favor of oligarchic groups. Sixth, rights as the main instruments of civil regulation are discredited. Consequently, the public consciousness forms impressions about the defenselessness of households and entrepreneurs before harassment of bureaucracy. Seventh, police corruption stimulates development of organized crime, which merges with bureaucracy.

A wide range of negative economic consequences follow corruption. Corruption in public sector leads to decisions that may not meet public interests and therefore reduces efficiency in society. Corruption may also increase transaction costs for individuals and firms in their interactions with public sector bureaucracy. This may result in higher public spending and changes to the structure of that spending (e.g., in favoring public investment or procurement). Corruption in public procurement also may increase prices (i.e., taxpayers receive less for their money). This type of corruption also increases investment risk in the country, as it raises question about the rule of law. In a corrupt environment, people lose trust in public

institutions. Corruption can create a perverse incentive structure that provides incorrect signals with asymmetric information. Corruption introduces inequality among individuals, favors those who are able to bribe; redistributes resources to those who have decision-making power over valued resources and are willing to use it in somebody's favor. Corruption distorts the role of the government in the area of contract enforcement and protection of property rights. Corruption may reduce the trust of citizens in democracy and market economy (Tanzi, 1999).

Intervention of the state in the economy has three main roles: (1) the allocation of funds consists of corrections to the weaknesses of the market, such as imperfect information and competition or limited rationality that leads to wrong allocation of the resources and are obstacles to development; (2) the state has to act on the stabilization of economic activity and the redistribution of wealth, and (3) the state makes a certain amount of goods and public services available for everyone. However, the different forms of corruption in civil service prevent the state from fulfilling wholly its roles insofar as they give way to distortions in public decision-making (Delavallade, 2006).

The International Monetary Fund's (IMF's) studies (Gupta et. al., 1998) of cross-country regressions showed considerable impact of corruption. A worsening of the corruption perception index (CPI) by 2.5 points (on a scale of 1 to 10) is associated with an increase in inequality equivalent to the reduction of education at the secondary level by three years, which is indeed a large effect. A 1% increase in the rate of corruption reduces the income growth of the poorest (bottom 20%) by almost 8% per annum.

The corruption level of a country in general is a reliable indicator of the quality of its institutions. Recent research work aimed at pointing out priority fields in combating corruption have emphasized the need to control the transparency of rules and regulations about public decisions so as to limit the discretionary power and domain of civil servants. These studies also have discussed the role of incentives such as higher salaries and penalties for corruption in lowering such types of behavior (Tanzi, 1998).

To be more precise, corruption may occur in civil service in the form of bribes offered to a public official as reward for a favor shown toward a private actor. This is an obstacle to competition as it reduces the cost of economic activity for the active corruptor or creates for new opportunities. Corruption can also take the form of bribes to a public official for a service that would normally be provided by the administration without any additional tax. This can incite the civil servant to invent rules that make it legal to ask for a commission. In both cases, the rules of public decision-making are biased (Delavallade, 2006).

Varoudakis' (1996) typology, as well as Tanzi's and Davoodi's (1997) empirical research and that of Johnson, Kaufmann and Zoido-Lobatón (1999) have shown that the total amount of social spending is increased by bribes when public-decision makers are corrupt, especially under the influence of a bureaucratic system. When corruption exists, by diverting public funds, the state budget includes not only effective social expenditures, but also the diverted amounts. Corruption probably also reduces the amount of effective government expenditure.

The impact of corruption on the allocation of government spending can use various channels. First, as for bribe demand (i.e., collection), government authorities find themselves in a monopsony position, with little competition because of their small number compared to great demand. They decide the allocation of expenditures and contracts, which increases their negotiating power and develops bribe-seeking behaviors. Moreover, corrupt agents are incited to favor some spending items for which they know or expect that decisions are made in relative secret (e.g. defense, public order). Second, as for bribe supply (i.e., attribution), firms may be incited—namely by noncommittal laws or even tax codes that allow bribes to obtain contracts abroad—to bribe foreign civil servants to exporting arms, military equipment, oil, gas, or gold. Moreover, the effects of the competition level between sellers on the bribe offer is uncertain;

heavy competition between sellers could prompt them to pay commissions to compensate for these civil servants' weak negotiating power and get market shares (Gupta, de Mello, & Sharan, 2000). On the other hand, low competition induces anticipation of significant bribes to obtain these markets (Mauro, 1998).

To sum up, consequences of corruption cost much more than the cost of bribes paid to officials. Corruption is not only a crime but also a symptom of systemic economic crisis. The most important condition needed to eradicate corruption is efficient social policy directed at increasing life quality and wealth. Moreover, real losses from corruption significantly exceed those calculated on the basis of few revealed corruption crimes and accomplished investigations. It is particularly interesting to note that the sum total of allocated public spending correlates significantly with corruption: the higher the level of corruption, the weaker the portion of allocated spending. Analysis of the correlation table suggest that corruption practices reduce not only the global part of the budget allocated to different budgetary items but also the relative part allocated to social sectors.

BACKGROUND ON CORRUPTION IN RUSSIA

The World Bank has estimated that annual worldwide bribery is close to $1 trillion. Fifteen percent of enterprises give bribes in Western Europe and North America, 30% in Asia, and around 60% in Eastern Europe and Middle Asia (Petrova, 2007). The corruption system in Russia involves more than 2.5 million people, and the society pays them approximately $40-45 million per annum. In 2006, there were approximately 6 thousand bribe-taking crimes, 4 thousand bribe-giving crimes in the public sphere and about 2 thousand commercial grafts were registered. Thus, corruption income reached 7% of an average company's annual sales. According to the most optimistic estimates, total annual losses caused by corruption exceed $30 million or around 1% of GNP in buying goods and services for public needs. As a result, market efficiency declines, democratic institution fail, and economic and political inequity increase. Obviously, corruption has become a national threat (Kupreschenko, 2008).

Direct and indirect economic losses caused by corruption can be distinguished. Direct losses are calculated as public budget income shortages. For instance, the Russian Federal Tax Department increased its own efficiency and increased its income by $500 million. Indirect losses are much more difficult to estimate, though approximate calculations can be made by using international comparisons. These calculations are based on regression models in which corruption level, on the one hand, and general economic efficiency indicators, on the other hand, are correlated. One recent example is the research, which showed that scales of corruption in Russia, cause additional expenses for investors equal to an additional 43% taxation (ibid.).

According to the Freelance Bureau (2005), an approximate estimate of losses from top-level corruption can be made on the basis of well-known examples for which losses have been calculated. This process showed that a decrease corruption levels from Mexico to Singapore has the same effect as a 20% increase in taxes. Losses from corruption are caused by nonmarket pricing, which leads to 5-15% consumer goods price increases. Corruption causes additional costs equal to 15% greater taxation or 10% employment decline. Good examples of corruption in top executive power all over the world are found in contracts for public needs. Not surprisingly, losses from this kind of corruption exceed 30% of such public expenditures (ibid.).

A slight increase has occurred in frequency of bribery from 38.72 to 39.30%. Some data have been based on impersonal interviews: 21% give bribes to tax inspectors, 16.2% to policemen and judges, 13.9 to fire inspectors, 13.4% to public officials who sign contracts for public needs, 12.5% to customs officers, and 4.1% to public officials of legislative power (ibid.).

Russian experts have distinguished the corruption potential of Russian regions. In these experts' opinions, the most corrupted territories are big cities, transport nodes, ports, and transit zones. Interestingly, no zones are completely free of corruption. The least corrupted are spheres in which advantages are difficult to estimate, for instance, private health services and innovative business.

The most corrupted spheres are political power, police, communal services, tax, customs services, public health, and education. The most common corruption transactions are: overestimation of costs, especially in state entrepreneurship; kickbacks from public and private partnership; bribery in the business sphere aimed at obtaining/granting competitive advantages; bribery in business sphere aimed at licensing and accreditation; bribery among politicians for granting certain advantages to business; bribery in schools aimed at obtaining/granting false certificates; and bribery in hospitals aimed at obtaining/granting better services.

Executive power is the most corrupted in Russia. State officials are always engaged in property redistribution using ordered bankruptcies, unfriendly mergers and absorptions, business captures, lately including widespread corporate raider seizures of property. Not surprisingly, this business is very profitable and can be compared with the drug trade. Estimated profitability of corporate raider seizures reaches 500% (Kupreschenko, 2008)!

The growth of corruption in Russia occurs mainly in the form of kickbacks for obtaining large-scale contracts. The share of kickbacks in the cost of these contracts recently increased from 1.51 to 1.99%, and the share of other types of bribes in the total turnover of all Russian companies fell from 1.43 to 1.07% (ibid.). In 2005, the annual volume of bribes distributed by Russian businessmen was in $316 million; the average Russian company pays $135,800 per annum (ibid.).

It is also important to pay attention to low-level corruption. Small and medium enterprises in Russia spend a minimum of $500 million per month on official bribes (around $6 million per annum). The preliminary analysis showed that 10% of gross income is spent on bribes (ibid.).

It would not be an exaggeration to say that the main reason for corruption is poverty and low quality of life. This is persuasively confirmed by international research. The level of corruption is identified by CPI, which is annually determined and published by Transparency International (TI, 2010). This index seems to be objective, as it reflects estimates of corruption levels among businessmen and analysts in miscellaneous countries. The absence of corruption corresponds to 10; growth of corruption drops the index to 0. Russia stands in 146th place among the 180 least corrupted countries in 2010; the CPI calculated on the basis of eight surveys by TI is 2.2. In comparison, the index exceeds 9.0 in good practice economies such as Singapore, Sweden, and Switzerland.

The least developed countries of the world shoulder a double burden: poverty and corruption. TI therefore recommends that states with low incomes oppose corruption and provide greater access to information about budget expenses. A sign of national corruption is unprecedented development of low-level corruption, which is founded on the historically based principle of management in the Russian state, that is, the institution of so-called feeding. As a result, the majority of the population ethically accepts corruption as a form of problem-solving. More, 54% of Russians are tolerant of bribes to executives, 27% acknowledged that they sometimes give bribes to official public executives. Interestingly, young people showed more tolerant attitude toward bribery than the elderly.

Illegal interaction between public officials, police, and criminals are widespread in modern Russia, especially in big cities. Corruption phenomena have also spread in the judicial system. Judges often solve deals in favors of wealthier complainants. Recent sociological surveys show that only 14% of respondents have answered that the present court is objective; more than 21% suppose that it is not objective, and

more than 57% are convinced that "the result depends on the price" (Kimlatskiy & Machulskaya, 2007, p.10).

Experts have noted that the Russian electoral process is highly corrupt. Corruption occurs in illegal financing of electoral campaigns and mass media, grafting of persons called to provide openness and publicity for the electoral process (the watchers, members of the electoral commissions with consultative privileges). Last year, large criminal groups actively introduced their representatives in the legislative and executive branches of all levels to pursue the lobbying interests of the former. These lobbyists actively master the electoral system and direct significant material and financial facilities in electoral funds to their own representatives.

Education also is corrupt at all stages, even in primary education. Bribery often occurs at entrance and intermediate qualification exams. More, a shadow market has emerged and affects term papers, diplomas, and theses. As a result, general efficiency of education decreases. The medical services market remains nominally free of charge; however, it appears that many free services provided to the population by medical organizations are limited and differentiated on quality. As a consequence, many types of officially free services are performed in the shadow economy. Interestingly, high price often does not mean high quality of medical services.

The redistribution of property by a new class of top public officials and businessmen, a strong desire to occupy the high position in society not as a result of professional skills but on account of wealth, reassessment and the fall of certain valuables in society, weakness of local authorities, and staff leapfrogging have become reasons for the rapid development of corruption in modern Russia.

Table 1 reports how poverty rates were reduced as a share of GDP according to the European Commission method (2007) as the difference between poverty reduction before and after social spending. The third column of Table 1 shows residuals from regression of initial poverty on poverty after social transfer (% before minus % after social transfers). The fourth column shows the extent to which the poverty situation is better than the predicted level. The fifth column describes the predicted value based on linear regression of social expenditures and improvement of the social situation). Eurostat data on poverty after social transfers are taken here. Efficiency of social spending (column 6) is measured on the basis of the coefficient of poverty after transfers better than expected (column 4) corrected by the predicted value, which shows improvement of the social situation (column 5).

Social expenditure as a share of GDP is the highest in Sweden and France and the lowest in all three Baltic countries. Despite low levels of social expenditures, the latter show significant reductions in their poverty rates. The other essential correlations observed in the table are represented in the Figures below, which test for the existence of correlation between social spending efficiency and corruption.

The two variables in Figure 1 are correlated (0.37). Social expenditures explain 28% of the variation in the percentage of poverty reduction among the countries. The figure of 8 %-points of initial poverty reduction is expected for Russia. Next, the correlation between social expenditures per GDP (column 2) and poverty situation after transfers better than expected (in % points) (column 4) is examined.

Table 1: Poverty Reduction at Existing Levels of Social Expenditures and Corruption: European Commission Method and Results Based on the Corrected Method

Country (1)	Social expenditure per GDP (2)	Reduction of poverty, %-points (3)	Poverty situation after transfers better than expected (in %	Predicted value of improvement of the social situation) (5)	Residual (Social Expenditure Efficiency	CPI 2009*** (7)
Austria	29.0	12	2.63	1.9	0.73	7.9
Belgium	29.3	12	1.23	2	-0.76	7.1
Czech R.	19.3	12	4.73	-1.17	5.9	4.9
Denmark	30.9	16	4.53	2.5	2.03	9.3
Estonia	13.1	7	-2.37	-3.13	0.76	6.6
Finland	26.6	16	3.83	1.14	2.69	8.9
France	31.3	12	2.63	2.63	0	6.9
Germany	29.6	13	2.93	2.09	0.84	8.0
Greece	23.6	2	-5.97	0.19	-6.16	3.8
Hungary	20.7	14	1.13	-0.72	1.86	5.1
Ireland	18.2	15	0.03	-1.52	1.55	8.0
Italy	26.0	4	-4.67	0.95	-5.62	4.3
Latvia	12.9	5	-6.47	-3.19	-3.28	4.5
Lithuania	13.3	7	-3.77	-3.07	-0.7	4.9
Netherlands	28.3	11	4.43	1.68	2.75	8.9
Poland	20.1	10	-2.17	-0.91	-1.25	5.0
Portugal	24.7	7	-2.37	0.54	-2.91	5.8
Romania	15.1	5	-3.67	-2.5	-1.17	3.8
Russia	17.2**	8*	-2.07*	-0.58*	-2.63*	2.2
Slovak R.	17.3	8	2.13	-1.8	3.93	4.5
Slovenia	23.7	12	3.33	0.22	3.11	6.6
Spain	20.6	4	-4.67	-0.76	-3.91	6.1
Sweden	32.7	17	4.83	3.07	1.76	9.2
UK	26.3	11	-1.87	1.05	-2.92	7.7

*Note. * = calculated by the author. Sources: Herrmann et. al. (2008), TI Agency Report* (2010), Russian Federal Statistics Department** (2009), and the author's calculations on Microsoft Excel software.*

Figure1: Correlation between Social Expenditures and Poverty Reduction
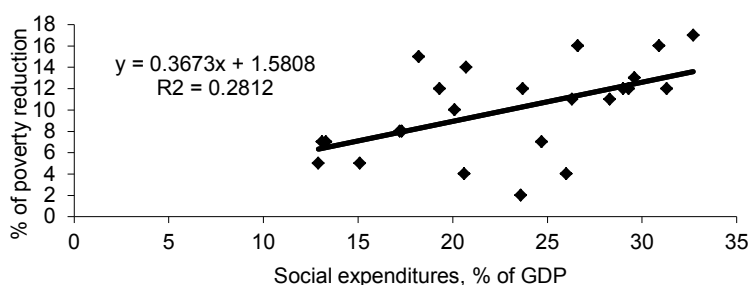

Figure 1 tests the hypothesis of correlation existence between social spending efficiency and corruption.Source: Herrmann et. al. (2008)

Figure 2 shows a positive relationship between social expenditures and poverty after transfers better than expected (in %). The two variables are correlated (0.35): social expenditures explain around 35% of the poverty situation better than expected in the percentage among the countries. Obviously, while figures for all Scandinavian countries and some Central Europe countries are positive, for all three Baltic countries, Italy, Spain, Portugal and some others they are negative. Noticeably, the calculated figure for Russia is -2.07, which is close to the Poland's (-2.17) and Estonia's (-2.37) ones. Not surprisingly, figures for transition countries are mostly negative, however, a few opposite examples exist for less corrupted

countries like Slovenia, Czech and Slovak Republic, in which market transition processes have longer history. Second, the correlation between poverty situation better than expected (column 4) and predicted improvement of social situation (column 5) is shown.
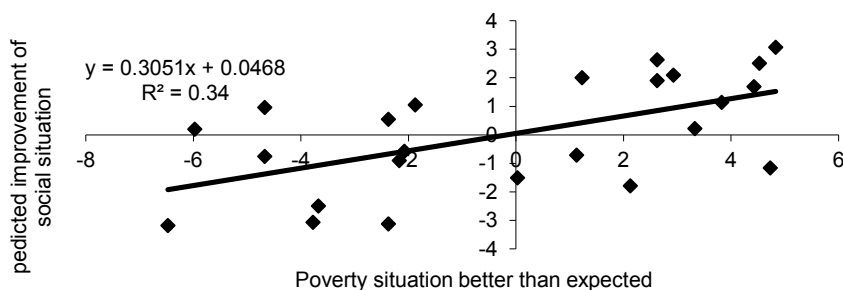
Figure 2: Correlation between Social Expenditures and Poverty situation Better than Expected.
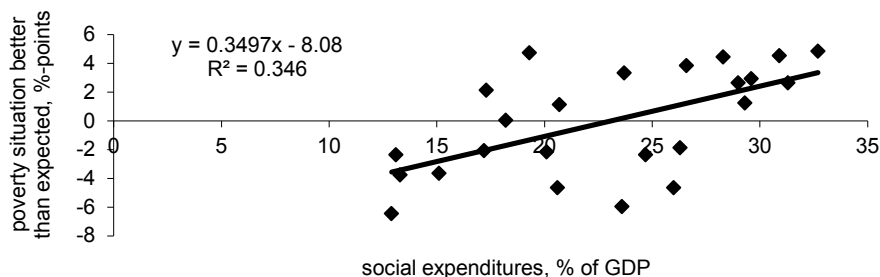
Source: the author's calculations on Microsoft Excel software based on Herrmann et. al. (2008). figures for transition countries are mostly negative, however , a few opposite examples can be found for less corrupted countries like Slovenia, Czech and Slovak Republic, in which market transition processes have longer history.

Figure 3 shows a positive relationship between social expenditures and poverty after transfers better than expected (in % points). The two variables are correlated (0.31): social expenditures explain around 34% of the poverty situation improvement in the percentage among the countries. Lastly, correlation between efficiency of social expenditure calculated by European Commission (column 6) and corruption measured by the CPI (column 7) is explored.

Figure 3: Correlation between Poverty Situation Better than Expected and Predicted Improvement of Social Situation

The two variables are correlated (0.31): social expenditures explain around 34% of the poverty situation improvement in the percentage among the countries.Source: the author's calculations on Microsoft Excel software based on Herrmann et. al. (2008).

Figure 4 shows the correlation between CPI and efficiency of social expenditures that proves our hypothesis. The two variables are correlated (0.69): CPI explains around 17% of the efficiency of social expenditures among the countries. As might be expected, social spending aimed at poverty reduction is more efficient in less corrupted countries that prove my working hypothesis.

Figure 4: Correlation between Efficiency of Social Expenditure and Corruption
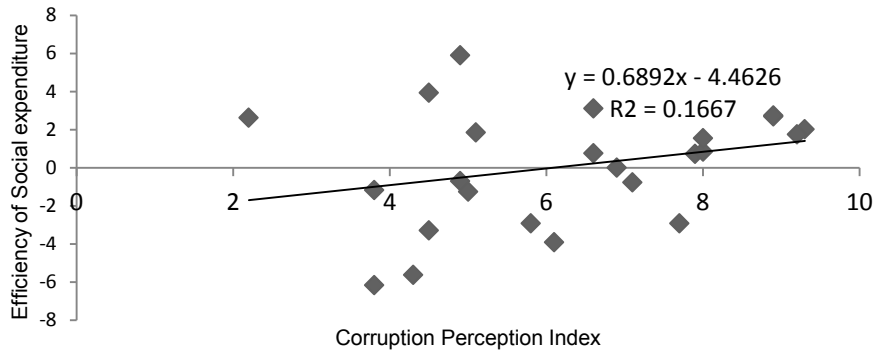
The two variables are correlated (0.69): CPI explains around 17% of the efficiency of social expenditures among the countries. Source: the author's calculations on Microsoft Excel software based on Herrmann et. al. (2008) and TI Agency Report (2010).

To sum up, Russia remains a highly corrupted country from top to bottom, and the social items of public expenditures are no exception. Applying two alternative methodologies – the European Commission's and that suggested by Herrmann et. al. (2008) – it is possible to conclude that that efficiency of state expenditures for reducing poverty rates is greatly influenced by corruption.

RECOMMENDATIONS FOR IMPROVEMENT

The neoliberal agenda that emerges from the research maintains that to diminish the negative consequences of corruption and increase the general efficiency of public spending, governments should: redirect rather than increase public expenditures; revise the pension systems and unemployment benefit schemes (these should be implemented in parallel); encourage people to work longer and be more active so as to reduce the social, economic, fiscal and other challenges of coping with aging populations (Herrmann et. al., 2008).

The first set of measures involves a reduction of bribe-seeking opportunities. Specific measures include the creation of procurement legislation or rules, transparent procedures, and strong and independent audit institutions. Simultaneously, the principal's (i.e., the public's) control over the agent (i.e., political executives and bureaucrats) is tightened by the elimination of information asymmetry. Alternatively, information asymmetry can be reduced by gradual strengthening oversight institutions, the media, and civil society. Additionally, the behavior of corrupt public officials can be controlled by enforcement of ethical codes of behavior and by strict criminal sanctions against bribe-taking.

The second set of measures involves control of supply-side behavior. Obviously, an essential element of the struggle with corruption is administrative reform aimed at bureaucratic process simplification to transfer certain functions to non-governmental organizations (NGOs). As a result, public control of state management is maintained. This approach includes enforcement methods such as disbarments, penalties, criminal sanctions against bribe payers, or development of ethical codes of conduct and other self-regulation mechanisms. Although these steps are often sufficient to combat corruption when both the purchaser and seller are from the same country, these measures typically fail when the buyer and supplier are from different countries.

Numerous unsuccessful attempts have been made to eradicate corruption. The main reason for such failure is the stability of approaches that have been used. It is impossible to imagine that corrupt power

will stage an effective fight against corruption. As can be expected, these people could not influence the factors that cause corruption. Moreover, the struggle against corruption often results in a struggle between political rivals.

Generally speaking, it is necessary to make a systemic revision of legislation on corruption. Temporary Russian legislation consists of laws of three types: (1) those put into effect recently; (2) those implemented at the beginning of the transition, and (3) those enacted during the Soviet period. Some legislative acts set a rule and the substitute acts distort and/or incorrectly interpret the former. Lack of transparence, contradictory character of these laws, and/or possibility of free interpretation promotes the various types of corruption. Apparently, they should be revised as they impose conceptual adjustments to various social-economic legal relations.

To sum up, corruption is a phenomenon with a systemic nature. Hence, the struggle against it is efficient only when a certain complex of economical and political measures is implicated. Executive power's improvements in decision-making. Mechanisms to make them more transparent and public and implementation of stricter punishment for corruption crimes, are obligatory conditions of a successful struggle to overcome corruption.

CONCLUDING COMMENTS

The goal of this paper is to summarize the effects of corruption at social expenditures efficiency. Even though the negative influence of corruption might seem obvious, the extent, at which it decreases efficiency of social spending in Russia remains unclear. Basic reasons and consequences of corruption were investigated to identify the extent to which Russia corresponds to European trends. Next, on the basis of research of Herrmann et. al. (2008), the recent Transparency International Agency's Report (2010), and Russian Federal Statistics Department data on national budgetary accounts, the econometric analysis were used in order to test the hypothesis about negative effect on poverty situation and social expenditures efficiency.

European Union countries' and Russia's evidence was provided to show that efficiency of public expenditures aimed at poverty reduction increases in less corrupt countries. The most important condition for eradication of corruption is efficient social policy directed at increasing quality of life. In Russia, attention is devoted mostly to the consequences of corruption but not to its reasons. For this reason, complementary implications in economic policy suggest that corrupt countries like the Russian Federation should be induced to make the policy more transparent.

The main limitation of the analysis is that all estimates of corruption are approximate. Similarly, there is no perfect methodology for estimating the efficiency of social spending. Consequently, the logical continuation of the research would be study of correlations based on alternative methodologies for comparing relevant indicators for Russia, other transition economies, and developed countries.

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