



The **Australia Institute**
Research that matters.

The cost of corruption

The growing perception of corruption and its cost to GDP

Corruption increases costs and reduces economic growth. Worsening perceptions of corruption in Australia since 2012 have potentially reduced GDP by \$72.3 billion, or 4% of our latest GDP figures.

Discussion paper

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Summary

Corruption costs 5% of GDP worldwide. The cost of corruption to economies is well established, and much research exists on the impact of corruption on investment, business costs, efficient allocation of capital and economic inequality.

Trust in government is at a historic low in Australia, and according to Transparency International's Corruption Perception Index (CPI) Australia has increasing levels of perceived corruption. Since 2012 Australia has slid to 13th on the international CPI index.

Using Transparency International's CPI and economic analysis from PriceWaterhouseCoopers (PwC) this report finds that worsening perceptions of corruption in Australia has potentially reduced GDP by \$72.3 billion, or 4%.

To target the cost of corruption, and therefore attract greater investment, the Australia Institute recommends establishing a federal anti-corruption commission to investigate and expose systemic corruption and misconduct in federal politics and government.

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Introduction

The perception of corruption in Australia is growing, as is public mistrust in government. Australia has fallen six positions on the international Corruption Perception Index since 2012, and recent polling shows 85% of Australians think there is corruption in federal politics.

Corruption comes at an economic cost, impacting business investment and growth. This report summarises the costs of corruption and then uses analysis from Transparency International and PwC to quantify the cost of corruption to Australia's GDP.

The Corruption Perception Index

Each year Transparency International publishes an international Corruption Perceptions Index (CPI). Since 2012, Australia has fallen 6 positions in this index, showing a growing perception of corruption in Australia.

The CPI provides a measure of the perception of business people and country experts of the level of corruption in the public sector. It provides an index and ranking for 176 countries, based on data from 13 sources including the African Development Bank, the World Bank and the World Economic Forum.¹

To be included, the sources must quantify perceptions of corruption within the public sector, with a reliable methodology and a multi-country ranking. The data sources are standardised to a scale of 0-100 and the totals averaged to produce a score. At least 3 data sources are required for a country to be included in the final score. In 2016 8 data sources were averaged to calculate Australia's final score.²

The CPI produces both a score and a rank. The scores are on a scale of 0-100, and countries are then ranked from 1 to 176. Countries with the same score are given equal ranking.

¹ See Transparency International, 2016, *Source Description*, http://files.transparency.org/content/download/2056/13236/file/CPI_2016_SourceDescriptionDocument_EN.pdf

² Transparency International, 2016, *Short Methodology Note*, http://files.transparency.org/content/download/2054/13228/file/CPI_2016_ShortMethodologyNote_EN.pdf

Australia in the Corruption Perceptions Index

In 2012, Australia was ranked 7th in the CPI with a score of 85 out of 100. In 2013 this score dropped dramatically to 81, resulting in a ranking of 9th. In 2014 Australia's score dropped again to 80, and our ranking fell to 11th. In 2015 Australia scored 79 and ranked 13th, remaining there in 2016.³

The reason cited by Transparency International for Australia's fall in the CPI include inaction by successive governments in dealing with public sector corruption, particularly in relation to foreign bribery scandals. Speaking to ABC after the 2015 CPI report, Transparency International Australia CEO said, "With Australia's worst foreign bribery offences having been committed by former or current government-owned entities - the Australian Wheat Board, Note Printing Australia and Securrency Limited - there is no excuse not to have implemented all of the OECD's reform recommendations in this area by the end of the year."⁴ Transparency International Chairman Anthony Whealy QC added that government inertia and apathy was causing the slide, stating that without enforcement bodies prosecuting corruption cases then the perception of inaction will continue.⁵

Within Australia, public perceptions also reflect this downward trend. Recent polls, studies and surveys show that trust in government is at a record low in Australia and still falling.⁶ A study conducted by the University of Canberra in 2016 found only 5% of Australians trust government.⁷ A similar study by the Australian National University in 2016 found that 74% of Australians think politicians are 'too often interested in

³ See Transparency International, 2016, *Corruption Perception Index results table*, http://www.transparency.org/news/feature/corruption_perceptions_index_2016 and <http://www.transparency.org/cpi> for detailed year by year results

⁴ Main, 2016, *Australia continues to slide down International Corruption Index*, <http://www.abc.net.au/news/2016-01-27/australia-perceived-as-more-corrupt/7118632>

⁵ Kitney, 2017, *Federal government under fresh pressure to act on corruption*, *The Australian* <http://www.theaustralian.com.au/business/news/federal-government-under-fresh-pressure-to-act-on-corruption/news-story/669e0d990f10335c7c7df9b165c17ba1>

⁶ See Andrew Leigh, *Explaining distrust: Popular attitudes towards politicians in Australia and the United States*, in *The Prince's New Clothes: Why do Australians Dislike their Politicians?* edited by David Burchell and Andrew Leigh, UNSW Press, UNSW, Sydney, 2002, Chapter 2; and <http://www.abc.net.au/news/2016-06-24/trust-in-australian-political-system-at-lowest-level/7539706>

⁷ <https://theconversation.com/now-for-the-big-question-who-do-you-trust-to-run-the-country-58723>

themselves'.⁸ A recent poll commissioned by the Australia Institute revealed that 85.3% of respondents thought that there is corruption in federal politics.⁹

The growing perception of corruption can be further understood by looking at recent cases that have come to light through media investigations and state anti-corruption commissions:

- Ongoing support of the Adani Carmichael mine from state and federal governments despite the company's opaque corporate structure and history of legal non-compliance;¹⁰
- The 2016 foreign bribery scandal involving Rio Tinto executives allegedly paying \$10.5 million to a close confidant of the President of Guinea in exchange for special treatment for its Simandou iron ore project;¹¹
- The 'revolving door' between industry and government, with former Ministers and Premiers taking up jobs with industry groups soon after leaving office. Recent cases include former federal Resources Minister Ian MacFarlane who retired from politics and was then appointed as CEO of Queensland Resources Council,¹² and former Queensland Premier Anna Bligh who was appointed as CEO of Australian Bankers Association;¹³
- The July 2013 findings of the NSW ICAC that former NSW government ministers engaged in corrupt conduct in relation to mining exploration licences;
- Opaque governance structure and decision making process of the \$5 billion tax payer funded North Australia Infrastructure Fund;¹⁴

⁸ <http://www.abc.net.au/news/2016-12-20/2016-australian-election-disaffected-study/8134508>

⁹ Polling reported in Farr, 17th January 2017, Overwhelming majority believes polities are corrupt, <http://www.news.com.au/finance/work/leaders/overwhelming-majority-believes-polities-are-corrupt/news-story/0f181019b1f1dcdd1485e262f5419b13>

¹⁰ Environmental Justice Australia, 2017, *The Adani Brief*, <http://envirojustice.org.au/major-reports/the-adani-brief>

¹¹ Sexton, 2016, *Rio Tinto bribery scandal*, The Daily Telegraph, <http://www.dailytelegraph.com.au/business/rio-tinto-bribery-scandal-two-former-chief-executives-embroiled-in-email-trail/news-story/fe4216a2852d6a25fa150e6acbd257f4>

¹² Henderson, 2016, *Former resources Minister Ian MacFarlane says new mining company job complies with code of conduct*, ABC, <http://www.abc.net.au/news/2016-09-26/ian-macfarlane-appointed-to-run-queensland-mining-lobby/7876942>

¹³ Silva, 2017, *Anna Bligh appointed as first female Australian Bankers' Association CEO*, ABC <http://www.abc.net.au/news/2017-02-17/anna-bligh-appointed-first-female-aust-bankers-assoc-ceo/8279578>

¹⁴ The Australia Institute, 2017, *Adani and Governance of the Northern Australia Infrastructure Facility*, <http://tai.org.au/content/adani-and-governance-northern-australia-infrastructure-facility>

The costs of corruption

The total economic cost of corruption worldwide is estimated by the World Economic Forum to be equivalent of 5% of global GDP.¹⁵ Corruption impacts the economy in a number of ways.

Corruption increases the costs of doing business. The World Economic estimates that corruption adds on average 10% to the cost of doing business, as corruption can involve additional transaction costs such as bribes.¹⁶ As an example, a 2013 Grant Thornton report estimates fraud is costing the Australian construction industry an additional \$5 billion each year.¹⁷

When corruption exists, the optimal allocation of capital will be distorted. This is because corruption leads to the best-connected contractors and those more likely to give bribes being chosen above those offering the best product.¹⁸ In addition, corruption leads to governments giving advantage to projects that offer personal benefit above those that have maximum public benefit.¹⁹

Corruption can also limit competition in a market. When politically well-connected business people own large companies, they are likely to use their political connections to stop new entrants into their market and create monopolies. This can happen particularly with privatisations of services, for example energy, resources and telecommunications.²⁰ Research from the Melbourne Energy Institute shows that recent electricity price surges in South Australia are largely due to lack of competition in the gas and electricity markets.²¹ An argument could be made that this monopoly is maintained with the help of the political connections of the three companies involved, though the lack of an anti-corruption investigation into this case makes this hard to verify.

¹⁵ <https://www.oecd.org/cleangovbiz/49693613.pdf>

¹⁶ <https://www.oecd.org/cleangovbiz/49693613.pdf>

¹⁷ [https://www.grantthornton.com.au/press/press-releases-2013/australian-construction-fraud-costs-estimate-at-\\$5-billion-per-year/](https://www.grantthornton.com.au/press/press-releases-2013/australian-construction-fraud-costs-estimate-at-$5-billion-per-year/)

¹⁸ *ibid.*

¹⁹ Lambsdorff, 2003, *How Corruption Affects Productivity*, KYKLOS Volume 56 2003, p. 457-474

²⁰ Swanson, 2015, *Why some billionaires are bad for growth and others aren't*, https://www.washingtonpost.com/news/work/wp/2015/08/20/why-some-billionaires-are-bad-for-growth-and-others-arent/?utm_term=.3b860e20aa0d

²¹ McConnell and Sandiford, 2016, *Winds of Change: An analysis of recent changes in the South Australia energy market*, Melbourne Energy Institute, http://energy.unimelb.edu.au/data/assets/pdf_file/0017/2054152/SA_PRICES_FINAL.pdf

Furthermore, corruption increases wealth inequality, which in turn impacts economic growth. Research by economists at the University of New South Wales and the University of Queensland find that 80% of people on the BRW Australia's top 200 rich list made their money through political connections. They find that their 'political favours' theory explains the rise in inequality more accurately than the traditional 'marginal productivity of skills' theory.²²

An international study supports this theory. Researchers from the University of Michigan and Columbia University compared the amount of wealth coming from political connections across countries. Using Forbes magazine's international listing of billionaires, they derive a global measure of wealth inequality and examine its effect on economic growth. They find that a higher level of billionaire wealth as a proportion of GDP corresponds with slower economic growth. They then examine the source of that wealth, and find that politically connected billionaire wealth has an even greater negative impact on economic growth. With 65% of Australia's billionaire wealth coming from political connections, Australia ranked 3rd among a top 5 list which included Colombia, India, Indonesia and Korea. The impact on GDP of increasing inequality, including through policies such as corporate tax cuts, is significant. The researchers estimate that a 3.72 percent increase in the level of wealth inequality would cost a country about half a percent of real GDP per capita growth. The study concludes that wealth inequality as a result of income amassed through political connections has a greater negative impact on economic growth than inequality through other means.²³

Businesses are less likely to invest in countries that have high levels of perceived corruption. There is strong empirical evidence to show that corruption has an adverse impact on the ratio of investment to GDP.²⁴ Given these factors, it is not surprising that researchers have found a correlation between levels of perceived corruption and economic growth.

²² Frijters and Foster, 2015, *Rising Inequality: A benign outgrowth of markets or a symptom of cancerous political favours?*, Australian Economic Review, Vol. 48, Issue 1, pp. 67-75, 2015

²³ Bagchi & Svenjnar, 2013, *Does wealth inequality matter for growth? The effect of billionaire wealth, income distribution, and poverty*, IZA Discussion Paper No. 7733, November 2013, <http://www.sciencedirect.com/science/article/pii/S0147596715000505>

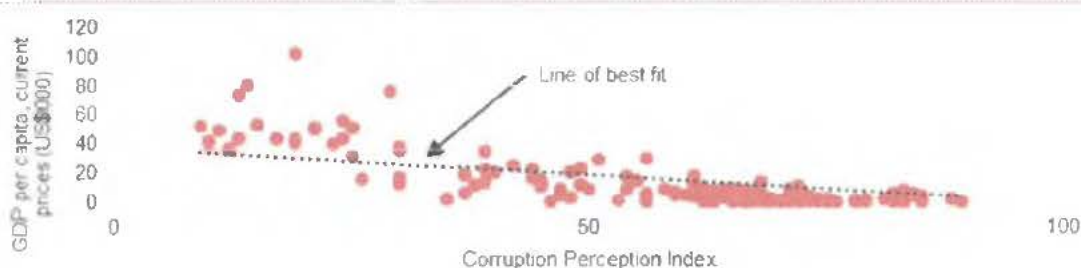
²⁴ See for example Habib & Zurawicki, 2002, *Corruption and Foreign Direct Investment*, Journal of International Business Studies, 33, Second Quarter 2002, 291-307, and Campos et al, 1999, *The Impact of Corruption on Investment*, World Development 27: 1059-67

Economic cost to Australia's GDP

Analysis by PriceWaterhouseCoopers (PwC) finds a correlation between GDP per capita and the Corruption Perception Index.

PwC has calculated that every one point increase in perceived corruption, based on the CPI, is associated with USD\$380 per capita decrease in GDP.²⁵ To do this they have inverted the CPI and graphed it against the GDP per capita of each country represented (see Figure 1 below).

Fig 1: Rising country-level corruption is associated with decreasing GDP per capita, suggesting corruption creates barriers for businesses across all economies



Note: The Corruption Perception Index used here is based on the Corruption Perception Index published by Transparency International but has been inverted so that a score of 100 indicates the highest level of perceived corruption.
Sources: PwC analysis, Transparency International, IMF

Australia had a Corruption Perception Index score of 79 in 2012, increasing to 85 in 2016, or a six point increase. PwC finds that each notch is associated with a US\$380 per capita decrease in GDP, or AUD\$486.²⁶ Australia's six point worsening score would, under PwC's methodology, be expected to lead to Australia's per capita GDP being AUD\$2,916 lower than would otherwise be the case. Extrapolated by Australia's current population of 24,794,136,²⁷ the total potential reduction in GDP associated with increases in perceived corruption since 2012 is AUD\$72,299,703,492.

This AUD\$72.3 billion represents 4% of Australia's AUD\$1,780 billion GDP.²⁸ In other words, Australia's GDP could have been 4% higher if our 6 point worsening in corruption perception since 2012 had not occurred.

²⁵ PwC, 2016, *The Cost of Corruption – Too big to ignore?*,

<http://www.pwc.com/gx/en/issues/economy/global-economy-watch/cost-of-corruption.html>

²⁶ Exchange rate at 10 January 2018

²⁷ Australian Bureau of Statistics, *Population Clock*, as at 10 January 2018,

<http://www.abs.gov.au/AUSSTATS/abs@.nsf/Web+Pages/Population+Clock?opendocument&ref=HPKI>

²⁸ ABS (2017) 5206.0 - Australian National Accounts: National Income, Expenditure and Product, Sep 2017, <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5206.0Sep%202017?OpenDocument>

Conclusion

With rising perceptions of corruption in Australia, and a growing mistrust in government, the cost of corruption in Australia is significant.

It may be impacting the level of competition in our markets, particularly in cases of privatisation of key services like electricity and resources. It may be making Australia a more unequal society, the 65% of our billionaire wealth coming from political connections. It may be causing taxpayers money to be distributed for personal political benefit over public need. It may be increasing the cost of doing business in Australia and impeding business investment.

Some industries are more susceptible to corruption than others. As part of their analysis on the cost of corruption, PwC asked CEOs around the world which sectors were most susceptible to corruption. Over 2 years, global CEOs rated mining as the most susceptible to corruption, followed by other commodity intensive industries construction and oil and gas extraction.²⁹ Australian specific research supports this finding. A study by UQ and UNSW economists find evidence that commodity intensive and heavily regulated industries are likely to be more corrupt. They find that 80% of the richest 200 Australians made their fortunes in mining, property and other sectors where political favours including favours in the distribution of mining concessions can be extremely profitable.³⁰

Using analysis from PwC, perceived worsening of corruption since 2012 may have reduced Australia's GDP by \$72.3 billion, or around 4% of latest GDP figures.

To target the cost of corruption in Australia, the federal government should establish a federal anti-corruption commission, with the broad jurisdiction, public hearings and investigative powers necessary to investigate and expose corruption and misconduct in federal politics and government. A federal ICAC would sure up public trust in government, and show companies internationally that Australia is serious about tackling corruption.

²⁹ PwC, 2016, *The Cost of Corruption – Too big to ignore?*,

<http://www.pwc.com/gx/en/issues/economy/global-economy-watch/ccost-of-corruption.html>

³⁰ Frijters and Foster, 2015, *Rising Inequality: A benign outgrowth of markets or a symptom of cancerous political favours?*, Australian Economic Review, Vol. 48, Issue 1, pp. 67-75, 2015