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Governance Redux for Removing Corruption out of Business: An Analytical Study.

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Abstract The paper underscores that the 'nature' of governance and the 'drivers' of corruption are complex presenting interlinkages that are not easily quantifiable or manipulable by policy framers. This is, in fact, a key lesson from systematic failures of many existing anticorruption efforts. Thus, it is essential to be methodical. The country governance setting is a main factor of the likely effectiveness or ineffectiveness of any anticorruption measure.

This framework provides a "lens" for the thinking about and crafting of strategies to develop and advance anticorruption agendas for countries at large and corporates in particular. Furthermore, the paper situates and attempts to chart corporate corruption and the business case for anticorruption. Corporate corruption is *prima facie* an inscrutable and unsolved problem. If we move beyond simplistic explanations that posit base motives (such as greed and power), it indeed becomes dodgy to explicate why 'breaking the rules' are so rampant. This element of corruption is important, as we grapple to make corporations corruption free and ethical. Even if one assumes that fraud itself cannot be entirely eradicated, but fraud and corruption risks need to be managed like any other business risks.

Keywords: Corruption, Regulation, Governance, Institutions, Political Economy.

Analyzing Operating Environment for Business

The development of anticorruption policies needs to commence with a definite perceptive of the country's governance and operating environment. The Political economy analysis (PEA) is increasingly used as a tool for better understanding the political and societal factors which

both drive and limit development. "A political economy lens broadens operational considerations beyond technical solutions to include an emphasis on stakeholders, institutions and processes by which policy reform is negotiated and played out in the policy arena" (World Bank 2008, vii). In many countries the institution of anticorruption agencies and measures overlook such an evaluation, and this partially explicates the 'letdown' of anticorruption initiatives. Therefore, methodical analysis of governance and operating environment entails examining varied facets of the country's milieu.

The socio-political study is vital in this regard as it is a decisive determinant of anticorruption outcomes for individual sectors and for the country at large. "Of late, the private sector's readiness to address the subject of the enabling environment – meaning that business, apart from working on internal codes of conduct (micro-level), must pay attention to the regulatory framework, the legal system and property rights (macro-level) in order to fight corruption at its root has gained ground" (Sullivan, 2006: 67). Business as key propeller of economic progress and development plays a valuable role in purging out corruption, particularly when functioning in countries with feeble institutions which often make available lush ground for corruption to 'clutch' the system. Recent studies are centering their attention on these features and strategies of the state to explain the scope and root of corruption.

The dread of the Leviathan State has now given way to equivalent focus on economic oligarchs who have the clout to 'capture the state' and shape its policy, regulatory and legal setting to their benefit, producing focused rents at the cost of the rest of the economy[1]. Regarding corruption data sources, Kaufmann et al. (2009) report "high levels of correlation (0.65 or over) amongst prevailing governance indicators on the whole and corruption indicators in specific. In most cases privatization also does not offer an assurance that the newly founded units are no longer serving politically motivated interests". Similarly, whether

[1] According to A.K.Jain in his book *'Political Economy of Corruption'*- Wealth and power intersect in the behaviour of an individual functionary who (mis-) uses public power toward ends for which it was not intended and is compensated by the wealth-owner who benefits from the misuse. The compensation can take many forms, the most common form being bribery. This interaction comes closest to the current tendency to define corruption narrowly in terms of the use of public power in exchange for bribes. Even when the unequal distribution of power results from the application of the rules of the system, the poor regard the lack of income equality resulting from the consequences of unequal distribution of power as corruption (pp 5-6).

"a downsized government is less capable of milking the citizenry is equally questionable: privatized firms can be equally exposed to public interference and demands for bribes. What was previously taken from state-owned enterprises is then extorted from private firms.

Typically, private firms pay large bribes than their well-networked and entrenched state-owned counterparts" (Lambsdorff 2002: 76–77). Finally, many transition economies experienced massive corruption in the course of privatization programs. This may be another reason why downsizing the public sector does not help in reducing corruption. One might guesswork that liberalization may not instantly cut corruption. In fact, many studies indicate that the instantaneous consequence of liberalization is to upsurge rather than lessening corruption. In fact, decentralization on its own may not an instrument for checking corruption by ripping the state off its extortionate capacities and carrying administration nearer to the public.

But an alternate to a bulky centralized public sector decentralization which may weaken local self-government gets captured by strong local or sometimes feudal players. Many economists point to one foremost root cause of corruption as depraved regulatory apparatus. Ill-designed establishments are believed to be at the frontline of transferring adversative enticements to policy-makers, officeholders, and the community in general. Consequently, detecting corrupt rule and misdirected state involvement can be supportive in becoming conscious of zones where sleaze is likely to happen. Though, bad rule and fraud are frequently interconnected. When local firms are given privileged behavior in public tenders, this might encourage corruption, but it might also be the complete outcome of sturdy private interests that capture public assets. In other cases, corruption causes corrupt protocols, and not the other way round.

Meta-analysis offers valued tools for assessing and synthesizing the effects of corruption. Consequently, linear relationship amongst corporate governance and state governance is explored. This allows for a comprehensive qualitative and quantitative assessment of corruption, and an additional nuanced and empathetic view of the roots of the predicament and as an outcome - a stronger foundation for policy recommendation. Meticulous thought is paid in the paper to the concept of 'state capture' by corporate sector (i.e., the proclivity of

companies to profile the fundamental 'rules of the game' including 'purchase' of lawmaking and court decisions).[2]The universalist paradigm of anti-corruption adopted so far advocate obvious, prescribed corporate governance practices conversely, it is ignored that national governance matrix does significantly determine the characterization of "good" governance practices, and thus the optimal set of anti-corruption strategy could vary across countries.

Analytical framework for anticorruption policies

The mainstay assertion of analytical framework in this paper is that anticorruption policies and programs need to be crafted on the foundation of a careful analysis of the 'quality of governance' and the 'patterns of corruption' in a country. Additionally, governance breakdown at the state level cannot be divorced from the interface between the corporate and state sectors, in particular, from the heretofore underemphasized influence that firms may exert on the State. Bad regulation and sleaze are relatively two sides of the same coin. For example, when domestic firms are given privileged behavior in public tenders, this might tempt corruption, but it may also be the absolute outcome of robust private interests that capture public funds. In such cases, corruption causes bad regulations, and not the otherwise. "If monopoly rights are given in exchange for bribes, corruption leads to market distortions.

But those who argue that these monopoly rights should be abandoned as a way to get rid of corruption misunderstand the situation. At the heart of the problem are illegally innovative politicians and corporate individuals who scheme to assign these rights" (Lambsdorff, 2002). Under these circumstances, corporate strategies may exacerbate mis-governance at the state level or may fall victim to it. Anti-corruption therefore is analogous to destroying the Gordian knot; piecemeal approaches often appear futile[3]. It alerts the public that much has to be done, without exactly proposing what measures have to be taken and where to set priorities. This assertion is straightforward enough but it is not put into consequence in many countries.

[2] http://www.ebrd.com/russian/downloads/research/economics/workingpapers/wp0051.pdf

[3] http://siteresources.worldbank.org/INTWBIGOVANTCOR/Resources/measure.pdf

The nature of governance and the drivers of corruption are multifaceted; presenting interactions among them that are not easily detectable, and even much less manipulability by public policy framers. This is, in fact, a critical lesson from the malfunctioning of the existing anticorruption efforts. A whole host of social forces such as authority relations, peer pressure and cultural normalization may lead otherwise law-abiding and ordinary people to participate in financial malfeasance, fraud and bribery. So, "the crisis of corruption is intimately linked to the institutional and cultural conditions: once a constitution allows the 'get away from the Hobbesian state of nature', this action introduces and 'codifies the control of Leviathan' and permits its (parasitical and self-regarding) manipulation in social interaction" (Hobbes [1651] 1985: 202, 228). Such institutional command over (economic) resources and transactions certainly direct to corrupt deeds.

"The power of formal institutions to put order to social and economic life poses one of the oldest dilemmas. The Leviathan's state institutional power to protect transactions and (re-)distribute resources also means constituting a monopoly which enables this opportunistic exploitation of the institutional power" (Greif, Milgrom and Weingast 1994: 745). Conversely, corruption is meticulously interconnected to customs, official and familiar rulebooks and the particularistic legal circumstantial situation of that specific culture. Examining, elucidation and fighting fraud must mull over these particularities. The New Institutional Economics and Governance literature are delving into this analysis of both formal and informal institutional arrangements and the consequential constrictions that profile the interaction of and between them[4].

Approaching fraud from an institutional economic perspective, as well as from a governance one, can enhance our empathetic view of the root causes of fraud and the possibility for restructuring. Anwar Shah, (2007) links "these standpoints and contends that because corruption is itself a sign of central governance fiasco, more the frequency of sleaze, the less an anticorruption approach should contain strategies that are narrowly targeted to immoral actions and the more it should emphasis on the comprehensive fundamental structures of the

[4] A neo-institutional analysis of corruption has been developed, among others, by Husted (1994), della Porta and Vannucci (1999) and Lambsdorff (2002).

authority milieu". Kaufmann, Kraay and Mastruzzi take a broader approach and examine the association between indicators of governance and economic outcomes. Drawing information from an extensive variety of sources, the World Bank Institute constructed six indices. "In count to a measure of corruption control, the indices include: voice and accountability, political uncertainty and violence, administration efficiency, supervisory burden and the rule of law.

The authors argue that these perceptions-based data on governance do an improved job of capturing reality than theoretically objective measures of the rules of the game". They study the issue econometrically and argue that the dominant direction of causation is from weak governance, including high corruption, to low growth. This view has theoretical as well as empirical support, the prescriptions of economists who urge countries to get their macroeconomic incentives right will not work unless the state has institutions capable of putting such policies into effect. Even if there is also a feedback mechanism from low growth to high corruption and from high growth to low corruption, the growth process cannot begin unless reasonably well functioning institutions are in place. Reaching from the constitutional codices and legal systems to the informal norms and arrangements, researchers consent that institutional edifice matters in social and economic life.

Donatella della Porta and Alessandro Pizzorno have spoken "of `business politicians', a new class of political entrepreneur who `combines arbitration in (legal or illegal) commercial dealings, first- hand partaking in financial activity, and political mediation in the outmoded sense". A corrupt transaction would be embedded into a wider background of exchange. A legal transaction may thus act as a ''guarantor'' for the corrupt deal. One of the central functions of robust institutions is to uphold transactions against opportunistic conduct. However, these safeguarding apparatuses can work in binary traditions: it can shield legal transactions and facilitate to economize on transaction costs, or it can be applied to carry out dealings that run counter to the formal standard of legal actions – corrupt business being one of its indicators.

Gerring and Thacker (2005) report a "positive parallel between regulatory superiority and nonappearance of sleaze. Many writers admit that corruption might cause policy distortions

and not vice versa, bringing about difficulties of simultaneity bias". Others claim that their "instruments for policy alterations determine the course of causality. Surely, policy alterations and fraud appear to be twosome quite often". A simple correlation for an illustration of twenty-six African countries is provided in Lambsdorff and Cornelius (2000) where they show that "corruption is definitely coupled with the degree to which ''government regulations are vague and lax.'' Corruption is therefore not a standardized, standalone problem.

Rather, it is a symptom that state/society relations function in ways that chip away at the equality and legality of the government and that lead to misuse and the poor targeting of public spending. "In highly corrupt countries even nominally pro-growth policies are likely to be sabotaged by the self-seeking behavior of government officials and of private individuals and businesses – both domestic and foreign. Even when growth does occur, insiders use their status to obtain disproportionate gains. It thereby is a wishful assessment to direct poor countries to grow cure for corruption" (Rose-Ackerman, 2006). Rose-Ackerman distinguishes "between low level fraud and grand corruption. In general, low-level fraud can lead to the incompetent and discriminating delivery of scarce assistances, challenge the determinations of community programs, reassure officials to generate red tape, upsurge the cost of doing business and limit entry, and little state legitimacy" (Rose-Ackerman 1999).

Note, nonetheless, that such corruption may have political payback for incumbents. The bribes may be paid at the lowest level in the hierarchy, but they may be part of an organized system that is used to favor political allies and to build campaign war chests, and not only to obtain individual cash benefits. At that point, low-level corruption merges with high-level corruption. 'Grand' corruption have similar structures with low-level payoffs, but it can be further extremely weary of state functioning – bringing the state to the edge of absolute fiasco and decline in the economy. Rose Ackerman distinguishes three varieties. "First, a subdivision of the public sector might be systematized as a rent-extraction machine. Second, a nominal democracy may have a corrupt electoral system, with money determining the outcome. Third, governments engage in large projects and transfer assets in ways that have a significant effect on the wealth of domestic and foreign business organizations. The extremes are kleptocracy, on the one hand, and state capture by powerful private interests, on the other.

In some cases, concentrated power exists on both sides, and we have a bargaining situation similar to a bilateral monopoly in the private market" (Rose- Ackerman 1999: 115).

"Economic and social exchanges as well as legal and illegal acts are thus made easy by being entrenched in a societal structure, which is somewhat outside individual control and motivation" (Granovetter 1985). "These embedded social structures and practices also play a dynamic role to smoothen corrupt transactions" (Rose-Ackerman 1999: 98; Cartier-Bresson 1997: 163). "This is done by restraining entree to capitals and decision making, permitting the extraction and redistribution of rents among participating elites via patron-client networks" (North et al. 2007). "Therefore, there is a tacit acceptance of rent seeking and corruption as the glue that holds together these institutions and systems of power.

In the most detrimental examples, corruption becomes rapacious and compromises serious state roles" (Khan 2007; Johnston 2005). "There exists by now plenty of evidence that nations damaged by fraud display poor government organizations. For example, corruption leads managers to waste more time negotiating with bureaucrats" (Kaufmann and Wei 1999). The ranks between governments and corporate are indistinct in numerous nations, with elites expansively chasing business interests both for personal advancement and to fulfil patrimonial obligations. There are many instances in which parliamentary adoption of laws and policies serves the particular interests of business groups. Moore and Unsworth (2006, 708), proposed a "more nuanced interpretation of Political Economy Approach as summarized "bad governance is often caused or worsened by the ways in which underprivileged nations interrelate with international economic and political forces, authoritative wealthier countries, and big transnational private enterprises."

Therefore, examination of corruption in this perspective must commence with the examination of 'institutional preconditionalities' that form and determine the contours of unethical transactions. Considering this vicious circle, a welfare investigation of corruption must include the inquiry of institutions and parameter and must not contemplate them exogenic to the study. A vicious circle appears because excessive regulation, once in place, offers opportunities for impending corrupt transactions. Once corruption becomes the rule, self-seeking bureaucrats attempt to increase their income by imposing further troublesome

impediments on the private sector. Hoping for the payment of speed money public servants are induced to create further artificial bottlenecks and to increase the queue in front of their office. The lengthier the queue, the dearer the price for cutting through it. "Speed money increases the velocity of services only for the briber. Furthermore, the very act of creating market distortions can be the explicit goal of collusion between agents and clients. When customers pay agents for constraining competition by distressing their competitors, misrepresentations are a forthright consequence of the dishonest dealings" (Bardhan 1997: 1322).

Governance Redux and Embedding

Governance literature is getting focused on 'how institutions develop, how they are designed and how they surface as a consequence and result of maximizing behaviour of individuals in conjunction with power structures' and thus, how they 'scrimp and save' on transaction cost. The fundamental reason is that governance reorganizations need to be endogenic to be robust. One such approach whereby the principal seeks to strike deals, which are unfavourable to the general public, is provided by representatives of the Chicago School. In their view, lobbying groups and politicians design regulations so as to create rents and promote the narrow interests of individuals or private parties. "Politicians supply shield against wearisome competition by means of grants, import quotas, tariffs, tax exemptions, and preferential treatment to interest groups paying for this service" (Stigler, 1971). "Governments operate with reasonable competence to resolutely attain purposely incompetent goals" (Posner 1974: 337–9).

As seen by representatives of the Chicago School, it is not even the principal's self-serving behavior that is responsible for the inefficiency of laws and regulations but rather the strong leverage that interest groups have over government operations. "The government is not intentionally self-serving but falls victim to the interests of private actors. This argument suggests the existence of two types of self-serving regimes. A first type is called a ''predatory government,'' a ''grabbing hand'' regime" (Djankov et al. 2001), characterized by guidelines and protocols that are designed so as to profit the government. A second type is described by the Chicago School as a regime where lobbying groups are in a strong position and

regulations are created to generate rents for their benefit.

The contributions by Tullock (1980a: 27) and Shleifer and Vishny (1993) can be "regarded as a big contributors to the investigation of the ''grabbing hand'' regime. They argue that self-seeking governments that are controlled are superior to disorganized, predatory governments. In the latter case a businessperson must bribe several departments simultaneously for the operation of his business, for example, the local legislature, the central ministry, the fire authorities, the police, and the water authorities. Each of these institutions acts independently and extorts the businessperson. By means of their independent revenue maximization, the departments ''overgraze'' the marketplace and hurt from the ''tragedy of the commons.'' The impact of governance on corruption networks is, therefore, an appealing theme that has not been deliberated upon adequately. This argument carries over to the functioning of 'networks' in facilitating a corrupt transaction. Strong patron-client networks ensured that the ¯flow of favours and benefits was anchored in personal relations between individuals, a system which the deficiencies of the state administration ensured was largely self-perpetuating.

The existence of strongly entrenched clientelistic grids may contribute to the expansion of a path dependency, in which it becomes nearly intolerable to escape from what Donatella della Porta has "described as the `vicious circles' of clientelism-corruption-clientelism and poor administration-corruption-poor administration. Venality is hardly a recent phenomenon in politics, but the emergence of so-called `business politicians', as described above, reflects a perceived tendency for a growing number to enter politics primarily for personal gain" Understanding the underlying principles of corrupt transactions and their embeddedness in the web of relationships helps to develop new strategies for combating corruption. Jean Cartier-Bresson (463-476) discusses the "advent of institutionalized socio-economic networks of corruption. These networks assist system of hybrid co-ordination for the exchange of widely diverse goods and services (which can be financial, partisan, societal, representative and so forth).

They also create standards which are largely non-monetary or non-material by which to measure these exchanges, and promote a value system which goes beyond the principles of

purely market relationships". Cartier- Bresson investigates which organizational forms promote an expansion of corruption and encourage individuals to abandon legal frameworks in favor of corruption networks which, like all markets, are embedded in social structures. In practice, he contends, corruption networks vary in form not only according to how they are organized, but also according to their location (national, regional) and their activities. Rose-Ackerman provided a good definition of the frame of reference of theories of corruption markets when she wrote, from an instant when complicity between political parties, the upper echelons of management and private or public industries becomes the foundation of a large-scale fraud in Europe, it is essential to broaden the economic approach by examining how different resources (economic/political, social, symbolic) are swapped. This type of exchange amongst political, economic and social systems is not the pluralist archetypal, but somewhat the prototypical of neo-corporatist democracies in which discussion and co-management form the source of the politico-economic arrangement. Agents can constrain their principal. They can obtain a powerful position vis-a` -vis the principal. Principals can also be constrained by powerful lobbies. Such lobby groups may provide campaign funding or be instrumental in pursuing the principal's political goals. In return, the government may offer distortionary laws and regulations that are of interest to lobbies. They create bottlenecks and market distortions and offer the resulting artificial rents to their beneficiaries. The government then becomes dependent on its supporting private interests. McChesney (1987: 102) noted that "traditional rent seeking theory describes a politician as the ''passive broker among opposing private rent seekers.'' Tullock (1993: 26) posits that "politicians are not in a powerful position to pursue their own interests. Rather, they are merely acting on behalf of other's interests. Because of the restrictions faced by the principal, his self-serving behavior is likely to cause allocative distortions. Valuable resources would be misallocated. At the legislative level tariffs can be lowered for favoured sectors or tax privileges may be given to industries in exchange for bribes. In this case, the tax burden of other sectors would increase.

Entrenched corruption arises only where cultures function mainly with particularistic forms of trust disregarding the universalistic standards. Tirole (1986) "analyzes one such characteristic of this network by means of a three-tier principal-supervisor-agent model. This extension of a conventional principal-agent model helps draw inferences about the sort of corrupt relationships that could develop under a three-tier unitary government structure.

Moreover, a 'bad' collective reputation of public administrators creates 'more incentives to engage in corrupt activities than if they had always behaved honestly', determining even for newcomers a vicious circle 'where the new generations grieve from the original sin of their elders' (Tirole 1996). These inferences are highly sensitive to underlying assumptions about principal-agent relationships under a multitiered system of governance. Schramm and Taube argue that "today these networks also constitute a formidable enforcement mechanism for corrupt transactions in Chinese society. Guanxi networks_ may transcend their normal functions and coordinate illegal, corrupt transactions by embedding these deals in trusted social relationships that contain unscrupulous behavior by any party".

These networks therefore enable the sealing of corrupt contracts and are accommodating in dispersion information on dishonest opportunities. As Lambsdorff observes, corruption is no exception: "corrupt relationships can be set up with partners with whom some kind of organizational link already exists. Pre-existing relations can lay the basis for economic exchange by providing the vital protection against opportunism'" (2002: 233). Corruption becomes a cause of distortionary regulation (Lambsdorff 2002b; Rose-Ackerman 1999: 9–17). For instance, the examination of disproportionate bureaucratic regulation in De Soto (1989) leads the author to assume that they were mostly driven by the yearning to produce corrupt revenues.

A vicious circle can exist whereby inefficient regulation leads to corruption, which in turn promotes the additional spread of wearisome regulation so as to augment administrative authority and the prospect to exact further payoffs. As articulated by Myrdal (1956: 283), "in many developing nations . . . the damaging effects [of quantitative controls] have been serious. Corruption does not help to overcome cumbersome regulation but acts as an inducement to public servants to create artificial bureaucratic bottlenecks. Corruption acts, therefore, as sand in the wheels".

Guriev (1999: 2) says that top-level corruption "is particularly unproductive, as it redistributes rents in favor of agents, and consequently makes it more alluring for probable entrants," thereby leading to complex total corruption. Quantifying and understanding corruption in business becomes even more composite when the spotlight transfers from abject

and unconcealed corruption to more subtle forms of upstream corruption at the business government nexus. When no cash is exchanged, but entrusted power in its place is leveraged to build position of power, both the magnitude of the problem and the ways to engage with it becomes exceedingly tricky to pin down empirically[5]. Take the risk of policy capture at the business-government nexus as an example. Mara Faccio (2006), to study these linkages collected information on the political connections of large shareholders and top officers of more than 20,000 publicly traded firms in 47 countries[6].

Concluding Observations

"Corruption is bad not because money and benefits change hands, and not because of the motives of participants, but because it privatizes valuable aspects of public life, bypassing processes of representation, debate, and choice" (Thompson 1993). The result was staggering and provides a compelling substantiation that 'conflicts of interests' permeate developing and developed countries alike and require urgent attention by policy-makers. In the United Kingdom, for instance, politically connected firms are estimated to account for almost 40 per cent of market capitalisation – a number that rise to an overwhelming 80 per cent in Russia (Faccio, 2006). Research also underscores that the 'unjustifiable reimbursement' of such political associations is existent, noteworthy and ubiquitous. Faccio additional study establishes that strengthening corporate integrity is not only the duty and accomplishment of business leaders and regulators, but, '[it] takes a village of several non-traditional players', such as auditors, the media and employees, to provide the important checks and balances for detecting corporate fraud (Faccio, 2006). Bribery in business is a fraction of the bigger picture of private sector corruption. Other corrupt practices, such as corporate fraud, cartels and undue sway on public policy, work as disparaging forces that chip away fair competition,

[5] Entrepreneurs who often play a governance role in corrupt markets are specialized brokers. Brokers play a crucial role: they reduce identification and information costs by building contacts (that is, a system of friendship and trust ties); they collect and transmit reserved information, necessary to win the confidence of those who want to participate in the illegal exchange; they assume some of the risks of illegal transactions; they also help solve problems of coordination that arise between the central authorities allocating resources and those at the local level who must manage them.

[6] http://corruptionresearchnetwork.org/resources/frontpage-articles/corruption-and-the-private-sector

stifle economic growth and eventually undercut companies' own existence. Exceedingly corrupt countries have deficient apparatus for law formulation and enforcement. This insufficiency raises the transaction costs in the economy, increasing the cost of private capital.

The problem is compounded by path dependency (the fact that a major break with the past is difficult to achieve, because major reforms are likely to be blocked by powerful interest groups); cultural and historical factors; and attitudes. These considerations lead principals to the conclusion that any endeavor to restrain corrupt behaviors will invite strong retaliation from powerful interests. Therefore, citizen enablement (through decentralization, right to information, citizens' charters, bills of rights, regular elections, and other forms of civic engagements by civil society organizations) assumes dangerous importance in fighting corruption, because it may have a significant impact on the incentives faced by public and private officials to be responsive to public interest.

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