

The impact of Corruption

Tackling corruption could reap significant benefits for the South African economy

October 2016

MG South Africa, a South African entity and a member firm of the KPMG network of independent member firms affiliated with KPMG International e ("KPMG International"), a Swiss entity. All rights reserved.

ndeavo

The integnation contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. All to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that is accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of

Co

Kenig

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International Cooperative ("KPMG Interna

Contents

What activities qualify as "corruption"?	7	
The potential negative effects of corruption	9	
What is our measurement of corruption and why?	12	
Financial misconduct at national, provincial and local government level	13	
Corruption perceptions impact negatively on economic growth	14	
How do South Africans perceive the extent of corruption?	14	
The potential opportunity costs of corruption	16	
Way Forward	18	

Introduction

he International Organization for Standardization (ISO) will release muchanticipated Anti-Bribery standards by the end of 2016. Those standards will provide a framework for private companies' anticorruption compliance management systems and policies, as well as guidelines for identifying and addressing bribery risks.

South Africa ranked as the 61st most corrupt country out of 168 countries in 2015 according to Transparency International. In this article, we explore the potential costs of current levels of corruption for the South African economy and their implications for the socioeconomic rights of South Africa's poorest citizens. Before explaining that the state could partially reduce



those costs if it could tackle the corruption problem effectively, we first briefly outline the types of activities captured by the word "corruption".



What activities qualify as "corruption"?

What activities qualify as "corruption"?

Corruption is pervasive in both developing and advanced economies.¹ However, no globally agreed-upon definition of corruption exists, with lay persons using the term interchangeably with transgressions including lobbying, bribery, fraud, collusion and theft.

The simplest definition—"the abuse of public power for private benefit"— which the World Bank uses, is limited to forms of corruption involving public officials.²

The definition in South Africa's Prevention and Combatting of Corrupt Activities, Act 12 of 2004, (PCCA) is broader and includes any "gratification" that would induce either public or private actors to act in an improper manner in the performance of their duties. The Act would prohibit, for example, not only the receipt of benefits by a public official, but also the breach of a fiduciary duty by a director of a company in exchange for some benefit.

Typical examples of corrupt activities that public sector officials engage in, in exchange for some form of gratification, include the embezzlement of public funds and the theft of public assets.³ However, the benefit need not be in monetary form and need not flow to the public official himself to amount to corruption. Examples of benefits include a public official allowing their juniors to record annual leave as sick leave or a provincial minister encouraging the procurement of goods and services from a business owned by a family member.



¹ See, e.g. Transparency International (2015). *Europe: A Playground for Special Interests Among Lax Lobbying Rules*. Available at:

http://www.transparency.org/news/feature/europ e_a_playground_for_special_interests_amid_lax_l obbying_rules; Gallup (2013), Government Corruption Viewed as Pervasive Worldwide. Available at:

http://www.gallup.com/poll/165476/governmentcorruption-viewed-pervasive-worldwide.aspx.

² See, e.g., World Bank (1997). *Helping Countries Combat Corruption*. Available at http://www1.worldbank.org/publicsector/anticorr upt/corruptn/corrptn.pdf.

³ See, e.g., OECD. *Issues Paper on Corruption and Economic Growth*. Available at

http://www.oecd.org/g20/topics/anti-

corruption/Issue-Paper-Corruption-and-Economic-Growth.pdf.

The potential negative effects of corruption

The potential negative effects of corruption

Public sector corruption has both direct and indirect effects on the institutions of a country. The direct costs of corruption include not only bribes, but also funds wasted on inflated procurement contract prices, and stolen public assets. The indirect costs include inefficiencies resulting from the deterioration of institutions and criminal activities.⁴ Corruption has implications for social welfare by affecting the distribution of income and assets and unemployment, the environment and health. ⁵ A culture of corruption also affects the rule of law by weakening the institutions tasked with enforcing a country's laws.

Further, there is evidence that corruption reduces private investment in a country, particularly foreign direct investment, and has dampening effects on the competitiveness of firms and innovation.⁶ A 2009 study finds that a one-point increase in the corruption level (measured by the International Country Risk Guide Index) leads to a reduction in per capita FDI inflows of about 11 percent.7

Whatever the mechanisms used to examine the direct and indirect effects of corruption, it means that





there are fewer state resources available to fulfil the socioeconomic rights guaranteed in the South African Constitution, Act 108 of 1996. These include the right to basic education, the right to healthcare, food, water and social security, and the right to housing. The Constitution recognizes that the state cannot fulfil those rights exhaustively, and that they are limited to the extent that the state has available resources to address them. ⁸ Nonetheless, redirecting even a portion of the current levels of wasted

⁸ See, e.g., Currie I and de Waal J (2005). The Bill of Rights Handbook.



9

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

⁷ Al-Sadig A (2009). *The Effects of Corruption on FDI Flows*. Cato Journal (although noting that, over time, the investors value institutional strength more than perceptions of corruption).

state resources would undoubtedly contribute to the economic and social development of the poorest South Africans.



Source: Constitution of the Republic of South Africa, Act 108 of 1996



What is our measurement of corruption and why?

What is our measurement of corruption and why?

There is an opportunity cost of the wasted funds lost to corruption, as the state or the private sector could have spent the funds on more productive uses.

As one would expect given its secretive nature, corruption costs are difficult to calculate. The most commonly cited estimate is the World Bank's \$1 trillion lost to bribery alone in 2013 on a global basis (3% of global GDP).⁹ The World Economic Forum has estimated that corruption costs 5% of global GDP annually.¹⁰

We partially estimate the extent of public sector corruption using three different methodologies.

• First, we look at publically available financial misconduct figures available from the Auditor General's annual reports.

- Second, we consider results from a study identifying a causal relationship between the Corruption Perceptions Index (CPI) and a country's GDP.
- Third, we use survey statistics of the South African public's perceptions of and involvement in bribery.

As corruption is by definition unrecorded, and due to the indirect effects of corruption, as well as multiplier effects in the economy, the actual costs of corruption could vary considerably from these numbers. Our analysis nonetheless provides a starting point for considering the alternative uses of these funds.

 ⁹ See, e.g., OECD, The Rationale for Fighting Corruption (2014) (available at http://www.oecd.org/cleangovbiz/49693613.pdf).
 ¹⁰ Ibid.



Financial misconduct at national, provincial and local government level

The Auditor General's annual financial audits compare the financial management objectives of government departments with actual expenditure outcomes. The audits focus on three types of financial misconduct—fruitless and wasteful expenditure, irregular expenditure and unauthorised expenditure--which are defined in the Public Finance Management Act 1 of 2004. These three categories may capture some component of corrupt activities if the financial misconduct was for nefarious purposes rather than maladministration.¹¹

The recorded amounts of financial misconduct amounted to billions of Rands in 2014/2015, as can be seen from the table below.

2014/2015	Fruitless and Wasteful Expenditure	Irregular Expenditure	Unauthorised Expenditure	
National Government	R221 million	R7.32 billion	R414 million	
Provincial Government	R715 million	R18.37 billion	R1.23 billion	
Municipalities/Local Government	R1.34 billion	R14.75 billion	R15.32 billion	
Total	R2.28 billion	R40.43 billion	R16.96 billion	

Source: Auditor General Reports 2014/2015

It is not possible to isolate the values of corrupt activities from these recorded amounts, but it is clear that if the wasted expenditures from corruption are even a fraction of these amounts, there are significant costs to the South African economy.

The top offending national departments in 2014/2015 were:¹²

Fruitless and Wasteful Expenditure

- Correctional Services R 28 million
- Rural Development and Land Reform R6.1 million
- Statistics South Africa R 4.3 million
- The Presidency R 3 million
- Public Works R 2.1 million

Irregular Expenditure

- Basic Education R728 million
- Defence R 559 million
- Health –R398 million
- Police R 281 million
- Correctional Services R 164 million

Unauthorised Expenditure

- Basic Education R 6.5 million
- Public Works R 5.5 million
- Traditional Affairs R 2.3 million
- Government Communications and Information Systems R0.71 million

Source: Auditor General Reports 2014/2015

¹² Auditor General Reports (2015). Available at: http://www.agsa.co.za/Documents/Auditreports/PFMA20142015.aspx.



¹¹ See, e.g., Corruption Watch (2014). *Getting a Grip on Irregular Expenditure in Municipalities*. Available at: http://www.corruptionwatch.org.za/getting-a-grip-on-irregular-expenditure-in-municipalities/.

Corruption perceptions impact negatively on economic growth

The Corruption Perceptions Index (CPI) collated by Transparency International, ranked South Africa 61 out of 168 countries with a score of 44 out of 100 (with 100 being the least corrupt) in 2015, which is down from 45 in 2010, 50 in 2000 and 56 in 1995.¹³

There is a strong negative correlation between perceptions of corruption and output, with the two variables influencing one another in a negative feedback loop due to a reduction in private investment.

A 2011 study estimates that a one-unit increase in the CPI is associated with an approximately 0.6% decline in the growth rate of GDP of a country.¹⁴ Applying this estimate to South Africa, if South Africa were to have attained a score of 45 in 2015, it could have earned R23 billion in additional GDP, holding other factors constant.¹⁵ To put that in perspective, that amount exceeds the tax increases of R18 billion in 2016/2017 and the R16 billion allocated to higher education over the next three years proposed in the 2016 Budget Speech.¹⁶

How do South Africans perceive the extent of corruption?



Survey statistics measure the tolerance of a society to acts of corruption. A 2007 survey estimates that 34% of South African firms say they are expected to pay bribes to get awarded public procurement contracts, and on average the bribe amounts to 2% of the value of contracts.¹⁷ A 2015 survey estimates that 26% of South Africans know someone whom an official asked to pay a bribe, and that 75% of those people paid the bribe. Thirty-four percent of those who paid bribes did so to escape a traffic office and paid on average R219 per bribe.¹⁸ It is not possible to estimate how much money the state would have been recovered in fines, but we estimate that the amount spent on bribes to avoid traffic fines might have amounted to approximately R710 million in 2015.¹⁹ A recent survey by law firm Edward Nathan Sonnenbergs found that of 132 corporate respondents operating in a range of industries, 39% had experienced bribery over the previous 2 years, despite 90% having anti-corruption compliance programs in place.²⁰

Afternoon_Thing_23+September&utm_medium=email&utm_term=0_c81900545f-379dd512ad-128224637#.V-umYhH7UaJ.



¹³ Transparency International Corruption Perceptions Index Results. Available at: http://www.transparency.org/cpi2015#results-table.

¹⁴ Ugur M, Dasgupta N (2011). *Evidence on the economic growth impacts of corruption in low-income countries and beyond: a systematic review*. London: EPPI-Centre, Social Science Research Unit, Institute of Education, University of London. The review consider studies on low-income and "mixed" studies (low-income and non-low-income countries), with the effect on GDP being similar across the two (0.65% and 0.57%). South Africa is classified as a middle-upper-income economy by the World Bank; World Bank Country and Lending Groups (available at https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups).

¹⁵ IMF GDP data. Available at:

http://www.imf.org/external/pubs/ft/weo/2016/01/weodata/weorept.aspx?sy=2014&ey=2021&scsm=1&ssd=1&sort=country&ds=.&br=1&c=199&s=NGDP&grp=0&a=&pr.x=64&pr.y=16).

 ¹⁶ 2016 Budget Speech. Available at: http://www.treasury.gov.za/documents/national%20budget/2016/speech/speech.pdf.
 ¹⁷ World Bank Group. *Corruption Statistics from Enterprise Surveys*. Available at

http://www.enterprisesurveys.org/data/exploretopics/corruption.

¹⁸ Ethics Institute of South Africa (2015). South African Citizens' Bribery Survey.

¹⁹ This is derived by taking the approximate population of South Africa (52 980 000) in 2016 and multiplying it by the statistics derived from the survey ($26\% \times 75\% \times 34\% \times R219$).

²⁰ Marked Increase in Bribery in SA—Survey, Daily Maverick, 23 September 2016. Available at:

http://www.dailymaverick.co.za/article/2016-09-23-bribery-up-in-

sa?utm_source=Daily+Maverick+First+Thing&utm_campaign=379dd512ad-

The potential opportunity costs of corruption

The potential opportunity costs of corruption

We have estimated some of the potential opportunity costs of corruption for service delivery related to each of the socioeconomic rights listed above. The fiscus could have spent the estimated losses on:²¹

Estimated corruption values (R)	Ambulances	Paramedics salaries	Teacher salaries	Old-age grant	Child- support grant	Toilets	RDP houses
R1 million	4	6	6	63	268	20	10
R710 million	2840	4034	4413	44 691	190 043	14 200	7 100
R23 billion	92 000	130 682	142 994	1 447 725	6 156 317	460 000	230 000

Such additional expenditures could start to address South Africa's dire needs regarding, among other issues, emergency healthcare and childhood development. Further, we estimate that an additional R1 million of government expenditure could result in 4 additional jobs, R1.48 million in additional GDP and R400 000 in additional taxes due to multiplier effects.²²

²¹ KPMG calculations, raw data available from: Mail & Guardian (2014). *MEC's car costs three ambulances* [Online]. Available: http://mg.co.za/article/2014-05-15-mecs-car-cost-three-ambulances; Healthcare salaries (2015). Paramedic salary [Online]. Available: http://www.healthcare-salaries.com/allied-health-professionals/paramedic-salary; NAPTOSA (2015). *Wage agreement signed – 7% salary increase (effective 1 April 2015).* Available at: http://www.naptosa.org.za/index.php/doc-manager/30-labour-matter/11-salary-related/528-salary-scales-2015-draft-educators-lecturers/file; South African Social Security Agency (2014/15). *Presentation to the Portfolio Committee on Social Development.* Available at: http://pmg-assets.s3-website-eu-west-1.amazonaws.com/151015sassa.ppt; South African Social Security Agency (2014/15). *Presentation to the Portfolio Committee on Social Security Agency (2014/15). Presentation to the Portfolio Committee on Social Development.* Available at: http://pmg-assets.s3-website-eu-west-1.amazonaws.com/151015sassa.ppt; Htxt (2015). *Gauteng primary school gets solar-powered toilets.* Available at: http://www.htxt.co.za/2015/01/23/gauteng-primary-school-gets-solar-powered-toilets/; Democratic Alliance (2015). *RDP houses repaired at up to 3 times the cost of building them.* Available at: https://www.da.org.za/2015/03/rdp-houses-repaired-3-times-cost-building/.



Way Forward

Way Forward

Tackling corruption could have a positive effect on South Africa's economic output by strengthening institutions and creating a virtuous cycle of trust in the state and investment, ultimately contributing to GDP, and reducing unemployment and income inequality. If the state could tackle some of the current costs of corruption, this could have substantial positive effects for the economy and support the progressive realisation of our citizens' socioeconomic rights.

In subsequent articles, we will consider potential mechanisms to prevent corruption, whether originating from a public or a private source, in light of the upcoming ISO certification anti-bribery standards.









Contact us



Lullu Krugel Chief Economist and Director

T +27 (0)82 708 2330 E lullu.krugel@kpmg.co.za



Kathryn Lloyd Economist

 T
 +27 (0) 82 388 9170

 E
 Kathryn.Lloyd@kpmg.co.za



Nina Kirsten Economist

- T +27 (0)60 692 0341
- E <u>Nina.Kirsten@kpmg.co.za</u>



Thabiso Mofulatsi Economist

T +27 (0)82 708 2330 E Thabiso.Mofulatsi@kpmg.co.za