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Institutional Corruption: Few Issues

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Abstract:

Institutional corruption is defined as an act by a public or a private agent that can be justifiable legally but still is corrupt. This arises out of missing institutions, laws and regulations. Furthermore, ability of powerful agents in influencing law making and implementing regulation can be a source of institutional corruption. This paper brings forth a few issues of institutional corruption and it presents qualitative empirics in the case of exploitation of non-renewable natural resources in the Indian context.

Keywords: Illegal and Legal Corruption; Institutions; Exploitation of Non-renewable Natural Resources

1. Introduction

Corruption is generally defined as ‘misuse of public office for private gain’. Constitution of a country broadly defines rights and obligations of the public and the framework of the legislature in making laws and regulation and independent judiciary to interpret and enforce the constitution. When one says ‘broadly defined’, it implies certain degree of discretionary powers in the hands of the legislature and judiciary in making and enforcing laws. The degree of discretion could be a source of corruption in a country. On the other hand, missing institutions, laws and autonomous regulatory bodies can be a source of corruption. An example is the absence of autonomous regulatory bodies in regulating exploitation of non-renewable resources. Even if laws are in force, corruption can arise in implementation of the laws. For example, the police (or Central Bureau of Investigation, CBI), prosecutors, and powerful private agents could collude and distort the evidence making the judiciary ineffective.

In India’s case, the constitution of India is the supreme law, which guarantees the basic rights of individuals and rationalizes the powers and functions of the various bodies at the centre and state levels. Any law enacted by the government, both at the centre and state levels, that infringes on these rights, when challenged, is liable to be quashed by the courts. The constitution acts as a political as well as a financial document. The legislative powers are distributed between the centre and states with each assigned rights to enact laws based on delineation. Commercial laws are mainly enacted by the central government.

Public office generally refers to the legislature, executive, judiciary, police and bureaucracy. The sources of corruption can be traced to scarcity, property rights and their enforcement, transaction costs and information asymmetries, and political position (Patibandla and Sanyal, 2009; Dixit, 2015). Scarcity leads to opportunities for corruption in the sense that it provides the ability to

create artificially a scarcity and creates opportunities to profit from them. Good examples of illegal rents through imperfect information are tax evasion, service of public goods such as ration cards to the poor when poor are unaware of their rights, and insider trading by managers of publicly listed companies, etc. At present, as Debroy and Bhandari (2011) observe “...the largest discretionary abuse now concerns land acquisition, conversion of agricultural land into non-agricultural usage and building regulations, and areas where unrealistic land and building laws, and tenancy laws, have created artificial shortages.”

Illegal rent from position is extracted by persons in strategic positions, which enables them to either benefit or inflict harm. Politicians and bureaucrats can extract kickbacks for government purchases, licenses, permits, amnesty and so on (Patibandla and Sanyal, 2009; Patibandla, 2013). Persons in judiciary can behave similarly.

Lessig (2011) defines the concept of ‘institutional corruption’. Institutional corruption is an act by a public or private agent that is legally justified but still is corrupt. This arises when powerful private agents influence making laws and regulations that suit their interest at the cost of the public at large. For example, a few years ago the Supreme Court of the United States (U.S.) ruled that private agents are free to contribute as much as they wish to politicians for campaign finance. Once a private agent contributes large sums for the election of a politician, he/she would influence the politician in power to make rules and regulations in their favour.¹ Pethe. Et.all

¹ The political powers of big business such as the defence industry, natural resource industry such as oil and gas, the processed food industry and gun lobby in the U.S. are common examples. The 2008 Financial Crisis of the U.S. is a good example of costs of institutional corruption. In the late 1990s, the financial markets and institutions were deregulated under the ideology that free markets function efficiently. Subsequently, the Wall Street bankers created asset (mortgage) bubble by generating imperfect imperfections which destroyed billions of dollars of public savings and investments when the bubble burst. Most Wall Street bankers went scot free (Stiglitz, 2012).

(2012) make a distinction of illegal and legal corruption. They observe that legal corruption arises from abuse of discretionary powers by politicians and tactical law and policy making, which includes use of information advantage by politicians to make private gains. They make use of the concept of “honest graft” where politicians use their insider information (for example, on where some projects such as roads or dams are going to be located) and profit by purchasing assets whose price will rise when this happens (for example, land in locations that will boom after initiation the project).

In India’s case, the non-performing assets (NPAs) of the public sector banks are a striking example of institutional corruption. Powerful business men and groups could borrow large sums of money from the public sector banks through political influence and divert the funds for private gains and declare bankruptcy of the business and get away with it because of poorly defined and enforced bankruptcy laws. It appears the NPAs amount to eleven lakh crore rupees at present. Since the beginning of the Nehru’s Fabian Socialist Policies² of the early 1950s, powerful family business groups have been able to build family business empires with tax payers’ money by cornering industrial licences and the public sector financial institutions (Patibandla, 2006a; Tripathy, 2004). Significant part of this burden fell on the poor because a major part of the government revenues were indirect taxes (Patibandla, 2006). Under the prevailing Fabian Socialist Policies and Regulations, this was legally justified.

² Jawaharlal Nehru contradicted himself as a great scholar and his economic policies as the first Prime Minister of India. Nehru in his book “*The Discovery of India*” discussed in length the extreme poverty and suffering of farmers and the people in the rural India. He documented it with personal experience of travelling across and into remote areas of India. On the other hand, his Fabian Socialist Economic Policies hardly benefited large section of the poor, especially those living in the rural areas.

This is not meant to generalize all family businesses. It is well-known that J.R.D. Tata made significant contribution to the Indian industry and science despite strong resistance from and discrimination by the British colonial government.

At present, illegal mining of natural resources and land mafia arising out of collusion between politicians and powerful private agents can be termed as institutional corruption owing to poorly defined and enforced common property rights of the tribal groups in different parts of the country (Sahu, 2008).³ Gandhi and Walton (2012) observe that since the initiation of economic reforms of 1991, income inequality has been increasing at an exponential rate in India. They observe a major part of this wealth is generated by ‘rent-seeking’⁴ in areas where the government still plays a role in issuing licences and implementing regulation.

In Section 2, I bring forth a few conceptual issues of institutional corruption; and in Section 3, I present qualitative empirical analysis of exploitation of non-renewable natural resources in India.

2. Conceptual Issues

Lessig (2011) defines institutional corruption “A situation where influences within an economy of influence tend to weaken the effectiveness of an institution, especially by weakening public trust of the institution.”

In India’s case, the UPA’s (United Progressive Alliance) rule from 2004 to 2014 presented large- scale corruption on several fronts. One can observe qualitatively that the public lost trust in the government. Narendra Modi of BJP (Bharatiya Janata Party) contested the general elections in 2014 with the slogan of

³ For example, in the state of Gujarat, the government acquired 1,777 acres of land to construct Sardar Sarovar Dam: 1400 acres of land which belonged to tribals remained unused. The state promised to give back the land to tribals. However, the land is being used to construct nature parks, gardens and woodlands for tourists.

⁴ Gandhi and Walton observe “ By economic rent we mean a return on a factor of production in excess of what could be obtained from alternative use in a fully competitive activity,”

‘Maximum Governance with Minimum Government’. Subsequently, he was elected prime minister with clear majority in Lok Sabha. Since the formation of the government, there have not been any major corruption scandals at the center. The issues relating to black money stashed abroad and tax evasion still remain a major issue of institutional corruption. One of the theme Modi campaigned in the 2014 general elections was improving ‘easy of doing business’. Ease of doing business should be interpreted in terms of reducing transaction costs of doing business but not providing public resources such as land and water at subsidized rates below their real opportunity costs to private agents.

There are several definitions of “an institution” in sociology, economics and political science. In simple terms, “an institution” may be observed as a social contract between two or more people for common objective. The following issue is how well each individual’s preferences are reflected in common objective. Social choice theory tells us it is impossible for rules of collective action to reflect each individual’s preferences perfectly (Arrow, 1951). An individual whose preferences are least reflected in the rule will stay in the group if he is better off than being on his own or defecting to another group.⁵ Or she/he breaks the law. For example, the imposition of prohibition of consumption of alcohol in the early part of the last century in the U.S. resulted in emergence of mafia for bootlegging. It entrenched itself and branched into other areas after the lifting of the prohibition. An individual could defect to another group if she/his preferences are reflected better in that group – political, economic and social refugees. In this context, institutional corruption is if a few are able to make their preferences reflected in common objective proportionately more than the rest.

Team theory has similar connotations (Alchian and Demsetz, 1972). The common objective can be achieved by more than one person working together. Two or more people work as a team if the value generated by the team is higher than the sum of values of each individual acting alone. The following issue is about how they design the system of measurement of each member’s effort and corresponding

⁵ In other words, democracy needs checks and balances on the laws based on majority preferences and should not degenerate into majority fascism.

reward and limit the degree of free-riding. An example is regulation of natural monopolies by the government. In the case of natural resources, extraction has natural monopoly properties. The government has to play an important role in giving contracts through transparent process and afterwards, it has to regulate the private player that she/he charges a price that is equal to long run marginal (average) costs and share wind fall gains through international price movements with the government. If the regulators takes bribes and allows the private player to retain windfall gains it can be termed as free-rider outcome and consequent institutional corruption especially if the contracts are highly incomplete.

The other aspect of team theory is Olson's (1965) argument that small groups are more effective than large diffused groups in capturing the state because they can undertake reciprocal monitoring. A powerful agent or colluding agents in a public or private office can make a private gain at the cost of diffused groups without breaking the law or simply making laws that make it possible. This arises from the political process and consequently the way laws are defined and enforced (legislature, executive and judiciary). The other aspects are degree of informational imperfections,⁶ the way property and contract rights are defined and enforced, scope and autonomy of regulatory institutions, established norms and how effectively private agents or groups (civic society) are organized.

North (1990) observes that institutions are "the humanly devised constraints that structure political, economic, and social interactions. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitution, laws, property rights)." In his schema, a fine line between individual incentives and constraints determines economic development. We do not have a theory of this fine line. North traces it historically in the U.S. North's definition emphasizes informal and formal constraints. The modern public and private institutions are a result of increasing complexity of social arrangements of a group or groups (countries) of people to serve broadly defined

⁶ Policy makers have insider information about policy changes which have implications on business. They (and family members and friends) can use this information to make money in the stock markets which is legal but unethical.

common objectives of members of the group. The constraints (institutions) have to change with changing moral landscape (for example, constraints imposed by religious groups and caste system), market dynamics (for example, emergence of complex financial derivatives) and technology (for example, the implications of the internet on global business and freedom of expression). The change can be gradual or sudden through crises or external shocks (that break prisoner's dilemma interactions).

The U.S. is a modern and the oldest democracy in the world with people choosing to be governed by elected representatives drawing a balance between individual incentives and constraints of common good which is termed as the republic of a representative democracy (Lessig, 2011). However, many natural resources such as oil and gas are treated as private property of agents but not common property of the people. Consequently, the oil companies are very powerful politically in influencing government rules and regulation.

A public institution is basically delegation of the implementation (also making) of the rules of the society to an individual or sub-set of group of individuals by paying a fees and giving some powers. In a democracy, it is done through electoral process. "Public trust of an institution" can be seen in terms of moral hazard outcomes of principal agency relation. Informational imperfections or asymmetries allow a public official to use the powers to serve her/his private gain at the cost of the society or a sub-group of a society (Pethe, et al, 2012).⁷

Moral, ethical and virtue issues of institutional corruption have complex issues. Politicians can project themselves as "saviours". In India, there are several politicians representing the interests of the backward-caste groups. If there is no discrimination of the backward-caste groups, these politicians have no reason for their existence. Some of them may develop self-interest in the discrimination and informational

⁷ For example, in India (the largest and complex democracy in the world) at present there is very low public trust of government, politicians and big business owing to large- scale corruption scandals. In legal terms very few or none of them are convicted owing to institutional failures- the expected gain from corruption is extremely high and the expected cost is extremely low (Patibandla, 2013).

imperfections (ignorance).⁸ Not performing an action by a leader that mitigates informational imperfections can be seen as a form of institutional corruption. Not initiating or blocking a reform is institutional corruption. It is qualitatively recorded that the leaders representing the tribal groups collude with mining companies and uproot tribals in states such as Chhattisgarh. Most of the groups are unaware of their constitutional property rights.

Acemoglu and Robinson's (2012) in their book "*Why Nations Fail*" show when elites who monopolise de jure political power lose power: they may still exert disproportionate influence in politics by increasing the intensity of their collective action (e.g., in the form of greater lobbying, bribery, or downright intimidation and brute force); and thus ensure the continuation of the previous set of economic institutions. At present, parties such as the Congress and its coalitions which lost the elections comprehensively in 2014 resist reforms that could improve growth rate such as Goods and Services Tax (which requires constitutional reform), land acquisition bill and labour market reforms.⁹

Politicians can come to power by sending signals to voters based on asymmetric or imperfect information. It is costly for individual voters to verify the information. Consequently, the outcomes of this political process may result in some private gains to the constituents at the cost of (long term) public goods. Laws based on asymmetric or imperfect information are source of institutional corruption. For example, laws that govern drilling by oil companies provide information about economic benefits of job creation and gas prices but not the extent of negative externalities involved which individual private agents may not be able to assess.¹⁰

⁸ A few leaders of the backward-castes, when they came to power at the state level did not invest in primary and secondary education for uplifting the people.

⁹ Source: Televised proceedings of Rajya Sabha of the monsoon sessions of 2015 and 2016.

¹⁰ China has been able to achieve 10 percent of annual GDP growth since 1980 which does not account for the extent of negative externalities of polluting rivers, land and air. The conventional measures of GDP have limitations.

In the common-law countries, some of the laws emanate from judicial decisions. Judicial decisions are supposed to reflect the scope of a country's constitution broadly. In civil-law countries, laws emanate from the government at the centre. Although, several elements of among them are similar- for example the limited liability system in the financial markets emerged from the common-law countries first and was later adopted by civil-law countries- the processes differ. It is easier for new laws to be enacted by the civil-law countries because of centralization of powers. The capture of government by powerful vested interest groups is supposedly higher in the civil-law countries than the common-law countries. However, when the courts in the U.S. implemented the regulation in the nineteenth century, it was subverted by big business (the rail-road companies), which forced the government to usurp the main role in regulation.

There are two dimensions to the formal laws; one is definition and the other is their enforcement. When laws are poorly defined, they give discretionary powers to government agents such that they could interpret them according to the context and extract rents. The vaguely defined rules work in favour of large agents who can incur the transaction costs of finding the gaps. Enforcement of laws involves the costs of monitoring, information, delegation under agency relations and transaction costs of the courts and the accountability of agents. Enforcement of laws also depends on the way a judge interprets (preferences, ideology) it and some laws may be a result of judicial decisions and there is a large body of literature on this issue in the law discipline- institutional structure of courts (politics, economics and justice).

As mentioned before, one of the important sources of institutional corruption is the way property rights are defined and implemented. In capitalist societies, there has to be a fine definition of what is private and what common property is. For example, a private agent can own a piece of land, but the ground water is public property. In the Coasian theorem of property rights (1960), collective action is necessary when individual actions cause costs to a society at large owing to negative externalities. Collective action is socially more efficient than individuals acting in isolation in the presence of transaction costs. A negative externality resulting out of a single individual's action affects a group of individuals. The sum of costs of

individual action in isolation could be higher than the costs of collective action in rectifying the negative externality. Collective action can take alternative forms; private ordering of individuals getting together for bargaining or government enforcing the property rights. In the presence of high transaction costs, and incidence of free riding within a group (Olson, 1965), the government's definition and enforcement of property rights becomes the superior choice. However, in countries such as India, transaction costs of enforcement by government or courts are high. If these transaction costs are the same as the transaction costs of group formation and bargaining, there will be a grid-lock, and one powerful external agent could get away by externalizing the negative externality; or the powerful agent can expropriate resources from the less powerful agents at prices lower than their opportunity costs. These outcomes of institutional corruption are common in India and also in the U.S. in the case of extraction of oil and gas.

As mentioned before, most of the natural resource industries have natural monopoly properties which require the government intervention in issuing licenses and contracts to private players and regulation at the *ex post* contract stage. Williamson's (1985) theory of incomplete contracts and governance is pertinent for examining this issue. Williamson shows implications of transaction costs on governance choices. Transaction costs differ in three critical dimensions; frequency, uncertainty and asset specificity. All contracts are incomplete. It is not possible to incorporate all possible contingencies into a contract. The behavioural assumptions are bounded rationality and opportunism. Bounded rationality (Simon, 1957) refers to behaviour intendedly rational, but limitedly so owing to informational imperfections and cognitive abilities. Opportunistic behaviour is conceptualized in terms of self-interest with guile. In the *ex ante* stage of a contract, the market is competitive. Once two agents get into a contract, it becomes a bilateral monopoly. Guile implies that when contracts are incomplete, agents renege on their promises when the environment changes or when one realizes that the other party has invested in assets specific to the contract (locked-in).

The incomplete contract framework tells us that it is not possible for laws and regulation to capture all possible contingencies that can occur at the *ex post* stage. At best, one can incorporate contractual safeguards at the *ex ante* stage which does not eliminate all costs of opportunism owing to incompleteness of contracts. In industries such as oil and gas, large private firms may possess more inside information of exploration (uncertainty), risks, and technology than the law-makers which they can use to make supernormal profits. These industries are economically and politically sensitive—once a large firm invests in exploring and exploiting the natural resource, it could manipulate the supply to increase bargaining in *ex post* contractual stage. Apart from this, poor understanding and asymmetric information of the technology by the law makers may help the large firms to externalize negative externalities of production. The corruption that arises because of incomplete contracts is legal but institutional.

Few Propositions

The following brings out a few broad propositions of institutional corruption especially regarding exploitation of natural resources.

Higher the inequality of a society both in terms of wealth and information about rights and obligations of the people, higher is the institutional corruption. For example, in India, there are about 100 dollar billionaires who account for 25 percent of the wealth (Gandhi and Walton, 2012). They can influence the electoral outcomes and law-making process by the politicians. In other words, they can make their preferences reflected in the laws more effectively than the poor and the uneducated. Stiglitz (2012) calls this ‘the price of inequality’.

Following Olson, the more concentrated the industry structure, higher the ability of large corporations to capture the political process. In a decentralized governance structure, it is

difficult for one or a few powerful agents to capture the political process. However, in the case of the Indian federal system, the government agents representing different states may have different economic interests.

The capturing of the political process can occur at local level (the effluent emitter pays a water inspector to look the other way or blame a nearby plant), the municipal level where pollutants are measured at the level of the delta or wherever it merges into the river by forming coalitions with fellow polluters, the state level by getting the state to accept weaker standards, and the national level by building coalitions with state governments to protect jobs in the industry. Likewise, the cost of internalizing negative externalities may occur in different ways. Following from the observation, the contracts for resource extraction will be given to the powerful agents in non-transparent way, especially if there are no laws and regulations that mitigate incompleteness of contracts. The resources will be undervalued at the cost of the society at large. Higher the supernormal profits the private agents make, higher is the institutional corruption as we treat natural resources as common property of people.

If the costs of internalizing negative externalities are higher than the costs of capturing the political process, large corporations have incentives in undertaking those costs. The costs of influencing the political process are costs of campaign finance, ability of large corporations to get into implicit collusion, lobbying, industry associations and organization and effectiveness of civic bodies and the extent of research funded by the corporations. The inefficiencies of the outcome of the political process should be examined by the way the laws and property rights are defined and how autonomous are regulatory bodies and the functioning of the judiciary.

3. Qualitative Empirics

One of the most significant areas where costs of institutional corruption are high is the exploitation of non-renewable natural resources. Natural resources have specific features: they are common property of people, non-renewable, involve negative externalities both on production and consumption sides and have natural monopoly properties. The common property issue has several dimensions; are they common property of people of a specific region of a country; are they common property of people of a country and; do they have common property elements of people of the globe as a whole? To illustrate the point, exploitation of the Amazon forests by Brazil has implications on the rest of the world. Strong federal states such as Canada treat natural resources as common property of states. The Indian government takes natural resources as common property of the country rather than region-specific.

The non-renewable characteristics of the resources imply prices should reflect both present and future generations' demand and supply. The negative externalities dimension requires the internalization of these costs by the producers and consumers. The natural monopoly properties of the resources require that government should play an important role in issuing contracts to private players and regulation. These dimensions of natural resources result in market failures on several fronts and involve complex issues. Just to give an example, privatization of natural resources such as gold and diamond mines and oil and gas in African countries such as Ghana, Sierra Leone, and Nigeria led to multinational firms exploiting these resources without benefiting the public, and caused civil wars and negative externalities of polluting the rivers and land owing to missing institutions in these countries. In Nigeria, it is estimated that corrupt deals between government officials, the state oil company and oil majors have cost Nigerians \$ 35 billion over the last ten years (The Economist, November 24-30, 2012).

Ostrom (2015) shows that common property resources are efficiently utilized in a decentralized system of a small group of people monitoring each other to avoid the tragedy of commons. However, if an (large) external agent, without long-term stakes is introduced this outcome fails, which requires for the government to define and implement property rights. Coase theorem (1960) showed that in the absence of

transaction costs, private agents come out with efficient property rights through mutual bargaining. However, the presence of transaction costs requires the state intervention in defining and enforcing property rights. On other hand, the state itself can be captured by a few powerful groups or agents who use the resources for personal gains (Olson, 1965.) The capture of the state can take place both through illegal and legal means. In this paper, I examine corruption in the privatization and utilization of India's natural resources.

In India, in the recent past, there has been clear evidence of deals and attempts at deals for the transfer of publicly-owned resources to private hands on terms which are more than generous to the private parties and involve substantial losses in potential income as well as other costs to the public exchequer (Ghosh, et al, 1995). Apart from this, exploitation of natural resources has resulted in violation of human rights of tribal groups.

Oil and Gas Industry

The oil and gas industry is usually divided into three major components: upstream, midstream and downstream, though midstream operations are usually included in the downstream category. The upstream oil sector is a term commonly used to refer to the searching for and the recovery and production of crude oil and natural gas. The upstream oil sector is also known as the exploration and production (E&P) sector. The upstream sector includes the searching for potential underground or underwater oil and gas fields, drilling of exploratory wells, and subsequently drilling and operating the wells that recover and bring the crude oil and or raw natural gas to the surface. Midstream deals with transportation of Crude Oil and Natural Gas for further processing. Pipelines and tankers are major part of midstream business. Downstream involves refining and petrochemical production by processing crude oil and natural gas. Sometimes it additionally refers to marketing of petroleum products. Large corporations control

the exploration, exploitation and distribution. Several reports show that large corporations make super-normal profits by manipulating the supply and the regulatory process.

Transparency International (2012) published a report which shows that oil and gas and mining industries are the most corrupt globally. The report captures bribery and “state capture” in terms of large corporation abilities to influence public policies. The U.S. is listed among the most corrupt countries in this regard.

In case of India, foreign oil majors were nationalized in the early 1970s. Since then, the government’s public sector companies monopolized the sector. In the 1999, the government opened up the sector for private participation with New Exploration Licensing Policy (NELP). In the same year, the government awarded the contract to one of the largest diversified business groups in India the Reliance to explore natural gas in Krishna and Godavari (K&G) river basin with a production-sharing agreement. In 2002, the company announced largest gas find in the world in the K&G basin. Subsequently, the Reliance Industries was split between two brothers Mukesh and Anil Ambani. They got into a family feud of sharing the surplus (monopoly rents) of exploiting the K&G basin (Guha and Ghosh, 2014).

In 2004, Mukesh Ambani promised to supply gas to Anil Ambani’s Dadri Power plant at a price of \$ 2.34 per mBTU. The quantum of supply was to be 28 mscmd (million standard cubic metres a day) for a period of 17 years. However, the petroleum ministry refused to approve the price saying it had the right to determine the price of natural resources.

Anil Ambani filed a suit in High Court in 2009 for enforcement of the contract. The high court ruled in favour of Anil Ambani stating that Mukesh Ambani should honour the June 2005 family agreement to supply gas at \$ 2.34 per mBtu per the original terms of the contract (Guha and

Ghosh, 2014). This poignantly shows the failure of the high Court in the understanding and interpreting the broad framework of the constitution. The high court saw the case purely in terms of the legality of the contract but not the institutional corruption of exploitation of natural resources of the country.

In 2010, the Controller Auditor General (CAG), an autonomous body established by India's constitution, reported that the contracts were awarded in a non-transparent manner, unreasonable rates, and the company made profits by purchasing gas at a price of USD 4.2 per mBtu where the price of imported LNG ranges between USD 12 and USD 17 per mmBtu resulting in net loss to exchequer. The CAG took a stand disapproving the production sharing contract and laid blame on the government. This is a case of where laws and policies appear fair, and rational, the way in which rules and procedures are framed and implemented by bureaucrats acting at the behest of the politicians, resulting in institutional corruptions (Guha and Ghosh, 2014).

In May 2010, the Supreme Court of India gave a verdict that gave complete authority to the government to price, utilize and distribute natural resources which belonged to the country but not to powerful private agents. This implies that the private exploration of natural resources must be based on the contract that any supernormal profits (price above long run average costs) must be given to the government (the public). Secondly, the costs of the negative externalities of pollution of water, land and air must be borne by the private producer. At present, there is no clarity on these issues and no mechanism of the Reliance Company in internalizing negative externalities (pollution) which destroys land and water surrounding the K&G basin.

Allocation of Coal Blocks

The coal blocks allocations was one of the biggest corruption scandals in India under the UPA rule from 2004-2014. Even the Prime Minister's office was accused of corruption in the allocation of coal blocks to powerful business men and groups. A detailed discussion of the corruption is given in Wikipedia.¹¹ I briefly discuss institutional corruption aspects of the allocations by the central government.

In 1973, the central government nationalized exploitation of coal mines. The government also created Coal India Limited (CIL). For three decades, CIL was the major producer of coal. Starting in 2004, the government started to allocate coal mines to private players. The Coal Mines Act of 2007 partially deregulated the sector. The government started to allocate coal blocks to private players. In March 2012, the CAG reported that there was no competitive bidding and transparency in the allocation of the blocks which resulted in monopoly rents to the business men who received the allocations. The captive firms were allocated vast amounts of coal, equating of hundreds of years of supply for a nominal fees. The CAG report shows a windfall gain of \$ 160 billion to the allotted. The Prime Minister argued the allocations were legal under the prevailing laws and regulation. The government not establishing a regulatory body that facilitates competitive bidding and regulate pricing and monopolistic behaviour is institutional corruption. In 2013, lawyer Prashant Bhushan argued for creation of a special investigation team to investigate the case as it involved very powerful personalities in the government and the business world. In 2014, the Supreme Court of India set up a special court of CBI to try cases arising out of the coal block allocations. Interestingly, the government reported missing files relating to the allocations to extent of 157.

¹¹ https://en.wikipedia.org/wiki/Indian_coal_allocation_scam

In September 2014, the Supreme Court of India cancelled the allocations of 204 coal blocks. The NDA government which came to power in 2014 passed a bill to allocate the coal mines that were declared illegal by the Supreme Court and the bill provides details of the auction process, compensation for prior allotted, the process for transfer of mines and details of authorities that would conduct the auction. It also established a transparent process for auction of the mines.

Most of the powerful players who were responsible for the scandal have gone scot-free because of institutional corruption arising out of missing institutions and regulatory bodies that monitor and regulate exploitation of natural resources of the country. Powerful agents have vested interest in blocking the laws and regulations so that they could derive monopoly rents. This is a huge cost to the public of a developing economy.

The Case of Vedanta Alumina in Bauxite Mining

The case of Vedanta Alumina mining in the state of Orissa presents the case of a powerful business group violating the basic human rights of native tribal and causing environmental damage by taking advantage of poorly defined common property rights and laws.

Vedanta Company is a globally diversified mining company with its stock listing in London. It is the largest mining company in India. In October 2004, the Orissa government got into a joint agreement with Vedanta Alumina, a subsidiary of Sterlite Industries for mining bauxite deposit from the Niyamgiri hills of Orissa (Sahu, 2008). The tribal group of Dongarias are the original landowners, who have been living in the region for centuries. The Orissa government colluded with Vedanta for extraction of the resource at the cost of the human rights of the tribals and environment. The 2004 agreement between the Orissa government and Vedanta gave powers to the company over the local population and resources, including the right to usurp land and water

and other resources. Sahu (2008) observes “India’s national laws have, however, enabled Vedanta’s free reign. The laws do not comply with international human rights standards; they offer not adequate respect for community land rights, no rights of refusal or of informed consent, and no effective protection for traditional livelihoods and cultures.”

In 2006, the government enacted the Scheduled Tribes and Other Forest Dwellers Act. The act recognizes the right to hold and live in the forest land under the common occupation for livelihood. Sahu observes the Orissa government still violated the act as it did not take the local communities into consideration. The state government signed agreements with several mining companies by promising thousands of acres of land without taking local people into account. Later, the Supreme Court found illegalities in the central government clearances to the company and blocked diversion of the land away from the local people. In August 2010 the Union Ministry of Environment and Forests rejected forest clearance to the bauxite mining project. The Orissa Mining Corporation challenged the ministry’s rule in the Supreme Court. Subsequently, the court ordered the state government to organize gram (village) sabhas (courts) of Dongarias under the Forest Rights Act of 2006. According to this, the Orissa government had to take account of the views and votes of the tribal group whether mining could be allowed. The villagers voted unanimously to oppose mining in their Niyamgiri hills. However, the government officials still keep the tribal group ignorant of their full rights (Mishra, 2013) and therefore strive to retain discretionary powers for rent-seeking.

4. Conclusion

Institutional corruption is defined as an act by a public or a private agent that is legally justifiable under the existing laws and regulation but still is corrupt. This arises out of missing institutions, laws and regulation and also the ability of powerful agents or groups in influencing the making

of laws and implementing regulations. This paper has brought forth a few issues of institutional corruption starting with the discussion of what is an institution.

The mainstream neo-classical economists talk of Pareto optimality and derive general equilibrium. In order to do, this they make strong assumptions such as all agents are perfectly rational with perfect information. This basically means reducing the whole world into a single agent. It is difficult to say what an optimal institution is. An institution can be observed as a social contract between two or more people for a common objective. Social contract has to draw a fine balance between individual incentives, preferences, rights and obligations and constraints of collective action based rules and we do not have a theory of this fine balance. At best, we can make comparative economic organizational approach over time and across different societies.

It is not possible for individual preferences to reflect perfectly in the collective action based rules. The worst case of institutional failure is dictatorship in which one or a few powerful groups impose their preferences on the public at large. In democracies, majority preferences should result in a political party coming to power. Even in democracies it is not necessary that a political party comes to power with majority voting. For example in the 2014 general elections of India the prime ministerial candidate Narendra Modi of BJP came into power with majority in Lok Sabha with 31 percent of country's public voting for him. One can argue it is a plurality but not a clear majority. Although Modi has majority in Lok Sabha, several of his laws and reforms are blocked by members of Rajya Sabha, the members of which are not elected representatives. One can argue this is a part of checks and balances of restraining possible majority fascism of democracy. On the other hand, we can go by Acemoglu and Robinson's (2012) argument that when elites who monopolise de jure political power lose power, they may still exert disproportionate influence in politics by increasing the intensity of their collective action

As mentioned, the constitution of a country presents the broad frame work of rights of people, the power of legislature, executive and independency of the courts. In several cases, constitutions of countries are not a result of voting by the public. They are a result of great vision of extraordinary leaders. The examples are Thomas Jefferson in the case of the U.S. and B.R. Ambedkar in the case of India. When we say broad framework of constitution there is always a certain degree of discretion in the hands of legislature and executive in making laws and regulations and the court system in interpreting them. For example, India's first Prime Minister Nehru adopted Fabian Socialist policies for developmental goals. As a consequence, the government ceded enormous powers both in the legislation of acts and the administrative apparatus. The government enacted a plethora of rules, laws and bye-laws. Since the independence, the central and state governments brought in about 30,000 laws. The Fabian Socialist Policies gave enormous powers to politicians and bureaucrats which resulted in wide spread corruption through issuing industrial licences and public funds to powerful private agents. These policies helped India's family business groups to build family business empires with tax payers' money by cornering the licences and the public financial institutions. Under the prevailing rules and regulations, this corruption was legally justifiable. India started the process of economic reforms in the late 1980's and the early 1990's as a move towards a market economy. However, since the beginning of the 1990's reforms, income inequality has been increasing at an exponential rate because of rent-seeking by powerful economic agents in those areas where there is still government intervention in issuing licences and implementing regulations. High degree of income inequality is a major source of institutional corruption.

This paper has applied some of the concepts of institutional corruption to exploitation of non-renewable natural resources in the Indian context. I have discussed three case studies on the irregularities involved in

the K&G gas basin gas exploitation by Mukesh Ambani group, allocation of coal blocks by the central government under the UPA regime and bauxite mining by Vedanta. In all the cases there have been significant institutional failures and corruption. Exploitation of gas of K&G basin was awarded to Mukesh Ambani group without competitive bidding and non-transparency of contracts with respect to pricing, proper sharing of the resources and obligation with respect to internalization of negative externalities. The notable aspect of this case is institutional failure of the court system. When there was dispute between the government and the brothers, the high court ruled that Mukesh Ambani had to abide by the contract with Anil Ambani. The court failed to see the institutional corruption side of the contract and gave the verdict by the legality of the contract. Finally, it was the Supreme Court which ruled that natural resources of a country are common property and private individuals can-not treat it as a private property. Even later, there is no transparency about sharing the surplus with the public and internalization of negative externalities by the producers.

In the case of Coal Block Allocation, the central government of the UPA regime allocated coal blocks to powerful business men at prices far below their opportunity cost. The CAG showed the magnitude of loss to the exchequer. Even in this case, the Supreme Court got involved forcing the government to improve the transparency in the allocations.

The case of Vedanta Company in bauxite mining shows the collusion between the state government of Orissa and the company in appropriating the lands of tribal groups and destroying the basic human rights of the people. Only when PILs were lodged by few activists in the courts, the Supreme Court intervened and ruled that it was up to the people to decide whether they wanted to sell the land to the company. The people voted unanimously not to sell their land. In small societies, resources are managed by norms that evolve over time. However, when producers become large, the historical experience is that conservative norms start disappearing,

even in the pre-capitalist formation. The remarkable aspect of the Dongarias tribe of the Niyamgiri hills is that they rejected lucrative bribes of Vedanta Company promising them good jobs and infrastructure, in order to preserve their way of life. However, the government agents make efforts to reduce the awareness of the rights of the tribal groups. Conventional measure of economic growth in terms GDP and per capita income figures is misleading if one does not take into account the costs of negative externalities.

The final issue is whether we could eliminate institutional corruption altogether in the country? Just as it is difficult to define an optimal institution, it is difficult to eliminate institutional corruption similar to the impossibility theorem of social choice. The following issue is; what are the ways of reducing it? One of the ways of reducing is decentralization of governance under the argument that individual preferences are reflected better in the collective action based rules in small groups than collective action based rules of large groups. On the other hand, if we consider India's institutions, in several parts of India caste is the basic identity in voting behaviour of people. Politicians representing specific backward classes may develop a vested interest in the backwardness and do not invest in education and development of backward classes. This is a typical prisoners' dilemma outcome.

In the case of non-renewable resources, decentralized common property ownership of people involve complex issues. Some of the resources may have to be treated as a common property of the world as a whole: for example, utilization of oceans, rain forests, exploitation and consumption of fossil fuels with strong negative externalities both in production and consumption. Societies and countries have to formulate appropriate rules and regulations in finding balance between the rights of people of a specific region and their obligations towards common property rights of people as a whole.

Civic bodies and independent media can play a role in reducing institutional corruption. However, several civic bodies are riddled in corruption. At present, a few large media houses are owned by big business and there is a large number of small news channels especially in the regional languages, which broadcast news with regard to illegal and institutional corruption. The conviction rate is very low owing to institutional failures of laws and their enforcement, the police and the judiciary. The recent ruling of the Supreme Court of India with respect to defamation laws may restrain journalists from exposing institutional corruption with the fear of law suits by powerful agents. Unfortunately, the Indian judiciary system still follows quite a few outdated laws inherited from the British colonial rule of a couple of hundred years which were discarded by the British themselves as institutions evolved.

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