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Corruption in the supply chain: forms and impact on consumers



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This paper was prepared by Adli Amirullah (former Senior Research Executive, IDEAS), Danya Frances, (former Research Assistant), Laurence Todd (former Research Director, IDEAS) and Sri Murniati (Senior Manager, Public Finance Unit, IDEAS).

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EXECUTIVE SUMMARY

Combatting corruption has been a persistent challenge for Malaysia. Corruption scandals involving the highest levels of public office in recent years have resulted in significant political backlash and public awareness on the cost of corruption in the country. Despite the considerable political attention paid to corruption, however, there is a lack of serious effort to investigate how corruption impact the cost of living. In the long term, an understanding of how corruption exert pressures on the prices of consumer goods and services will be of utmost importance to generate public awareness and to push for meaningful reforms to combat corruption.

This paper aims to fulfil that gap by documenting and exploring how “everyday corruption” can negatively impact prices of consumer goods and services and, therefore, the cost of living. It also explores the range of actions that can be taken by the government and relevant stakeholders to address various forms of corruption that will affect the prices. We utilised both qualitative and quantitative methodologies to analyse how corruption can impact prices. Existing literature on the impact of corruption on the economy and prices was studied to develop a conceptual framework for assessing qualitative data collected through semi-structured interviews with private sector operators in three critical sectors: construction, education and healthcare. To scrutinize the relationship between corruption and prices, we conducted an econometric analysis to test the correlation between corruption and price levels in Malaysia.

In sum, this paper makes the following findings about the impact of corruption on the cost of living in Malaysia:

1. While bribery is the most common form of corruption in both public and private sectors, there are other forms of corruption that often take place such as extortion, embezzlement, fraud, abuse of discretion, and favouritism.
2. Information asymmetries and misaligned goals create conditions that are conducive to corruption. Corruption often happens when people want to circumvent bureaucracy and evade regulatory enforcement. Social norms can entrench tolerance towards corruption, especially when it is seen as a legitimate transaction or ‘cost of doing business.’
3. Corruption imposes a “mark-up” on goods and services and results in increasing prices of consumer goods and services.
4. Corruption also reduces legitimate competition, impacting the development of the private sector, with negative outcomes for consumers.
5. Corruption undermines the delivery of public services and results in less efficient government spending.
6. Our econometric analysis suggests that control of corruption is negatively correlated with inflation. As control over corruption is reduced and corruption worsens, prices increase. Further in-depth analysis over a wider period should be undertaken when more data is available.

Finally, the paper proposes the following policy recommendations to address the abovementioned issues and to break the negative cycle arising from corruption and the escalating cost of living:

1. To maintain the momentum for the implementation of the **National Anti-Corruption Plan** (NACP), including by issuing a Progress Report on the implementation of the NACP.
2. To prioritise public procurement reform, including developing the **Government Procurement Act** (GPA) with transparency standards and review mechanisms.
3. To support targeted policies and promote broader reforms to increase transparency, including the enactment of freedom of information legislation.
4. To strengthen the powers and independence of the Malaysian Anti-Corruption Commission (MACC), including granting powers to investigate public and private sector individuals living beyond their means and to increase the scrutiny and independence of key public appointments.
5. To empower the private sector in the fight against corruption, by encouraging development of industry-specific guidelines, building on the examples in some sectors, and boosting the confidence of those coming forward with amendments to the Malaysian **Whistle Blowers Protection Act**.
6. To simplify the regulatory environment to reduce the incentives for corruption, including empowering the Malaysia Productivity Corporation to undertake a more aggressive review of unnecessary regulation, including targeting practices associated with corruption. A specific review of regulations relating to foreign workers should be undertaken.
7. To promote more competitive and innovative markets, as a long-term solution, so that more competitive markets will help to reduce the incentives for corruption and make corrupt acts more difficult. Reforms to reduce the restrictiveness of Malaysia's business environment in areas such as starting a business, price controls and protected services, should be prioritised.

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I. INTRODUCTION

I.1 Corruption in this study

This research takes a broad definition of corruption introduced by Transparency International which is the abuse of entrusted power for private gain. Such a broad definition captures corruption offences committed by public and private sectors and by those who give or solicit bribes and accept them. It also captures any acts of abusing power both in public and private institutions. However, we acknowledge that such a broad definition of corruption is difficult to be applied because it does not introduce exact form or practices of corruption. To help us identify forms of corruption, we refer to Amundsen's main forms of corruption: bribery, extortion, embezzlement, fraud, and favouritism (Amundsen, 1999). We also refer to forms of corruption identified in the Malaysian Anti-Corruption Commission Act (MACC) as well as the United Nations Convention against Corruption (UNCAC) to enrich our understanding of the Amundsen's classification. The MACC Act was passed in 2009 to establish the Malaysian Anti-Corruption Commission (MACC) as the authority responsible for anti-corruption efforts. The Act outlines offences that are penalized under the Act. Four types of offences are covered by the Act: soliciting/receiving gratification, offering/giving gratification, intending to deceive, using office or position for gratification).¹ UNCAC recommends countries to penalise the following acts of corruption: bribery involving local and foreign public and private officials, self enrichment, embezzlement, trading in influence, money laundering, concealment and obstruction of justice. The MACC Act provisions, together with other anti-corruption legislations in Malaysia, are largely consistent with provisions of the UNCAC, although the UNCAC review in 2013 also notes improvements can be made (UNODC, 2013).

I.2 Research scope and objectives

This research attempts to document forms of corruption that may have an impact on increasing prices and therefore increasing cost of living. We narrow down our focus to three important sectors where corruption can take place: construction, education and healthcare. Overall, we aim to accomplish the following four research objectives:

1. To identify and document various forms of corruption especially in these three sectors.
2. To explain how these forms of corruption negatively impact prices in Malaysia.
3. To test the relationship of corruption and price levels in the Malaysia context.
4. To provide recommendations that can be taken by the government and relevant stakeholders to address it.

¹The Act penalises individuals that are directly involved in the Act and, with the introduction of Section 17A recently, corporations in which the individuals are affiliated.

1.3 Research methodology

This paper probes the impact of corruption on the cost of living in Malaysia by using a mixed methodology approach. This includes both qualitative and quantitative components.

Firstly, to conduct a theoretically-informed analysis, we study relevant theories on corruption in the academic literature. We draw on existing literature to identify the forms, causes and impacts of corruption, in particular with respect to the impact on cost of living.

Secondly, to provide empirical evidence for the theories, researchers at the Coalition for Business Integrity (CBI) conducted a number of semi-structured interviews with stakeholders in the three critical sectors. The interviewees were a diverse group of people representing perspectives ranging from junior level staff to senior management, and they include teachers, managers, supervisors, contractors, sales executives, suppliers, and developers. Interviewees from the three major sectors were identified based on their participation in these industries (i.e. managers of businesses) and invited to share their experience of corruption during the interviews. The interviewers produced write-ups based on these interviews. To encourage the disclosure of information and frank discussions, we assured our interviewees that whatever information provided will be anonymized.

Thirdly, researchers at IDEAS have undertaken an econometric analysis on the relationship between corruption and inflation in Malaysia and analysed the write-ups from the semi-structured interviews. The researchers did not independently fact-check the accounts provided by the interviewees, but trust their accounts in good faith and accept it as the realities or – at the very least – perceptions from the ground. Where possible, IDEAS researchers have sought to corroborate claims written by the interviewers with publicly available media reports and relevant sources.

Additionally, CBI and IDEAS held two-day closed-door roundtables with stakeholders from the three sectors. In these two-day closed-door roundtables the initial findings of the paper were shared and additional insights on corruption on the three sectors were further collected. Some new insights from these roundtables are included in this paper.

The analysis presented here is done in good faith and intended to provide a contribution to the discussion on combating corruption in Malaysia. Although a detailed assessment of past and ongoing policy efforts to combat corruption is beyond the scope of this study, we hope that it provides a useful reference for those interested in championing broad policy reforms based on our analysis and recommendations.

2. FORMS OF CORRUPTION

Corruption comes in different forms. In this chapter, we discuss the different forms of corruption based on definitions provided in the literature and the empirical accounts provided by our interviews. This is not intended to serve as a definitive typology or academic categorization of corruption, but merely to provide an understanding into the forms of corruption that can take place in the three sectors that we identify and how they impact the cost of living in Malaysia.

2.1 Bribery

Amundsen defines bribery as “the payment (in money or kind) that is given or taken in a corrupt relationship”. Bribery is usually given or taken to influence decisions of those with authority to take action or to make favourable decisions to the giver or to disregard any offences or responsibilities (Shacklock et al., 2006). Bribes are therefore usually given to either receive or expedite services, or receive special treatments. Facilitation payment, *duitkopi*, kickbacks are categorized as bribery.

Malaysia’s corruption legislation, the 2009 MACC Act (Section 3), defines bribery or “gratification” quite broadly. The definition covers both monetary and non-monetary types of inducement or reward. Below is the definition of gratification/bribery in the MACC Act:

“Gratification” means

- (a) money, donation, gift, loan, fee, reward, valuable security, property or interest in property being property of any description whether movable or immovable, financial benefit, or any other similar advantage;
- (b) any office, dignity, employment, contract of employment or services, and agreement to give employment or render services in any capacity;
- (c) any payment, release, discharge or liquidation of any loan, obligation, or other liability, whether in whole or in part;
- (d) any valuable consideration of any kind, any discount, commission, rebate, bonus, deduction or percentage;
- (e) any forbearance to demand any money or money’s worth or valuable thing;
- (f) any other service or favour of any description, including protection from any penalty or disability incurred or apprehended or from any action or proceedings of a disciplinary, civil or criminal nature, whether or not already instituted, and including the exercise or the forbearance from the exercise of any right or any official power or duty; and
- (g) any offer, undertaking or promise, whether conditional or unconditional, or any gratification within the meaning of any preceding paragraphs (a) to (f);

Our interviews indicate that the construction sector, especially the property development sector, is riddled with corruption.² Rampant corruption practices in property development sector are possibly because property development processes require business players to have multiple stages of interaction with the authorities.³ Property development typically begins with land acquisition, land conversion, submission of building and infrastructure plans, tendering, construction, and finally obtaining a certificate of occupation. Several interviewees stated that bribery risks exist at every stage of the process. The level of bribes varies with every project and location, where Klang Valley attracts higher bribes as compared to second tier cities like Ipoh and Malacca.

According to the interviewees, the pre-development process, which comprises of land acquisition, land conversion where applicable and submission of building and infrastructure plans, are vulnerable to some forms of bribes. The bribes, according to them can incur about one to four percent of development value. Another area that is risky for bribes are when the developer submits application for credit to the bank. During this process, it is possible that bribes are paid to ensure credit application is approved even though the developer is not credit worthy.

During the early development stage when the developer or the main contractor tenders out work packages, corruption instances are also quite rampant. Our interviewees indicate that a bribe of around RM500,000 can be paid to the main contractor to obtain a project with a value of RM100-300 million. Some of the interviewees also mention using entertainment to influence decisions of main contractors. One of the interviewee indicates that expensive dinner and entertainment in the night club are somewhat a norm to win the tender.

When the construction process starts, there are more avenues for corruption to take place. One of such avenues is the construction companies' employment of foreign workers. Interviewees stated that a typical main contractor can employ about 200 foreign workers for a project and pays between RM500 to RM 1,000 bribe to relevant agencies to secure a 5-year contract for their workers. Another avenue of corruption is the inspection process where relevant agencies are tasked to ensure the construction process complies with existing rules. Our interviewee indicated that during house construction, which typically takes between two to three years, the main contractor encounters multiple demands of bribes from officers of multiple agencies who carry out inspection on worksites. One interviewee even suggests that a main contractor needs to set aside around RM20,000 every month to meet these various demands for bribes. If such bribes are not paid, contractors face various difficulties from having their foreign workers detained to their application for certain activities that are not approved. Approval for construction lorries for example can be delayed for six months if bribes are not paid. In these instances, it seems that bribes have turned into extortion. Our interviewee also talked about potential corruption in the procurement of architectural materials such as tiles, glass panels, aluminum frames, sanitary fixtures and security systems, where architects and consulting engineers can secure kickbacks from recommending or procuring these architectural materials.

Our interviewee also identifies risks of bribery during the end of construction stage, when the developer tries to secure Certificate of Completion. During this period, some respondents points to the possibility of staffs from relevant agencies to require unnecessary tests for the certificate to be produced. In doing so, they recommend certain companies to be contracted by the developer. These companies, according to one of the respondents, charge higher prices than the market price, indicating the possibility of kickbacks to the agencies being included in the price. Due to this process, the certificate of completion is produced late and affects the operation plan of the developer.

² This finding is consistent with a more comprehensive research carried out by (Transparency International (2008) and Kenny and Warburton in Indonesia (2001).

³ The above is based on interviews conducted with multiple site teams from three construction companies in the Klang Valley.

While many of the interviewees from the construction sector view these bribes to be a burden and therefore increases the costs of their business, some view certain forms of bribes, especially the 'entertainment' to be part of the cost of doing business. A few interviewees did not regard "entertainment expenses" such as fancy dinner treats as bribery. This suggests that more efforts to define corruption more broadly and educate the public about bribery need to be done.

Bribes are by no means an exclusive phenomena to the construction industry. Instances of corruption also took place in education and health sector. In education sector, our interviewee shares potential corrupt practices in the process of opening early childhood education facilities, especially to obtain licenses from relevant agencies. In public schools, several newsreport indicate that one of the risky areas for bribery is providing school contracts for canteen operators. The bribe was given either to reward the school operator for giving a letter of support, such as the case in a school in Rawang (*Astro Awani*, 6 February 2017). In the health sector, our respondents identified the potential risk of corruption in the procurement of drugs in the private health care sector, where medical practitioners may be given certain inappropriate incentives to choose certain drugs to be prescribed to their patients. The respondents however highlighted the Pharma Code of Ethics, which restricts the influence corporations can have over medical practitioners. This includes receiving sponsorships for various events and accepting bribes for procuring medicine from a particular company.

2.2 Extortion

Another form of corruption that was identified by our interviewees is extortion. Corruption literature differentiates bribery and extortion even though both of these forms of corruption share similar features namely the exertion influence over an action or decision. The main distinction between the two is that the latter involves the use of payments or positive incentives to induce cooperation, while the former achieves this through coercion (Shacklock et al., 2006). **The use of extortion victimises those who are subsequently forced to engage in corrupt activities.** While public interest or individuals who are directly harmed by a corrupt act are the victims of all forms of corruption, extortion creates a further victim out of the party being coerced (Shacklock et al., 2006).

Academics identified several situations that are risky for extraction. Among them are poor quality of infrastructure including unreliable supplies (Herrera et al. 2007). Unreliable supplies give individuals who control them an opportunity to set up hurdles for those who want to access them and they impose compensation for the access. Individuals that are in position of greater vulnerability are more at risk of extortion. For example, Yusof and Arshad (2020) found that younger and women-managed/owned companies were more likely to be targeted for bribe payments.

Several examples of extortion were highlighted by interviewees, including public officers conducting excessive inspections to inflict fines and additional charges on business premises. Some of these inspections are carried out during off hours. Construction sites, canteens, restaurant kitchens and foreign workers' dormitories are among places that are singled out by interviewees as venues where extraction is risky. A frequently mentioned evidence of extortion mentioned by our interviewees is harassment of foreign workers. Authorities – including police officers – will harass foreign workers by locking them up for two weeks or longer if no bribes are paid up. Such tactics are used to intimidate business owners or contractors – and cause losses by disrupting their operation – who then have to comply to their request. This is especially common in the construction sites where foreigners work as construction workers.

2.3 Embezzlement

Embezzlement are corrupt practices which involves the taking or conversion of valuables, money or property by a person who is not entitled to them but has access to them because of their position or employment (Shacklock et al., 2006). It is “a theft of resources by people who are put to administer it” (Amundsen, 1999).

Embezzlement may not necessarily increase the cost of doing business directly. But it may harm the parties that are supposed to receive the intended outcomes (supplying parties). These supplying parties have a claim to be included in the performance of specific tasks or outcome as a result of their funding, but this is violated by the corrupt parties who convert these resources into their own possession. The corrupt parties directly benefit from these converted assets while severely harming the supplying party since their resources are diverted from the intended aim. Embezzlement can occur when those in positions of authority take advantage of their discretion over the allocation of resources. Most of the embezzlement cases that are provided by our interviewees happened in the education sector: Most of them related to the school fund or rent of school facilities to a third-party. Some examples brought by the respondents is the embezzlement of scholarship fund in Melaka (The New Straits Times, 13 November 2019) and embezzlement of rental payment of school field in Penang (The Star, 14 January 2020).

2.4 Fraud

Fraud is a form of corrupt practice whereby the perpetrator manipulates and distorts information, facts, or expertise to gain profits (Amundsen, 1999). False claims, falsification of documents, misrepresentation of facts are a few examples of fraud. Section 18 of the MACC Act specifically penalizes any acts that intend to deceive such as false claims.

One of instances of fraud that several interviewees identified is the use of student visa to recruit foreign workers. Some private higher education institutions, according to the interviewees, have become conduits for foreigners wanting to enter and work in the country. According to one interviewee, “some recorded the registration of over 1,000 foreign students when the colleges could each take in only 80. When enquired, the institutions’ management failed to give logical answers, so we believe certain groups have been using the colleges to bring in foreigners purportedly as students, for lucrative returns.”

Another fraudulent practice involves unaccredited courses and study programs. Interviewees asserted that some private education institutions deceive students into paying and enrolling for study programs that are not accredited by the Malaysian Qualifications Agency (MQA). Most recently, a group of students alleged that they are left in limbo because their degrees are unrecognised after their university fails to maintain accreditation (Malay Mail, 3 May 2021). One of the interviewees opines that such instances could happen because Malaysia has too many private colleges, as such the agency does not have resources and manpower to monitor and chase them.

2.5 Favouritism

Favouritism is a more complex concept that blurs the line of corruption but can be an important factor in determining abuse of discretion. In some cases, abuse of discretion is not motivated by narrow self-interest but by the less tangible benefit of advancing the interests of those linked to the individual. Favouritism can be based on different things; some are based on race, religion, political affiliations, personal and organizational relationships, or even geographical factors (Shacklock et al., 2006). The favouring certain group or individual itself is not an act of corruption. However, when such favour leads to corrupted distribution of resources, it is possible that an act of corruption has taken place.

Our interviewees argue that Malaysia's affirmative action policies may have the unintended consequences of normalizing favouritism more widely across society. While Bumiputra-favouring policies do play an important role in supporting wider socio-economic goals of the government with regards to Bumiputras, this legalised favouritism also normalizes and justifies differential treatment based on race. Such favouritism, according to an interviewee, may contribute to the inclination of companies to only engage with companies owned by people with the same ethnicity. Even if co-operation between ethnic groups occur, according to this interviewee, such cooperation tends to be superficial. An interviewee from a property firm added favouritism and nepotism could be the underlying factor of a widespread "Alibaba" practice in Malaysia's construction sector, whereby a Bumiputera company won a government tender for construction work, and then handed over the project to a non-Bumiputera contractor after taking a cut from the project.

Another form of favouritism that the interviewees identified is a list government preferred suppliers. This point was raised by kindergarten operators who lamented that kindergarten operators are required to secure services such as pest control, building plans and purchasing fire extinguishers from operators in the preferred list in order to get license to open their kindergartens. Two interviewees in the education sector acknowledged that ethnic favouritism in schools have been very demotivating for their profession. One interviewee lamented the dwindling numbers of ethnic minorities (both in terms of students and teachers' population) in her school, while another interviewee expressed disappointment due to being passed on for promotion despite being a more senior and qualified candidate. Both of them attributed favouritism among co-ethnics as the factor for their respective events.

3. CAUSES OF CORRUPTION

There are numerous causes of corruption which have been identified by researchers and regulators.

Based on the academic literature and the assessment of the information provided from our interviews in the education, health and construction sectors, this chapter emphasised three primary approaches to explaining the causes of corruption.

3.1 Abusing information asymmetries for personal gains

Information asymmetry is one of the causes corruption identified in the principal-agent model theory. The principal agent model considers all interactions and interrelations of corrupt acts as occurring between two parties, – the principal and the agents. The principal-agent model relies on two assumptions. Firstly, that there is a goal-conflict between the principal (who is typically assumed to represent public interest) and the agents (who assumingly prefer to engage in corruption due to the personal benefits gained). Secondly, that the agents possess more information than the principals since they are responsible for the performance of their duties, thus resulting in an information asymmetry between the two (Rose-Ackerman, 1978).

The principal-agent model can help to explain how corruption occurs within public authorities.

In the context of public authorities, political leaders or high-ranking bureaucrats are the principal while the low-ranking bureaucrats are the agents. The lack of information regarding the actions and discretion applied by low-ranking bureaucrats in carrying out various processes and decisions over resources acts as a challenge for the principal to effectively monitor them, and thus creates opportunities for the agents to engage in rent-seeking activities (Marquette & Peiffer, 2018).

The principal-agent model can also describe corrupt interactions between the general public and the authorities.

The principal-agent problem also presents itself when members of the public assume the role of the principal, while public officials, including bureaucrats and politicians hold the role of agents. The agents have the capacity to abuse their position and discretion over public services in order to gain private rents from the public, and the public cannot perfectly monitor or hold them accountable since they do not possess the same knowledge and information as the agents do regarding these services (Marquette & Peiffer, 2018).

The agents are motivated to abuse the information asymmetry present due to the goal mismatch that exists between them and the principals.

Should the agent have the same goal as the principal, then there would be no incentive to engage in corruption even if information asymmetry exists between the two. Information asymmetry presents an opportunity for the agent to partake in corrupt acts but the push factor for the agent to take that opportunity is a goals mismatch. Typically, the pursuit of economic gain in their own self-interest is the goal of the agents, thus incentivizing them to engage in corruption. This is echoed by the findings of the KPMG 2013 Survey (KPMG Malaysia Fraud Bribery and Corruption Survey, 2013) in which 82% of the respondents stated that the desire to win or retain business and private gain was the most common driver for bribery and other forms of corruption.

Personal economic circumstances motivate individuals to abuse information asymmetry for personal gain. This goal conflict between the agent and principal stems from the extremely strong motivation to gain income, which is exacerbated by inadequate and dwindling civil service salaries, the absence of risk-spreading mechanisms (which include a full-fledged labour market and insurance), and poverty (Gray & Kaufman, 1998). These aspects increase the value of bribes and other forms of corruption within the agent's personal economy (their personal financial situation), although its actual value may be small when contrasted against the public value affected. Even a small quantum can hold substantial weight in the agent's personal economy, making the net benefits for the agent to partake in corrupt acts extremely lucrative (Søreide, 2014). The goal mismatch that results from this is easily channeled towards various forms of corruption as there are multiple opportunities for information asymmetry due to the broad discretion of bureaucrats, unclear, ever-changing, and badly disseminated regulations as observed in developing and transition economies, alongside the large monopoly rents available in highly regulated economies (Gray & Kaufman, 1998).

We find this principal-agent model to be a common cause of corruption in our interviews with stakeholders in the education, construction and healthcare sectors. Interviewees repeatedly raised occasions in which public officials including police officers delay various processes such as getting approvals for construction lorries and obtaining licenses for kindergarten operators, in order to secure bribes or other forms of compensation for their private gain. The principals in these situations (contractors and kindergarten operators) are not able to hold them accountable since the agents possess more information on these processes. Increased inspections on construction sites, kindergarten and school premises, and harassment of foreign workers follow this same logic as police and officials are responsible for ensuring compliance with regulated standards according to their discretion, leaving the principals at their mercy due to the lack of information they possess on these standards. The principals are then forced to pay the requested fees or offer bribes to avoid these summons and excessive inspections.

3.2 Circumventing bureaucracies or avoiding enforcement

Corruption can also emerge as a response to excessive bureaucracy. The 'greases the wheels' hypothesis views corruption as a "grease" that could lubricate and smoothen over various bureaucratic processes. This is more likely when bureaucracies are ineffective and poorly run. This notion is echoed by the findings of the KPMG Survey 2013 (KPMG Malaysia Fraud Bribery and Corruption Survey, 2013), where 81% of respondents cited obtaining routine administrative approvals from public officials and agencies as a driver for engaging in corruption. The undue bureaucratic processes set in place produce various inefficiencies which firms and other players "grease" over through corruption.

Where regulations are perceived as excessive, there can be a rational economic incentive to engage in corruption. For example, Lui (1985), used a formal economic model to show that corruption is able to efficiently reduce the amount of time spent in queues. This is possible because bribes and other forms of corruption incentivize bureaucrats to speed up various processes, in an otherwise sluggish and time-consuming administration (Méon & Sekkat, 2005). Based on the responses from the interviews, this phenomenon is observed in the Malaysian context as well. For example, large developers in the construction industry compromise building by-laws, plot ratios and other standards in their projects. Regulations put in place for these specifications are considered to be a hindrance to the profitability of these projects, leaving developers to use various forms of corruption such as bribery and abuse of discretion to conceal these compromises.

Perversely, corruption that “greases the wheels” can contribute positively to economic growth – at least in the short run. Corruption can also help overcome tedious bureaucratic regulations and foster growth, as argued by Huntington (1986). He stated that this phenomenon of increased growth was observed in the 1870s and 1880s in the United States, where industrial, railroad, and utility corporations experienced faster growth as a result of corruption.

Under this hypothesis, corruption can act as a competitive auction. Beck and Maher (1986) and Lien (1986), propose the possibility of corruption enhancing decision making by officials, since corruption can imitate the outcome of a competitive auction if bureaucrats cannot make certain decisions or do not have sufficient information. These authors have formally shown that the ranking of bribes can imitate the ranking of firms by efficiency. Leff (1964) explained that the intuition behind this is that licenses and contracts are offered to the more generous bribers, who can offer higher efficiency since they are willing to offer a larger sum in bribes thus correlating the capacity to offer bribes with success.

However, relying on corruption to reduce the inefficiency of bureaucratic processes has severe negative impacts over the long term. Regulatory standards are intended to serve a social function and therefore when corruption is used to compromise these standards, this can result in negative outcomes for society. Interviewees highlighted such issues, for example, compromised regulated standards in the construction industry typically consist of large developers compromising building by-laws, plot ratios, density, and master plan of township in the name of maximizing the profitability of projects, and authorities collecting arbitrary premiums upon the sale of “agricultural land” to defray cost of infrastructure like roads, drains and other amenities. The resulting consequences of these failures are increased traffic congestion, overflowing drains, and disregard for parking capacity, recreational facilities and land for the construction of cemeteries. Due to the actions of the responsible authorities and developers, their successors and fellow developers are forced to work around and even adopt these lowered standards for congestion, drainage, parking capacity and others, thus creating an inferior standard for housing and property development that does not meet regulated standards and risks the safety and development of the city and society as a whole.

Greasing the wheels also requires access – which creates effective barriers to entry for some firms. In order to be able to use corruption as a grease, there must be established connections or channels for the “grease” to be able to compensate for excessive bureaucratic processes. These connections and channels forge an informal social security whereby the members within these networks take care of their members, who in turn remain loyal and repay the benefits they receive according to their abilities (Šumah, 2018). Being a part of this community or network of nepotism and cronyism that uses corruption as grease, allows various parties to enjoy the benefits of bypassing the bureaucracy as their success in business depends on establishing close relationships between businesses, government officials, and politicians (Søreide, 2014). However, it also creates barriers for those who are not part of these networks.

Access to foreign workers is an issue which motivates corruption. Several interviewees highlighted how corruption occurs when some companies undercut the rules to hire foreign workers. In particular, within the education sector, several interviewees recounted that some private institutions have become conduits for foreign workers to enter the country under a student visa which is easier to apply for than a work permit.

A few interviewees said that many corruption happens when people choose to 'settle' rather than being issued with a summon. For example, local authorities can issue summons or fines to small business owners or roadside hawkers for not fulfilling certain regulations e.g. uncleanliness at construction sites. The interviewee said that many contractors only clear their trash at the end of the project, but the sites often remain unclean before the completion. So the City Councils will visit them and ask for some money so as to forbid them from writing a summon every other day. Another interviewee said that health officers also often inspect kindergartens and nurseries to check for mosquito larvae, and occasionally they ask for 'cash' to settle in exchange for not giving compounds.

Another interviewee told of a time when documents sent to the government went 'missing' until some money is paid to a middleman in charge. Accordingly, after the relevant engineers signed and approved all the relevant documents, the certificate of payment was made and sent to an official in one ministry for payment to be made. Yet, the certificate of payment went missing and did not reach the said official. Nobody knows where the certificate went to until someone paid the person some money and a meal and the certificate of payment suddenly reappeared.

3.3 Exploiting social norms towards corruption

Finally, the collective action approach demonstrates how corruption can arise based on how individuals perceive themselves and their community. The collective action approach proposes that an individual's perceptions of the larger community is a direct cause of their willingness to engage in corruption. This is explained through the classic collective action problem in which members of a collectivity fail to contribute to the production of a common pool resource or a public good (Olson, 2007). If the benefits of collective action are non-excludable, the incentive of an individual to contribute towards producing those collective benefits is diminished, causing more free-riders and preventing the collective benefit from reaching its fullest potential. The perceived gains and judgement of individuals to contribute towards this common good are highly influenced by the perception of the actions and trustworthiness of other group members (Marquette & Peiffer, 2015).

Corruption can flourish when it is perceived as "the norm." In the case of corruption, Teorell and Rothstein (2015) explained that corruption persists due to the perception of individuals that most individuals in their position engage in corruption. This means that it makes little sense for even an 'honest' person to avoid corrupt practices if there is the perception of corruption being the 'standard operating procedure'. These perceptions of others' involvement in corruption are heavily influenced by sociocultural norms and identities as shown in the New Economic Sociology (NES) perspective. This perspective explains corruption as a cultural substrate that is related to the prevailing network of social relations, known as a culture of dependency. In this culture of dependency, the domination by a superior is considered as legitimate by a dependent subject and the latter remains loyal to the superior subject to gain benefits (López & Santos, 2014).

In Malaysia, the role of race in defining community may also contribute towards corrupt practices. Malaysia's policies of race-based affirmative action normalise and institutionalise community identity grounded in race. As a result, there is the perception that non-Malays are not favoured in the Malay-controlled public sector while Malays are not favoured in the Chinese- and foreign-controlled private sector (Lee & Khalid, 2016). This acceptance of favouritism as a sociocultural norm is perpetuated across time and creates a circular effect as the perceptions of the community towards various ethnic groups in Malaysia become cemented, thus resulting in an environment more conducive to corruption. Addressing this cause of corruption is more convoluted than the others due to its presence in government policies and prerogatives as opposed to being mere individual bias.

Interviewees also raised a troubling social norm in which bribes are seen as “transactions” and tolerated by the community. A site manager of a construction company was adamant that there is no issue of business integrity in buying a dinner replete with wine and women. He justified it by saying that this has been the norm in the past 40-50 years. Another interviewee, a CEO of construction company too agreed that entertainment in the night clubs is still a major 'business building campaign' and it is inevitable to participate in it. According to him, some of the VIPs including a distant member of a royal family had also ask for a certain sum of money every month like RM 150,00 in cash to help them secure a contract. The money is insisted to be paid in cash to avoid being noticed if it is paid by cheque or a direct transfer. Some project managers also asked for kickbacks as little as a couple of thousand ringgits or otherwise he might give the sub-contractors some unnecessary harassment in one way or another. The interviewee further lamented that project managers too expect some form of entertainment as the industry believes that the best way to gain one's favour is to “wine, dine and make a deal.”

Such an open tolerance towards corruption is also noticeable in the education sector. For instance, there are services offered to or among students to complete assignments in exchange for remuneration. An interviewee working in a local college shared that the price to have an assignment done of possibly 2,000 to 2,500 words at an undergraduate level would be at around RM1,000 to RM1,500 and for those at the Master's level at RM2,000 to RM2,500 for a postgraduate assignment. He also alleged that some private colleges would even award a Diploma or a Degree to anyone who could pay for it and the students are not required to even attend class.

4. CONSEQUENCES OF CORRUPTION

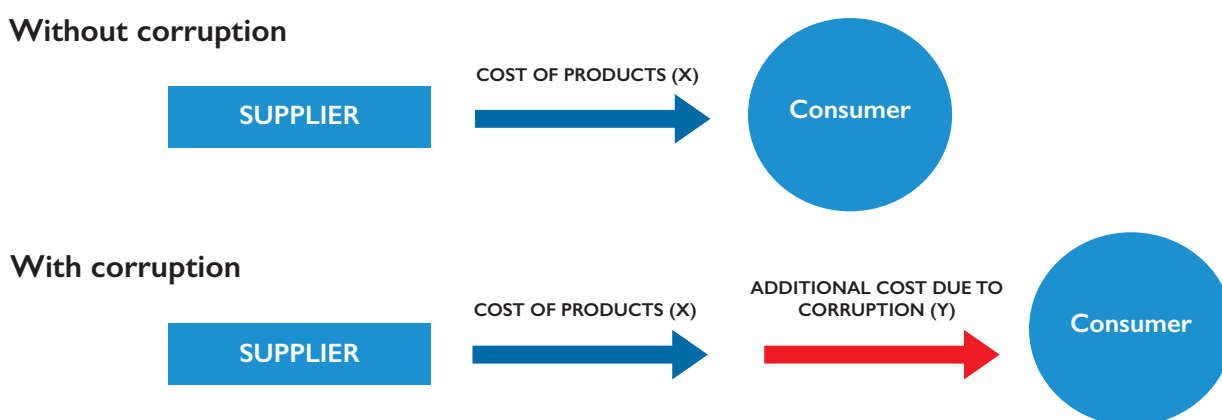
Corruption has a significant economic impact through various channels. According to the World Bank, the average income in countries with a high level of corruption is about a third of that of countries with a low level of corruption. Transparency International Malaysia has also estimated that corruption resulted in a total loss of MYR 47 billion in GDP. (The Star Online, 26 May 2018). These large losses arise because corruption siphons money and resources from productive uses to private gain, but as noted above, corruption can take many different forms and therefore the channels through which corruption impacts society are complex.

In terms of impacting the cost of living, corruption can present multiple challenges for society. In this chapter, we focused on the impact of corruption on the cost of living. In this respect, corruption reduces effective spending power in multiple ways, including increasing prices for goods and services and also through reducing the potential for income growth. We also consider the ways in which corruption exacerbates the challenge of high cost of living through these different channels.

4.1 Corruption increases the price of goods and services

The cost of corruption in the supply chain is passed on to the consumer. The most direct impact that corruption can have on the cost of living is through increasing the costs of doing business – costs which are then passed on to the consumer. When suppliers of goods and services are required to engage in corrupt practices – such as paying bribes – this increases the cost of doing business, and these costs will be passed on to the consumers. The impact can be significant: research has shown that the increase in costs increase in costs due to illegal payoffs can be as high as 30 per cent (%) (Wade, 1982). Budak and Vizek (2015) found that the general price level increases by 0.135 per cent (%) when the TI-CPI score decreases by 1 per cent (%), i.e. when corruption gets worse. The study finds that that the price of corruption is the highest for consumer services: a 1 per cent (%) increase in perceived corruption increases the prices of consumer services by 0.25 per cent (%), which suggests that the effect of corruption on prices of services is twice as large as that on prices of goods.

Figure 1: How corruption ‘mark up’ and pass the cost to consumers



Total Cost to Consumer is (X) + (Y) where Y is the ‘Mark Up’

The costs of corruption for businesses – and ultimately consumers, are high in Malaysia. Dealing with corruption is an everyday reality for many businesses in Malaysia, as shown by the response of 71 per cent (%) of respondents in the KPMG Survey 2013 (KPMG Malaysia Fraud Bribery and Corruption Survey, 2013) who believe that corruption is inevitable when conducting business and 64 per cent (%) of respondents who believe that business cannot take place without corruption in Malaysia. Yusof and Arshad (2020) found that 20% of firms applying for construction permits or having visits or meetings with tax officials were expected to pay bribes. The exposure to bribe expectations were even higher for import and operating licenses. The study found that, on average, 11 per cent (%) of firms' total annual sales were apportioned for informal gifts or "speed money." Whilst not all of these costs might not necessarily satisfy the conditions of corruption, it indicates the scale of the corruption challenge in Malaysia.

Cost of corruption can be quantifiable and unquantifiable. The table below summarizes several cost of corruption brought up by our interviewees.

Table 1: Interviewees' accounts of the cost of corruption

| Quantifiable | Unquantifiable |
|---|--|
| Higher charges for development and equipments due to extortion. | Harassment of foreign workers. |
| Higher cost of business operation due to bribes paid to avoid inspections and summons. | Erosion of social trust and collective action. |
| Reduces legitimate competition when many contractors are unqualified but use bribes to procure a project. | Poorer service when a contract is extended due to bribery or favouritism. |
| Long-term strain on public finance which pressures cost of living through raised taxes. | Exit of talent pool when people get demotivated in a corrupted system and quit the profession. |

As a result, corruption can directly increase the prices of essential goods and services. Increases in the cost of doing business, will be passed on to the consumer. For example, interviewees reported increases in housing prices due to the various leakages and corrupt transactions that occur along the supply chain. Developers sell units at higher prices increasing the burden of Malaysian buyers. Education sector interviewees also reported that higher education institutions are forced to charge higher tuition fees to account for the various leakages along the supply chain. As such, the cost of essential services, housing and education, can be directly inflated as a result of corruption.

Importantly, corruption also inflates the cost of housing. The following table presents an the corruption related cost in property development based on information provided by several interviewees in the construction sector. There is a possibility that this cost is passed on to customers.

Table 2: An estimate of corruption-related costs in property development

| STAGE | SUB-STAGE | INSTANCES OF CORRUPTION | GROSS DEVELOPMENT VALUE & PERIOD | |
|--|---------------------------|--|----------------------------------|---------------------------|
| | | | RM 200 Million 2 years | RM 500 Million 4 years |
| Pre-Development Stage | Permit | Permit-application related bribe payment "kaw tim" | RM 6 mil | |
| | Securing Credit from Bank | Bribe | Unknown | |
| Development Stage | Procurement | Bribe to main contractor/developer | RM500K | RM 17.5 mil |
| | Construction | Securing foreign construction workers RM500x200 | RM100K | RM 0.5 mil |
| | | Reengineering and change in material supply | RM 22.5 mil | RM 10 million |
| | Inspection | On-site demand from various agencies RM20k x 24 months | RM480K | RM 1.08 mil |
| Total estimated bribery in the entire construction process: | | | RM29.58mil | RM 29.08 |
| Percentage of bribery in this supply chain: | | | 14.8% | 5.8% |

4.2 Corruption distorts competition, curtails private sector development, and raises entry barrier

Corruption can also have an indirect impact on prices by reducing competition in the market. In general, when markets are competitive, firms will compete to offer the lowest price at the best quality and consumers benefit. Corruption also increases price levels by reducing the efficiency of private markets as it pushes businesses underground and reduces the purchasing power of citizens. Based on the interviews, we identify that corruption causes both the inefficient reallocation of resources and creates an entry barrier for firms.

When corruption intervenes in market processes, the result can be that resources are channeled to less efficient uses. The first inefficiency caused by corruption comprises of resources (including contracts) not being allocated to the most efficient firms but instead to those with connections and no scruples (Rose-Ackerman, 1996). This may occur when firms willing to pay bribes succeed in the marketplace, despite offering goods and services of an inferior quality or at a higher price. This reduces the competition present in these markets as only select firms and labourers who are part of these corrupt transactions are able to enjoy business opportunities and/ or compete in the market. This reduction in competition within markets could also propagate price fixing and other distortions in the market which would increase prices even further.

Corruption can also represent a barrier to entry for firms unwilling to engage in corrupt practices.

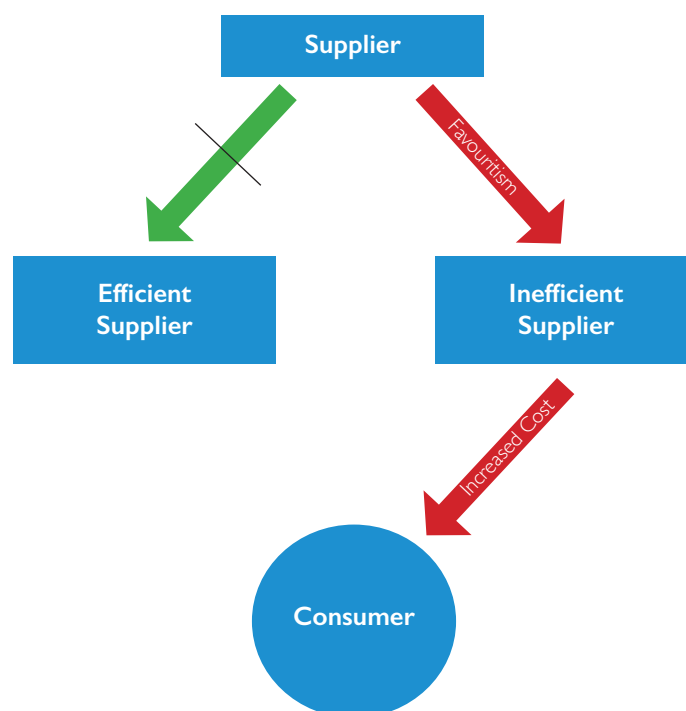
When corruption is rife, those firms unwilling to engage will be at a competitive disadvantage. This will reduce the overall number of firms competing in the marketplace to offer goods and services to the consumer, thus leading to higher prices for the consumer as a result of lower competitive pressures. This not only puts pressure on firms who do not have the capacity to offer bribes and other forms of corrupt compensation, but also creates an expectation for the firms that are complicit, whereby they expect not only the desired decision or outcome such as winning a contract but more inequitable outcomes such as monopoly benefits, inefficient subsidies and future laxness in regulations (Rose-Ackerman, 1996).

When bribery is pervasive, it creates a barrier to entry for firms unwilling to engage in bribery.

Bribery filters out parties who are not willing to engage in corruption from those who are. Those parties who partake in paying bribes enjoy the gains derived from these actions or decisions gained from the party receiving the bribes, while others lose out. This is a loss of business opportunities and expansion that is seldom calculated e.g. the opportunity costs that we miss when firms exit due to their unwillingness to engage in corrupt practices.

An interviewee shared an experience on how corruption made it difficult to enter property development in a northern state. According to him, corruption is endemic but done a lot smarter and more discreetly. Government departments can cause delays if companies refuse to pay grafts or engage the contractors they recommended. **Overall, countries with lower levels of corruption also tend to have more competitive markets.** Alexeev and Song (2013) argued that the link between product market competition and corruption is negatively correlated. Their empirical work on this issue suggest that stronger

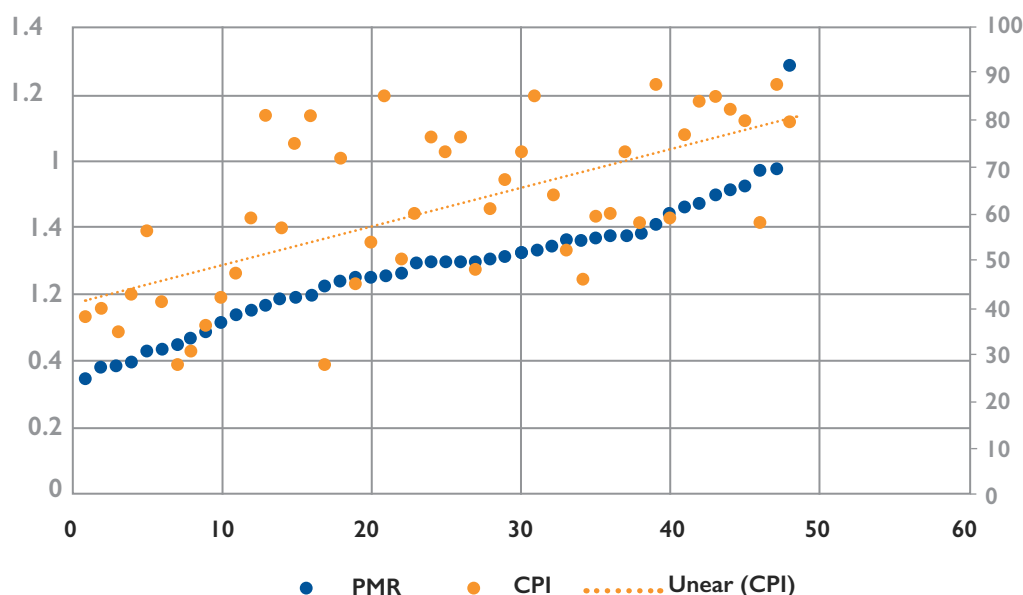
Figure 2: The misallocation of resources due to corruption



competition is associated with greater cost-reducing corruption. The OECD's Product Market Regulation (PMR) Indicators provide a common benchmark of how competitive a country's regulatory environment is. The figure below demonstrates that countries with lower levels of corruption tend to have more competitive regulatory frameworks. Corruption is likely to be both a cause and symptom of uncompetitive markets, and therefore enhancing the regulatory framework to promote competition may be an important response to corruption.

The barriers to entry may be even higher for foreign businesses looking to invest in Malaysia. The presence of corruption can be a disincentive to foreign owned firms, which may have more choice over where

Figure 3: Product Market Regulation (PMR) Indicators (LHS) and Corruption Perception Index (RHS) for selected OECD and non-OECD countries.



Note: Higher PMR score indicates higher level of restriction on competition. Higher CPI score indicates lower level of corruption.

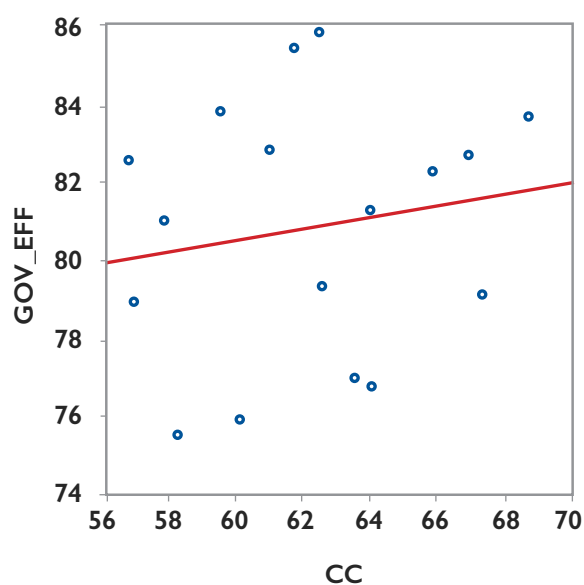
to do business. When a potential market exhibits high levels of corruption, they may choose to go somewhere else. Yusof and Arshad (2020) found that the value of bribes paid by foreign-owned firms was higher than for local firms in Malaysia – a fact which might disincentive foreign investors coming to Malaysia. Other studies have demonstrated the link between corruption and Foreign Direct Investment (FDI), for example, Alemu (2012), found that across a sample of Asian economies, a 1 percent (%) increase in the corruption level triggers an approximately 9.1 percentage point decrease in FDI inflow. From a consumer perspective, lower levels of FDI will reduce the availability of goods and services in Malaysia. Canare (2017) also finds that corruption has a negative effect on FDI inflows in general.

4.3 Corruption undermines the delivery of public services and produces inefficient government spending

Corruption can also negatively impact the quality of public goods and services, further impacting the cost of living. The reduction in efficacy of public goods and increased government deficit is another consequence of corruption. This will reduce the quality of public services received by taxpayers, with a direct impact on the cost of living. Reduced quality of public services may also force consumers to seek other, more expensive providers. Finally, to the extent that corruption reduces the efficiency of public services and increases government spending, this can result in higher inflation creating further pressure on the cost of living.

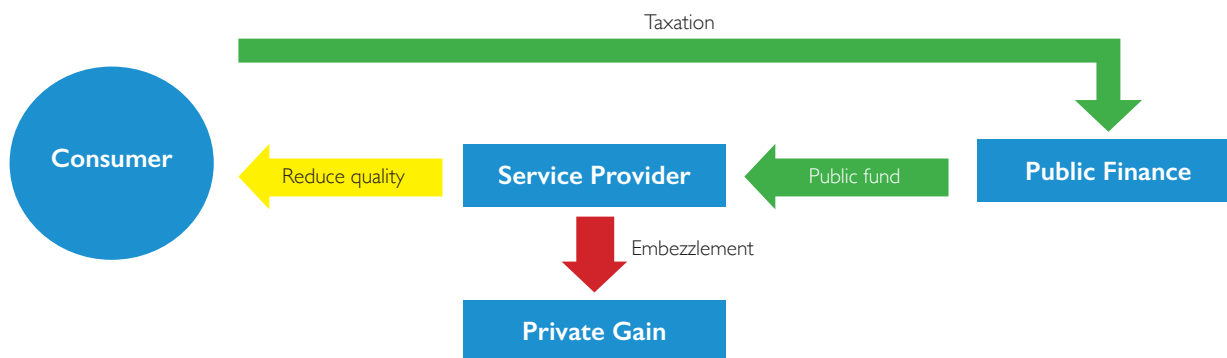
Corruption can reduce the quality and effectiveness of the public sector. Inefficient distribution of economic and public resources from productive fields to more manipulated and unproductive fields, hinders financial performance in the public space (Özşahin & Üçler, 2017). When corruption misallocates resources in the public sector, this can directly compromise the quality of public goods and services. When more efficient, or higher quality providers are passed over in favour of those willing to engage in corruption, this can result in reduced quality. This incurs both an economic cost and also a social cost, as resources are diverted from government socioeconomic goals. Studying Indonesia, Wardhani (2017) found that higher good public governance is associated with lower corruption; and lower corruption is associated with high public service quality.

Figure 4: Government effectiveness and Control of corruption (World Development Indicators) for selected countries



Corruption diverts public resources away from much needed investments. Decisions which are subject to undue influence can result in sub-optimal public investments and “white elephant” projects (Gray & Kaufman, 1998), of which there are several notable cases in Malaysia.

Figure 5: Misallocation of public resources due to corruption



Corruption may also drive business underground, reducing government revenue. Small and medium enterprises will experience the strain of these phenomena more so than large enterprises – possibly incentivising them to reduce their investments and operations to account for this increase in costs or go underground altogether (Gray & Kaufman, 1998).

As a result, corruption can place a long-term strain on public finances which can create further pressure on the cost of living through higher taxes. The cost of these failed public goods and services can create pressure on government finances. If the government responds by raising taxes, then this has a direct impact on the cost of living, as consumers retain less of their income. Del monte and Pennacchio (2020) use a panel of OECD countries over the period 1995–2015, to provide evidence that corruption increases public debt and that this effect is independent of the size of government expenditure. Their estimates suggest that if corruption was halved, public debt would decrease by 2 per cent (%) in the short term. Blackburn and Powell (2017) study the effects of corruption on public finances and find that the embezzlement of tax revenues by public officials leads the government to rely more on seigniorage to cover its expenditures. ‘Seigniorage’ is a profit made by a government by issuing currency, especially the difference between the face value of coins and their production costs.

Higher government borrowing can also lead to higher inflation. If the Government chooses to increase borrowing, this can indirectly impact cost of corruption by increasing inflation, and resulting in the so-called, “inflation tax”, whereby high government spending results in inflation which is ultimately borne by the taxpayers through higher prices. Elkamel (2019) that corruption jointly with public finance means, seigniorage and borrowing, increase the level of inflation. Blackburn and Powell (2017) studied the effects of corruption on public finances and found that the embezzlement of tax revenues by public officials led the government to rely more on seigniorage to cover its expenditures, leading to higher inflation. Based on a study of 40 countries between 2003-2010, Samiimi and Abdeni (2012) support the view of a positive relationship between corruption and inflation tax.

Several media reports provided evidence on how public projects were delayed or experienced a huge spike in costs due to suspected corruption. A report in *The Sun* (April 2014) quoted a former senior health ministry official as saying that there is a vast difference in pricing when it comes to the building and upgrading of government hospitals. The report said it costs about RM800,000 per bed in the private sector while it costs RM1.8 million when government hospitals are built. (This calculation is the industry norm. For example, a 100-bed private hospital, complete with furniture, fittings, equipment including an operation theatre is costed at RM8 million and this does not include the cost of the land. Similarly, the same hospital, if built by the government would incur a cost of RM 18 million.) The Tanjong Karang Hospital project, which has been delayed for a decade, will finally be fully completed later this year. *Malaysiakini* (June 16, 2018) reported that this 150-bed hospital costs RM277.2 million, which is equivalent to RM1.848 million a bed. The Tanjong Karang Hospital is a “minor specialist service hospital” with a medical and ward block and two operating theatres. The 300-bed Shah Alam Hospital was completed after much delay at a total cost in excess of RM550 million. This worked out to RM1.83 million a bed. The hospital is a secondary referral centre. By comparison, the 300-bed KPJ Kuching Specialist Hospital has all the latest modern medical facilities including orthopaedic and traumatology, cardiology and heart surgery, chemotherapy and radiation oncology as well as plastic surgery facilities. Phase one of KPJ Kuching has 150 beds and only costs RM130 million to build. The cost per bed is only RM866,666.

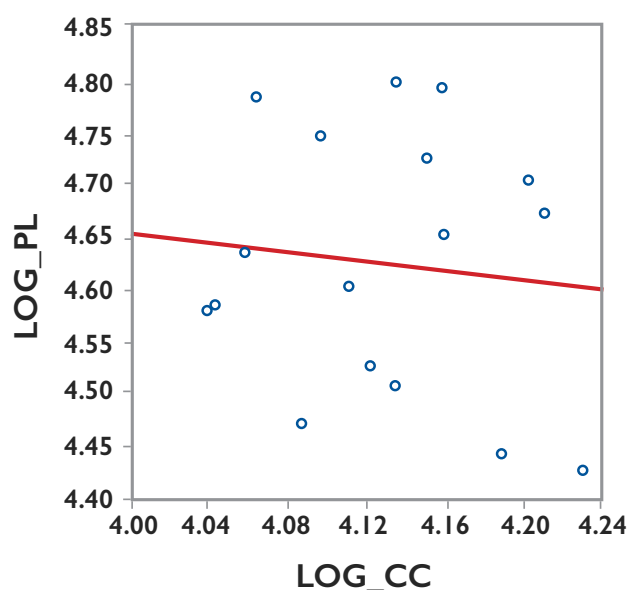
Delays in the construction and delivery of hospitals also adds costs to the taxpayer. The Shah Alam Hospital is a good example. *The Edge Financial Daily*, (April 2, 2015) reported that the government is planning to take legal action against Sunshine Fleet Sdn Bhd -- which is owned by three members of the Selangor royal family -- and was the main contractor for the new Shah Alam Hospital over cost overruns due to the company’s failure to deliver the hospital. The company -- Sunshine Fleet was awarded the original contract to construct the 2,300-bed hospital in Section 7, Shah Alam in November 2007 for RM491.6 million. However, as the deadline for the delivery neared in 2010, only 27 percent of the construction was done. Despite the non-delivery of the project, Sunshine Fleet was paid RM139.9 million by the government for the portion of the works done. The government later re-tendered the project and awarded it to Gadang Engineering in October 2011 for RM410.87 million. Sunshine Fleet is 70%-owned by Tengku Puteri Arafiah, the Sultan of Selangor’s sister. The company was awarded the original contract to construct the hospital in Section 7, Shah Alam in November 2007 for RM491.6 million. However, as the deadline for the delivery neared in 2010, only 27% of the construction was done.

4.4 Corruption leads to a perverse cycle of increased cost of living, higher prices, and more corruption

As a result of these factors, corruption can contribute to higher levels of price inflation. Based on these observations and findings, we can conclude that corruption can increase prices in the private sector, both directly and indirectly, and also increases the likelihood of inflation rises from less efficient government spending. This conclusion is widely observed in the literature. Based on a study of 20 countries between 1995-2015, Ozahin and Ulcer (2017) found that high corruption increased inflation rates. Al Marhubi (2000) finds a significant positive association between corruption and inflation, even after controlling for a variety of other determinants.

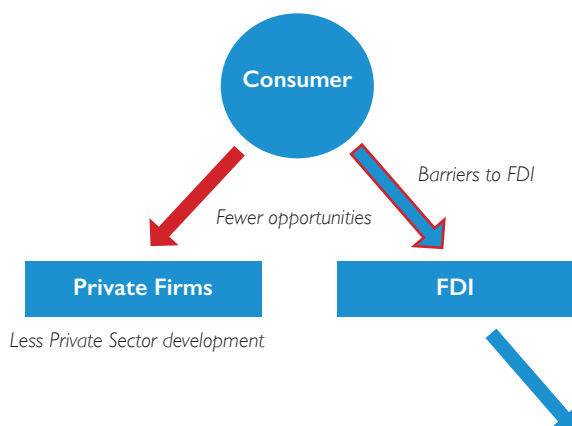
Pressures on cost of living from higher inflation can incentivise corruption, leading to a vicious circle. Research has also found inflation can itself be a driver of corruption: tat Braun and di Tella (2000) found that a one standard deviation increase in inflation variance from the median can lead to an increase in corruption of 12 per cent (%) of a standard deviation and a decline in growth rates of 0.33 percentage points. As a result, corruption and inflation can form a vicious cycle of price rises.

Figure 6.: Log of Price Level against Log of Control of Corruption (World Development Indicators) for selected countries



Whilst on the one hand, corruption can lead to higher prices, it can also reduce incomes, thus creating a double pressure on the cost of living. The cost of living is also a function of incomes, and while corruption may increase the income of a few, it is detrimental to the economy as a whole and therefore suppresses income for the wider society. For example, Herzfeld (2005) finds that Corruption affects economic growth, the level of GDP per capita, investment activity, international trade and price stability negatively. Additionally, it biases the composition of government expenditures. The research estimates that an increase

Figure 7: Corruption reduces private sector development and disincentivizes FDI



of corruption by about one index point reduces GDP growth by 0.13 percentage points and GDP per capita by 425 US\$.

In order to supplement the findings in the literature that corruption increases prices, we have undertaken a new analysis of the relationship between inflation and corruption, building on the methodology elaborated by Budak and Vizek (2015) (details of the analysis are provide in Appendix I). Our findings for Malaysia reinforce what has been identified in other studies: the price level increases as control of corruption reduces. It is important to note that this analysis is based on very few samples, and therefore only represents a preliminary analysis; it also does not demonstrate a statistically significant relationship. However, this finding provides further impetus to the need to tackle corruption to address cost of living pressures.

Tackling corruption needs to be part of a comprehensive plan to tackle concerns over the cost of living. This analysis highlights how corruption can negatively impact prices – therefore any meaningful policy strategy to ameliorate the cost of living needs to address the symptoms and causes of corruption.

CHAPTER 5: POLICY RECOMMENDATIONS

Addressing corruption and alleviating the cost of living will require a sustained policy effort.

Corruption is a multifaceted phenomenon that includes bribery, embezzlement and fraud, extortion, abuse of discretion, and favouritism. The causes of corruption are multifarious and include information asymmetry, excessive bureaucratic process, and perceptions of the larger community. The MACC provides the primary tool to combat corruption in Malaysia, but ultimately reducing corruption on a systemic scale will require a concerted effort across all segments of society.

This paper has identified several broad policy messages, which can be considered in the fight against corruption. The primary purpose of this paper is to examine how corruption impacts the cost of living, rather than provide a detailed policy prescription. However, in observing the various accounts provided by interviewees, there are several broad policy messages that come through. These recommendations are intended to build on and contribute to existing policy initiatives.

Recommendation 1: Maintaining momentum on implementation of the NACP

The National Anti-Corruption Plan (NACP) established under the previous Government, provides the foundation for many important reforms. In January 2019, the government published the NACP, which included many reforms that could make a material difference to efforts to tackle the challenges identified in this paper. This includes new requirements on disclosure of conflict of interest and asset declaration. **The status of the NACP has been confirmed under the current government.** Prime Minister Tan Sri Muhyiddin Yassin is reported to have said the Perikatan Nasional-led government is still committed to fulfilling the initiatives under the NACP and that the **National Centre for Governance, Integrity and Anti-Corruption (GIACC)** would be maintained and it would help evaluate the anti-corruption initiatives under the NACP. This is a much lauded commitment on the part of the Prime Minister and underscores the importance that the government places on anti-corruption.

However, relatively little progress has been reported to date. The NACP includes various ambitious timelines for implementation, and while some measures have been implemented, the Government has not provided a comprehensive report on the implementation of the strategies outlined in the Plan. In the absence of such reporting, the general public cannot hold the government to account and are not made aware of what progress has been made. The Government should therefore issue a Progress Report on the implementation of the NACP.

Recommendation 2: Prioritizing public procurement reform

Public procurement should be a priority for reform. This report highlights the extent to which corruption remains a problem within the public sector. Indeed, the NACP reports that 40 per cent (%) of corruption complaints originate from public procurement. Therefore, reform of the public procurement system is essential to combat corruption. The NACP included a clear commitment to introduce a **Government Procurement Act (GPA)** which would strengthen regulation and oversight of the public procurement regime. We understand that the Ministry of Finance is proceeding with plans to enact this Act.

The Government should proceed with plans to introduce government procurement legislation, and this should include clear transparency standards and a review mechanism. Given the importance of the public procurement system, the enactment, development and implementation of the GPA should be prioritised. In order to ensure the legislation makes a meaningful impact on the issue of corruption, the legislation should include strong mechanisms to increase transparency because despite the existence of policies and commitments to ensure transparency, there remains significant gaps in the availability of information on awards (Murniati, 2020). Moreover, the GPA should introduce a complaints and review mechanism, in line with international standards on procurement legislation, to ensure better accountability of aware decisions (Murniati, 2020).

The role of quasi-public agencies should also be systematically reviewed. Although not formally within the scope of the GPA, the Government should also review the use of quasi-public agencies and State-Owned Enterprises (SOEs) in delivering public services.

Recommendation 3: Supporting targeted policies with a wider drive towards transparency

A stronger focus on transparency is needed to break down information asymmetries which can cause corruption. The report highlights that information asymmetries are a major driver of corruption, in line with the principal-agent model. Therefore, in addition to targeted policy reforms, such as in public procurement, there is a need to pursue broader reforms with increased transparency across the public sector.

The Government should enact a Freedom Of Information Act and empower government agencies to make data publicly available. To promote wider transparency, the government should move forward with plans to enact the Freedom of Information Act as provided for in the NACP.

Recommendation 4: Strengthening the powers and independence of Malaysian Anti-Corruption Commission (MACC)

To further strengthen the powers and independence of the Malaysian Anti-Corruption Commission (MACC), including granting powers to investigate public and private sector individuals living beyond their means and increasing the scrutiny and independence of key public appointments. **The MACC leads the fight against corruption in Malaysia and has led various key initiatives.** The MACC is at the forefront of the fight against corruption and is the primary vehicle to tackle corruption in the country. The NACP provides the MACC with further remit to deliver on this important mission.

The MACC could be further strengthened, by providing additional investigatory powers and increasing Parliamentary scrutiny of senior appointments. IDEAS has previously made recommendations on the strengthening of the MACC and many of the proposed reforms remain relevant as useful steps to strengthen the powers and independence of the MACC (IDEAS, 2016).

The Government should consider strengthening the independence of the MACC, through establishment of an independent constitutional commission. The MACC needs to be autonomous and independent from the Executive. In order to combat corruption effectively, the independence of its Chairman and members of the Commission must be ensured. It is important to create a structure that has a strong check and balance mechanism, independent of Executive interference. It is proposed that a new Independent

Anti-Corruption Commission (IACC) should be created by the Government. An independent, stand-alone, constitutional commission headed by constitutionally recognised Commissioners. The new structure separates the IACC from the statutorily established MACC which will remain as the investigative arm for anti-corruption related matters but will report directly to the IACC instead of the Government.

Senior appointments to the MACC should be subject to greater scrutiny and independent of Executive discretion. The appointment of MACC members and the Commissioner should be subject to scrutiny by cross-partisan Parliamentary Committee and these appointees should have security of tenure, whereby the appointee can only be removed in the same manner as a judge, i.e., a tribunal appointed by the Yang di Pertuan Agong.

The powers of the MACC should be expanded to enable investigation of public officials living beyond their means. Referring to the example in Hong Kong, specifically Section 10 of the Prevention of Bribery Ordinance of Hong Kong, the government should consider amending the MACC Act to enable the MACC to investigate public officials living beyond their means.

The MACC should not assume prosecutorial powers, but the role of the Public Prosecutor should be separated from that of the Attorney General. The previous Government had intended the separation of the roles of the Public Prosecutor and Attorney General but failed to secure the parliamentary support for the necessary constitutional amendment. This commitment should be taken up by the current and any future government as a vital step in limiting any conflict of interest between these two important roles.

Recommendation 5: Empowering the private sector in the fight against corruption

The private sector plays a crucial role in the fight against corruption, but interviews suggest some lack of awareness over what constitutes corruption. The issue of corruption is not limited to the public sector, and the private sector also has an important role to play. Based on the interviews conducted, there remain some confusion and disagreement over what constitutes corruption, for example, within the healthcare sector where practitioners presented different views over what constitutes corrupt behaviour in respect of gifts.

The recently amended Section 17A, MACC Act is helpful in focusing on liability but it needs to be accompanied with awareness raising and capacity building activities. The amendment has served as an important mechanism to impress upon the private sector the responsibilities of company directors to be vigilant in relation to potential corruption within the business. However, for this amendment to be effective in making a systemic reduction in the level of corruption, it needs to be accompanied by wide ranging awareness raising and training activities to ensure that companies understand their responsibilities.

The government should work with Business Associations to encourage the development of industry codes and standards which reflect the different demands in each sector. From the healthcare industry interviews, the use of Ethics codes was highlighted as an important tool to self-regulation. The Government should consider how best to encourage other business groups and industry players to develop similar standards that reflect the particular challenges within their industry, prioritising education and construction.

Legislation should be amended to give whistle-blowers more confidence to speak out. In order to encourage individuals to come forward with evidence of corruption, the **Whistle-blower Protection Act 2010** (WPA) should be further strengthened. Under the WPA, whistle-blowers can only report corruption to an enforcement agency (MACC, Securities Commission, etc.). In other countries, for example the United Kingdom, whistle-blowers can speak to a lawyer, his/her employer, a Minister of the Crown or anyone prescribed by the Secretary of State. The Malaysian Government should consider an amendment to the WPA to allow individuals access to similar persons. Whistle-blowers should also be provided with regular updates on the status of the case throughout the entire process and individuals who disclose matters related to the Malaysian **Official Secrets Act 1972** (OSA) should be granted whistle-blower status and protection.

Recommendation 6: Simplifying the regulatory environment so as to reduce the incentives for corruption

The government can simplify high regulatory barriers which can be a driver of corruption. In line with the “greases the wheel” hypothesis, many parties are motivated to engage in corruption in order to avoid long-winded bureaucratic hurdles. Regulatory standards should not be compromised, but the process of complying with regulation can be made easier. For example, Malaysia ranks 12th overall in the **Ease of Doing Business Index**, but 126th for **Starting a Business Index**, suggesting additional improvements can be made. The Malaysia Productivity Corporation (MPC) should be given the necessary mandate to ensure unnecessary regulatory barriers are removed.

The use of “preferred suppliers” by public authorities, or other actions which restrict choice, and the use of digitalisation to simplify regulations and reduce personal contact can also reduce regulations. The process of removing unnecessary regulatory barriers, should be extended to any requirements imposed by public authorities to use a pre-determined set of suppliers. The use of such restrictions should be minimised, and only used on the basis for a narrowly justification. The use of such restrictions should be included within the scope of the reviews of unnecessary regulatory burdens undertaken by MPC. The scope for corruption reduces as government interactions are digitalised and recorded, and therefore “e-government” should also form a key plank of the government’s drive for modernisation of the regulatory environment. The government should specifically address the nexus that seems to exist between corruption and the hiring for foreign workers, which was identified as an issue in both the construction and education sectors.

Recommendation 7: Promoting more competitive and innovative markets

Beyond measures to tackle corruption directly, a broader strategy to promote competition and innovation can help to counter the negative impact of corruption. Inefficient market structures act as fertile ground for different forms of corruption; monopolies propagate forms of corruption that extract existing rents, while more contested but poorly regulated markets incentivize players to seek cost-reducing forms (such as abuse of discretion and bribery) of corruption to obtain a competitive edge (Alexeev & Song, 2013). The government should therefore consider that a broader strategy to promote competition effectively can also contribute to the goal of reducing corruption. Johari et al. (2018) employ a cross-sectional analysis and find that innovation is positively significant in reducing corruption. This research suggests that innovation creating the conditions for more dynamic and innovative markets can help to reduce corruption, as it causes the private sector to become less dependent on favouritism from the public officials and authorities. The government should prioritise areas where Malaysia’s regulatory environment is too restrictive, including starting a business, prices controls and anti-profiteering, and highly protected services.

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Appendix A: Methodological Notes on Econometric Analysis

Inspired by Budak's and Vizek's (2015) study, we investigated the impact of corruption towards Malaysia's general price level using econometric analysis. Due to limited data on corruption in Malaysia, this econometric analysis time series data from the years 2003-2019 with a total of 16 number of samples for each variable. The response variable for this analysis will be the consumer price index as the proxy for the general price level in the economy and its data source is from the Department of Statistics Malaysia (DOSM). For the analysis, there are 6 explanatory variables which are: control of corruption, Gross Domestic Product (GDP) per capita, money supply, trade openness, overall tax burden or fiscal dominance, and political instability.

The first explanatory variable is the control of corruption. This variable is the proxy for corruption whereby the higher the control of corruption score, the more control a country is perceived to have on corruption. This data is taken from the World Governance Indicator (WGI) where WGI defines this dataset as 'reflecting perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests'. The hypothesis for this explanatory variable with the response variable is that they are negatively correlated such that the higher the control of corruption score, the lower the general price level in the economy.

The second and third explanatory variable is GDP per capita and money supply respectively. These variables are included because it has been suggested in the Budak and Vizek (2015) study and both variables have solid literature behind it to test against price level. For the money supply variable, Budak and Vizek (2015) suggested using M1 money aggregate. For this study, both data sets were extracted from DOSM and both have been hypothesised to be positively correlated with the price level.

For the fourth explanatory variable, we used trade openness as a variable that measures the degree of openness of a country. The formula for this variable is the proportion of total trade to GDP as suggested by Budak and Vizek (2015). This variable is hypothesised to have negative correlation with price level since the more open the economy is, the more competitive the market will be, and thus, the general price level is expected to be lower. This data was also extracted from DOSM.

The fifth explanatory variable is the overall tax burden and fiscal dominance. This variable as suggested by Budak and Vizek (2015) is a variable to measure government revenue relative to GDP. However, to improve this variable to include in this study, the variable's formula will be redefined to capture more accurate tax burden or fiscal dominance. This study will be using the proportion of government expenditure to its revenue. With this formula, it will reflect the fiscal dominance of a country in an accurate way since we can know how much the government is spending relative to its revenue. The hypothesis for this variable is positively correlated with the price level since the higher the proportion of government expenditure to its revenue, the higher the price level in the economy due to the increase of government expenditure in the economy.

The final explanatory variable is political instability. This variable's data is extracted from WGI database where it is defined as 'measuring perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism'. Hence, the hypothesis for this variable is that the higher the political instability score, the higher the price level.

After defining each variable, it is then possible to construct the theoretical equation for the econometric analysis. The theoretical equation is as follows:-

$$PL = \beta CC_t + \beta CC_{t-1} + \beta GDP_t + \beta MI_t + \beta OPEN_t + \beta TAX_BURDEN_t + \beta POL_t + \epsilon_t$$

Where PL: price level; CC: control of corruption; GDP: GDP per capita; MI: money supply; OPEN: trade openness; TAX_BURDEN: overall tax burden and fiscal dominance; POL: political instability; and ϵ : error term.

Note that in the theoretical equation, this analysis added the lagged effect of 1 period on control of corruption variable to capture the lagged effect in the economy. With the theoretical equation that uses a double log model as suggested by Budak and Vizek (2015), we ran the regression analysis with Ordinary Least Square Method (OLS) using E-View to analyse the impact of corruption on the price level. The summary of the result is shown below:

Table 3: Estimation Results

| | Coefficient |
|----------------------------|-----------------------|
| Constant | 0.9758* (1.9217) |
| Ln CC _t | -0.06999 (-1.0425) |
| Ln CC _{t-1} | -0.0251 (-0.343) |
| Ln GDP _t | 0.1945** (2.347) |
| Ln MI _t * | 0.1418** (2.7003) |
| Ln OPEN _t | 0.02796 (1.3635) |
| Ln TAX_BURDEN _t | 0.1693 (1.4322) |
| Ln POL _t | 0.06118 (1.5802) |
| R ² | 0.9956 |
| Adjusted R ² | 0.9918 |
| F-statistics | 259.9086*** |

Notes: PL: price level; CC: control of corruption; GDP: GDP per capita; MI: money supply; OPEN: trade openness; TAX_BURDEN: overall tax burden and fiscal dominance; POL: political instability;

***, ** and * indicate significance at the 1%, 5% and 10% levels respectively.

Figures in round parentheses represent t-values.

Based on the table above, although the control of corruption variable both in real time and lagged effect is not statistically significant, the data shows that the control of corruption score is negatively correlated with the price level. Thus, the higher Malaysia's control of corruption score, the lower the price level in the economy.

Moreover, other explanatory variables except trade openness, met all the priori sign hypotheses for each explanatory variable where GDP per capita, money supply, tax burden or fiscal dominance, and political instability are positively correlated with the general price level of the economy. These results are parallel with the existing literature and do not contradict any economic theories.

Since the trade openness hypothesis is not accurate, one can only speculate on reasons for this. One possible explanation could be that Malaysia's openness is over a relatively short period, compared to well-developed countries that have a long history of openness. Because of this, the price setting mechanism in Malaysia could be less efficient when compared to the developed countries and it may be more subject to specific features of the local market (Budak & Vizek, 2015). Budak and Vizek (2015) further explained that another explanation for this result would be since corruption is widespread in most transition countries, the impact of corruption on prices may not be immediate and may be divided into thresholds. For example, Budak and Vizek (2015) explained that corruption may only affect the price level if it exceeds a certain threshold of corruption transaction.

One of the major drawbacks from this analysis is that the explanatory variable of control of corruption is not significant. This can be explained by not having a large enough sample size. As mentioned, this analysis only has 16 samples and it is exceedingly small due to the unavailability of control of corruption score data prior to 1995. Hence, this analysis could be re-run for future study for in the Malaysian context if the number of samples can be increased to at least 50 since the data for control of corruption is being consistently updated every year since 1995.

In conclusion, this econometric analysis provides strong evidence of the correlation between corruption and general prices in the economy. If corruption prevails in a country, it may affect prices negatively and lead to poor internal competition and as such in the long run, will negatively affect the wellbeing of the Rakyat.

Appendix B: List of Select Interviewees

| Date of Interview | Interviewee Job Designation | Sector | Location |
|-------------------|---|---------------------|---------------|
| Sep-20 | Civil Engineer | Building contractor | Kuala Lumpur |
| Sep-20 | Manager | Contractor | Selangor |
| Sep-20 | Site engineers | Main contractor | Kuala Lumpur |
| Sep-20 | Manager | Furnishing supplier | Kuala Lumpur |
| Oct-20 | Site teams | Main contractors | Kuala Lumpur |
| Oct-20 | Development engineer | Developer | Kuala Lumpur |
| Dec-20 | National High School Teacher | Education | Selangor |
| Dec-20 | National High School Teacher | Education | Selangor |
| Dec-20 | National high School Teacher | Education | Perak |
| Dec-20 | University Lecturer | Education | Kuala Lumpur |
| Jan-21 | Senior lecturer | Education | Selangor |
| Jan-21 | Private College Lecturer | Education | Selangor |
| Jan-21 | Government High School Teacher | Education | Sabah |
| Jan-21 | Associate Professor (private university) | Education | Selangor |
| Jan-21 | Associate Professor (public university) | Education | Kuala Lumpur |
| Feb-21 | CEO | Medical | Selangor |
| Feb-21 | General Manager | Medical | Selangor |
| Feb-21 | Senior Sales Executive | Medical | Penang |
| Feb-21 | Senior Manager | Pharmaceutical | Kuala Lumpur |
| Feb-21 | Senior Manager | OTC Market | Petaling Jaya |
| Mar-21 | CEO | Construction | Selangor |
| Mar-21 | Senior Manager | Developer | Selangor |
| Mar-21 | Director of an air-conditioner contractor | Construction | Kuala Lumpur |
| Mar-21 | Senior Site Supervisor | Construction | Klang |
| Mar-21 | Project Manager | Construction | Kuala Lumpur |
| Mar-21 | Civic Engineer | Construction | Kuala Lumpur |



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