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## Corruption and Development

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# CORRUPTION AND DEVELOPMENT

## WHY DOES CORRUPTION STILL AFFECT GROWTH?

*Maxime Delabarre*

### ABSTRACT

This essay investigates the relationship between corruption and development. By a study of the determinants of the phenomenon as well as its implications on growth, this paper address the corruption challenge faced by governments and policymakers. Based on the theoretical framework of the political economy of development, I argue that even though the causality is not entirely clear, it is however without debate to say that development is necessarily linked with anti-corruption initiatives. If some counterexamples still exist, it is remarkable to see that the vast majority of developed countries did fight corruption at some point. Still, the path to fight corruption is blurry. It is unlikely for a developing country to get rid of the phenomenon on its own, without external help. Finally, according to the classical studies on the quality of institutions, this paper concludes that a strong rule of law and government effectiveness are among the key factors able to fight a corrupt system.

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## I. INTRODUCTION

“In the developing world, corruption is public enemy N<sup>o</sup>. 1,” said World Bank President Jim Yon Kim<sup>1</sup> after the launch of a wide campaign against bribes, then considered as a negative determinant of growth.

Corruption has been widely defined over the years. Svensson argued that corruption is the “misuse of public office for private gain”.<sup>2</sup> Fisman and Golden considered corruption as an equilibrium resulting from individuals’ interactions.<sup>3</sup> Corruption is also widely considered as a tax applied to production – usually with a higher cost involved because of the uncertainty necessary to the bribe<sup>4</sup> – which would directly reduce growth.<sup>5</sup>

Still, measuring corruption is not an easy task. One way used to estimate corruption is surveys. Applying this technique in Uganda, Svensson found that firms paid, on average, 8% of their total costs in corruption.<sup>6</sup> However, most of the indicators are relying upon the perception of corruption. Especially, this process has been used in one of the first preeminent study linking corruption and growth in 1995.<sup>7</sup> This essay will use the World Bank’s Control of Corruption Index (rescaled).<sup>8</sup>

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<sup>1</sup> Anna Yukhananov, *World Bank president calls corruption “Public Enemy No. 1,”* REUTERS, December 19, 2013, <https://www.reuters.com/article/us-worldbank-corruption-idUSBRE9BI11P20131219> (last visited Dec 11, 2020).

<sup>2</sup> Jakob Svensson, *Eight Questions about Corruption*, 19 J. ECON. PERSPECT. 19–42 (2005).

<sup>3</sup> Ray Fisman and Miriam A. Golden, *Corruption: What Everyone Needs to Know*, (Oxford University Press, 2017).

<sup>4</sup> Andrei Shleifer & Robert W Vishny, *Corruption, the quarterly journal of economics* (1993).

<sup>5</sup> WILLIAM EASTERLY, *THE ELUSIVE QUEST FOR GROWTH: ECONOMISTS’ ADVENTURES AND MISADVENTURES IN THE TROPICS* 241 (2001).

<sup>6</sup> Jakob Svensson, *Who Must Pay Bribes and How Much? Evidence from a Cross Section of Firms*, 118 Q. J. ECON. 207–230 (2003).

<sup>7</sup> Paolo Mauro, *Corruption and growth*, 110 Q. J. ECON. 681–712 (1995).

<sup>8</sup> Daniel Kaufmann, Aart Kraay & Massimo Mastruzzi, *GOVERNANCE MATTERS III: GOVERNANCE INDICATORS FOR 1996–2002* (2003).

Through surveys and questionnaires, it seems that corruption is most prevalent in developing countries than in the richest parts of the world. Henceforth, the question of the relationship between corruption and development is usually asked. The negative correlation between corruption and incomes has been widely studied but the causality seems harder to demonstrate. Either way, the international community has been widely interested in the matter over the past years. International instruments, such as the Anti-Bribery Convention from the OECD and its UN and World Bank counterparts, have been hugely ratified. National governments also get to grips with the issue, including the extraterritorial position of the US Department of Justice through the Foreign Corrupt Practices Act.

## II. THE DETERMINANTS OF CORRUPTION

The determinants of corruption at the country level have been widely studied in the literature. Overall, it seems that lower GDP per capita is correlated with a higher level of corruption. Fig. 2 represents the negative relationship between GDP per capita and the Corruption Index in 2018. However, based on this consideration, two theories could exist. Economic factors and development could influence corruption (and thus be its determinants) or corruption level impacts institutions and development. The openness index is a good proxy since almost all highly corrupted countries in 1995 were closed economies.<sup>9</sup> Other causes have been studied by Treisman. He concludes that, overall, protestant traditions, British history, democracy, and unitary states are all correlated with a lower level of corruption.<sup>10</sup> Other studies have found similar results albeit focusing on different periods and countries.<sup>11</sup>

Institutions adapt to income and needs. Through this short statement, Lipset addresses, among others, the human capital theory which states that effective

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<sup>9</sup> Jeffrey D Sachs et al., *Economic reform and the process of global integration*, 1995 BROOK. PAP. ECON. ACT. 1–118 (1995).

<sup>10</sup> Daniel Treisman, *The causes of corruption: a cross-national study*, 76 J. PUBLIC ECON. 399–457 (2000).

<sup>11</sup> Daron Acemoglu, Simon Johnson & James A Robinson, *Institutions as a fundamental cause of long-run growth*, 1 HANDB. ECON. GROWTH 385–472 (2005); Simeon Djankov et al., *The new comparative economics*, 31 J. COMP. ECON. 595–619 (2003); Rafael La Porta et al., *The quality of government*, 15 J. LAW ECON. ORGAN. 222–279 (1999).

judicial systems or government stability require education.<sup>12</sup> Henceforth, when the population is literate the politics are less likely to be corrupted.

Following this line of argument, the question of colonialism has been addressed. It has been argued that institutions were better conceived in colonies when a high number of colonizers were present. Hence, a hospitable environment is negatively correlated with corruption.<sup>13</sup> Other authors demonstrated that legal origin matters and countries with a history of English colonialism are less likely to be subject to corruption than French ones.<sup>14</sup> Following this line of argument, Persson and Tabellini studied the impact of political institutions on corruption and demonstrated the effect of accountability.<sup>15</sup> Studying the effect of democracy, Table 1 shows the negative correlation between the quality of democratic institutions and corruption.

However, if the link between corruption and democratic institutions is quite clear, it seems at best incomplete. Svensson demonstrated the negative correlation between human capital and corruption.<sup>16</sup> A study has shown how an information campaign in Uganda against corruption has helped to fight it, demonstrating the importance of education.<sup>17</sup> Those two variables are hence very likely to be determinants of corruption as well. Moreover, contending that democracy does a better job at fighting corruption than autocracy is mainly advocated through transparency and its impact on elections.<sup>18</sup> However, when studying the proportion of democracies and autocracies the conclusion is less clear, as Fig. 1 shows.

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<sup>12</sup> Seymour Martin Lipset, *POLITICAL MAN: THE SOCIAL BASES OF POLITICS* (Expanded ed ed. 1981).

<sup>13</sup> Daron Acemoglu, Simon Johnson & James A Robinson, *The colonial origins of comparative development: An empirical investigation*, 91 *AM. ECON. REV.* 1369–1401 (2001).

<sup>14</sup> Rafael La Porta et al., *Law and Finance*, 106 *J. POLIT. ECON.* 1113–1155 (1998).

<sup>15</sup> Torsten Persson & Guido Tabellini, *Constitutions and economic policy*, 18 *J. ECON. PERSPECT.* 75–98 (2004).

<sup>16</sup> Jakob Svensson, *Eight Questions about Corruption*, 19 *J. ECON. PERSPECT.* 19–42 (2005).

<sup>17</sup> Ritva Reinikka & Jakob Svensson, *Fighting corruption to improve schooling: Evidence from a newspaper campaign in Uganda*, 3 *J. EUR. ECON. ASSOC.* 259–267 (2005).

<sup>18</sup> Simeon Djankov et al., *Disclosure by Politicians*, 2 *AM. ECON. J. APPL. ECON.* 179–209 (2010).

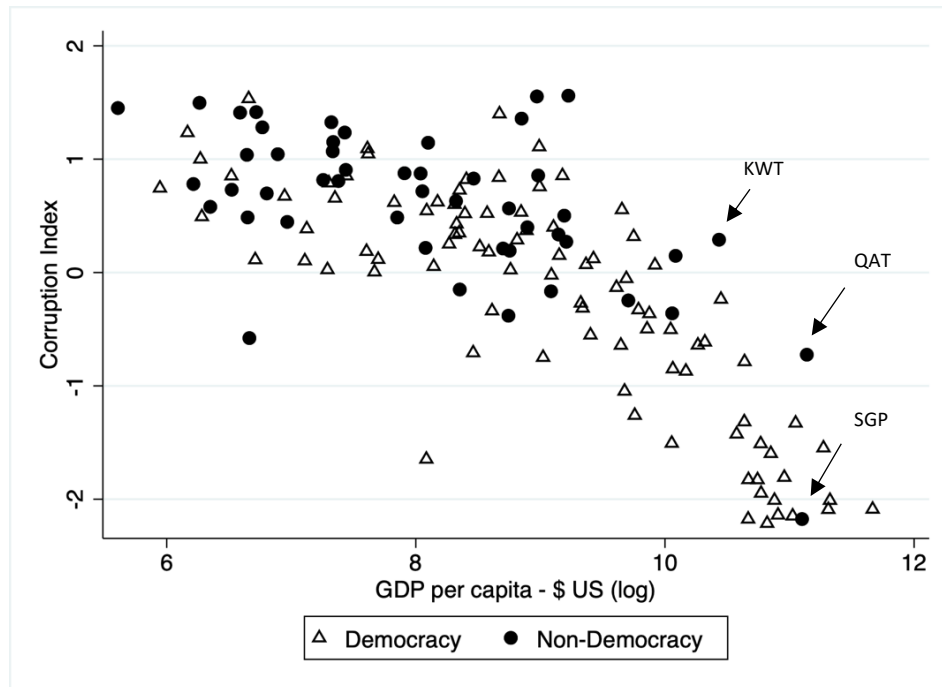


Fig. 1: Corruption, GDP per capita (log of \$US), and Democracies in 2018

**Notes:** Author's graph. Data for Corruption Index and GDP per capita from the World Bank. Corruption Index is from the Control of Corruption Index, rescaled so that higher values reflect higher corruption. Democracy data from Polity Score.

Henceforth, the quality of institutions is by far one of the strongest determinants of corruption but cannot explain everything. Rule of law, government effectiveness, political stability, and accountability are all negatively correlated with the level of corruption as Table 2 demonstrates.

Some sectors are also more concerned with corruption than others and corruption is higher for public officials as they detain a sort of power. Several studies have analyzed the extent to which relatively low wages in the public sector could explain their openness to corruption. The argument is as follows: the lower the bureaucrat wages the more they would be open to external sources of income. This is displayed in Fig. 3.

### III. CORRUPTION AND GROWTH

If the link between development and growth has already been demonstrated (see Fig. 2), it is not clear yet whether corruption indeed adversely affects development. For example, a study demonstrated that, in Ukraine, corruption of public employees allows them to have the same level of consumption as the private sector. Accordingly, it seems that bribes perfectly offset the low wages or the other way around.<sup>19</sup> In this case, Olken and Pande argued that the adverse effect on growth is true only when the deadweight loss of corruption is greater than the one of taxation needed to raise public salaries.<sup>20</sup> However, for the victims, either who cannot benefit from the efficient redistribution of income from the State or who are forced to bribe where corruption is deeply implemented in the administration, corruption widens inequalities as the poorest pay relatively more of their incomes in bribes.<sup>21</sup> If the efficiency of corruption could be discussed for public employees, it is however clear that firms are negatively affected by this situation. If some firms pay bribes to avoid taxes, this is far from efficient for every company. Fisman and Svensson demonstrated that, based on a dataset of firms in Uganda, corruption is three times less efficient than paying taxes.<sup>22</sup>

Real losses occur for the society especially when corruption prevents a positive externality – such as redistribution – to happen. In Brazil, test scores of students were negatively affected by corruption, probably resulting from less training offered to teachers in those areas.<sup>23</sup> The political closeness of firms is also likely to increase their benefits from the government. As such, corruption distorts the effective allocation of public goods, and this results in a loss ranging between 0.15% and 0.30% of GDP.<sup>24</sup>

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<sup>19</sup> Yuriy Gorodnichenko & Klara Sabirianova Peter, *Public sector pay and corruption: Measuring bribery from micro data*, 91 J. PUBLIC ECON. 963–991 (2007).

<sup>20</sup> Benjamin A. Olken & Rohini Pande, *Corruption in Developing Countries*, 4 ANNU. REV. ECON. 479–509 (2011).

<sup>21</sup> Jennifer Hunt, *How corruption hits people when they are down*, 84 J. DEV. ECON. 574–589 (2007).

<sup>22</sup> *Are corruption and taxation really harmful to growth? Firm level evidence*, 83 J. DEV. ECON. 63–75 (2007).

<sup>23</sup> Frederico Finan & Claudio Ferraz, *Motivating politicians: the impacts of monetary incentives on quality and performance* (2009).

<sup>24</sup> Asim Ijaz Khwaja & Atif Mian, *Do lenders favor politically connected firms? Rent provision in an emerging financial market*, 120 Q. J. ECON. 1371–1411 (2005).

Moreover, the question of the correction of externalities matter as well. Bribes paid to avoid a fine reduce the cost of breaking the law and impeach the State to redistribute the gains. This kind of efficiency loss has been addressed with driver licensing in India.<sup>25</sup> Corruption led to people unable to drive with the right to do it.

Still, despite those apparent negative effects of corruption, some argue that it can be beneficial under certain conditions. Specifically, we could consider some firms using bribes to correct deficiencies of some governments. When too rigid regulations are in place, some authors argue that efficient corruption could appear.<sup>26</sup> This argument is at best flawed because it does not take into account the fact that bad regulations could be the direct result of corruption.<sup>27</sup> More, as Table 3 demonstrates, corruption is negatively correlated with growth. But, if the negative effect of corruption on growth is the classical relationship, some credible arguments are stating that it is reversed. With low development and scarce economic resources, corruption develops. The fact that high-income countries have an average of corruption much lower could come from the eradication of corruption following development and not the other way around.

The link between corruption and inequality has also been studied using the Gini coefficient. A strong correlation exists between corruption and inequalities as more corrupted countries tend to redistribute less. This argument is quite logical as more corrupted countries allow for only a sub-optimal redistribution. More it seems that corrupt countries tend to tax less richest individuals. This analysis is strongly supported by the IMF study conducted in 2002 linking high corruption to low development, the formation of human capital, and social spending.<sup>28</sup>

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<sup>25</sup> Marianne Bertrand et al., *Obtaining a driver's license in India: an experimental approach to studying corruption*, 122 Q. J. ECON. 1639–1676 (2007).

<sup>26</sup> Samuel P. Huntington, *POLITICAL ORDER IN CHANGING SOCIETIES* (2006).

<sup>27</sup> Fisman and Golden, *supra* note 3.

<sup>28</sup> Sanjeev Gupta & George Abed, 17 *Does Corruption Affect Income Inequality and Poverty?* (2002).



#### IV. THE CORRUPTION CHALLENGE

If corruption is negatively correlated to economic growth, one can wonder why governments and political leaders across the world do not get rid of it. The path seems quite clear: setting up good quality institutions and eliminate the incentives for corruption. The task is not impossible, as Hong Kong or Singapore's strong fight against corruption demonstrates. Of course, the first difficulty is the question of credible commitment of government officials. If those officials do have interests in the situation, it is unlikely that they would fight it but rather take some measures to win elections, without committing to it enough to handle the issue. Also, interest groups are particularly active when it comes to corruption and some big companies could consider that the situation is good for them and hence pressure the government so that nothing changes. For example, even if Georgia successfully reduced corruption for some time, the President has been forced to leave the country which demonstrates how strong interest groups can be powerful.

This rallies the argument according to which corruption is an equilibrium, hard to unsettle. Olken and Pande argue that new government and politicians can difficulty be considered as handling corruption in the first few years of their mandate as it could take some time for them to realize how a corrupt system could benefit their interests.<sup>29</sup> Banerjee et al. found similar results, demonstrating how a policy implemented in the Indian health care system was effective for only 6 months.<sup>30</sup> Corruption is then hard to fight in the long-term, but the short-term aspect is not easy either. Depending on which form of corruption is the easiest at some point, corrupt politicians can easily switch.<sup>31</sup>

Institutions are also of the utmost importance. Most programs rely on legal institutions, which are not developed enough in developing countries, if not corrupt themselves. If Hong Kong and Singapore are notable exceptions, it is mainly because their programs were based on other factors such as strong legal auditing, increase in the public wages, reorganization of the

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<sup>29</sup> Olken and Pande, *supra* note 20.

<sup>30</sup> *Putting a Band-Aid on a Corpse: Incentives for Nurses in the Indian Public Health Care System*, 6 J. EUR. ECON. ASSOC. 487–500 (2008).

<sup>31</sup> Paul Niehaus & Sandip Sukhtankar, *Corruption dynamics: The golden goose effect*, 5 AM. ECON. J. ECON. POLICY 230–69 (2013).

administration, etc. All of those measures were efficient because political leadership was strongly committed.

External advisors are also a solution. Because of commitment, anti-corruption agencies must respond to external leadership and not to the government. In Hong Kong, the Independent Commission was ultimately responding to the UK. On the contrary, its Kenyan counterpart responded to the government. This simple difference is the reason as to why the former succeeded and not the latter. Another example would be the anti-corruption initiative launched in China whereby no close relations of Xi Jinping were ever arrested. Finally, the culture of corruption is hard to fight. Only through strong educational programs will a government be able to shift a country's values in the right way. Even when voters are supporting the change, too many obstacles exist so that challengers can overthrow corrupt incumbents. External pressures have been applied in Guatemala or Italy, showing satisfactory results.

## V. CONCLUSION

To conclude, even if some doubts can exist on the causality in the corruption-development correlation, development passes through anti-corruption initiatives. However, some highly corrupted countries are developing at a fast pace, among which China. Still, strongly linked with it, when not induced by, countries' development should happen through the enactment of good quality institutions, with safeguards and counter-power. Democracy makes corruption more unlikely as electors can decide on the faith of a government.

The path to fight corruption is unclear though. If some exceptions exist it is unlikely for a developing country to get rid of the phenomenon without external help. It seems that the implementation of a strong rule of law-based judicial systems as well as enhancing government effectiveness are interesting solutions. Overall, one solution does not fit all, and a country facing a corruption problem will likely need a strongly committed leadership as well as wide policy reforms to tackle it.

## VI. APPENDIX

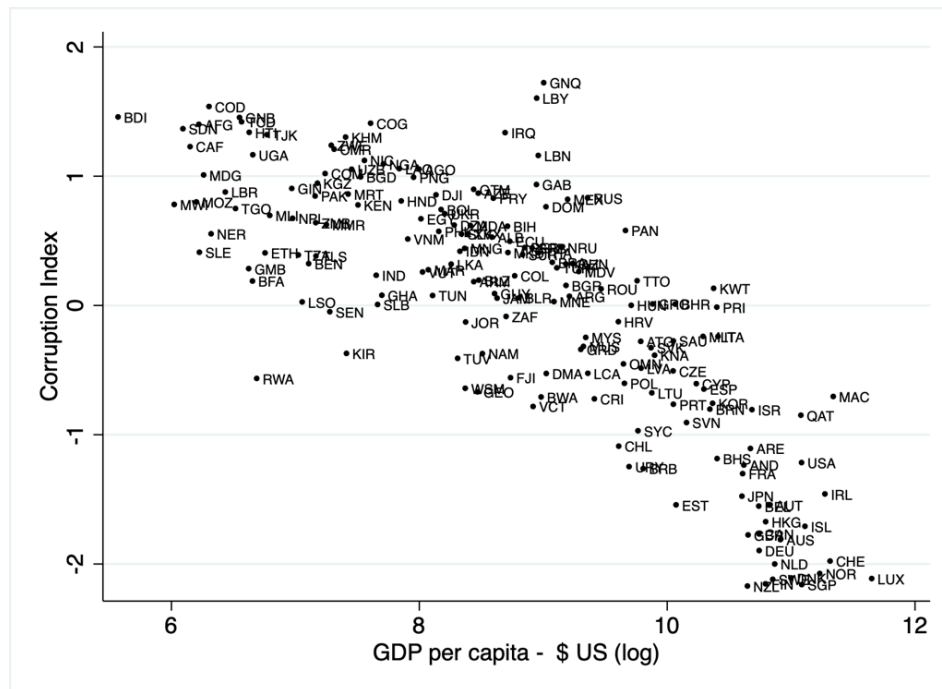


Fig. 2: Corruption and GDP per capita (log of \$US) in 2018

**Notes:** Author's graph. Data for Corruption Index and GDP per capita from the World Bank. Corruption Index is from the Control of Corruption Index, rescaled so that higher values reflect higher corruption.

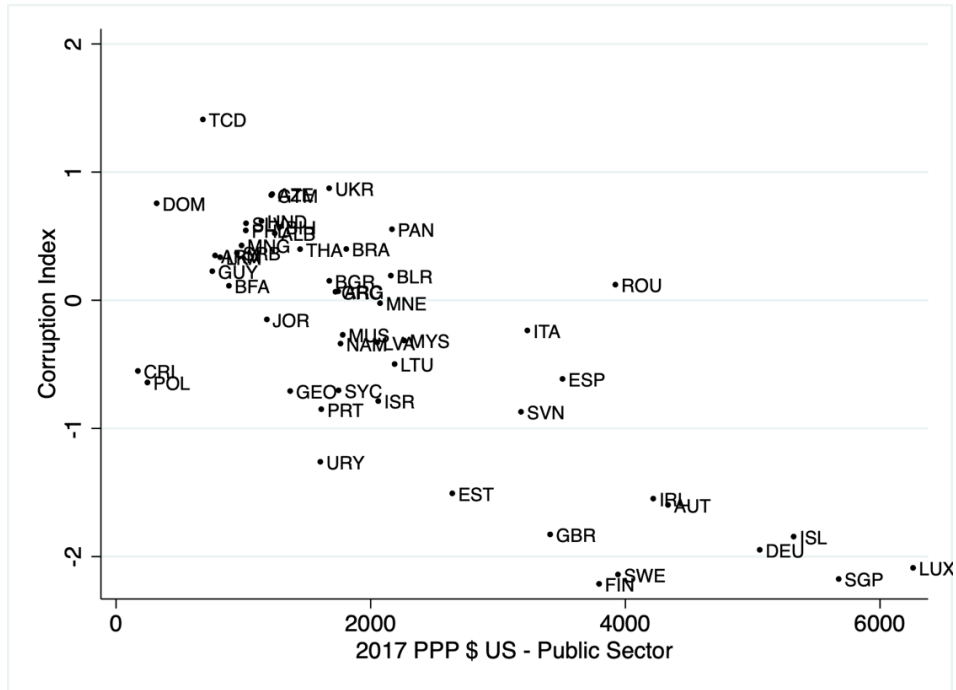


Fig. 3: Corruption and Public Sector wages (monthly)

**Notes:** Author’s graph. Corruption Index is from the Control of Corruption Index, rescaled so that higher values reflect higher corruption. Data for Public Sector wages from the International Labor Organization.<sup>32</sup>

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<sup>32</sup> International Labor Organization, Data Explorer, Mean nominal monthly earnings of employees by sex and economic activity - Harmonized series , [https://www.ilo.org/shinyapps/bulkexplorer6/?lang=en&segment=indicator&id=EAR\\_4Ms\\_TH\\_SEX\\_ECO\\_CUR\\_NB\\_A](https://www.ilo.org/shinyapps/bulkexplorer6/?lang=en&segment=indicator&id=EAR_4Ms_TH_SEX_ECO_CUR_NB_A) (last visited Dec 14, 2020).

	OLS		Fixed Effects	
	Year = 2018			
	(1)	(2)	(3)	(4)
	Corruption	Corruption	Corruption	Corruption
GDP per capita	-0.0000367*** (-11.52)	-0.0000363*** (-11.00)	-0.00000108 (-1.03)	-0.000000882 (-0.85)
Trade (% of GDP)	-0.000545 (-0.63)	-0.000698 (-0.81)	-0.000125 (-0.37)	-0.000161 (-0.50)
Inflation	0.00865 (1.17)	0.00784 (1.08)	0.00193** (2.94)	0.00191** (2.91)
Population growth	0.0708 (1.71)	0.0667 (1.60)	-0.00926 (-0.86)	-0.00941 (-0.88)
Polity score	-0.0302** (-3.26)		-0.0136*** (-5.36)	
Democracy		-0.376** (-3.36)		-0.108*** (-4.75)
Constant	0.642*** (4.53)	0.766*** (4.91)	1.430*** (22.26)	1.458*** (23.33)
Observations	108	108	1991	1991
R-squared	0.687	0.688	0.966	0.966
Adj. R-squared	0.669	0.669	0.963	0.963
Year FE	NO	NO	YES	YES
Country FE	NO	NO	YES	YES

*t* statistics in parentheses

\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 1: Corruption and Democracy

**Notes:** Author's work. Data for trade, inflation, population, and GDP per capita come from the World Bank's World Development Indicators. Democracy is a dummy variable based on the Polity Score (Democracy = 1 if Polity Score  $\geq$  6). Corruption Index is from the Control of Corruption Index, rescaled so that higher values reflect higher corruption

<b>OLS</b>	
Years = 2000 to 2018	
(1)	
Corruption Index	
Voice & Accountability	-0.0748*** (-4.84)
Political Stability and Absence of Violence/Terrorism	-0.0601*** (-6.33)
Government Effectiveness	-0.263*** (-11.23)
Rule of Law	-0.622*** (-25.26)
GDP per capita	-0.0000041*** (-6.70)
Inflation	-0.00230** (-3.25)
Population growth	-0.0113** (-2.67)
Democracy	0.0847*** (4.66)
Constant	0.0274 (1.51)
Observations	2086
R-squared	0.915
Adj. R-squared	0.915

*t* statistics in parentheses  
\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 2: Determinants of Corruption

**Notes:** Author's work. Data for trade, inflation, population, voice and accountability, political stability, government effectiveness, rule of law, and GDP per capita come from the World Bank's World Development Indicators. Democracy is a dummy variable based on the Polity Score (Democracy = 1 if Polity Score  $\geq$  6). Corruption Index is from the Control of Corruption Index, rescaled so that higher values reflect higher corruption

	OLS		Fixed Effects	
	Year = 2018			
	(1)	(2)	(3)	(4)
	GDP per capita (log)	GNI per capita (log)	GDP per capita (log)	GNI per capita (log)
Corruption Index	-0.961*** (-10.95)	-0.974*** (-11.34)	-0.199*** (-7.61)	-0.189*** (-8.03)
Trade (% of GDP)	0.00227 (1.72)	0.00198 (1.57)	-0.00295*** (-9.69)	-0.00266*** (-9.28)
Inflation	-0.0167 (-1.56)	-0.0124 (-1.13)	-0.000578 (-0.35)	-0.00161 (-1.78)
Population growth	-0.212* (-2.41)	-0.218* (-2.53)	0.0225*** (5.04)	0.0216*** (5.32)
Constant	8.926*** (49.54)	8.896*** (50.27)	5.714*** (97.22)	5.710*** (108.58)
Observations	132	132	2692	2669
R-squared	0.606	0.615	0.984	0.985
Adj. R-squared	0.590	0.600	0.982	0.984
Year FE	NO	NO	YES	YES
Country FE	NO	NO	YES	YES

*t* statistics in parentheses

\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 3: Growth and Corruption

**Notes:** Author's work. Data for trade, inflation, population, and corruption come from the World Bank's World Development Indicators. Democracy is a dummy variable based on the Polity Score (Democracy = 1 if Polity Score  $\geq$  6). Corruption Index is from the Control of Corruption Index, rescaled so that higher values reflect higher corruption

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