

Impacts of corruption on growth economics essay

[Economics](#)



**ASSIGN
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Bachelor Thesis

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I. Introduction

Bureaucratic corruption has been widely condemned by the society because of the harmful consequences. It is commonly blamed for the failures of many developing countries. These criticisms are essentially based on moral ground as corruption reflects corrosive bureaucracy of a country. However, to be unbiased the emphasis should only be on the economic aspect and therefore disregards the ethical aspect. Bureaucratic corruption refers to the misuse of public office for private gain. The misuse of public office usually practiced in a form of bribery, nepotism, patronage or embezzlement. But the discussion

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is limited to a corruption of a particular form, which is bribery. Bribes can be perceived as tax, therefore, like tax, it increases costs for a transaction and in turn are associated with low economic activity. Bribes can also be perceived as a form of lobbying to influence or to deter a certain decision implemented by the government. As the practice of bribing are widespread across countries, the discussion of corruption sparks interest in the empirical literatures. The study in the field of corruption has a long history in economics literatures. The relationship between bureaucratic corruption and economic corruption has been a topic of discussion over the last 50 years. Unfortunately academics expressed their difficulty in measuring corruption. Empirical evidence in this field has also been limited due to difficulty in quantifying efficiency of governments. It is not surprising as corruption usually practiced in secrecy and silence. Fortunately recent study has started to use regression analysis and construct indexes to assess the level of corruption in a country. The study of cause and consequences of corruption attract academics to explore the relationship of corruption with economic growth. Most academics approves that corruption would have an adverse effect on economic growth. Nevertheless corruption could conceivably be beneficial to economic growth. To extensively discuss the association between economic growth and corruption, understanding the cause of corruption would be a preeminent first step. The source of corruption might be too varied and complicated to identify empirically. However there are few characteristics that every corrupt country has in common. This phenomenon could be an evidence to discover the characteristic of a country's political, economic and social systems that might affect the cost or benefit of corruption. And thus would ultimately find a country characteristic that might

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cause a tendency toward corruption. The most obvious characteristic would be the economic development of the country. Though there are few other characteristics including transparency of political institutions, economic rent and market competition. To this extent, the thesis will attempt to examine the negative relationship between corruption and economic growth. The research question can be formulated as: Does corruption hinder economic growth? To answer the research question, this paper will review past literatures that have discussed the effects of corruption on the economy. This thesis concludes that literatures reach no agreement regarding the relationship between corruption and economic growth. However to contrast both ideas, extensive discussion of two opposing opinions on the relationship between corruption and growth would shine a light to review both arguments. To date the study of corruption remains one of the most interesting and difficult subject to study. To extensively discuss the matter, it is plausible to start after the origin of corruption. The second chapter discusses the main characteristic that would cause corruption and the empirical evidence. Issues regarding the direction of causality would also be discussed briefly. The following chapter elucidates the procedure, competency and description of important measure of corruption. In literature review, both opposing opinions regarding the relationship between economic growth and corruption would be discussed comprehensively. To finish, the conclusion would summarize the focal issues from all of the preceding chapters. A few suggestions regarding a solution in minimizing corruption would also be presented in the last chapter.

II. Causes of Corruption

Why is corruption more widespread in some countries than others? Before discussing even further the relationship between corruption and economic growth, recognizing the cause of corruption is essential. This section of the thesis will analyse the possible factors that lead to the occurrence of corruption followed by a short description of the direction of causality. A couple of decades ago there are not many literatures discussing the cause of corruption as it is difficult to study corruption empirically. Fortunately, academics in recent studies have found a variety of factors that may correlate countries with high perceived corruption. This can be achieved by regressing corruption indexes on several potential explanatory variables. Economic development and transparency of political institutions is a few of the factors that are believed to contribute to the level of perceived corruption of a country. The strongest and most consistent factor is economic development. Treisman (2007) have found that lower perceived corruption correlates to higher economic development. For instance, in 2005 the correlation between log of per capita GDP and the probability for bribes is -0.72. Furthermore the correlations between log of per capita GDP and the corruption perception indexes by Transparency International and World Bank are also robust, 0.79 and 0.81 respectively. The correlation also survived the inclusion of various controls including trade and inequality. These evidences verified that there is indeed a negative correlation between corruption and economic development. On the contrary, there are a few countries that were perceived as corrupt but can still grow rapidly. This higher economic development in turn increased democracy in some countries. Therefore it can be concluded that democracy or higher political rights can also be the key in decreasing

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corruption. As mentioned above, a transparent political institution is necessary to reduce the level of corruption. This is supported by empirical findings which confirm that higher political freedom will increase the World Bank corruption index. Political rights are measured by the Freedom House index, higher political rights and civil liberties will consequently lead to lower index. Decreasing the index by one unit is expected to decrease the World Bank corruption index by 0.13 in 2005. Unfortunately the results are less significant by using Transparency International corruption Index. And the results are not always significant if substituting Freedom House index with other political freedom index. Treisman (2007) also argued that besides political rights, press freedom, the duration of democratization and how the President is elected in the country each has an effect on the corruption index. The higher the press freedom, the higher the corruption index. The press freedom index is also constructed by FH. An increase of press freedom by one unit is expected to increase the corruption index by 0.012. A last interesting discussion is the Presidential system. A country which elect their President directly has lower corruption index by 0.11 compared to those countries whose President is elected by the legislature. In support, his previous works, Treisman (2000) also found that countries which have been a democratic country without interruption since 1950 have a significant impact on corruption. This study investigated if democracy has been established for a longer time will positively affect the corruption index. If a country has been a democracy since the year 1950, the corruption index is expected to increase by 0.56. He argued that the current state of political system is not significant, but a long exposure to democracy would lower corruption. Other notable factors are economic rents and market

competition. Ades & Di Tella (1999) presented evidence that corruption have a relationship with economic rents available for civil servants to capture. Corruption tends to be greater where there are more economic red tapes in the country especially if the economy is oriented toward natural resources. They explain corruption as industrial policy function which shows subsidies in manufactures are correlated to corruption indexes. At the same time, the degree of openness to trade will reduce monopoly power of domestic firms. Thus diminishing the profits available for corrupt civil servants. In the same direction, Treisman (2000) found that the share of imports in GDP is correlated to Transparency International Index from 1996 to 1998. Svensson (2005) also found that highly corrupt countries are less open and regulate their market more extensively. From his results highly corrupt countries indeed have a significantly different policy characteristic from countries with low corruption rates. Unfortunately the above factors of corruption that has been presented can be ambiguously categorized as either consequences or causes of corruption. The direction of casualty is blurred in few cases. For instance, openness to trade and the extent of red tapes are highly endogenous in the direction of casualty with corruption. Treisman (2000) found that high corruption could cause a high level of bureaucratic regulation but not the other way around. The data could not be concluded that government regulatory interventionism would lead to higher perceived corruption or corruption can be reduced by merely limiting red tapes. Even more alarming, corruption may also both be the consequence and cause of a variable at the same time. This would eventually trapped countries in a vicious circle. Where by intervening this variable would only escalate corruption even further. There are several attempts to identify the correct

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causality of corruption. But the issues of casualty have not been fully resolved, since causality may also works in both directions.

III. Measures of Corruption

Another difficult task for academics is to measure the magnitude of corruption. This chapter will explore the different measures and methodology of how corruption is quantified. Secondly there will be a brief discussion on the competence of the corruption perception indexes. Why is this important to the question? Not until a couple of decades ago, corruption has not been measured quantitatively. As most corruption is surreptitious, empirical work on quantifying corruption is extremely problematic and challenging.

Measuring government efficiency is not necessarily labeled as an exact science either. Consequently, empirical research on this field is fairly rare and the empirical results are mostly ambiguous or inconclusive. As it is difficult to measure corruption, perception index is one of the best alternative methods to measure corruption. Perception index measures corruption by expert assessments and public surveys regarding corruption. Fortunately more and more establishments published a perception index towards corruption. A widely recognized index is referred to as the Corruption Perception Index, henceforth CPI. Countries are graded annually by an index from 0 to 10 by the Transparency International. A 0 indicates that a country is highly corrupt. And if a country scores a 10, its government can be perceived as clean. The method used to construct the index is by public assessments through more than ten different institutions. The assessments compile questionnaire regarding country's abuse of public power exclusively in form of bribery and the effectiveness of eradicating

corruption in the public sector. Consequently it will cover both political and administrative parts. It also aims to reduce measurement error by averaging different resources. Similarly, World Bank also published a rating control of corruption. The two ratings are highly correlated with correlation of 0.98 in 2004. Both have slightly different research methods. But the most striking difference is that Transparency International only covers countries that have three components rating. This will lead into smaller country coverage but will indeed increase precision. Another index that has been used by the earliest empirical study on the relationship between corruption and economic growth is the Business International Index, henceforth BI. This index is founded by the firm BI and is based on a questionnaire answered by correspondents in 70 countries. This index is founded by the firm BI and is based on a questionnaire answered by correspondents in 70 countries. The index composed of nine sub-indexes. The study took three sub-indexes that were most relevant to his study to derive a bureaucratic efficiency level. In other words, the bureaucratic efficiency level in his study comprises of the judiciary system, red tape and corruption sub-indexes. Each index was given a grade between 0 and 10. Grade 10 on judiciary system is better than a 5; grade 5 on corruption and red tape is worse than a 10. To no surprise, these three indexes were correlated to one another. The correlation between corruption and red tape was 0.79 and to judiciary system was 0.78. The correlation between red tape and judiciary system was 0.78. This is because in countries where red tape hinders bureaucratic efficiency, there is bound to be corruption. In countries where corruption in the form of bribery becomes a tradition, government officials tend to cause bureaucratic delay unless given a sum of money. There are times in the study where he used institutional

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efficiency, which he derived it from using all nine indexes from BI and the variable political stability. Even more complex than previous indexes, International Country Risk Guide (ICRG) formulates an index comprising of more than 20 variables. The index includes both descriptive assessment and economic data. It divides into 3 subcategories of risk including political, economic and financial risk rating. Each subcategory compromised into several risk components and weights. As corruption is one of the most significant components to political stability, it is assigned as one of the variables. The measurement is based on points, 6 as the uppermost grade and 0 as the least desirable one. The foremost advantage of ICRG is that ratings are available since 1980 annually. This index also has a high correlation with Transparency International and World Bank index, with correlation of 0.88 and 0.84 respectively. Although these indexes have been used frequently in numerous leading journals, the reliability has been questioned from the start. Knack (2006) argued that the data do not measure corruption itself but only opinions and perception towards the level of corruption. Such opinions are usually not based on personal experience and therefore could be biased. Moreover expert assessment might be influenced by their western preconceptions and familiarity with certain cultures. Other concerns focus on the sources of constructing index as different index measures different subjects. For instance, both Transparency International and World Bank have different source of survey. Some sources are evaluations by foreign experts; others are a poll for local citizen or international investors. As a result, many wonder what exactly the average is measuring and question the competence. Even if identical survey questions were asked, it would be interpreted differently between different

nationalities. For instance, a small amount of bribe is considered to be a minor inconvenience in a country with rampant organized crimes but not in developed countries. Thus comparability of surveys across countries cannot be compared fairly. In defense, Lambsdorff (2004) argued that there is no better alternative. This is especially true in the early study of corruption, as there were only a few sources can be found in this very sensitive subject. Rates of prosecution or conviction for corruption might be an alternative but these are likely only reflect the competency of police and judiciary not corruption as a whole. Another alternative is by comparing the value of existing infrastructure stock to past infrastructure spending. Unfortunately this approach is clearly difficult to extend the research cross-nationally. Aside from those two ideas there are other plausible alternative. Recently, Transparency International began to ask respondents about their own experiences of corruption. Such data would be less likely to be biased and distorted by impressions or false news. Another defense to support the use of perception index is the fact that all of these ratings are highly correlated. Treisman (2007) explained that even though each index has a slightly different methodology to conduct their researches, these different indexes are aimed at a common target. Even the correlation between domestic and international business executives surveys by World Economic Forums in 2005 is correlated at $r = 0.87$. The ratings reflected no Western or culture bias, as both experts' surveys are highly correlated. Conclusion

IV. Literature Review

This section of the thesis will review both sides of the argument regarding the relationship between corruption and economic growth. Corruption has

been widely criticized by the society because of the negative implications. Apart from criticism based on moral grounds and incompetence, corruption is assumed to have important prejudicial effects on the economic growth. Surprisingly, corruption might have been beneficial for economic growth at some levels. Mauro (1995) is considered a pivotal study in this field because it is one of the earlier literatures to provide empirical evidence that corruption negatively affects economic growth. In the study, a regression analysis was used to investigate the effect of corruption on economic growth for the period 1980 – 1983. To measure the aforementioned forms of corruption, author used the Business International Index (BII). The study used 3 of the 9 indicators that comprise the BII as a means to measure the level of corruption. The 3 indicators, corruption, legal system and red tape, are then averaged and named collectively as the bureaucratic efficiency index. This index is considered to be a superior measure than the corruption index alone. Another variable important in the study is known as the ethnolinguistic fractionalization (ELF) index, graded 0 to 100. It is a measure how the population in a given country is varied in terms of the ethnic or linguistic background. A high ELF index indicates that a country has a 'rich' variety of ethnic groups or groups that speak different dialects. This is not necessarily positive because different ethnic backgrounds tend to have conflicts. It was found that the ELF index is negatively correlated with bureaucratic efficiency. On the other hand, a low ELF index is given to those countries whose population comes from a uniform ethnic background and rarely has issues with ethnic conflicts. The ELF index is used mainly as an instrument to investment and economic growth in the regression analysis in order to address the issue of endogeneity. The ELF index is assumed to be

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highly correlated with corruption and bureaucracy efficiency but also assumed to be exogenous. The study is divided into two important parts. The first part of the study investigated the relationship between investment and corruption. The second part of the study investigated the relationship between economic growth and corruption. Since the investment rate is an essential channel of economic growth, therefore finding out the relationship between investment and corruption will help explain the relationship between economic growth and corruption. The empirical section used the one standard deviation change method to analyze the impact of bureaucracy efficiency to economic growth. The standard deviation is an econometric measure to indicate a dispersion of data from the average. The standard deviation for the bureaucratic efficiency in the study was calculated to be 2.16 while the standard deviation for corruption was 2.51. These values are then multiplied by the respective regression coefficients to obtain the impact of an increase in the standard deviation. It was estimated that a one standard deviation increase in bureaucratic efficiency was associated with an increase in investment rate by 4.1 (2.16 x 0.019 [coefficient]) per cent. For example, if Indonesia could improve its bureaucratic efficiency (2.25) to the level of Malaysia (7.00), its investment rate could increase by more than 9 per cent. When the ELF index is used as an instrument to the investment rate, the coefficient decreased to 0.004. Taking the same two countries as an example, Indonesia's investment rate would increase by 0.3 per cent. From the empirical results, countries with higher corruption tend to have lower rates of investment. It was estimated that a one standard deviation increase in bureaucratic efficiency was associated with an increase in growth rate by 1.3 (2.16 x 0.006 [coefficient]) per cent. If Indonesia could improve <https://assignbuster.com/impacts-of-corruption-on-growth-economics-essay/>

its bureaucratic efficiency (2.25) to the level of Malaysia (7.00), it would boost growth rate 2.9 per cent. When the ELF index is used as an instrument to the growth rate, the coefficient increased to 0.014. Taking the same two countries as an example, Indonesia's growth rate would increase by 6.7 per cent. Therefore, countries with higher corruption tend to have lower growth rates. Mo (2001) also has empirical evidence that corruption negatively affects the economic growth. In the study, a regression analysis was used to estimate the effect of corruption on economic growth for 46 countries. The study used the Transparency International CPI to measure the level of corruption. Corruption level, GDP per capita in the year 1970, political rights and population growth were used as the main determinants for economic growth. It was found that an increase of the corruption index by one unit was associated with a 0.545 percentage points increase in growth rate. Therefore the study found empirical evidence that corruption has a damaging effect on economic growth. Compared to the other two channels in addition to the regression analysis, the study also provided estimations for three channels through which corruption affects economic growth. The channels are essential aspects of the study because they are the intermediary process between corruption and economic growth. The study suggested corruption travels via the human capital channel, the political stability channel and the investment channel. Political stability is measured by the sum of the average number of assassinations per million inhabitants per year and number of revolutions per year. Corruption is positively correlated with income inequality and thus political instability. Large income gaps are likely to cause violent activities because of the displeasure felt by the lower income groups. It also decreases productivity, employment and

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investment. As a result, political instability tends to occur in highly corrupted countries. The study calculated that political instability contributes approximately 63.6 per cent of the relationship between corruption and economic growth when the three channels are assumed to be independent to each other. Even though it was seldom discussed in similar literatures, his empirical finding shows that political stability is the most important consequence. The second channel through which corruption affects economic growth is investment. It is measured by the ratio of investment and total output. Corruption is negatively correlated with the level of investment in a given country. Countries with perceived high corruption will discourage investors to establish private business opportunities because of the severely high risk. The risk relates to the probability the investor receives her reward for investing. Since investment is a direct component of GDP, then highly corrupt countries are unlikely to be conducive for investment opportunities. The study calculated that the investment channel contributes approximately 28.4 per cent of the relationship between corruption and economic growth when the three channels are assumed to be independent to each other. It shows that human capital has moderate importance to economic growth relative to other channel. Lastly, human capital is measured by the average schooling years for individuals above 25 years of age. Corruption is negatively correlated with productive activities. Hence if the returns of productive activities decrease faster than the returns to corrupt activities then more resources will be allocated for corruption. In the long run, the stock of human capital will decrease if a country is highly corrupted. The study calculated that human capital contributes approximately 9.7 per cent of the relationship between corruption and

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economic growth when the three channels are assumed to be independent to each other. Compared to the other channels, this result exhibits the least amount of importance to economic growth. In reality, however, the three channels are likely to be dependent to one another. Therefore, studying their effects in isolation will run the risk of biasedness. High corruption will indeed cause the three channels to permeate the relationship between corruption and economic growth simultaneously. The research concluded when all three channels are analyzed together, the result is as follows. Human capital contributes approximately 14.8 per cent; political instability contributes approximately 53 per cent while the investment channel contributes 21.4 per cent. The remaining 11.8 per cent is assumed to be a direct effect of corruption to economic growth. Both methods of estimating the contributions of each channel showed that the political stability is the channel that is most affected by the incidence of corruption. In addition, the remaining channels also display similar results from two different approaches. From the two studies above there are ample of evidence that discuss the negative effects of corruption on growth. However, past literatures do not all agree on these results. There is a strand in the corruption literatures, which provide strong arguments to which corruption may be beneficial to economic growth. Leff (1964) argued that corruption is commonly perceived negatively and this becomes an important obstacle to an unbiased re-examination of the subject. He reasons that corruption can be favorable; especially as the economic policies in many underdeveloped countries may be based on priorities other than global economic development and growth. Typically, government officials and bureaucrats are primarily oriented toward maintaining their status quo. Other goals such as an increase in military

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power available or expansion of its control over society, maybe justified in case of economic development. But at the same time, the immediate effect of some policies could hinder economic growth. Thus with this reasoning, bribery might induce the government to have favorable view toward activities that would improve economic growth. The policies that are sought after by investors would help economic development and growth. It also provides incentive for government officials to have more energetic action towards entrepreneurs. He also perceived corruption as a hedge against bad policy. For instance, even though the government intends to promote growth, there is no assurance that its policies are successful to achieve the goal. Even worse, it may be taking a vital step into the wrong direction. In this case, corruption can reduce the losses from such mistakes. This is especially beneficial for underdeveloped countries because it commonly stands in special needs for such safeguard. Even though the policy goals are clearly specified, competent counsels are usually well divided into different suggestions in policies. As a result, if the government erred a decision in a policy, the course that is possible because of corruption might be a superior policy. So as the government is implementing a certain economic policy, the investors, with their sabotage, are implementing another policy. Just like insurance, it involves costs if the government's policy is precise. But if it is not, it could be a hedge against bad policy. This kind of safeguard is very beneficial against consequences of a serious policy mistake. According to the study, corruption could induce technological innovation and thus economic growth. Innovators in an underdeveloped society are commonly opposed by the existing economic interest. The existing firms will usually seek help from the government with their future investments and returns. They feel

threatened with the new production process or products because of the financial competition. If government refuses to intervene and support innovations, the new technology can be established. In the more usual case, however, existing firms can depend on their long association with bureaucrats for protections. In this situation, bribery may enable innovator to protect his innovation without having to establish themselves politically. Corruption is a less radical approach to achieve support from certain political cliques or parties. Lastly, Leff (1964) believed that corruption also reduces uncertainty and thus increases investment. It is widely known that investment decisions always occur in the midst of risk and uncertainty. These difficulties are greatly influenced by political and economic environment in the particular country. Investing becomes very risky as misjudging the market would lead to a major loss. Aside from economic estimates, investors also face a major problem which is the uncertain behavior of the government. The government has an extensive control and role in the economy because its consent is essential to conduct most economic activities. The irrational decisions and the frequent changes of official personnel and policy add to the risks. Consequently, investors have to be assured that in the future government would not interfere with their affairs. Hence, as investment always takes place around risk and uncertainty, the magnitude of risk is magnified around an unstable political environment. In short, by enabling investors to take more control, reduce uncertainty and influence their environment, corruption can increase the rate of investment and thus economic growth. A definite illustration is the fact that in the period of political turmoil and crisis, investment shrinks and economic stagnation occurs. There are also several other arguments concerning competition and <https://assignbuster.com/impacts-of-corruption-on-growth-economics-essay/>

efficiency that would eventually leads to economic growth. Since license and other favors from the government officials are in limited supply, the bidding for such favors are competitively allocated among entrepreneurs. And because payment of the highest bribes is the most principle criteria for allocation, the importance to generate revenue become even more significant. As efficiency of production is one of the dependent variable to generating revenue, a tendency toward competition and efficiency is introduced into the system. Thus it can be concluded that " Efficient Corruption" may allow entrepreneurs to be more productive in an economy overwhelmed by bureaucratic hold-ups and bad rigid laws. This chapter concludes that these literatures reach no uniform agreement concerning the relationship between corruption and economic growth. Though there are more literatures that provide evidence that suggest corruption is indeed harmful to economic growth, there are also strong evidence that corruption can be beneficial to the economy. Explain why review the journals separately?

V. Conclusion

The main aim of this thesis was to investigate the relationship between corruption and economic growth. This field of social studies is relatively new therefore past studies are not found in abundance. As the empirical study of corruption keeps evolving and advancing, more viable empirical works are published. This is remarkable considering corruption is a frustratingly difficult subject for a social scientist to study. In recent developments, academics have found number of factors that may link economies with high perceived corruption. This is attained by regressing corruption indexes on several

potential explanatory variables. As previously explained; countries that is perceived by citizens and experts to be less corrupt are the one which are highly developed, transparent government, minimum economic rents and open to international trade. However the direction of causality of these factors still cannot be classified as either consequences or causes of corruption. Some literatures claim that corruption can also be a consequence and cause of a variable at the same time. As a result countries would eventually be trapped in a vicious circle. One major hindrance for studies about corruption is the issue of how corruption is quantified. Past studies tried many variations on the measurement of corruption. Fortunately researchers are getting better at constructing indexes of perceived corruption. The most widely known measure up to today is the CPI. It is a simple measurement conducted by Transparency International which gives a grade 0 to a completely corrupt government and a 10 for a completely clean government. More complex indexes are the Business International Index and the ICRG. The BII measures corruption for 9 different elements. It relies on the survey response in which it asks business establishments in a country. The ICRG uses 20 variables to quantify corruption, making it a very complex measure. More important variables are weighted more heavily than other 'less important' variables. Knack (2006) pointed out that the indexes discussed are based on opinions of individuals and businesses. It cannot be measured precisely as other economic indicators such as economic growth. However, Lambsdorff (2004) explained that there is no other way to indicate the magnitude of corruption and these indexes are sufficient to reflect the level of corruption. Lastly, Treisman (2007) argued these indexes have a common goal even though the methodologies are different across each one.

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Past academics are split on the discussion of the role of corruption in the economy. The literature by Leff (1964) justified corruption in a sense that it improves the efficiency of an economy. It may reduce uncertainty and thus boost investment which encourages entrepreneurs to be more competitive. However empirical studies by Mauro (1995) and Mo (2001) claim corruption have negative impacts on the economy. Mauro (1995) found lower perceived corruption increases the investment rate. In turn, higher investment can result in higher economic growth. Mo (2001) also found that corruption is deterrent to economic growth through four different channels namely the direct channel, the investment channel, the human capital channel and the political stability channel. It was concluded that an improvement of the corruption index by one unit may boost economic growth by 0.545 per cent. In conclusion, it is in the best interest of every country to reduce corruption. It is evident from past studies that countries with less corruption is more rich and more advanced than corrupt ones. There are numerous attempts by government to eradicate corruption although some policies are not as effective as others. To achieve low corruption, countries can focus internally by on improving political institutions. Secondly, governments can establish an independent anti- corruption agency which is directed at supervising business transactions and ensure the transparency of government institutions. As corruption is closely related to country's legal system it would be advisable to improve the competence of every part of the legal system including police and judiciary. Lastly hiring private firms to manage public sectors such as import inspection on custom duties would also decrease the opportunity for officials to receive bribes. Not only it would improve the performance of the sectors but also would decrease corruption.

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