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The incidence and persistence of corruption in economic development

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Abstract

Economic development and bureaucratic corruption are determined jointly in a dynamic general equilibrium model of growth, bribery and tax evasion. Corruption arises from the incentives of public and private agents to conspire in the concealment of information from the government. These incentives depend on aggregate economic activity which, in turn, depends on the incidence of corruption. The model produces multiple development regimes, transition between which may or may not occur. In accordance with recent empirical evidence, the relationship between corruption and development is predicted to be negative.

JEL classification: D73; H26; O11

Keywords: Corruption; Bribery; Tax evasion; Development

1. Introduction

Public sector corruption is pervasive throughout the world. In one form or another, and to a lesser or greater degree, it exists in all societies, at all stages of development and under all types of politico-economic regime. Over the past few

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years, the fight against corruption, particularly in developing countries, has become high on the agenda of various international organisations, such as the World Bank and IMF (e.g., Jain, 2001; Rose-Ackerman, 1997). This has been motivated by a deepening belief that good quality governance is essential for sustained economic development. Recent innovations at the empirical level have allowed this belief to be tested, and there is now a large body of evidence to support it. By contrast, there remains relatively little by way of formal theoretical analysis that would lend rigour and precision to the arguments involved. Our objective in this paper is to provide such an analysis.[1]

A broad definition of public sector corruption is the abuse of authority by bureaucratic officials who exploit their powers of discretion, delegated to them by the government, to further their own interests by engaging in illegal, or unauthorised, rent-seeking activities. To many observers, corruption in public office is an inevitable aspect of state intervention which typically entails some transfer of responsibility from the government to a bureaucracy in a principal-agent type relationship. A considerable amount of research, in both economics and political science, has been devoted towards understanding the micro-foundations of this relationship and the implications for efficiency and welfare (e.g., Banerjee, 1997; Carillo, 2000; Klitgaard, 1988, 1990, 1991; Mookherjee and Png, 1995; Rose-Ackerman, 1975, 1978, 1999; Shleifer and Vishny, 1993). Much less research has been directed towards analysing the joint determination of corruption, growth and development within the context of fully specified dynamic general equilibrium models.

At the empirical level, it is only since the early 1980s that reliable data on corruption has become widely available. Prior to that time, researchers were forced to rely largely on anecdotal evidence obtained from country-specific case studies. This made it difficult to evaluate alternative views about the effects of bureaucratic malfeasance. A seemingly plausible view was that corruption could actually be growth-enhancing by helping to circumvent cumbersome regulations (red tape) in the bureaucratic process: that is, bribes may act as 'speed money' which bureaucrats accept in return for overcoming institutional rigidities that work against efficiency (e.g., Huntington, 1968; Leff, 1964; Leys, 1970; Lui, 1985). As well as being questionable on conceptual grounds (e.g., Bardhan, 1997), this view may be challenged on the basis of more recent, more systematic, and more persuasive empirical evidence. This evidence has been obtained using cross-country corruption data compiled since the early 1980s from questionnaire surveys by a number of international organisations (most notably, Business International Corporation, Political Risk Services Incorporated and Transparency International). While differing in their precise construction, these corruption indices – which rank countries according to the extent to which corruption is perceived to exist – are very closely correlated with each other, lending weight to the argument that they provide

[1]For surveys of the existing literature, see Bardhan (1997), Jain (2001) and Rose-Ackerman (1998).