



Bureaucratic competition and public corruption: Evidence from transition countries

Aboubacar Diaby^a, Kevin Sylwester^{b,*}

^a Monitoring and Evaluation Division, Alliance for a Green Revolution in Africa, Kenya

^b Department of Economics, Southern Illinois University-Carbondale, United States

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ABSTRACT

Some past theoretical models have predicted that bribes paid by firms to government officials are greater under a decentralized bureaucracy where a firm faces numerous officials. A “tragedy of the commons” arises where officials set bribe payments too high and so drive firms out of the industry. Other models predict the opposite as numerous officials in a decentralized bureaucracy bid down bribe payments. Using the Business Environment and Enterprise Performance Survey from the World Bank, a firm level survey covering 24 former communist countries and Turkey, we examine whether reported bribe payments by firms are higher when firms face potentially numerous demands for bribes. We find that bribe payments are higher under a more decentralized bureaucratic structure. This finding is robust across different purposes for which bribes are used but particularly strong for firms that use bribes in dealing with taxes and customs. Results are also robust across different bribe environments.

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1. Introduction

Corruption can be viewed as the inappropriate actions of an agent to further the agent's interests at the expense (monetary or otherwise) of the principal's. The World Bank views such corruption as occurring within the public sector when public officials misuse their office for private gain. Such corruption is treated by newspapers, NGOs, civil society leaders, etc. as one of the “the greatest obstacles to economic and social development” in many developing countries.¹ Beginning with Mauro (1995), many empirical studies have found that corruption lowers economic growth or investment.² A survey of this literature can be found in Svensson (2005) and Asieudu and Freeman (2009). Using household data from Liberia, Beekman et al. (2013) find that corruption could even lower economic activity by 50% at the community level. Corruption could raise uncertainty thereby lowering investment and lower tax revenues which could hamper government financed development projects but corruption could also exert indirect costs, making other institutions less effective. Private rights for some are presumably less secure if other agents can

* Corresponding author at: Department of Economics, MC 4515, Southern Illinois University-Carbondale, Carbondale, IL 62901, United States. Tel.: +1 618 453 5075.

E-mail address: ksylwest@siu.edu (K. Sylwester).

¹ See the World Bank (2001).

² However, others have argued that corruption can “grease the wheels” or act as “speed money” that could promote development. See Leff (1964), Huntington (1968), Aidt (2003) and Dreher and Gassebner (2013). Egger and Winner (2005) find that corruption positively influences inward FDI. Still others find a more complex association. Mendez and Sepulveda (2006) find that corruption has a non-monotonic association with growth in politically ‘free’ countries but not in ‘not free’ ones. Barassi and Zhou (2012) report not only that corruption deters a multinational corporation from entering a country but also that corruption could “grease the wheels” and lead the same multinational to increase its FDI once it is already established. Ledyeva et al. (2013) find that less corrupt regions in Russia attract investment from relatively low corruption countries whereas regions in Russia with greater corruption attract more investment from more corrupt countries. Still others see more muted effects. For example, Busse and Hefeker (2007) report weaker associations between corruption and FDI.

skirt the law by paying officials to look the other way. Uncertainty regarding institutions will also increase if corruption causes a greater degree of capriciousness among government officials. Lower tax revenue might not only deter development projects but also provide less funding for institutions such as courts and other institutions that could improve regulatory quality or government efficiency.³

Given the purported importance of corruption for economic outcomes, a related line of research considers the determinants of corruption. Treisman (2000) considers various historical, cultural, and economic factors to determine as to what extent they can explain the differing degrees of corruption across countries. Using panel data for Italian regions, Del Monte and Papagni (2007) report that political and cultural factors are more important than economic ones in determining degrees of corruption. Apergis et al. (2012) find that corruption is lower in the U.S. states that score higher in economic freedom indices. Pieroni and d'Agostino (2013) obtain similar results using firm-level data across countries as more government intervention accompanies higher corruption.

Others have considered whether the bureaucratic structure influences the level of corruption. Abbink (2004) reports that regular rotation of officials (so that the same officials do not persistently interact with the same potential bribers) reduces corruption. Van Rijckeghem and Weder (2002) examine to what extent corruption declines with increased wages for civil service workers. Others consider the degree of centralization of the bureaucracy. Rose-Ackerman (1978) argues that a decentralized regime would lower bribery as competition across government officials would bid down the amount of bribes. However, Shleifer and Vishny (1993) develop a model where firms must collect several licenses and permits from (potentially) several officials. If these officials do not coordinate, then a tragedy of the commons can result in that burdensome bribe payments could drive some firms out of business and thereby lower the pool from which to extract bribes. Because a single government official acting as a monopolist would incorporate this effect into his demand for a bribe, total bribe payments under the centralized bureaucratic structures would be lower than under the decentralized, competitive ones. Subsequent research has explored these ideas more fully. Blackburn and Forgues-Puccio (2009) create a model where firms need several licenses to operate. They find that coordination among officials lowers the total amount of bribes and so is less harmful to growth.⁴ Drugov (2010) also considers firm behavior under centralized and decentralized bureaucracies. He finds that greater bureaucratic centralization achieves a better ex post allocation of licenses due to the reasons outlined above.

Given conflicting views on the association between the structure of the bureaucracy and the total amount of bribe payments, empirical examinations are also necessary. Unfortunately, little has been done due to a general unavailability of data on bureaucratic structure. Campos et al. (1999) investigate the role of predictability of corruption on investment. They find that the effect of corruption upon investment is less negative when firms a priori know the amount of the bribe. Presumably, centralized regimes are more predictable than under a decentralized bureaucracy where firms interact with numerous officials.⁵ Olken and Barron (2009) examine trucking in Aceh in Indonesia where drivers must pay bribes at checkpoints along the route. They find evidence that total bribe payments were greater under decentralized structures.⁶

This paper considers whether the level of bribes that firms pay is higher when they report greater centralization among government bureaucrats. We use a dataset constructed by the World Bank in cooperation with the European Bank of Reconstruction and Development. The 1999 Business Environment and Enterprise Performance Survey (BEEPS) spans 4100 firms across 24 post-communist countries and Turkey.⁷ Not only do they ask firms about the extent of their bribe payments, they also delve further into the types of interactions that firms have with government officials, including how likely firms believe that subsequent bribes will follow initial ones. We find that firms report lower bribe payments under more centralized bureaucratic structures. We also find that this result holds across different purposes for what the bribe is used (avoiding taxes, securing government contracts, etc.) and across different bribe environments such as the extent to which bribes are predictable and the degree to which government regulations are viewed as obstacles by the firm.

We find this sample extremely useful as problems of corruption could be of particular interest to these former communist countries. Hillman and Schnytzer (1986) describe rampant corruption within the Soviet Union. Bribery occurred throughout supply chains and bribes were also employed to procure government offices. Even political purges were a tool used to obtain or protect rents by removing rivals. Boettke (2001) describes Soviet communism as analogous to mercantile systems centuries ago where kings would gain revenues by selling monopoly rights to suppliers. Boettke argues that the move away from a market economy allowed the government to extract rents by limiting competition. Corruption then allowed leaders to extract the surplus

³ Aside from income, some research has considered how corruption could affect other outcomes. Gupta et al. (2002) find that increases in corruption are associated with rising income inequality and poverty. Gupta et al. (2001) report that corruption is associated with higher military spending.

⁴ Mishra (2006) also finds that coordination among officials results in a lower total amount of bribes.

⁵ See Shleifer and Vishny (1993).

⁶ Other studies examine associations between corruption and the extent that government expenditures are decentralized in a federal versus a centralized system. Fisman and Gatti (2002a), Fisman and Gatti (2002b), and Treisman (2002) all consider cross-country samples but obtain dissimilar findings. Treisman (2002) argues that the relation between decentralization and (the absence of) corruption as found in the former two studies breaks down once cultural characteristics are considered in the model. Chen (2004) finds that the reforms in China, requiring local governments to share more formal revenue with the central government but allowing them to keep more off-budget revenue, spurred corruption in local governments. However, Oto-Peralias et al. (2013) finds that decentralization decreases corruption as it brings governments closer to the people. Firm level-studies also consider to what extent the decentralization of political power between national and local governments determines the degrees of corruption. See Bardhan and Mookherjee (2006) and Treisman et al. (2009) for surveys.

⁷ We use the term "post-communist" instead of "transition" since "transition" implies that the move to a market economy is ongoing. Although an ongoing transition was likely true for some countries in 1999 when the survey was undertaken, it need not be true for all either because the move to a market economy was completed (Hungary) or because it was aborted (Uzbekistan). Hence, we use the term "post-communist". See Hillman (2003) for further discussion.

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