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## Corruption and governance around the world

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## *Chapter 7*

# Putting the Pieces Together

“The world is round  
and the place which may seem like the end  
may also be the beginning.”

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Ivy Baker Priest (1905–1975)

## **7.1 Conclusions and Limitations of the Research**

In this thesis we have argued that corruption should not be seen from a normative perspective, but must be viewed from a wider socio-political context. Thus, a definition of corruption must consider discretionary power, economic rents, and the judicial system (Jain, 2001). Modifying Waterbury (1973) and Jain (2001), we therefore may define corruption as private rent-seeking behavior using the discretionary public power that contravenes the judicial system. This definition opens a possibility for cross-country comparison. Also, various forms of corruption can be identified, ranging from the minor abuse of influence to institutionalized bribery and systematic kleptocracy.

Through corruption perception-based indexes, scholars are able to compare cross-country differences in corruption. Once such a comparison can be made, the incidence of corruption can be also analyzed using a set of economic and non-economic variables.

In the literature, corruption has been attributed to a low level of development—including a low level of income, an unequal income distribution, and a low level of education—and to restricted economic openness, a large

population size and a high rate of population growth. Scholars have also identified a high correlation between corruption and aspects of the political system in place, including the regime type, election procedures and the organization of political parties, political stability, and the governmental system. The bureaucratic environment that includes remuneration, the recruitment system, and the quality of the bureaucracy, is also considered as an underlying factor of corruption. Finally, the quality of law enforcement, religious and cultural characteristics, as well as a country's geographical position and its natural resources have been claimed to be related to corruption.

From this long list of attributes, however, we only identified two variables that are not sensitive to changes in corruption measurement, model specification, as well as the number and composition of observations used in the regressions. The robust variables in this sense are government effectiveness and rule of law. To recall, the former represents "the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the governments commitment to policies." The later captures mainly "the extent to which agents have confidence in and abide by the rules of society, perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts, the success of a society in developing an environment in which fair and predictable rules form the basis for economic and social interactions, and importantly, the extent to which property rights are protected" (Kaufmann, et al., 2002: 177-178). We find no other variable that can be regarded as robust as these two variables.

This finding implies that corruption is deeply rooted in poor governance; or, stated differently, corruption and poor governance are like two sides of coin. The literature indicates that the cost of poor governance is very expensive, ranging from a low public infrastructure quality, high rates of infant and child mortality, a high level of illiteracy, to income inequality. We study the link between governance and one economic growth. We construct a new index of governance applying factor analysis to the International Country

Risk Guide (ICRG) dataset on indicators of governance, i.e. democratic accountability, government stability, bureaucracy quality, corruption, and rule of law. We focus on ICRG data as these are the only governance indicators available for a long time span and a large group of countries. In other words, these data allow us to examine causality. Factor analysis is an ideal instrument to analyse to what extent the different dimensions of governance as identified in the ICRG data set contain the same information. We find that the various dimensions can be combined into one governance index. Next, we test whether our index is related to growth in varying samples of countries and different sets of conditioning variables. We find that our index is positively related to economic growth. This result is fairly robust across different samples of countries and model specifications.

Today, the majority of nations are suffering from corruption. Various scholars pose that there is an association between the prevalence and the persistence of corruption. As Mishra (2006) argues, when there are many corrupt agents, it is optimal to be corrupt; thus once corruption is widespread, it will be persistent. Mauro (2004) also indicates that in countries where corruption is pervasive, there is no incentive for individuals to combat corruption and make it immutable.

This view, however, is not entirely correct. Using 20-year span of data, we find that only few countries stagnated at the same level of corruption. However, there are two groups of country signifying the change in countries' corruption levels: those showing an improvement and those facing a deterioration in their levels of corruption. In other words, there is a tendency toward a convergence through upward and downward dynamics. So in the long run, corruption is not persistent. Our analysis shows that research should not focus on the explanation of corruption persistence, but should be redirected towards explaining the process of corruption convergence.

Finally, one may question whether there is a systematic spatial pattern in the distribution of governance around the globe. In the final study of this thesis we investigate governance from a spatial point of view. We discover a positive spatial correlation where poorly (well) governed countries are spa-

tially clustered with those performing the same quality of governance. A further investigation indicates that a country's quality of governance is determined not only by its domestic characteristics, but also its neighbors' quality of governance. This conclusion remains whether we take only geographical distance or a combination of geographical and 'political' distance into account.

Along with the systematic spatial pattern of governance, we also find that the effect of governance determinants is not constant over space. In some countries, the income effect of governance is high, but it is low in others. The same applies to the fraction of population that is protestant (a variable commonly argued to represent a society with an egalitarian structure). We also find that the model considering spatial heterogeneity outperforms the global linear regression model where the effects of governance determinants are homogenous across space.

This thesis has some limitations. Our survey of the corruption determinants is based on a qualitative approach, whereas with the development of meta analysis technique, a quantitative approach now is possible. Applying this technique to the literature discussed in Chapter 2 is a topic on our future research agenda.

As regards the sensitivity analysis, we ignore the possible interaction effects among the long list of the corruption determinants. Also, we do not pay further attention to the indirect mechanism among the determinants. As we find that government effectiveness and rule of law are important in explaining corruption, it would be interesting to investigate factors explaining these variables. Similar issues apply to our study on the growth impact of governance.

In the study on corruption persistence we find that corruption changes over time. It therefore is interesting to analyze factors that influence this change. Finally, in the study of the spatial dimension of governance, we limit our investigation to geographical distance and cross-country differences in domestic politics. The influence of international politics, for example, is still missing from our study.

## 7.2 Policy Implications

Some policy implications can be derived from the findings in this thesis. First, corruption is not a curse passing on generations. Our study discovers that corruption changes over time. It is evident that even though many clean countries are found to become less clean, many corrupt countries have been able to reduce their levels of corruption. So our research is good news for countries that want to reduce corruption: it takes time, but it is possible.

The question now is that where should we start? Two starting points have been indicated in this thesis, namely an improvement in the quality of government and in the quality of the rule of law. Our finding is that these two variables are robustly correlated with corruption in all circumstances. As a logical consequence, bureaucratic and judicial reforms can be seen as the main items on the anti-corruption policy agenda. Bureaucratic reform may start from an adjustment of the pay structure.<sup>1</sup> In corrupt countries public officials are paid less than their counterparts in the private sector. Also, in these countries bureaucrats with discretionary power are paid at the same rate with those without such power.<sup>2</sup> Such a structure creates an incentive for corruption to occur.

Yet, bureaucratic reform is only one step to combat corruption. The other step is judicial reform with two related dimensions. First are measures that reduce the possibility of corruption to occur and increase the likelihood to detect corrupt acts. Second are measures to penalize corrupt acts not as an ordinary crime but an extraordinary crime. The former refers to an improvement in the rule of law system, the latter concerns the enforcement of the law. In short, the main objective of bureaucratic and legal reforms is

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<sup>1</sup> Certainly, a bureaucratic reform covers a wide range of change in bureaucratic system. Here we focus on the pay structure because of two reasons. First, corruption relates to private wealth seeking behavior using discretionary power, thus the reform in pay structure is directed to the heart of the problem. Second, the reform in pay structure may be followed by other related reforms in the bureaucratic system such as the recruitment system, career path, etc.

<sup>2</sup> Pensions also still do not distinguish between those who retire in good order and those who do not.

to find a combination of carrot (a system of incentives) and stick (prevention and sanctions) that minimizes the level of corruption.

Finally, as neighbors matter for good governance, regional cooperation should also be put on the agenda to combat corruption. On the one hand, good governance cannot be seen merely as a national issue with domestic-specific characteristics, because it has encompassed national borders to become a regional issue. On the other hand, some international policy issues have been initiated world wide, but they may be too general and may ignore regional-specific characteristics. Our study implies that special attention has to be paid to policies and actions at the regional level. At this level policies and actions may tackle some shortcomings that cannot be handled at the national level (e.g., a bunch of domestic constraints faced by countries individually) and at the international level (i.e., a one-size-fits-for-all prescription) as well.