



## The determinants of corruption in transition economies

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### ARTICLE INFO

#### Article history:

Received 2 April 2010

Received in revised form

24 August 2011

Accepted 26 August 2011

Available online 3 September 2011

#### JEL classification:

K42

O17

O57

P26

P52

#### Keywords:

Transition economies

Corruption

Marketization

Rule of law

Democratization

### ABSTRACT

This paper examines the determinants of corruption in transition economies. We found that the progress of structural reform, comprising marketization, rule of law, and democratization had a crucial impact on the extent of corruption control in former socialist countries.

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### 1. Introduction

The drastic reform of the economic system has provided great benefits for former socialist states. Despite remarkable economic growth in recent years, however, these countries are facing some grave social issues. Above all, the spread of corruption throughout all aspects of civil life is regarded as one of the most serious problems. In the communist era, corruption was common and considered by the citizenry as a necessary evil. It functioned as a social mechanism used to overcome obstacles established by rigid bureaucratic systems and chronic supply shortages that could affect business operations and everyday activities. For instance, bribery-prone informal transactions among bureaucrats in planning offices and those involved with material-technical supply organs and enterprise managers were inextricably linked to the system of a formal planned economy. The transactions functioned as a sort of lubricant for alleviating various output difficulties caused by factors such as inconsistency between supply

and output plans and incomplete distribution systems (Nove, 1986). In other words, although bribery between bureaucrats and enterprise officers under socialism was motivated by the self-interest of the individuals, it was considered to be an institutionalized, socially necessary evil for achieving goals and maintaining the national economy.

In contrast, in the process of systemic transformation to a capitalist market economy, corruption began to take place more for self-interest than as a socially necessary evil in the former socialist states. This started to occur mainly due to a faltering enforcement of law and weakened police authority as well as generally poor living conditions against the background of a culture of abuse nourished in the socialist life. Now, compared to the communist regime, the act of bribing bureaucrats to make them turn a blind eye on illegal conduct or tax evasion or to procure state-owned assets or receive government subsidies or contracts in an illicit way has become more widespread in the transition economies (Iwasaki and Suzuki, 2007).

The significance of corruption in the former communist bloc is clearly shown in objective assessments by third parties. In fact, according to the World Bank (2007), only eight of 34 transitional countries exceed the world average of the Control of Corruption Index, and most of the remaining 26 countries fall much below

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**Table 1**

Panel regression analysis of the divergence in the level of corruption of transitional countries from the world trend.

Source: Authors' estimation. Original sources of the Control of Corruption Index and GDP per capita (unit: 10,000 US dollars) are from the World Bank (2007) and the United Nations' public data, respectively.

Independent variable: Control of Corruption Index <sup>a</sup>	[1]	[2]	[3]
Degree of economic development			
GDP per capita	0.581*** (16.62)	0.583*** (16.85)	0.584*** (16.87)
GDP per capita (quadratic value)	-0.050*** (-11.91)	-0.050*** (-11.97)	-0.050*** (-11.97)
Transitional country groups <sup>b</sup>			
All transitional countries	-0.282*** (-2.90)		
Countries newly joining the EU in 2004		0.390** (2.18)	
Non-EU member countries in Southern and Eastern Europe as of 2004		-0.284* (-1.67)	
Central and Eastern Europe countries newly joining the EU in 2004			0.405* (1.81)
Baltic countries			0.364 (1.26)
Countries newly joining the EU in 2007			-0.050 (-0.14)
Non-EU member countries in Southern and Eastern Europe			-0.351* (-1.83)
CIS member countries		-0.680*** (-4.56)	
European CIS member countries			-0.592** (-2.36)
Central Asian and Caucasian CIS member countries			-0.723*** (-4.02)
Asian transitional countries <sup>c</sup>		-0.384* (-1.70)	-0.384* (-1.70)
N	1528	1528	1528
Adj. R <sup>2</sup>	0.504	0.518	0.519

Notes: All models are estimated using the two-way random-effects estimator. The estimation period is from 1996 through 2006. Constant terms are not reported for brevity. The figures in parentheses are the *t* value.

\* Indicate the significance level at 10%.

\*\* Indicate the significance level at 5%.

\*\*\* Indicate the significance level at 1%.

<sup>a</sup> The Control of Corruption Index covers more than 200 countries in the world. The index measures the degree to which public power is exercised to obtain personal gain and is processed so that 99% of data falls within the range from -2.5 (worst) to 2.5 (best).<sup>b</sup> Default category is nonformer socialist transitional countries.<sup>c</sup> Including China.

it. In Table 1, using panel data for the period 1996–2006 covering 202 countries throughout the world, we regressed the Control of Corruption Index to a dummy variable(s), which assigns a value of 1 to transitional countries or to a specific group of them, controlling GDP per capita and its quadratic value.<sup>1</sup> As shown in the table, the extent of corruption control in former socialist states deviates downward when compared to the trend of the whole world, even after considering the economic development level of these countries. Moreover, the table clearly indicates that a noticeable difference in the degree of corruption has arisen among transitional countries themselves.

The above findings are closely related to the fact that these countries are still in transition from a planned system to a market economy. As discussed above, the socio-economic disorganization triggered by the collapse of the planned system became a hotbed of corruption in the transition period and, hence, the governments in the former socialist states had to restore national order through conducting a strenuous promotion of political democracy, rule of law, and market economy to replace communism. This is the reason that we can expect a corruption control effect from the so-

called transformation policy. There is a significant gap, however, among transitional countries as to what extent the government pushed forward with necessary measures for this goal. In addition, the historical preconditions and external circumstances that these countries face are so different that these factors may have a close relationship with the remarkable disparity of the corruption level among them. Nevertheless, the determinants of corruption in transition economies have been investigated on the macro-level in only a few studies. In addition, as reported later, the preceding studies have some shortcomings that need to be overcome. In this paper, we examine this issue through the estimation of a new empirical model using the Control of Corruption Index for 32 transitional countries as the dependent variable.

The next section considers various factors that can affect the corruption level in transition economies and discuss the remaining issues of the previous research. Section 3 describes the data and empirical methodology. Section 4 reports the estimation results. Section 5 summarizes the major findings and concludes the paper.

## 2. Literature review and remaining issues

The determinants of corruption, confirmed by preceding studies with high statistical significance, are broadly divided into three categories, namely, economic, political, and cultural, in accordance with the classification of La Porta et al. (1999). Among them, the variables that can be applied to the empirical analysis of transition economies in each category are discussed below.

<sup>1</sup> In general, the corruption level tends to decline along with the development of a national economy and increasing income levels. It is argued, however, that the marginal effect in which economic development controls corruption gradually diminishes. Accordingly, we predict that the estimates of GDP per capita and its quadratic value have a positive and a negative sign, respectively.

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