



Corruption and growth in Africa



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ABSTRACT

A major concern in the development of African economies is the impact of corruption on economic growth and while there is general agreement on its detrimental effects, there is considerable debate over its nature and importance. In particular there is little work on the interaction between corruption, government expenditures and how this influences economic growth in countries in the region. This paper takes an endogenous growth model, extends it to include different categories of government spending and then introduces the possibility of corruption, which is allowed to have different effects on each of the categories. The results confirm the negative effect of corruption and military spending, but also show that corruption interacts with military burden, through indirect and complementary effects, to further increase its negative effect. The policy implications are that the effects of corruption on economic growth are worse than was thought in countries which have high military burdens.

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1. Introduction

Corruption is a major concern for developing countries as it can have a seriously damaging effect on development and welfare. Certainly the countries with the lowest scores in the United Nations Human Development Indicators (HDI) tend to also have low scores in Transparency International's corruption perception index¹ and, while simple correlations do not imply causation, they are supported by a considerable body of empirical research on the relation between corruption and economic growth. This is evident in the meta-analyses by Campos and Dimova (2010) and Ugur (2014), who conclude that corruption has a negative impact on growth, but this is not a consensus view as there do still remain dissenting voices (Méon and Weill, 2010). One important finding in these cross country studies is the potential for heterogeneity across groups of countries. This is particularly the case for Africa, which has many countries that have both high corruption and low HDI ratings. Corruption in Africa is systemic in many countries and the development impact is likely to be different from other regions as a result of their experience of conflicts and structural adjustment programmes and of the existence of weak institutions, high levels of external aid, limited FDI and economic freedom, dependence on commodities and raw materials and, in many cases, relatively small private industrial sectors (de Jong and Bogmans, 2011; Beekman et al., 2013; Pieroni and d'Agostino, 2013; Diaby and Sylwester, 2014). In addition, the nature of corruption can be more decentralised and disorganised than in other countries (Gyimah-Brempong, 2002) although, when

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¹ See <http://www.economist.com/blogs/dailychart/2011/12/corruption-and-development> The Economist Dec 2nd 2011.

endemic, it is used to finance personal advancement in the government bureaucracy. The role of government spending is also a particularly important issue in Africa, given the existence of a number of predatory states and elites (Kahana and Qijun, 2010).

Cross country studies of the interrelationship between corruption, government spending and economic growth have in fact become a major strand of research in political economics in recent years and this has led to some interesting findings. Corrupt countries have been found to have higher government spending (Rose-Ackerman, 1999) than non-corrupt ones and increasing the size of government has been found to increase corruption in some countries, notably the United States (Goel and Nelson, 1998). The opposite result has also been found, however, suggesting that checks and balances might increase with size of government (La Porta et al., 1999).² So there is some evidence of heterogeneity across different groups of countries.

There is also evidence that different types of government spending can vary in their vulnerability to corruption and that some areas of public intervention are particularly susceptible to the creation of an environment in which it is easier to collect bribes and to keep them hidden (Rose-Ackerman, 1997; Shleifer and Vishny, 1993; Mauro, 1997; Tanzi, 1998; De La and Delavallade, 2009). One form of government spending that seems to be particularly prone to corrupt practices is military spending. The secrecy and limited competition in the defence sector can lead to a relatively high level of informal contracts and to rent-seeking activities, providing fertile ground for the growth of corrupt practices. It is also likely that the public in many countries are willing to accept what the military say, both when a threat exists, but also if one is constructed, and not to question the leadership. This can increase the cost of military activities, encourage rent seeking in the military sector and crowd out productive investment in the private sector (d'Agostino et al., 2012).

This paper considers how corruption interacts with government spending to influence economic growth in African countries. It makes two specific contributions to the literature, contributing to the research on the specificities of the African subcontinent and moving beyond the usual focus on the relation between aggregate government spending and corruption to consider how different categories of government spending interact with corruption to influence growth.

It is developed from a number of strands of the existing literature. First, starting from the approach of Barro (1990), which takes government spending to be complementary to private production, it follows (Devarajan et al., 1996) in assuming that all government spending components are productive, in the Arrow and Kurz (1970) sense.³ This endogenous growth framework, with quantities of public services as an input, is then generalised to allow an investigation of how the quality of institutions (through corruption) affects growth, when governments reallocate their total expenditure across the different public spending categories. Second, it develops an estimable model to investigate empirically how the interaction between corruption and government spending (Mauro, 1998; Gupta et al., 2001), together with the quality of institutions (Svensson, 2005; Aidt, 2009), help to explain the variance in growth rates across the sample of countries. This provides results that are consistent with the theoretical analysis. In particular, corruption accentuates the negative effect of military burden on the growth rate. These findings might be interpreted as showing how the quality of institutions can influence economic growth in the sense that if government spending is affected by corruption, the component that is particularly open to rent seeking will be most affected by corrupt practices. Thus, it is not just the existence of corruption that is important in reducing growth, but the manner that it interacts with the different types of government spending.

The remainder of the paper is organised as follows. Section 2 presents the baseline endogenous growth model and extends it to include different types of government spending and corruption, with Section 3 then presenting the empirical model, discussing the dataset and the variables used. Section 4 then discusses the statistical methods used and how direct and indirect effects of categories of government spending and corruption are obtained and then presents the baseline estimates. Section 5 provides the results of various robustness checks and some concluding remarks are presented in Section 6.

2. An endogenous growth model with corruption and government spending

Starting from the endogenous growth model of Barro (1990), assuming a representative agent with infinite lifetime who maximizes lifetime utility U by choosing the consumption level c_t at time t , denoting the subjective discount rate as ρ and given an isoelastic utility function of the form $u(c_t) = (c_t^{1-\sigma} - 1)/(1-\sigma)$, the agent maximises the following function:

$$U = \int_0^{\infty} u(c_t)e^{-\rho t} dt. \quad (1)$$

The representative agent has a Cobb–Douglas type production technology with constant returns to scale,

$$y = f(k_t, g_{it}) = Ak_t^{1-\alpha-\beta-\delta} g_{1t}^{\alpha} g_{2t}^{\beta} g_{3t}^{\delta} \quad (2)$$

² Although Billger and Goel (2009) find that this reduction in corruption as the size of government grows does not hold for the most corrupt countries.

³ In fact this also complements the time series studies of Mittnik and Neumann (2003), d'Agostino et al. (2011) who find that when the different types of government spending are distinguished they vary in whether they are productive or unproductive.

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