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Do Higher Government Wages Induce Less Corruption?

Cross-Country Panel Evidence

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Abstract

Prior studies have lent mixed evidence on the effectiveness of increasing government wages to reduce corruption. Based on a dynamic principal-agent model, this study uses cross-country data over ten years (1999-2008) and various statistical models to present updated evidence. Our analyses show that increasing the government relative wage by one unit (i.e., by the amount of the average manufacturing wage in a country) is associated with a decrease in the level of perceived corruption by 0.26 units. The effect appears to be particularly significant for non-OECD countries (where corruption is more rampant) or for countries with a relatively low government wage. The overall policy implication is: Whereas increasing government wages can help curtail corruption, solely relying on government wages to reduce corruption can be very costly. For example, to reduce the level of corruption in non-OECD countries to that in OECD countries, the government wage would have to be increased by about seven times.

Keywords: Corruption; Principal-agent Model; Bureaucracy; Panel Data