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Is corruption bad for economic growth? Evidence from Asia-Pacific countries

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ABSTRACT

This study utilizes the bootstrap panel Granger causality approach, which incorporates both cross-sectional dependence and heterogeneity across countries, to investigate whether corruption negatively impacts economic growth in thirteen Asia-Pacific countries over the 1997–2013 period. The empirical results show that there is a significantly positive causality running from corruption to economic growth in South Korea, a significantly positive causality running from economic growth to corruption in China and no significant causality between corruption and economic growth for the remaining countries. According to the empirical results, we do not support the common perception that corruption is bad for economic growth for all thirteen Asia-Pacific. On the contrary, results of this study suggest that the "grease the wheels" hypothesis is supported for South Korea. Additionally, results of this study indicate that for most Asia-Pacific countries, policy makers' use of anti-corruption policies to promote a country's economic development may not be effective. Finally, results of this study also suggest that for China, increase in economic growth leads to an increase in corruption.

1. Introduction

Corruption represents a common issue globally. Due to the common perception that corruption hinders economic development, both emerging market economies and democratic developed

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countries have begun to seriously consider the economic harm of corruption and have thus begun to invest in resources to prevent and control corruption. Similarly, in response to increasing awareness around the potential relationship between corruption and economic growth, international organizations have also established various anti-corruption plans and departments for this cause.

The relationship between corruption and economic growth has also been an ongoing topic of debate within academia. Due to growing concerns over corruption's harmful effects on economic development, numerous studies have been devoted to the exploration of this relationship. Mauro (1995)'s cross-country empirical study shows that severe corruption significantly deters investment and economic growth. Poirson (1998) and Leite and Weidmann (1999) suggest that corruption has a negative impact on economic growth. According to Tanzi (1998) and Rose-Ackerman (1999), corruption negatively affects a nation's competitiveness by not only decreasing financial investments, economic growth and government expenditures on education and health, but also causing imbalanced expenditures, misguided market incentives and poorly allocated national resources. Meanwhile, Mo (2001)'s study argues that while corruption has a significant negative effect on economic growth; after factoring in variables such as investment, human capital and political instability into the analyses, the negative effect appears to have a diminishing impact and eventually becomes statistically insignificant. Similarly, Monte and Papagni (2001)'s study looks at the case of Italy's municipality and shows that corruption not only directly limits the average labor income, but also decreases private investments, which in turn, decreases the efficiency of public investment expenditures and slows down economic growth. Gyimah-Brempong (2002)'s study shows that corruption not only decreases economic growth but also contributes to inequal income distribution in African countries. Svensson (2005)'s study, which follows that of Mauro (1995), also supports that corruption has a negative impact on economic growth. Gyimah-Brempong and Camacho (2006)'s study, which uses panel data from 61 countries at different stages of economic development over a 20-year period to investigate regional differences in the effect of corruption on economic growth, finds that there are statistically significant regional differences in the growth impact of corruption. The largest growth impact of corruption is found in African countries while Organisation for Economic Cooperation and Development (OECD) and Asian countries have the lowest growth impact. Ajilore and Elumilade (2007)'s study shows that corruption is cointegrated with economic growth in Nigeria, where a negative one-way causality from corruption to economic growth is observed. Mobolaji and Omoteso (2009)'s study supports Mauro's hypothesis of corruption having a negative impact on economic growth. Tsaturyan and Bryson (2009)'s study investigates the relationship between corruption and economic growth with 39 countries in Armenia and finds that corruption hinders economic performance. Maiyaki (2010) argues that corruption slows growth, leads to inefficient investments in public projects and slows down foreign investments. Johnson, LaFountain, and Yamarik (2011) finds that corruption plays a significant and causal role in lowering growth and investment across the states. The main findings of d'Agostino, Dunne, and Pieroni (2012) confirm the expectation that corruption and military burden lower the growth rate of gross domestic product per capita. Dridi (2013) suggests that the negative effect of corruption on economic growth is mainly transmitted by its impact on human capital and political instability. Shera, Dosti, and Grabova (2014)'s study uses the panel data analyses and reveals that there is a statistically significant negative relationship between corruption and economic growth.

Although most empirical studies agree that corruption negatively affects economic growth, some scholars believe that corruption has the opposite effect. More specifically, some researchers believe that corruption heightens the administrative efficiency of government agencies and decreases the transactions cost of time, which ultimately positively influences economic growth. Leff (1964), Bayley (1966) and Huntington (1968) suggest that under certain circumstances, individuals or corporations may bribe policy makers to turn around unfavorable situations caused by existing laws and regulations and other political inflexibilities, which in turn ends up promoting economic efficiency. In fact, Lui (1985)'s study shows that political bribery has lead to shortened political processes. Similarly, Klitgaard (1988) and Acemoglu and Verdier (1998) both used the theoretical model to prove that when a nation is pursuing the maximization of national output, an optimal level of corruption exists. The studies suggest that while the optimal level of corruption may be relatively low, it exists because anti-corruption efforts represent a cost in itself. Wedeman (1997) discovered that many countries enjoy rapid economic growth despite facing corruption. Colombatto (2003) suggests that in certain

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