

IMF Working Paper

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Subject: Corruption, Growth, and Public Finances

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CORRIGENDUM

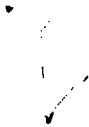
The following correction has been made in WP/00/182 (November 2000):

Page 4, Figure 1: revised

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads
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I. INTRODUCTION

In the last decade corruption has received a great deal of attention from a broad spectrum of the public. The study of corruption is no longer regarded as a subject of inquiry exclusively by students of politics and sociology. It now occupies the attention of many other fields such as political economy, public administration and law. Many international and regional organizations now regard corruption and poor governance as major obstacles to good policy-making. The current interest in corruption probably reflects an increase in the scope of corruption over the years, and is in part fueled by a better understanding of the economic costs of corruption. Thus it does not just reflect a greater awareness of an age-old problem.

Until recently segments of the economic literature had presented a romantic view of corruption. This view made corruption seem an almost virtuous activity and possibly good for growth in a world stifled by bad governments. For example, in various theoretical studies it was argued that corruption removes or relaxes government-imposed rigidities; greases the wheels of commerce; allocates investment and time to the most efficient users; keeps wages low; and may even act as a political glue that holds a country together.² The romantic view of corruption has been replaced, in more recent years, by a more realistic and much less favorable view. According to this new view, the payment of bribes is not a panacea for overcoming red tape and cumbersome government regulations; the highest bribes are paid by rent seekers and not by the most efficient individuals; a comprehensive civil service reform is better at reducing corruption than simply raising wages; corruption is subject to increasing returns which perpetuate it; and corruption creates an environment that, in time, can lead to the collapse of political regimes.

This paper elaborates on these contrasting views of corruption and, from this perspective, analyzes the conceptual and empirical links between corruption, economic growth, and public finances. There are many indirect channels through which corruption lowers growth, and recently some formal models have been developed that link corruption directly to growth. By contrast, there are papers in the public finance literature, and particularly on the tax side, which systematically investigate corruption, tax evasion and the incentive structure of tax inspectors and the public. This paper discusses some related issues.

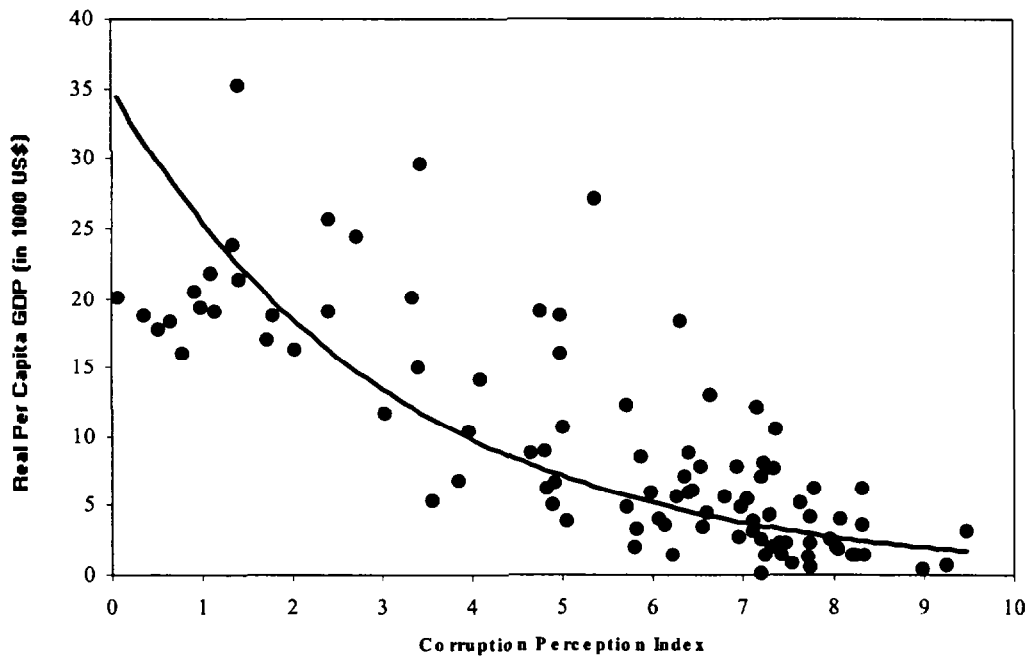
II. CORRUPTION AND GROWTH

As a point of departure, it is important to describe two associations which have appeared prominently in the recent empirical literature on corruption. First, there is a negative association between corruption perception indexes and levels of economic development

² For a concise survey of this literature, see Tanzi (1998).

measured by real per capita GDP.³ Figure 1 shows, for a sample of 97 countries in 1997, that countries with higher perceived corruption tend to have lower real per capita GDP. Or, putting it differently, countries with low per capita income tend to have higher corruption. The correlation coefficient is -0.80 which is statistically significant with a t-ratio of -13.2 .⁴ Second, there is a negative association between corruption perception indexes and economic growth as measured by growth in real per capita GDP.

**Figure 1. Corruption and Development
in 97 Countries**



³ The corruption perception index is the extended Transparency International index and is taken from Lambsdorff (1998) and real per capita GDP is in purchasing power parity U.S. Dollars and is taken from International Monetary Fund's World Economic Outlook database. The original index which ranges from 0 (highly corrupt) to 10 (highly clean) has been rescaled (i.e., adjusted index = $10 - \text{original index}$) so that higher values of the adjusted index represent higher perceptions of corruption.

⁴ Similar results are obtained using other corruption indexes. Recent studies of causes of corruption interpret this correlation as causation running from per capita GDP to corruption; see Treisman (2000).