Does corruption cause income inequality and long-run poverty?(Evidence from Nigeria)

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DOES CORRUPTION CAUSE INCOME INEQUALITY AND LONG-RUN POVERTY (EVIDENCE FROM NIGERIA)

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ABSTRACT

There is a significant relationship between corruption and economic stagnation in Nigeria. Corruption is one of the fastest ways to poverty because higher growth rate is associated with lower poverty levels. Corruption slows down the rate of poverty reduction by reducing growth. Income inequality has been shown to be harmful to growth and if corruption increases income inequality, it will also reduce growth in the process thus becoming an impediment to poverty reduction. Corruption makes poverty self-reinforcing especially in low-income countries. Corruption reduces the poor's access to public goods. When it goes unchecked, corruption is often accompanied by economic stagnation, misallocation of resources, social and economic disparities, and political violence. Corruption grows into tax evasion, poor tax administration and exemptions which disproportionately favors the rich, privileged, and wealthy population groups.

INTRODUCTION

Corruption is a serious cankerworm that has eaten deep into the moral fabric of the Nigerian society thereby causing attendant rot, decay, and decadence with negative spillover effects on other facets of life. This study focuses on public sector corruption which is the use of legislated powers by government officials for illegitimate private gain. Corruption is the abuse of public power, office, and resources by government officials for personal gain through extortion, offering or accepting bribes, kickbacks, and estacode. It is a fallout and indication of the governance problem.

It is possible that corruption could drive inequality leading to the elimination of the middle class often accompanied with rising unemployment, double digit inflation, quantum misappropriation of public funds, lack of accountability, unexplainable sources of wealth by the ruling class, contract scams, lack of prioritization of public needs, inaccurate budgetary provision to critical sectors, fiscal irresponsibility and absence of the rule of law (Franses & de Groot, 2016).

REVIEW OF RELATED LITERATURE

THEORETICAL LITERATURE

Corruption may be seen as dishonest or fraudulent conduct by those in power typically taking the form of bribery, kickbacks, and estacode. Many Scholars have different views about the problem of corruption. This is because corruption is believed to be a major contributor to slow growth and development in Africa that also doubles as the poorest region of the world (Jain, Nundy, & Abbasi, 2014).

Corruption is broadly categorized into public and private. Public sector corruption is most relevant to our study which means corruption of the political process of government agencies mostly the police as well as corruption in processes of allocating public funds for grants, contracts, and related activities. There is also corruption in terms of admissions into prestigious academic institutions in the country where children of the rich who sometimes do not have up to the required cut-off marks are admitted because of privilege.

Although studies exist already on the nexus between corruption and economic growth, this research is novel by looking at the mechanism which poverty may be related to corruption and bribery. Government officials sometimes use their authority for private gain in designing and implementing public policies. In this way, corruption distorts government's role in resource allocation. This is dire because it signals the governance problem confronting countries with weak institutions including Nigeria thereby compromising the efficiency of critical sectors in the economy like education, health and defense.

In addition to these, some scholars have argued what is corruption and what is not; a gift to a public official to influence a decision (popularly known as a kickback) may serve more than an intended purpose. It may become an inducement by means of improper considerations to commit a violation of duty. This when viewed from the public lens could lead to inflation of contract sums, uncompleted or abandoned projects, blind oversight functions etc. Bribery is a daily pervasive and an unavoidable course of action if the corrupt government officials want to live beyond their means.

Regardless of these postulations which opine that corruption is the primary determinant of poverty in developing nations, there is no substantial empirical evidence or unanimity among researchers to validate the claim that corruption is directly responsible for increasing level of poverty in the literature (D. Acemoglu & Robinson, 2019).

In Africa, corrupt government officials and their misgivings has led to wanton poverty, destruction, violence, and gross mismanagement that has stunted economic trajectory of the continent. As such, poor African countries cannot bear the cost of corruption which inhibit development and minimize the ability of government to reduce poverty. The existence of corruption in a society can result in hopelessness and overdependence on foreign aid. The misuse or inefficient use of public funds can adversely impact the living standards in a society (Chernomas & Hudson, 2019)

The theoretical underpinnings linking poverty to corruption are based on the premise that poor people who live among the rich are more likely to be victims of corrupt behaviors by officials of government. This is because the poor rely heavily on services provided by the government since it is expected to be better and cheaper.

There is a plethora of literature on corruption yet very little practical solution. This issue is embedded and possibly informally institutionalized which is the reason many government functionaries and officials steal from government coffers. Corruption increases the level of poverty prevalent by reducing the level of social services available to the poor.

There are excellent reviews of the literature on the economic impact of corruption which spans over corruption, income inequality and poverty where I would prefer to call the Trilemma problem.

Corruption has the ability to influence income inequality and poverty through various channels some of which include “biased tax systems, overall growth, poor targeting of social programs and through its impact on human capital formation, education inequalities and asset ownership” (Todaro, 1995).

Sectoral corruption and transmission mechanism including overall implication on inequality and poverty in Nigeria is carefully studied. These sectors are health, education, agriculture, transportation/communication, and finance.

It is sad and unfortunate that when most countries of the world were witnessing growth miracles, African countries were witnessing growth disasters (Romer, 2006). It has not really been established if growth disasters in Africa especially Nigeria, have been driven solely by corruption or other factors such as unemployment, inflation, balance of payment problems or any other macroeconomic variable. These are attendant effects of corruption since misallocation of resources leads to efficiency issues.

One can argue that individuals expend a large portion of their income on bribes and gifts to get what they want. Findings reveal that poor people spend more in a system operating on corruption since they are the ones to lubricate the system to do basic things which ought to be done ordinarily (Bamisaye, Alimi, & Ajagun, 2017).

Furthermore, public institutions that should prosecute corruption are weak and ineffective. These institutions include civil groups that exert moral pressures, political parties and the media that have the ability to expose the wrongdoings of corrupt officials and the legal system that has the authority to punish and prosecute the guilty (Santos Salas, 2013).

IMPACT OF CORRUPTION ON INEQUALITY, GROWTH AND ASSET OWNERSHIP

According to (Daron Acemoglu & Robinson, 2015), “corruption is a symptom and not the main disease”. To get rid of corruption and global poverty, they recommend that there is an urgent need to build and strengthen strong institutions that will have the ability to work for the people of the developing world rather than tolerate existing structures which currently serve the narrow, graft-addicted elites that suck poor nations dry. According to them, “Nothing will unlock Africa’s economic potential more than ending the cancer of corruption”.

Corruption is one of the fastest ways to poverty for two reasons. First, evidence suggests that a higher growth rate is associated with lower poverty levels. Corruption slows down the rate of poverty reduction by reducing growth (Babatunde et al., 2018). Income inequality has been shown to be harmful to growth and if corruption increases income inequality, it will also reduce growth in the process thus becoming an impediment to poverty reduction. Corruption therefore makes poverty self-reinforcing especially in low-income countries.

Secondly, corruption reduces the poor’s access to public goods. They are the class that need these goods more than any other in the society. The poor because of their financial constraint are not able to pay for some of these services especially when it has to do with health (Epstein, 2014). When it goes unchecked, corruption is often accompanied by economic stagnation, misallocation of resources, social and economic disparities, and political violence.

Subsequently, corruption grows into tax evasion, poor tax administration and exemptions which disproportionately favors the rich, privileged, and wealthy population groups. This reduces the tax base and the progressivity of the tax system leading to increased income inequality in the process.

The siphoning of public funds from poverty and welfare programs by powerful and influential individuals will diminish the intent of these social programs on income distribution and poverty (Babatunde et al., 2018).

It is possible that "asset owners can use their wealth to lobby the government for favorable trade policies including exchange rate, trading policies and preferential tax treatment of their assets" (Stiglitz, 2013). This could well be the case of Nigeria. These favorable trade policies will therefore result in higher returns to the assets owned by the wealthy and lower returns to the assets owned by the less privileged and downtrodden leading to income inequality.

Corruption also increases the operating cost of governance wasting resources available for other competing uses including financing of social spending which is essential for the formation of human capital. It is correct to say that a higher rate of corruption is associated with lower education and health spending with the bulk of the funds stolen by officials. The famous economist Thomas Piketty has a solution. He believes that a "tax cut and increase in the financial contribution of the wealthy to society can help rebuild it" (Piketty, 2014). This is necessary since Nigeria was ranked 149th out of 180 in the perception's corruption index by Transparency International (TI) in 2020.

Furthermore, the operating cost of governance reduces the funds available for financing technology, innovation, and education. This according to Picketty is found to play its part in the dynamics of growing inequalities in assets and income as misallocation of scarce resources generates resource allocation issues.

The Presidential system of government is also a major setback since it is expensive to run. With more than 36 cabinet ministers, bicameral legislature with both the Senate and House of Representatives totaling 469 heavily renumerated members, Heads of Parastatals and agencies. This issue is of dire importance because operating cost of governance is outrageous at present with a lot spent on practicing pseudo federalism. The federating units are not left out as the State governors are as equally corrupt or at least with propensity to be corrupt.

In Nigeria for instance, corruption is found in the" award of contracts, promotion of staff, dispensation of justice, misuse of public offices, position and privileges, embezzlement of public funds" etc (Franses & de Groot, 2016)

It is estimated by transparency International that Nigeria has lost over 11 trillion naira ($28billion) to these top civil servants and politicians from the government between 1999 and 2015 capturing the period in which the country has practiced democracy. As such, this has attendant effects on economic growth since it is evident in the poor state of electricity, transport, health, education and communication (Dauda, 2017). This affects Nigeria's standing and reputation among its peers and before the international community. The existence of the Economic and Financial Crimes Commission (EFCC) which was set up to checkmate and try suspected and fraudulent officials has not helped matters as prosecution has been selective and friends/cronies of the government of the day walk free.

IMPACT OF CORRUPTION AND INEQUALITY ON GOVERNMENT PROVISION OF GOODS AND SERVICES

Corruption has often been found to have efficiency consequences through impacts on government provisions of goods and services. First, it increases the cost of government goods and services which can have multiplier effects like raising the price of these goods and services. The efficiency loss would arise if projects that would be cost effective at the true costs are no longer effective once the costs of corruption are included and hence not done (Bamisaye et al., 2017)

Corruption can generate additional efficiency costs through distortions. Corrupt officials usually cannot steal cash directly since they can be easily detected; instead, they need to go through a variety of more convoluted procedures to extract rents. "Theft of government resources increases the cost of government activity so that otherwise worthwhile government projects such as redistribution schemes or public works projects become non-cost effective" (A. Banerjee et al., 2015)

Furthermore, corrupt government officials need to hide their activity which gives rise to two types of distortions into the procurement of government activity. First since corruption is secret, "the government may not anticipate the amounts lost to corruption; it may then underfund some activities in relation to its preferences when the losses due are taken into account" (Duflo, 2000)

This paves way for corrupt officials to substitute the type of goods that match their prices to make hiding and falsification easier. According to a study conducted in rural Indonesia, villagers are better able to detect corruption where prices are marked up; village officials instead hide their corruption by deflating quantities claiming to procure enough granite, stone, and gravel to make an asphalt road that is 25 cm thick but instead build a road that is 10 cm thick. These roads constructed do not last long and in a few years are due for repairs again leading to regenerative corruption (Dauda, 2017).

Another aspect of this corruption happens when it is less for government institutions to correct an externality. A good example would be a situation where a judge or police officer can be bribed; instead of paying an official fine, the marginal cost of breaking the law is reduced from the official fine to the amount of the bribe.

IMPACT OF CORRUPTION ON GOVERNANCE SYSTEM (DEMOCRACY)

The nexus between democracy and economic development is an important discussion in political science and economics. Theoretically, the relationship is ambiguous as a large literature has argued that democracy and capitalist growth are contradictory (Schumpeter, 1942).

Democracy can also have beneficial effects on economic growth by constraining kleptocratic dictators, reducing social conflict or preventing politically powerful groups from monopolizing lucrative economic opportunities. Other scholars argue that democratic institutions may create distortions due to their redistributive tendencies but may perform better than non-democracies (oligarchies) in the long run because they avoid the sclerotic entry barriers that these other political systems tend to erect to protect politically powerful incumbents.

The connection between political and economic freedom is a controversial one. Some observers such as (Schumpeter, 1942) believe that the two freedoms are mutually reinforcing. In this view, he believes that democracy fosters economic rights and tends to stimulate growth. "He also believes that there is the presence of growth retarding features of democracy. These features involve the tendency to enact rich-to-poor redistributions of income in systems of majority voting and the enhanced role of interest groups in systems with representative legislatures".

Authoritarian regimes tend to partially avoid these drawbacks of democracy as most dictators do not engage in central planning. Examples of autocracies that have expanded economic freedoms include the "Pinochet government in Chile, the Fujimori administration in Peru, the Shah's government in Iran and several previous and current regimes in east Asia" (Barro, 1994).

Furthermore, the effects of autocracy on growth are adverse. A good example of this situation is when a dictator uses his power to plunder the nation's wealth and then carry out non-productive investments as seen in Africa, Latin America and some other planned economies of eastern Europe and the Marcos administration in the Philippines seem to fit this model (Barro & Sala-i-Martin, 2004). As such, they believe that dictators come in two forms, “one whose personal objective often conflict with growth promotion and another whose interest dictate a preoccupation with economic development”.

Democratic institutions are in existence to provide a check on governmental power and thereby limit the potential of public officials amassing personal wealth and to checkmate against implementation of popular policies. This is because the policies that stimulate growth need to be politically unpopular implying that the political effect of democracy on growth is theoretically inconclusive (Barro, 1996).

There is a substantial literature in political science investigating empirical linkages between corruption and power. This is similar to the argument in (D. Acemoglu & Robinson, 2009) where they emphasize “inclusive political institutions”. This concept involves significantly more than democratic institutions. It envelopes in particular checks and balances as well as constraints on executives, legislatures and bureaucrats to ensure a broad distribution of political power in society except to note that (D. Acemoglu & Robinson, 2009) show no evidence of a statistical or causal effect from economic growth to democracy.

THEORETICAL FRAMEWORK

As stated earlier, the desire for personal gain is often understood as the primary source of public sector corruption but this remains an over-simplification of the complex relationships between individuals and the state. This research is anchored on the most popular theory of corruption in the economic literature. This theory is the principal-Agent model and the related agency problem.

The principal-agent problem assumes that economic agents (public officials) serve to protect the interests of the principal (whether the public, supervisors, or parliament). However, the interests of the agents often “diverge from the interests of the principal while the former can prescribe the pay-off rules in the principal-agent relationship. There is information asymmetry to the advantage of the agent which could be used by him for personal benefit” (Jensen, 2016).

In relation to this study, an agency problem therefore occurs where the agents choose to engage in a corrupt transaction in furtherance of their own self-interest and to the detriment of their principal. Thus, to limit the agency problem, the principal can design incentives and schemes including monitoring, bonding, and oversight to curb the agent’s potential abuses.

This plays out a lot in the Nigerian society in the award of contracts, employment opportunities, admissions, and every other thing you can think of when the people elect leaders to act on their behalf, but the leaders become self-serving seeking out their own interest first and always acting based on selfishness instead of being altruistic.

EMPIRICAL LITERATURE

Several efforts have been made to examine major determinants of corruption. A reasonable number of studies focused on a group of countries and employed either cross-section or panel data in their analysis.

For instance, (Babatunde et al., 2018) analyzed the effect of democracy on corruption in a cross-country study during the 1946-2008 period using the Ordinary Least squares (OLS) and Instrumental variable (IV) techniques. The results confirm "that democracy as a system of government reduces corruption. Other factors that reduce corruption include national income level (captured by log of Gross domestic product per capita), democracy duration and democracy in conflict".

(A. V. Banerjee & Duflo, 2007) adopted the two-step system-Generalized Method of Moments (system-GMM) estimator to study the relationship between governance and natural resource in 129 countries from 1984-2007. The result from his study suggests that "exports of natural resources promote corruption while high income levels have a negative relationship with corruption". It is however unclear why exports of natural resources here promote corruption, but the thinking would be that politicians fall over themselves to misappropriate foreign exchange earned from the exports of these natural resources. A good case in point is Nigeria and the availability of crude oil which is the highest foreign exchange earner in the nation. Politicians do everything possible to get to policy circles so they can oversee appropriation of the funds that come from it.

(Santos Salas, 2013) examined corruption determinants in 150 countries between 1998-2005 period using the Hausman and Taylor's technique to estimate a random effects model that incorporates both the effects of corruption that vary overtime and those that are time in-variant. "The results demonstrate that greater law enforcement and high-income levels reduce corruption". Similarly, greater freedom of expression and accountability do have a negative and significant effect on corruption according to the researchers. On the other hand, corruption is not significantly affected by ethnic fractionalization, natural resource abundance, dominant religious tradition, population size or political stability.

Furthermore, (Sloboda & Sissoko, 2020) examined the effect of government size and democracy including government size on corruption across countries using OLS, IV and GMM estimators. The results suggest that income level, government size and democracy including government size-democracy interaction are negatively related to corruption. This is just analogous to the work by Santos where corruption was measured in 150 countries using Hausman and Taylor's Technique while Sloboda used OLS, IV and GMM but both find a negative relationship between corruption and inequality in a democratic setting of government. This sharply contradicts the findings of (Babatunde et al., 2018) that democracy as a form of government when practiced reduces corruption rather it finds that interactions between income, inequality and governance structure is what determines the level of corruption in an economy.

On their part, (Hao, Gai, Yan, Wu, & Irfan, 2021) employed random effects and fixed effects models to study the determinants of corruption in transition economies using panel data spanning 1996-2006 and did not find any significant relationship between corruption and income inequality. His findings are the same or at least similar to the work of (Sloboda & Sissoko, 2020) although it is vague why there is a negative relationship between corruption and inequality. Many factors such as data, methods of estimation and measurement errors may be handy in explaining the variation in results from different authors.

Nevertheless, (Babatunde et al., 2018) found that progress in the rule of law, democratization and marketization are some of the ways to control corruption in developing countries including Nigeria which is the focal point of his study but remained silent as to how to estimate these concepts numerically. Similarly, (Epstein, 2014) used the Leamers' Extreme Bound analysis and OLS with White-corrected robust standard errors to analyze the linkage between corruption and democracy, autocracy and political stability across countries in the 2000-2009 period.

The results find that corruption is less in unstable democracies compared to stable autocracies even when autocrats turn despots in the long run. Many examples of this abound in Africa including the likes of Muammar Ghaddafi of Libya, Paul Biya of Cameroon, Faustin Toudera of Central African Republic, Idris Deby of Chad, Felix Tshisekedi of DRC, Abdel Fattah Al-sisi of Egypt, Teodoro Mbasogo of Equatorial Guinea, Abiy Ahmed of Ethopia, Albert-Bernard Bongo of Gabon, Paul Kagame of Rwanda, Mohammed Abdullahi of Somalia And Yoweri Museveni of Uganda. These despots started out as benevolent dictators in the beginning and turned absolute as time went on. So the favorite maxim that power corrupts and absolute power corrupts absolutely by (Acton, 1964) is axiomatically plausible. As such, the comparison between corruption and inequality in a democratic and autocratic setting is different since they represent fundamentally different ideologies.

In addition to these, (Duflo, Dupas, & Kremer, 2015) investigated the impact of oil rents on corruption in the health sector of 30 oil exporting nations employing the least squares and system GMM estimators over the 2000-2005 period. The authors found that an increase in oil rents has a positive and significant effect on corruption and increase in child's mortality. Furthermore, "oil rents do have a negative and significant impact on political rights but a positive and significant relationship with civil liberties". This validates the study conducted by (A. V. Banerjee & Duflo, 2007) which was cited earlier where they both found that exports of natural resources promote corruption.

Furthermore, (A. V. Banerjee & Duflo, 2007) investigated the corruption effect of history, geography and government in a sample of 100 countries. The results of the estimation find "that democracy, income per capita, urbanization, use of English common law system and government size are associated with lower corruption". In the same vein, (A. Banerjee et al., 2015) assessed the determinants of corruption using cross-sectional data for 98 countries. "The results of the quintile and OLS regression indicate that greater economic freedom and larger government size do not directly reduce corruption significantly in most corrupt countries". The study also concludes that greater democracy in a country appears to reduce corruption. Their findings are in tandem to the conclusions drawn by other authors including (Babatunde et al., 2018).

Also (A. V. Banerjee & Duflo, 2008) studied the causes of corruption in a cross-national study using OLS regressions with White-Corrected standard error and IV technique. The author's findings suggest that "more developed countries with a free and widely read press, a long history of liberal democracy, more openness to trade and a high proportion of women in government are less corrupt". Comparatively, corruption is high in countries that experience high inflation levels, disruptive service regulations and depend on fuel exports.

In addition, (Arellano, 2013) evaluated the determinants of corruption in 20 regions of Italy between 1963 and 2001 adopting the Two stage Least squares (TSLS) approach. "He finds that economic variables such as government consumption and economic development, political and cultural differences (party concentration, presence of voluntary organizations and absenteeism at national elections) are significant determinants of corruption in Italy". The researcher discovered that corruption level is less in rich and more democratic countries including countries that are predominantly protestant. This contradicts the findings of (Babatunde et al., 2018) that corruption seems to be high in politically unstable countries.

Furthermore, (Jensen, 2016) employed the OLS and IV methods to assess the determinants and effects of corruption across states in the US during the 1976-2012 period. The results show that corruption is less in wealthy and more educated states. In addition, racial fractionalization and income inequality are important determinants of corruption while corruption is not related to government size.

Additionally, (Gillespie, 1990) employed OLS and IV techniques to examine the effect of the level of quality of openness in corruption in 133 countries. “The results show that both the level and quality of openness have a reducing impact on the level of corruption”. In the same vein, high-income level as well as free and open press have a significant effect on corruption. This is just the same way that (Barro, 1997) found that “the level of development, democracy and economic freedom do have a negative and significant effect on corruption in the US”. Although plausible, it is difficult to measure openness in corruption as done by the researcher. Variables and data do really matter and go a long way into the findings and results of the study.

Moreover, (Hao et al., 2021) employed OLS and TSLS methods to examine the effect of decentralization on corruption in a sample of countries. The results demonstrate that decentralization, government size and income per capita have a negative and significant effect on corruption. The only exception according to him is high population rate which has a positive and significant effect on corruption. Studies of corruption in Nigeria using Parsimonious error correction mechanism and an experimental research design found a negative relationship between corruption and output growth in Nigeria (Babatunde et al., 2018). Other scholars validated Babatunde’s claims using cointegration test, granger causality test and the OLS method to examine the impact of corruption and found that there is a long run relationship between the level of corruption and economic growth in Nigeria mostly adopting the Error correction Model (ECM).

Finally, a few studies reported positive and significant relationship between corruption and economic growth while many others found no relationship at all between corruption and economic growth in real output making use of the Gross Domestic Product (GDP) as a function of corruption and adopting the Wald Test for short run dynamic impact to test for the relationship. (Iyoha, 1997).

The empirical findings for a panel of around 100 countries strongly support the general notion for conditional convergence. For a given starting level of real per capita GDP, the growth rate is enhanced by higher initial schooling and life expectancy, lower fertility, lower governmental consumption, better maintenance of rule of law, lower inflation, and improvements of terms of trade. For given values of this and other variables, growth is negatively related to the initial level of real per capita GDP (Barro, 1994; Barro & Feldstein, 1978).

CONCLUSION

A wide range of policies can help reduce inequality. They include more support for education including pre-school, increasing the minimum wage, strengthening earned income tax credits, strengthening the voice of the workers in the workplace including through unions and more effective enforcement of anti-discrimination laws (Stiglitz, 2012).

Secondly, (Stiglitz, 2012) believes that “high inequality has weakened aggregate demand fueling asset price bubbles through hyper-expansive monetary policy and that deregulation is not the only response”. Higher public investment in infrastructure, technology and education would both revive demand and alleviate inequality which would in turn boost growth in the long and short run according to him.

For most poor and developing countries to transition to industrialized nations, there must be a plan towards equitable income distribution and lifting millions out of poverty. Africa needs to wake up and change its growth trajectory for a secured future if it ever wants to be on the path of growth.

Finally, corruption ought to be tackled holistically because of its dangerous intergenerational effects. Political will must be present if the challenges of corruption and inequality are to be properly addressed.

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