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Corruption, Inequality and Economic Growth

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Abstract

Corruption is worst curse of social system, which ruins all values of community and derails badly. It causes inequality in the whole chain, due to which some parties get too much profit, while other becomes miserable, leading to several street crimes as well as moral devaluations. Due to corruption and inequality, the economic growth is poorly affected, leading to imbalance in the society, causing lack of demand in the market, opportunities of labor and misbehavior of customers. Public can not avail proper advantages of capital movement in the society, and there is no proper regulation of taxation, due to that economic growth also become stuck at low levels.

Keywords: Corruption, inequality, economic growth, society, tax

Introduction

Corruption is not a new but an ancient universal problem having various degrees. It is considered as root cause of the entire problems of any economy. Corruption is termed as a deadly virus which attacks the vital structures required for a society's progressive functioning. It is the main obstacle in the way of economic growth and development of a country. Due to the curse of corruption, social trust has been lost badly which led towards inequality in the system, and affected prospects of health care, public education, as well as labor (Rothstein & Uslaner, 2005). Moreover, corruption disturbs the mechanism of supply, demand, and behavior of consumer, which ruins the society (Obydenkova & Libman, 2015).

Corruption is defined as transfer of interest from public to private sector. World Bank defines corruption as "The abuse of public office for private gain. Corruption is every transaction between actors from the private and public sectors through collective utilities that are illegally transformed into private gains". According to Transparency International (TI, 2009), corruption is misuse of entrusted political power for personal gain.

Corruption is indeed one of the greatest obstacles for long run economic and social development especially in developing countries. It not only affects economic growth and development of a country but also damages its institutional quality badly. It is a symptom and outcome of institutional deficiency with negative effects on economic growth (Ugur & Dasgupta, 2011).

As corruption adversely affects economic and social development of developing as well as developed countries, major institutions started examining the sources and solution of corruption. World Bank has identified corruption as the single greatest hurdle to economic and social development. It weakens development by distorting rule of law and weakening the institutional foundation on which economic growth depends. IMF states, "Many of the causes of corruption are economic in nature, and so are its consequences-poor governance clearly is detrimental to economic activity and welfare" (Akai et al. 2005).

Although these international organizations consistently claim that corruption hinders economic growth yet Economists have not necessarily agreed with the claim from theoretical standpoint. Economists hold startlingly different views regarding effects of corruption. Different studies show the relationship between corruption and economic growth but with conflicting results.

A different view is that corruption exerts a negative effect on economic growth. Economists like (Gould & Amaro-Reyes, 1983; Kaufmann, 1997; Mauro, 1995; Pellegrini & Gerlagh, 2004; Wei, 1997) and some international organizations like UNDP, World Bank and IMF analyzed that corruption has adverse effects on economic growth and development of economies.

In Pakistan corruption is widespread, particularly in the government and lower levels of police forces. Today, the position is very bad, the devil of corruption is reining every field of national activity, and the unfair practice is so rampant that a common man feels frustrated. Peoples exclaim that corruption is a curse and it has stolen the peace of mind.

These statistics show that in Pakistan corruption is higher than all other SAARC member countries except Bangladesh. Although Pakistan has witnessed improvement in the world corruption perception index in 2013 from 27 to 28 and ranks from 139 to 127 out of 177 countries which is a good sign for our country yet it is higher than all other SAARC countries except Bangladesh. So there is growing need to reform accountability and anti-corruption policies at higher levels within the state government.

Corruption does not affect only economic growth of a country but also increases income inequality. Income inequality can be defined as "the disproportionate distribution of total national income among households". Low income people are mostly affected by corruption as it diverts public spending from the

projects which are beneficial for poor people like education and health to those projects which are favorable for high income group like defense. This in turn leads to increase in income inequality and poor become poorer. Moreover inequality results in economic inefficiency, social instability and unfairness in the country. Inequality affect economic growth as well as poverty, it affects negatively the economic growth rate (Bagchi & Svejnar, 2015), as well as, responsible of higher street crimes (Shrivastava & Ivanova, 2015).

The inequality in Pakistan has increased drastically in the last eight years and the trend continues unabated despite all claims of poverty reduction. The main factors that govern personal income distribution include distribution of assets; functional income distribution; transfers from other households, government and rest of the world; and tax and expenditure structure of the government. It may also be increase due to increase in corruption. As different studies has found the positive and significant relationship between inequality and corruption.

Dincer & Gunalp (2008) investigated that increase in corruption leads to increase in income inequality and poverty. Similarly high inequality is associated with greater corruption (Barreto, 2001).

A lot of empirical work has been done to analyze the relationship of corruption, inequality and economic growth for panel type analysis but to my knowledge no study has been conducted yet to examine such type of relationship for Pakistan. The current review fills this gap and investigates the relationship among corruption, inequality and economic growth in Pakistan.

Literature Review

Egunjobi (2013) scrutinized relationship between corruption and economic growth in Nigeria using time series data from 1989-2009. The variables used in the study include GDP (proxy for Economic growth), Government capital expenditure (proxy for Capital), foreign private investment (proxy for FDI), Expenditure on Education (Proxy for Human capital), Total labor force and Bribery and Corruption index (proxy for Corruption). In the study, first stationarity has been checked through ADF unit root test which suggest that all variables are stationary at level in logarithm form so simple regression is appropriate for estimation. Further granger causality test is used to check directional effects. The results reveal that there is direct effect of corruption on economic growth while indirect on foreign private investment, education expenditure and capital expenditure.

Matthew & Adegbeye (2013) investigated the link between corruption and economic growth in Nigeria and also their directional relationship. Corruption and economic growth are used variables. An appropriate technique OLS is used for estimation after checking stationarity of all series through ADF and PP test. Furthermore Granger causality test is applied for testing directional relationship. The results suggest that corruption damages economic growth in Nigeria and the causal link is also prevails between corruption and growth. Consequently, in order to decrease the corruption possible anti-corruption policies should be adopted.

Samadi & Farahmandpour (2013) explored the effect of income inequality on corruption based on the country's economic freedom by categorizing countries according to their economic freedom. The study classifies countries into four groups according to their average of economic freedom in four groups (free, mostly free, mostly unfree and unfree countries). The variables used in study are Corruption, Income Inequality, Economic Development, Unemployment Rate, Education and Urbanization Rate. The data sources are Transparency International (TI) database, UNU-WIDER database (WIID) and World Development Indicator (WDI). The results show that there exist positive relationship between corruption and income inequality in free as well as mostly free countries as decrease in one lead to other in same way while negative relationship exist in mostly unfree countries as decrease in inequality worsen the corruption due to their monitoring system.

Ajie & Wokekoro (2012) analyzed the relationship between corruption and economic development in Nigeria using time series data from 1980-2011. Corruption, Gross Domestic Product (proxy for economic growth), Unemployment Rate, Debt stock, Government Expenditure and Political Stability are observed variables. OLS (ordinary least square) estimation technique is used for estimation. The results of the study show that corruption affect economic growth in Nigeria negatively and badly. So in order to reduce it, anticorruption policies should be adopted related to good governance and political system etc.

Fiorino et al. (2012) tested the endogeneity between corruption and economic growth over the cross country/region. They used panel data set from 1980 to 2004 of 20 Italians region. The study take the a newly collected dataset that has the benefit of assembling socio-demographic, economic and politico-institutional variables at local level and make available a practical solution. The other observed variables are public expenditure, population growth, inequality, school attainment, labor force unit, diffusion of newspaper and some other etc. A two-step procedure is used for estimation. The data source is Italian Institute of Statistics (ISTAT). First determinants of corruption have been estimated in Italian regions using OLS and then the endogeneity is tested between corruption and economic growth using the fitted value of first model. The findings suggest that there exist negative relationship between corruption and economic growth.

Pulok (2010) made an attempt to analyze the link between corruption and growth using time series data from 1984-2010 with the help of ARDL estimation approach in Bangladesh. ADF and PP unit root test has been

applied on all series which suggest that ARDL is suitable technique for estimation. GDP, Corruption index, Gross fixed capital formation and Govt total consumption expenditure, Public expenditure on education, total factor productivity growth rate, depreciation rate and population growth rate are observed variables. The results show that in Bangladesh corruption affect economic growth negatively in the long run.

Akan & Arslan (2007) scrutinized the effect of corruption on FDI (Foreign Direct Investment) by using time series data from 1986 to 2006 in Turkey and also their causal relationship. The variables used are FDI and URI (Unrecorded Income) as proxy of Corruption. First stationary of data have been checked by using unit root test like ADF and then an appropriate technique that is Johanson co integration technique is used for estimation. Furthermore Granger causality test is applied to check the directional effects. The results suggest that corruption affects FDI negatively. Moreover causality is unidirectional that is it exists only from corruption to FDI and not the other way round.

Viorică et al. (2011) investigated relationship among corruption, economic growth and FDI and also the determinants of corruption in Romania by using time series data from 1997 to 2009. The variables of the study are Corruption, Economic Growth, FDI, Economic Freedom, Education and Governance. The data sources are World Bank, INSSE (The Romanian Institute of Statistics) and Eurostat. In this study, first the correlation between corruption and foreign Investment and also between corruption and economic growth has been checked through correlation test. The results of correlation tests show that there is significant and positive correlation b/w corruption and FDI while insignificant correlation b/w corruption and economic growth. Secondly, multiple regression method is used for estimation of determinants of corruption. The result suggests that corruption is significantly and negatively correlated with the Level of education and the degree of Economic Freedom while positively related with Governance.

Islam et al. (2011) examined the relationship of corruption and financial development in different countries using time series data. ARDL estimation approach is used for estimation. Further Granger causality test is used to check causal relationship. The findings of the study suggest that corruption stimulates the financial development and there exist bidirectional causality between them. Moreover results show that corruption and financial development are analogous to each other.

Azfar & Gurgur (2005) generated an analysis by conducting the survey to observe the influence of corruption on health and education the Philippines. To see the effect of corruption on health and education different estimation techniques like Tobit, OLS, Random effect and Robustness are used. Different proxies are used for health as well as education. Furthermore public sector management in rural and urban sector is also used for analysis. The results suggest that corruption effect both health and education negatively. Moreover corruption affect rural and urban sector public sector in different way.

Findings were documented to find out the effect of corruption on economic growth by using the Barro Type endogenous growth model, via its impact on physical capital, human capital and labor over the period of 1987 to 2007 in Nigeria. GDP (Gross Domestic Product), TSE (Tertiary School Enrolment (proxy for human capital)), GCE (Capital Expenditure (a proxy for physical capital)), TEM (Total Employment (a proxy for labor)) and COR (Corruption Perception Index) are the variables used in the study. The data sources are Central Bank of Nigeria (CBN) and Nigerian Bureau of Statistics (NBS). First the ADF (Augmented Dickey Fuller) in applied to check unit root properties of all used variables. Then Engle-Granger two steps method is used to find out long run relationship between variables. Further Parsimonious Error Correction Model is employed to check separately effect of corruption on GDP, human capital, physical capital and labor. The findings suggest that corruption has a significant and negative effect on GDP, human capital as well as labor while it exerts positive effect on physical capital. The study reveals that corruption yield negative influence economic growth directly as well as indirectly. So Govt. should take possible steps to reduce corruption for development (Aliyu & Elijah, 2008; Sunkanmi & Isola, 2014).

Delavallade (2006) used three-stage least squares method to investigate the effect of corruption on Govt. spending on sixty four developing counties from the period of 1996 – 2001. The study examined the effect of public spending in two ways: First, scrutinizes the influence of corruption on the total expenditure then also see the sector wise effect. Corruption, Public total expenditure, Sector wise allocated expenditure and some control variable as urban population, Taxes, Debt, Proportion of social contribution in GDP and dependency ratio are the observed variables. The findings of the study suggest that corruption affects the Govt. expenditure negatively both total as well as sector wise that is it reduces the public expenditure and their use in good way. As public expenditures are important for economic development and growth, so corruption should be reduced.

The relationship between corruption and poverty was evaluated from various developing countries using a panel data set over the period of 1997-2006 and also check the causality between them. Corruption, Poverty and control variables are Inflation, Political stability, Rural Population and Gender are the observed variables used in the study. Human poverty index (HPI) is used for poverty. The study used GMM (Generalized Method of Movement) and Granger causality test for estimation. The data sources are UNDP HDR (Human Development Report), TI (Transparency Index) and WDI (World Development Indicator). The results show that

there exist bidirectional causality between corruption and poverty. So policies should be adopted to reduce corruption as if policies adopted to reduce one say corruption will also leads to reduce other one (Negin et al. 2010; Rahayu & Widodo, 2013; Yusuf et al. 2014).

Analysis was documented to show the link between corruption and income inequality using panel data set 1984-2004 and applying GMM (Generalized Method of Movements) estimation technique of 71 developed as well as developing countries. Income inequality is dependent variable while corruption, trade to GDP ratio, population growth, GDP per worker, Secondary school enrolment, Govt. expenditure and capital per worker etc are independent variables used in the study. The data sources are IMF, IFS, ICRG and WDI etc. The results show that there exist significant relationship between corruption and income inequality. As if corruption increases it leads to increase in income inequality and both in turn affect economic growth (Gupta et al. 2002; Gyimah-Brempong, 2002; Gyimah-Brempong & de Gyimah-Brempong, 2006; Li et al. 2000).

There had been thoughtful variations in both radical and financial organizations in China over the last 20 years. Moreover, the stride of conversion had controlled to difference, the country in the close of expansion. The role of legal institutions, monetary deepening and radical diversity on growth rates was assessed by custom panel data of the Chinese shires (Hasan et al. 2009). Multidimensional disparities in health care delivery were observed from Henan Field in central China, which focused on exploratory the multi-scale fitness care inequality in Henan from two magnitudes, urban-rural and core-margin and inadequate the three-dimensional belongings of China's multiple evolutions, regional expansion policies, and indigenious economic expansion on fitness maintenance delivery (Li & Wei, 2014).

Foreign direct investment (FDI) had responsible for being one of the main issues flared provincial inequality in Chinese districts since it had extremely unequally dispersed spatially. If this reason had truth, then supervisory role of FDI had answer to decrease provincial inequality. However, it had problematic to settle the optimistic effect of FDI on economic progress with its probable adverse result on provincial disparity, which was studied on the base of panel data of all Chinese districts during 1979-2003 (Wei et al. 2009).

Regional inequality in china's health care was expenditure inequality in china by challenging two theories on health expenditure union, which was organized by Cross-section regressions and cluster analysis. As well as, long-run association was observed between health expenditure inequality, income inequality, and provincial government budget deficits (BD) by using new panel cointegration tests with health expenditure data in China's urban and rural areas (Chou & Wang, 2009).

Spatial Data Analysis of Regional Inequality in Fujian Province in China since 1990 presented examines the sequential inclinations of diverse level dissimilarities, altitudinal requirement and devices of regional development in Fujian by using outdated statistic directories and altitudinal statistical methods, such as 1) Theil-index and its decomposing method, 2) ESDA statistic techniques, and 3) three regression models. Thus, this proposed that locality, urbanization, decentralization and globalization had significant influences in regional inequality in Fujian Province (Chen, 2011; Wei, 1999, 2002).

Akai et al (2005) analyzed the effect of corruption on economic growth in United State using a state level cross sectional data for different time periods separately as short run (1998–2000), middle (1995–2000) and long run (1991–2000). 2SLS estimation technique is employed for estimation. The variables used in the study are GSP Growth, Corruption Index, Real GSP Per Capita, Investment, Government Expenditure, Education Metropolitan Population Political Competition Index and Plains Dummy etc. The results suggest that corruption has negative as well as significant effect on economic growth for middle and long run while insignificant for short run.

Conclusion

Literature confirmed that corruption and inequality is inversely proportional to economic growth. Higher corruption leads towards inequality of monetary system, which disturbs social setup via street crimes and poor trust in the society. Similarly, inequality affects too much behavior of people, due to injustice of opportunities and transactions of capital, causing negative impact on economic growth. Moreover, corruption and inequality affects the supply and demand of social system, which bulldoze the economic growth.

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