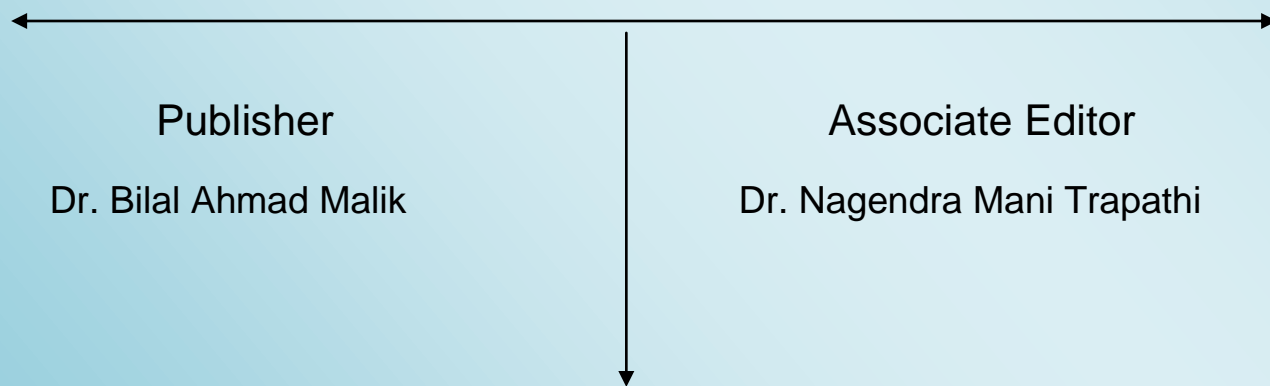# North Asian International Research Journal Consortium

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CORRUPTION AND SUSTAINABLE DEVELOPMENT: A PANEL DATA ANALYSIS OF SELECTED AFRICAN COUNTRIES

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ABSTRACT

Corruption is not new in Africa, it is a global phenomenon. The height it manifests largely punctured the pivoting structures of long run growth fundamentals. A number of studies have shown that African countries exhibited relatively high levels of corruption which constrained free flow of efficient allocation of productive resources to growth enhancing activities. This study, however, modelled corruption and sustainable development within the context of a sample of Ten (10) selected African countries between 1980 and 2015 using cross-sectional data analysis. Sustainable development was captured using real GDP per capita income, while corruption was measured using perception based index designed by International Organizations such as Transparency International (TI). The empirical results from the study tilted to the general position held in the literature that corruption retards sustainable economic development through its negative effects on real GDP per capita income, investment and productivity efficiency. Policy direction is instructive at strategies aimed at discouraging corruption.

Keywords: Corruption, Development, Investment, Panel Data, Africa

JEL classification codes: D72, O1, E22 , C23, N27

1.0 INTRODUCTION

The key factor militating against Africa's realization of good governance and sustainable development is corruption. Corruption has infiltrated into the political, economic, social and cultural fabrics of the society, thereby impoverishing the entire system. Africa's pace of development has stagnated and declined persistently over the years compared to other regions. Indicators of development such as real GDP per capita income, infrastructure, literacy level, healthcare etc. has deteriorated. In addition, poverty and income inequality widened colossally. The situation in Africa contradicts other regions experience in terms of growth and development. The stagnated development position in Africa was accredited to culture of impunity, corruption and bad governance

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(Lumumba 2011). Plethora of studies[1] have shown that African countries exhibited relatively high levels of corruption which constrained free flow of efficient allocation of productive resources to growth enhancing activities. The literature have recognized a number of channels[2] through which corruption downplayed economic growth. Though, a number of the channels have been investigated empirically. However, this study focused on two channels through which corruption undermines economic growth. The channels include: investment and productivity (in relation to productivity growth). This paper maintains that corruption distorts business transactions, imposes additional cost on production, raises prices of goods and services and creates distortions in investment plans and decision making. The nature of corruption in Africa is such that it misallocates public investment to unproductive and rent-seeking projects, where the scope for corruption is very high. Besides, corruption affects the efficiency level of production efforts negatively, thus reducing the marginal productivity of factors to zero level. Corruption does not only condition an economy's productivity level, it also retards growth potentials.

Persistent and sustainable growth in investment and productivity drives economic growth. However, investment and productivity growth in Africa remained sluggish and stunted due to inappropriate innovation system directed at raising investment and productivity fundamentals, ineffectiveness of law and order to create a conducive atmosphere for raising quality investment and productivity and corruption. With corruption, sustainable development remains obscure in Africa's growth process. Corruption also debar the continent from realising the benefits of Millennium Development Goals (MDG).Corruption is unfavourable to state efficiency, hampers budget stability, diminishes expenditure efficiency and distorts its distribution between different budgetary functions.

In this paper, we study the impact of corruption on investment and productivity growth in African countries as a way of exploring the channels through which corruption beclouds economic growth. To accomplish the objective of this study, we employed a sample of Ten (10) selected African countries for the period 1980-2015 using panel data ordinary least squares (PDOLS) technique.

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[1] .See Mauro(1997); Anoruo & Braha(2004); Mendez & Sepulvedo(2005) and   Baliamoune-Lutz and Ndikumana (2007)
[2] .The channel include: investment, tax revenue, school enrolment, life expectancy, inflation and aid, human capital accumulation, labour productivity, and political instability. For more discussion on the transmission channels, See Hodge et.al (2009) and Mo (2001).

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A number of empirical findings[3] have documented that corruption affects per capita GDP through its impact on investment and productivity growth. Investment captures private and public investment. The way in which corruption affects private investment is entirely different from the way it affects public investment. While in private investment, it imposes constraints on market transaction costs, raises both the cost of doing business and prices of goods and services and also creates distortions in investments plans and decision strategies. Corruption therefore beclouds private investment. Corruption and public investment are positively connected if it has to do with public spending on capital projects. Public officers hide under capital expenditure to allocate resources to rent-seeking and unproductive projects to obtain personal gains especially where the scope and cost of projects cannot be easily ascertained. In the case of productivity growth, corruption reduces productivity efficiency, neutralized the knowledge components of factors and turned negative the externality from human capital, thus retarding economic growth. When the lower level workers discovered that senior cadre counterparts engages in rent-seeking activities and are corrupt, production efforts reduces and potential productivity frontier sagged down. Following the introduction, the rest of the paper is organized as follows. Section two reviews the literature while the data and estimation methodology are presented in section 3. Section 4 discuses the empirical results, while section five concludes the paper.

2.0 REVIEW OF LITERATURE

It is difficult to separate corruption from other anti-growth factors[4] working against Africa's growth potentials. Corruption comes in different shapes and dimensions. Most corrupt practices are personal benefit based activity. If the benefits derived from corrupt activity exceeds the cost incurred, it pays the corrupt agents to stimulate more interest in the act. Otherwise, the opposite would be the case. In some cases, corrupt practices could be targeted to enrich close friends, families, tribes, groups etc. The most common description of corruption was given by the World Bank (2000) as the abuse of public office for personal benefits. Public office may be abused when public officers practically engages in extorting bribes from private agents to circumvent public policies and processes for competitive advantage and profit. Corruption does not only domicile in public offices, it does happen in private offices. Being clandestine in nature, it takes place out of public view. The abuse of public office may not only relate to bribery, it could take the form of patronage, nepotism, theft of state assets or diversion of state resources (World Bank, 2007; Tanzi, 1995). Specifically, Gould (1991) bemoaned corruption as a moral problem and

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[3] .For more discussions on the effects of corruption on per capita GDP and productivity growth, see Mo (2001); Pellegrini & Gerlaugh (2004); Ndikumana (2007); Dissou & Yakautsava (2012); Ogun (2014); Ogunlana (2015).

[4]. Such factors include maladministration and incompetence, large-scale fraud, organised and disorganized crime and international theft. The factors have consequential effects on development objectives, long term economic growth, poverty level and global trade position.

unethical observable fact that contains a set of moral aberrations against accepted societal norms. The description of corruption by Gould (1991) is in line with Dobel (1978) who branded corruption as the moral incapacity to make disinterested moral commitments to actions, symbols, and institutions which benefit the substantive common welfare. Moral norms are dynamic and differs from one society to another. What is regarded in one culture as corruption may be regarded as a routine culture in another. For example, in African culture, 'gift giving' is a regular occurrence, but in western culture, it is regarded as corruption (see de Sardan 1999 and Qizilbash 2001). For corruption to firmly spread its tentacle, Jain (2001) identified three necessary and sufficient conditions. The conditions include: availability of discretionary power, existence of economic rents, and a weak judicial system.

Africa's corruption problem emanated from many sources. First, there is need to recognize the fact that the colonial government in various African countries left a good democratic order and attracted foreign capitals to promote development. With the exit of colonial government, African leaders failed to develop a good administrative and judicial institutions to direct appropriately what the colonial government left. Consequently, the elites in government took the advantage to manipulate state resources to enrich their pockets, while the down-trodden masses suffered. Second, Africa leaders commit state resources to questionable and less productive projects that yield low welfare benefits to the masses. In most cases, contracts are awarded to families, friends, groups etc. without due process of competitiveness. Third, the police and judicial system are twin agents aiding corruption in African countries as they constitute the conduit pipe through which the powerful figures in the system legitimized their stolen wealth. The question that needs answer centres around fixing corruption in Africa. This is an herculean task and may take longer years to achieve. Following this, African leaders have duties on their hand to ensure that transparency and accountability remains the key watchword in allocating and disbursing state's resources.

The description of corruption from the foregoing indicates that corruption is so prevalent in Africa to the extent that the public at large lost confidence in the government's ability to manage the economy. Corruption not only enrich primitively African leaders, it also allows them to manipulate and stereotyped the thinking faculty of the populace. The literature has pointed out some institutional and constitutional gap which may fester corruption. When discretionary power is given to public officers in the allocation and disbursement of public spending, such power is perverted to make personal benefits. A defective and inefficient tax system breeds corruption. Poor wage structure and workers remuneration not commensurate with work done raises the propensity for corruption. In

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addition, misappropriation of borrowed funds (internal & external) and misuse of foreign aid are routes of corruption (See Mauro, 1995).

In order not to misplace focus of this study, given the arrays of corruption routes, this study explains the role of discretionary powers exercised by public officers in the allocation and disbursement of public spending in Africa. Public officers have high discretion to determine the type, composition and geographical position of projects and service delivery. The discretion tends to be very high particularly if the disbursement expenditure falls under the category of capital expenditure than recurrent expenditure. Public officers find it very convenient to manipulate invoice for road construction projects, buying of military armaments etc. whose exact costs are difficult to ascertained. For recurrent spending such as payment of public and civil servant salaries, public officers finds it very difficult to embezzle such disbursement.

Empirical findings from a number of studies have shown that corruption is harmful to sustainable growth and development (Tanzi, 2002; Svensson, 2005; Gyimah-Brempong, 2002). There are empirical regularities in the findings that countries with episode of corruption tends to experience slow growth. This findings have implications for African countries growth process. First, African countries are known to experience defective growth structure based on worse governance result. Second, countries in Africa performs poorly in terms of growth fundamentals compared to other developing and developed regions. Consequently, we could conclude that governance and corruption are the critical factors working against sustainable growth and development in Africa. In totality, corruption have also destroyed the living conditions of the people by widening the gap between the rich and the poor, reduced pro-poor project, raises the cost of doing business and intensify abysmal rise in prices of goods and services.

The discussion on the effects of corruption on an economy over the years have produced empirical exposition establishing the link between corruption channels and sustainable economic growth and development. Some strands of scholars investigated the impact of corruption on economic growth while others study its impact on domestic/or foreign direct investment. Studies that have established a link between corruption and investment channels suggested that corruption lowers private investment and tilts public investment spending towards promoting skewed income distribution, reduced infrastructure projects, reduced tax revenue inflow and misallocate public resources to less productivity projects. For example, Mauro (1995) carried out an empirical analysis of corruption and investment for 58 countries during the period 1970-1985. Findings from the study

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showed that corruption has a negative effect on the ratio of investment to GDP. In another study carried out by Rahman *et.al* (1999) on the effect of corruption on economic growth and Gross Domestic Investment using Bangladesh database suggested that corruption affects economic growth by reducing FDI. In the study conducted by Tanzi & Davoodi (1997) on the nexus between corruption and public expenditure. Findings from the study showed that corruption manipulated items of public investment, skewed the composition of public expenditure to low and inferior projects and also caused inefficiency in tax revenue inflow.

Corruption constitute a long run variable in the productivity growth framework. The influence of corruption on productivity cannot be overemphasised as it determines the growth structure of productivity. Specifically, corruption has the tendency of exerting negative effect on productivity growth, thus causing hindrance on growth and efficiency level of production efforts (see Ogunlana, 2015). The theoretical and empirical studies on corruption have jointly suggested that corruption raises the cost of business transaction, creates uncertainty in business plans, leads to inefficient economic outcomes, diverts productive talents to rent-seeking activities, promotes underground economy, raises poverty level and income inequality.

3. DATA AND METHODOLOGY

3.1 Data Description

This study employed unbalanced panel data from Ten (10) selected African countries for the period 1980-2015. The choice of the period is informed based on data availability. Five endogenous variables are included in the estimation. The endogenous variables include: real GDP per capita, share of investment in GDP, productivity percentage of GDP, openness to trade (proxied by the sum of import and export divided by GDP) and corruption. Real GDP per capita and openness to trade variables are expressed in logarithmic form to reduce them to the same base. The data were sourced from the World Development Indicator (WDI) and Africa Development Indicator (ADI) database. Data on corruption were sourced from the Corruption Perception Index (CPI) developed by Transparency International (TI). The CPI has values between zero (0) and ten(10). Zero value indicates extreme corruption and value of ten indicates no corruption. Low score on CPI implies that public officers engages in unlawful side-payment receipts in the form of extortion, bribes, fraud and embezzlement.

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3.2 The Empirical Model

The objective of this study is to analyze the effect of corruption on sustainable development in African. To accomplish this objective, we first specify an equation establishing the effect of corruption on economic growth (measure of sustainable development). The effect is shown by equation (1) below.

$$Pcrgdp_{it} = \theta Pcrgdp_{i,t-1} + \vartheta End_{it} + V_i + \epsilon_{it} \qquad (1)$$

In Equation (1), real GDP per capita of country i at period t is expressed as a function of real GDP per capita lagged period t-1 and vector of endogenous variables (such as corruption, investment, trade openness and productivity growth). θ and ϑ are parameters to be estimated.

The second task is to ascertain the effect of corruption on investment per cent of GDP. Equation (2) below show the estimating equation.

$$Totinv_{it} = \theta Totinv_{i,t-1} + \vartheta End_{it} + \varphi Exo_{it} + V_i + \epsilon_{it} \qquad (2)$$

In Equation (2), investment per cent of GDP of country i at period t is expressed as a function of investment per cent of GDP lagged period t-1, vector of endogenous variables (such as real GDP per capita income, corruption and trade openness), and vector of exogenous variables (such as law and order, real exchange rate and real interest rate). θ, ϑ and φ are parameters to be estimated.

The third task of this study is to explore the effect of corruption on productivity growth. Equation (3) below show the estimating equation.

$$pgdp_{it} = \theta pgdp_{i,t-1} + \vartheta End_{it} + \varphi Exo_{it} + V_i + \epsilon_{it} \qquad (3)$$

Equation (3) show that productivity growth of country i at period t is expressed as a function of productivity growth lagged period t-1, vector of endogenous variables (such as corruption and trade openness) and vector of exogenous variables(such as law and order, real exchange rate and real interest rate). θ, ϑ and φ are parameters to be estimated.

The inclusion of trade openness in equation (3) is justified on the ground that countries that are more open to foreign markets tends to have better productivity outcomes and improved technological innovation. This view

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found empirical support from the works of Baily and Gersbach (1995), Tybout (2000) and Miller and Upadhyay (2000). Stable macroeconomic environment with appropriate culture of law and order would facilitate good innovation system and diffusion of ideas which would promote investment and productivity. It is on the basis of this that we have included variable capturing law and order into the investment and productivity growth equation to ascertain their degree of influence. Real exchange rate and real interest rates are financial variables which directly and indirectly affects investment and productivity through variations in their competitive rates. Real exchange rate and real interest rates are indicators of financial stability. The models would be estimated using the panel data ordinary least squares (PDOLS) regression technique.

4.0 PRESENTATION AND DISCUSSION OF EMPIRICAL RESULTS

Appendix Table 1 presents OLS panel estimated results from the three (3) models. Column 2 of table 1 showed the direct effect of corruption on economic growth. In all the selected African countries used in the estimation, lagged one period real GDP per capita income influenced the contemporaneous real GDP per capita income positively. Apart from lagged one period real GDP per capita income, other variables included in the estimation are corruption, investment, trade openness and productivity growth. The results revealed that estimated coefficients of investment (totinv), trade openness (opens) and productivity growth (pgdp) are all positive while the coefficient of corruption (corrupt) showed negative sign. It therefore implies that corruption affected sustainable development negatively in the selected African countries. The coefficients of investment and trade openness are statistically significant. This result corroborated the findings from plethora of studies which affirmed that corruption sand the wheel of growth and development, and that consistent and persistent increase in investment, trade openness and productivity lubricates the engine of growth (see Mo,2001; Gyimah-Brempong,2002; Tanzi,2002 and Baliamoune-Lutz & Ndikumana,2007).

In column 3, estimated regression results of model 2 is presented. Across the ten(10) selected African countries used in the estimation, lagged one period investment influenced contemporaneous investment positively. The results showed that estimated coefficients of real GDP per capita income (pcrgdp) and trade openness (opens) has positive effects on investment. However, the coefficient of corruption has negative effect on investment. This result suggests that corruption retards qualitative investment required in the process of growth and development. Real exchange rate (rexr) and real interest rates (rir) are financial variables that has significant implications on macroeconomic stability. Real exchange rate and real interest rate has positive effect on investment while law and

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order (lawor) influenced investment negatively. It should be noted that the increase in real GDP per capita income experienced in African countries has not translated into productive investment due to corruption.

In column 4, lagged one period productivity growth in all selected African countries influenced positively the contemporaneous productivity growth. The coefficients of corruption, law and order and real exchange rate affected productivity growth negatively. As earlier noted, corruption reduces productivity efficiency, decimate the marginal productivity of factor inputs and also neutralized their knowledge components. The negative sign on the corruption estimate suggested a drop in the efficiency level of production efforts. Law and order is expected to affect productivity growth positively. If law and order is used as a measure of productivity growth, a country that is subjected to weak law and order would face more uncertainty in productivity outcomes and in the long run affects productivity growth negatively. The justification for the negative influence of law and order on productivity growth could be adduced to inappropriate law and order administered on growth fundamentals. The negative coefficient of real exchange rate gives signal of volatility in exchange rate system. Some strands of studies have also linked productivity to exchange rate volatilities. Dollar (1992) used PPP based real exchange rate estimates to show that overvaluation of the exchange rate harms productivity. Razin and Collins (1997), Aguirre and Calderon (2006) find that large over and undervaluation of the exchange rate hurt growth. Rapid growths in productivity are often correlated with real exchange rate depreciation.

A number of trade theories on economic growth have provided intellectual support for the proposition that trade openness affected economic growth positively. Countries that are more open to the rest of the world have a greater ability to absorb technological advances generated in leading nations (see Grossman and Hepman, 1991; Edwards, 1993; Rodrik, 1995; Barro and Sala-I-Martin,1995). The coefficient of real interest rate influenced productivity growth positively.

5.0 CONCLUSION

This paper have analyzed the impact of corruption on sustainable development in Ten(10) selected African countries using investment and productivity growth channels. Panel data was explored and the analysis was done using panel ordinary least square regression technique. The paper confirmed that investment and productivity growth constitute credible channels through which corruption impacts on sustainable development. Findings from the study further showed that corruption retards productive investment and diverts productivity efficiency to rent-

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seeking activities. Furthermore, the study confirmed that increase in real GDP per capita income in Africa does not promote investment growth. Trade openness have not yielded optimal production efficiency in Africa.

APPENDIX

Table 1: Estimated OLS Panel Regression Results

Regressors	Model 1	Model 2		Model 3	
Pcrgdp (lagged)	0.9830** (97.8527)	Totinv (lagged) 0.8351** (26.1501)		Pgdp(lagged) 0.9114** (40.1839)	
Endogenous Variables Corrupt	-0.0039 (-1.0977)	**Endogenous Variables** Pcrgdp	0.2378 (0.2931)	**Endogenous Variables** Corrupt	-0.0038 (-0.1667)
Totinv	0.0015** (3.8639)	Corrupt	-0.0852 (-0.3158)	Opens	0.0134 (0.0980)
Opens	0.0989** (4.2012)	Opens	7.1642** (3.4274)		
Pgdp	0.0054 (1.4147)				
		Exogenous Variables Lawor	-0.0072 (-0.3560)	**Exogenous Variables** Lawor	-1.53E-05 (-0.0010)
		Rexr	(0.0065 (0.0045)	Rexr	-0.0528 (-0.4942)
		Rir 0.0508**		Rir	0.0004 (0.3751)

		(3.4968)	
Constant	-0.1086	-9.8420	0.3847
	(-2.2843)	(-1.7385)	(0.9215)
No. of Observations	350	350	350
R^2	0.971478	0.8215	0.885807
Adjusted R^{-2}	0.971063	0.8179	0.883809
F-Stat.	2343.356	224.892	443.4458
D.W	1.535961	2.446522	2.051983

Note: 1. T-statistic values in parenthesis; ** denotes significance at 5%

2. The dependent variable for model 1 is log of pcrgdp.

3. The dependent variable for model 2 is totinv.

4. The dependent variable for model 3 is log of pgdp.

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Dreams are not what you see in sleep,

it is the thing that doesn't let you sleep.

- APJ Abdul Kalam