

## Chapter 5

# The Impact of Corruption on Economic Growth: A Comparative Analysis between Europe and MENA Countries

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### ABSTRACT

*Even though corruption is correlated to political and moral degradation, there is no consensus on the impact of corruption on economic growth. Although, theory leans to the view that corruption has negative impact on growth, still empirical evidence and counter arguments show that there might be positive implications for corruption. This paper compares the corruption impact on growth in 17 developed European countries vs. 15 developing MENA countries using a pooled OLS model and a random effects model for the period (1999-2012). This paper contributes to the literature by examining the impact of corruption on growth in scarcely examined countries in Europe and MENA. Also, the paper findings are intriguing because they show that the region, as a proxy to degree of development, significantly influences the effect of corruption on economic growth.*

### INTRODUCTION

In an era of uprisings, people in different parts of the world are taking onto the streets to fight political corruption and to demand for freedom, fairness, and social justice. This is the age when the fight against corruption should be a thundering revolution. Nonetheless, the issue of corruption

has been brought into focus during the last two decades with a silent revolution aimed at combating corruption (Sandgren, 2005). Yet, the outburst of people, along with several corruption indicators, show that the magnitude of corruption is increasing and the fight against corruption now more than ever must be stronger. Corruption is often perceived by economists as the abuse of public office for

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private gain, but corruptive activities are not only limited to bribery, material benefits, or the public sector. Corruption is a complex phenomenon that is almost never explained by a single cause (Tanzi, 1998). This complicates measuring corruption and combating it. Thus, the fight against corruption must be pursued on many fronts and the measures of corruption should be continuously developed. Furthermore, the implications of corruption on the economy should be assessed on a regular basis especially with two opposing views on the effects of corruption on the economy.

Contrary to conventional wisdom that corruption can have detrimental effects on economic growth, the pioneering work by Leff (1964) showed that corruption may have a positive impact on economic development; several empirical research supported this “grease the wheel” view. However, Rose-Ackerman (1996) initiated a change in the perception of corruption and its effect on the economy. This gave rise to a school that opposed the positive impact of corruption on growth or economic development. The theoretical and empirical work that showed the negative effect of corruption on economic growth and development especially in the long-run supported the “sand the wheel” approach. This paradox implies that examining the relationship between corruption and economic growth is not a simple task mainly because several determinants of economic growth are influenced by corruption. The former leads the relationship between corruption and economic growth to be sensitive to the inclusion of determinants of growth to the extent of becoming statistically insignificant after the alteration of the econometric specification by including for example investment or human capital (Mo, 2001; Pellegrini, 2011).

In this study, we revisit the relationship between corruption and economic growth with a focus on assessing the impact of the region of corruption on economic growth. The region of corruption signifies as well the extent of development since we selected 17 European developed countries

versus 15 Arab developing countries. The chapter investigates whether corruption affects growth in Europe and the Middle East and North Africa (MENA) countries, and compares the corruption impact on growth using a pooled OLS model and a random effects model for the period 1999-2012. This chapter contributes to the literature by examining the impact of corruption on growth in developed European countries which were scarcely examined, because corruption was perceived as a problem in these countries that might impede growth only very recently (EC, 2014). Arab countries, where corruption is widely spread and have been realized as a main issue, however, lack empirical studies addressing it due to a lack of will for such scrutiny especially with corruption deeply rooted in the political and institutional settings of these nations (Chene, 2007).

Thus, the chapter aims at uncovering the influence of corruption on economic growth in Europe and the MENA countries. Section Two provides a brief theoretical underpinning and survey of related literature, Section Three describes our data and empirical methodology, Section Four reports the empirical findings and discussion of the results, and finally Section Five concludes the chapter.

## **THEORETICAL BACKGROUND AND LITERATURE REVIEW**

Economic research of corruption is relatively new since the link between corruption and the economy received rigorous attention after Rose-Ackerman’s (1996) article, *The Political Economy of Corruption: Causes and Consequences* (Danon, 2011). Nonetheless, research in the relationship between economic development and corruption was pioneered by Leff (1964) who first highlighted that corruption can amend a rigid administration; nonetheless, it was North (1990) who initiated the change in the perception of corruption, claiming an efficient judicial system that combats corruption

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