

## Chapter 35

# Corruption and Public Sector Borrowing in EU Transition Economies: A Panel Causality Analysis

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### ABSTRACT

*Corruption can be expressed as the abuse of public power for specific purposes and goals. The corruption in the public sector occurs as a result of state employees acting upon the private interests rather than public interest. The public borrowing policy is important for ensuring and maintaining the economic stability in a country. The high level of public borrowing is one of the important factors leading macroeconomic instability. Many institutional, economic, social, and political factors have been revealed as the determinants of public sector borrowing level. In this study, the causality relationship between corruption and public debt in 11 EU transition economies for the period of 2002-2017 was analyzed through causality tests of Kónya and Dumitrescu and Hurlin. Kónya panel bootstrap causality test revealed a one-way causality from public debt borrowing to corruption Croatia, Czechia, Hungary, Romania, and Slovenia and a one-way causality from corruption to public debt borrowing in Bulgaria, Estonia, Lithuania, Poland, Slovakia, and Slovenia. The Dumitrescu and Hurlin causality test discovered a bidirectional causality relationship between public debt borrowing and corruption.*

### INTRODUCTION

The corruption can be briefly defined as the abuse of public power for specific purposes and goals (Tanzi & Davoodi, 1997; Gray & Kaufman, 1998). The corruption can be existed for both public sector and private sector. But corruption can be more seen in the public sector. In this context, Klitgaard (1988) see the managers, who play an active role in the decision-making processes in resource allocation, abuse their duties and powers, and also take positions solely for their own interests, away from accountability,

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in the public sector as the source of corruption. The corruption does not only consist of taking bribes or transferring money to embezzlement, but also includes different actions such as fraud and bribery (Klitgaard, 1988). Furthermore, a negative relationship between corruption and transparency may have existed (Gray and Kaufman, 1998). The corruption level in a country emerges depending on discretionary power, accountability and monopoly power (Klitgaard, 1988). The corruption, is one of the institutional determinants of public borrowing, is one of the important structural problems in institutional, economic, and political structure.

Corruption is a complicated phenomenon with economic, social, and political dimensions and exists in varying degrees. Stiglitz (2002) asserts that corruption occurs as a result of governments acting according to private interests rather than public interest. Tanzi (1998) defined the corruption as the use of public power for personal gains, bribery and favoritism, receiving gifts and embezzlement, and damaging public property. In the relevant empirical literature, corruption is measured by various indexes. World Bank's control of corruption index and Transparency International's corruption perceptions index (CPI) are the ones widely used. The Transparency International's Corruption Perceptions Index reflects the degree of perceived corruption among public officials and politicians and is based on poll of polls, corruption-related data from expert and business surveys by various independent and reputable institutions (Rohwer, 2009). World Bank's control of corruption index includes the perception about how public power is used for private gain and based on data provided from various institutions (Rohwer, 2009). The aforementioned corruption indexes provide an idea to determine and compare the corruption level among the countries.

The rapid increases in the public sector borrowing requirement of the countries causes the public sector financing problem to reach increasingly serious dimensions at the present time. The share of the public sector in the economy raised gradually as a result of Keynesian approach in the period after the Second World War. The public sector deficits began to raise due to the insufficient increases in public revenues against the rapid expansions in public expenditures during this period. The stagflation phenomenon as a result of oil crises in 1970's weakened the confidence in Keynesian economic view. The decreases in production and employment, along with the stagflation phenomenon, have led the public sector borrowing requirement and in turn public sector deficits especially in developing countries. The public deficits stayed an important structural problem especially for the developing countries, although many fiscal measures were taken to combat with the public deficits in the period of accelerating globalization and liberalization during 1980s. Nowadays, public sector debt burden differs in terms of country and country groups, but it may negatively affect macroeconomic variables. A balanced and sustainable implementation of public borrowing policy, one of the fiscal policy instruments, is very important in ensuring and maintaining economic stability in a country (Bayar & Sasmaz, 2019).

In the relevant empirical literature, some researchers have revealed that the countries with high corruption levels generally have high public sector deficits and public sector debt burden (Grechyna, 2012; Cooray and Schneider, 2013; Benfratello et al., 2015; Henri, 2018). It may be resulted from that the raising corruption in public sector can pose an obstacle for efficiently sustainability of public expenditures. The inefficient increases in public expenditures stem from the expenditures not going to unproductive investments. This type of expenditures may negatively affect the public revenues through causing the erosion in tax revenues (e.g. see Hillman, 2004; Kaufmann, 2010; Faure, 2011). Faure (2011) suggested that irresponsible managers use the public sources irrationally to realize their own interests through abusing their duties and powers and in turn considerable increases in public sector expenditures are realized.

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