

One man, one bribe?

The effect of democracy on corruption



Photo: Ingvid Hestad

Quantitative studies show that democracy reduces corruption. This implies that building a well-functioning democracy should remain part of an anti-corruption approach. This policy brief takes a critical look at the evidence and explores the issue in relation to Bangladesh.

DEMOCRACY AND CORRUPTION IN BANGLADESH

Corruption is a huge challenge in Bangladesh. The country ranks 144th out of 176 countries in the Transparency International Corruption Perceptions Index for 2012. This is below India and Pakistan, and on a par with countries such as Syria and the Central African Republic. Corruption has been consistently high in Bangladesh in recent history. In Figure 1, the green line captures the score of Bangladesh on the World Bank Control of Corruption Index (rescaled from 0 to 10, where higher values represent more corruption) in the period 1996-2009. Not much variation can be seen in this period.

The level of democracy in Bangladesh has shown some variation in the same period, however. The suspension of democracy under the caretaker government in 2007 and 2008 is visible in the country's score on democracy indices. The blue line in Figure 1 represents the score on the Polity IV democracy index (which runs from 0

to 10 where higher values represent greater democracy) in the period 1996-2009. We see a clear dip in 2007-2008. The suspension of democracy in this period does not appear to have had much of an effect on the level of corruption, however. If anything, corruption appears to have gone down a little following the rule of the caretaker government.

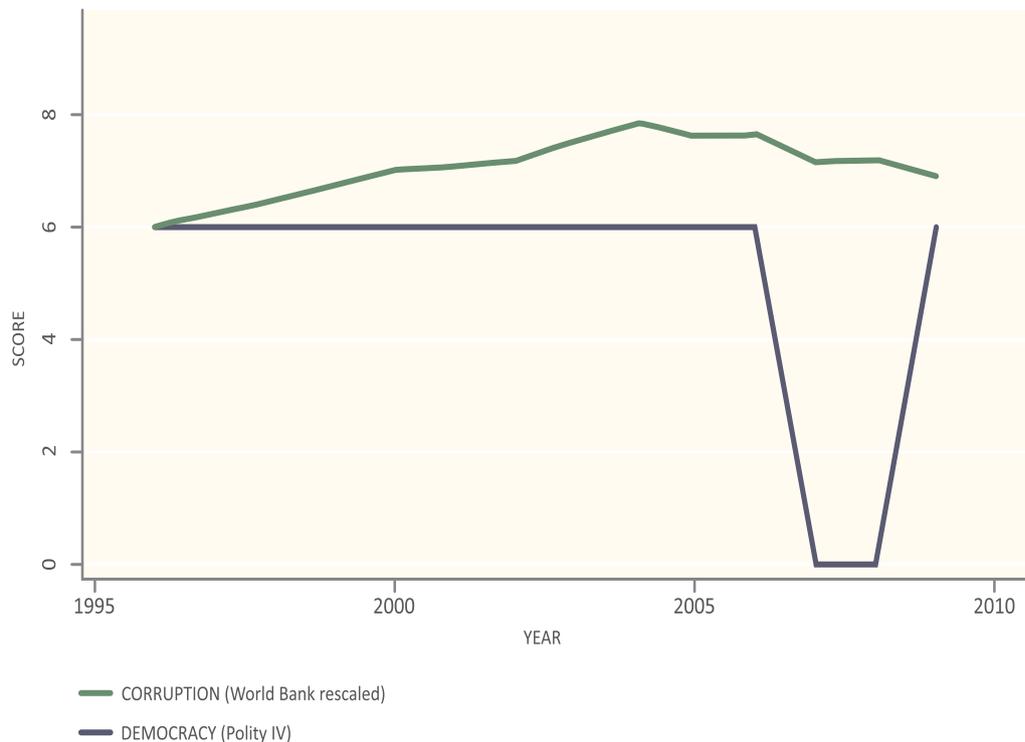
Does this mean that democracy is irrelevant for reducing corruption? Intuitively, one would expect democracy to reduce corruption as corrupt governments are more likely to be voted out of office. There may also be opposite effects, however, the need to finance political campaigns may induce politicians to trade political decisions for funding. The net effect of democracy is in the end an empirical question, but the data from Bangladesh does not really allow us to test this effect. To do so, we would have to control for other factors that could explain changes in corruption over the period, but the time series in Figure 1 contains too few observations to do so.

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FIGURE 1. DEMOCRACY AND CORRUPTION IN BANGLADESH 1996-2009



DEMOCRACY AND CORRUPTION IN THE WORLD

An alternative then is to look at data for a larger set of countries. In Figure 2 we have graphed the scores on corruption and democracy for 154 countries in 2009. Each dot represents a country, and we have highlighted a few countries by adding their name. Bangladesh is below the median country in terms of democracy, and above the median in corruption (the median is the middle value when countries are sorted by democracy or corruption, respectively). There is the suggestion of a downward sloping relationship in this figure, or possibly an inverted u-shaped relationship with a downward slope around the level of democracy Bangladesh is at. There are, however, also countries which do not conform to a downward sloping pattern; Singapore has little democracy and corruption, Mongolia extensive democracy and corruption.

number of studies have tried to estimate the relationship between democracy and corruption, controlling for other characteristics of countries that are related to these two variables. These cross-country studies present very mixed results, but generally struggle to find a robust relationship between democracy and corruption. Some studies suggest that corruption is affected by how long a country has been democratic, rather than by democracy itself.

The problem all these cross-country studies face is that, after controlling for a number of other variables, there can still be unobserved variables not controlled for that drive any relationship between democracy and corruption. To rule this out, some sort of exogenous variation in democracy is needed. One way to accomplish this is to use an instrument variable. This is essentially



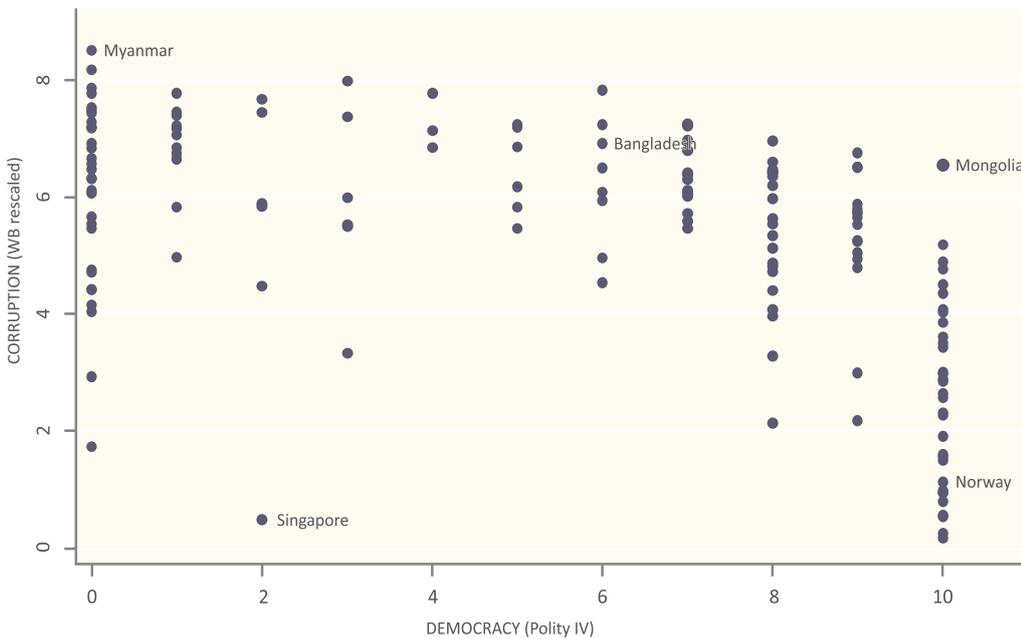
Cross-country studies generally struggle to find a robust relationship between democracy and corruption.

The simple plot in Figure 2 of course does not prove that democracy reduces corruption, either. There could be a number of other underlying variables that explain why democratic countries tend to have less corruption. One reason is that these countries typically are richer, but there are a number of such potential confounding variables. A

variable that affects democracy, but not corruption. This is the approach we have taken in a recent article written under the CPD-CMI institutional research collaboration agreement in Bangladesh (Kolstad and Wiig, 2011).

The instrument builds on the liberal peace thesis, according to which democratic

FIGURE 2. DEMOCRACY AND CORRUPTION IN THE WORLD 2009



countries are unlikely to go to war against other democratic countries. Past history of conflict with democracies can then be used to predict the level of democracy in different countries today. We use this variation in democracy to estimate its impact on corruption. This approach will identify the causal effect of democracy provided the instrument does not affect corruption through any other channel. And having a past history of war with democracies is unlikely to affect corruption today, once the general propensity of countries to be at war is controlled for.

The results from this article show that democracy has a significantly negative effect on corruption. In other words, democracy is more important in combatting corruption than previous studies would suggest. This result is relevant to Bangladesh, as developing countries with democracy levels around that of Bangladesh are those for whom the instrument creates the most variation in predicted democracy levels.

Though our study attempts to address an important methodological problem that other cross-country studies do not, one should of course be careful in basing policy on the conclusions of a single study. There are, however, other studies that reach similar conclusions using data on regional variation in democracy and corruption within a country.

DEMOCRACY AND CORRUPTION WITHIN COUNTRIES

Studies using regional data from a single country look at the effects of local democracy

on local levels of corruption. These studies are still relevant to debates about the effect of democracy at the national level since many of the mechanisms will be the same. The advantage of using within-country cross-sectional data is that the wider institutional setting will be the same for all regions compared. A similar challenge nevertheless arises as in cross-country studies; differences in democracy and corruption in regions within a country may be attributable to other unobserved differences between the regions. Due to a lack of regional data, this type of study cannot be performed in Bangladesh. Studies from other regions that attempt to address the challenge of unobserved differences between regions are nevertheless informative.

A study by Ferraz and Finan (2011) presents evidence from Brazil on the effect of elections at the municipal level on local corruption. They compare corruption levels in municipalities where mayors serve a first and a second term. Since there is a two-term limit, only the first-term mayors face the problem of being voted out of office due to bad performance. Comparing first and second term mayors therefore provide a good estimate of how reelection incentives affect corruption. To avoid results being driven by other differences between municipalities with first and second term mayors, only districts where mayors were elected with a narrow margin were compared. This comparison of districts which could have tipped either way is as close as you get to a random assignment of first and second term mayors. The authors also control for variables

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such as political ability and experience to avoid results reflecting personal differences between first and second term mayors.

The study finds that facing an election significantly reduces corruption, mayors who face reelection incentives misappropriate 27 per cent fewer resources than mayors who are in their last term of office. In other words, democratic accountability reduces corruption, consistent with our cross-country results.

REMAINING ISSUES

Democracy reduces corruption. At least this is what a methodologically informed review of existing quantitative studies in this area would suggest. This implies that building a well-functioning democracy should remain part of an anti-corruption approach.

This does not mean there are no issues left unresolved in analyzing the effect of democracy

on corruption. An important issue is whether certain types of democracy perform better in reducing corruption than others. For instance, is a majoritarian system where the winner takes all more or less conducive to corruption than proportional representation? Does a parliamentary system lead to more or less corruption than a presidential one? In analyzing these questions, the methodological problems discussed above come back with a vengeance. It is hard enough to find a credible source of exogenous variation in levels of democracy, let alone in the types of democracy we observe in different countries. This is nevertheless a question we need to address if we want to know whether differences in corruption are due to differences in democratic systems.

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FURTHER READING

Kolstad, I. and Wiig, A. (2011), Does democracy reduce corruption?, CMI Working Paper WP 2011:4, Bergen: Chr. Michelsen Institute

Ferraz, C. and Finan, F. (2011), "Electoral Accountability and Corruption: Evidence from the Audits of Local Governments", *American Economic Review*, 101, 1274-1311