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CAUSES OF CORRUPTION: AN EMPIRICAL INVESTIGATION IN A CROSS-COUNTRY FRAMEWORK

A thesis presented in fulfilment of the requirements for the degree of Doctor of Philosophy In Economics

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ABSTRACT

In recent years corruption has come to be considered as a pervasive phenomenon, and a major obstacle in the process of economic development. However, there exist few studies that discuss the factors that cause corruption and why some countries are more corrupt than others. This research contributes to that rather scanty literature and focuses on the causes of corruption. More importantly, the study empirically investigates various causes of corruption, in particular the role of economic development, democracy and economic freedom in explaining the observed variations in corruption across countries, and the nexus between democracy and economic freedom in combating corruption.

The study first tests the reliability of the recent quantitative innovations in the study of corruption in terms of the Corruption Perception Index, constructed by Transparency International. Using theoretical and empirical analysis, various hypotheses regarding corruption and its determinants are examined using panel data for 100 countries during the period 1995 to 2004. The empirical findings show that the subjective indexing process of corruption perception eventually converges to a common consensus. In evaluating the relationship between economic development and corruption, the results suggest that income per capita, education, unemployment, income inequality, economic freedom and democracy are among the factors which determine and help explain the cross-country differences in corruption. Furthermore, the assessment of the relationship between democracy and corruption shows that an ‘electoral democracy’, represented by ‘political rights’, is not in itself sufficient to reduce corruption. Instead, for low levels of corruption to exist, the presence of an advanced fully-formed mature democracy is required.

A characteristic of a mature democracy is the existence of an environment where the probability of being caught, if acting corruptly, is very high. In addition, the examination of the interaction between economic freedom and democracy suggests that economic freedom reduces corruption in any political environment, and the effect
is substantially larger with a high level of democracy. The interesting and important findings of the analysis indicate that there exists a non-linear relationship between corruption and the level of income as well as democracy. The findings suggest that developed countries have succeeded in controlling corruption through higher levels of economic development along with the economic and political freedoms that their peoples enjoy.
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<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>2SLS</td>
<td>Two Stage Least Squares</td>
</tr>
<tr>
<td>CCI</td>
<td>Control of Corruption Index</td>
</tr>
<tr>
<td>CPI</td>
<td>Corruption Perception Index</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FE</td>
<td>Fixed Effect</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>HICs</td>
<td>High-Income Countries</td>
</tr>
<tr>
<td>IV</td>
<td>Instrumental Variable</td>
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<tr>
<td>LICs</td>
<td>Low-Income Countries</td>
</tr>
<tr>
<td>MCLEAN</td>
<td>Mostly-Clean Countries</td>
</tr>
<tr>
<td>MCOR</td>
<td>Most-Corrupt Countries</td>
</tr>
<tr>
<td>MEDCOR</td>
<td>Medium-Corrupt Countries</td>
</tr>
<tr>
<td>MICs</td>
<td>Middle-Income Countries</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Economic Development</td>
</tr>
<tr>
<td>OLS</td>
<td>Ordinary Least Squares</td>
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<tr>
<td>PFERD</td>
<td>Period Fixed Effect with Regional Dummies</td>
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<td>PLS</td>
<td>Panel Least Squares</td>
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<tr>
<td>RE</td>
<td>Random Effect</td>
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<tr>
<td>TI</td>
<td>Transparency International</td>
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