Chapter 8
Corruption, Size of Government, and Economic Growth: Evidence from Global Data

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ABSTRACT
A big size government fosters corruption, which can lead to inefficiencies and resource costs that impede economic progress. In this chapter, it is argued that much of the previous studies have focused only on detecting the linear effects of corruption on growth. This study, therefore adopts the Threshold Autoregression (TAR) approach by using an annual panel data of 100 countries during 1990-2012 to evaluate any existence of a non-linear relationship. This study presents evidence that suggests the existence of a hump shaped (nonlinear) relationship between corruption and long-run economic growth. When the government size is small (11.518%), corruption positively affects economic growth. Whereas, when the government final consumption expenditure (% of GDP) is larger than 19.027%, corruption negatively affects economic growth. Furthermore, the result indicates that a non-linear relationship of the ‘Armey curve’ exists in our panel of countries. Thus, a government should investigate whether government size is over-expanding or not when designing its public finance policy.

INTRODUCTION
The growing concerns that high levels of corruption might reflect detrimental effects on economies have motivated a large amount of academic and policy-oriented research. Corruption happens and it happens across the countries. A lingering debate that still provides a powerful research motivation is whether corruption greases or sands the wheels of economic growth (Bardhan 1997; Pande 2008; Aidt 2009). Recent research has moved beyond simply analysing the direct effects and has tried to evaluate how corruption affects the relationship between size of government and economic growth. Government’s role in the economy is extremely crucial, as it is reflecting the responsibility in
policy making aimed at achieving economic stability and growth. Precisely, the presence of a government is essential to provide policy guidance and enforce regulation in ensuring the well-functioning of the entire economic system. Good governance will strengthen the whole system of an economy, and in turn supports a country’s sustainable economic growth. This point is consistent with Blackburn, Bose, and Emranul (2006: 2448) who claim that, “good quality governance is essential for sustained economic development”. Nevertheless, it is a fact that the role of government which is vital to an economy can be jeopardized by the arising problems of corruptions, as well as the size of a government which is considered too large. These obstacles appear to be serious policy concerns and challenges in both developed and developing countries, especially in countries that exhibit large government expenditures incompatible to the economic growth, and also in nations that their economies are harmed by the critical state of corruptions involving a large number of civil servants.

In its simplest form, public sector corruption is a concept uniquely signifies the abuse of public power for private benefit (Tanzi, 1998). This concept is broadly defined as the abuse of authority by bureaucratic officials who exploit their powers of discretion delegated to them by the government, to further their own interests by engaging in illegal or unauthorized rent-seeking activities (Blackburn, Bose & Emranul, 2006). Public sector corruption refers to any unlawful arrangements or practices which feature the manipulation of public authorization power motivated by illicit incentives to both public and private agents. Some common forms of public sector corruption are such as bribery, patronage, trading in influence, kickbacks, coalition for hidden gain, electoral fraud, and others. Public sector corruption is detrimental to a nation’s governance quality, as the involvement of civil servants in corrupt practice directly leads to bureaucratic malpractice in various aspects, including the official duties of high-level policy making, regulation enforcement, immigration affairs, the provision of public goods, tax collection, government expenditure, the granting of new infrastructure projects, as well as licensing. Obviously, public sector corruption put a nation and its economy to risk.

What are the causes of public sector corruption? Perhaps the causes are due to various factors. Public sector corruption occurs because of the motivation of the parties involved in obtaining illicit incentives. Blackburn, Bose and Emranul, (2006) mention that corruption appears from the incentives of both private and public agents in conspiring to conceal information from the government. There are other specific dimensions of the causes of public sector corruption. Tanzi (1998) suggests two main groups of factors. First, the factors that affect the demand by public, including regulations and authorizations, particular characteristic of the tax systems, particular spending decisions, and the provision of public goods below their market prices. Second, the factors that influence the supply by government officials, which include bureaucratic tradition, wage levels in the public sector, the penalty systems, institutional controls, transparency of laws and procedures, and also the examples reflected from leadership. Furthermore, economists reveal that institutional features can stimulate public sector corruption. A country which has good quality of democratic political institutions will allow its citizens to elect a right party, which is able to deter corruption and bring sustainable growth to the country’s economy (Aidt, Dutta & Sena, 2008). As this point is concerned, press freedom is addressed as a complement to democratic election in the effect on corruption determent (Kalenborn & Lessmann, 2013). Moreover, Goel and Nelson (2010) have postulated the factors of history, geography, and government in relation with public sector corruption. Historical influence is based on the view that history is essential in shaping the culture norms, which in turn determines the undertaking of corruption. The consideration of geography factor reflects
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