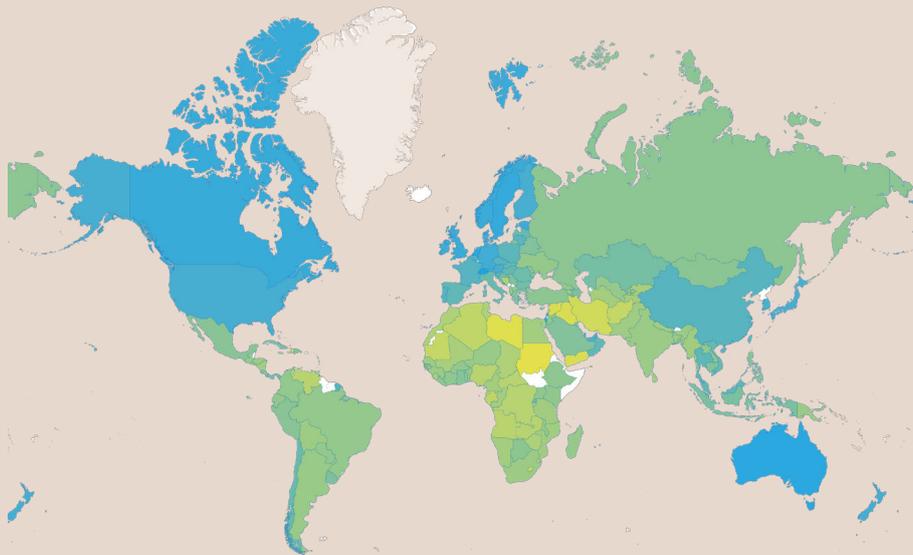


This PDF includes a contribution from the following book:

ELITE QUALITY REPORT 2022

Corruption: Is it always bad? A thought experiment and empirical evidence

Alexander Tonn, Doctoral Researcher Institute of Economics (FGN-HSG),
University of St.Gallen, Switzerland



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Corruption: Is it always bad? A thought experiment and empirical evidence

In the EQx2021, we highlighted the importance of acknowledging the difference between perception-based (subjective/ex-ante) and experience-based (actual/ex-post) measures of corruption. As was argued, the difference is important for correctly interpreting corruption for policymaking, research, and the self-reflection of elites.

The EQx applies a rather straightforward rationale to its V-DEM based Indicator *Political corruption* (COR, i.1): the less corruption, the better. In other words, corruption, a most blatant and direct form of theft and rent seeking, is always bad. But is this really always the case?

The EQx measures a state's overall propensity for value creation versus value extraction. Even though corruption represents value extraction par excellence, isn't it possible to imagine a case in which corruption actually boosts value creation as captured in other parts of the EQx, and thus lifts a country's overall EQx ranking?

Imagine the case of a young and curious group of entrepreneurs with a fantastic business idea. In country A, it takes several months to get the necessary permits and bribing the officials is impossible. In country B, it usually takes several months as well, but here a bribe can smooth and speed the process. The bribe therefore helps to boost an emerging business model that could ultimately offset the negative aspects of the corruption involved. While country A still has no operating business (due to the time it takes to get the permit), the business in country B is already creating value and thus lifts the country's EQx level *ceteris paribus*.

However, although the above example hypothetically suggests that a bribe could lift a country's overall degree of value creation, other after or parallel effects are not taken into consideration. What if the officials in country B get greedy and develop and scale their corrupt business models to start extracting from the entrepreneurs at regular intervals, not just at the time the license is granted? Also, the example above only holds true at $t=0$, with no competing firms; at $t=1$, where there is competition for licenses distributed through corruption the investment costs substantially increase. So, while the firm in country A needs to wait a little longer for their permit, they ultimately receive a license to operate that is 'waterproof', allowing them to focus all of their energies on increasing the overall value of their project.

Hence, while corruption might not necessarily always be bad, and especially in the short-run expedite business formation and create value for society, the chances that it outweighs the associated negative costs are unrealistic in the mid- to long-run. In the real world, corruption is a sticky phenomenon—once established, it is difficult to get rid of. Even more importantly, economic agents become accustomed to it and refrain from attempting to create long-term value. Thus, measures of corruption, while not universal, still approximate and give a good indication of value extraction. In the context of the EQx, the assumption that corruption is always bad is appropriate. Since the EQx is a holistic measure of a country's degree of value creation versus value extraction—on aggregate—the positive side-effects of an 'extractive' Indicator will ultimately come to life elsewhere in the index. This structure is one of the strengths of the EQx.

In terms of corruption, the EQx2022 unsurprisingly features decentralized democracies at the top of the rankings, with Denmark, Sweden, and New Zealand occupying three of the leading four positions (COR, i.1, rank # 1, # 3 and # 4 respectively).

The lower end of the spectrum is occupied by countries that have historically also been laggards in terms of general value creation. Chad, Azerbaijan and Venezuela rank the lowest for *Political corruption* (COR, i.1, rank # 151, # 150 and # 149 respectively). In general, we can see a clear pattern that lower levels of *Political corruption* (i.e., a high score for COR in Visual 4.1) are associated with higher levels of Elite Quality (the term 'purged' indicates that we have excluded the underlying COR Indicator to have unbiased overall EQx scores). That is, corruption stymies the value creation potential of elites, empirically supporting the idea that corruption is bad.

While the above example is rather simplistic in terms of how it is constructed, and the implications are probably rather obvious, we shouldn't neglect the basic truth that underlies it.

Alexander Tonn, Doctoral Researcher
Institute of Economics (FGN-HSG),
University of St.Gallen, Switzerland

Visual 4.1: EQx Scores correlation with *Political corruption* (COR, i.1)

Note: Orange dashed line indicates a fitted regression line. Adjusted R-squared: 0.519.
Random selection of country codes are printed in case of country overlaps.

