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Corruption and Economic Performance

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The former president of the World Bank, Paul Wolfowitz, was criticized for, among other things, making corruption his signature issue. Resistance within the bank to this emphasis was one of the reasons he was forced out. [1]

Did he have a point? Clearly, a construct can be developed in which corruption is beneficial. Some economies are so highly taxed and so controlled that an underground economy, which is by definition corrupt, can make the difference between a sustenance existence and abject poverty.

However, the case of greater interest that applying to the vast majority of economies, those that are not dominated by underground economies, yet display a degree of corruption. Does such corruption hamper or, as in the case of the underground economy, support economic growth.

Identifying Corruption

We have undertaken to address this issue by the direct route: measuring the degree of corruption in a variety of economies and then measuring over time the performance of these economies.

In order to measure the degree of corruption, it is necessary to define it. Fortunately, this job has already been accomplished. In 1998 and 1999, a rather disparate collection of financial authorities[2] came together and established the Financial Stability Forum. As part of their task, the FSF issues a Compendium of Standards. These standards address 12 “standard areas.”

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[1] It is reported that the new World Bank chief, Robert Zoelick, will continue this emphasis. *The International Herald Tribune*, June 25, 2007. (http://www.iht.com/articles/2007/06/25/business/wbank.php)

[2] The FSF characterizes its members as “senior representatives of national financial authorities (e.g. central banks, supervisory authorities and treasury departments), international financial institutions, international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank” http://www.fsforum.org/about/who_we_are.html.

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The Financial Standards Forum does not define a unifying theme about the standards, merely characterizing them as "minimum requirements for good practice." However, there is such a theme. All of the standards address issues of corruption, either stamping it out directly (e.g., "9 Special Recommendations against Terrorist Financing"), minimizing it through government supervision (e.g., "Objectives and Principles of Securities Regulation"), or developing data to reveal its existence (e.g., "International Standards on Auditing")

The key to this analysis is to appreciate that a country that fully implemented all standards would have minimal corruption because it would identify it when it occurred and, once recognized, would be committed to eliminating it. Conversely, a country that failed to implement the standards would not identify corruption and would have no commitment to eliminating it.

Measuring Corruption

Being able to recognize corruption is a start, of course. However, for analytical purposes, it is equally necessary to measure the degree of corruption in each country and to quantitatively express this measurement. Fortunately, this has already been done by eStandards Forum. Beginning in 2003, this organization used a precise process to assign numeric ratings to the 83 countries. (See Appendix 2 for a sample of ratings.)

The evaluation process was designed by the consulting firm, Oxford Analytica. The objective is to make the conversion from the qualitative standards expressed by the Financial Standards Forum to the single-number quantitative as precise as practical. Human judgments would be minimized so that independent evaluators using the same process would arrive at the same numeric rating.

Secondly, the process was designed to use publically available data. The use of such data helps ensure that the process is transparent. Also, public data is inherently more reliable than private data, as "the