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Are new states more corrupt? Expert opinions vs. firms' experiences

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Abstract: We find that new states are perceived to be more corrupt even though businesses do not report more bribery in newer states. This is suggestive of an unearned, and likely high, reputational cost to being a new state. These findings hold over a number of specifications that include additional economic, historical, and geographic controls.

Key words: corruption; corruption perceptions; bribery; state age

JEL Classification: D70, D73, D90, D02, F21, F23,

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1. Introduction

Are new states more corrupt? Newly independent states may lack the monitoring and governance mechanisms to control corruption. Furthermore, the transition to independent statehood is often fraught with political and economic instability, which may bring forth opportunities for corruption. Indeed, previous research finds that being a relatively new state has a deleterious impact on the perception of corruption (Goel and Nelson, 2010). On the other hand, many independence and separatist movements have been motivated, in part, by the desire to stamp out corruption. Some may succeed in replacing corrupt regimes with less corrupt ones.

In this article, we analyze the association between corruption and state age across two measures of corruption, one based on expert opinions and the other based firms' experience of bribery. In line with Goel and Nelson (2010), we find that being a relatively new state is associated with corruption perceptions. However, we find that the age of the state is not associated with firms' experience of bribery. These findings hold over a number of specifications which include additional economic, historical, and geographic controls. The fact that perceptions do not match experiences suggests that relatively new states may suffer an unearned reputational cost. It is plausible that experts penalize new states because of their relatively shorter history of governance and accountability. Experts depend on information to make judgements. The informational gap between older and newer states may create more uncertainty among experts, which may translate into more severe evaluations. In addition, experts may sometimes conflate the informational gap with a lack of transparency, again resulting in more severe evaluations.

Our argument is motivated, in part, by recent work which points to the limitations of corruption indicators that are based on experts' perceptions. The possibility of perception biases in commonly used metrics of corruption have been raised by Svensson (2003), Reinikka and

Svensson (2006), Treisman (2007), and Fan, Lin and Treisman (2009). Furthermore, Knack (2007) and Kenny (2009) argue that reality may only feed into perceptions indicators with a lag. Finally, Razafindrakoto and Roubaud (2010) find that surveys of individuals' experiences of corruption are not consistent with experts' evaluations for Sub-Saharan Africa. They conclude that this is due to the ideological and cultural biases in the expert evaluations of corruption.

2. Data and variables

We use two indicators of corruption. The first is the Corruption Perceptions Index, which measures the perceived level of public-sector corruption in 180 countries and territories around the world (Transparency International, 2016). The indicator is based on expert surveys and takes values from 1 to 10. We use data from 2012 to 2016 as previous CPI values were computed using a different methodology. The second corruption indicator comes from the World Bank's Enterprise Surveys and is based on a survey question designed to capture a firm's total annual informal payment or gifts to public officials. Therefore, it captures bribery incidence - the percentage of firms that report having had to pay a bribe across a range on interactions with the state. These data cover 121 countries from 2002 to 2016.

We measure the age of the state using an indicator that records the time period when a country became an independent entity. Previous research has used binary variables which take values of 1 if a country became independent after 1950, and 1 if a country became independent before 1900 (Goel and Nelson, 2010). Our measure of state age improves upon these variables. It follows Gallup, Sachs, and Mellinger (1999), who have developed an indicator which takes a value of 0 if independent before 1914, 1 if between 1914 and 1945, 2 if between 1946 and 1989, and 3 if after 1990. These categories are based on different periods in world politics,

characterized by shifts in the balance of power in the international system. We updated these data for states formed after 1996.

We follow closely the specifications and approach commonly used in studies that seek to explain corruption at the country level; in particular, the models of Dollar, Fisman, and Gatti (2001). To control for the economy we use per capita GDP and to account for broad institutional features we use the level of democracy from the Polity IV dataset. To control for broad historical factors we use dummy variables that capture the legal history of the state, including whether there is a British, French, German, Scandinavian, or socialist legal history. The economic data is from the World Development Indicators and the legal history dummies are from Beck, Demirgüç-Kunt, and Levine (2003). We also include a battery of regional dummies in our analysis to account for other broad cultural, geographic, and historical factors.

3. Corruption and state age: expert opinion vs. outcomes

Table 1 presents our main results. Columns 1-4 present findings related to expert perceptions of corruption. The first column is our base specification, which includes estimates of our measure of state age and our economic and democracy control variables. The second column adds regional dummy variables. The third column adds legal origin dummy variables to our base specification and the fourth column includes all of our economic, institutional, historical, and geographic controls. Columns 5-8 repeat these specifications using bribery as our outcome of interest.

The age of the state is associated with an increase in corruption perceptions across all age categories in the full model in column 4. By contrast, the association between bribery and state age is less convincing. There is an association between these variables in our base specification

in column 5 and our specification with regional dummies in column 6. When one controls for legal origin, however, this association does not hold.

GDP per capita is positive and associated with a lower incidence of corruption across all of our specifications. A socialist history is bad for both perceptions and reality, across all specifications. This is interesting in the context of our study as a socialist legal origin suggests a state of a particular vintage. It is not the age of the state that seems to matter for bribe incidence but the type of state it began as. By contrast, the level of democracy is associated with improved corruption perceptions but not the level of bribery.

The regional dummy for sub-Saharan Africa is statistically significant across all of the specifications where it is included. Surprisingly, the direction of the coefficient suggests that corruption is a smaller problem in this region in comparison to other regions. However, this is only when one controls for GDP per capita. When this GDP per capita is dropped from the specification the direction of the coefficient changes.

4. Conclusion

In line with previous research we find that relatively new states suffer from a reputational cost in terms of corruption perceptions. However, we find that these states do not experience more corruption on the ground. Firms in relatively new states are no more likely to report corruption than those in older states. Substantively, studies have found that perception-based indicators of corruption negatively affect foreign investment (Wei, 2000) but experience-based measures of corruption do not (Gillanders and Parviainen, 2017). Like many secretive activities, corruption is difficult to measure. Our findings and their implications underline the value and importance of using alternative measures of corruption.

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Table 1. Corruption perceptions vs. bribes

VARIABLES	(1) Perceptions	(2) Perceptions	(3) Perceptions	(4) Perceptions	(5) Bribe	(6) Bribe	(7) Bribe	(8) Bribe
Age = 1 (1914-1945)	-3.57*	-7.39***	-4.50***	-7.86***	5.60**	9.43***	3.58	6.00
	(1.858)	(1.938)	(1.575)	(1.682)	(2.590)	(3.310)	(3.717)	(3.660)
Age = 2 (1946-1989)	2.45*	-3.68***	0.93	-3.77***	2.88	11.50***	3.64	8.74*
	(1.410)	(1.230)	(1.352)	(1.270)	(2.797)	(4.403)	(3.238)	(4.649)
Age = 3 (1990-2016)	-5.91***	-5.98***	-1.80	-4.98**	3.81	5.31	-2.29	1.78
	(1.412)	(1.906)	(1.650)	(2.021)	(2.417)	(3.906)	(3.821)	(4.172)
Per capita GDP (log)	9.79***	9.75***	8.74***	9.39***	-6.37***	-8.83***	-6.78***	-7.99***
	(0.380)	(0.523)	(0.386)	(0.541)	(1.181)	(1.246)	(1.248)	(1.397)
Democracy scale	0.64***	0.67***	0.47***	0.54***	-0.32	-0.33	-0.23	-0.20
	(0.075)	(0.085)	(0.082)	(0.091)	(0.210)	(0.212)	(0.229)	(0.238)
Sub-Saharan Africa dummy		5.31**		4.68**		-15.94***		-9.71**
		(2.206)		(2.214)		(4.596)		(4.605)
Transition Economy. dummy		-4.07*		0.24		-0.39		-4.35
		(2.311)		(3.003)		(3.607)		(5.414)
Western Europe dummy		2.83		-0.70		11.38***		9.75**
		(2.189)		(2.159)		(2.796)		(3.786)
Latin America dummy		-12.61***		-10.57***				
		(2.014)		(1.923)				
Asia dummy		1.51		1.09		-5.92		-3.17
		(1.946)		(2.020)		(4.115)		(4.154)
French legal origin			-5.04***	-2.90***			0.21	-0.38
			(1.222)	(1.115)			(3.011)	(3.249)
Socialist legal origin			-5.24***	-4.55**			11.00***	9.77*
			(1.337)	(2.181)			(3.771)	(5.497)
German legal origin			9.14***	6.18***				
			(1.612)	(1.776)				
Scandinavian legal origin			18.83***	16.22***			8.31**	
			(1.895)	(2.311)			(3.800)	
Constant	-42.83***	-38.89***	-29.88***	-33.55***	68.63***	89.97***	69.73***	81.09***
	(3.727)	(5.275)	(3.942)	(5.598)	(10.270)	(10.891)	(11.607)	(13.681)
Observations	563	563	520	520	216	216	189	189
R-squared	0.656	0.729	0.721	0.762	0.267	0.341	0.297	0.324

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