

Impact of Corruption on Economic Growth in Nepal (2004 - 2017)

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Abstract

This study aims to examine the impact of corruption on economic growth in Nepal for the period 2004 - 2017. The result of the regression analysis shows that there is a negative relationship between the dependent variable (GDP) and corruption level in Nepal. This means that as the level of corruption activities increases, economic growth decreases significantly. Based on the findings, the study therefore recommend as follows: The activities of the anticorruption agencies in Nepal such as The Commission for the Investigation of Abuse of Authority (CIAA) should be strengthened; the public should be educated about the problems that corrupt practices create for the economy and the society at large, and be discouraged from participating in corrupt practices. Nepal should put in leadership positions honest individuals who would serve as role models to minimize the negative consequences of corruption with its negative impact on the development and growth of Nepal; corruption is easily growing in Nepal because government involvement in economic decision making is high.

Key Words: Corruption, Economic growth, Privatization, Transparency nepotism.

Introduction

Corruption has been identified as one of the major obstacles militating against rapid growth and development of the Nepalese economy. There is no widespread or comprehensive definition as to what constitutes corrupt behaviour, the most prominent definition share a common emphasis on the abuse of public power or position for personal advantage. A simple dictionary definition of the phenomenon refers to it as 'an impairment of virtue and moral principles.' According to the Transparency International (2017), a leading global anti-corruption watchdog, corruption is the abuse of public office for private gains for the benefit of the holder of the office or some third party. Corruption is the single most critical impediment to achieving the Millennium Development Goals (MDGs); and like a deadly virus, it attacks the vital structures and systems that engender progressive functioning of the society. Like in most developing countries, Nepal is still grappling with the dilemma of corruption that has largely retarded social development, undermined economic growth, discouraged foreign investments and reduced the resources available for infrastructural development, public service, and poverty reduction programmes. Much more disturbing, the scourge of corruption leaves the poor perpetually disproportionately under-privileged, even as it renders the development of democracy and the building of a society of opportunity more problematic.

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Thus, by diverting assets away from their intended use, corruption can be said to be the single most important factor responsible for the failure of governance and lack of sustainable socio-economic development in Nepal. Therefore, the main objective of this paper is to critically examine the effects of corruption on economic growth in Nepal. Specifically, the paper will examine the effectiveness of the various economic reforms aimed at reducing or eradicating corruption in Nepal. This study shall be guided by the following hypothesis: the corrupted a nation is the less developed it becomes.

Review of Literature

Corruption can be defined as 'an arrangement that involves an exchange between two parties (the demander and the supplier) which (i) has an influence on the allocation of resources either immediately or in the future; and (ii) involves the use or abuse of public or collective responsibility for private ends' (Macrae, 1982). Akindele (1995) has analyzed that there is ideologically, morally, culturally, politically and intellectually elusive to the point of losing sight of its detrimental and parasitic influence on people and the society at large. Because, it has no uniform definition, what is regarded as corruption depends on the actors, the profiteers, initiators, how and where it takes place. It also depends on the existing laws and regulations guiding certain actions. Some countries define corruption in the broadest form while others legislated on the narrow definition of the term.

Khan (1996) defines corruption as an act which deviates from the formal rules of conduct governing the actions of someone in a position of public authority because of private - regarding - motive such as wealth, power or status. Osoba (1996) defined as corruption as an anti-social behaviour conferring improper benefits contrary to legal and normal norms and which undermines the authorities' capacity to secure the welfare of all citizens. The World Bank defines corruption as the abuse of public office for private gains. Public office is abused through rent seeking activities for private gain when an official accepts, solicits, or extorts a bribe.

Public office is also abused when private agents actively offer bribes to circumvent public policies and processes for competitive advantage and profit. Public office can also be abused for personal benefit even if no bribery occurs, through patronage and nepotism, the theft of state assets or the diversion of state resources (World Bank, 1997). A public official is corrupt if s/he accepts money for doing something that s/he is under duty to do or that s/he is under duty not to do. Corruption is a betrayal of trust resulting directly or indirectly from the subordination of public goals to those of the individual.

A person who engages in nepotism has committed an act of corruption by putting her/his family interests over those of the larger society. It is argued that corruption is the perversion of integrity or state of affairs through bribery, favour or moral depravity. It takes place when at least two parties have interacted to change the structure or processes of society or the behavior of functionaries in order to produce dishonest, unfaithful or defiled situations. Corruption involves securing wealth or power through illegal means for private gain at public expense; or a misuse of public power for private benefit.

Corruption is not only found in democratic and dictatorial politics, but also in feudal, capitalist and socialist economies. Hindu, Buddhist, Christian and Muslim cultures are equally bedevilled by corruption. It is the cankerworm that has eaten deep into the fabrics of the country and had stunted growth in all sectors. It is defined corruption as the abuse of public trust for private gain. The prevalence of these activities in various aspects of our lives

has a tremendous adverse effect on the quality of life of this country, our living standards and national mind. Corruption brings a nation no good.

The issue of increase in corruption and its impact on economic growth has generated a lot of controversy and debate among academics, economists, bankers, policy makers, researchers and general public in recent times. The effects of corruption on economic growth are still an unresolved issue in both theoretically as well as empirically. This is because the theoretical positions on the corruption are quite diverse and the conventional wisdom is that a large level of corruption in the country is a source of economic instability or stagnation in Nepal. Some empirical studies did not agree with the conventional wisdom. A few studies reported positive and significant relationship between corruption and economic growth.

Some researchers have taken a holistic (broader) approach in the discussion of corruption by dividing into several division and sub-divisions. Taylor (2010) has included as -

Political Corruption: It occurs when politicians and political decision-makers, who are entitled to formulate, establish, and implement the laws on behalf of the people, are themselves corrupt. It also takes place when policy formulation and legislation is tailored to benefit politicians and legislators.

Bureaucratic Corruption: This occurs in the public administration or the implementation end of politics. It is the kind of corruption the citizens encounter daily at places like the hospitals, schools, local licensing offices, police stations, the various government ministries etc.. Bureaucratic corruption occurs when one obtains a business from public sector through inappropriate procedure.

Electoral Corruption: This includes promises of office special favours, coercion, intimidation, and interference with freedom of election, buying of votes, disenfranchisement, snatching of ballot boxes, victimizing and maiming, mutilation of election results in favour of losers and votes turn up in area where votes were not cast.

Bribery: The payment (in money or kind) that is taken or given in a corrupt relationship. These include 'Kickbacks', 'Gratuities', 'Pay off', 'Sweeteners', 'Greasing palms' and 'Scratching of back'.

Fraud: This involves some kind of trickery, swindle and deceit counterfeiting, racketing, smuggling and forgery.

Embezzlement: This is seen as the theft of public resources by public officials. It is when an official of the state steals from the public institution in which he/she is employed. In Nepal the embezzlement of public fund is one of the most common ways of wealth accumulation, perhaps, due to lack of strict regulatory systems.

Extortion: This is money and other resources extracted by the use of coercion, violence, or threats to use force. It is often seen as extraction from below.

Favoritism: This is mechanism of power abuse implying a highly biased of state resources. However, many see this as a natural human proclivity to favour friends, family, and anybody close and trusted.

Nepotism: This is a special sort of favoritism in which a public office holder prefers his/her kinfolk and family members. Nepotism occurs when one is exempted from the application of certain laws or regulations or given undue preference in the allocation of scarce resources (Amundsen, 1997; and Girling, 1997). These types of corrupt practices are

very common and widespread, to the fact that it is now seen as an acceptable norms and culture in the present day society.

Theoretical Framework

This section highlights some basic theories that have been used to support the effects of corruption on economic growth. Such theories amongst others are:

Policy-Oriented Theories of Corruption

The theory said that the role of government in fighting corruption. It states that despite corruption frequent occurrence, government involvement in corruption has undergone surprisingly with its effect of the growth of the economy which needs serious investigation. The theory opines that the high level of corruption in any country whether developed or developing countries will not allow the country's economy to grow and that if the field of administrative corruption is to become more theoretical and less descriptive, it must develop a framework and methodology that will help to measure its effect on economic growth.

Economic Growth Theory

The theory was propounded in reactions to the deficiencies in the Solow-Swan growth theory or model Lucas (1989). This theory as propounded lay more emphasis on the long-run growth rate of an economy and on the basis of endogenous factors rather than exogenous factors of the neoclassical growth theory. The Solow-Swan model explains that the long-run growth rate of output is based on two basic exogenous variables such as population growth rate and level of corruption in the country. The growth theory emphasizes on technical progress resulting from the rate of capital stock, human capital development, reduction in corruption and investment rate.

Policy Implications of the Theory

The theory, believes that economic growth is linked with improvement in productivity and reduction in corruption which ultimately result to a faster pace of innovation and extra investment in human capital. The theory predicted that externalities and spill over on corruption fight from developed countries will help to develop and maintain a competitive advantage in economic growth in Nepal.

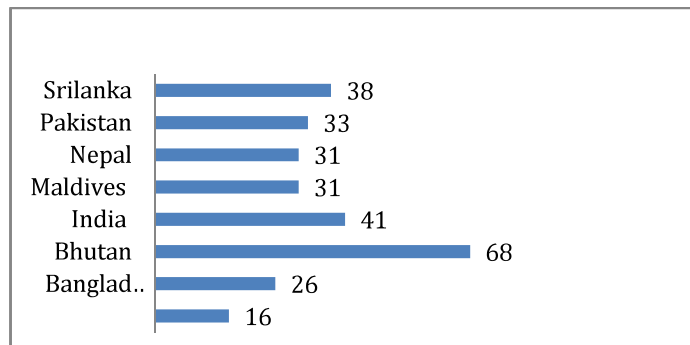
Extent of Corruption in Nepal

Among 180 countries, Nepal climbed two points to 124 in the Transparency International's annual Corruption Perception Index in 2017 from 122 in 2016. However, Nepal's position has stayed the same as there was no headway to reduce corruption this year. The report states that after the elections of 2017, corruption in the public sector, businesses and by government officials continue to plague the country. Previously, Nepal stood in the 122nd position in the CPI. The CPI measures the extent of corruption within a country on a scale ranging from 0 to 100. Countries securing higher score are rated as the least corrupt and those with low score are perceived to be the most corrupt. Transparency International has been publishing the report since 1995. Nepal was incorporated in its country list from 2004 AD.

In the CPI-2017, two third of the countries have scored below 50 with an average score of 43. The inability to control corruption has threatened democracy across the world. Highly corrupt countries are found to be repressive and authoritarian and curtail democratic practices. Likewise, in less corrupt countries, there is rule of law, independent monitoring

agencies, free press, and aware citizenry. Denmark, which received 88 out of 100, is the least corrupt countries in the world while Somalia, which received a score of 10, is the most corrupt country.

Figure-1: Corruption Perception Index of SAARC - 2017



Source: Transparency International, 2017.
In South Asia, Bhutan ranked at 25, India at 78, Srilanka at 89, Pakistan at 117, Maldives at 124, Bangladesh at 149 and Afghanistan at 172.

Causes of Corruption in Nepal

Few researchers have investigated the fundamental factors that have engendered and sustained corrupt practices in Nepal. Ajie and Wokekoro (2012) have included as -

(i) The weak institutions of government; (ii) Political office as the primary means of gaining access to wealth; (iii) Conflict between changing moral codes; (iv) The weakness of social and governmental enforcement mechanism; (v) The absence of a strong sense of national community; (vi) Dysfunctional legal system; (vii) Less effective government works with slow budget procedures; (viii) Lack of transparency; (ix) The great inequality in the distribution of wealth; (x) Low salaries and poor working conditions, with few incentives and rewards for efficient and effective performance; (xi) According to Dike (2003), the influence or pressure of 'Polygamous Household' and extended family system, and pressure to meet family obligations, which are more in less developed countries; (xii) The culture and weird value systems of the society. Becoming corrupt is almost unavoidable, because morality is relaxed in the society, and many people struggle for survival without assistance from the state and (xiii) widespread poverty. The causes of corruption in Nepal cannot move away significantly from the above factors.

Method of Study

This study examines the impact of corruption on the economic growth and development of Nepalese economy. The study employs time series data. In an attempt to estimate the impact of corruption on economic growth in Nepal, the secondary data obtained were divided into dependent and independent variables. The dependent variable is the Nepalese economic development represented by the gross domestic product (GDP in US \$) of Nepal denomination while the independent variables are the corruption perception index (CPI), inflow of foreign direct investment (FDI in US \$), external debt stocks (EDS in US \$), government expenditure (GE in US \$) and unemployment rate (UEMP). This relationship

was estimated using ordinary least square (OLS) technique. The model for this study anchors on earlier studies with slight modification.

Sources of Data

The data used in the study are annual time-series secondary data on the variables covering fourteen years period 2004-2017 obtained from various institutions and publications like the World Bank, Transparency International, NRB annual reports and internet, journals, text books, anti-corruption agencies reports and bulletins etc.

Data Presentation and Analysis

Table-1: Selected Macro Indicators and CPI in Nepal (2004-2017)

Years	GDP (in b \$)	CPI	FDI (in b \$)	EDS (in b \$)	GE (in b\$)	UEMP
2004	7.27	28.00	0.00	3.37	8.20	1.52
2005	8.13	25.00	0.00	3.19	9.34	1.48
2006	9.04	25.00	0.01	3.10	10.66	1.42
2007	10.33	25.00	0.01	3.62	12.27	1.37
2008	12.55	27.00	0.00	3.70	15.12	1.34
2009	12.85	23.00	0.04	3.78	15.71	1.74
2010	16.00	22.00	0.09	3.79	20.30	2.12
2011	18.91	22.00	0.09	3.83	23.46	2.53
2012	18.85	27.00	0.09	3.81	23.28	2.89
2013	19.27	31.00	0.07	4.01	24.43	3.30
2014	20.00	29.00	0.03	3.99	25.85	3.00
2015	21.41	27.00	0.05	4.15	27.80	3.10
2016	21.19	29.00	0.11	4.30	27.50	3.06
2017	24.88	31.00	0.20	4.96	33.29	2.74

Sources: 1. *Transparency International, Corruption Perceptions Index-2017* <https://www.transparency.org>
 2. *World bank, Data Bank, World Development Indicators, 2017*
<https://databank.worldbank.org/data/source/world-development-indicators#>

Model Specification and Statement of Hypothesis

Based on the theoretical and empirical models used in various literatures, the author started with specifying econometric model with GDP as dependent variable and corruption perception index, external debt stocks, and unemployment as the independent variables. However, due to multi-colinearity among independent variables, only corruption perception index, external debt stock and unemployment rates were taken. The final model reported in the paper is:

$$\text{GDP} = f(\text{CPI}, \text{EDS}, \text{UEMP}).$$

Given the variations in the data, the paper further takes the natural log values of the corresponding variables for the estimation purpose. The estimated equation taking natural log on both sides is represented as:

$$\ln \text{GDP}_t = \beta_0 + \beta_1 (\ln \text{CPI}_t) + \beta_2 (\ln \text{EDS}_t) + \beta_3 (\ln \text{UEMP}_t) + \mu$$

This paper aims to test that hypothesis whether corruption has significant impact on the economic growth in Nepal during the study period. The coefficient of interest here is β_1 with the priori alternative hypothesis of $\beta_1 < 0$. The hypothesis can be stated as:

H_0 : $\beta_1 = 0$. That is, corruption has no significant impact on economic growth in Nepal.

H_1 : $\beta_1 < 0$. That is, corruption has significant impact on economic growth in Nepal.

The description of the variables used in the model is defined as:

In GDP = Natural log of Gross Domestic Product (in US \$),

In CPI = Natural log of Corruption Perception Index,

In EDS = Natural log of External Debt Stocks (in US \$),

In UEMP = Natural log of Unemployment Rate,

β_0 = the constant term,

β_1 = the parameter estimate of CPI,

β_2 = the parameter estimate of EDS,

β_3 = the parameter estimate of UEMP, and

μ = Stochastic or random error term (with usual properties of zero mean and non-serial correlation).

Analysis and Interpretation of Results

The results of the model are presented in Table 2. The overall results show that model is statistically significant. The F - stat is 51.29 which suggests that coefficient of independent variables used in the model are not jointly zero. This would mean that overall fitness of the model is good. This is further evidenced by the R-square figures. The R-square is 0.93 suggesting that 93 percent variation in dependent variable is explained by the independent variables used in the model. The estimated coefficients are also statistically significant. Given the time series nature of the data, the Durbin - Watson statistics is 1.76 suggesting presence of autocorrelation in the model. However, the paper takes it as limitation and therefore further evidence on these aspects is recommended using more robust methodology and time series econometric tools.

Table 2: Regression Results

Dependent Variable: Log of GDP				
Independent Variables	Coefficient	Std. Err.	T	P > t
Constant	1.77	0.99	1.79	0.10
Log of Corruption perception index (In CPI)	-0.64	0.32	-2.01	0.07
Log of External Debt Stocks (In EDS)	1.89	0.40	4.72	0.00
Log of Unemployment Rate (In UEMP)	0.63	0.13	4.74	0.00
R-Square: 0.93, Adjusted R-Square: 0.92 F-stat: 51.29 (0.00), D-W-stat: 1.76				

Source: Author's computation based on data of Table 1.

The results show that control variables such as external debt stocks as measured by In EDS and unemployment rate given my In UEMP are statistically significant. These variables have been used as control variables in the model. The coefficient of log of external debt is

statistically significant at 1 percent and has positive contribution to economic growth. The estimated coefficient shows that 1 percent rise in EDS results into 1.89 percent increment in economic growth in Nepal. This is in line with expectation of theory as EDS inflows enhances the productive capacity of the country through capital accumulation, generates more employment opportunities and transfers the technology too. However, the coefficient of Unemployment rate is quite unexpected. This is statistically significant at 1 percent. As revealed earlier, this is contrary to expectations. It is generally expected that higher economic growth correlates with lower level of unemployment. However, this paper is using this variable as control variable so further exploration on this aspect is not carried in this paper.

The variable of interest- the CPI is found negative and statistically significant. The result shows that there is a negative relationship between the economic growth and CPI in Nepal during the study period. This is in line with the priori expectations and hypothesis of this paper that increase in corruption reduces the economic growth in Nepal. The result is also statistically significant at 10 percent. Owing to limited number of observations, this level of statistical significance is quite expected. The estimated coefficient is 0.64 indicating that one percent increase in perception index reduces the economic growth by 0.64 percent.

Conclusion

The study has found out that there is a significant relationship between corruption and the economic growth (GDP) period of 2004-2017. It has perused various literatures and all the literatures pointed to the fact that corruption abound in governance, public and private business and corporate environment in Nepal. Despite the presence of plentiful resources in the country, corruption has made it impossible for the government to translate the presence of the plentiful resources to improved standard of living in Nepal which has lead to increasing poverty level in Nepal. The study has examined the magnitude of the impact of corruption on Nepalese economy and found that Corruption Perception Index (CPI) the proxy for corruption has been hampering development proxy by the GDP of Nepal. It is thereby concluded that corruption has negatively affected economic growth and development in Nepal.

Corruption of many folds such as bribery, fraudulent acts, misuse of public and private funds and property, election rigging and ballot stuffing, money laundering, examination malpractices in schools of privately and publicly owned, are some forms of corrupt practices perpetrated in Nepal. Corruption has caused lack of public infrastructures that has increased the level of poverty in the country despite the enormous resources of the nation and less respect for fundamental human right. It shows that no matter the efforts of government to improve the economy and the presence of other developmental indices, when corruption is not reduced to its bearable minimum, economic growth and development will be very difficult to sustain in Nepal. The implication of this finding is that economy cannot grow fast without zero tolerance in corruption. Finally, the study support previous results in the literature of the effect of corruption on economic growth.

Recommendations

Based on the given findings, the following recommendations are presented.

- a) The policies that will enhance economic growth are expected to be encouraged in reducing corruption and poverty so that the level of economic growth can be improved.

- b) The activities or programmes of the anti-corruption agencies in Nepal such as the Investigation of Abuse of Authority (CIAA) and the Independent Corrupt Practices and related Offences Commission should be strengthened.
- c) There should be free and fair election in Nepal, so that the honest individuals who would serve as role models will be put elected into leadership positions so as to minimize the negative impact of corruption on economic growth in Nepal.

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