

Corruption and the Effects of Democracy

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The Economics of Corruption Passau October 2012

Outline

- 1 Introduction
- 2 Effects of Democracy
- 3 Corruption and Democracy Effects

Outline

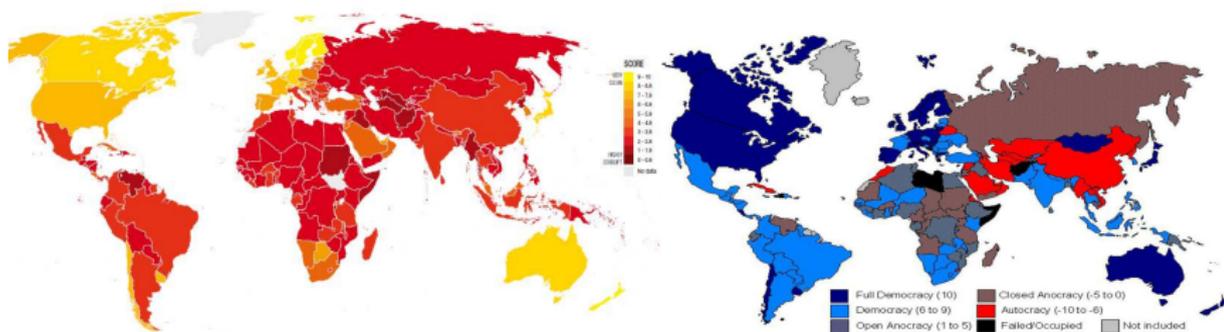
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Motivation

- Democratic Institutions may affect cooperative behavior
- Frey (1998): Swiss cantons with greater democratic participation face lower tax evasion
- Bardhan (2000): Farmers less likely to violate irrigation rules when they have crafted those
- But: Many young democracies do not seem to flourish

Motivation

There seems to be a clear link between corruption and democracy



Research Idea

- Countries with (better) democratic institutions tend to be less corrupt
- But how does corruption affect the workings of democracy?
- How are democracy and corruption intertwined?
- Does the prevalence of corruption undermine the effects of democracy?

Hypothesis

- Potential transmission mechanism: Social Capital
- Civic Capital: "the set of values and beliefs that help cooperation" Guiso et al. (2010)
- Participation/Democracy \rightarrow Civic Capital \uparrow \rightarrow Cooperation \uparrow
 - Dal Bó et al. (2010), Olken (2010)
- Corruption \rightarrow Civic Capital \downarrow \rightarrow Cooperation \downarrow
 - Fisman/Miguel (2007), Rothstein/Stolle(2008)
- Participation/Democracy \leftrightarrow Corruption \rightarrow Civic Capital ? \rightarrow Cooperation ?
 - Institutional Complimentarity?

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Design (Dal Bó, Foster, Putterman)

- Groups of four
- Part 1: Ten rounds prisoner's dilemma (random rematching)
- Part 2: Another ten rounds but payoffs can be modified

TABLE 1—STAGE GAME PAYOFFS (*in points*)

Initial/unmodified payoffs			Modified payoffs		
Own action	Other's action		Own action	Other's action	
	C	D		C	D
C	50	10	C	50	10
D	60	40	D	48	40

Voting (Dal Bó, Foster, Putterman)

Subjects can vote on modification at the beginning of Part 2

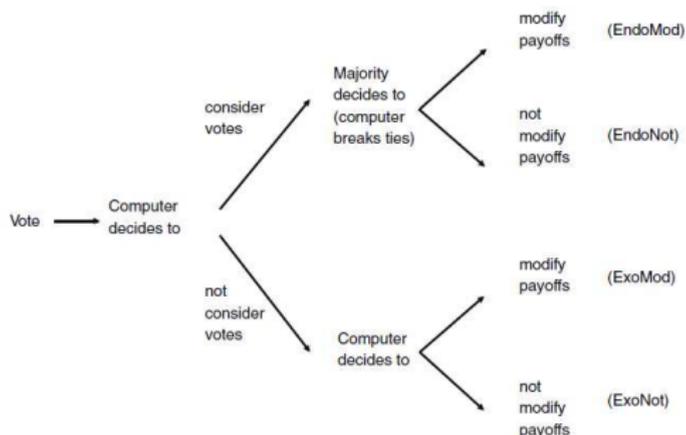


FIGURE 1. VOTING STAGE

- Subjects are informed whether the computer considered the votes and whether payoffs were modified
- They do not learn the exact distribution of votes

Results (Dal Bó, Foster, Putterman)

- Simple comparison of cooperation rates not feasible (selection)
- Therefore test for differences in outcomes of mechanisms given payoffs and individual votes:

$$E(C_i | Endo, P, v_i) - E(C_i | Exo, P, v_i)$$

There is an effect of democratic institutions in addition to the instrumental effect through policy choice

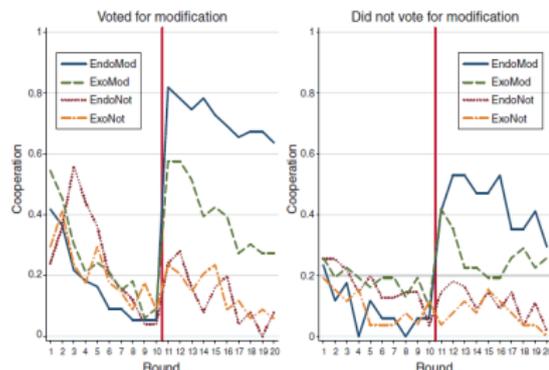
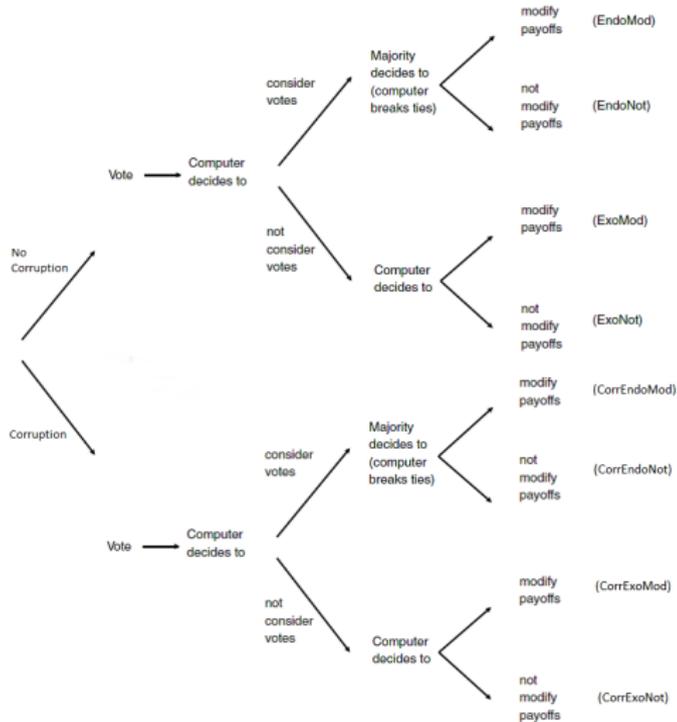


FIGURE 3. COOPERATION BY ROUND, VOTE STAGE RESULTS AND INDIVIDUAL VOTE

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Setup



Modeling Corruption

I introduce a corrupt administrative system:

- Some participants have the possibility to corrupt in Part 2:
 - decreasing all payoffs by 10 %
 - extracting a share of this rent (e.g. 70 %)
- All subjects are informed before the voting stage about the possibility of corruption (dissemination is common knowledge) but not about the actual occurrence
- Conditioning on vote and assigned role we can again compare the differences in cooperation under the different mechanism

Modeling Corruption (cont.)

Initial payoffs (No Corruption)			Modified payoffs (No Corruption)		
Own action	Other's action		Own action	Other's action	
	C	D		C	D
C	50	10	C	50	10
D	60	40	D	48	40

Initial payoffs (Corruption)			Modified payoffs (Corruption)		
Own action	Other's action		Own action	Other's action	
	C	D		C	D
C	45	9	C	45	9
D	54	36	D	43.2	36

Outlook

- Was George W. Bush right? (Does it suffice to introduce democracy?)
- Aim at entangling the relationship of corruption and democracy
- Shed some light on the black box of institutions
- Possible extensions:
 - Change transparency (assigned roles and/or corrupt acts known), detection
 - Measure civic capital (trust)