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
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
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 $\downarrow$
- Participation/Democracy $\leftrightarrow$ Corruption $\rightarrow$ Civic Capital ? $\rightarrow$ Cooperation ?
  - Institutional Complimentarity?
Outline

1. Introduction
2. Effects of Democracy
3. Corruption and Democracy Effects
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)

<table>
<thead>
<tr>
<th>Initial/unmodified payoffs</th>
<th>Modified payoffs</th>
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<tbody>
<tr>
<td></td>
<td>Other’s action</td>
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<tr>
<td>Own action</td>
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Subjects can vote on modification at the beginning of Part 2

- 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:
  \[ E(C_i \mid Endo, P, v_i) - E(C_i \mid Exo, P, v_i) \]

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

1. Introduction
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3. Corruption and Democracy Effects
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.)

<table>
<thead>
<tr>
<th>Own action</th>
<th>Other’s action</th>
<th>Initial payoffs (No Corruption)</th>
<th>Modified payoffs (No Corruption)</th>
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<tbody>
<tr>
<td>C</td>
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<table>
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<th>Initial payoffs (Corruption)</th>
<th>Modified payoffs (Corruption)</th>
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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)