

# **DETERMINANTS AND EFFECTS OF CORRUPTION ON INVESTMENT, GENERAL PRICE LEVEL AND SUSTAINABLE ECONOMIC GROWTH IN NIGERIA**

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## **Abstract**

The paper examined the determinants and effects of corruption on private investment rates, general price level and the rates of economic growth. The paper employed Ordinary Least Square (OLS) technique as corruption, private investment rates, inflation rates and GDP growth rates were found to be I(0) series. Corruption index for Nigeria from the Transparency International (TI) organization indicated that Nigeria was among the highly corrupt countries of the world. The econometric results revealed that the poor quality of Nigerian leaderships (whether military or democrat), the low level of income (GDP), political and macroeconomic instability and the absence of value system were the major determinants of corruption in Nigeria. The paper also found that corruption impacted insignificant positive effect on the general price level while it impacted significant negative effects on economic growth at 5 per cent level of significance. The effect of corruption on investment rates is still ambiguous. The paper, therefore, suggested significant reduction in the level of corruption in order to achieve price stability, high private investment rates and sustainable economic growth objectives in Nigeria. The paper concluded that the Nigerian populace should be re-orientated towards a better value system and policies to reduce poverty among the entire citizenry should be intensified.

## **Introduction**

Nigeria is facing many problems at present. Among these problems are high rates of poverty and unemployment, low investment, high rates of inflation, high level of

corruption and poor economic growth. The major one, however, is the developmental issue in which the level of corruption in the country is assumed to have worsened political, social and macroeconomic indicators and, indeed, the poverty alleviation programme of the Nigerian government. Virtually all the sectors of the Nigerian economy; be political, economic, security, education and other social service sectors are badly affected with corruption on daily basis if not on hourly basis. Although, corruption is a global phenomenon, evidence abounds that developed countries are less corrupt than developing countries of the world (Transparency International, 2005). Corruption is, however, pandemic in Nigeria.

Table 1: Corruption Perception Index for Some Selected African Countries (1994-2005)

Year	Nigeria	Botswana	Ghana	Mauritius	Morocco	Namibia	Senegal	South Africa
1994	0.99	NA	NA	NA	NA	NA	NA	7.4
1995	0.63	NA	NA	NA	NA	NA	NA	7.0
1996	0.69	NA	NA	NA	NA	NA	NA	5.7
1997	1.76	NA	NA	NA	NA	NA	NA	5.0
1998	1.90	6.1	3.3	5.0	3.7	5.3	3.3	5.2
1999	1.60	6.1	3.3	4.9	4.1	5.3	3.4	5.0
2000	1.20	6.0	3.5	4.7	4.9	5.4	3.5	5.0
2001	1.00	6.0	3.4	4.5	4.0	5.4	2.9	4.8
2002	1.60	6.4	3.9	4.5	3.7	5.7	3.1	4.8
2003	1.40	5.7	3.3	4.4	3.3	4.7	3.2	4.4
2004	1.60	6.0	3.6	4.1	3.2	4.1	3.0	4.6
2005	1.90	5.9	3.5	4.2	3.2	4.3	3.2	4.5

Source: Transparency International (TI) Publication for Various Years (1994-2005). NA = Not Available

That Nigeria is a corrupt country is not an exaggeration. Ample amount of evidence indicates that most Nigerians are corrupt. Indeed, the Corruption Perception Index (CPI) of the Transparency International (TI) organization presented in Table 1 confirms this fact. Table 1 clearly shows that corruption is more deepened in Nigeria than any other African country. The corruption index for Nigeria is between 0.60 and 1.9 indicating a worse situation while in some other African countries corruption index is

between 2.9 and 7.4. Apart from this ranking, Nigerians are living witness to high level of corruption on daily basis and the menace of corruption has spread its tentacles into all sectors of the Nigerian economy. For instance, slow movement of files in offices, police extortion at checkpoints, illegal fee fraud syndrome, embezzlement of public funds, port congestion, queues at passport offices and gas stations, ghost workers syndrome, election irregularities, examination malpractice and admission racketeering, favoritism in political appointment, selling of public items for personal gains, among others, have become the order of the present day Nigeria.

The level of corruption in Nigeria has reached a terrifying level in which almost every citizen is involved in one corrupt practice or the other; whether petty or grand. Those involved include; the leaders as well as the followers, the elites and the illiterates; the military and the democrats, the rich and the poor, the security and those to be secured. Evidence abounds that the just concluded 2006 National Population Census (NPC) exercise was marred with frauds. Many NPC officials were arrested for selling census material as high as  $\times 1.0m$ . Peoples were selected (not elected) into political post based on personal gains and interests. For instance, it has been reported that one Northern state governor is about marrying one of his lady commissioners as his third wife. Also, former inspector general of police was detained for corrupt practices while in office. Many state governors in Nigeria were also involved in the misappropriation of public funds and some had been impeached based on election frauds while many are still being investigated. No sector of the economy is free from the menace of corruption.

The corruption trend in the country is alarming as the list of corrupt practices in Nigeria as well as the people involved is endless. Although, the present civilian government has embarked on massive war against corruption via Independent Corrupt Practices Commission (ICPC) and Economic and Financial Crime Corruption (EFCC), such effort is yet to have a significant positive impact. Consequently, it seems that corruption has defied all the necessary solution. The issue of interest is, therefore, to examine the effect that corruption portends on the level of investment, general price level and economic growth in Nigeria. The paper examines the menace of corruption in Nigeria and determines those factors responsible for high level of corruption in Nigeria.

This will go a long way in resolving sustainable economic development problem in Nigeria.

The remaining part of this paper is divided into the following sections: section 2 focuses on the review of the literature emphasizing the meaning, determinants, effects and extent of corruption in Nigeria while section 3 empirically examines the effects of corruption on investment rates, inflation rates and GDP growth rates in Nigeria using Ordinary Least Square techniques. Section 4 presents findings on corruption determinants while section 5 concludes.

### Literature Review

The first issue on corruption is “where did it all begin?” In order to determine the sources of corruption in the Nigerian economy, we must first know its meaning. Corruption, a global phenomenon, is observed by Sen (1999) as the violation of the established rules for personal gain and profit. McMullan (1961) and Lipset and Lenz (2000) also view corruption as efforts to secure wealth or power through illegal means, secure private gain at public expense and/or a misuse of public power for private benefit. The definition of corruption as indicated by these authors includes all bribery acts such as the use of a reward like kickbacks, payoffs and greasing palms to pervert the judgment of a person in a position of trust. It also includes nepotism such as the bestowal of patronage through partiality rather than merit with the misappropriation of public resources for private uses.

Osoba (1996) also sees corruption as an anti-social behaviour conferring improper benefits, contrary to legal and moral norms, which undermine the authorities to improve the living conditions of the people. Other forms of corruption according to Bayart, *et al.* (1997) include embezzlement of public funds; frauds such as trickery, smuggling and forgery; extortions and favouritism and the diversion of scarce public resources into private pockets. All these types of act are the order of the day in the present day Nigeria. The question that readily comes to mind is what are the possible causes of corruption, which has eaten deeply into the Nigerian society?

Literature shows that there are several causes of corruption which are subdivided into political, economic and socio-cultural factors. Some authors have found the level corruption to depend strongly on the type of government existing in an economy. For instance, Girling (1997) and Lipset and Lenz (2000) and some other authors opine that corruption is widespread in most non-democratic countries while corruption level is low in many democratic societies. Similarly, Treisman (2000) finds significant evidence that federal states are more corrupt than centralized ones. This implies that the nature of the political system and culture of a country may expose people to corrupt practices. In addition, there is tendency for high level of corruption in a society where leaders have absolute power given the fact that “power corrupts and absolute power corrupts absolutely”. All political appointees are always informed at swearing ceremonies that they should not use their offices to amass wealth. This is a clear indication that most Nigerians see political appointments as means of making quick wealth thus reduce the quality of governance. Since 1993, Nigeria has been “electing” their leaders through elections (democratic means), it is thus expected that democracy must have reduced the level of corruption in the country. This issue is examined in this paper.

Literature further reveals that economic situation being experienced in a country is responsible for the level of corruption. For instance, Shleifer and Vishny (1993) and Ali and Isse (2003) have advocated that in a country where economic condition is poor there is tendency for such country to experience high level of corrupt practices which further worsens the rate of development. They also observe that a country with good macroeconomic performance stands to experience low (if any) level of corruption and develops rapidly. Hindrance to economic opportunity is, therefore, seen as the source of corrupt practices. Lipset and Lenz (2000) argue that such hindrance could be as a result of their race, ethnicity and lack of physical and other human resources. They argue further that cultures that stress economic success as an important goal but which strongly restricts access to opportunities will have higher levels of corruption. This view probably explains the high incidence of corrupt practices among Nigerians as many are highly success-oriented, but possess relatively low access to economic opportunities.

The review of the literature above indicates that the high level of poverty and instability may be responsible for the high incidence of corruption in Nigeria. Apart from these quantifiable factors, other less quantifiable factors have also been identified. Notable among them is that the average Nigerians prefers pleasure to work. Some individual Nigerians do not want to sacrifice today for future; they are just lazy. The politicians and our leaders should be blamed for this since they display recklessness in handling public assets and funds and enact laws and orders with a lot of loopholes. For instance, Wraith and Simpkins (1963) and World Bank (1994 and 1996) observe that widespread corruption remains a symptom of a poorly functioning state as witnessed in most developing countries such as Nigeria while Bowman (1991) and Broadman and Recanatini (2002) find lack of value system and ethical standard throughout the various institutions of government and business organizations as a major cause of corruption in most less developed countries including Nigeria. Corruption has also been seen by Lipset and Lenz (2000) as an outcome of social pressures to violate norms so as to meet the set goals of a social system. The social and political systems in Nigeria are at present faulty and it is observed that as war against corruption is going on in the country presently, corrupt activities are still being reported in Nigeria on daily basis. Corruption may be attributed to indiscipline among Nigerians; there is complete absence of value system. The question then is what effect does corruption portend on the Nigerian economy as the ugly phenomenon persists?

Literature on corruption indicates that its effects on macroeconomic indicators are myriad. For instance, Mauro (1995 and 1997b), Ades and DiTella (1996) and Gupta *et al* (1998) are of the view that corruption has serious negative effect on the economy in terms of slowing growth and increasing inequality. Also, Morris (1991), Mauro (1997a), La Porta *et al* (1998), Rose-Ackerman (1999), Della-Porta (2000), Seligson (2002), and Adsera *et al* (2003) observe that corruption portends a negative effect on democracy in terms of decreasing government effectiveness and political legitimacy and increase instability. In addition, Mauro (1997a) in his study confirms that corruption causes a reduction in quality of goods and services available to the public. He also observes that

corruption affects investment, economic growth, and government expenditure choices by reducing private investment.

Mauro (1997b) and Johnston (1997) observe that high rate of corruption creates a situation where investment returns are difficult to predict. They conclude that the effect of corruption is to limit investment, which is critical to the long-run sustainable economic growth. They argue further that corrupt behaviors have the tendency to scare away foreign and local investors with significant adverse effect on the economy. Svensson (2003) also opines that less corrupt activities make more resources available for private investment and that high rate of corruption at the political level reduces public revenues, which may translate into less public services.

Dike (2005) argues that corruption undermines effective governance, endangers democratic rule and erodes social and moral fabric of a country. Sen (1999) also opines that high level of corruption may cause public policy reforms ineffective. Lipset and Lenz (2000) also argue that the effect of corruption on growth is partly as a result of reduced level of investment because corruption adds to investment risk. Shleifer and Vishny (1993), and Lipset and Lenz (2000) also opine that the effect of corruption on education comes from the fact that the government spends relatively more on items to make room for graft. They argue that corrupt government officials would shift government expenditures to areas in which they can collect bribes easily; large and hard-to-manage projects, such as airports or highways, which make corruption easy.

Some scholars such as Nye (1967) and Max Gluckman (1955) argue that despite the negative effects of corruption, it can be beneficial to political development. They opine that scandals associated with corruption sometimes have the effect of strengthening a value system of a society as a whole. This may probably be the case in Nigeria given the level of treasury looting and human rights violations associated with the *Abacha* era and other past administrations. Many other authors argue that corruption may facilitate rapid growth. For instance, Braguinsky (1996) and Kaufmann and Wei (1998) observe that corruption may serve as “efficient grease” which removes all bottlenecks in terms of securing government approval. Hence, corruption is assumed to hasten investment decision and growth. Lui (1985) observe that corruption may allow investors to bypass

red tape and thus reward market performance. Similarly, Bardhan (1997) explains that corruption may be efficiency enhancing. Huntington (1990) observes that corruption among the political elites may reduce the likelihood of conflict and indirectly enhance economic growth.

The fact remains that corruption is a global problem but statistics show that the magnitude of corruption is not the same in all countries. Some countries are more corrupt than others and, indeed, Nigeria is ranked among the most corrupt countries of the world (Transparency International, 2005). The issue of corruption keeps reoccurring in every academic and informal discussion in Nigeria simply because of its danger towards meaningful development and it seems there is no end to this ugly phenomenon. Mbaku (1996) observes that most cleanup programs on corruption in Africa have been unsuccessful. Although, the paper is of the view that the origin of corruption can be traced back to the colonial era when Nigerians were bribed with different foreign goods in exchange for local products and slaves which was later referred to trade, this paper attempts to find whether poor economic condition, type of government, macroeconomic and political instability are responsible for the outrageous level of corrupt practices being experienced in Nigeria.

From the various definitions of the concept of corruption in the literature, it is observed that corruption is doing the wrong things instead of the right things. It is also believed that wrong things cannot bring forth good things, hence the effect of corruption is assumed to be negative in most discussion in the economic literature. For instance, evidence abounds that most products in Nigerian markets command high price, yet they are of low quality. The present state of many public goods such as schools, roads, railways, airports, hospitals etc., clearly confirm Mauro's hypothesis. Again, the act of bribery and corruption and the culture of delay or refusal of payment for services already done are factors scaring away most private investors. Corruption is now assumed to be the main means to accumulate quick wealth in Nigeria. Dike (2005) observes that corruption occurs in many forms and it has contributed immensely to the poverty and misery of a large segment of the Nigeria's population. Some other authors opine that corruption is positively correlated with some macroeconomic variables through some



linkages. The review of literature, therefore, indicates that the issue of quantifying the effect of corruption still remains inconclusive. This issue is, however, examined in this paper by adopting econometric analysis to really determine the effect which corruption portends on the investment levels, general price level and economic growth in Nigeria.

#### Effects of Corruption on Growth, Inflation and Investment Rates

The bi-variate regression results of the effect of corruption on the level of economic growth, general price level and investment rates are presented in Table 2, Table 3, and Table 4 respectively. The result in Table 2 clearly indicates a strong negative relationship between growth rate of annual real GDP ( $rgdp\%$ ) and the level of corruption ( $cpi$ ) in Nigeria for the period between 1995 and 2005. The result reveals that level of corruption (corruption perception index multiplied by 100) was responsible for poor economic performance in Nigeria. Both the current and lagged corruption indices ( $cpi_t$  and  $cpi_{t-1}$ ) impacts negatively on real income growth rate but only the current level of corruption is significant at 5 per cent level of significance. The correlation coefficient between the current and past level of corruption and economic growth rate are respectively -0.39 and -0.12. The country's current level of corruption must be reduced by at least 40.0 per cent in order to achieve 1.0 per cent increase in the level of economic growth.

Examining the effect of corruption on the general price level, the result in Table 2 indicates that the increase in the general price level measured by inflation rates ( $inf$ ) is partly caused by the level of corruption in the country. The past level of corruption ( $cpi_{t-1}$ ) impacts significant positive effect on the general price level at 10 per cent level of significance. The negative effect of the current level of corruption on general price level is insignificant at 10 per cent level of significance. The correlation coefficient between the past level of corruption and the general price level in the economy is 0.17 and that of its current level is -0.10 with the net effect being 0.07. The result implies that price stability can be maintained if the level of corruption in the country is reduced by at least 7.0%.

Table 2: Modelling the Effect of Corruption on Growth, Inflation and Investment Rates From 1994 to 2005

Variable	rgdp%	inf	pcinf%	gfcf%
rgdp% <sub>t-1</sub>	-0.5921 (1.4102)			
inf <sub>t-1</sub>		0.5118 (1.2219)		
pcinf% <sub>t-1</sub>			-0.5204* (1.8095)	
gfcf% <sub>t-1</sub>				0.1116 (0.7232)
Constant	95.2095 (3.0864)		0.0608 (0.2196)	5.2707 (4.3136)
Trend		0.0756 (0.0391)	-0.0834** (2.6432)	0.1302 (2.0897)
cpi <sub>t</sub>	-0.2910** (3.7708)	-0.1030 (0.6033)	0.0033* (1.6941)	0.0081* (1.8271)
cpi <sub>t-1</sub>	-0.1214 (0.9359)	0.1706* (1.6517)	0.0045** (1.9669)	-0.0120 (2.6613)
R <sup>2</sup>	0.7258	0.6091	0.6472	0.6825
F Statistics	6.18 (0.0223)	2.34 (0.1689)	2.75 (0.1292)	3.22 (0.0975)
DW Statistics	1.789	2.167	1.944	2.055

The figures in parentheses are absolute t-statistics  
 \* indicates significant at 10 per cent level of significance  
 \*\* indicates significant at 5 per cent level of significance  
 \*\*\* indicates significant at 1 per cent level of significance

Examining the effect of corruption on investment rates, the results in Table 2 reveal conflicting effects of corruption on the level of investment in the country. For instance, using private capital inflows rates (pcinf%), the result indicates a positive effect of both the current and the past level of corruption on foreign capital inflow into the country. The positive effect of corruption on capital inflow is significant at 10 per cent significance level for the current level of corruption while is it significant at 5 percent level for the past level of corruption. The result of the effect of corruption on ratio of gross fixed capital formation (gfcf%) also reported in Table 2 reveals that the current level of corruption bears significant positive effect on gross investment while the past level of corruption in the country bears significant negative effect on the level of capital formation. The two effects are respectively significant at 10 per cent and 5 per cent level of significance.

Table 3: Modelling Corruption (CPI) by OLS (1994-2005)

Variable	Model 1	Model 2	Model 3	Model 4
LAGGED CPI	0.31 (0.92)	-0.29 (1.08)	0.46* (1.65)	0.55* (1.69)
CONSTANT	0.62 (1.44)	2.33 (5.11)	0.96 (1.53)	0.54 (0.42)
YEAR OF DEMOCRATIC RULE	0.05 (1.16)			
REAL GDP GROWTH RATE		-0.22*** (3.77)		
LAG OF REAL GDP GROWTH RATE		-0.02*** (2.52)		
MACROECONOMIC INSTABILITY			-0.01 (1.25)	
LAG OF MACROECONOMIC INSTABILITY			0.02* (1.69)	
DEGREE OF OPENNESS				-0.02 (1.03)
LAG OF DEGREE OF OPENNESS				0.3 (1.56)
R <sup>2</sup>	0.34	0.84	0.48	0.52
DW	1.51	1.77	2.25	2.29

\* indicates significant at 10 per cent level of significance. \*\* indicates significant at 5 per cent level of significance. \*\*\* indicates significant at 1 per cent level of significance.

#### Findings on the Determinants of Corruption in Nigeria

The impacts of political and macroeconomic factors on the level of corruption were examined and the results reported in Table 3. Model 1 in Table 3 indicates that years of democracy have insignificant positive influence on the level of corruption in Nigeria. The implication of this result is that democratic governance has not helped in corruption reduction rather, it has worsened the Corruption Reduction Index. This indicates that the impact of war on corruption is yet to check corruption menace in the country. The implication of this finding is that many Nigerian politicians invest on politics (in the name of democracy) and use the opportunity to amass wealth, which is stored away in foreign countries. This act has worsened the level of corruption in the country. The Nigerian leaders do not live a relatively modest live; they display affluence and spend reckless which has further worsened the level of corruption in the country.

The result of Model 2 reveals that the level of economic growth measured by the real GDP growth rate bears a significant negative effect on the level of corruption in the country. The result indicates that poor economic performance as witnessed in Nigeria is strongly responsible for the high incidence of corruption. The negative effect of economic growth rate on corruption is observed at 1 per cent level of significance for both the current and past values of economic growth. The coefficient of the current and past real income indicates that for 1.0 per cent reduction in the level of corruption, the country's real income must increase by 2.0 per cent.

The results of Model 3 and 4 indicate that the past level of corruption has impacted significant positive effect on the current level of corruption in the country. This indicates that already corrupt society stands to face higher level of corruption in the future. Model 3 reveals that the past level of macroeconomic instability (measured by exchange rate volatility) was also partly responsible for the upsurge of corruption in Nigeria. This variable is significant at 10 per cent level of significance. The result clearly indicates that macroeconomic stability is a necessary condition for corruption to be curbed effectively in the country. The result of Model 4 does not confirm that corruption is externally influenced since the coefficients of the current and past level of trade openness (measured by the ratio of exports to income) are insignificant. The message here is that corruption in Nigeria is not externally motivated. The result must however be taken with caution as the paper is of the view that the proxy may not adequately capture the effect of external influence on corruption in the country.

### Conclusion

Corruption, caused by variety of factors, is a global phenomenon. The Nigeria's case is, however, alarming and drastic measures are required to combat the menace if any meaningful economic development is to be achieved in the long run. Corrupt practices are found in politics, ministries, academia and all nooks and crannies of the Nigerian economy. Examining the effect of corruption, the paper found that the price of corruption

is slow growth and Nigeria will continue to experience new dimensions of corrupt practices as the poor growth rate increases.

The paper concluded that good governance; transparency and accountability on the part of our leaders as well as political and macroeconomic stability are the key issues in tackling corruption in Nigerian. The paper observed that the present state of many public utilities such as electricity, public schools, hospitals roads, etc. is a clear indication that corruption erodes the quality of goods and services as greater percentage of the projects' costs had already been shared among the concerned individuals and the government agencies involved.

Since the paper found that corruption is not beneficial to the Nigeria economy because of the adverse effect it portended on investment, general price level and sustainable economic development in Nigeria, it is concluded that all efforts to eradicate corruption must be intensified. The present electoral and political manipulations going on the country would further undermine the fight against corruption in Nigeria. Good governance, reduction in poverty level and stability are, therefore, suggested for eradication of corrupt practices in the country. The question of whether it will be possible to effectively remove the scourge of corruption, both the petty and grand forms, in the Nigerian society depends strongly on democratic reforms of good governance, removal of electoral frauds and the achievement of macroeconomic policy stability in the country.

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