

The interplay of corruption and innovation in emerging economies

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Abstract:

The paper analyses effects of corruption on innovative activities. It argues that despite corruption is traditionally considered as a highly negative phenomenon, it may have a positive effect on innovation. This position allows to explain why developing countries with a high level of corruption sometimes demonstrate better indicators of innovative activity in particular areas than less corrupt advanced economies. However, our study shows that this positive relationship exists because of the prevalence of more serious problems associated with the persistent presence of the state in various spheres of economy. Moreover, we argue that not all innovations are in fact socially desirable, and those that are an outcome of rent-seeking behavior and incorporation of private interests in the legal system often negatively affect market mechanisms and undermine sustainable economic performance.

Keywords: *innovation, entrepreneurship, regulation, corruption, regulatory capture, emerging economies, rent-seeking behavior.*

1. Introduction

While it is generally perceived that corruption negatively affects economic and social wellbeing, it seems that correlation between this phenomenon and some indicators of economic development may really be positive. Some scholars, for example, argue that corruption can stimulate foreign direct investment (Egger and Winner 2005) or even raise economic growth (Leff 1964). At the same time, such indicators as investment or economic growth are closely intertwined with innovative activities, which are often considered as main driving forces of economic development. Thus, it is interesting to understand whether corruption indeed can play in favor of innovation, and, some cases from emerging economies suggest that it may be true.

Despite the problem of corruption has become central for many contemporary studies, there are not so much efforts focused on empirical research of the connection between corruption and innovation. Those that are often cited in the modern discourse mainly support the theoretical background of the public choice view that rent-seeking behavior weaken the incentives to innovate (see e.g. Murphy et al. 1993). The positive effect of corruption on innovation is mainly found in the opportunity to speed the bureaucratic process (see e.g. Ayyagari et al. 2014), but our findings allow to argue that the “speed taxes” are by far not the only positive externalities.

The distinctive features of emerging economies is that corruption in these countries plays a more prominent role in economic activity than in developed parts of the world. The emerging economies are mainly in the worst sections of the corruption perception index rank of Transparency International, where Russia is only on 135 position. Nevertheless, in many spheres that are usually regarded as innovative areas, Russia successfully competes with advanced European economies. Of course, there are various aspects that affect innovation but our study shows that corruption has taken a very important place in the process.

2. Research methods

The research is mainly based on the theoretical background and methodology of the Austrian school of economics, new institutional economics and public choice theory, including analysis of rent-seeking behavior and regulatory capture. In order to understand why some kinds of innovative activity are flourish in emerging markets where institutional environment is generally considered as highly corrupt, we study particular cases and compare them with their counterparts in advanced economies.

3. Main findings

In general, it is possible to distinguish three major categories of cases where corruption plays in favor of innovation. First, corruption might have a positive effect on innovation because bureaucratic corruption can countervail bureaucratic inefficiency. We do not have reasons to believe that existing rules serve actual social needs, and, thus, if corruption allows to circumvent them, then the outcome can be

more efficient than the inefficient institutional arrangements could otherwise produce. This idea has found its place in the Austrian economics scholarship. For example, Burton (1984) uses the term “intervention entropy” in order to explain the situation when “the losers” of government intervention find ways to “escape its burden”. Since efficiency of regulation in developed parts of the world is not always less dubious than in emerging markets and very often is expressed in the problem of “regulatory disconnection”, corruption indeed may play in favor of innovation. One of the interesting instances that demonstrate the issue is the development of the wireless industry in emerging economies (see e.g. Trubnikov 2017).

The second category is very similar to the the first one and it also tackles with a situation when corruption allows to countervail inefficient regulation. However, apart from the previous example, the phenomenon stems from the “regulatory capture” problem, and this is precisely the view from the public choice perspective (see e.g. Tullock et al. 2002). In this situation the role of corruption is double-edged: on the one hand, “grand corruption” not only protects interests of most powerful players but clearly aims to stifle innovation; on the other hand, “petty corruption” may allow independent entrepreneurs to bypass the captured rules. The case that supports this statement is the comparison of the telecommunications industry in Russia and in the advanced economies of the EU (Trubnikov 2018).

The third category has very distinctive features and can be considered as innovations driven by rent-seeking behavior supported by corrupt state mechanisms. Such innovations are a result of close cooperation of government and business and very often take a form of private-government partnership. This phenomenon helps to explain why some particular types of innovations, such as, for example, blockchain technology, have found greater support from governments in countries with higher level of corruption than in advanced economies. However, such innovations often aim to generate rent flows into pockets of rent-seeking actors and, as a result, may have a negative impact on the economy and cannot be considered as socially desirable innovative endeavors.

4. Conclusion

Despite corruption is mainly perceived as a negative phenomenon, our findings demonstrate that it may have a positive effect on innovation. However, it is very important to understand that this positive relationship exists because of the existence of more serious problems associated with the persistent presence of the state in the economy. Moreover, not all innovations are in fact socially desirable, and those that are an outcome of rent-seeking behavior and incorporation of private interests in the corrupt state system positively contribute only to some indicators of innovative activity, while, at the same time, negatively affect market mechanisms and undermine sustainable economic performance.

5. References

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