

# **The Negative Effect of Corruption on the Consolidation of Democracy**

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Recent events across the Middle East, the unrest against authoritarian regimes and the overthrow of decades long dictatorships, prompt questions about the possibility of a forth wave of democratization. Democracy does not only mean the rule of the people by the people, and the insurance of rights and freedoms. It comes at the price of all citizens' responsibility as political actors. While witnessing the demise of authoritarian regimes and an embrace of democratic values, it is important to identify what factors would make the new democracies more stable and successful. With the third wave of democratization, we noticed that countries reached various stages of consolidation at different paces. Some countries proceeded with reforms to strengthen the democratic state and others did not. What explains the difference between these two types of states? This paper hypothesizes and tests the proposition that the presence of political corruption during the democratization process stalls the process of democratic consolidation. This is a novel explanation that supplements the findings of established works about the process of democratization. This discussion is based on the assumption that in order to move from the transitional stage of democratization to the consolidation stage, a set of political reforms has to be implemented. One crucial set of reforms targets the political institutions of the state, and their accountability mechanisms, to create the necessary environment for the democratic game to be played.

There are four main phases of democratization: the fall of the authoritarian regime, the transition, the consolidation, and the maturing of the political order. During the consolidation stage, the process of democratization is represented by move from the electoral stage to the

normative stage. That is, besides introducing electoral institutions and having ‘free and fair’ elections, all the actors involved in a democracy, elites and masses regard democracy as the ‘only game in town’ (Linz and Stepan 1996). Countless democracies around the world are stuck in an ‘illiberal stage’, in which the institutions of democracy are well in place, but there are top down restrictions on the freedoms and rights guaranteed by a democracy (Zakaria 1997).

This study argues that political corruption is the cause of these restrictions. A number of political elites, through the practice of corruption, hold on to power and protect their select interests from the rest of the population. Due to this self-interested behavior, the country is left in a state of partial reform that prevents access to power from groups that are entitled to it, and does not offer justice and freedom for everyone, rights that a democracy is fully responsible for fulfilling. The state of reform is only as advanced as the government wants it to be. The flip side of this argument is that the unwillingness to complete the reform process by corrupt politicians cannot be countered by the democratic mechanisms of checks and balances, due to their sheer formal existence and impracticality. The democratic institutions of checks and balances, such as the division of power, an independent justice system and police, and an active civil society, exist mainly in theory. The executive uses its influence over the legislature to seek selective interests; the police and the justice system are corrupt and not independent from the political elites and unable to punish corrupt behavior; while the civil society is uninformed due to the lack of transparency and corruption in the media.

Neither the literature on democracy nor the one on corruption thoroughly addresses this causal direction or tests it. Previous studies have shown the opposite; that a higher level of democratization has a negative impact on corruption, but they have failed to address the endogeneity of the relationship, thus, the results lacking consistency and efficiency. They also

fail to express who would make the necessary institutional changes to curb corruption, since the actors responsible for it are corrupt.

## **Literature Review**

The subject of political corruption is almost missing from the democratic theory. However, most of those who do study it reached the conclusion that it is a cause and a symptom of the dysfunctions within a democracy (de Leon 1993; della Porta and Vannucci 1997, 1999; Elster 1989, 263-72; Rose-Ackerman 1999; Thompson 1995, Warren 2004, 328). The understandable difficulty of settling upon a set of commonly agreed propositions, regarding this relationship comes from precisely identifying the democratic mechanisms that corruption disables and empirically proving the relationship. Another challenge is agreeing on a common definition of corruption.

From a conceptual point of view, the establishment of a democracy has been long seen as the result of higher levels of modernization, which was a consequence of increase in wealth, the formation of a different class structure, tolerant cultural values, and economic independence from foreign actors. The mainstream school of thought (Lipset 1959; Almond and Verba 1963; Moore 1966; Dahl 1971; and O'Donnell, 1979, Acemoglu et al. 2008) which was concerned with necessary conditions for democratization, has been complemented during the last two decades with scholarship concerned with the mechanisms of democratization and consolidation (Shin, 1994, p.139). Recent studies look at the result of strategic interactions and agreements among political elites, conscious choices among various types of democratic constitutions, and electoral and party systems (Karl 1990). The recent trend is to focus on political leaders and strategic interaction between elites (Huntington 1984; Linz 1990). Additionally, new scholarship leaves

behind country studies to look comparatively at different countries in the search to discover the relationship between strategic interactions and the pattern of democratic transition, and further on, between the type of transition and the democratic political system that comes to live (Karl and Schmitter 1991).

### Measuring Democracy

The discussion about democratization has been marked by a lack of consensus on how to measure democracy. Some scholars have divided the world into democracies and non democracies, which for some purposes is appealing. But the dichotomous measures of democracy can affect analyses. Dichotomizing puts together countries with various degrees of democracy, and it also blurs distinctions between borderline cases (Bollen and Jackman 1989). Definitions of democracy have to include procedural dimensions, such as free and fair elections, but also normative dimensions related to the idea of equal members of society controlling the decision making process.

There are several guidelines that have been proposed for recognizing that a democracy has been consolidated. Among them there is the 'two election' test, that is, 'a democracy is consolidated when a government that has itself been elected in a free and fair contest is defeated at a subsequent election and accepts the result' (Beetham 1994, 160). This does not solve the problem of the dominant party model, where the electorate votes for the same party every election. Another test is if a country can sustain 20 years of regular competitive elections. However, a system does not only have to survive the passage of time but also shocks and crises which requires strong institutionalization that goes further than the electoral process (Whitehead 1989).

*The concept of consolidation represents the process of reaching broad and deep legitimation*, that is, all significant political actors, on both the elites and mass sides, come to believe that the democratic order is the most right and appropriate for them (Lipset 81; Linz 78; Dahl 129-31). Elites, all political competitors and potential competitors, i.e. political parties, interest groups, and movements have to regard democracy and its laws, procedures, and institutions, as the only game in town. The masses have to have a broad normative and behavioral consensus on the legitimacy of the constitutional system, regardless of class, ethnic, and nationality cleavages. This consensus should prevail in spite of poor or unsatisfying performance at any point in time (Linz and Stephan 1996; Przeworski 1991, O'Donnell 1992, Diamond 1997).

Przeworski argues that a democracy is consolidated when compliance, that is, acting within an institutional framework, represents the equilibrium of the decentralized strategies of all the relevant political process (Przeworski, 26). However, this observation is based on the assumption that institutions matter, first as rules of competition and, second, as codes of punishment for noncompliance; rules affect outcomes (Przeworski, 26, 27). This means not only approval of the rules but fundamental and self-enforcing restraints on the exercise of power. The moment the commitment to the punishment in case of misbehavior is truly believable, and respected, the leaders display a real interest in adhering to the rules of the democratic game. It involves strategic calculations of long-term benefit in case of loss of power but also a normative shift (Diamond 1997, 15).

This research subscribes to O'Donnell's definition of a consolidated democracy. Thus a political democracy has four unique differentiating characteristics in relation to all other types of political regimes. The first two characteristics pertain to the regime, the last two to the state and

its legal system. First consolidated democracies have fair and institutionalized elections, second they have inclusive and universalistic wayer. In addition to these procedural characteristics a consolidated democracy has two additional characteristics of the state. Thus, the third attribute is a legal system that enacts and backs –at least- the rights and freedoms included in the definition of a democratic regime and, fourth, a legal system that prevents anyone from being *de ligibus solutis* (above the law- ‘*estado de derecho*’) (O’ Donnell, 2007, 33)<sup>1</sup>.

To complete the definition of consolidated democracy, I add Stepan and Linz’s fifth arena of a modern consolidated democracy: the civil society, based on freedom of association and communication (Linz and Stepan 1995, 14). This is a crucial element since at the interaction between the civil society and the political society lays the legitimation of the democratic regime.

What factors affect the process of consolidation of democracy?

Several factors have been hypothesized to affect the level of consolidation. To date, their explanatory power is inconclusive. The following is a review of these factors.

The character of the previous regime has been hypothesized to have an effect on the process of consolidation. Although there is no systematic evidence that the consolidation process is in any particular way related to the type of authoritarian regime (sultanistic, bureaucratic, no-party or single party), some important distinctions need attention. A previous military regime

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<sup>1</sup> O’Donnell refers to this as horizontal accountability: “in terms of relations internal to the regime and the state, a democratic legal system entails that no public officer can escape from legal controls as to the lawfulness and appropriateness of his actions, as defined by political institutions that are legally enabled to exercise these controls” (2007, p. 34)

will have as a consequence the difficult task of depoliticizing the armed forces, and guarding the guardians. While a communist regime makes the consolidation process difficult, by leaving behind the task of the implementation of democratization in the state, and the introduction of the market economy simultaneously (Beetham 1994, 162).

Another hypothesis is that the mode of transition affects the process of consolidation. Huntington, for instance, refers to a process which combines 'transformation' and 'replacement' called 'transplacement', while Linz combines the process of 'reforma' and 'ruptura', called transaction (Huntington 1991; Linz 1990). What is important to remember is the effect of 'elite pacts' on the process of consolidation. Thus the chances of success are enhanced not only by formal agreements about the rules of the political interactions but also by informal agreements to limit the agenda of political completion (O'Donnell 1986, 37-47; Przeworski 1991). Elite pacts are dangerous from two points of view, if they include antidemocratic forces and if they exclude popular demands (Beetham, 164).

As far as the economic dimension is concerned, it has been hypothesized that a market economy is a necessary, though not sufficient, condition of democracy. However, market forces can prove both helpful and detrimental in the process of democratization. On the one hand, they have the same anti-paternalist credo, that is, the consumer/voter is the best judge for her own interest. Some of the consequences are the creation of an independent space of civil society, the restriction of the bureaucratic apparatus, and the reduction of the stakes in the electoral competition by separating the two. The big drawback that comes with a market economy is the deepening of income inequalities, which are an obstacle to effective political equality (Beetham, 165).



Another hypothesis related to the economic sphere is that democratic consolidation improves with economic development (Lipset 1959). The mechanism identified by Lipset is that development - through a reduction in the income inequality, a complex formation of civil society and an educated population - contributes to the consolidation of democracy (Lipset, 1959). But it is not at all clear that reduced inequality and a more educated population are necessarily the result of development (Beetham, 166). The scholarly work is confusing with voices on both sides of the argument (Muller 1988; Hadenius 1992). Hadenius finds that there is a strong positive correlation between education, literacy rates and democratization. The third hypothesis related to the economic issue is that a certain class structure affects the success of democracy (Moore, 1966). Democratization stands upon not only meeting the economic conditions for both labor and capital, but the political conditions of allowing both classes to participate in the representative system through political parties (Przeworski 1986).

As far as cultural explanations are concerned, the most recent trend is to divorce the circular thinking between democratic culture and institutions by selecting variables that are pre-political and pre-democratic, for example religious beliefs (Beetham, 168). Thus it has been argued that certain religions might be incompatible with democracy. Before Catholic countries have proved successful in the democratization process, non Western Christendom was considered incompatible with democracy (Huntington 1991). However, Russian orthodoxy, Confucianism and Islam also come across as having elements incompatible with some democratic principles. Russian orthodoxy with its conception that the popular will is more transcendental than empirical, Confucianism because it subordinates the individual to collective good, Islam due to the fact that it is created based on a legislative project, where politics and religion merge (Beetham, 168). Another cultural hypothesis is related to divisions of clearly

defined cultural groups within the same country which is argued to have a negative effect on the process of democratic consolidation. This argument goes as far back as J. S. Mill (1860).

Last but not least, there are the hypotheses related to political institutions. Thus, presidential systems last less than parliamentary ones; proportional systems should be less politically divisive than plurality ones (Lijphart 1984); and decentralized government is favorable to democratic consolidation. There is still controversy in regards to the empirical evidence that supports most of these hypotheses.

### Defining corruption

There is a large amount of literature on the significance and the measurement of corruption. The tendency has been to broaden the meaning, shifting away from specific types of office, organization or behavior. The latest definition focuses towards a 'relationship-centered' approach. Corruption is thus defined as 'the abuse of entrusted power' (Stamford et al. 2006, 59). In 1994 a transnational NGO, Transparency International (TI) was created to address the problems related to the lack of transparency and accountability in governance. According to TI, public corruption is the abuse of public office for private gain (Pope 2000). Klitgaard (1988) defined a corrupt official as one who 'deviates from the formal duties of a public role because of private-regarding (personal, close family, private clique) pecuniary or status gains; or violates rules against the exercise of certain private-regarding behavior'. First of all, it is important to identify if there is a common similar understanding of what corruption is across countries.

In some cultures it is common practice when a public official provides a service, for the beneficiary to respond with a tip or gift (Azfar et. al. 2001, 44). The difficulty is to identify when the gift or tip becomes a bribe. If the service is not based on the gift, the timing of the transaction

is different and the tip is given later, one could consider it courtesy and not corruption (Rose-Ackerman 1999, 91-111). The question is thus, is corruption culture specific? Similarly, can campaign financing be considered a form of corruption? Campaign practices in the U.S. can be and are by some considered to serve the purposes of corruption in other countries (Azfar et al, 2001, p. 44). The literature is rich in definitions of corruption. Some refer only to situations in which one of the parties is a public official (LaPalombara 1995; Oldenburg 1987). Others look also at corruption between two private parties as in the case of commercial bribery (Coase 1979). Despite these disagreements, there is a broad similar understanding of the term ‘corruption’ in the world.

The ‘classic’ definition refers to the use of public office for private gain. First, there is a public official (X) acting for personal gain, who violates the norms of the public office and damages the interests of the public (Y) to benefit a third party (Z) who rewards (X) for access to the public goods and services that he/she (Z) could not otherwise obtain (Philp in “Measuring Corruption”, Sampford et al 2006, 45). This definition, like most attempts to capture corruption suffers from shortcomings.

The United Nations Conventions against Corruption proposed and began to define corruption as a list of specific acts or types. Some of the more encountered forms are ‘Grand’ and ‘Petty’ corruption. Grand corruption refers to the highest levels of a national government. Petty corruption refers to the exchange of a small amount of money, the granting of minor favors by people looking for preferential treatment, and, even the employment of relatives in minor positions (Langseth in Sampford et al 2006, 9). Such that it can take the form of bribery, embezzlement, conversion, extortion, or fraud or it can take the form of nepotism or cronyism,

abuse of discretion, improper political contributions, which fall outside of what is traditionally considered criminal.

Grand corruption is more likely to affect the reform in a systematic way (TI). The recipients of this type of corruption are senior officials from the executive, such as heads of state, the cabinet, the government ministers, top civil servants (including military and security apparatus leaders); from the legislative, members of the parliament; from the judiciary, supreme and high court judges; and from the local and regional authorities, governors, and local council members. Their motivations should be for the well being of the nation and the electorate and not for the use of public position for private gain. They use their power to capture and accumulate resources in an illegal way through corrupt behavior such as bribes, fraud and embezzlement. Examples of corrupt political activity are privatization, land allocation, public contracting, and lending (U4 Anti-Corruption Resource Center).<sup>2</sup>

#### Democracy and corruption

The literature on corruption focuses mainly on proving the negative impact corruption has on development, economic growth, income inequality and trust. Corruption is commonly considered one the most severe obstacles to development. In regards to the detrimental effect of corruption on democracies and the other way around, to date, scholars have shown that party competition encourages unscrupulous politicians to win by exploiting the opportunities for vote buying and illegal party financing (Little 1996; Johnston 1997; della Porta and Vannucci 1999). The protection of civil liberties and the enforcement of an independent judiciary can have

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<sup>2</sup> U4 Anti-Corruption Resource Center <http://www.u4.no/themes/political-corruption/introduction.cfm>

negative effects on corruption (Rose-Ackerman 1999; Schwartz 1999; Jamieson 2000; Moran 2001). Also, the protection of freedom of speech allows investigative journalism to find about and deter corrupt public dealings (Giglioli 1996, da Silva, 2000). Statistical studies find on the one hand a linear negative relationship between democracy and corruption (Goldsmith 1999; Sandholtz and Koetzle, 2000), while others observe corrupt practices increase with the political liberalization in Southeast Asia, Latin America, and former Soviet republics (Cohen 1995, Harris-White and White 1996). An argument has been made that due to the fact that democratic achievements lead to higher wages (Goldsmith 1995; Rodrik 1999) this, in turn, reduces incentives and opportunities for corruption among elected and appointed officials (Sandholtz and Koetzle, 2000, Van Rijckeghem and Weder 2001).

Mobilizing public preferences to agree upon who gets what, when, and how, and creating functioning institutions to process them are very complex endeavors. Research done on democracy, economic growth, income distribution, and war making looks at curvilinear solutions as better representations of reality (Hung-En Sung 2004, 181). In the same fashion, some scholars argue that corruption might be a transitional phenomenon, specific to the process of democratization, when procedural practices are still on the way to be strengthened by a solid liberal culture and effective institutions (Harris-White and White 1996, Rose –Ackerman 1999). The perspective of long-term remedies for corruption is brought about by the prospect of democratization, but there is a need for sustained effort to actually make them work in a successful manner (Mantinola and Jackman 2002).

Warren (2004) develops a theoretical model for mature democracies arguing that corruption fractures the bond between collective decision-making and people's powers to influence collective decisions through speaking and voting, which is the very link that defines

democracy. In regards to accountability, O'Donnell notes that in most Latin American countries, and in particular in those without traditional practices of protecting civil rights, even after introducing new democratic constitutions, the legal institutions lack reformation and the arbitrary practices of state agents remain unchanged (O'Donnell 2007, 2). The same is true for former communist countries. Stark and Bruszt (1988, 188) call this essential feature of healthy polities 'extended accountability' referring to the embeddedness of the decision making process in networks of autonomous political institutions that bound the arbitrariness of incumbents (Stark and Bruszt, 188)

Thus, the literature on corruption and democracy is inconclusive on the effect of corruption on democracy. I intend to supplement this void by arguing that corruption has a causal negative effect on democracy during the consolidation process.

This research focuses on how corruption mostly hurts democracy during its process of consolidation through two mechanisms. First, it damages the process of consolidation through blocking the inclusion in the political process of groups who have the right to participate and compete in the political arena (e.g electoral fraud). The indirect consequence of this obstruction is the fact that the checks on the powers of the winners are diminished. The second mechanism is lack of control on power, that is, the lack of accountability. The controls on the abuse of power are low in corrupt societies due to lack of rule of law and feeble civil societies. I find the second point key in building an accountable, stable democracy. If this link is missing, inclusion in politics is affected by default. Following, I will test the effect of corruption on these two important mechanisms in a democracy.

**Hypothesis 1** *Political corruption has a negative effect on the accountability mechanisms of a democracy, delaying the consolidation process.*

**Hypothesis 2** *Political corruption has a negative effect on the inclusion mechanisms of a democracy, delaying the consolidation process.*

### **Data and Measurement**

In order to test my hypotheses I will use panel data (cross-national, time-series) with random effects and perform several two-stage least squares analyses with one instrumental variable. Following is a discussion of the variables, case selection, and methods employed.

The dependent variable is *Democracy*. There is a lot of disagreement over what is an adequate measure of *democracy*. I selected four indicators. In the first model I will use the Freedom House (FH), political and civil rights scores which is the most widely employed measure for democracy. It has the benefit of an extensive temporal and geographical coverage. Each country and territory receives a numerical rating—on a scale of 1 to 7—for political rights and for civil liberties; a rating of 1 represents the highest degree of freedom and 7 the lowest level of freedom. These ratings establish if a country is classified as Free, Partly Free, or Not Free.

In order to test the validity of my results I also conduct tests with the *Polity IV* measure of democracy (Marshall and Jaggers, 2000). It measures the extent of authoritarian patterns within a country. It looks at how the executive is selected, the degrees of checks on executive power, and the form of political competition. The score depicts the regime authority spectrum on a 21-point scale from -10 (hereditary monarchy) to +10 (consolidated democracy).

For further robustness checks, I use the Worldwide Governance Indicators (1996-2008). The six aggregate indicators of governance represent the combined views of a high number of enterprise, citizen and expert survey respondents in industrial and developing countries. The

individual data sources for the aggregate indicators are obtained from a variety of survey institutes, think tanks, non-governmental organizations, and international organizations, and the indicators are updated on an annual basis since 2002. Results are reported in standard normal units ranging from around -2.5 to 2.5 continuous.

To test the first hypothesis, 'Control and Accountability' I use the *Rule of law* measure of the WGI index, defined as "the extent to which agents have confidence and abide by the rules of society, and in particular the quality of contract enforcement, the police and the courts, as well as the likelihood of crime or violence" (WGI).

In order to test the second hypothesis, 'Inclusion', I will use the *Voice and Accountability* measures of the WGI index "the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media" (WGI). Although the denomination of the variable includes the term 'accountability' it refers less to the legal institutional make-up and the balance of power and more to the ability of people to hold their representative accountable through voice and participation. Consequently, this measure has been selected to test hypothesis two, regarding inclusion.

The independent variable of interest is *Corruption*. Due to its illicit and immoral nature political corruption is one of the most inaccessible human behaviors to study scientifically. It is a clandestine action, and the high profile modes of enrichment and power abuse are intentionally tacit, concealed, and non-communicated. Due to its nature, observing a purposefully concealed activity poses problems for statistical measurement (Amundsen 1999, 28).

In order to test the proposed hypotheses I use Transparency International's Corruption Perceptions Index (CPI). It employs a ten-point scale to one decimal place. It ranges across different indicators. It is a composite index that uses compiled and/ or published data for two



previous years. In 2008 it was composed of thirteen surveys of business people and assessments by country analysts originating from 11 independent institutions. All sources use generally the same definition of corruption such as ‘the misuse of public power for private benefit’, including bribing of public officials, kickbacks in public procurement, or embezzlement of public funds (TI).<sup>3</sup>

Even though the World Bank control of corruption indicator and Transparency International CPI indicator present a very high correlation I will not employ this measure as the independent variable. The former is measured as the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests. Since WB measures the *control* of corruption it creates unsolvable problems of endogeneity. Not only that the disturbance term of the dependent variable, democracy measured as accountability or voice is correlated with the variable of

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<sup>3</sup> One of the pitfalls of this perception index is that it depends mostly on largely ordinal and imprecise judgments of its respondents; whose perception matters? There is a noted tendency for the CPI surveys to portray the view of Western businessmen that conduct business overseas. This existing index also avoids the challenge of integrating ‘harder’ versus ‘softer’ sources of data. Such ‘hard’ data would include figures for prosecutions for corrupt activity. Sure, these accounts would pose another puzzle, if the high number of prosecutions is due to the support of high corruption or as proof of low tolerance within the respective society (Philp, in Sampford et al, 2006, p. 49). Despite these pitfalls, CPI remains the most commonly employed measure for corruption.

interest, but in this case both the dependent variable and the independent variable almost literally overlap in definition and measurement.

Most of the control variables have been selected from the literature on democratization with attention to recent studies and their fixes for problems of endogeneity and omitted variable bias.

*Economic Indicators* According to the modernization theory, economic development is a precondition of democratic establishment (Papaioannou and Siourounis 2008, Hadenius and Teorell 2005; Boix and Stokes 2003; Przeworski et al. 2000, Alvarez et al. 2000; Burkhart and Lewis-Beck 1994; Lipset 1959) I include a measure of wealth as log of GDP per capita in purchase power parity value, and I also control for the logged Growth rate. Decreased economic growth has been found to be correlated with regime collapse (Gasioworski 1995, Geddes 1999). Since one of the most important debates is the direction of causality between economic development and democracy, and growth and democracy I use a now commonly employed method of controlling for it, the lag of the economic variables (Wright, 2009; Back and Hadenius, 2008). Both GDP and Growth are lagged at t-2. The data on Income is obtained from IMF. Additionally, I control for the effect of the economic crisis on the level of democratization by adding a dummy variable coded 1 for 2007.

*Institutional factors* Several binary variables have been added to test for the likelihood that institutional make up has an influence over the level of democracy. Former British colonies are usually associated with good governance due to the nature of the English legal system (La Porta et al. 1999). (CIA Factbook).

There is an expectation that parliamentary versus presidential systems might have a positive effect on the success of the democratization process due to the higher availability of

political contestation in parliamentary systems. The literature has no resolve for this hypothesis. I introduce a dummy variable coded 1 if *parliamentary* and 0 if presidential to control for this institutional difference (CIA Factbook). Similarly, a decentralized government should be an obstacle in the ability of corrupt political officials to extract local rents. A binary variable for *federal* government is also introduced (Norris 2009). One last institutional measure controls for the effect of being a member of the OECD.

*Social factors* The expectation is that ethnically fractious countries would perform worse in combating corruption (Alessina et al. 2003). *Ethnic fractionalization* is a variable that measures the degree of ethnic fractionalization within a country and it represents an index from 0 to 1, with 0 meaning no heterogeneity and 1 complete fractionalization (source: Alessina, et al 2003). With respect to cultural controls, four dummy variables are used to control for religious composition. According to previous studies, there is an inherent incompatibility between *Muslim* and *Orthodox* religions and democracy. Also, previous studies have shown an incompatibility between the hierarchical organization of *Catholic* societies and democracy. The only religion found to be positively influencing the level of democracy is the *Protestant* religion. (CIA Factbook).

*Regional factors.* Several regional dummies have been added to control for geographic effect on the level of democratization.

-Table 1 about here-

#### The Instrument

As mentioned above, testing the effect of corruption on democratization suffers from endogeneity problems. I have selected an instrument measured as the level of tariffs in a country.

The variable *Tariffs* represents the tariff rates based on unweighted averages for all goods in ad valorem rates, applied rates, or MFN rates (source: UNCTAD TRAINS and WTO IBD). In the following section I discuss the methodological pitfalls of testing the effect of political corruption on the level of democratic consolidation and the need to use an instrumental variable.

Attempting to isolate the effect of corruption on the level of different components of democracy suffers from grave statistical problems since the two variables are highly endogenous. The common understanding and most of the studies that link democracy and corruption treat the first as an independent variable and show the partial negative effect of democracy on corruption. They all suffer from the same endogeneity problem. Reversing the equation is uncommon and difficult to model. Consequently, I will use a statistical tool, called ‘instrumental variable’, and I will test several models of time series two-stage least square regressions. This method allows us to isolate only the effect of the endogenous variable on the dependent variable without the noise from the correlation between the unobserved causes of corruption and democratization.

The logic behind this method is that the 2SLS regression is a fix for models in which the disturbance term of the dependent variable is correlated with the cause or causes of the independent variables, in this case the disturbance term of the democracy variable is correlated with the disturbance term of corruption. The instrumental variable replaces the problematic variable. As the name indicates, the method includes two stages. In the first stage the instrumental variable is used as an independent variable while the endogenous variable is the dependent variable in the regression. The second stage consists of an OLS regression using the predicted values of the newly created variable to approximate the initial dependent variable, in this case, the effect of the values of corruption, approximated by the level of tariffs, on democracy. In order to achieve accurate results the disturbance term of the instrumental variable

should not be correlated with the disturbance term of democracy. This is an unknown fact, and there is no statistical test for its validity. Next, I present the reasoning behind choosing the ‘level of tariffs’ as the instrumental variable in the model.

I assume that the level of tariffs is correlated with the level of corruption, but that tariffs are not correlated with the unobservable determinants of democracy. There are two generally accepted models of explaining this relationship. The Ades and di Tella (1999) argument is that the presence of foreign competition has a negative outcome for corruption since it can put pressure on the domestic sector (‘foreign competition effect’). The direct consequence would be a decrease in rent-seeking behavior. On the contrary, having high tariffs and non tariffs barriers discourages imports, and keeps competition at a minimum. This fuels corruption. The second model, labeled the ‘direct policy effect’ (Gatti, 2004, 852) refers to how restrictions to trade and financial flows create the opportunities for collusive interaction between private and public sector, which result in exchange of favors for bribes. It is more attractive for actors to pay a bribe versus large amounts of taxes and customs duties required by governments.

The relationship between corruption and tariffs is the result of an unsophisticated cost benefit analysis on behalf of both actors. Using Thibault and Kelley’s (1959) payoff matrix in the case of Homan’s beneficial agreement one can find an equilibrium in an import clearance process between two individuals (Apaza, working paper 2007). In this game, due to low pay, the officer would rather receive a bribe (payoff =2), but is afraid of losing his job (payoff of not accepting bribe  $2-1=1$ ); while the Importer would rather pay the lower cost of a bribe (payoff =2), but in the case the officer does not accept he still has to pay taxes (payoff of offering bribe  $2-1=1$ ), which is valued higher than paying the high taxes from the beginning (payoff 0). (Apaza, 2007, p13). Surely, this is a different type of corruption than the corruption I refer to in this

design. Petty corruption though, is highly correlated with senior political grand corruption in new democracies, so this allows the use of the level of tariffs as an instrumental variable in the model. Consequently, the expectation is that the higher the tariffs are in a country, the more likely that country is corrupt.

		Importer	
		Not offer bribe	Offer bribe
Officer	Not accepting bribe	0	0
	Accepting bribe No import duty charge	0	2

Table 2: Payoff Matrix: accepting the bribe versus respecting the law (Apaza 2007,12)

-Table 3 about here-

The other precondition for a good quality instrument is that it is not correlated with the unobservable factors influencing the dependent variable, here democracy. In Table 3, for exemplification purposes I have selected countries in the same tariffs range that dramatically differ in the value of democratic establishment (e.g. Singapore, US, Estonia, Indonesia, El Salvador, and the US). I also chose countries in the same democratic bracket but varying in the level of tariffs (e.g. Nicaragua, Honduras). Even more, in some of the examples (Nicaragua, El Salvador) though the level of tariffs decreases or increases, the democratic scale point remains unchanged. Or the other way around, though the tariff level stays the same (Singapore) the country sees an improvement on democracy scale<sup>4</sup>.

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<sup>4</sup> The pair wise correlation between corruption and the FH democracy indicators is .66, between tariffs and corruption is .48, while between the FH indicator and tariffs is .27. These numbers

The two-stage least square generic regression model for this study is:

$$1^{\text{st}} \text{ stage} \quad \text{Corruption} = \alpha_0 + \alpha_1 \text{Tariffs} + \alpha_j X + \xi_{1t} + \mu_{1i} + \varepsilon_{1it}$$

$$2^{\text{nd}} \text{ stage} \quad \text{Democracy} = \beta_0 + \beta_1 \text{Corruption} + \beta_j X + \xi_{2t} + \mu_{2i} + \varepsilon_{2it}$$

I use the above econometric model to separately test the effects of the variable of interest, corruption, against all of the selected indicators of democracy (from WGI, Freedom House, and Polity IV). Here  $x$  is a vector of control variables such the economic, institutional, regional, social, and demographic indicators.

This is a dynamic model, cross-sectional and over time with random effects. An ideal model would include country fixed effects which can account for variation over time excluding all country-specific noise. However, since there are a high number of cases in the panel that do not vary in the level of democracy over time, dropping these observations would induce severe selection bias. The fixed effects method looks at the effect of the variable of interest on the dependent variable within a country and if levels of democracy do not change that unit would be dropped; such that, the next best available method is TSCS with random effects.

The universe of cases is composed of all democracies and hybrid regimes around the world as defined by the Economist Intelligence Unit (EIU) index of democracy (2007) from 1994 until 2007. I chose 1994 as base year since it is the first year with available data, from Transparency International. 2007 is the last year with available data on tariffs. The EIU index is

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point to the fact that ‘tariffs’ represents a good instrument. The variation we see in the level of democracy due to corruption is correctly instrumented through tariffs since there is less correlation between democracy and level of tariffs (under .3) while tariffs and corruption, and corruption and democracy correlations are more significant.

built on five democratic categories, the electoral process and pluralism, civil liberties, the functioning of government, political participation, and political culture (EIU, 2007, p.2). It represents a snapshot of the present stage of democracy around the world for 165 independent states and two territories. The large choice of cases offers a wide variance on the level of democratization excluding all authoritarian regimes. This way we can see the effect political corruption at all stages of democratic development. In the next section, I present the results for the 125 countries over 14 years.

## **Results**

The results of the two-stage least squared TSCS models presented in table four are in line with the expectations. Models one through three show clear statistical and substantive significance for the effect of corruption on democratic institutions. In model four, which uses the WGI Voice and Accountability measure, the instrumented corruption measure fails to reach statistical significance only at  $p < .181$ .

-Table 4 about here -

In the first model, using the Freedom House indicator for democracy, the variable of interest reaches significance at the .05 level with a coefficient of -1.23 points. Model two presents the estimation for the Polity IV index. Here too, the instrumented corruption measure achieves significance at the  $p < .10$  level by -2.5 points.

Models three and four report results for the Worldwide Governance Indicators aggregate measures of democracy. Corruption is again significant at the  $p < .05$  level (-.25). Interestingly enough, the economic crisis dummy only reaches significance in this model (-.08), although the magnitude is almost negligible. This is probably due to the fact that data availability stops in



2007, and I use lagged economic indicators. So, the effect of economic crisis might have not been captured by this analysis. Having a decentralized government is a drawback according to these findings (-.12), and so is being a South American country (-.31). Contrary to the expectations, being a Protestant country returned results of negative sign making it less likely to be democratic, and reaching significance in this third model (-.25), along the same lines as being an Orthodox country (-.25). Similar to estimations from previous studies, I find in this model that being a British colony has positive effects on the rule of law component of democracy (.25). Additionally ethnic fractionalization seems to have a considerable negative impact (-.27) on this measure of democracy.

Though barely failing to reach significance in the fourth model, which uses the Voice and Accountability measure of the WGI index, the coefficient of the instrumented corruption measure is in the right direction.

One interesting finding is that very few other variables test significant while controlling for corruption, which suggests omitted variable bias in previous studies. If corruption was not a crucial variable factoring in the democratic equation, then, many other controls should have reached significance as they did in other studies.

## **Discussion**

These findings are very valuable since the magnitude of the change in the democratic level with a unit improvement in the corruption score is very significant.

In the first model (Freedom House index), the magnitude of the effect of corruption is in line with the theorized hypotheses. The negative coefficient means that indeed corruption has a negative impact on democracy by 1.23 points, which is remarkably significant. Such that fighting

corruption and decreasing its value, by 1 point only, generates an increase in the Freedom House measure by 1.23 points. While FH ranges 1 to 7, and since approximately 70 % of the countries range on the democracy scale between 3.5 and 6.5, an increase 1.23 on this scale can make a real difference. The substantive interpretation is that it can move *flawed democracies* to the *full democracies* bracket. The Central Europe measure also reaches significance. New democracies in Central and Eastern Europe have almost 2 points advantage on the democratic scale (1.95).

In model two, the magnitude of the estimator is also significant by -2.5 points. Since the Polity index ranges -10 to 10 and given that 90% of the cases here are above the 1 point threshold, a 1 point decrease in the corruption index represents a noteworthy 2.5 points increase in the democratic level. This represents a significant jump on the democratic scale.

In model three the magnitude of the effect is once more noteworthy by -.25 points. Since approximately 77% of the countries range on this index between -1.25 and 1.25, then the .26 point increase in the WGI indicator can represent a considerable improvement of the rule of law in a country. The only important note to this model and the following estimation is that both WGI measures are perception indexes, which can be subjective to the source of perception.

The magnitude of the effect of being a country in South America has on the level of democracy is large enough to raise questions about what specifically about South America makes it less likely to have good governance scores. This is a question to explore further in detail in other studies.

These findings shed light on two debates in the literature. They address the development-democracy dilemma and add a causal factor for the success of the democratization process. When controlling for corruption, we observe flawed democratic mechanisms of inclusion in politics, and control of power. The second observation is that economic development loses

significance in the democratic equation. Neither income per capita nor higher economic growth generate better democracy scores when accounting for corrupt behavior and all other regional, social, and institutional factors, though significant in their absence (tested separately).

The link between higher income and better institutions is not obvious when corrupt political behavior is factored in. One excellent example, though not part of this data analysis, is China. Though experiencing incredible levels of growth, the outcome is not translated in better civil rights and liberties, inclusion in politics, and definitely not accountability.

In a less radical example take two countries experiencing high growth, one being corrupt and one less corrupt. In the latter, much of the money, during periods of increased growth, might go untaxed since corrupt behavior, such as bribes from companies to taxing agencies or simply non-reported gains will diminish the amount of money the government will receive. In less corrupt states most of the funds will be properly taxed and will reach governmental programs, which can improve institutions by properly remunerating, for instance, civil servants. On the other hand, even if economic growth may result in higher governmental resources, in corrupt countries, these funds get budgeted to projects that benefit companies related to politicians instead of going to social programs; which in their turn, can improve the lives of citizens through education and health care, and can also increase governmental legitimacy, all key components of democracy.

The fact that in all tests most of the previously significant factors in the democratic equation do not reach significance raises important questions of causal claims; less so in the case of the rule of law measure of governance, where a few indicators have a partial effect on democracy. Though statistical tests are probabilistic and indeterminate in regards to the ability to make such important claims, it is of special interest to further explore this loss of weight once

leadership, and in particular flawed leadership is factored in. This means that more careful attention needs to be paid in current research to the effect of and weight assigned to leadership.

Exploring the mechanism behind these findings I find that the negative effect on the consolidation of democracy comes from corrupt senior politicians, who misappropriate public resources for private gain, do not reform the justice system and the enforcement mechanisms to allow their independence and proper functioning and disable, thus, the democratic mechanism of accountability; they also disable the democratic inclusion mechanisms, such as voice, representation and participation from and on behalf of citizens. Once the formal democracy has been implemented and the democratic institutions are in place, the successful functioning of these rests upon completing the reforms, ensuring separation of power and creating an environment for the citizens to trust the regime. Without the elites assuming and respecting the rules of the game, and self-enforcing them, a mature democracy cannot be reached.

This process has roots in the first moments of the transition. After the fall of the authoritarian regime, the rules set by the first political elites, create a path dependence that dominates politics in democratizing countries. The consequence is that within corrupt societies (inherited from pre-democratic legacies and weak initial reform) officials can privately benefit from abusing their authority. The costs of completing the reforms exceed the benefits of maintaining a stage of state capture. The process of reform as a succession of reforms over time is supported by the winners until time  $t$ . (Hellman economic reforms model alike) Once passed this threshold, the winners will have an interest in vetoing more reform initiatives, since such measures have the potential of increasing checks on power and decreasing the private gains of previous stages. The consolidation of democracy stops, thus in a stage in which a few benefit from concentrated gains at a significant social cost.

Not discounting institutional constraints and structural dependencies, actually aside from them, we need to explore how the lack of institutional control on political leaders creates a vicious circle of constitutional manipulation on behalf of and for the benefit of politicians in power. If all else given, corruption accounts for almost a fourth of the variation in the democratic score, depending on the source, then we can conclude that it is a universal problem regardless of the environment. Singapore teaches us, more than we thought possible, that curing corruption is possible at the hand of a strong and determined leader. Though this is an imperfect example, the lesson is not that corruption can be fixed in an authoritarian manner, but that corruption can be fixed through enforcement.

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**Table 1. Summary statistics**

Variable	Mean	Std. Dev.	Min	Max	Observations
Democracy (FH)	5.45	1.42	1	7	1994
Democracy (Polity2)	6.73	3.96	-9	10	1647
Democracy (WGI v)	.36	.77	-2.03	1.82	1375
Democracy (WGI r)	.17	.97	-2.29	1.96	1361
Corruption	5.25	2.37	.1	10	1267
Tariffs	11.02	7.02	0	47.8	1120
GDP pc	11326.92	11918.81	14.20	82440.74	2088
GDP growth	4.07	4.28	-44.40	24.95	1963
Economic crisis	.23	.42	0	1	2108
Parliament	.4	.49	0	1	1785
Federal	.34	.47	0	1	1732
British colony	.27	.44	0	1	1785
OECD	.24	.42	0	1	2125
Ethnic fractionalization	.39	.24	.002	.93	2085
Africa	.2	.40	0	1	2125
Asia	.18	.38	0	1	2125
Central Europe	.16	.36	0	1	2125
South America	.24	.42	0	1	2125
Middle East	.03	.17	0	1	2125
Protestant	.29	.45	0	1	2125
Catholic	.37	.48	0	1	2125
Muslim	.10	.30	0	1	2125
Orthodox	.08	.27	0	1	2125

Table 3 Tariffs and democracy descriptive<sup>5</sup>

	Tariffs	Democracy	Tariffs	Democracy	Tariffs	Democracy
	2000		2005		2007	
<b>Singapore</b>	0	3	0	3.5	0	3.5
<b>Estonia</b>	1.1	6.5	1.7	7	1.6	7
<b>Nicaragua</b>	3	5	6.8	5	5.4	5
<b>US</b>	3.6	7	3.1	7	3.0	7
<b>Armenia</b>	4.3	4	3.6	3.5	2.9	3.5
<b>Kyrgyzstan</b>	4.6	2.5	-	-	2.9	3.5
<b>El Salvador</b>	7.2	5.5	6.4	5.5	5.2	5.5
<b>Indonesia</b>	7.8	4.5	6.0	5.5	6.6	5.5
<b>Honduras</b>	8.1	5	6.7	5	5.2	5

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<sup>5</sup> \*Tariffs range from 0 – 47.8

**Table 4. Democracy and Corruption**

	(1) Democracy Freedom House	(2) Democracy Polity IV	(3) Democracy WGI Rule of Law	(4) Democracy WGI Accountability
Corruption	-1.233** (0.588)	-2.505* (1.530)	-0.258** (0.109)	-0.703 (0.525)
GDP pc (lag t-2)=	-0.710 (0.539)	-1.637 (1.406)	0.134 (0.102)	-0.393 (0.484)
Growth (lag t-2)	-0.121 (0.102)	-0.320 (0.272)	0.0111 (0.0231)	-0.0106 (0.0407)
Economic Crisis	0.180 (0.146)	0.258 (0.407)	-0.0868** (0.0361)	0.00599 (0.0702)
Parliament	-0.259 (0.350)	0.217 (0.998)	0.0220 (0.0780)	-0.0723 (0.242)
Federal	0.239 (0.330)	1.137 (0.918)	-0.120* (0.0716)	0.169 (0.249)
British colony	-0.101 (0.273)	-0.762 (0.726)	0.252*** (0.0690)	0.0594 (0.169)
OECD	-0.720 (0.690)	-1.634 (1.804)	0.206 (0.138)	-0.335 (0.544)
Central Europe	1.953* (1.077)	4.009 (2.915)	0.0754 (0.210)	0.961 (0.848)
Middle East	0.552 (1.175)	3.157 (3.029)	-0.241 (0.262)	0.411 (1.020)
South America	1.134 (0.822)	3.386 (2.166)	-0.316* (0.182)	0.513 (0.679)
Africa	0.485 (0.578)	-0.152 (1.522)	0.135 (0.149)	0.146 (0.390)
Asia	0.125 (0.658)	0.0422 (1.710)	-0.0212 (0.153)	0.0985 (0.508)
Protestant	-0.253 (0.353)	-0.733 (0.928)	-0.250*** (0.0872)	-0.106 (0.219)
Catholic	0.348 (0.418)	0.418 (1.091)	-0.0220 (0.106)	0.200 (0.277)
Orthodox	-0.218 (0.538)	0.377 (1.424)	-0.248* (0.141)	-0.0846 (0.386)
Muslim	0.160 (0.532)	0.109 (1.443)	-0.131 (0.113)	0.113 (0.378)
Ethnic Fractionalization	-0.140 (0.569)	-1.975 (1.559)	-0.266* (0.146)	-0.0967 (0.404)
Constant	18.09** (7.497)	35.14* (19.58)	0.562 (1.393)	7.325 (6.646)
Observations	541	539	429	429
Pseudo $R^2$	.25	.13	.87	.48
df_m	18	18	18	18

Standard errors in parentheses\* p&lt;.10, \*\* p&lt;.05, \*\*\* p&lt;.01