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Applied Financial Economics ›

Volume 21, 2011 - Issue 7

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Economy-wide corruption and bad loans in banking: international evidence

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Pages 455-461 | Published online: 24 Jan 2011

Cite this article https://doi.org/10.1080/09603107.2010.532112

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Abstract

This study investigates the effects of economy-wide corruption on bad loans across a large sample of countries. The evidence reveals that greater corruption is associated with more bad loans. Loan defaults are lower in faster growing economies, in economies with higher lending rates and in nations in the Euro zone, ceteris paribus. However, other institutional controls, including central bank autonomy, financial underdevelopment, bank-based economies and transition nations fail to show appreciable effects on the incidence of bad loans. The findings are robust to an alternate corruption measure and to endogeneity of corruption. Policy implications are discussed.

Acknowledgements

This research was conducted when Dr. Goel was visiting the Bank of Finland. We are grateful to the bank for its hospitality and to the participants of XVIII 'Tor Vergata' conference on money, banking and finance, and Finlawmetrics 2010 for comments. Michael Naretta provided useful research assistance. The views expressed, however, are our own.

Notes

[1] A widely accepted definition of corruption takes it to be the abuse of public office for private gain.

[2] The behaviour of the central bank has also been taken elsewhere to capture banking-sector institutional quality (Huang and Wei, 2006; Arnone et al., 2007; Hasan and Mester, 2008).

[3] Year-to-year comparisons of the index, however, are problematic (see www.transparency.org for details). Consequently, we conduct a single-year cross-country study.

[4] The raw corruption indices have been transformed to unbind them (for consistency with the underlying assumptions of estimation methodology) and for ease of interpretation (higher post-transformation indices values imply greater corruption).

[5] A positive association between bad loans and corruption has been noted elsewhere, albeit with a different focus (Islam, 2007).

[6] Details are available upon request.

[7] As noted earlier in this article, we are able to examine the effect of overall corruption in an economy and not banking-sector corruption identifying specifically the presence of corrupt bankers (Islam, 2007).

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