Research Project on Corruption and Ethnicity

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This project suggests two broad topics around which to choose a research question. For more research topics, please see the syllabus of "Contract theory" of 2014/2015 and "Organizational Economics" of 2015/2016. You can also browse the research sections of our websites: https://sites.google.com/site/mtroyamartinez/research and https://sites.google.com/site/michelevalsecchi/ (both "papers" and "teaching" sections). The ultimate question to be investigated depends on the research interests of each student.

The thesis can use theory and/or empirical analysis. Students wishing to carry on a thesis with empirical analysis are required to take a course in microeconometrics. Students wishing to pursue a theoretical thesis are encouraged to take the course on "Organizational Economics". Students interested in running an experiment (in the lab or online) might be able to do so (under some conditions). Other skills that might be useful (depending on the exact empirical question and methodology) are ArcGIS.

1. Corruption, bureaucracies and incentives

There is increasing evidence that bureaucrats matter for economic outcomes (Bertrand et al. 2016). Bureaucrats matter because they enjoy an information advantage vis-à-vis their superiors with respect the implementation of a program or the provision of a service, which translates into a discretionary power that can be misused depending on the bureaucrats' ability, incentives and organizational structure.[1]

The result is the abuse of public office for private gain, which is exactly the definition of corruption commonly used in economics (Olken and Pande 2012). Although hard to study, there is piece-meal evidence that corruption is harmful for socio-economic outcomes (Bertrand et al. 2007).

Corruption can take several forms. The most investigated type of corruption is bribes. The standard theoretical model of bribing features a three-tier structure with a principal, a supervisor and an agent. The principal is usually a politician, the voters or the society at large, the supervisor is a bureaucrat, and the agent is a third party such as a citizen or a regulated firm. The society delegates a task to the bureaucrat. A bribe arises when the third party and the supervisor collude to take the wrong decision; that is, a decision that is not optimal for the principal, but that the third party prefers. For instance, consider a bureaucrat in charge of employing a drinking water provider for City X. Providing potable

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[1] An additional feature providing bureaucrats with discretionary power is the difficulty to measure their performance, typically because of multi-tasking issues.

water is costly for the provider and the bureaucrat is in charge of making sure that this happens (by paying the provider only if the water is potable). However, the water provider can pay a bribe to the bureaucrat to persuade her to pay even if the water is not potable. The seminal papers are by Tirole (1986) and Laffont and Tirole (1991). See Burguet, Ganuza and Montalvo (2016) for recent reviews of this collusion in hierarchies literature.[2]

Most of the above literature assumes that bribing can be enforced. However, given the illegality of bribes, it is unlikely that any of the parties involved in the bribe will be able to go to court in case of breakdown of the collusion agreement.[3] An interesting strand of literature for future research is to depart from this point of view by exploring how the need of **self-enforcing bribing** affects collusion. Only a few papers consider this avenue (e.g. Martimort (1999), Martimort and Verdier (2004) and Dufwenberg and Spagnolo (2015)). These papers acknowledge the fact that the bureaucrat may contract with the same water provider over time. What ensures that each party honors their part of the illegal transaction is the fact they want to keep contracting in the future. In other words, the water provider will pay the bribe because he wants the bureaucrat to employ him in the future. In general, the more the parties value the future, the larger the bribes that would be self-enforceable. The policy implication is that policies such as bureaucrats' rotation will effectively reduce bribes.

Sometimes, even the service provision cannot be court-enforced. This happens, for instance, when the quality of the good to be provided (e.g. the construction of a road) cannot be written down in a contract in a way that a court could enforce. This type of incomplete contracts is common when unforeseen events are possible or when the performance assessment is subjective. They are known in the literature as **relational contacts** (see the seminal paper by Levin (2003) and Malcomson (2012) for a survey). In these circumstances, the provider supplies the service and bureaucrat pays for it because they want to keep on contracting in the future. As with self-enforcing bribing, the more both parties care about their future, the better the service that it is provided in equilibrium. Differently from self-enforcing bribing, policies such as bureaucrats' rotation will reduce not only bribes, but also the quality of the service. A few papers have started to look into this issue (see Spagnolo (2012) and references therein). Troya-Martinez and Wren-Lewis (2017) look at this environment and establish how contracts to incentivize the provision of quality should be designed when there may be corruption underneath. A possible research idea would be to investigate how different anticorruption policies affect this type of relationships.

Corruption can take forms other than bribes, like embezzlement. More generally, corruption typically features a public officer but not necessarily a private counterpart. The benchmark model to study this type of corruption is the Becker-Stigler model (1973, but see Olken and Pande (2012) for a simple overview), which also motivates most of the empirical literature on corruption and deterrence.

Empirical studies have looked at whether bureaucrats are negatively selected into office (Hanna and Wang 2014), which incentives bureaucrats respond to (for example, Valsecchi 2016), whether the organizational structure matters for the equilibrium level of corruption (Shleifer and Visny 1993; Olken and Barron 2009, Burgess et al. 2012). Various econometric challenges (like, for example, how to measure corruption) led researchers to abandon cross-country studies in favor of within-country investigations. While the latter could be undertaken in any country, they tend to focus on relatively corrupt countries, like Indonesia, Brazil and Russia.[4] Empirical research on corruption could aim at measuring corruption, testing its determinants (as predicted by the models such as those listed above)

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[2] Moe (2012) has a survey chapter on government agencies that informally applies ideas about organizational design and performance to understand the complexity (and, at times, seeming perversity) of government agencies.

[3] Or, depending on the order of the events, the court cannot make sure that the bureaucrat pays the service provider once she has received the bribe.

[4] For example, corruption in Russia ranked 131/176 in the ranking of least corrupt countries (Transparency International 2016).

or even (perhaps more ambitiously), estimating the effects of corruption on economic decisions, including, but not limited to, investments or the type and frequency of daily economic transactions.

One convenient way to tackle such empirical questions is typically to take advantage of so-called natural experiments, like legislative changes. For example, between 2001 and 2004, Russia undertook a drastic reform in business regulation. Three national laws were passed to liberalize entry and operation of existing businesses with respect to inspections, licenses, and registration. In particular, each inspecting agency (for example, fire, sanitary, labor, or certification inspection) was forbidden from performing no more than one inspection in two years to each particular firm (see Yakovlev and Zhuravskaya (2013) and the MABS reports for more details). One potential avenue of future research would be to exploit the variation in the enforcement of the regulation to explore the impact of limiting the bureaucrats' discretion on corruption.

2. Ethnicity, favoritism and trust

There is now substantial evidence that ethnic diversity matters for both economic outcomes and conflict incidence. Initial cross-country studies suggested that ethnic diversity was negatively correlated with political and economic outcomes (Mauro 1995, Easterly and Levine 1997) and positively correlated with civil conflict (Montalvo and Reynal-Querol 2005). These studies attracted a lot of attention and spurred a substantial literature that developed in two main directions.

One strand of literature, in the spirit of the most recent macro-development literature, aims to test whether the reduced form relationship between ethnic diversity and economic outcomes (and/or civil conflict) is robust to econometric strategies stronger than cross-country correlations. This literature takes advantage of spatial data like digital maps of ethnic groups around the world, nighttime light intensity or georeferenced data on conflict events to run subnational analyses for many countries. For example, de Luca, Hodler, Raschky and Valsecchi (2016) test whether country leaders favor their own ethnic groups using panel data for more than 10,000 ethno-regions in 140 countries. Another example is Michalopoulos and Papaioannu (2016), who study the effect of ethnic partitioning (one of the consequences of colonial rule in Africa) on conflict.

Another strand of literature, more micro-oriented, aims to uncover the mechanisms through which ethnic diversity might affect economic outcomes. For example, there are at least two mechanisms for which ethnically homogeneous societies might do better than divided ones (Alesina and La Ferrara 2005). First, it could be that individuals care more about co-ethnics than they care about members of other groups. Second, it could be that individuals are better at supporting coordination with co-ethnics than with members of other groups because of advantages in exchanging information (in presence of imperfect information), or because of advantages in monitoring and punishment (with or without imperfect information). Both mechanisms suggest the ethnically homogeneous societies might be more trustworthy and able to support a wider set of economic transactions than ethnically diverse ones. Both mechanisms also suggest that ethnically diverse societies might be more prone to favoritism, i.e., favoring individuals based on ethnic affiliation rather than merit (see, for example, Drugov 2017 for a theoretical framework).

Another mechanism suggested in the literature is that individuals might have preferences more similar to those of co-ethnics than to those of members of other groups. This mechanism is consistent with the finding that ethnically homogeneous societies enjoy greater public good provision than ethnically diverse ones (Alesina, Baqir and Easterly 1999).

Researchers aiming to separate and test these mechanisms have resorted to labs in the field (Habaryama et al 2007) or very disaggregated data for small study areas (Robinson 2016 on Malawi, Suri et al. 2016, on Malawi, Hjort 2014 on Kenya). However, these studies have not yet succeeded in providing us with a clear understanding of which mechanism work (and when), which makes it an attractive avenue for further research.

While the literature is replete with mechanisms (and evidence) associating ethnic diversity with negative economic outcomes, Alesina and La Ferrara (2005) suggest that diversity, to the extent it brings with it diversity in skills that are complementary in production, can generate positive economic outcomes. Unfortunately, while there are some studies providing evidence of such an effect in the lab, there is no evidence of such effect in real organizations. One exception might be a recent paper by Rasul and Rogger (2015) on ethnic diversity within bureaucracies in Nigeria. Another (excellent) exception is Montalvo and Reynal-Querol (2016), who find that local ethnic diversity is associated with greater nighttime light intensity as well as greater likelihood of having a trade market, which is consistent with different ethnic groups specializing in different economic activities whose output they then trade with each other. This is certainly an area for which we need further research.

Russia constitutes an extremely promising setting to study these issues: it is home to more than 185 ethnic groups, with extreme heterogeneity in the degree of local diversity. Potential avenues for research include estimating the mechanisms through which local diversity within firms or public organizations affects socio-economic outcomes, as well as investigating the effect of historical events on ethnic minorities, and whether/how such effect persisted over time. For example, one could study the Russian Old Believers, who used to control a large share of the textile manufacturing industry and were persecuted on religious groups throughout the 19th century.

Finally, an avenue of future research that can be tackled by using either macro either micro methodologies is to test what are the basic differences that matter the most between ethnic groups with respect to economic outcomes. Examples of successful steps in this direction are Michalopoulos and Papaionnu (2013) on political centralization, Ashraf, Bau, Nunn and Voena (2016) on females' education and dowries.

Available databases:

* European Bank for Reconstruction and Development:

BEEPS dataset is a survey of firms in 37 Russian regions. It gives information on the variation of regulatory environment and entrepreneurs' perceptions. It is available at http://ebrd-beeps. com/

* World Bank:

The World Bank provides access to a rich source of other microeconomic survey data of entrepreneurs and consumers: http://microdata.worldbank.org/

* CEFIR:

MABS (Monitoring of Administrative Barriers to Small business) dataset: it collected data on regulatory burden on Russian firms by means of regularly repeated surveys of top managers in 2,000 small firms in a selection of 20 regions of Russia. See reports on survey results at www.cefir.org/index.php?l=eng&id=25 and interactive data base at www.cefir.ru/monitoring.

* RUSLANA:

Database on financial statements/income statements, balance sheets, cash flow statements/for all businesses (private or traded on stock exchanges) in Russia, Ukraine, and Kazakhstan. Students should have access to the RUSLANA database through CEFIR. For more information, see https://ruslana.bvdep.com/

* Russian official statistics:

Modern Russian official statistics both at national and regional level available at official Rosstat website http://www.gks.ru/wps/wcm/connect/ rosstat/rosstatsite/main/

* Surveys of governance and public officials:

The World Bank conducted two survey panels, a panel of district and settlement level public officials carried out in 2005 (a year preceding the enactment of the reform legislation) and 2007 and a survey of rural households carried out in the beginning of 2006 and in 2007 in the same randomly selected rural districts and settlements of three regions of Russia, the Republic of Adygheya, Penza, and Perm Oblast.

* Corruption, economic freedom:

Country level time series of indicators describing the extent corruption and degree of individuals' freedom have been developed by several institutions, including Heritage Foundation, Index of Economic Freedom. http://www.heritage.org/index/ See also: https://www.cesifo-group.de/ifoHome/facts/DICE/Business/Enterprise-Environment/Conduct-Regulations/economic-freedom-composit-index/fileBinary/economic-freedom-composit-index.xls

* Households well-being, local public goods, infrastructure:

 The World Bank has series of nationally representative surveys that contain very detailed information on households' well-being as well as information on local public goods and infrastructure (other countries are also available) http://iresearch.worldbank.org/lsms/ lsmssurveyFinder.htm

* The transparency ratings of regional governments in 2000:

www.strana.ru/print/128316.html

Ethnologue: Languages of the World, 16th edition | SIL International

Ethnographic Atlas by George P. Murdock

Geo-Referencing of Ethnic Groups (GREG) :
Weidmann, Nils B., Jan Ketil Rød, and Lars-Erik Cederman. 2010. "Representing Ethnic Groups in Space: A New Dataset". *Journal of Peace Research* 47(4): 491–99.

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