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THE EFFECTS OF CORRUPTION ON ENTREPRENEURIAL ACTIVITY: A CROSS- COUNTRY STUDY (SUMMARY)

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SUMMARY

THE EFFECTS OF CORRUPTION ON ENTREPRENEURIAL ACTIVITY: A CROSS-COUNTRY STUDY

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Principal Topic

Social scientists and policymakers have long believed that economic corruption affects entrepreneurial activity. They have differed, however, on precisely why and how corruption matters. One group, employing transaction cost reasoning, argues that corruption erodes trust and hence increases the costs of doing business. The parties involved in entrepreneurial ventures have to invest not only in bribes and payoffs but also incur heavier costs of monitoring each other because of lower levels of trust. (Casson, 1982; Casson and Godley, 2005) A second group emphasizes instead that corruption in institutional environments affects the allocation of entrepreneurial activity. Corrupt institutions do not so much lessen the incentive for entrepreneurship as it creates alternative (often less socially productive) paths in which entrepreneurial effort can be invested. (Baumol, 1994) Finally, network or embedded approaches to the subject distinguish between the generalized trust emphasized in the first two approaches and particularized trust in family, kin, and associates. The latter kind of trust, these scholars point out, may actually allow corruption to facilitate certain kinds of entrepreneurship. (Tonoyan, 2004)

Method

In analyzing the effects of corruption on entrepreneurship, we look at the effects of corruption, along with other variables on firm founding at the country level. Specifically we analyze the link between the institutional environment, corruption and the level of entrepreneurship. To test these arguments, we examine the rate of entrepreneurship in 175 countries. Since our interest is on the effects of the regulatory costs of doing business within a country as well the level of corruption on entrepreneurial activity, we utilize data from the World Bank, transparency international, the OECD as well as other sources to examine these relationships. Using event history analysis we demonstrate the effect of corruption on the likelihood entrepreneurial activity within a country.

Results and Implications

We find that the effects of corruption on entrepreneurship are complicated. In support of the network point of view, we suggest that corruption may have positive effects on the level of entrepreneurship in certain contexts. In situations where starting a business is difficult, corruption may allow access to certain markets that would be blocked or take too long for the entrepreneur to gain access to.

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