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Corruption, democracy, and economic growth in Kenya

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Abstract

The relationship between corruption, democracy, and economic growth is complex and multifaceted across empirical studies. Understanding this relationship is crucial for policymakers, researchers, and scholars alike as they seek to promote stable democracies and sustained economic development in middle-income countries. Kenya has long grappled with issues of corruption and challenges to its democratic processes. These problems have significant implications for governance, economic growth, political stability, religion, and social cohesion. This study investigates the effects of democracy and corruption control on Kenya's economic growth from 1990 to 2020. Utilizing the generalized method of moments (GMM) model for regression econometric analysis, the findings indicate that both democracy and control of corruption exert a positive and significant influence on economic growth in Kenya. The results of the democracy model support a positive correlation between democratic governance and economic development, while the corruption model aligns with the "sand in the wheels" hypothesis, suggesting that corruption may hinder economic growth in Kenya. Consequently, advancing democracy, streamlining bureaucratic processes, and implementing anti-corruption measures are crucial for achieving sustainable economic growth in Kenya. Ultimately, promoting good governance and transparency is essential for sustainable economic development, as strong democratic institutions can help mitigate corruption and enhance economic growth potential.

Keywords: Corruption, Democracy, Economic growth, Kenya.
JEL Classification: D72; D73; O47.

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Contents

Contribution of this paper to the literature

Kenya has long grappled with issues of corruption and challenges to its democratic processes. These problems have significant implications for governance, economic growth, and social cohesion. Understanding the dynamics between corruption and democracy in Kenya is crucial for addressing these longstanding challenges.

1. Introduction

Economic literature posits that democracy has the potential to enhance the quality of economic institutions, as suggested by Olson (1991). The effectiveness of institutions is crucial for optimizing public goods, thereby fostering economic growth. Variations in institutional quality are evident between democratic and autocratic regimes and are influenced by the prevailing levels of human capital within an economy (Krieger, 2022). The interplay of political participation significantly shapes governmental resource allocation. Opportunistic governments are likely to optimize the balance between rent-seeking and the provision of public goods to garner political support. In autocratic contexts, it is rational for the government to prioritize rent-seeking over public goods to sustain that support (Plümper & Martin, 2003). Consequently, democracy is associated with increased efficiency, thereby promoting productivity and growth. However, excessive political participation may compel governments to over-invest in public goods provision, leading to inefficiencies that can stifle private investment and hinder growth (Krieger, 2022; Plümper & Martin, 2003).

The relationship between corruption levels and economic growth presents ambivalence, with empirical studies suggesting that effective corruption control can enhance resource allocation efficiency and stimulate private sector growth (Iliyasu & Muhammed, 2023). Hodge, Shankar, Rao, and Duhs (2011) argue that corruption control may facilitate economic growth through a reduction in wastage and total government spending. Moreover, Kato and Sato (2015) posit that corruption might function to "grease the wheels" of the economy, thereby promoting efficiency, especially in less developed nations with fragile institutions. Conversely, alternative research indicates that corruption can diminish expenditure efficiency and detrimentally impact economic performance, effectively "sanding the wheels" of the economy (Mose, 2024; Nguyen & Bui, 2022). Nur-tegin and Jakee (2020) and Mose (2021) argue that corruption incentivizes those in authority to allocate budgetary resources based on personal preferences, resulting in distorted budgets that disproportionately favor projects susceptible to corruption and manipulation. Consequently, corruption exacerbates government expenditure, leads to wastage, and hampers domestic investment. Additionally, d'Agostino, Dunne, and Pieroni (2016) argue that corruption impedes economic growth by fostering increased military and unproductive expenditure.

The relationship between corruption, democracy, and economic growth is complex and interconnected. Corruption, which involves the misuse of power for personal gain, can undermine democratic institutions and diminish public trust in government. When corruption is prevalent, citizens may become disillusioned and politically apathetic, leading to weakened democratic practices. Democracy plays a vital role in combating corruption by promoting transparency, accountability, and citizen participation (Friedman, 1962). In a healthy democratic system, voters can hold leaders accountable, which serves as a deterrent to corrupt behavior. Strong institutions, such as an independent judiciary and anti-corruption bodies, are essential for investigating and addressing corrupt practices, fostering a culture of integrity. Corruption can significantly hinder economic growth by creating inefficiencies and discouraging investment. When businesses must navigate bribery and corrupt practices, economic competitiveness suffers, and public funds that could be used for vital services are misallocated. This can lead to stagnation or a decline in economic performance. Conversely, economic growth can strengthen democracy by fostering a more engaged and demanding middle class. However, if growth benefits only a small elite, it can exacerbate inequality and fuel corruption, undermining democratic values. Thus, inclusive and equitable economic development is crucial for supporting democratic governance.

2. Literature Review

Endogenous growth models posit that growth factors, institutions, and policies significantly influence economic expansion, with public goods serving as one of the key fiscal policies that affect resource allocation, private sector regulation, and public sector growth (Nguyen & Bui, 2022). Modernization theory suggests that the processes of economic, democratic, and political development in contemporary societies can lead to economic inequality, gender disparities, political instability, and corruption. Corruption is often viewed as a means of leveraging public power for private gain (Huntington, 1968). While various theories acknowledge the issue of corruption, they differ in their explanations of its causes and effects on growth and the economy. Moreover, the "wheel hypothesis" of corruption argues that it can sometimes be beneficial by "greasing the wheels" of the economy, thereby enhancing efficiency, particularly in poorer nations with weak institutional frameworks (Kato & Sato, 2015). Conversely, the alternative hypothesis indicates that corruption can diminish expenditure efficiency and detrimentally impact economic performance, effectively "sanding the wheels" of the economy (Dzhumashev, 2014; Nguyen & Bui, 2022). According to Friedman (1962) in his "Capitalism and Freedom" hypothesis, the interplay between political and economic freedoms is intertwined, and the impact of democracy on economic growth is contingent upon the quality of economic institutions (Friedman, 1962). Corruption can be linked to the political environment. Authoritarian regimes may foster corruption as a means of consolidating power, while democratic systems may struggle with corruption due to competing interests and the challenge of accountability.

3. Material and Methods

The study utilizes time series data from Kenya spanning the years 1990 to 2020. Data on GDP per capita growth (GDP), expressed as annual percentages; gross capital formation (GCF); final government consumption as a proxy for government expenditure (GE); along with consumer prices (as annual percentages) representing the inflation rate (CPI), were sourced from the World Development Indicators (World Bank, 2025). In contrast, data on control of corruption (CCR) and Democracy (DEM) were obtained from the Worldwide Governance Indicators (Kaufmann & Kraay, 2024) and Machine Learning (ML) democracy indices. These democracy indicators are scaled from 0 to 1,

where the values indicate weak to strong democratic performance, respectively. The control of corruption rankings range from -2.50 for weak to 2.50 for strong. Below is Table 1 for all target variables where data are available.

Table 1. Description of variables.

Variable	Description	Data source	Expected sign
Control of corruption (CCR)	Corruption Control Index	WDI	Positive Nguyen and Bui (2022)
Democracy (DEM)	Machines learning democracy index	ML	Positive Krieger (2022)
Government expenditure (GE)	General government final consumption expenditure (% of GDP)	WDI	Positive Ghose and Das (2013)
Investments (GCF)	Gross capital formation (% of GDP)	WDI	Positive Iliyasu and Muhammed (2023)
Inflation (CPI)	Consumer prices index (%)	WDI	Negative Nguyen and Bui (2022)
Economic growth (GDP)	GDP per capita growth (%)	WDI	Dependent variable

The foundational framework for growth regression analysis was derived from the seminal works of Barro and Sala-i-Martin (1995) on growth theories. Their equation posits that economic factors exert influence over human and physical capital through enhancements in stock, technological advancement, and ultimately, economic growth. Conversely, certain factors may diminish investment incentives, foster inefficiency, and induce market failures, thereby decelerating growth (Iliyasu & Muhammed, 2023). In alignment with the empirical findings of Nguyen and Bui (2022) and Iliyasu and Muhammed (2023), this study adapted the growth model to formulate growth equation 1, aimed at analyzing the impacts of corruption and democracy factors on economic growth within the context of Kenya. To analyze the effect of democracy and corruption on economic growth, the following model is used for this study.

$$GDP = f(CCR, DEM, GE, CPI, GCF) \quad (1)$$

The above model is written in the following general growth equation.

$$GDP_t = \delta_0 + \delta_1 CCR_t + \delta_2 DEM_t + \delta_3 GE_t + \delta_4 CPI_t + \delta_5 GCF_t + \varepsilon_t \quad (2)$$

In the above equation, δ,s are the coefficients, t indicates time dimension, and ε show error term.

This study uses the Generalized Method of Moments (GMM) estimation technique, as established by Arellano and Bond (1991), to explore the relationship between explanatory variables and economic growth, as shown in Equation 2. Prior research, including works by Cieślik and Goczek (2018), Hajamini and Falahi (2018), and Nguyen and Bui (2022), has successfully applied GMM for this purpose. GMM effectively addresses endogeneity issues by treating independent variables as endogenous when correlated with error terms. It also accommodates heteroscedasticity, avoids normality assumptions, and can estimate models not derivable from first-order conditions (Ergün & Göksu, 2013). The estimation incorporates a matrix of instrumental variables correlated with endogenous variables but uncorrelated with model errors. To validate the GMM estimates, diagnostic tests like the Hansen and normality tests will be performed, along with J-tests to confirm the exclusion of certain instruments (Hansen & West, 2002). Finally, a stationarity test using Phillips-Perron (PP) unit root tests will ensure that all variables are of the same order before proceeding with the regression analysis.

4. Results and Discussion

The study examined the properties of the time series data of the sample size using the Phillips-Perron (PP) unit root test. The results of the stationarity test are presented in Table 2.

Table 2. Unit root test results.

Variables	Level		First difference		Decision
	Adjusted t	Prob.	Adjusted t	Prob.	
GDP	0.74	0.99	-7.77	0.00	I (1)
GE	-1.97	0.29	-4.87	0.00	I (1)
CCR	-2.16	0.22	-5.37	0.00	I (1)
DEM	-4.80	0.00	-	-	I (0)
CPI	-2.79	0.07	-12.14	0.00	I (1)
GCF	-2.97	0.04	-6.59	0.00	I (1)

Note: Null hypothesis: The variable has a unit root.

According to the findings in Table 2, all variables exhibit a unit root, except for democracy, both significant at the 1% level. However, the five variables achieved stationarity after first differencing, indicating a mixed series of I(0) and I(1). Given the extensive duration (T) of the study, the unit root test was crucial in confirming the stationarity of all variables before the Generalized Method of Moments (GMM) estimation.

Table 3. GMM results.

Variable	Coefficient	Standard error	t-statistics	p-value
CCR	0.828	0.284	2.915***	0.007
DEM	5.405	0.376	14.350***	0.000
GE	0.196	0.006	29.995***	0.000
GCF	-0.010	0.005	-1.892*	0.070
CPI	0.001	0.001	1.042	0.307
Diagnostic	Durbin-Watson test = 2.014		Adjusted R2 = 0. 653	
	Hansen test = 2.116		P- value = 0.145	
	Jarque-Bera test= 1.199		p-value = 0.548	

Note: * $p < 0.1$, *** $p < 0.01$ are significance levels, in which the null hypothesis is rejected.

The study conducted a Generalized Method of Moments (GMM) regression analysis to define the relationship between economic growth and explanatory variables. Table 3 shows regression results using the GMM approach.

The examination of the interplay between democracy and economic growth reveals a pronounced positive correlation. Specifically, empirical evidence suggests that a 1 per cent increase in democratic governance correlates with an approximate increase of 5.405 per cent in economic growth. Prior research conducted by Sakyi and Adams (2012) and Tutuncu and Bayraktar (2024) has posited that democratic institutions significantly contribute to economic advancement. Baum and Lake (2003) elucidate this relationship by highlighting that democracy exerts a favorable influence on economic growth through mechanisms such as enhanced political stability, greater personal freedoms, and increased investments in health and education, which in turn elevate life expectancy. The literature on economics supports the assertion that democracy enhances the overall quality of economic institutions, as articulated by Olson (1991). Higher-quality institutions facilitate more efficient government expenditure, which is often linked to improved economic performance. In their study focused on Ghana, Sakyi and Adams (2012) found that democracy catalyzes economic growth through productive expenditure and complementary reforms such as macroeconomic stability and adherence to the rule of law.

Furthermore, the control of corruption has been empirically demonstrated to exert a positive influence on economic growth within the Kenyan context, with statistically significant results identified at the 1 per cent level. Specifically, a 1 per cent improvement in corruption control is associated with an approximate increase of 0.828 per cent in economic growth. These findings are consistent with those of Iliyasu and Muhammed (2023) in Nigeria, who contend that corruption impedes economic progress, effectively acting as "sand in the wheels" of development. Conversely, d'Agostino et al. (2016) suggest that corruption can be detrimental to economic growth by resulting in elevated military expenditures. Additionally, the phenomenon of corruption is often associated with the inefficient allocation of resources, the proliferation of a shadow economy, and suboptimal human capital development, as noted by Kato and Sato (2015). However, this perspective differs starkly in the Kenyan context, where corruption may operate as a mechanism for "greasing the wheels" of economic activity, thereby enhancing governmental efficiency. Nguyen and Bui (2022) further argue that under certain conditions of improved governmental management, corruption can stimulate economic growth. Additionally, Kato and Sato (2015) assert that corruption may facilitate more efficient economic operations, particularly in developing nations characterized by fragile institutional frameworks.

The regression analyses reveal a significant positive relationship between government expenditure and economic growth in Kenya, with a 1 percent increase in government spending leading to an approximate 0.196 percent rise in economic growth. This supports the Keynesian and endogenous growth theories, which argue that fiscal policy, particularly government spending, enhances economic growth through better resource allocation and increased support for private investments (Gisore, 2020). In terms of investment, a significant negative relationship is observed, indicating that a 1 percent increase in gross capital formation leads to a 0.010 percent decline in economic growth. This phenomenon is attributed to high debt levels, the crowding-out effect of investment, elevated interest rates, and inflationary uncertainties, which collectively hinder private and public sector capital development (Iliyasu & Muhammed, 2023). In certain contexts, especially in low-income countries, there might be negative impacts of gross capital formation on specific sectors such as manufacturing or private investment (Fumey, Mose, & Provide, 2024). Conversely, Ghose and Das (2013) and Nguyen and Bui (2022) found that fixed investment can stimulate growth. Lastly, while inflation shows a positive association with economic growth, its impact was not statistically significant during the study period. This suggests inflation uncertainty may dampen private sector confidence and growth, aligning with Nguyen and Bui (2022). In contrast, Iliyasu and Muhammed (2023) reported a positive relationship in Nigeria, attributing it to increased production output.

The coefficient of determination, adjusted R-squared, indicates that 65 percent of the variation in the dependent variable is explained by the independent variables, demonstrating a strong fit of the data to the model. Additionally, a Durbin-Watson value of 2.014 confirms that the error term is free from serial correlation, suggesting that autocorrelation is not a concern. J-tests, or Hansen tests, were conducted to assess the validity of the instruments. The Hansen J statistic showed a p-value greater than 0.05, which indicates that the study cannot reject the null hypothesis that the instruments are correctly excluded. This finding supports the conclusion that the instrumental variables are jointly valid, thereby allowing for the application of the GMM estimation technique.

5. Conclusion

The relationship between democracy, corruption, and economic growth is complex and significant in Kenya. Democracies tend to promote accountability and political stability, creating an environment conducive to economic growth by upholding the rule of law and property rights, which encourage investment. Conversely, corruption can severely hinder economic progress by misallocating resources and creating inefficiencies, diverting funds from essential public services and eroding public trust in institutions. This disillusionment can lead to decreased civic participation and weaken democratic governance. While authoritarian regimes might achieve short-term growth, they often foster an environment ripe for corruption and undermine long-term stability. Ultimately, promoting good governance and transparency is essential for sustainable economic development, as strong democratic institutions can help mitigate corruption and enhance growth potential.

To mitigate corruption effectively, a comprehensive approach is necessary. Strengthening independent institutions such as Kenya's anti-corruption agencies is crucial for promoting accountability. Enhancing transparency in government operations through open budgeting and public procurement processes can deter corrupt practices. Establishing strong protections for whistleblowers encourages reporting without fear of retaliation, fostering a culture of accountability. Additionally, promoting civic engagement allows citizens to hold officials accountable, while rigorous enforcement of anti-corruption laws ensures proper investigation and prosecution without political interference. Ethical training for public officials and leveraging technology for oversight can further reduce corruption risks. Finally, international cooperation in sharing best practices strengthens global efforts against corruption. By implementing these strategies, governments can create a more transparent and accountable system, significantly reduce corruption, and promote sustainable development.

Promoting democracy involves key strategies focused on political participation, accountability, and civil liberties. Strengthening democratic institutions such as independent electoral commissions and judiciary systems is essential for fair elections and the rule of law. Educating citizens about their rights empowers active political participation and civic responsibility. Supporting free and independent media fosters information dissemination and public debate, while protecting human rights ensures that diverse voices are respected. Encouraging civil society organizations provides platforms for advocacy and influence in policy decisions. Lastly, international cooperation can aid democratic reforms by sharing best practices and resources. By implementing these strategies, societies can create an inclusive democratic environment that empowers citizens and enhances governance.

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