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CORRUPTION, BANKING STABILITY AND ECONOMIC GROWTH IN THE MENA REGION

Abstract:

The positive relationship between well-functioning banking systems and economic growth is both empirically evidenced and theoretically underpinned with advances in endogenous growth theory. This issue again attracts attention since the financial crisis of 2008. Recent works highlight that banking and financial performance does not depend only on factors specific to the financial system; it is also affected by the quality of institutions. As policy makers battle to establish the good institutional environment for stable banking activity providing more effective intermediation of capital, corruption may prove a major hindrance. It may drive some borrowers such as small firms without bank connections to drop investment with positive impact and thus reducing their growth, while borrowers with such ties may have easier access to funding. The supply of funds to banks' connected parties may be associated with higher default rates and lower average recovery rates than non-connected ones, which could therefore destabilize the banking system. In as much as the stability of the banking system is a basis of economic stability and an important pre-condition for sustained growth it is a core objective for economic regulators and supervisors. This paper explores the impact of corruption on the stability of the banking sector and thereby on economic growth, using an unbalanced panel of aggregate data from 17 countries in the Middle Est and North Africa (MENA) region over the period 2008-2015. This region proves relevant upon several grounds. In fact, the key anti-corruption indexes show very high corruption levels in many countries across the region compared to global averages. Furthermore, in 2011 some MENA countries experienced upheavals, the Arab Spring that was partially driven by the demand to stop corruption. However, interim governments, continuing conflict, prevailing nepotistic networks and uncertain political futures still characterize many of these countries; effects of the 2011 events on the scope and nature of corruption in this region are unclear, making very appealing the studies addressing corruption challenges in MENA countries in pursuit of stability and growth in this region. Estimating the various models with the three-stage least squares (3SLS) estimator assess for direct and indirect impact of corruption upon banking stability and economic growth, respectively. According to estimates, corruption favors the occurrence of non-performing loans and deteriorates the stability of banks. Corruption has an indirect and negative effect on economic growth: it harms economic growth by taxing private investment and encouraging the flow of capital towards non-productive uses.

Keywords:

Banking Stability; Corruption; Economic Growth; MENA Region; Non-Performing Loans

JEL Classification: D73, G21, O47