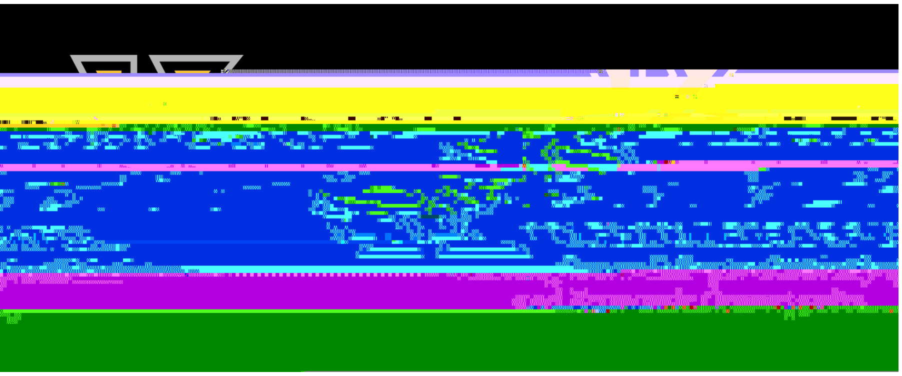

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In the minds of many, corruption and the stock market are synonymous. Various Hollywood depictions of "Wall Street," along with a few books by Michael Lewis, have made sure of that. The reality in terms of their overall impact on the economy, however, is that the two are more or less polar opposites: one is good and one is bad.

A well-functioning financial sector, including stock markets, is kind of important for economic growth (meaning GDP growth).

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w a simplified explanation and there are plenty of de

caveats. But taking idle funds from savers and allowing productive firms to put them t

return for a share of profits is the basic idea, C-11.6 and that's why having a stock market muled distrust in public institutions, the number of bribes or irregular payments necessary to get things done, and contract enforcement. Using those measures, we look at the corruption-stock market relationship for 87 countries from 1995 to 2017.

When comparing the full sample of 87 countries, we find no significant relationship between corruption and stock market growth. That result alone may seem a bit unexpected, but it's not too shocking, since comparing large groups of diverse economies often leads to insignificant results. The countries are so different from one another that the effects are hard to disentangle. So, to get a closer look, we divided the sample into two groups, developing and developed economies,[5] and looked at the relationship within each group. These results are a bit more surprising.

For the group of developed economies (those with higher per capita incomes), the results are as expected: corruption is negatively related to stock market development. There we go. Corruption makes things in general more difficult, and that includes listing on the stock market! There is also evidence of a diminishing returns effect, as the economy's income level had a negative effect on the effect of corruption itself. This also makes sense. The higher an economy's per capita income: the more developed it is, the lower its level of corruption already, so the smaller effect a further incremental decrease in corruption will have on its stock market. Again, these results seem to make sense intuitively.

The results for the group of developing economies are the surprising part. Developing economies show no significant relationship between corruption and stock market development (which also means they drive the insignificant relationship for the full sample). That's especially surprising given the results for the developed group that suggest diminishing returns – if higher income economies see a smaller negative effect of corruption on stock market development, shouldn't lower income economies see a larger negative effect? Or, conversely, if that relationship holds, we would expect corruption to have a larger effect on developing economies.

But it doesn't. Reducing corruption does not seem to have an impact on stock market development in developing economies at all. Only in wealthier, developed economies, that already have less corruption than those in the developing group. Why?

From what we can tell the answer isn't that less corruption would never have an effect. It's just that developing economies tend to have levels of corruption that are already so high that small reductions do not make a significant impact on firms' decisions to list on the stock market, given the rest of the economy's conditions.

Consider a new, growing firm that faces a large variety of costs, some of which may be due to corruption. All of those costs, as well as the business outlook of the economy as a whole, contribute to whether or not the firm will be healthy enough to list publicly. Though the primary purpose of listing is to gain more access to funding by selling shares to the public, the process itself is quite cumbersome, and the firm must be strong enough to convince investors to buy in. Now consider what happens if there is a reduction in the economy's level of corruption, so that those related higher, a marginal