

Effect of Corruption, Income Inequality, and Unemployment on Poverty in Context of Nepal

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ABSTRACT

The aim of this study is to look into the connections between unemployment, economic inequality, and poverty in Nepal. In the study, variables including absolute poverty, CPI index score, Gini coefficient, and unemployment are used with data from 2000 to 2020. The Toda Yamamoto test was used in the study to determine whether the variables were causally related because not all data were stationary, even at the second difference. Additionally, the stability was evaluated using a cointegration test, and the normalcy test was observed using a descriptive analysis. According to the study's findings, poverty in Nepal is significantly influenced by corruption, income inequality, and unemployment. The variables are found to have a direct or indirect correlation with one another. Therefore, the study comes to the conclusion that preventing poverty in Nepal would be difficult without reducing corruption, economic disparity, and unemployment. Policymakers may find the findings helpful in creating plans to combat poverty and advance the nation's economy.

Keywords: Poverty, Corruption, Unemployment, Income inequality, Toda yamamoto, Granger causality
JEL Classification: I32, D73, J64, D63

Introduction

Poverty is one of the major problems that affect the economy of a society, state, and country. We need earning for a living so to live, people are engaged

in different income generating work and activities to earn living. It is difficult to eliminate poverty at once. In simple words, poverty can be defined as lack of basic needs. While defining poverty, a definition varies, as there are different angles to observe poverty. We can define poverty according to traditional views or modern one. The traditional approach defines poverty as a shortfall in monetary value. Modern viewers talk about lack of good education, lack health facilities, social discrimination, and justice all should be considered as indicators while defining poverty (Fusco, 2003).

In Nepal, major occupation used to be Agriculture but after Maoist insurgency it was changed due to migration and centralization. Now, main source of country's economy is remittance. Poverty is decreasing gradually due to remittances from migration, more diverse labour income (Sapkota, 2013). Migration remittances increased Nepal's GDP between the late 1990 and 2014 this can be considered one of the major factors in reducing poverty. As poverty of Nepal in 1994/95 was 42 percent and instead of as declines to 31 percent in 2003 (World Bank,2020).

There is a common belief that poverty is caused due to unequal distribution of resources, corrupt system, and unemployed conditions (Addae-Korankye, 2014). Moreover, lack of sufficient employments and unequal distribution in resources create difficulties in less developed countries (Dabla-Norris et al., 2015). People are at risk of hunger and homelessness due to absolute poverty (Pumariega et al., 2022).

Corruption is a very old social illness. The old Hindu scripture 'Atharva Veda' warns people to avoid corruption. In one of the statements in Atharva Veda it said that the wealth earned through pious means flourishes and those who earn through dishonest means are destroyed (Laskar, 2020). Corruption is a social and economic evil, which hampers the overall development of a country and society (Shah, 2018). Nepal Corruption Index in 2004 ranked Nepal in 90th position with a score of 24 out of 146 countries listed (Transparency International, 2021). The requirement for transparency in the allocation of public expenditures is important if the goal of investments in public goods is to increase the economic growth of developing countries (Castro, 2019).

Income inequality is a remarkable disparity in the distribution of income between individuals, groups, populations, social classes, or countries. Income inequality is a major dimension of social stratification and social class that affects and get affected by many other forms of inequality, such as inequalities of wealth, political power, and social status (Carter & Howard, 2020). According to the World Bank Nepal (2021), as Nepal undergoes a significant shift towards becoming a federal and secular republic, it presents a crucial moment for the country to capitalize on opportunities for poverty reduction, enhancing the income of the bottom 40 percent, and pursuing an agenda focused on inclusive growth and responsible provision of services. However, Oxfam and HAMI (2019) in their findings indicate that the wealthiest 10 percent of Nepal's population possess wealth that exceeds 26 times the combined wealth of the poorest 40 percent.

Talking about unemployment, it is a condition in an economy where an individual is willing to and is capable of working, but unable to find a job. Because there are no jobs available on the market, a person is unemployed, and they are not contributing to the economy. It is lacking the condition of utilization of resources that eats up the production in an economy (Nepal, 2020). Looking at all scenarios, the purpose of this study is to find the impact of corruption, income inequality, and unemployment on poverty. Is there any direct relationship between poverty, corruption, income inequality and unemployment? The aim of this research is to examine the influence of corruption, income inequality, unemployment on poverty in the context of Nepal. The question of the study for research are used as what the relation between corruption, income inequality and unemployment on poverty in context of Nepal is, and what the role of corruption, income inequality, and unemployment on poverty in Nepal is. The general objective of the study is to analyze the role of corruption, income inequality, and unemployment on poverty in Nepal whereas specific objective is to analyze the relation between corruption, income inequality, and unemployment on poverty in Nepal and to investigate the trend or pattern of effect on poverty due to corruption, income inequality, and unemployment in Nepal.

Nepal, is one of the least developed nations in the globe. Even though Nepal is richer in natural resources, its economy is dependent on imports of basic commodities, goods and materials. According to National Planning Commission (2021), 17.4 percent of Nepalese are multidimensional poor. There are many causes of poverty such as political system, administrative system, geographical features, and many more. Keeping natural features like landlocked countries, natural calamities aside, there are various factors about the system of a state that is artificial just like plans and policies about the economic system. When it comes to a question about “what are the causes of poverty?” to the general people of Nepal, most of them consider “corruption, income inequality, unemployment”.

Despite the recent economic gains made by Nepal, the nation still struggles with extreme poverty. This study intends to investigate how poverty in Nepal is affected by corruption, economic inequality, and unemployment. The goal of the research is to pinpoint the main causes of the nation's ongoing poverty by examining the correlations between these variables. The results of this study will give policymakers and other interested parties useful information for creating targeted interventions and strategies to reduce poverty and encourage inclusive growth in Nepal.

Hypothesis

H1: There is an effect of corruption, income inequality, and unemployment on poverty.

Review of Literature

Theoretical review:

Marx & Engels (1967) argued that unemployment is a natural outcome of the unstable capitalist system and that crises of mass unemployment are to be expected. They viewed unemployment as an essential component of capitalism, with periods of recovery and growth intertwined with it. Initially, unemployment arises due to the scarcity of means of production. According to their perspective, as capital and production expand, unemployment rates also rise. They further posited that workers' wages would remain at subsistence levels, and the unemployed would experience a continuous decline in their economic well-being. This connection between unemployment and poverty highlights how the capitalist system perpetuates economic hardships for those without work (Marx & Engels, 1967). Poverty can be linked with income with the labour market to the structural view, where corruption lies on political theory and unemployment under the behaviour theory (Brady, 2019).

According to Chene (2014), the corruption affects economic development in terms of economic efficiency, it also has a distributional impact. Poverty can only be fought in the presence of strong institutions, and equitable distribution of resources (Addae-Korankye, 2014).

In general, after some conceptual and theoretical review it can be said there are some factors which affect poverty. Poverty, income inequality, corruption, and unemployment are related somehow directly or indirectly in a broader sense.

Enofe et al. (2016) analyzed and found an insignificant positive relationship between corruption, unemployment, and poverty. Bayar et al. (2017) explored Central and Eastern European Union transition economies and observed a one-way causality from poverty to corruption and from income inequality to poverty. Gupta et al. (2018) examined corruption in Nepal and highlighted the need for effective policies and programs to address corruption and its associated factors. Iskandar & Saragih (2018) found that corruption has positive significant effect on the level of poverty ratio in 1% significance level in the long run. Using Autoregressive Distributed Lag (ARDL) and dynamic Error Correction Model (ECM) result shows 1% increase in corruption would increase the poverty ratio by 1.36% in the long run.

Shabbir et al. (2019) emphasized the positive relationship between poverty and corruption, advocating for measures to reduce poverty and combat corruption in less developed nations. Muhammad & David (2019) used descriptive statistics and a logistic regression model to study the characteristics of the participants and understand how unemployment affects poverty. They collected data from 102 individuals in three different regions of the state. Their findings from the study reveal a direct correlation between poverty and unemployment, suggesting a possible causal connection between the two variables.

Ojo et. al (2020) tried to find the relationship between political corruption, income inequality and poverty between 2000 and 2019. They had carried out study within the framework of fully modified ordinary least square and Granger causality. Their research showed that there is a significant negative association between political corruption and income inequality in Nigeria. There was insignificant direct connection between corruption and the headcount of poverty in Nigeria. Their studies imply that the current poverty levels in the country are not directly driven by political corruption.

These studies collectively contribute to the understanding of the multifaceted relationship between corruption, inequality, poverty, and unemployment, offering valuable insights for policymakers and researchers.

Research Gap

Study on the connection between corruption, income inequality, and unemployment on poverty has exploded since existing researches were not able to definitively establish which of these three variables is causally related. In light of all of this, the current study uses the VAR model to examine the causal link between corruption, income inequality, and unemployment on poverty in Nepal. The nature of the relationship between the nation's corruption, income inequality, and unemployment on poverty must thus be examined. Even though Nepal has adopted a strategy of poverty alleviation and elimination of corruption since the restoration of democracy in 1993, adequate economic progress has not been found, and there is a paucity of study on the subject. The objective of this study is to fill the aforementioned empirical gap.

Conceptual Framework

In the context of Nepal, the relationships between corruption, economic disparity, unemployment, and poverty can be intricate and intertwined in (Figure 1). These components are linked together in complex ways. For instance, corruption can thwart efforts to lower unemployment and economic disparity, which keeps people in poverty. In turn, unemployment and income disparity can foster an environment in which corruption might flourish. Sustainable poverty reduction efforts in Nepal depend on tackling corruption, lowering economic inequality, and encouraging job development. The relationship between corruption, economic disparity, unemployment, and poverty in Nepal is explained generally in this response, it is crucial to notice.



Figure 1. Relationship of corruption, unemployment, economic disparity, and poverty.

Research Method

Research method involves the scientific study of how research is conducted, outlining the typical steps taken to investigate a research issue. Alok & Mishra (2017) describe research methodology as the adopted scientific approach for conducting research.

Data description and variables

To analyze data, a vector autoregressive model is used. The long-term and short-term relationships between the unemployment rate, Gini coefficient, corruption index, and poverty rates were examined using data from 2000 to 2020. Using data from 21 samples, this objective is achieved. All of the data used in this analysis were gathered from the central bank and finance ministry of Nepal's websites.

UNE: UNE denotes unemployment shown unemployment rate in Nepal.

DIS: DIS denotes Gini coefficient used to measure income disparity in Nepal.

COR: COR denotes Corruption Index used to measure in Nepal

POV: POV is used to measure poverty level in Nepal

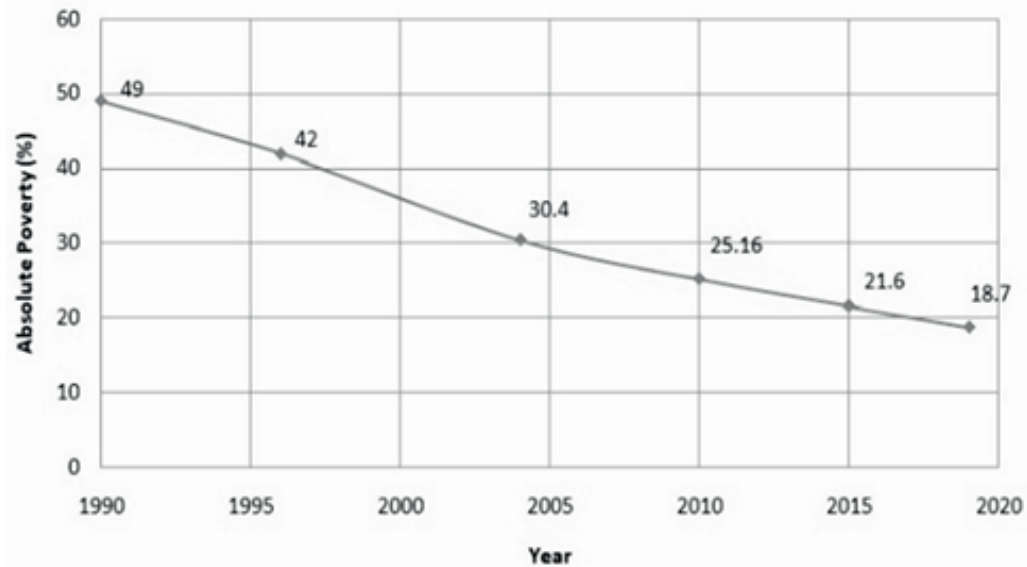


Figure 2. Population below poverty line (Ministry of Finance, 2020)

Tools and Techniques

This study is based on the time series data of Nepal collected from 2000 to 2020 A.D. The data analysis should be used per time series properties and nature of data. To make the information noticeable and comprehensible, tabulation and graphical diagrams are prepared.

Source of data

The data used in the study was obtained from various sources. The poverty data (Figure 2) was extracted from the economic survey graphs of Nepal provided by the Ministry of Finance (MoF, 2020). The absolute poverty rate in Nepal was 36.32 percent in 2000 and gradually decreased over the years, reaching 18.7 percent in 2020. Income inequality data, measured by the Gini coefficient, was sourced from Oxfam and HAMI (2019), World Bank (2021), and GapMinder (2018). The Gini coefficient fluctuated between 39.50 percent and 49.50 percent from 2000 to 2020. Unemployment rate data was obtained from the World Bank's ILOSTAT Database, showing an increase from 1.80 percent in 2000 to 4.44 percent in 2020. Corruption data was based on the Corruption Perception Index (CPI) provided by Transparency International, with Nepal's score ranging from 22 to 34 between 2004 and 2020.

Methodology

Firstly, data is checked to determine if it is stationary or non-stationary. For data analysis, EViews 10 software is used. Based on the properties of available data, we need to find out which test is suitable as it belongs to time series analysis. If data show stationary trend, then analysis would be easy using the Granger Causality Test, if not we have to use different tools and techniques. If the results have a mixture of both stationary and non-stationary, we should go for Toda-Yamamoto Augmented Granger Causality Test which is independent of order of integration and possible co-integration (Toda & Yamamoto, 1995). We have to find out lag intervals in Vector Autoregression (VAR). Toda-Yamamoto Test is generally used for non-stationary data, nevertheless it can also be applied if variables are a combination of stationary and non-stationary. To test stationary and non-stationary nature of data, unit root tests are done and observed.

In order to investigate the causality among public debt and Gross Domestic Product and the direction of causality, the causality test proposed by Toda-Yamamoto (Toda & Yamamoto, 1995) was applied. This test is an appropriate approach to avoid some of the problems faced by the Granger Causality Test. For the Granger Causality Test to be performed, the series must be stationary or be integrated in the same order. However, it should be considered that there may also be causality between different series of integrated series. An advantage of this test is that it does not consider the cointegration information in the system. Testing can be done regardless of whether

the series is cointegrated. In the Toda-Yamamoto approach, the standard vector autoregressive model (VAR) is created by using the levels regardless of the order of the series. Then, the actual order of the VAR model is artificially changed to $k + d_{max}$ by adding the maximum integration order d_{max} . However, the coefficients of the terms added to the model are not taken into consideration. In this causation procedure, the integration order (d_{max}) must not exceed the actual range (k) of the VAR model. According to the Toda- Yamamoto causality test procedure, poverty, corruption, Gini coefficient and unemployment are presented as in Equation 1.

$$poverty_t = \alpha_0 + \sum_{i=1}^{k+d_{max}} \alpha_1 poverty_{t-i} + \sum_{i=1}^{k+d_{max}} \alpha_2 corruption_{t-i} + \sum_{i=1}^{k+d_{max}} \alpha_3 Gini\ coefficient_{t-i} + \sum_{i=1}^{k+d_{max}} \alpha_4 unemployment_{t-i} + \varepsilon_1 \dots\dots\dots 1(a)$$

$$corruption_t = \beta_0 + \sum_{i=1}^{k+d_{max}} \beta_1 corruption_{t-i} + \sum_{i=1}^{k+d_{max}} \beta_2 poverty_{t-i} + \sum_{i=1}^{k+d_{max}} \beta_3 Gini\ coefficient_{t-i} + \sum_{i=1}^{k+d_{max}} \beta_4 unemployment_{t-i} + \varepsilon_2 \dots\dots\dots 1(b)$$

$$Gini\ coefficient_t = \delta_0 + \sum_{i=1}^{k+d_{max}} \delta_1 Gini\ coefficient_{t-i} + \sum_{i=1}^{k+d_{max}} \delta_2 poverty_{t-i} + \sum_{i=1}^{k+d_{max}} \delta_3 corruption_{t-i} + \sum_{i=1}^{k+d_{max}} \beta_4 unemployment_{t-i} + \varepsilon_3 \dots\dots\dots 1(c)$$

$$unemployment_t = \eta_0 + \sum_{i=1}^{k+d_{max}} \eta_1 Gini\ coefficient_{t-i} + \sum_{i=1}^{k+d_{max}} \eta_2 poverty_{t-i} + \sum_{i=1}^{k+d_{max}} \eta_3 corruption_{t-i} + \sum_{i=1}^{k+d_{max}} \eta_4 unemployment_{t-i} + \varepsilon_4 \dots\dots\dots 1(d)$$

Data Analysis and Findings

Firstly, we checked whether level data of all variables are integrated or not. That means all variables are stationary or not. To test stationarity ‘Augmented Dickey-Fuller test’ is conducted and the result is in Table 1 and Table 2.

Table 1. P-value of variable at level

| Variables | P-value |
|------------------|---------|
| Poverty | 0.001 |
| Inequality (dis) | 0.030 |
| Unemployment | 0.995 |
| Corruption | 0.747 |

Table 2. P-value of variable at first difference

| Variables | P-value |
|------------------|---------|
| Poverty | 0.36 |
| Inequality (dis) | 1.00 |
| Unemployment | 0.69 |
| Corruption | 0.02 |

Lag Length Selection

In order to use Toda-Yamamoto test, lag length criteria should be tested. The following table shows the selection of lag length criteria. The VAR lag order selection criteria is 2 as shown in Table 3.

Table 3. VAR Lag order selection

| Lag | log L | LR | FPE | AIC | SC | HQ |
|-----|-----------|-----------|-----------|-----------|-----------|-----------|
| | -120.4378 | NA | 188.8563 | 16.59170 | 16.78052 | 16.58969 |
| 1 | -42.76787 | 103.5599 | 0.056330 | 8.369049 | 9.313116 | 8.358993 |
| 2 | -2.125732 | 32.51371* | 0.003994* | 5.083431* | 6.782751* | 5.065330* |

Source: Based on Author's computation from EViews 10

VAR model Estimation

Following is the representation for VAR model estimation (Equation 2). The result of VAR Granger Causality is shown in Table 4.

$$POV = 0.20 \times POV (-1) - 0.08 \times POV (-2) + 0.38 \times UNE (-1) - 0.94 \times UNE (-2) - 0.10 \times DIS (-1) + 0.30 \times DIS (-2) + 0.07 \times COR (-1) - 0.07 \times COR (-2) + 3.30 + 0.73 \times POV (-3) - 0.13 \times UNE (-3) - 0.22 \times DIS (-3) + 0.02 \times COR (-3)$$

$$UNE = 0.41 \times POV (-1) - 0.66 \times POV (-2) - 1.90 \times UNE (-1) - 1.09 \times UNE (-2) + 0.18 \times DIS (-1) + 0.26 \times DIS (-2) + 0.02 \times COR (-1) + 0.02 \times COR (-2) + 23.73 + 0.65 \times POV (-3) + 0.36 \times UNE (-3) - 1.25 \times DIS (-3) + 0.10 \times COR (-3)$$

$$DIS = - 11.67 \times POV (-1) + 8.58 \times POV (-2) + 1.46 \times UNE (-1) + 11.68 \times UNE (-2) + 0.96 \times DIS (-1) - 2.75 \times DIS (-2) - 0.222 \times COR (-1) + 0.32 \times COR (-2) - 33.76 - 0.11 \times POV (-3) - 2.93 \times UNE (-3) + 5.75 \times DIS (-3) - 1.137 \times COR (-3)$$

$$COR = - 7.91 \times POV (-1) + 3.92 \times POV (-2) + 10.51 \times UNE (-1) + 3.01 \times UNE (-2) + 0.69 \times DIS (-1) - 2.26 \times DIS (-2) + 0.11 \times COR (-1) - 0.33 \times COR (-2) - 39.28 + 3.00 \times POV (-3) + 2.73 \times UNE (-3) + 3.86 \times DIS (-3) - 1.19 \times COR (-3)$$

Table 4. VAR Granger Causality result

| Dependent variables | Independent | Causality/Direction | P-value |
|---------------------|-------------------|---------------------|---------|
| Poverty | Corruption | Causality | 0.0000 |
| Poverty | Income inequality | Causality | 0.0082 |
| Poverty | Unemployment | Causality | 0.0071 |
| Corruption | Poverty | No Causality | 0.8202 |
| Corruption | Income inequality | No Causality | 0.4620 |
| Corruption | Unemployment | No Causality | 0.1480 |
| Income inequality | Poverty | No Causality | 0.6147 |
| Income inequality | Corruption | No Causality | 0.4550 |
| Income inequality | Unemployment | No Causality | 0.1062 |
| Unemployment | Poverty | No Causality | 0.6065 |
| Unemployment | Corruption | No Causality | 0.3118 |
| Unemployment | Income inequality | Causality | 0.0140 |

Diagnostic Checking

Heteroskedasticity, Serial correlation, and Residual Normality Test

To evaluate the validity of model premises and the precision of model predictions, diagnostic checking, which includes tests for heteroskedasticity, serial correlation, and residual normality, is necessary in econometric analysis. These checks are crucial because if the model's presumptions are not met, it may yield unreliable findings and lead to absurd conclusions.

When the variance of the error term in a regression model varies depending on the values of several independent variables, this is referred to as heteroskedasticity. The assumption of homoskedasticity, according to which the variance of the error component is constant across all values of the independent variable, is broken by this. Heteroskedasticity causes parameter estimates to be skewed and ineffective, which results in inaccurate interpretations of the relationships between the variables. To ensure that the model's predictions are valid, testing for heteroskedasticity is essential. Serial correlation occurs when an error term in a regression model correlates with its own lagged values. Autocorrelation can lead to skewed parameter estimations, ineffective hypothesis testing, and inaccurate confidence. To ensure that the model's predictions are accurate, serial correlation testing is essential. The error component in a regression model, on the other hand, is assumed to be normally distributed with a mean of zero and a constant variance under the assumption of residual normality. Deviations from this presumption can be a sign that the model is misspecified or that outliers are present

in the data.

To make sure that model predictions are accurate and that analytic findings are sound, residual normality must be tested.

Dependent Variable: Poverty

Table 5. Heteroskedasticity, Serial Correlation, and Residual Normality test

| Test | Null Hypothesis | Name of Test | P-value |
|-------------------------|----------------------------------|-------------------------|---------|
| Heteroskedasticity Test | There is no heteroscedasticity | Breusch -Pagan -Godfrey | 0.05 |
| Serial correlation | There is no serial correlation | Breusch-Godfrey | 0.07 |
| Residual Normality Test | Residual is normally distributed | Jarque –Bera | 0.95 |

Source: Author’s computation.

Poverty is the dependent variable in this model. The p-value for the heteroskedasticity test is higher than 5 percent, as seen in the Table 5. Since there is no heteroscedasticity, the null hypothesis is accepted, which is positive for the best model. The p-value for the serial correlation test is also greater than 5 percent. It is advantageous for the model to be fitted that the null hypothesis (that there is no serial connection) is accepted. The next test is to determine whether the residual is regularly distributed. The fitted model performs well since the null hypothesis "residual is normally distributed" is accepted in this case when the p-value is more than percent. Here, every test backs up the model (Figure 3). Therefore, it is safe to say that the model fits the data well.

Normality Test

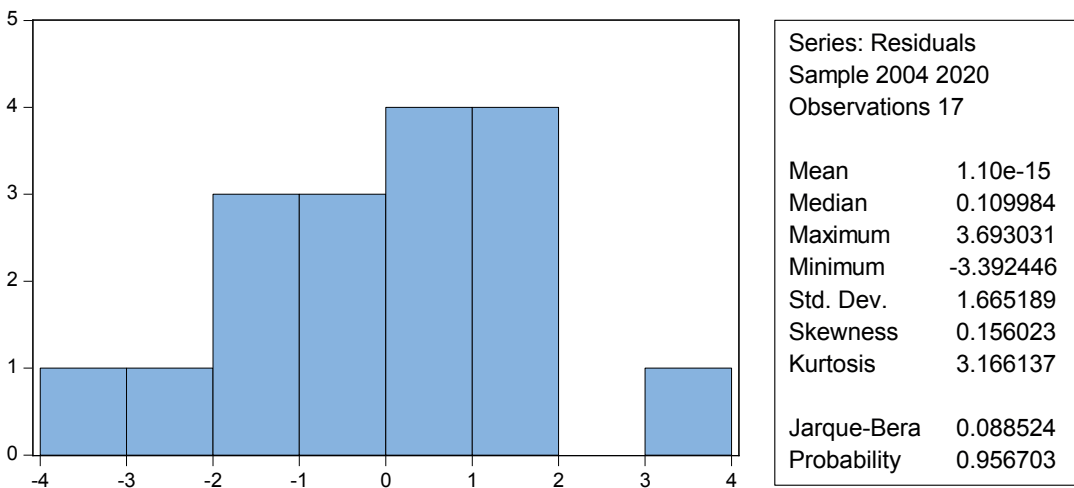


Figure 3. Normality Test**Conclusion**

The effect of corruption, income inequality, and employment on poverty in Nepal has been researched in this study. There are few previous studies about an effect on different factors on poverty in Nepal. Nevertheless, the research on the combined effect of corruption, income inequality, and unemployment on poverty in the context of Nepal has not been carried out recently. Some data on poverty, income inequality exists but it is not sufficient and systematic, thus creating difficulties to collect and estimate yearly data. With a single source and larger sample size of evidence, it would have been more reliable and the probability of any error would be less.

This study has investigated the nature and the direction of causality among disparity, poverty, unemployment, and corruption index of Nepal by using yearly data from 2000 to 2020. A modified version of the Granger Causality Test proposed by Toda and Yamamoto is applied for testing the bilateral causality between the four variables. The empirical results point out that one-way Granger causality runs from corruption and unemployment to poverty whereas there is bidirectional causality between income inequality and poverty as shown in Table 4. Corruption and unemployment cannot be caused by poverty. Similarly, there is no causality between unemployment and corruption, and income inequality and corruption for the mentioned time period. Policymakers can take a cue from this conclusion and should adopt more structural reforms on employment policy, corruption control, and income inequality which directly affect poverty. So, it can be safely concluded that poverty can be reduced through employment generation, end of corruption, and reduction of income disparity among people. In order to prevent poverty or alleviate poverty, the government must control corruption, income inequality, and unemployment. These factors cannot be excluded in poverty alleviations plans and programs. Without a decrease in corruption, income inequality, and unemployment ,poverty alleviation plan and programs solely cannot contribute to alleviate poverty.

The study has some limitations, despite the optimistic results. First of all, it is solely constrained by secondary time series data. Second, not every affecting aspect can be included. Therefore, expanding this research to include additional relevant variables would be good in order to elucidate the numerous ways that trade affects economic growth. Thirdly, it only contains 21 years' worth of annual data from 2000 to 2020. If results were provided with quarter data, they would be more reliable. Fourth, the study only uses the Granger Causality Test and the VAR. Results would make more sense if more econometric techniques were used.

Conflict of Interest

Author declares no conflict of interest.

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