

I Introduction: Why Study Corruption in Countries with Weak Institutional Environments?

TUNISIA. The country was ruled by the dictator Ben Ali from 1987 to 2011. While he was known to be corrupt, the public did not know the extent of his corruption. Needless to say, Ben Ali was beyond the law and no one could investigate him for corruption. After Ben Ali's fall in 2011, the new government seized the following illegal gains by him and his family and friends: "550 properties, 48 boats and yachts, 40 stock portfolios, 367 bank accounts, and 400 enterprises at an estimated value of \$13 billion (the equivalent of 25 percent of the 2011 Tunisian gross domestic product), as well as \$28.8 million held in a Lebanese bank account" (Yerkes & Muasher, 2017, p19).

VIRGINIA, the United States. From the early to the mid-2010s, there was a high-profile corruption case that mesmerized Virginians, and also shocked the whole nation, because the person charged in the case, Bob McDonnell, was the state's governor and a 2016 presidential hopeful. In 2011, while he was still in office, Bob McDonnell and his wife were investigated by the Virginia State Police for corruption: receiving from a businessman gifts and loans totaling \$177,000 to promote the businessman's product. It turned out that the governor did not even have the power to do so: his call to the University of Virginia to study the product was ignored by the scientists at the university (Walker, 2013). McDonnell and his wife were indicted for and convicted of corruption though the conviction was overturned by a higher court for a retrial which never happened.

MALAYSIA. This country is currently mired in a large corruption scandal involving billions of dollars. The corruption scandal revolves around two focal points: the Malaysian state-owned fund, 1MDB, and the family of the former prime minister, Najib Razak. What is interesting is that this scandal is not confined to Malaysia; it affects many countries and international organizations. As of July 2018, the following countries or foreign entities were known to be affected by the scandal: Switzerland (especially Swiss banks), Hong Kong, Scotland, the United States (including several major financial institutions and a film studio), Singapore, Luxembourg, the United Arab Emirates, the Seychelles, China, and Australia (Wikipedia, 2018a).

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CHINA. The country's economy has enjoyed high growth in the past thirty years or so. Its export-driven economy has earned China a large trade surplus and a huge reserve in US dollars. The Chinese Communist Party controls the country's resources and decides how to use them. One of the ways it has been spending the country's resources is to embark on a global philanthropic effort of unrivaled scope and scale. From 2000 to 2014, China provided aid, totaling \$350 billion, in various forms to 140 countries and territories. Since 2009, China has been the largest provider of foreign aid. In addition, the Chinese government provides funding to about 150 countries to teach Chinese language and culture. It has also set aside \$5.1 billion for scholarships for foreigners to study in China (AIDDATA, 2017; Radio Free Asia, 2018; Wikipedia, 2015b).

While these facts may, in themselves, be intriguing in different ways (depending on the perspective or the background of the reader), it may not be obvious why I have listed them here. How do they relate to what we will discuss in this book? As I will explain in this chapter briefly, and in the following chapters in greater detail, they are closely related to the reasons why we want to study bribery and corruption in countries with weak institutional environments, and how such bribery and corruption affect the world. Before we delve into our main topics, though, let us review the general background to the study of corruption.

I.1 CORRUPTION: A GLOBAL EPIDEMIC

Corruption is a major problem across the globe. If we take a glance at the map developed by Transparency International (TI), the leading international corruption watchdog, based in Germany, which monitors corruption in the world, and we note, on the map, the use of shading to indicate the level of corruption in each country, we find ourselves overwhelmed by a huge shadowy globe! Countries that are very clean (lightly shaded) are far outnumbered by countries that are corrupt (heavily shaded) (see Figure 1.1). Specifically, Transparency International created a "Corruption Perception Index," based on survey data, that uses a scale of 0 (highly corrupt) to 100 (very clean) to measure the level of corruption in each country (see Table 1.A.1 in the Appendix to this chapter). In 2017, the year in which the latest survey

results were released, the global average score was 43, below the midpoint of 50. Only 23 out of 176 countries have achieved a score of 67 (two-thirds of the full 100) or higher. Fifty percent of all countries have a score of 38 or lower! These numbers indicate that, unfortunately, being corrupt is the norm among many of the countries of the world. Most people live in countries in which corruption and paying bribes are part of their daily lives. Furthermore, there is no sign that the situation is improving. According to Transparency International, there were more countries witnessing a worsening of corruption in 2017 than there were countries that had seen an improvement. Even with the caution that the TI's corruption scores are based on the perceptions of the people surveyed, we can still safely say that corruption, worldwide, is persistent and is not getting better. This not-so-optimistic trajectory has prompted TI to emphasize that the global community has "the urgent need for committed action to thwart corruption" (Transparency International, 2017).

The realization that corruption is deeply rooted and that it has spread widely throughout so many countries is not new; numerous scholars in the fields of political science, economics, sociology, and management have produced voluminous studies about it (see, e.g., Fishman & Golden, 2017 for a review on the study of corruption). However, corruption is a complicated and multi-faceted phenomenon that infiltrates the different dimensions of societies across geography and time, so that there are many aspects of corruption that have not been carefully studied in detail; consequently, there are many gaps in the literature of corruption studies. One of them is the lack of new and insightful perspectives to explain the various types and effects of corruption across societies with different institutional environments, especially among countries that are infected by rampant corruption. For example, while Peru and China are both ranked as highly corrupt by Transparency International, with a corruption score of 35 for Peru and 40 for China (Transparency International, 2017), the effect of corruption on the two countries'



FIGURE I.1 Map of Corruption Perception Index, 2017
Source: Transparency International, 2017

economic development seems to be quite different. A Western business executive traveling in Peru and seeing the poverty and the poor infrastructure could easily conclude that corruption has hurt the country badly; however, the same executive traveling in China and seeing the abundance of consumer goods and first-rate infrastructure would be puzzled as to why corruption does not seem to slow China's rapid economic development. Thus, there is a need for what sociologist Robert Merton would call "a middle range theory" (Merton, 1968), which can integrate theory and empirical observation and provide an insightful explanation of certain aspects of corruption and its effect on a society.

In this book, from the perspective of institutional theory, I will examine the bribery–corruption relationship in countries with weak institutional environments and how this relationship interacts with and affects the economic development in these countries and in the international political economy. In doing so, I will propose several new arguments, including an explanation of why some of these countries thrive despite corruption, and the emergence of a new form of corruption in which a national government bribes the rest of the world.

I will draw on the research and frameworks that I have developed or co-developed with my colleagues during the past fifteen years or so (Alon, Li, & Wu, 2016; Li, 2004, 2017; Li & Ouyang, 2007; Li, Park, & Li, 2004; Li & Wu, 2010), and will add my new thoughts and observations. To support my arguments in the book, I will use evidence that I have accumulated, both from observations and from interviews that I have made on the differences between the East and West.

The basic premise of my arguments in this book is that the likelihood of acts of corruption and bribery, which are the individual-level behaviors of a government official or of a business executive (or of a citizen), is, to a great extent, determined by the institutional environment of the society. This environment will not only determine an intention to pay and/or to take bribes, but it will also

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determine the consequences for the economy of someone's doing so. In other words, differences in institutional environments lead to diverging outcomes of corruption. Specifically, I will focus on the antecedents and the consequences of corruption in societies in which the governance institutions, such as the rule of law and the free flow of information, are weak, because, after all, these societies suffer the most from the adverse effects of corruption, and therefore urgently need help to fight it.

In this introduction, I will provide the background necessary for the study of corruption and will briefly describe the theoretical framework and the major topics to be covered in the book.

1.1.1 What Is Corruption?

In this book, I focus on corruption by government officials and I adopt the definition of corruption offered by Shleifer and Vishny (1993), which describes corruption as the sales of government goods or services by government officials for private gains. Those "private gains" can go directly to the official or to the relatives, friends, or any collaborators of the official. The government goods or public goods can range from huge projects worth billions of dollars (such as approval of government procurement), to public infrastructure projects, public goods and services vital to citizens (such as quotas of public schools, public hospital beds, or firefighting services), to routine services (such as obtaining a passport, visa, permit, or driver's license). For example, when a citizen applies for a passport at a government passport office, instead of processing the application according to government rules, a corrupt passport officer may first threaten to reject the application and then may extort extra payments to process it.

Sometimes the public goods or services can be eliminations of bads (the opposite of goods in economic terms), such as prison terms. For example, a warden may furnish an overly positive report for a prisoner's parole request if the prisoner pays a bribe, or an official may simply create a new fee for all firms without delivering any corresponding service, and then punish any firms that refuse to pay.

1.1.2 The Negative Effect of Corruption on the Economy

Figure 1.2 shows the relationship between the corruption level and the level of per capita income across countries. The trend is very clear: poor countries tend to have a high level of corruption.

Theoretically, there is a consensus among the scholars of corruption that, in general, corruption has a negative effect on economic development (see, e.g., summary reviews by Fishman & Golden, 2017; Holmes, 2015; and Rose-Ackerman and Palifka, 2016). The reason that corruption hurts economic development is two-fold: misallocation of resources, and loss of economic resources.¹

More specifically, the reasons why corruption adversely affects economic development can be understood from the following perspectives. First, the country's citizens and firms are the ones that have to pay for the corruption, and those payments will be displaced from productive use by those citizens and firms. As a result, corruption takes much-needed economic resources, such as capital investment funds or funds for education, away from economic development and puts them into corrupt officials' pockets.

Second, in order to increase their opportunities to take bribes or to steal from public funds, corrupt officials tend to increase governmental approval processes to make them more powerful so that, at each approval step, the official in charge can ask for bribes, wasting both time and capital for people and businesses. The corrupt officials can also create new, one-of-a-kind projects or projects with complicated and opaque cost structures, so that they can easily steal funds from them. These behaviors can cause a misallocation of resources, both for the economy and for society. An example of these projects is real estate development in many countries, which requires many approvals in land zoning and acquisition, building codes and inspections, financing approvals, and so on. Each step in this long and complicated process provides an opportunity for the approving official to extort payment. Another kind of resource-distortion project is the expensive, custom-designed project that cannot be easily

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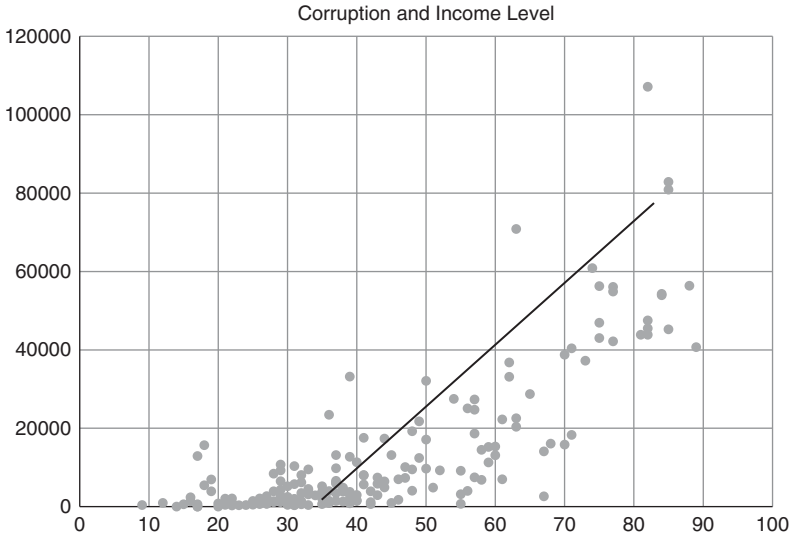


FIGURE 1.2 Corruption and per capita income across countries
 Vertical axis: three-year (2014–2016) average income (GDP) per capita (US \$); horizontal axis: Corruption Perception Index (CPI) score (2017) (1 = most corrupt, 100 = least corrupt).
 Sources: Transparency International and World Bank. The chart includes 180 countries with non-missing data of CPI and income per capital.

benchmarked, so that the corrupt official and the briber can collude to jack up the total cost and split the illegal gains. Projects of this sort include nuclear power plants and mega construction projects such as airports and highways. Corruption-induced distortion has plagued many underdeveloped countries. For instance, traveling in poverty-ridden African countries, one would see underfunded and rundown elementary schools but one would also notice expensive highways that could be used for landing airplanes. A possible reason for this disparity is that the cost of building new schools can be relatively easy to calculate on a per-student basis and thus has little room for squeezing out bribery to pay officials, whereas the construction of an expensive highway is a more lucrative project for stealing funds.

Since corruption is illegal, even in the most corrupt countries (Fishman & Golden, 2017, p. 27) offenders risk being caught and punished. This leads to the third way in which corruption hurts economic

development. In order to avoid detection, corrupt officials tend to create more secret projects and to hide their ill-gotten gains away from their own societies in foreign banks, further exacerbating the negative effects caused by the first and second reasons. Furthermore, the grim prospective of being caught – or even shot – forces the corrupt officials to ask for a huge amount of money to make the effort worth their while (or life). As Shleifer and Vishny (1993) show, giving harsh punishment to corrupt officials does not stop corruption, as it does not address the root cause of it; it merely increases the price of corruption. The effect of corruption on the economy and on corrupt officials is a vicious circle. More corruption makes an economy poorer; a poorer economy makes the per capita income lower, and thus the corrupt officials' paychecks smaller, which prompts the corrupt officials to extort more bribes, increasing their chance of being caught.² From this perspective, we can argue that cleaning up corruption is beneficial for the corrupt officials because, as the society has more resources freed from corruption to invest in the economy, the per capita income will rise and so will that of the officials. This reduces the drive for extorting bribes, which reduces the chance of being caught. The success stories of Hong Kong and Singapore in fighting corruption are cases in point (see Chapter 7 and Quah, 2017).

The above reasons can also explain why corruption is so difficult to eradicate: First, the official, such as the head of state, who has the power to clean up the corruption, is often the one behind it. Obviously, he or she has no incentive to expose his or her own activities. In general, a government full of corrupt officials tends to lack effective mechanisms to monitor and prosecute those corrupt officials (in effect, themselves). Second, the secrecy of corruption makes detection difficult. This is especially the case when the briber is not a victim of the corruption (see Chapter 2, Table 2.1.1) so that the briber, like the corrupt official, wants to hide the corrupt transaction. In general, the property right of the state is fuzzy and impersonal, so for corruption that involves stealing state properties, the incentive for other officials to detect and turn in the culprit is low.

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Third, the very nature of the bribery–corruption relationship requires that there be a built-in positive feedback mechanism that ensures that it never stops and that it increases in scale and scope. For example, in many highly corrupt governments, in order to become an official and to get promoted, one must bribe the officials who control the personnel and promotion decisions. Thus, it is not difficult for bribers to figure out that, once they get the new position, they need to collect more than they paid for it in order to make the risk-taking endeavor worthwhile.

I.2 MY APPROACH TO EXAMINING CORRUPTION IN THIS BOOK

I.2.1 *An Institutional Approach to Studying Corruption*

Corruption is not randomly or sporadically spread across all of the countries in the world. It has a fairly clear pattern, and it systematically affects some countries more than others. A number of theoretical frameworks have been developed to explain cross-country patterns in corruption (see reviews by Fishman & Golden, 2017; Rose-Ackerman & Palifka, 2016; and Holmes, 2015). While these frameworks differ in many aspects, they converge on the common, systematic features that are present in societies suffering rampant corruption.

A good way to understand the features of highly corrupt societies is to look at the features of *very clean* societies. Research shows that all of the very clean societies share the following features (Shleifer & Vishny, 1993; Tanzi, 1998):

1. **A political system that ensures fair and effective political competition.** Pressure from opposition parties is an effective way to keep incumbent officials more honest and less corrupt. In contrast, in highly corrupt societies, the political power tends to be exclusively controlled by one political group, such as a party, a family, or a military dictator.
2. **A limited government.** Reducing the government's role in the economy and the society mitigates corruption. In highly corrupt societies,