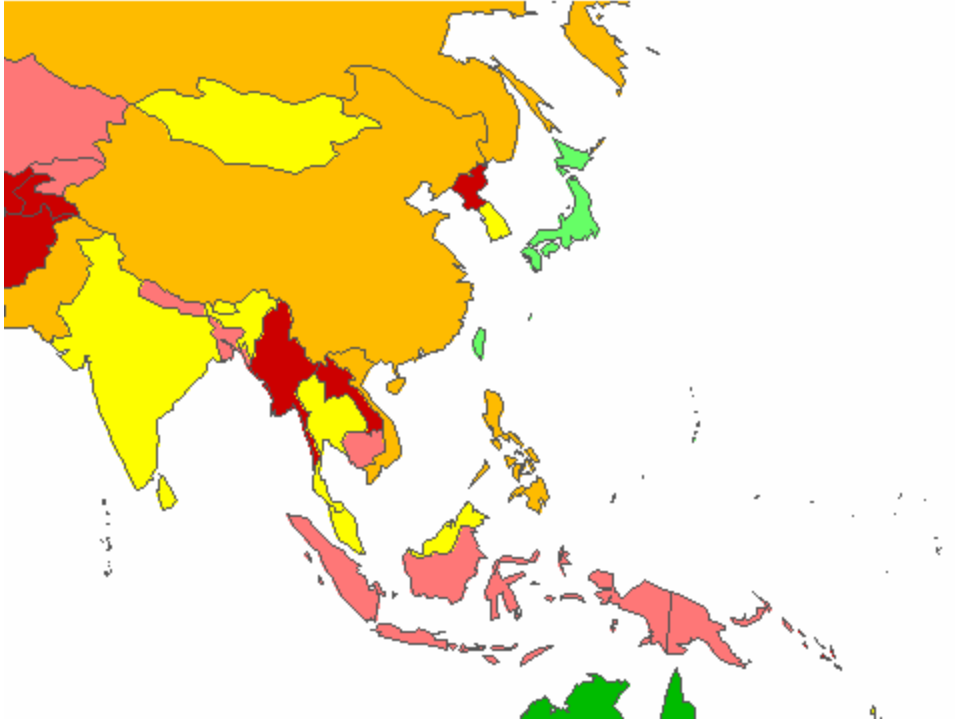


7. Corruption

Map 7: Rule of Law
Rule of Law (2004)



Source: Map based on Kaufmann, Daniel, Aart Kraay and Massimo Mastruzzi. 2005. "Governance Matters IV: Governance Indicators for 1996-2004." Washington, DC: The World Bank. Available at: <http://info.worldbank.org/governance/kkz2004/worldmap.asp#map>

Color Coding: The above map depicts the percentile rank on the governance indicator, subject to a margin of error. Percentile rank indicates the percentage of countries worldwide that rate below the selected country. Each country color pattern follows a simple quartile distribution (for illustrative purposes): the best quartile (over 75th percentile) is in green (with top 10th colored in darker green), the second best quartile (over 50th) is in yellow, the third (over 25th) is in orange, and the fourth is in red (with bottom 10th in darker red). If data are unavailable for a country, it is colored in dark gray.

KK "Rule of Law" indicator includes several indicators which measure the extent to which agents have confidence in and abide by the rules of society. These include perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts. Together, these indicators measure the success of a society in developing an environment in which fair and predictable rules form the basis for economic and social interactions, and importantly, the extent to which property rights are protected.

7.1 From “rule of man” to “rule of law”

East Asia is widely perceived to be one of the world’s most corrupt regions. Since the 1997 crisis, corruption scandals have been frequently reported in the regional and international media. The relationship between government and business in East Asia is often characterized as “crony capitalism.” East Asia certainly includes many countries in which corruption is widespread. However, this chapter will examine and challenge the idea that corruption is endemic to East Asia and that there is any characteristically East Asian level of corruption.

Corruption in East Asia poses an apparent paradox. In some countries in East Asia, high levels of corruption have coexisted for extended periods with rapid economic growth and development¹⁸¹. Clearly, this runs against the conventional wisdom that corruption impedes economic and social progress. The chapter will explore the various hypotheses put forward to explain this paradox and will assess their empirical bases. It will investigate the characteristics of corruption in East Asia and the extent to which the autocratic mode of governance that characterized many East Asian countries in the postwar period may have enabled an East Asian model of corruption which was less damaging to growth and development.

Before the crisis, commentators were quick to call upon “Asian values” to explain East Asia’s remarkable postwar success. Post-crisis, such people were equally quick to suggest that “Asian values” explained the crisis, being in some way more conducive to corruption than those of the west. This chapter will suggest that attitudes towards corruption may be evolving as part of the economic and social transformation sweeping the region. Democracy and decentralization have clearly made significant advances across the region. The chapter will suggest that demands for new modes of governance and more effective action to tackle corruption have grown and may grow further during East Asia’s renaissance. The economic, political, and social transformations sweeping the region have already rendered the East Asian model of organizing and constraining corruption unsustainable.

Countries in the region will move further from traditional modes of governance based on “rule of man” to modern modes of governance based on “rule of law,” or as the Chinese say from *renzhi* to *fazhi*.¹⁸² This chapter will note that there is much evidence to suggest that, in the longer term, this will result in more effective governance and reduced corruption. However, the legal, political, and administrative institutions needed to make

¹⁸¹ Wedeman (2002) refers to this as “the East Asian paradox.”

¹⁸² The terms *renzhi* and *fazhi* differentiate political systems and the relationship between the state and its citizens. *Renzhi* (“rule of man”) vests rights in the larger community or nation defined according to the ruler’s determination of the society’s greater good. *Fazhi* is a more ambiguous term. It can be translated as “rule by law” or “rule of law.” In this chapter, the term is used to denote “rule of law”—governmental authority is legitimately exercised only in accordance with written, publicly disclosed laws adopted and enforced in accordance with established procedure. “Rule by law” can be understood to mean that the state uses the law as a means of social control without reference to the process of its formulations without any implication on citizens’ rights or legitimacy. “Rule by law” has existed throughout much of East Asia’s history, but emphasis on “rule of law” as a core element of good governance is more recent.

to make democracy and decentralization work will take time to build up. In the short term, there is at least a risk that the challenges of corruption intensify across the region. The road from *renzhi* to *fazhi* may not be an easy one for many countries (Map 7).

7.2 Is there an East Asian level of corruption?

7.2.1 Defining corruption

In the English language, the term corruption is colorful but vague. In its simplest sense, it refers to a process of decay, rot, or perversion. Beyond this, it is at best a shorthand reference for a large range of illicit and illegal activities.¹⁸³ In its broadest usages, it can refer to both the act or process of corrupting and the state of being corrupt. It can refer to such processes in public office, private business, or personal life.

In the context of public sector governance, corruption is often succinctly defined as “the misuse of public office for private gain” (e.g., Svensson (2005)). Even in the limited context of the public sector, however, corruption comes in too many forms to permit easy generalization.

Activities frequently accepted as corrupt include bribery; stealing, misappropriation, and misuse of public funds or assets; illegal fines, duties, taxes or charges; vote rigging; abuse of privileged information; mis-procurement; manipulation of regulations and licensing; campaign financing abuses; influence peddling and favor-brokering; acceptance of improper gifts; cronyism, and nepotism. However, societal norms may vary as to how inappropriate each form of corruption is, or even as to whether it is considered corruption at all¹⁸⁴.

Nevertheless, a number of distinctions is often drawn. There is “grand corruption” (the theft of billions of dollars by a Marcos or Suharto); and “petty corruption” (for example, the demanding of small bribes by public service providers). There is “administrative corruption” (perpetrated by lower-ranking bureaucrats and functionaries); and there is “political corruption” (sometimes called “clientelism” or “state capture,” the misuse of public power by elected and senior officials to shape the rules of the game to the advantage of themselves and those who pay them, at the expense of the rest of society). A distinction is sometimes drawn between corruption of the “deviant” variety, where officials take inducements to do things they are not supposed to do; and corruption of the “grease money” kind, where officials take inducements to do what they are supposed to do anyway, or to do it more quickly. Finally, and arguably of particular relevance in the East Asian context, there is “syndicated corruption,” in which elaborate systems are

¹⁸³ As discussed in detail by Bardhan (1997), not all illegal transactions are corrupt, nor are all instances of corruption or bribery illegal. Bardhan uses wide-ranging examples that are corrupt but are not necessarily illicit or illegal: from tipping the *maitre d'* to get a better table at a restaurant than other customers, to cases of gift-giving by lobbyists to politicians, campaign contributions to Political Action Committees, or post-retirement jobs in private firms to bureaucrats of agencies meant to regulate them.

¹⁸⁴ As Huntington (1968) notes, in the early nineteenth century, Britain accepted the sale of peerages but not of ambassadorships, whereas the United States accepted the sale of ambassadorships but not of judgeships.

devised for receiving and disseminating bribes, and “non-syndicated corruption,” in which individual officials may seek to compete for bribes in an *ad hoc* and uncoordinated fashion.

Although most people would consider all these forms of corruption undesirable almost by definition, it seems very likely that these diverse forms of corruption will have impacts which differ significantly in extent and incidence.

7.2.2 *The level of corruption*

Measuring corruption remains complicated by its very nature. Not only is corruption typically secretive but, as discussed above, it takes many different forms.

Capturing objective measures of corruption is extremely difficult. Financial measures of corruption are “extremely approximate”¹⁸⁵ and typically available only for the worst cases of “grand corruption.” Transparency International’s 2004 Global Corruption Report, for example, included some estimates of the funds allegedly embezzled by ten leaders of the last 20 years who were notorious for corruption. According to these estimates Mohamed Suharto, President of Indonesia between 1967–98, embezzled about US\$15 to 35 billion; Ferdinand Marcos, President of the Philippines between 1972–86, US\$5 to 10 billion; and Joseph Estrada, President of the Philippines between 1998–2001, somewhere between US\$78 to 80 million.¹⁸⁶

At the household and firm level, corruption levels are often measured by the monetary cost of bribes. World Bank-sponsored Investment Climate Surveys (ICSs) have recently been attempting to collect such data at the firm level. However, firms (and households) may be unwilling to admit to paying bribes and so estimates of the frequency and value of bribes paid may be distorted.

Because of the difficulties of obtaining objective information about corruption, the dominant empirical approach to examining the determinants of corruption is through perceptions-based data. Perceptions of corruption may be different than the actual level of corruption, affecting the conclusions of empirical studies. That being said, Kaufmann, Kraay, and Mastruzzi (2006) argue further that measuring perceptions matter directly: “if for example citizens believe the courts and police to be corrupt, they will not want to use their services regardless of what the objective reality is.”

Most widely cited indicators of corruption are cross-country perception-based indices: the Transparency International (TI) Corruption Perceptions Index (CPI) and Kaufmann-Kraay (KK) the Control of Corruption Index (CCI). As with all governance indicators, both indices are subject to measurement errors.¹⁸⁷

¹⁸⁵ Transparency International (2004, p. 13).

¹⁸⁶ Ibid.

¹⁸⁷ Both datasets include standard errors for each observation. Adapting a simple rule of thumb used by Kaufmann, Kraay, and Mastruzzi (2005) only half of East Asian countries in the KK CCI sample, and one-third in the TI CPI sample can be placed in their relevant tercile with a 95 percent significance level.

The CPI, which is prepared by Transparency International—an international civil society organization—is a composite index reflecting perceptions of business people and country analysts, both resident and non-resident.¹⁸⁸ The 2005 survey ranks 159 different countries, drawing on 16 different polls from 16 different polls from 10 independent institutions. For a country to be included it must feature in at least 3 polls (allowing most major East Asian countries to be included with the exception of North Korea). The CPI has been produced annually since 1995, although its authors describe the index as “a snapshot, with less capacity to offer year-to-year trends.” The CPI ranks countries in terms of the degree to which corruption is perceived to exist among public officials and politicians. The surveys used in compiling the CPI ask questions relating to misuse of public power for private benefit, but do not make any other distinctions: for example, between administrative and political corruption, or between petty and grand corruption. Figure 7.1A illustrates the CPI for East Asian countries in 1995, 2000, and 2005.

A complementary measure is the CCI, one of the Kaufmann-Kraay (KK) governance indicators, prepared biannually since 1996 with the support of the World Bank, based mostly on non-World Bank sources¹⁸⁹. Like the CPI, the CCI is a composite indicator, drawing on multiple primary indicators of perception of corruption and producing country rankings. Like CPI, CCI focuses on public corruption but otherwise treats corruption as a single, homogenous phenomenon. Whereas the CPI is stand-alone, however, the CCI is one of six KK indicators, which also include voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, and rule of law. The KK indicators have a slightly larger coverage than CPI (209 countries) and draw on a wider range of surveys (352 variables culled from 37 data sources produced by 31 organizations). Figure 7.1B illustrates the CCI for East Asian countries in 1996, 2000, and 2004.¹⁹⁰

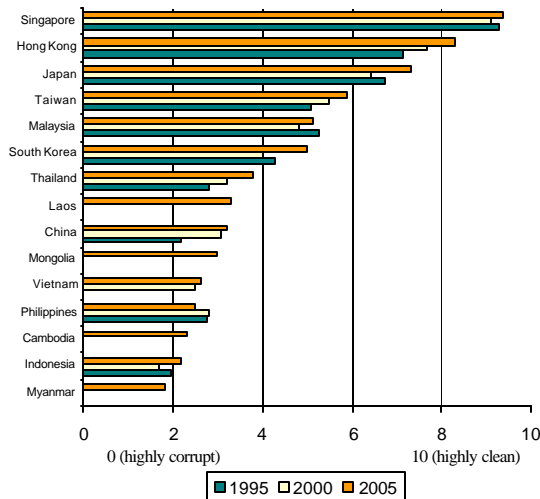
¹⁸⁸ The CPI is available on the web at http://www.transparency.org/policy_research/surveys_indices/cpi and is described more fully in Lambsdorff (2005).

¹⁸⁹ The CCI and other KK indicators are available on the web at <http://info.worldbank.org/governance/kkz2004/> and are described more fully in Kaufmann, Kraay, and Mastruzzi (2005).

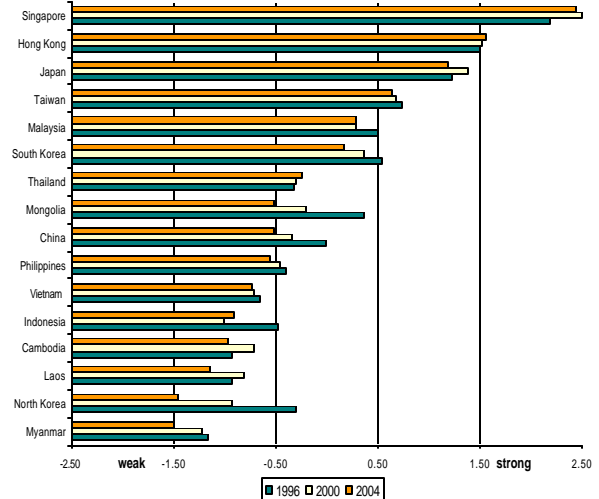
¹⁹⁰ Both for TI CPI and KK governance indicators changes in trends are subject to measurement error and these may not be trivial. Kaufmann, Kraay, and Mastruzzi (2005) write: “Over the eight-year period from 1996-2004 spanned by our governance indicators, we find that in about five to seven percent of countries we can be confident (at the 90 percent significance level) that governance has changed substantially. And at a lower 75 percent significance level, roughly 20 percent of all observed changes stand out as significant.” They show however, that many data sources agree about the direction of change in a given country.

Figure 7.1: Indices of corruption vary widely across countries in East Asia

A: Transparency International Corruption Perceptions Index, 1995 – 2005



B: Kaufmann-Kraay Control of Corruption Index, 1996 – 2004



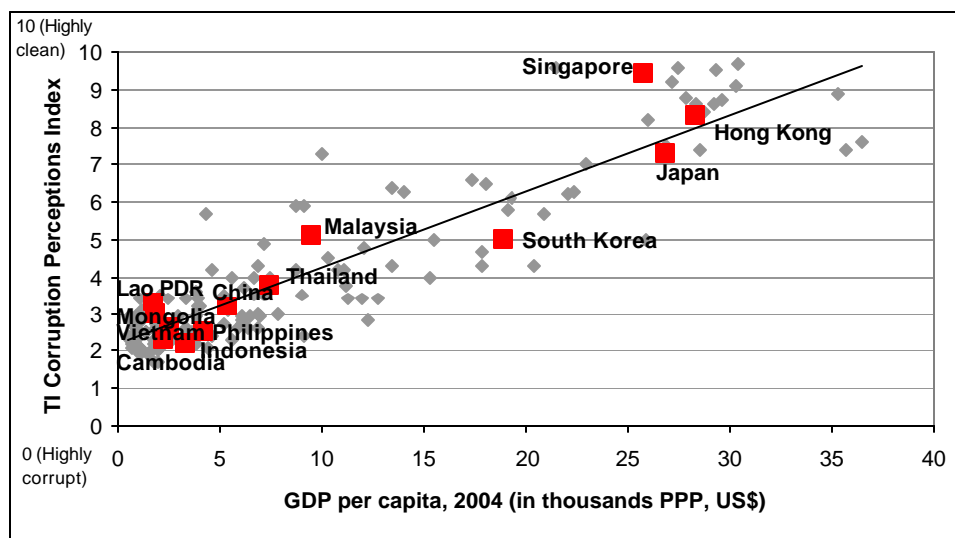
Sources: Transparency International CPI (2005), Kaufmann, Kraay, and Mastruzzi Governance Matters IV: Governance Indicators for 1996-2004 (2005).

These two perception-based indicators offer broadly similar conclusions as far as East Asia is concerned. The first observation is that there is an enormous range. Some East Asian countries rank among the least corrupt in the world: using the CPI, Singapore ranks between Denmark and Sweden; Hong Kong (China) between Canada and Germany; and Japan between Chile and Spain. Other East Asian countries rank among the most corrupt: Myanmar ranks between Turkmenistan and Haiti; Indonesia between Iraq and Ethiopia; and Cambodia between the Republic of Congo and Burundi.

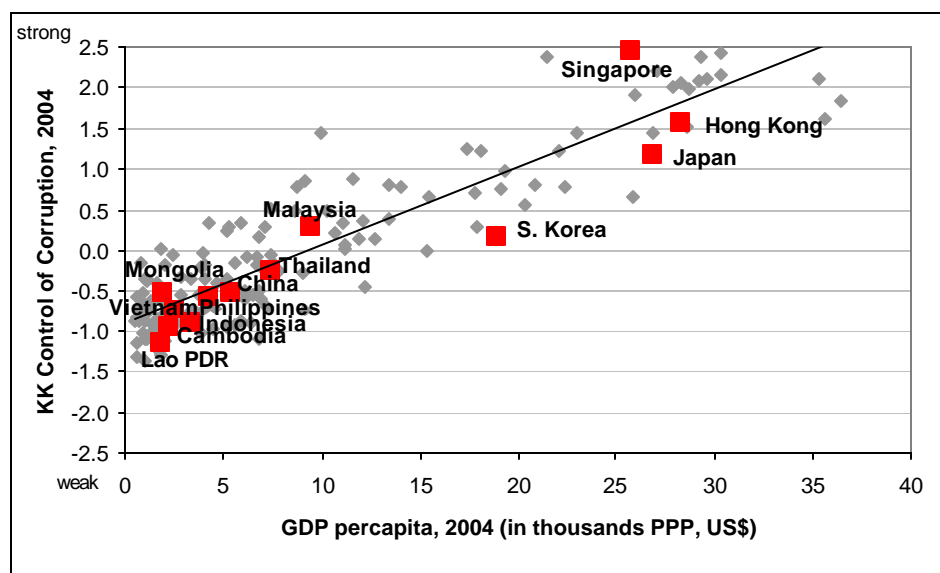
The second observation is that there is a correlation between corruption indices and GDP per capita. As Figures 7.2A and 7.2 B illustrate, the level of corruption in many East Asian countries in 2004 appears to be broadly in line with what their GDP per capita would predict. Both the CPI data (shown in Figure 7.2A) and the CCI data (shown in Figure 7.2B) tend to suggest that corruption in Japan, Hong Kong (China), South Korea, Thailand, China, the Philippines, Vietnam, and Mongolia is broadly at the level that would be predicted by their various GDPs per capita.

Figure 7.2: Richer countries have lower corruption indices (global with East Asian countries highlighted)

A: Transparency International Corruption Perceptions Index, 2005 and GDP per capita, 2004



B: Kaufmann-Kraay Control of Corruption Index, 2004 and GDP per capita, 2005



Sources: Transparency International CPI (2005), Kaufmann, Kraay, and Mastruzzi Governance Matters IV: Governance Indicators for 1996-2004 (2005), and World Development Indicators Database (2006).

The third observation is that, despite the general correlation between the perception of corruption and GDP per capita, levels of corruption vary widely for countries at similar levels of per capita income. Thus, for example, using the CCI, Indonesia with a GDP per capita of \$3,361 (in 2003 in purchasing power parity terms) ranks as more corrupt than Vietnam with a GDP per capita of \$2,490; China with a GDP per capita of \$5,003 ranks the same in terms of control of corruption with Mongolia with a GDP per capita of \$1,850. As Figure 7.2 illustrates, both indices suggest that Singapore and Malaysia have

less corruption than predicted by their GDPs per capita; whereas Taiwan (China) has rather more. The CCI (Figure 7.2B) also suggests that Indonesia, Cambodia, Laos, North Korea, and Myanmar have control of corruption significantly worse than would be predicted by their GDPs per capita. Clearly, corruption is not wholly determined by income.

7.3 Is there an East Asian model of corruption?

7.3.1 *The East Asian paradox*

As Campos (2001) argues, corruption in East Asia presents proponents of good governance with an apparent paradox. China, Indonesia, Vietnam, South Korea, the Philippines, and Thailand have all managed to trade successfully and to attract large inflows of private investment over several decades (although the Philippines and Vietnam were latecomers). Social outcomes associated with core public goods have generally been much better than would be predicted by GDP per capita. Economic growth has been amongst the fastest in the world. Yet for much of this period these countries have figured prominently in global lists of highly corrupt countries.

How can this paradox be resolved? A number of hypotheses have been proposed.

Hypothesis 1: A false paradox

Some authors have argued that the paradox is a false one. One aspect of this, alluded to in the previous section, is that there may be less corruption in East Asia than is popularly understood. In the wake of the East Asian crisis, there was much media discussion of “crony capitalism” in East Asia. However, as Figures 9.1A and 9.1B illustrated, although some East Asian countries rank among the most corrupt countries in the world, others rank amongst the least corrupt.

As Figure 7.2 illustrated, in many East Asian countries corruption is at about the level that investors and trade partners might expect for countries at their level of GDP per capita. MacIntyre (2001) points to standard economic factors influencing expected rates of return on investment. He notes that if there are very large profits to be had, investors are likely to be willing to bear increased costs associated with bribery and increased risks associated with less certain property rights. He notes that in Indonesia’s case there were a number of important factors which contributed to the creation of a business environment in which good rates of return could be expected, including most obviously the prevailing rate of economic growth, the microeconomic incentive structure, and sector-specific factor endowments.

Some statistical evidence casts doubt on whether there is a paradox at all. Statistical estimates by Mauro (1995) suggest that corruption does deter investment. In a regression of the total investment/GDP ratio (averaged over 1980-1985) on a constant and the corruption index, the point estimate of the slope is 0.012. As Wei (1999) points out, the simple implication of this is that if the Philippines could reduce its corruption level to the

Singapore level, other things being equal, it could raise its investment/GDP ratio by 6.6 percentage points.

Wei (1997) shows that, controlling for other factors such as GDP per capita, the impact of corruption on FDI is no different in East Asian than in other countries. The implication of his cross-country regressions is that in East Asia other factors swamp the negative effect that corruption has on FDI. This offers a possible explanation for why East Asian countries have grown more rapidly despite significant levels of corruption.

In an article provocatively titled “Why Does China Attract So Little Foreign Direct Investment?”, Wei (2000) argues that, given China’s income and population, the amount of foreign investment it attracts falls well below the level that cross-country regressions would predict. This is particularly the case, he argues, if adjustment is made for the significant amount of Chinese investment that is not really foreign, but is Chinese investment round-tripped through Hong Kong (China). Wei attributes the lower than predicted level of FDI in China to corruption, as well as other government-induced barriers to foreign investment.

Against this, Campos, Lien, and Pradhan (2001) argue that Wei’s analysis is potentially problematic because FDI is dominated by OECD countries. They suggest it is quite possible that the results would be different if the OECD countries were excluded from the sample as “hosts” of FDI or, alternatively, the dependent variable used was private investment (both domestic and foreign). They suggest that other middle-income and low-income developing countries would be a more appropriate comparator. Furthermore, they note that Wei’s observation regarding the importance of FDI from overseas Chinese indicates that informal institutions may be an important omitted variable that affects the nature of corruption and thus its impact on investment.

Rock and Bonnett (2004) present cross-country regression analysis suggesting quite different conclusions to Wei. They find that corruption slows growth and reduces investment in most developing countries, particularly small developing countries. However, they find that growth may actually have increased with corruption in the large East Asian newly industrializing economies (a group they construct including China, Indonesia, South Korea, Thailand, and Japan; and analyze over four different time periods between 1980 and 1996).

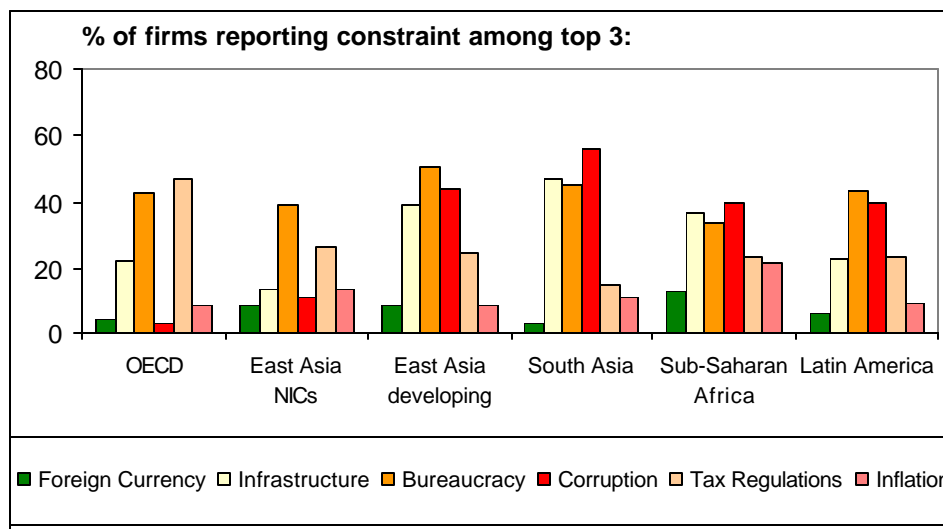
Survey evidence presents us with similar contradictions. Evidence from World Bank and International Finance Corporation Investment Climate (Enterprise) Surveys tends to support the idea that corruption is not a major constraint to business in all East Asian countries. As Table 7.1 illustrates, less than one-third of firms surveyed considered corruption a “severe or major constraint to business” in China, Thailand, Malaysia, and Vietnam. Firms in Cambodia, Indonesia and the Philippines saw corruption as a more serious constraint.

Table 7.1: Corruption can be a severe constraint for enterprise in East Asia

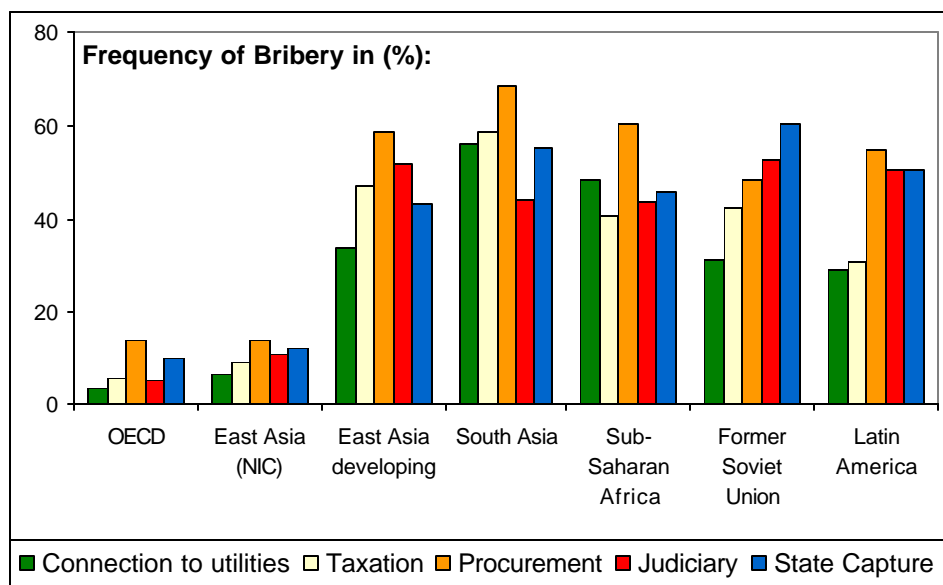
Country	<i>Is corruption a constraint to business? (percent of responses)</i>		
	<i>No</i>	<i>Minor</i>	<i>Severe or major</i>
Cambodia	4.7	39.4	55.9
Indonesia	29.3	29.2	41.5
Philippines	40.6	24.3	35.2
China	24.1	48.5	27.3
Thailand	49.7	32.1	18.3
Malaysia	53.8	31.7	14.5
Vietnam	52.3	17.8	14.2

Source: Investment Climate (Enterprise) Surveys of the World Bank and IFC, using un-weighted averages.

A rather different trend in perceptions across firms in East Asia can be observed in the World Economic Forum's most recent Executive Opinion Survey. Kaufmann (2006) groups East Asian countries in the survey into two: East Asian Newly Industrialized Countries (NICs)—South Korea, Hong Kong (China), Singapore, and Taiwan (China)—and developing East Asian countries—Cambodia, China, East Timor, Indonesia, Malaysia, Mongolia, Philippines, Thailand, Vietnam. Using firms' responses to "top three constraints to business," he compares them to other groupings. As illustrated by Figure 7.3A, corruption is not perceived to be a major constraint in NICs. Moreover, firms in this group are the least likely among all other regions to report corruption as a major obstacle to their business. However, the situation seems to be dramatically different for developing East Asia, where firms surveyed report corruption as a major obstacle to their business. Figure 7.3B illustrates that the venues of bribery and frequency also sharply contrast between the two groups within the region. While the reported frequency of bribery for permits utilities, taxation, awarding of public contracts, and judiciary is as low in East Asian NICs as in OECD, in the developing East Asia reported levels are more at par with Sub-Saharan Africa and former Soviet Union countries.

Figure 7.3: Is corruption a major constraint to business? No single answer for East Asia**A: Top Constraints to Business (WEF Executive Opinion Survey, 2005)**

Source: Kaufmann (2006) based on Executive Opinion Survey 2005 of the World Economic Forum covering 117 countries. The question posed to the firm was: Select among the above 14 constraints the five most problematic factors for doing business in your country.

B: Frequency of Bribery (WEF Executive Opinion Survey, 2005)

Source: Kaufmann (2006) based on Executive Opinion Survey 2005 of the World Economic Forum covering 117 countries. Question posed to the firm was: In your industry, how commonly firms make undocumented extra payments or bribes connected with permits / utilities / taxation / awarding of public contracts / judiciary? (“common”... “never occurs”).

Even if the somewhat contradictory results above may convince us that in the absence of corruption GDP growth and FDI flows may have been more spectacular, they still fall short of explaining why high levels of corruption do not absolutely undermine growth and development in East Asia, as they do in other developing regions.

Hypothesis 2: Economically efficient corruption

At the other extreme, some have put forward the hypothesis that corruption is “economically efficient.” This argument is one which was prevalent in development literature in the 1960s (Leff 1964, Huntington 1968) although it still has proponents. The argument is essentially that tolerating a certain amount of corruption may be a “second-best optimal” response in the face of another policy distortion; or, as Huntington puts it, “in terms of economic growth, the only thing worse than a society with a rigid, over-centralized, dishonest bureaucracy is one with a rigid, over-centralized and honest bureaucracy.”

For example, bribery may allow firms to get things done in an economy with excessive regulation and licensing (the “grease money” argument). It is suggested that, by allocating licenses and government contracts to the firms able to pay the highest bribes, a system based on bribery might support the growth of the most efficient firms (Lui 1985). It is suggested that corruption may help “get prices right” by raising administratively repressed prices to market clearing levels or by enhancing civil service remuneration where it is unsustainably low.

Some also theorized that optimal policy design may not involve minimizing corruption, since that may imply too large of a sacrifice of other welfare goals. For example, Acemoglu and Verdier (1998) suggest that there may be an optimal level of corruption and property rights enforcement, trading off the costs and benefits to society. Higher wages for public sector officials would reduce corruption and improve the extent of property rights, since stakes are higher for officials if they get caught taking bribes. However, a strategy of high public sector wages may result in high taxes, and attract many talented individuals to the public sector, even though they could have been more productive in the private sector. They conclude that it may be optimal to allow some corruption and not enforce property rights fully; less developed economies may choose lower levels of property right enforcement and more corruption.

There are strong counter-arguments to most of these “efficient corruption” propositions. As Myrdal (1968) was the first to point out, corrupt officials may actually cause greater administrative delays to attract more bribes. As Bardhan (1997) puts it, “the distortions are not exogenous to the system and are instead often part of the built-in corrupt practices of a patron-client political system.” Shleifer and Vishny (1993) also make the point that a country’s regulatory burden may be endogenously exploited by corruption-prone officials for the purposes of extracting bribes. Tanzi (1999) argues that bribes tend to channel resources not to those who are more efficient in economic activity but to those who are more skilled at bribery. The World Development Report 1997 illustrates how a competent and honest civil service is the lifeblood of an effective state; and provides empirical evidence that adequate pay and meritocratic recruitment and promotion are

correlated with economic growth and investors' perception of bureaucratic quality even when controlling for other factors (WDR 1997, p. 92).

Such empirical evidence as exists for Asia tends to support these counter-arguments. Using data from the Global Competitiveness Reports for 1996 and 1997, Kaufmann and Wei (1999) examine the relationship between bribe payment and management time wasted. Contrary to the "grease money" argument, they find that firms that pay more bribes are also likely to spend more, not less, management time with bureaucrats negotiating regulations.

Focusing on a sub-sample of the Asian countries, Kaufmann and Wei undertake an explicit examination of what they term "the Asian exceptionalism hypothesis" (that for reasons of "Asian culture" corruption facilitates economic growth in Asia). They reject overwhelmingly the Asian exceptionalism hypothesis, concluding that in fact in Asian countries the amount of management time wasted increases faster with bribes paid than in the global sample.

Singapore's case is an excellent example of how an effective state and low corruption may be supported through competitive public sector wages, together with recruitment and promotion of the best and the brightest in the civil service (see Box 7.1).

Altogether, the empirical evidence weighs heavily against the "grease money" argument; and against the argument that tolerance of corruption is an effective or fiscally efficient way of motivating civil servants.

Box 7.1: Singapore and civil service

Singapore, the least corrupt East Asian country today, was rife with corruption until the 1960s. The low salaries and rapidly rising cost of living during the post-war period, combined with the inadequate supervision of civil servants, created ample incentives and opportunities for corruption.

When the People's Action Party assumed power 1959 civil servants pay increased significantly to levels competitive with private sector as a key pillar of a strategy to establish an honest and effective civil service. Public sector salaries in Singapore average 114 percent of those in private sector, and senior Singaporean civil servants have been better paid than their U.S. counterparts (WDR 1997, p. 95). It is often suggested that Singapore's cabinet ministers' salaries are pegged to those of the CEOs in the largest multinational firms in the world. The Singapore Prime Minister's pay is several times that of the United States President (Wei, 1999, p. 18). This is seen as a safeguard against the political corruption seen in other parts of the world. "I'm one of the best paid and probably one of the poorest of the Third World Prime Ministers," Lee Kuan Yew, then Prime Minister of Singapore, told a Cabinet Meeting in 1985 (cited in Quah, 1988, p. 14).

Merit-based recruitment and promotion and maintaining the prestige of public service were also key pillars to achieving a highly clean and effective civil service in Singapore. Singapore's civil service is among the top in the world for its coherence and sense of purpose. About 5 percent from the top of the graduating class of the National University of Singapore (and more recently Nanyang Technological University) are admitted each year as prospective civil service recruits and put through a one-year training program in order to establish a common understanding of what is expected of them and to build trust among them. Meritocratic promotion system ensures that civil servants' and agencies' goals are aligned.

Hypothesis 3: An East Asian Model of Corruption?

Between these extremes lies a more balanced hypothesis: that corruption has been damaging for East Asia and has discouraged FDI and slowed growth; but that “corruption regimes” in East Asia have generally been better managed than in other parts of the world and so the extent of the trade-off has been somewhat dampened. There are both theoretical and empirical arguments to support the idea of an East Asian model of corruption.

Huntington (1968) was an early proponent of the view that the structure of political and bureaucratic institutions and processes are important determinants of the level and nature of corruption:

“Corruption thrives on disorganization, the absence of stable relationships among groups and of recognized patterns of authority. The development of political organizations which exercise effective authority and which give rise to organized group interests—the “machine,” the “organization,” the “party”—transcending those of individual and social groups reduces the opportunity for corruption. Corruption varies inversely with political organization.”

In an important paper, Shleifer and Vishny (1993) propose an economic model of corruption in which different types of political and bureaucratic institutions for the management of corruption may exist (see Box 9.2). They suggest that different regimes may create greater or lesser distortions and costs. Shleifer and Vishny suggest that any corruption is distortionary and hence costly (and more distortionary and costly than taxation, because of the need for secrecy). However, since bribes are set at higher levels under the weak government scenario, corruption is more distortionary under weak government than under strong government.

With regard to East Asia, Shleifer and Vishny consider the Philippines before and after President Marcos as an example. They argue that under President Marcos it was always clear who needed to be bribed and by how much. All bribes flowed to the top and the bribes were then divided between all the relevant government bureaucrats, who did not demand further bribes from the buyer of the package of permits. Since the demise of Marcos, they argue, the number of independent bribe takers has probably increased; the level of corruption has probably increased; and efficiency of resource allocation has probably declined.

Shleifer and Vishny also imply that more organized corruption may also reduce uncertainty. In South Korea, for example, they argue that although corruption was pervasive (at the time of writing in the early 1990s), the person paying the bribe was assured of getting the government good that was being paid for, and would not need to pay further bribes in future. By contrast, they suggest, in many African countries and in post-Communist Russia, not only do numerous bureaucrats need to be bribed to get a government permit, but bribing one does not guarantee that some other bureaucrat or even the first one does not demand another bribe.

Box 7.2: Corrupt governments as “joint monopolists”

In an important paper, Shleifer and Vishny (1993) propose a mode of corruption in which the structures of government institutions and of the political process are important determinants of the level of corruption. In particular, they argue, weak governments that do not control their agencies experience very high corruption levels; whereas stronger and more centralized governments may experience lower levels of corruption.

Their model builds on an analogy from the industrial organization literature—the idea of a “joint monopolist.” A joint monopolist is a firm with a monopoly in two strongly complementary goods. Such a firm will price differently from multiple independent monopolists, each producing only one of the strongly complementary goods. A joint monopolist will price so as to maximize returns across both markets; whereas independent monopolists will tend to push up the price of their respective products regardless of demand effects in the complementary markets, and all will suffer.

This simple notion to a model of corruption can be extended to a case in which government officials have to be bribed to provide licenses or permits. In many cases, a private firm needs several complementary licenses or permits to conduct business. For example, this firm might need an investment license and a planning permit. In the case of a strong, corrupt government with tight control over its agencies, the value of bribes for investment licenses will be kept down so as to expand the demand for the complementary planning permits; and the value of bribes for planning permits will be kept down so as to expand the demand for investment licenses.

Alternatively, under a weak, corrupt government with loose control over its agencies, the investment agency and the planning bureau may set bribes independently. Each agency sets bribes so as to maximize total bribes taking the other’s output as given, and so the per unit bribe is higher and the output (the number of investments licensed and plans permitted) is lower. By acting independently, the two agencies actually hurt each other, as well as the private buyers of permits.

This analysis suggests that any corruption is distortionary and hence costly (and more distortionary and costly than taxation, because of the need for secrecy). However, since bribes are set at higher levels under the weak government scenario, corruption is more distortionary under weak, decentralized government than under strong, centralized government.

Source: Shleifer and Vishny (1993).

A similar, almost contemporaneous model is that of Olson (1993) who (perhaps significantly drawing his metaphor from Chinese history) argues that “stationary bandits” are preferable to “roving bandits.” Through uncoordinated competitive theft (or corruption), “roving bandits” destroy the incentive for economic agents to invest and produce, leaving little for either the population or the bandits. Both can be better off if one bandit sets up as a “stationary bandit” who monopolizes and rationalizes theft (or corruption). The rational and successful stationary bandit, Olson argues, will monopolize theft in his domain and will limit what he steals because he knows that in the long run he will be able to extract more if he gives his subjects the public goods and incentives they need to invest and produce additional income and wealth. Because of this, Olson suggests, investment and growth should be lower in countries governed by roving bandits.

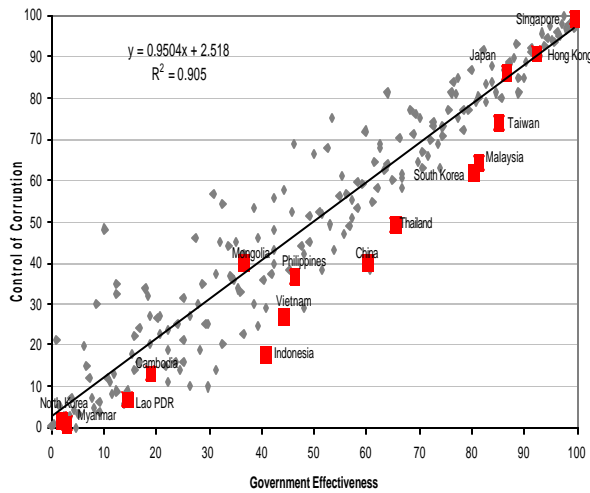
Both quantitative analysis and country case studies tend to support the relevance of these ideas in the East Asian context. The simple scatter charts presented in Figures 7.4A and

7.4B, prepared using Kaufmann-Kraay indicators for 2004, suggest that East Asian countries generally are perceived as having greater government effectiveness and better regulatory quality than would be predicted by their control of corruption percentile.

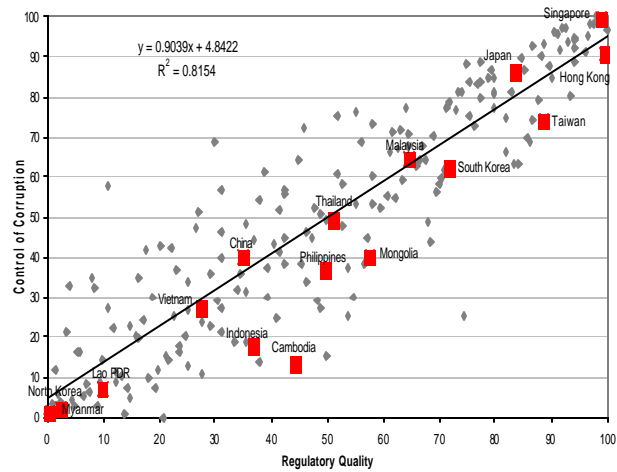
The simple scatter charts presented in Figures 7.5A and 7.5B, prepared using the 2003 (latest available) United Nations Development Program Human Development Index

Figure 7.4: Corruption indices and comparator governance indicators (global percentiles, with East Asian countries highlighted, 2004)

A: KK Control of Corruption and Government Effectiveness



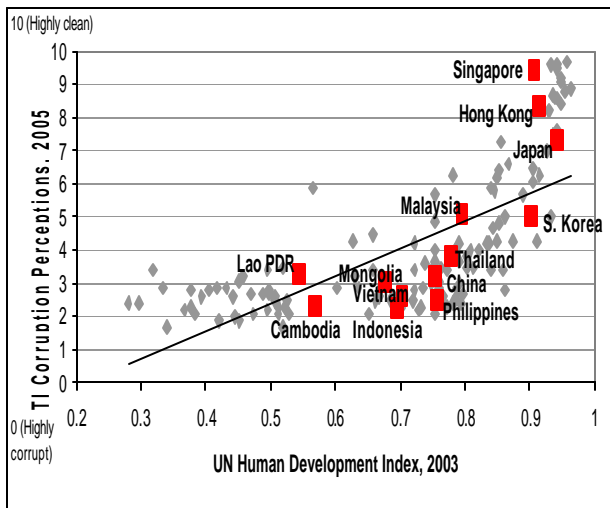
B: KK Control of Corruption and Regulatory Quality



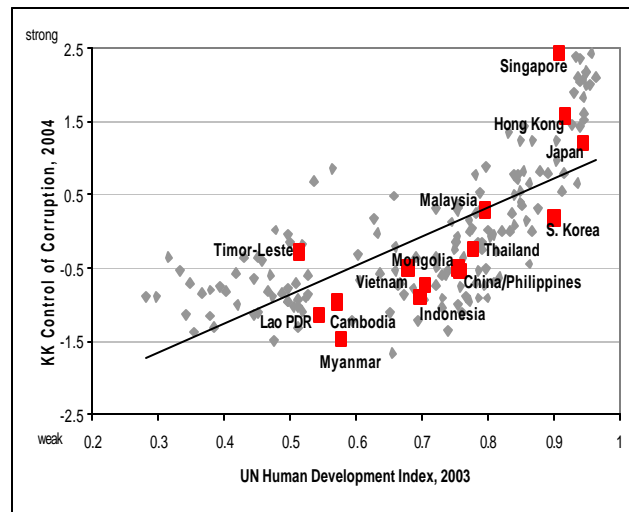
Source: Prepared using data from Kaufmann, Kraay, and Mastruzzi (2005).

Figure 7.5: Corruption indices and the human development index (global with East Asian countries highlighted)

A: CPI and HDI



B: CCI and HDI



Source: Prepared using data from CPI 2005, CCI 2004, and HDI 2003.

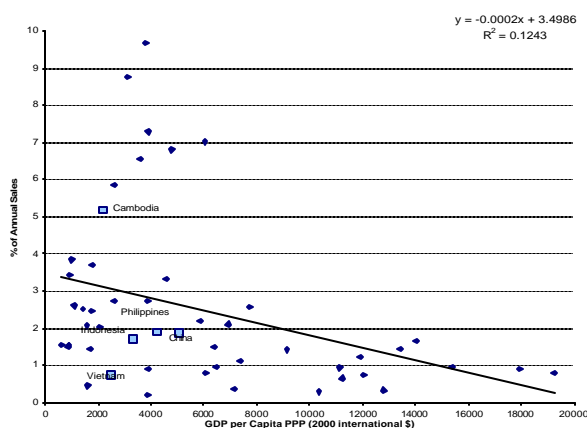
(HDI) and the CPI (Figure A) and CCI (Figure B) suggest that East Asian countries generally have better human development outcomes than would be predicted by their level of corruption.

The impression these data give is of corruption in East Asia being widespread but orderly, going hand-in-hand with nevertheless generally effective, well-regulated and benign (or at least developmental) government. In line with the Shleifer-Vishny model, it would appear that East Asian governments have typically managed corruption in such a way as to minimize the adverse impacts on investment and growth. In line with the Olsen model, it would appear that East Asian governments have typically managed corruption in such a way as to minimize the adverse impacts on human development and hence growth.

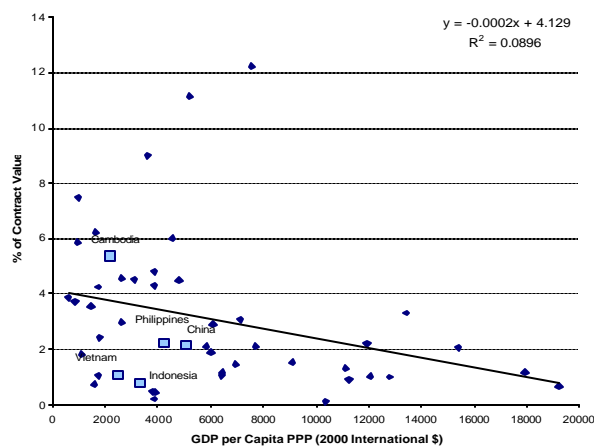
Similarly, the scatter charts in Figure 7.6A and 9.6B, prepared using data from World Bank Investment Climate Surveys, suggest that bribes to secure a contract with government or to “get things done” are lower as a share of contract value or annual sales in most East Asian countries surveyed (China, Vietnam, Indonesia, and the Philippines) than would be predicted by GDP per capita. This finding appears to be consistent with the hypothesis about countries with strong, centralized government setting bribes at lower levels.

Figure 7.6: Informal payments and gifts (as a percentage of contract value) and per capita GDP (global with East Asian countries highlighted)

A: Percent of annual sales paid in gifts or informal payments to public officials to “get things done”



B: Percent of contract value expected in gifts or informal payments to secure a contract with the government



Source: Investment Climate Survey database of the World Bank and IFC (2006), using un-weighted averages and World Development Indicators (2006).

The exception is Cambodia—a country which, as Box 7.3 illustrates, fits the “competitive corruption” model better than the “organized monopoly” model.

Box 7.3: “Competitive corruption” in Cambodia

At the end of the Khmer Rouge period, there were no functioning state institutions left in Cambodia. The legacy of conflict depleted the country’s human talent on which both public sector and entrepreneurship is based, and destroyed the social institutions that glued the society together. After 1979, both the Cambodian state and civil society had to be rebuilt. The growth in Cambodia over the past decade has been remarkable in light of the destruction wrought by years of conflict, but it has been heavily dependent upon a narrow base, namely garment exports and tourism. Corruption reduces the rate of growth and the rate in which the economy diversifies.

The problems of Cambodia’s weak formal and informal institutions are felt most directly and acutely in the form of corruption. The government tried to fill the institutional vacuum through administrative measures, which often proved to be unsuccessful and created opportunities for corruption. Overlapping and expensive regulation created room for excess discretion and rent-seeking, which add to business costs.

It takes 86 days to start a business in Cambodia—36 days longer to start than in Vietnam and 53 days longer than in Thailand (Doing Business Database, 2006). The private sector’s incentives are distorted: staying in the informal sector appears to be a rational response to the investment climate since informal firms face lower taxes and fewer requests for bribes. The Investment Climate Assessment (ICA) report in 2004 found that Cambodia has the most annual inspections, the highest cost per capita to officially register businesses, the second highest amount of time for management to deal with officials after China. Trade facilitation practices are particularly constraining, with the second longest clearance times, averaging 16 per year, after Pakistan and some of the highest observed incidence of unofficial costs.

According to the ICA survey, unofficial payments do not appear to “grease the wheels”—bribes do not necessarily expedite service in Cambodia. There is no statistical difference between the speed of administrative procedures for firms reporting higher versus lower ratios of bribes as a share of sales for essential services such as utility connections. Firms of all sizes acknowledge paying bribes; but the larger and more “formal” the enterprise, the higher the bribes as a share of sales. Private sector firms estimate that unofficial payments cost firms an average of 5.2 percent of total sales revenue; and for large firms this number exceeds 6 percent. Unofficial payments are a large component of doing business in Cambodia, to the extent that the share of revenue consumed by unofficial payments is more than double that found in a parallel surveys in Bangladesh, Pakistan, or China.

A recent survey finds that institutions seen as most corrupt were the customs service, courts, police, and tax collection, and for all but the last of these institutions, surveys suggest that corruption has worsened between 2000 and 2005. The majority of respondents in the later survey rejected the notion that corruption becomes acceptable because it is so common, or that a small salary entitles a civil servant to bribes, so to some extent the increase may be affected by increasing intolerance for corruption in Cambodia (Center for Social Development 2005 survey cited in World Bank East Asia and the Pacific Region [2005]).

The same survey suggests that on average each household pays US\$24.5 per annum on bribes comprising between 1.4 - 2.2 percent of total expenditure; 5 percent of total income. Cost of bribes is only a small fraction of the overall burden of corruption. Indirect costs to households range from undelivered services to higher prices for consumption and investment goods; from forgone revenue that otherwise finances service delivery to the dispossession of poor and poorly connected families from access to common resources as local authorities sell these off as private property.

Sources: World Bank East Asia and the Pacific Region (2005); World Bank (2004); and World Bank East Asia Pacific Region (2004).

Campos, Lien, and Pradhan (2001) present cross-country regression analysis to suggest that, while corruption impacts adversely on investment, it will tend to have smaller adverse impacts under regimes in which corruption is “predictable” (in the sense that the favor, service, or product being sought is more likely to be granted). Using survey data collected for the World Bank’s 1997 World Development Report, they show that corruption does indeed impact adversely on investment; but that for any given level of corruption, the “predictability” of corruption has a positive effect on investment. Other things equal, countries in which corruption is predictable tend to attract relatively higher levels of corruption. The authors suggest that countries can be classified into three categories: those with high levels of corruption and a low degree of predictability in corruption; those with high levels and a high degree of predictability; and those with low levels and a high degree of predictability. They suggest that while most developing countries fall into the first category and most developed countries into the third, East Asia’s “miracle economies” fall into the second category.

MacIntyre (2001) uses a country case study of Indonesia and a centralized monopoly corruption regime argument of the Shleifer and Vishny variety to resolve the East Asian corruption paradox. With reference to Indonesia, MacIntyre argues that special features of the Suharto regime allowed it to function much like a joint monopolist trying to maximize profits across complementary products. He argues that Suharto’s system was grounded on two pillars, corruption and investment. Suharto’s system gave ample opportunity to extract rents and distribute these across the bureaucratic and political client groups involved in perpetuating this system. At the same time, the system managed to keep the costs of generating the rents from squeezing out long-term investment. MacIntyre details a number of events when Suharto clamped down on corruption— not in order to eliminate it but in order to ensure it remained under his control. He argues that this provided a greater degree of predictability for investors. While investors might have to pay substantial bribes, they were assured that their investments would be protected from unpredictable and uncoordinated corruption.

Indonesia during Suharto years had temporary but striking interventions that targeted corruption. Suharto issued a presidential decree that disempowered the entire customs bureau in 1985 when the corruption became serious enough to jeopardize his whole system of rent extraction. In an unprecedented move, the Bureau’s bureaucratic functions were outsourced to a foreign company. Similarly in 1986, when textile industry was imperiled by the cotton import monopoly, executive action was taken to dismantle the monopoly and its senior officials were fired.¹⁹¹ Although none of these interventions aimed at eliminating corruption, they were simply seen as necessary to ensure the sustainability of the respective sectors and hence of overall rent streams.

Further evidence exists of the extent of centralization of corruption in Indonesia under Suharto. In an innovative study of Indonesia under Suharto, Fisman (2001) created an index named the “Suharto Dependency Index” measuring the political connectedness of firms listed on Jakarta Stock Exchange. He showed that rumors of Suharto’s health

¹⁹¹ MacIntyre (2001, p. 37).

problems between 1995 and 1997 had a strong negative impact on the share prices of firms which ranked high on the “Suharto Dependency Index,” and furthermore the impact increased as rumors got worse.

Kang (2002) and Chang (2001) present similar arguments in their case studies of corruption in South Korea. Both argue that South Korea managed to establish a corruption regime in the post-war period which permitted rapid economic growth despite extensive corruption. Kang argues that there was a “balance of power among a small and stable set of government and business elites.” To fund their operations, political elites took massive donations from the *chaebol* (the dominant firms in Korea). *Chaebol* donations were sometimes used for humanitarian or developmental purposes, but were part of a larger web of money politics. Kang presents evidence suggesting that businessmen who did not provide politicians with sufficient “voluntary donations” when asked had their loans called by the Bank of Korea, suffered a tax audit, or had their subsidy application denied. Kang characterizes the arrangement as one of “mutual hostages,” with both sides benefiting from the arrangement and having strong incentives not to undermine the other’s benefits. The collusion of a powerful business class and a coherent state meant that corruption, though widespread, was constrained.

According to Huntington (1968), most forms corruption involve an exchange of political action for economic wealth. Where there are many avenues to accumulate wealth but few positions of political power he argues, the dominant pattern will be the use of the former to achieve the latter. Huntington argued that in the United States, for example, wealth has commonly been a road to political influence rather than political office a road to wealth. In most modernizing countries, however, opportunities for the accumulation of wealth through private activity are limited and therefore politics becomes the road to wealth.¹⁹² Similarly, Kang (2002) concludes that different development trajectories of South Korea and the Philippines—while in both countries growth and corruption existed side by side for decades—may be explained by the balance of economic and political power. Even in the period of rapid growth economic, political power was balanced and corruption never spiraled out of control in South Korea. In the Philippines, however, imbalance between the two factors led to abuses and corruption that was large enough to choke off growth.

7.4 Is East Asian tolerance of corruption declining?

7.4.1 East Asian values and corruption

There has been much debate about whether corruption means the same thing in Asia as it means in the West. “What you regard as corruption in your part of the world, we regard as family values,” Mohammed Suharto (then President of Indonesia) is reported to have told James Wolfensohn (then President of the World Bank)¹⁹³. It is frequently argued, especially with reference to East Asia, that cross-country comparison of corruption is inappropriate, since public ethics are culturally specific.

¹⁹² Huntington (1968, p.66).

¹⁹³ Quoted in Mallaby (2004).

Some have argued that the cultural characteristics of Asia make it more inclined to corruption. For example, Tanzi (1995) has argued that firms in some countries are culturally less inclined to have arms-length economic relationships, which in turn may lead to more ingrained corruption. It is certainly the case that the giving and accepting of gifts is a normal way of doing business in many parts of Asia.

Against this, Mahbubani (2006) argues that a Confucian notion of obligation to society characterizes East Asian elites. Vogel (1991) argues that while East Asian societies do not greatly focus on binding legal codes as do societies in the West, they have detailed rules about the behavior of an individual in his or her group. Vogel cites the emphasis on loyalty, responsiveness of people in organizations to group demands, and the predictability of individual behavior in the group setting as characteristics well-suited to the needs of industrialization, particularly for those who are trying to catch up.

Fukuyama (1999) points out that “Asian values” arguments fail to recognize Asia as a diverse place, where values vary significantly from country to country. Thus, Confucianism is interpreted very differently in Japan, Korea, and China; kinship ties vary in importance throughout Asia, playing a minimal role in Japan and a very important one in southern China. Furthermore, as others have pointed out, Eastern religions, including Confucianism, Islam, Buddhism, and Hinduism each condemn corruption. Fukuyama also suggests that “Asian values” arguments falsely suggest a direct impact of values on behavior. He suggests that institutions may be at least as significant, with values mediated through a variety of institutions before making themselves manifest.

Neither values nor institutions are static but may evolve over time. For example, the long-established tradition of receiving gifts in the Japanese administration has been restricted by the National Public Service Ethics Law of August 1999, which obliged senior officials to report gifts of a value greater than 5,000 yen (roughly \$50 equivalent).

Survey evidence from Thailand shows that people make quite sophisticated distinctions between appropriate and inappropriate gifts: although Thais have a higher limit than those in many other countries on the amount of money officials may take from the private sector before it is considered corruption, they do not tolerate major payoffs involving high-level officials and major investors (Phongpaicht and Piriyanangsan, 1994).

As we discussed in the context of Cambodia, survey evidence suggest that households do not agree that corruption is acceptable because it is so common, or that low salaries entitle civil servants to bribes. Indeed, researchers who conducted this survey conclude that to some extent the increase in number of respondents who say corruption has worsened may be affected by increasing intolerance for corruption in Cambodia (Center for Social Development 2005 survey cited in World Bank East Asia and the Pacific Region [2005]).

7.4.2 The demand for new forms of governance

Demands for new forms of governance and enhanced anti-corruption effort have been on the rise across East Asia. Corruption has figured prominently in public discourse and

political events, including convictions of two former presidents of South Korea, the resignation of President Mohammed Suharto in Indonesia, and the ouster of both President Ferdinand Marcos and President Joseph Estrada in the Philippines. These trends are reflected in the gradual move towards democracy in some countries; and a more rapid and general move towards decentralized governance across the region.

There has been a gradual spread of political rights and civil liberties around the region. In 1976, only one of the fifteen East Asian countries shown in Figure 7.7 were considered “free” (shaded white), five “partially free” (shaded gray) and nine “not free” (shaded black) by the Freedom House’s Freedom in the World Index.¹⁹⁴ Since 1998, the equivalent rankings are six “free,” three “partially free” and six “not free.” Although not all observers would agree with the individual categorizations, it is clear that political democracy and civil liberties made advances around the region in the period under review (and particularly in the period between 1986 and 1997— starting with the fall of Marcos in the Philippines in 1986 and the Constitution of the Sixth Republic in South Korea in 1987, and ending with the East Asian crisis of 1997).

Figure 7.7: The spread of political rights and civil liberties in East Asia, 1976–2004

	1976	1978	1980	1982	1984	1986	1988	1990	1992	1994	1996	1998	2000	2002	2004
Myanmar	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black
Cambodia	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black
China	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black
Indonesia	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Black	Black	Black	Black	Black	Black
Japan	White	White	White	White	White	White	White	White	White	White	White	White	White	White	White
Laos	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black
Malaysia	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray
Mongolia	Black	Black	Black	Black	Black	Black	Black	Black	Gray	White	White	White	White	White	White
Korea, DPR of	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black
Philippines	Gray	Gray	Gray	Gray	Gray	Gray	White	Gray	Gray	Gray	White	White	White	White	White
Singapore	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray
Korea, Rep. of	Black	Gray	Gray	Gray	Gray	Gray	White	White	White	White	White	White	White	White	White
Thailand	Black	Gray	Gray	Gray	Gray	Gray	Gray	White	Gray	Gray	Gray	White	White	White	White
Vietnam	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black	Black

Note: Black = “not free”; gray = “partially free”; white = “free.” DPR = Democratic People’s Republic.

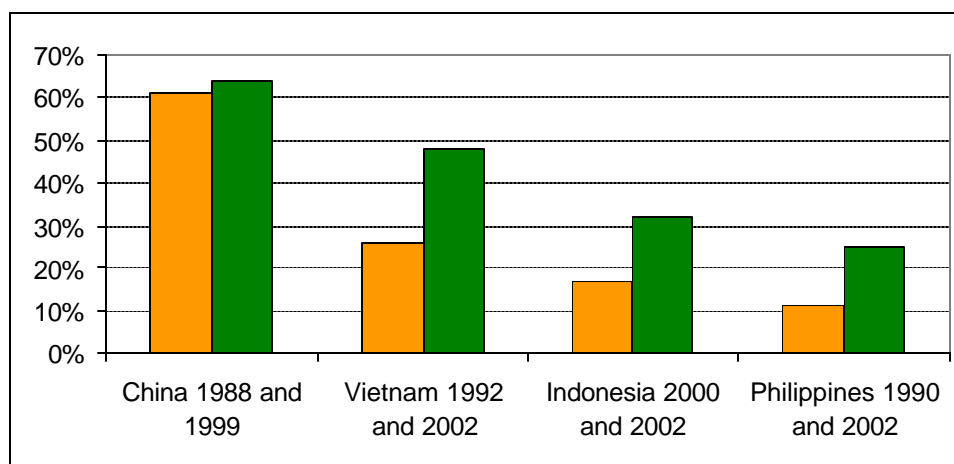
Source: Freedom House: *Freedom in the World* Country Rankings.

¹⁹⁴ For more detail on the methodology of the Freedom in the World Index see <http://www.freedomhouse.org/template.cfm?page=15&year=2005>

The 1997 crisis, as damaging as it was in the short term, created opportunities for long-lasting institutional reform. In Thailand for example, according to Hicken (2001), new institutions and institutional arrangements put in place by the new constitution improved the quality of governance institutions. In the wake of the financial crisis, Thailand was able to adopt a new constitution allowing numerous changes into the political system—such as the switch to single-member districts and the addition of a nationwide party list. Prior to these reforms, the interaction of electoral and party systems in Thailand was producing a political system filled with multiple veto players who were focused on their narrow constituencies and supporters, curbing the incentives and the capabilities of policy makers to push for much needed reform. New institutions in time reduced the number of parties, and thus, in turn reduced the number of veto players in the system, allowing for more decisive policy making. Political reforms also broadened the constituencies of Cabinet members giving them greater incentives to provide national policies—which had significant impact on governance and on deterring corruption.

More general has been the process of decentralization, which has affected almost all countries in the region. East Asia's decentralization has come later than in many other parts of the world: before 1990, most East Asian countries were highly centralized. Today, however, subnational governments play a central role in much of the region's development; delivering many critical services and accounting for a significant fraction of total public expenditure (see Figure 7.8).

Figure 7.8: Subnational expenditure as a share of total public spending (various East Asian countries and years, percent)



Source: World Bank Public Expenditure Reviews.

It is important to recognize that there are different types of decentralization, each with different formulations on fiscal, administrative, and political dimensions. East Asian countries have followed different paths with different speed. The Philippines and Indonesia have rapidly introduced major structural, institutional, and fiscal reforms and pushed sweeping decentralization reforms following the sudden end to authoritarian rule—introducing the basic elements of a decentralization framework, subnational democratic elections, and substantial resource sharing. China and Vietnam have taken a more piecemeal, ad hoc approach to decentralization. Cambodia and Thailand have established significant elements of decentralization at the formal policy and legislative levels, but are slow on implementation.¹⁹⁵

There are clearly countries in East Asia—Myanmar and North Korea for example—which political modernization may not touch for some time. Taking the region as a whole, however, it seems likely that demand for political modernization will continue to grow.

With reference to the United States, Friedman (2005) has recently argued that economic growth historically has created conditions conducive to the strengthening of governance. The standard accounts of European history also suggest various connections between the economic and social transformations of the industrial revolution and the process of political modernization. Growing urban populations and the rise of educated and articulate middle classes may make demands for greater political representation, reduced corruption, and more effective service delivery harder for political leaders to ignore.

As advanced East Asian countries mature, growth rates can be expected gradually to converge with those of advanced OECD countries. Rates of return will eventually become less spectacular and may no longer be adequate to compensate investors for the prevailing levels of corruption. Investors and trade partners may no longer be willing or able to absorb the extra costs and uncertainty associated with corruption. The ability to control corruption may therefore become a binding constraint to growth in a way that it has not hitherto been. Indeed, a mechanism of this kind may well have contributed to the demand side for better governance and reduced corruption in Singapore, Japan, and Hong Kong (China) over the last half century.

Both domestic and global environments have changed drastically across the region; in an era of sweeping economic, political, and social transformations and full-scale integration into the global economy no East Asian state has a grip on the whole state apparatus and the economy as Suharto did in the 1980s. It is becoming increasingly difficult to imagine that East Asian states can maintain “corruption regimes” of the kind they have in the past.

Regional and global integration may create demand for reduced corruption from businesses. In the short term, action to tackle corruption in customs administration may be necessary to support WTO accession. The requirement to eliminate remaining trade barriers, as part of ASEAN Free Trade Area (AFTA) or World Trade Organization (WTO) commitments, will further reduce policy-induced sources of rents.

¹⁹⁵ See World Bank (2005) for detailed review of decentralization in East Asia.

In the longer term, economies will become more complex as a result of the integration process and increased cross-border flows of capital and ideas. The success of East Asian economies will depend less and less on factor endowments, such as cheap labor or natural resources, and more and more on the ability of such economies to address bottlenecks in the availability of human capital, efficient infrastructure, or innovation. The demand for government that helps address these bottlenecks, rather than simply extracting rents, may also grow as a consequence.

Foreign Direct Investment may bring with it international accounting and auditing standards which help deter corruption. Integrity and trust may become pre-requisites for success in business in a way that they were not hitherto. Corruption may be harder to broker across national and cultural boundaries as Foreign Direct Investment becomes ever more significant. Greater intra-regional and international exchange of ideas may expose citizens to other governance models and to debates about governance less widely accessible domestically.

7.5 Will political modernization reduce corruption?

If political modernization is set to accelerate across East Asia, how will this impact on corruption? Empirical investigations are ambiguous as to the effect of democracy and civil liberties on corruption, and as to the effect of decentralization on corruption. On balance, the available evidence would tend to support the presumption that the spread of political and civil liberties and the development of more decentralized forms of governance will tend to reduce corruption. However, there is also some evidence to suggest that these effects may take some time to play out and their full benefits may be contingent on a parallel and necessarily more gradual process of institution building.

7.5.1 A longer-term view

Most East Asian countries have experienced unprecedented social and economic change in the past few decades. Economic development, spread of education, and growing affluent middle classes have been key drivers for better governance. Scott (1972) argues that, with a more equal income distribution, a relatively large middle class will exist that can act to hold elites accountable and, as a consequence, result in lower levels of corruption. Glaeser, Scheinkman, and Shleifer (2003) propose that inequality enables the rich to subvert the political, regulatory, and legal institutions of society for their own benefit.

Empirical studies on democracy and corruption draw our attention to complex and often difficult-to-prove links between the two. Rose-Ackerman (1999) argued that elections increase the accountability of politicians, but also produce new incentives for corruption as political financing needs increase. Brunetti and Weder (2003) did not find any impact of democracy on corruption in a cross-country analysis. However, Treisman (2000) and Chowdhury (2004) present more subtle pictures. In the work of Treisman (2000), democracy is found not to reduce corruption significantly in general; but a long exposure to democracy does appear to reduce corruption—democracies are significantly less corrupt only after 40 years.

Chowdhury used cross-country regression analysis to confirm that democracy and press freedom can have significant impact on corruption—noting that the two work together, with the presence of press freedom bringing public corruption cases to public attention while democracy allows the public to punish corrupt politicians by ousting them from public office. Like Treisman, Chowdhury notes that there may be a substantial time lag, and that though a move to democracy and press freedom may influence the extent of corruption, an immediate improvement is unlikely. Montinola and Jackman (2002), drawing on cross-country analysis, conclude that political competition helps reduce corruption, but only beyond a threshold level. They find that corruption is slightly higher in countries with intermediate levels of political competition than in their less democratic counterparts, but once past the identified threshold, higher levels of competition are associated with considerably lower levels of corruption.

It is quite possible that, as countries transition to democracy, democratic consolidation will take time and institutions will need to be strengthened before corruption levels come down. It is quite possible in an environment with weak institutions and poorly established accountability mechanisms that elections will produce new opportunities and incentives for corruption. As Diamond (1997) writes:

“Democracy may be the most common form of government in the world, but outside of the wealthy industrialized nations it tends to be shallow, illiberal, and poorly institutionalized. If there are no immediate threats of democratic collapse in most of those countries, neither are there clear signs that democracy has become consolidated and stable, truly the only viable political system and method for the foreseeable future. In fact, of the more than 70 new democracies that have come into being since the start of the third wave, only a small number are generally considered to be deeply rooted and secure.”

Acquiring good institutions is a slow process. Even the most advanced countries that now rank amongst the least corrupt in the world were once riddled with corruption in every sphere of public life. Institutions that enable these states to deal with corruption evolved over time, but it was not always a linear progressive path. The U.S. experience is a good example (see Box 7.4). Legislative corruption in the U.S. was so serious that Theodore Roosevelt is known to have lamented that the New York assemblymen, who engaged in open selling of votes to lobbying groups, “had the same idea about public life and civil service that a vulture has of a dead sheep.”¹⁹⁶

¹⁹⁶ Garrathy & Carnes (2000) cited in Ha-Joon Chang (2002).

Box 7.4: The history of corruption in the United States

The extent of corruption actually increased for quite some time in the U.S., in parallel with unprecedented economic growth. Glaeser and Goldin (2005) show this by using public documents—newspapers—to construct an index of reported corruption.

Taking advantage of the advent of online searchable editions of long-established U.S. newspapers (including the New York Times and a large group of small-town newspapers), they search for the words “corruption” and “fraud” (and their variants, such as “corrupt” and “fraudulent”) and count the number of pages of articles containing these words in newspapers. They adjust this index to control for size of the newspaper and the overall amount of attention given to politically relevant stories.

Glaeser and Goldin find that the extent of corruption increased until the 1870s, and declined between the 1870s and the 1920s, with most of the decline concentrated in the mid-1870s to 1890 and in the 1910s. They argue that the rise in corruption across the 19th century can be explained by the fast increasing scale of both government and the economy: budgets of local governments swelled, increasing the potential benefits of corruption. Why then during 1870s and 1920 did corruption in the U.S. decline despite the continuous rise of the size of the government, and high returns from corruption in the judiciary? Glaeser and Goldin find that the answer lies within the higher cost facing corrupt officials. In 1900, many actions that are considered corrupt and illicit today were legal. Institutional checks and balances were weak—governments rarely prosecuted themselves, and the higher levels of government were sufficiently weak that they could not provide a check on local corruption. Availability of information was also a serious problem—although national newspapers exposed corrupt practices, many smaller city media outlets were tied to the political establishment, and did not fulfill their informational role properly.

But by early 20th century the U.S. was able to establish and operationalize a fuller apparatus of modern checks on corruption. Rules were generally replaced discretion in many areas, including patronage networks. Different levels of government more effectively patrolled each other. Greater competition and political independence in the news media assured more transparency across the nation, not just in the big cities. Finally, voter expectations about corrupt behavior had changed and revealed corruption was more likely to lead to political defeat.

Empirical investigations into the effect of decentralization on corruption provide mixed results. Treisman (2000) finds that federalist countries have higher rates of corruption. However, Treisman’s measure of decentralization is a simple one, based on the existence or non-existence of a federal structure. Fisman and Gatti (2002) instead measure decentralization as the share of government expenditure at subnational level, and use cross-country regression analysis to show that this measure of decentralization is strongly and significantly associated with lower corruption. Fisman and Gatti find that their regression results hold with and without the countries which decentralized over the period 1980–1995 in the sample. However, their paper does not set out to investigate whether the impact of decentralization on corruption becomes stronger the longer a country is exposed to it.

Much like democracy, decentralization in weak institutional settings is not a panacea for good governance or curbing corruption. Although the empirical research is scarce and existing findings are weak, there is a heated debate about the links between decentralization and corruption. Table 7.2 summarizes some of the potential benefits and

Table 7.2: Potential links between decentralization and corruption

	<i>Benefits</i>	<i>Risks</i>
Short term	<ul style="list-style-type: none"> ▪ Brings governments closer to the people ▪ Overcome information asymmetries ▪ Enhance transparency and accountability ▪ Allows for local innovation 	<ul style="list-style-type: none"> ▪ Local governments may be more susceptible to “state capture” ▪ Local politicians may be more likely in engaging in clientelism to win elections ▪ Capacity constraints may be a problem for local government and also for local checks and balance institutions—local legislature, judiciary, media, and civil society
Long term	<ul style="list-style-type: none"> ▪ Promotes tax and policy competition ▪ Underpins long-term political reform 	<ul style="list-style-type: none"> ▪ Creates intergovernmental tension, may increase uncertainty ▪ Exacerbate disparities between lagging and advanced regions ▪ Fragments economies of scale ▪ Intense interregional competition may lead to excessive cuts in tax rates and public goods

Note: State Capture is defined as “actions of individuals, groups, or firms in the public and/or private sectors to influence the formation of laws, regulation, decrees, and other government policies to their advantage through the illicit and nontransparent provision of private benefits to politicians and/or civil servants.” Clientelism refers to “Politicians distributing publicly funded goods to selected members of the electorate in return for votes and political support.”

Source: Based on Kaiser (2006) and Campos and Hellman (2005).

risks of decentralization in the short and long term with respect to corruption. The expected benefits from decentralization are all based on the assumption that the accountability mechanisms at the local level are functional, and information is available for locals to demand better governance. In reality, local institutions are often too weak and mechanisms in place to ensure information flows are often dysfunctional.

7.5.2 *Shorter-term dynamics*

Country case studies cast some light on the shorter term dynamics of the relationship between democratization, decentralization, and corruption. Whilst welcoming Indonesia’s transition to democracy as a positive development in the longer run, MacIntyre suggests that corruption may actually get worse during the transition. He notes that this represents an important step in the direction of more transparent governance and a more independent legal system. However, in the short and medium term Indonesia’s swing from centralized authoritarian rule to more democratic and more decentralized government may be associated with a less attractive investment climate and greater corruption—where it has progressed beyond tight centralization but has not yet developed a truly independent legal system or transparent governance institutions. In terms of the Shleifer and Vishny model, Indonesia is likely to move from a situation where there is a single monopolist for bribes to a more distortionary situation in which there are multiple independent monopolists in the market for bribes.

Decentralization has been driven by political rationale in many countries following a legacy of authoritarian rule, often as an attempt to deal with cross-cutting social and economic tensions and to ease the local grievances toward the central state. It is seen as a shorter route of establishing accountability between policy makers, citizens, and service providers in order to improve service delivery. In the Philippines and Indonesia, decentralization was adopted after the sudden collapse of authoritarian regimes (Marcos

in 1986 and Suharto in 1997, respectively) fueled demand for legitimate, local representation. These two have gone furthest in implementing comprehensive programs in the region.¹⁹⁷

Indonesia started its decentralization process in the late 1990s, but the climax of the process was the “big bang” decentralization in 2001 during which control of a significant share of public resources and direct authority over nearly 2 million civil servants were transferred to the local level. Recent empirical evidence from Indonesia appears to confirm that corruption may actually have got worse in the first few years following the “big bang” decentralization. The World Bank’s Productivity and Investment Climate Survey (PICS) asked firms about the impact of decentralization on key aspects of the governance and investment climate. As Figure 7.9A illustrates, firms perceived decentralization as having a negative impact in four areas: labor regulations, licenses, policy uncertainty, and corruption. Most notably, more than 40 percent of firms thought that decentralization had made corruption worse and only 11 percent thought it had reduced corruption. PICS data also suggests that corruption is perceived as one of the major obstacles to business in Indonesia and that local corruption is perceived as even more serious an obstacle than national corruption (Figure 7.9B). According to the same survey firms pay 64 percent more in informal payments as a share of annual revenues to local governments than they do to national level officials on average. But, informal payments seem not to translate into “grease money,” as firms also spend 15 percent more of their time dealing with local regulations than with national regulations. Although these results are preliminary, it is difficult to argue that decentralization helped bolster state’s accountability at least from the Indonesian firms’ perspective.

Figure 7.9: Impact of decentralization in Indonesia

Figure A: The Negative Initial Impacts of Decentralization in Indonesia, as cited by firms

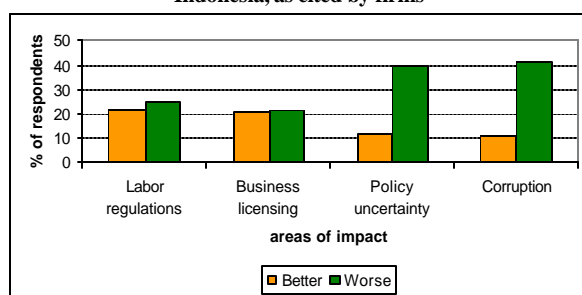
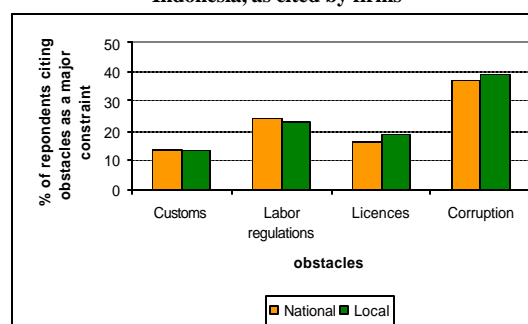


Figure B: Local and National Obstacles to Business in Indonesia, as cited by firms



Sources: Updated from Campos and Hellman (2005) using final Indonesia Productivity and Investment Climate Survey database.

¹⁹⁷ This section on decentralization and corruption in Indonesia and the Philippines is based on Campos and Hellmann (2005).

Clientelism and capture is also a problem at the local level; local legislative candidates are reported to pay national party organizations for ballot slots, and their selection is linked to elite village networks. Voters are often influenced by direct payments and other transfers.

The Philippines major decentralization reform took place during 1992-1993. Perception-based measures of corruption have consistently improved, but it is not clear whether decentralization has been the key driver for this trend. An extensive study—based on surveys of households and public officials at different levels of government—by the Center for Institutional Reform and the Informal Sector at the University of Maryland and the World Bank in 2001 concluded that while perceptions of corruption are much lower for lower levels of government, local governments are no more accountable to local preferences than the central government, given a variety of constraints on responsiveness. But there are promising developments; in the Philippines, perhaps due to longer experience with decentralization, reliable information on local government performance is beginning to develop fostering competition.

Similarly Chang (2001) and Kang (2002), in case studies of South Korea, draw connections between the change in the investment governance regime in the late 1980s and mid-1990s and the making of the 1997 crisis. Both illustrate this graphically through the corruption scandal that surrounded the rapid rise and dramatic collapse of Hanbo Steel in early 1997. Chang points to the abolition of industrial planning under the Kim Young Sam government, which came to power in 1993, and argues that this exposed even the core manufacturing industries to corruption by eliminating the criteria that put clear limits on how influential politicians and bureaucrats could extend favors to their “paying customers.” Kang suggests that the crisis occurred in part because the 1987 transition to democracy “diffused the power of the state,” upsetting the balance of power between the small and stable set of business elites which had managed to restrain corruption and make it (in the context) actually beneficial to growth.

Although skeptical about the depth of political modernization in China, Pei (2006b) points to the evidence of growing corruption in highly decentralized China:

“The number of “large-sum cases” (those involving monetary amounts greater than \$6,000) nearly doubled between 1992 and 2002... The number of officials at the county level and above prosecuted by the government rose from 1,386 in 1992 to 2,925 in 2002. An optimist might believe that these figures reveal stronger enforcement rather than metastasizing corruption, but the evidence suggests otherwise... On average, 140,000 party officials and members were caught in corruption scandals each year in the 1990s, and 5.6 percent of these were criminally prosecuted. In 2004, 170,850 party officials and members were implicated, but only 4,915 (or 2.9 percent) were subject to criminal prosecution.

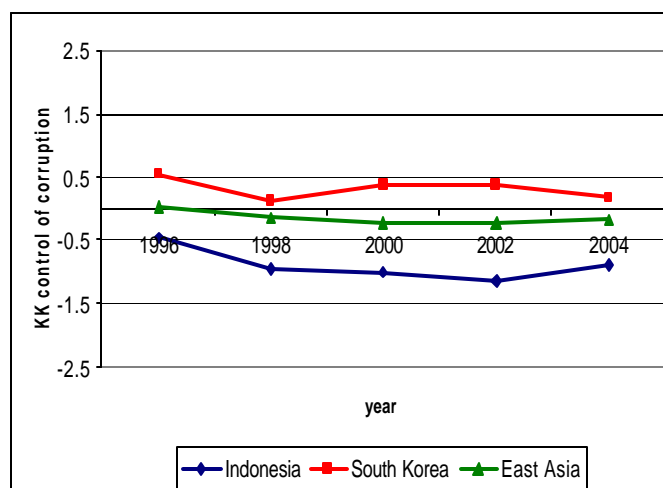
...Regional data suggest that large-scale corruption rings account for 30 to 60 percent of all the cases of graft uncovered by authorities. In some of the worst instances, entire provincial, municipal, and county governments were found to be tainted. In Heilongjiang Province, a corruption scandal involved more

than 400 local officials, including the former governor, the former organizational chief of the party's provincial committee, a vice governor, the chief prosecutor, the president of the provincial high court, and eight of the province's 13 party bosses. According to official reports, in Shenyang (the capital of Liaoning Province), Fuzhou (the capital of Fujian Province), and more than 30 other counties and prefectures, groups of senior local officials, including party chiefs and mayors, have been on the payroll of organized gangs involved in murder, extortion, gambling, and prostitution."

The validity of using corruption indicators to make comparisons over time is open to some debate. Comparison of corruption rankings is certainly not meaningful: a country or region may stand still in terms of corruption but slide down the rankings due to advances in other countries or regions. Even comparisons using point estimates needs to be made with caution. The surveys used to compile these composite indicators vary from year to year. A change in perception may lag the fundamentals by a number of years. Nevertheless, as Figure 7.10 illustrates, the CCI does suggest there has been a decline in control of corruption in East Asia as a region, and in Indonesia and South Korea as cases in point, over the period for which data is available.

Summing up such arguments, MacIntyre writes: "the one thing worse than organized corruption is disorganized corruption." This argument is in fact rather similar to that of Huntington (1968) who argued that political modernization, defined as a transition from an autocratic to a more democratic government, is usually accompanied by increases of corruption, attributing this problem to underdevelopment of the institutions supporting democracy. Huntington points to the "organizational imperative": the need to prioritize the strengthening of political and bureaucratic institutions supporting democracy if political modernization is to succeed and corruption is not to increase.

Figure 7.10: Trends in control of corruption 1996–2004 (East Asia and selected countries)



Note: Point estimates. Best = +2.5; worst = -2.5

Source: Kaufmann, Kraay, and Mastruzzi (2005) dataset

7.6 Conclusions

Despite the frequent use of terms such as “crony capitalism” and “endemic corruption” to describe the region, it is clear that there is no one East Asian level of corruption. Evidence suggests there is tremendous variation in levels of corruption across the region. Although some East Asian countries such as Myanmar and Cambodia rank among the most corrupt countries in the world, others such as Singapore and Hong Kong (China) rank amongst the least corrupt. In many East Asian countries, corruption is at about the level that might be expected for countries at their level of GDP per capita. But there are certainly outliers which are significantly more or less corrupt than their GDP per capita would predict—and this should serve as both a warning to those who are inclined to ignore the issue, as well as a source of optimism for would-be reformers.

There may, at least until recently, have been something approaching an East Asian model of corruption. Countries in the region appear to have been able to achieve higher levels of investment and growth than would have been predicted by their corruption level. Of course, investors may have been prepared to tolerate a certain extent of corruption (bribe payments, uncertainty) given the high rates of return available in rapidly developing economies. Even taking account of these other factors, however, East Asian countries appear to have been able to establish regimes in which corruption was managed so as to minimize its impact on investment and growth. The autocratic, centralized mode of governance that has characterized many East Asian countries allowed the persistence of a “centralized monopoly” on the creation and allocation of economic rents. This was almost certainly damaging to investment and growth. However, it perhaps allowed for a more orderly, more predictable, and less damaging form of corruption than observed in other developing countries.

Demands for new forms of governance and reduced corruption are on the rise across East Asia. Economic growth and education are creating an increasingly outspoken and articulate urban middle class. Investors and trade partners may no longer be willing or able to absorb the extra costs and uncertainty associated with corruption. The dynamics of growth and integration are clearly driving at least some East Asian countries to new, more democratic, and decentralized modes of governance. The regime for containment and reduction of corruption will need to evolve in parallel. What was enough is no longer enough. Fighting corruption is moving up the agenda and East Asian governance is moving from “rule of man” (*renzhi*) to “rule of law” (*fazhi*).

In the longer term, political modernization will very probably bring with it improvements in transparency and accountability and reductions in corruption. At the same time, it would be naïve to assume that improvement will be continuous and linear. The established regimes for managing corruption under pre-crisis models of governance have been swept away in a number of East Asian countries—but new institutions for rule of law, transparency, and accountability at central and local levels will take longer to establish. The result may well be an increase in corruption in the short and medium term. The imperative for institution building has never been greater.

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